Law Council
OF AUSTRALIA

Legal Practice Section

17 February 2023

Personal and Indirect Tax, Charities and Housing Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: charitiesconsultation@treasury.gov.au

Dear Treasury

DEDUCTIBLE GIFT RECIPIENT REGISTERS REFORM
TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL 2023

1. This submission has been prepared by the Charities and Not-for-Profits Committee of the Law Council of Australia's Legal Practice Section (the **Committee**). The Committee welcomes the opportunity to make a submission to you in relation to the Treasury Laws Amendment (Measures for Consultation) Bill 2023 (the **Bill**).

2. The Committee thanks you for the opportunity to make this submission. Overall, the Committee supports the transfer of the administration of the four deductible gift recipient (**DGR**) categories from portfolio agencies. The comments in this submission are intended to draw your attention to specific issues and to recommend refinements that the Committee believes would improve the Bill.

Recommendation 1: The transfer of administration of the four deductible gift recipient categories should be to the Australian Charities and Not-for-profits Commission rather than the Australian Taxation Office.

3. The Bill proposes that the Australian Taxation Office (**ATO**) would gain responsibility for assessing eligibility for the four unique DGR categories. The change is intended to make all DGR categories consistent in administration, reduce red tape imposed on endorsed organisations, and simplify the application process for organisations seeking DGR status.

4. We note that the Australian Charities and Not-for-profits Commission (**ACNC**) already has responsibility for assessing a number of other organisations and funds which are DGRs, including Public Benevolent Institutions (**PBI**) and an institution whose principal activity is to promote the prevention or the control of diseases in human beings, that is, Health Promotion Charities (s 25-5 (5) items 13 & 14 of the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (**ACNC Act**)).

5. Applications for DGR endorsements for these organisations are made at the same time as the application to the ACNC.

6. This, as with the ascertainment of charity status, places the core definitional decision with the ACNC. We note that the application allows for the information required for

ATO processing to be included in the ACNC form, which is forwarded to the ATO at the appropriate time.

7. This arrangement permits such decision making on the status of charities, PBIs and Health Promotion Charities to be beyond the perception or claim that tax considerations are influencing in any way in which the applications are dealt with by the regulator.

8. We recommend that the definitional element of the four unique DGR categories also be dealt with initially by the ACNC and then forwarded to the ATO for tax endorsement.

9. We can see the advantages of one regulator being tasked with definitional issues to avoid conflicting interpretations and streamline administration. This is particularly important, for example, for PBIs that deliver development aid outside Australia or operate Overseas Aid Gift Deduction Funds which do similar activities and often as a controlled entity of a PBI.

10. This is made all the more compelling if our recommendation to abolish the requirement for gift funds is accepted to further streamline administration both for the DGR and the ATO.

Recommendation 2: The proposed amendments be changed to remove the requirement for the DGR entities to maintain a gift fund.

11. Under the proposed amendments, the four DGR categories will now be endorsed under paragraph 30-120(a) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 97**) (that is, as a whole) because they will be endorsed as an institution, and no longer endorsed under paragraph 30-120(b) of the ITAA 97 (that is, endorsed for *the operation of* a fund, authority or institution).[1] They will however be required to maintain a gift fund.

12. The Exposure Draft Explanatory Materials note that the proposed requirement to maintain a gift fund is a departure from existing requirements for organisations endorsed with DGR status under paragraph 30-120(a) of the ITAA 97.[2]

13. In our view, this departure will create inconsistency and confusion. For example, it creates uncertainty for charities seeking to comply with paragraph 30-125(6) of the ITAA 97, which applies differently depending on whether a DGR is endorsed as a whole or is endorsed for the operation of a fund, authority or institution. Currently, only DGRs which are not endorsed as a whole are required to maintain a gift fund under paragraph 30-125(2). As such, where paragraph 30-125(6) refers to entities 'not required by this section to meet the requirements of section 30-130', it is clearly referring only to DGR entities that are not endorsed as a whole.

14. However, the proposed amendments make it a special condition for each of the four DGR categories to meet the requirements of section 30-130 of ITAA 1997. Under paragraph 30-125(2)(c), to be entitled to endorsement as a DGR, a charity must meet the relevant special conditions. When applying paragraph 30-125(6) are these four DGR categories "required by this section to meet the requirements of section 30-130"

[1] Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductible Gift Recipient Registers Reform, see for example sch 1 cl 7(1)(b) and cl 7(2)(a) which deem this to be the case for already existing DGR endorsed entities.
[2] Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures 4 for Consultation) Bill 2023: Deductible 5 Gift Recipient Registers Reform [1.12] [1.18] [1.24].

or not given the lack of clarity in interpreting sub-paragraph 30-125(1)(b)(iii)? This legislative confusion is most easily resolved by simply removing the gift fund requirement for the four DGR categories covered by the exposure draft.

15. This is also supportable from a policy perspective. Even DGR entities that are endorsed for the operation of a fund, authority or institution are not required to maintain a gift fund if that DGR entity is also endorsed as a whole under paragraph 30-120(a) (see paragraph 30-125(2)(e)). We submit that the protection that the gift fund is intended to provide is not necessary where the entity is endorsed as a whole, which is why it is not required for DGR entities endorsed under paragraph 30-120(a).

16. While we understand that requiring gift funds for these four categories might be a strategy to assist DGR entities to transition from operating a public fund, we see no reason why they cannot be treated in a similar manner to the other entities endorsed as a whole and not required to maintain a gift fund (such as a registered PBI). It sends a confusing and complicated message to the not-for-profit sector and is out of sync with the intention of the reforms to "*make all DGR categories consistent in administration, reduce red tape imposed on endorsed organisations, and simplify the application process for organisations seeking DGR status*." [3]

17. Further, even though the transitional provisions have attempted to simplify the transition from a public fund to a gift fund, in reality, entities endorsed on the four registers will have governing documents, which operate as contracts between the members of the entities, that retain the public fund requirements, such as majority responsible persons, and maintenance of a public fund committee. Accordingly, while the legislation makes clear that the Commissioner will no longer require these things, the charities themselves will still need to amend their governing documents before they are able to depart from the public fund requirements. In these circumstances there is even less sense in insisting on a gift fund requirement. It does not assist in any transition, and instead maintains an unnecessary distinction for these four DGR categories. See also our comments in relation to our recommendation 9 about amending governing documents, paragraphs 43–47 below.

18. If Treasury determines not to remove the gift fund requirement for these categories, we urge the Government to:

    (a) clearly explain the rationale behind the transition from a public fund to a gift fund;

    (b) provide clear guidance on the legal difference between a 'gift fund' and a 'public fund' (see below our recommendation 8, paragraphs 40–42); and

    (c) amend paragraph 30-125(6) to make clear whether these four categories are required to comply with paragraph 30-125(6)(a) or paragraph 30-125(6)(b).

[3] Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures 4 for Consultation) Bill 2023: Deductible 5 Gift Recipient Registers Reform [1.1].

Recommendation 3: Amend the proposed definition of a Harm Prevention Charity to remove the 'in Australia' requirement.

19. As per the transitional provisions, all entities on the four registers will be deemed to be endorsed under paragraph 30-120(a) ITAA 97 and all newly endorsed entities will be endorsed as a whole and therefore also under paragraph 30-120(a) ITAA 97. This will mean that these entities will now only need to satisfy paragraph 50-50(1)(b) of the ITAA 97 in relation to their income tax exemption. They will no longer need to meet 'the physical presence test' in paragraph 50-50(1)(a) to demonstrate eligibility for income tax exemption. This will bring the requirements for these DGRs in line with the requirements for all other Item 2 DGRs, such as PBIs and Health Promotion Charities. We strongly support this reform which will reduce red-tape and delivers on the need for greater consistency.

20. However, in relation to "in Australia" requirement, we note that the current drafting in proposed subsection 30-45(1) provides that a Harm Prevention Charity (**HPC**) is:

> *'an institution whose principal activity is the promotion of the prevention or the control of behaviour that is harmful or abusive to human being* ***in Australia****'* [emphasis added.]

21. The inclusion of 'in Australia' here appears to be based on an outdated interpretation of the 'in Australia' special condition in section 30-15 ITAA 97. That section requires DGR entities that are covered by an item in any of the tables in Subdivision 30-B to be 'in Australia'. Previously, the ATO's interpretation of this requirement was that the purposes and beneficiaries of the DGR entity must be in Australia.[4] The statement in the Department of Social Services' Harm Prevention Charity Guidelines[5], that an HPC must 'be established and operated in Australia and have its purposes and beneficiaries in Australia', reflected this interpretation of the 'in Australia' requirement.

22. The ATO no longer interprets the 'in Australia' condition in this way,[6] however the Guidelines had not been updated to reflect this change. As such, the proposed formulation is unnecessarily restrictive on the activities of an HPC.

23. The Explanatory Memorandum notes that the proposed drafting "continues to mean that harm prevention charities in Australia must have its purposes and beneficiaries in Australia, and not another country". Although the Guidelines include this requirement, in our experience, the regulators have not enforced this requirement, since it is understood to be an outdated interpretation. If the proposed wording is not modified, many HPCs which do undertake harm prevention activities overseas would be significantly impacted.

24. There is no policy basis for including a more restrictive 'in Australia' condition for HPCs and, instead, these charities should be subject to the same 'in Australia' requirements as most other DGR entities.

[4] See for example, Taxation Ruling TR 2003/5: Income tax and fringe benefits tax: public benevolent institutions.
[5] https://www.dss.gov.au/communities-and-vulnerable-people-programs-services-register-of-harm-prevention-charities/register-of-harm-prevention-charities-guidelines.
[6] Taxation Ruling TR 2019/6: Income tax: the 'in Australia' requirement for certain deductible gift recipients and income tax exempt entities.

Recommendation 4: Remove the requirement for Environmental Organisations and Harm Prevention Charities to have a policy of not acting as a mere conduit.

25. The DGR reforms offer an opportunity to consider whether any current requirements are necessary or appropriate.

26. The non-conduit requirement which is currently in place for institutions on the Register of Environmental Organisations (**REO**) (subsection 30-270(2) ITAA 97) and HPCs (subsection 30-289A(1) ITAA 97) is redundant.

27. We submit that the proposed special condition that the fund, authority or institution must 'have a policy of not acting as a mere conduit for the donation of money or property to other organisations, bodies or persons' needs to be removed.

28. We understand the policy intent behind this requirement to be that the relevant DGR entity cannot simply act as a mere fund or conduit for other organisations. However, the 'institution' requirement means that these entities could not do so in any event, and necessarily have to have their own activities other than merely distributing funds to other entities. This requirement is therefore unnecessary and confusing. Further, the maintenance of charity registration and compliance with ACNC governance standards is inherently inconsistent with acting as a mere conduit.

29. Finally, all gifts for which a deductible gift receipt is provided must be true gifts[7]. The receiving DGR must not be directed by a donor to act as a conduit by passing a donation of money or property to other entities, bodies or persons. This applies to gifts received by all DGRs. There is therefore absolutely no need to specifically refer to a non-conduit requirement for REOs and HPCs.

30. If contrary to our recommendation, the requirement is retained, then it should be clarified:

    (a) First, it is not clear what it means to have a *policy* of not acting as a mere conduit. Does this need to be a written document, or simply an approach taken by the entity?

    (b) Secondly, the current wording may be seen to suggest that the entity could never pass on funds to another entity despite that being consistent with its purpose. This is not the way the requirement is interpreted in practice but, on the wording of the legislation, it is not clear.

Recommendation 5: Remove the requirement that a Harm Prevention Charity must be income tax exempt.

31. Proposed subsection 30-45(1) contains a condition that the institution must be endorsed as exempt from income tax under subdivision 50-B. It is not clear why there is an income tax exemption requirement when there is already a requirement that the institution be a registered charity. It is likely simply a historical requirement which operated before the 'registered charity' requirement was inserted, making it redundant. We submit that this should be removed.

[7]See ATO Taxation Ruling 2005/13
https://www.ato.gov.au/law/view/document?DocID=TXR/TR200513/NAT/ATO/00001

Recommendation 6: Modifications should be made to the transitional provisions.

32. We make the following comments about the transitional provisions:

(a) Paragraph [1.12] of the Explanatory Materials notes that a small number of REOs are endorsed under paragraph 30-120(a) of the ITAA 97. These organisations do not appear to have been dealt with in the transitional provisions.

(b) For current DGR entities, the transitional provisions provide that the Commissioner will, notwithstanding an entity's governing document, allow surplus assets to be given to any DGR upon winding up. It is unclear why this does not also apply to entities which have already applied for DGR endorsement given that the application would have been made with the current requirements in mind. We recommend this be clarified in the transitional provisions.

(c) The proposed legislation only treats current HPCs and REOs as being endorsed under paragraph 30-120(a) *if* they have rules which contain the required winding up provisions. This should not be a precondition to transferring to whole of entity endorsement, particularly because the law requiring those provisions will no longer apply. For some DGR entities, there may be a technical or historical reason why the requirement has not been met, and consequently, the ongoing status of these DGR entities would be unclear.

Recommendation 7: The proposed provisions for overseas aid should be refined to:

(a) recognise that the in-country partners may be individuals, not just organisations;

(b) make clear that a PBI which has the purposes of delivering development or humanitarian assistance activities which has DGR endorsement as a PBI need not also be endorsed under the proposed item 9.1.1; and

(c) take into account the position of religious institutions (and any other institutions in a similar position) that operate developing country relief funds.

33. The proposed provisions relating to overseas aid (subsection 30-80(1)) simplify the requirements for this DGR category and we welcome this as several of the eligibility criteria are already requirements for charity registration under the ACNC Act. We note that the words in paragraph (b) of the proposed item 9.1.1, "*in partnership with* ***organisations*** *in the country, based on principles of cooperation, mutual respect and shared accountability*" (emphasis added) replicate the words of the heading of current eligibility criteria 3 as set out in the Department of Foreign Affairs and Trade's Overseas Aid Gift Deduction Scheme—Eligibility Criteria.[8] That heading, however, does not limit developing country relief funds to working only with "organisations". In the Eligibility Criteria, it is recognised that the work may be with individuals: "[*t*]*he*

[8] https://www.dfat.gov.au/sites/default/files/oagds-eligibility-criteria.pdf

organisation will demonstrate how it works with developing country partner organisations or groups, ***not just individuals***" (emphasis added).[9]

34. Item 9.1.1 contemplates that entities in this category will be "institutions". Further the effect of the proposed transitional provision will be that where an organisation operates a DGR endorsed developing country relief fund before the commencement of the amendments, the organisation will be considered to be DGR endorsed as a whole, and the developing country relief fund will be treated as a gift fund of the organisation (s 20(4)). Currently, the organisation itself is not required to have a principal purpose of delivering development or humanitarian assistance (or both). Rather, as set out in the Department of Foreign Affairs and Trade's Overseas Aid Gift Scheme Guidelines[10], the sole purpose of *the fund* must be to provide relief to people in declared developing countries, while the organisation must have *a* clear objective to support overseas aid. This means that the organisation which operates the fund can have purposes which are broader than delivering development or humanitarian assistance. The change will potentially affect a number of DGR entities, including ones which are also registered PBIs, and ones which have broader purposes (such as religious organisations).

35. There are currently several PBIs with DGR endorsement who operate developing country relief funds (also DGR endorsed). The effect of the transitional provision will mean that they have two DGR endorsements at the organisational level. This would be a problematic / impossible outcome as it would mean that they would have two main/principal purposes (main purpose of a PBI and the principal purpose in item 9.1.1 of delivering development and/or humanitarian assistance). Even if these main/principal purposes are different ways of expressing the same overall mission and can align as described in the following paragraphs, it appears irreconcilable to have legislative requirements requiring the one organisation to have two differently expressed principal purposes.

36. There is a view currently that such PBIs no longer need to operate developing country relief funds because as the ACNC Commissioner has recognised in its Commissioner's Interpretation Statement: Public Benevolent Institutions:[11]

> "*In an international development and relief context, people in receipt of relief or humanitarian assistance work …, will generally be considered "people in need". Additionally, people who are in receipt of development assistance will also be considered "people in need", where that assistance is provided to necessitous people in developing countries.[35] Development assistance is understood as being activities that improve the long-term well-being of people in developing countries, which build their capacity and provide long-term sustainable solutions to needs stemming from poverty and distress. Development assistance is thus preventative in that it stops such needs recurring. It is equally "relief" in the PBI context because it relieves the needs of the people assisted.*"[12]

What is set out above is undoubtedly the correct position. However, the Commissioner's Interpretation Statement is currently internally inconsistent

[9] above
[10] https://www.dfat.gov.au/sites/default/files/oagds-guidelines.pdf.
[11] https://www.acnc.gov.au/tools/guidance/commissioners-interpretation-statements/commissioners-interpretation-statement-public-benevolent-institutions
[12] ACNC Commissioner's Interpretation Statement: Public Benevolent Institution, paragraph 5.9.6.2

because it also states: "… *the ACNC takes the view that the concept of "relief" for the purposes of s.30-85 is not identical to the concept of "relief" for PBI purposes*"[13].

37. In our view, it is timely that it be made clear that a PBI which has the purposes of delivering development and/or humanitarian assistance activities overseas which has DGR endorsement as a PBI need not also be endorsed under the proposed item 9.1.1.

38. Separately, the relevant provisions of the Commissioner's Interpretation Statement should also be amended which will assist to clarify this. However, the current Bill ought to also make this clear and not, as it currently does, create a paradox for PBIs with overseas aid funds.

39. The proposed transitional provision (subsection 20(4)) will also be problematic for organisations which have a broader (or other) purpose than delivering development or humanitarian assistance, but are endorsed as a DGR for the operation of a developing country relief fund. This would include religious organisations (charities for the advancement of religion which operate a developing country relief fund (which is DGR endorsed). For these organisations, we recommend there needs to be a way of maintaining charity registration with a charitable purpose that is not the principal purpose suggested in the Bill and operating a developing country relief fund. The developing county relief fund need not be a public fund but can be something akin to what is currently required for a public library that is operated by another entity.[14]

Recommendation 8: Education must be provided on the legal difference between a 'gift fund' and a 'public fund'.

40. If the legislation is passed in its current form, DGR entities must be educated on the differences between a gift fund and a public fund. These are difficult tax concepts that many not-for-profits, *especially* those who do not have in-house counsel or access to a lawyer will struggle to understand, yet will have an impact on the day-to-day operations of the organisation, for example:

    (a) An organisation maintaining a gift fund is not required to have a management committee to manage the fund (a departure from the requirements of maintaining a public fund). This will be particularly relevant to organisations who have invested time and resources into public fund committees that sit separately to the regular board of management.

    (b) An organisation maintaining a gift fund is not required to actively seek donations of money or property from the community in the same way that an organisation maintaining a public fund is. This will be particularly relevant to organisations who dedicate resources to fundraising activities to meet the public fund requirements.

41. In addition, the education surrounding the reforms should make clear that an entity's governing document is still a legally binding document and must be complied with even where the requirements are more onerous than those required by the

[13] ACNC Commissioner's Interpretation Statement: Public Benevolent Institution, paragraph 5.8.4
[14] See ATO Taxation Ruling 2000/10 (https://www.ato.gov.au/law/view/document?DocID=TXR/TR200010/NAT/ATO/00001)

Commissioner under the amended legislation. See our recommendations 9 and 10 below.

42. As set out in more detail below, the public fund requirements will likely remain for many DGR entities as they are required to be set out in their governing documents. This will create confusion and risk DGR entities breaching their governing documents if the government's messaging is simply that these requirements no longer apply. Therefore, as outlined as Recommendation 9 below, information and education should be provided about the need to check governing documents, and guidance and assistance given to assist DGR entities to change those rules where necessary.

Recommendation 9: Legal support and education should be provided to organisations to amend governing documents to meet new legal requirements and funding should be provided to community legal centres and to other community legal education providers for the not-for-profit sector, such as Justice Connect for this purpose.

43. The proposed legislative reform will have significant impacts on the governing documents of the DGR entities. Some clauses will become redundant while some will remain relevant, but only correctly understood if read in conjunction with the ITAA 97.

44. It is confusing and against principles of good governance to have a governing document that has not been updated to reflect legal requirements. It undermines the integrity of the organisation's governing documents, puts significant strain on resources if not-for-profits and is confusing to the public who may access the organisation's governing document on the ACNC Charity Portal.

    (a) DGR entities should be provided with legal support (including funding) and education to remove unnecessary clauses from governing documents, for example clauses:

        - requiring the establishment of a management committee for the operation of the public fund
        - requiring the provision of statistical information to the relevant Department
        - requiring the relevant Department to be notified of certain information
        - dictating how receipts are to be issues in the name of the public fund, and
        - clauses (or internal policies) that dictate that REOs are required to have 50 or more members.

(b) DGR entities should also be provided with legal support (including funding) and education to amend certain clauses in governing documents, for example:

- The clauses relating to the public fund must be deleted and updated to reflect the requirement for a gift fund.

  This issue is further exacerbated by the current drafting of the transitional provisions.[15] Those provisions appear to override existing winding up clauses to permit distribution to any DGR, which is likely to come as a surprise to HPCs and REOs used to the current restrictions. Further, the transitional provisions appear to make it optional for the DGR entity to continue to have clauses about the public fund in the organisation's governing document for an indefinite period of time. This is confusing and creates doubt and ambiguity about the requirement to update the organisation's governing document.

- HPCs and REOs must update winding-up clauses to reflect the requirement that in the event of winding-up, they are no longer obliged to transfer surplus assets of the fund to another entity on the register.

  This issue is further exacerbated by the confusing drafting of the transitional provisions,[16] where it appears optional for the DGR entity to continue to have an outdated winding up clause for an indefinite period of time. As with the above point, this is confusing and creates doubt and ambiguity about the requirement to update the organisation's governing document.

45. Funding should be provided to community legal centres and to other community legal education providers for the not-for-profit sector, such as Justice Connect

46. The difficulty of updating governing rules should not be underestimated, especially for HPCs and REOs in the form of charitable trusts, where amendments would often require applying to the relevant Supreme Court for a discretionary order. Recent cases demonstrating the difficulties faced by trustees of charitable trusts in attempting to amend trust deeds, at least partly due to taxation law changes include *Seaton, Noble & Motteram*, [17] *Public Trustee (The Community Foundation of South Australia)* v *Attorney-General*[18] and Re Public Trustee of Queensland as trustee of Queensland Community Foundation.[19]

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[15] Treasury Laws Amendment (Measures 4 for Consultation) Bill 2023: Deductible 5 Gift Recipient Registers Reform, see for example sch 1 cl 7(2(b), cl 7(4)(b), cl 11(2)(b), cl 11(4)(b), 16(2)(b), 16(4)(b), 20(4)(b), 20(6)(b).

[16] Treasury Laws Amendment (Measures 4 for Consultation) Bill 2023: Deductible 5 Gift Recipient Registers Reform, see for example sch 1 cl 7(2(c), cl 11(2)(c).

[17] S *[2002] SASC 152 where an application was sought to modernise a public ancillary fund trust deed in part to comply with tax requirements.*

[18] *(SA)* [2019] SASC 172 where an order was sought to wind up a public fund that had difficulties migrating to a public ancillary fund. The community foundation was partly a casualty of alterations to federal taxation law rolling public funds into the category of public ancillary funds, causing some existing public funds to have difficulty in complying with the new Commonwealth provisions.

[19] [2016] QSC 276 about amendments by the trustee of a community foundation to a trust deed so to comply with its obligations as trustee and Public Ancillary Fund requirements (https://eprints.qut.edu.au/134579)

47. The Government may also consider including a provision which overrides some or all of these requirements in the DGR entity's governing document[20] although we recognise there may be challenges in doing so.

Recommendation 10: Provisions be added to enable the Australian Business Register to include information about which DGR category a DGR entity is endorsed under.

48. The public registers are a useful way of identifying which DGR category applies to an organisation. As these lists will no longer be public on the websites of relevant departments, we recommend that the Australian Business Register be updated to clarify which DGR item number applies to an entity that is endorsed as a DGR.

Conclusion

49. The Committee would welcome the opportunity to discuss this submission with you. In the first instance, please contact the Chair of the Committee, Ms Seak-King Huang on shuang@milnerhuang.com.au.

Yours sincerely



Geoff Provis
Chair
Legal Practice Section

[20] See for example, s 151(2AA) *Corporations Act 2001* (Cth).