

# **Submission to the Board of Taxation**

## ***Draft Charities Bill, 2003***

### **Institute of Public Affairs**

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Charities have changed the way they do business, the work of charities is more ambiguously political than was once the case, indeed the very notion of a charity is problematic. None of this would matter if charity status did not carry certain tax assisted privileges. As it does, there is a need to clarify and delimit the definition condition of a charity. Ultimately, the combination of public assistance and a liberal attitude to the nature of charity work is best balanced by a disclosure by charities to donors of two key concepts, the efficiency of the charity and the nature of the work undertaken in the name of the charity. Disclosure to donors, not limits to non-partisan advocacy, is the answer to the scrutiny required for the public support of charity work.

#### **Introduction**

The rise in influence, scale and resources of non-profit, non-government organisations, most of which are charities, is one of the most significant public policy phenomena of the past 25 years.

The sector is involved in most aspect of public affairs, not only providing essential services but as advocates, advisors and adjudicators. The sector has grown rapidly in terms of the number of organisation, funding and staff. By some measure, the sector is now estimated to be the eighth largest sector in the economy, with total revenue in the billions and staff in the tens of thousands.

Regulations applied to the sector, including tax laws and fund raising regulations, as well as the standards voluntarily adopted by the sector have, however, failed to match the sector's increasing influence and role.

The weak and inadequate official and voluntary regulatory standards have, to some extent, had a deleterious impact on the sector. These include:

- ❑ Poor levels of accountability to the community, donors and to the taxpayers;
- ❑ Expansion into activities that are not of a charitable nature;
- ❑ Adoption of lobbying as a dominant activity;
- ❑ Involvement in the political process;
- ❑ Pursuit of for-profit activity; and,

- Undertaking violent protest and illegal activity.

These activities have occurred, in part from a lack of clear regulations and laws, and in part, from a lack of their enforcement. In the absence of adequate regulation and enforcement, the sector as a whole has exhibited a reluctance to voluntarily adopt adequate standards of accountability, transparency and behaviour.

In this context, the Board of Taxation's review of the Charities Bill is both welcome and timely.

However, the IPA strongly recommends that further and wider investigations into the sector be undertaken. In particular, we suggest that various recommendations made by the Industry Commission Inquiry 1995 *Report on Charitable Organisations in Australia*, be pursued with urgency. Including:

- The ATO should introduce a process to review charities receiving tax deductibility and other tax benefits;
- Charities with a total income above a minimal threshold should be incorporated under the Corporations Law and should be required to produce and lodge financial statements which comply with those required under Corporations Law;
- A study by the Council of Australian Governments into input tax exemption of charities with the aim of their simplification and phased replacement;
- Removal of the exemption from Fringe Benefit Tax for Public Benevolent Institutions;
- A study by the Council of Australian Governments into fundraising regulation with the aim of achieving uniformity or mutual recognition of legislation;
- Establish a Commonwealth Government-funded pilot best practice program for the sector;
- The Australian Accounting Standards Board and the Public Sector Accounting Standards Board should expedite the development and application of accounting standards for the charity sector.

In addition to these concerns with the sector, the matter of immediate concern to the IPA and to the Board of Taxation is the workability of the definition of a charity and the ways and means by which the charity status is decided. The remainder of this submission deals with these matters.

In a previous submission on these issues,<sup>1</sup> the Institute of Public Affairs argued that a new statutory definition of charity was necessary, preferring that charities should be narrowly defined with a strong emphasis on direct relief action. The draft Bill seeks to widen the definition of charity by expanding the list of charitable purposes (sections 10 and 11). These changes extend the list of charities only marginally, and with a small

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<sup>1</sup> Inquiry Into the Definition of Charities and Related Organizations, Submission by The Institute Of Public Affairs by Jim Hoggett, Director of Economic Policy, Institute of Public Affairs, 19 January 2001  
<http://www.ipa.org.au/Speechesandsubmssns/jimcharitiessub.html>

additional cost to revenue. Largely they set in legislation expansions that have occurred through the courts or by government decisions over a number of years. The IPA accepts these changes, but remains concerned that the workability of the definition may be tested on the issue of the scrutiny of charities, in particular, their advocacy (hereinafter referred to as lobbying).

## **Lobbying By Charities**

The Bill seeks to codify the lobbying activities of charities. In this regard, parts of Clauses 4 and 8 are relevant.

Clause 4 (1) states that,

*a reference in any Act to a charity, to a charitable institution or to any other kind of charitable body, is a reference to an entity that:*

*(c) does not engage in activities that do not further, or are not in aid of, its dominant purpose;<sup>2</sup>*

The Explanatory Material for Clause 4 of the Bill states that,

‘ ... any activities in which the charity engages must further, or be in aid of, its charitable purpose. This requirement ensures that the entity must give effect to its charitable purpose. The activities of the entity, when considered with the dominant purpose of the entity, form an overall picture as to the charitable character of the entity. Activities are not considered in order to determine the best way for the entity to achieve its purpose; but simply that the entity gives effect to that purpose by furthering it.’<sup>3</sup>

Clause 8 of the draft Bill would exclude from charitable status organisations that have among their purposes:

*(2) (a) advocating a political party or cause;*

*(b) supporting a candidate for political office;*

*(c) attempting to change the law or government policy; if it is, either on its own or when taken together with one or both of the other of these purposes, more than ancillary or incidental to the other purposes of the entity concerned.<sup>4</sup>*

The explanatory material for Clause 8 of the Bill states that,

‘Ordinarily, representing to Government, from time to time, the interests of those the entity seeks to benefit would be seen as incidental and in aid of the dominant purpose of the charity ...

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<sup>2</sup> Exposure Draft *Charities Bill, 2003*.

<sup>3</sup> Exposure Draft *Charities Bill, 2003*. Explanatory Material, section 1.15.

<sup>4</sup> Exposure Draft *Charities Bill, 2003*.

However, the independence of charities from Government and from political processes is an important component of their role in serving the public benefit.’<sup>5</sup>

In its submission<sup>6</sup> to the Board of Taxation ACOSS refers to Clause 4 of the draft Bill and argues that lobbying should be an integral part of a charity's strategy to relieve poverty or protect the environment, ‘not an exercise designed to achieve political power or influence in its own right. The *Charity Definitions Inquiry* recognised this as the primary test of whether an organisation engaging in advocacy purposes can be a charity.’ Similarly, and referring to Clause 8 (2)(c), ACOSS argues that there is no need to single out ‘non-partisan’ lobbying for special treatment because all of the activities of a charity should further a charitable purpose, and partisan lobbying should not be banned outright, but be restricted.

The ACOSS position is that ‘non-partisan’ lobbying could become the dominant method of the charity, and the charity remain a charity, so long as the lobbying supports the dominant purpose of the charity. The argument is that lobbying for changes to public policy and the law can be a more effective means to provide a public benefit, than direct amelioration. Indeed, it is common practice, as ‘thousands of charities regularly engage in public lobbying and lobbying to further charitable purposes ... This activity includes lobbying governments and other political parties, researching issues of concern in these areas and developing public policy proposals, and raising these issues in debate in the mass media.’

ACOSS contends that ‘Clause 8 is bad law because it implies that the ATO and the courts should restrict the lobbying role of charities, but offers them little or no guidance on how this should be done, or why it should be done. The proposed restrictions on public lobbying would lead to apprehension among charities as to how ‘far’ they can engage in lobbying without losing charitable status, and significantly increase both administrative burdens and compliance costs’. ACOSS further contends that under its approach the ATO and the courts would need to develop a set of legal tests to distinguish between organisations that are charitable and those whose political purposes ‘overwhelm’ their charitable purpose(s). The ACOSS approach does not attempt to restrict the *kind* of non-partisan lobbying activities in which charities can engage, or to arbitrarily limit the *amount* of resources devoted to it.

Although the EM for Clause 4 suggests that ‘activities are not considered in order to determine the best way for the entity to achieve its purpose’, some tests will have to be applied, some measurements made, some reporting will be essential in order to satisfy the second part of the EM, ‘the entity gives effect to that purpose by furthering it’. Whether debate about acceptable and unacceptable purposes takes place under the head of the nature of the charity, or under the head of the nature of the techniques used by the charity, is not so important. The point is to have the debate. The purpose of the charity

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5 Explanatory Material, sections 1.54 and 1.55.

6 ACOSS, 2003. ‘A Charity By Any Other Name ...’ Submission to the Board of Taxation on the Draft Charities Bill, September.

will be brought into focus by whatever test. To test the propositions, however, requires good information.

For example, there is an assumption that a donor understands the purpose of the charity when the charity's methods are direct. Giving aid to the poor, planting trees, and writing letters to foreign governments on behalf of political prisoners means that the requirement to inform the donor is not great, because the purpose is unambiguous. As the methods and definition of charities have widened the assumption of donor knowledge may not hold. The charity no longer gives direct aid to the poor, it wants to use the tax system to achieve equality. Does lobbying to create more generous unemployment benefits or a more progressive tax system constitute charity for the poor, or is it the pursuit of an egalitarian ideology? Is lobbying to tax hydrocarbons a public benefit or the pursuit of an environmental ideology based on assumptions of resource depletion? Is lobbying for an International Criminal Court the pursuit of human rights, or the pursuit of an anti nation-state ideology?

The methods, as well as the scope of charities have changed, and in doing so, so has the purpose of charity. Lobbying means activity to change policies in favour of the view of charities, which are almost invariably that more public resources should be devoted to their favourite cause. Charity work is no longer unambiguously good, or for the public benefit. It may be altruistic, but increasingly it is imbedded in a political framework that seeks to use public power for system change. These methods are unambiguously political in nature. Arguably, it is also at odds with the public and donating public expectations of the charities.

The IPA agrees that charities have, for a very long time seen their work as concerned, not for instance, with direct ameliorative work for the poor or the restoration of the environment, but in changing the law. The question is whether such work should be publicly assisted. If the Government decided that lobbying by charities should not be publicly assisted, then it should be disallowed altogether, the breach of which should cause the loss of charity status. Whether charities would cease to lobby with the loss of such support is moot, but they would likely suffer the loss of donor support for their charitable purposes, a matter of real concern to them and to government. Clearly, the risk in losing donor support for charitable works is a high price to pay for banning lobbying. Moreover, in the areas defined as publicly beneficial, there is useful public policy work undertaken by charities. Charities clearly have a public lobbying role to play. Indeed, they are encouraged, indeed paid in some instances, by government to do so.

But for the tax assistance that comes with charitable status, the IPA would not recommend any restriction on lobbying, including on partisan political activity. Largely, the behaviour of private associations such as charities is a matter for the members of those associations and their donors. ACOSS notes that a recent review of the UK charities legal framework (Home Office 2003) recommended that the UK Charity Commission 'should emphasise that trustees have the freedom to pursue whatever activities they judge to be in the best interests of the charity.' How are they to do so? What is their guide? The problem, analogous to charitable trusts, is that with the

reinterpretation of the purpose of trusts and charities over time, they can stray a long way from their original purpose. While purposes are rarely immutable - they are adjusted as significant events determine - there is often a tension between the original and new purposes. The best way to determine whether the purposes are still acceptable is to have the donors make a judgement. Some ownership in the charity rests in the donor. When a major donor is the taxpayer, they too have an interest in these matters. How is their interest to be registered?

For some charities, for example, the Red Cross, taking a politically partisan position would run a considerable risk of losing support among its donors, not to mention those political parties whom it did not support. For other charities however, for example, environmental groups with well established links with the Greens party, the risk to the donor base is much less. In either case, *provided the donors are kept well informed*, the behaviour of the executive of the group will be judged by the donors. The weakness in this analysis is that charities are not membership organisations. Typically, like political parties, but unlike employer or employee associations, they only 'represent' interests in a nominal sense. Donors are not members and have no voice, they have the power of spending their donor dollar elsewhere, but they have no formal rights to change the direction of the charity or even to be informed.

Taxpayer-funded lobbying is, however, an altogether different matter. The political parties receive considerable taxpayer assistance to conduct their public election activities. In return, the parties must account for such expenditure, including the disclosure of donations and donors. Lobbying by charities, even in a non-partisan way, may or may not determine the fate of politicians who decide policy, but it does seek to determine the menu of policies from which politicians choose. Tax assisted lobbying carries some obligations, and obligations mean scrutiny in the fulfilment of those obligations. The difficulty rests with the nature of the obligations for charities. If some of their taxpayer support is used for lobbying, how is it to be disclosed? If only the 'partisan' element is to be disclosed, it will need to be distinguished from that used for non-partisan lobbying. Even under the ACOSS suggestion, the purpose, if not the nature of lobbying will have to be determined, and that may well require disclosing the activity to the government and to donors.

This raises another issue, that the ATO has not, until now, attempted in a systematic way to regulate the lobbying activities of charities. At present, there is almost no scrutiny of charities, no performance requirements for their taxpayer support. ACOSS wants to maintain the status quo in this regard, and continue to have the ATO do little in regard to checking the credentials of charities, despite the fact that charities admit that their methods are now more political. Even under the broad-brush approach of 'dominant purpose', some activity will have to be evaluated, and data will have to be available. It may be highly unlikely that any form of lobbying would be found to be other than in aid of the charitable purpose, but it does not resolve debate on the concept of charity. Is lobbying an effective means to achieve charitable purposes, does it change the purpose of the charity?

Government must decide whether it is comfortable with the public funding of lobbying. If it is not entirely comfortable with lobbying, the question is, how best to achieve some scrutiny of the expenditure of taxpayer funds on lobbying? The scrutiny required in order to satisfy the public as to the use of its funds does not disappear with the argument that it is in support of the charity. The lobbying may well be a clue as to the charitable purpose.

As to which body should administer the taxation status of charities, there should be no demur, the ATO is the body responsible for the application of tax law for all taxable entities, it should be so for charities. The idea of a Charities Commission is anathema to objective application of the law. The likes of a Charity Commission would become a Trojan horse for the sector within government. Its interest would be in protecting the interests of the sector, not the tax revenue.

The IPA agrees with ACOSS that social policy is not developed in a vacuum by governments or government departments, and that the input of charities as experts and commentators is critical. Attempts to regulate the lobbying activities of charities would not be workable in this environment. They would also diminish the effectiveness of charities - and of public policy - in addressing important issues such as poverty and the protection of the environment.

### **Defining And Regulating Lobbying**

The IPA agrees with the proposition that, as it stands, the Bill requires a clear definition of public lobbying. It also requires a line to be drawn between 'acceptable' (non-partisan) and 'unacceptable' (partisan) lobbying. For example, ACOSS asserts that, in order to define lobbying generally, certain distinctions must be drawn. Some examples are, with comments in italic:

- 'direct lobbying and indirect attempts to influence Governments, such as media activity or grassroots campaigning'; *why the distinction?*
- 'propaganda and community educational purposes'; *what is the difference between the two and how much effort will it take to make the distinction?*
- 'research and policy development aimed at changing the law or policy and that which supports or enhances it'; *Why the distinction?*
- 'advocacy that is part of an established process of collaboration between a charity and Governments to improve policy and that which is initiated by the charity to change the law'; *a distinction without a difference?*
- 'charities negotiating the terms and conditions of their Government funding and lobbying for innovation and change in community funding programs run by Governments'. *Why the distinction?*

ACOSS argues that an examination of the objects of a charity, not its activities, would not require the ATO or the courts to define 'advocacy', nor impose heavy compliance burdens on charities, since it would be clear in the vast majority of cases whether an organisation meets the above requirement. Unfortunately, such a position does not relieve the charity of that burden. The distinctions above are neither obvious nor reasonable.

The example given by ACOSS where a charity might promote a political party ‘incidentally’ in pursuing its charitable purposes where it objectively compares the policies of the parties from the standpoint of its charitable purpose (eg the promotion of health) requires the activity to be measured and evaluated. Charities are inevitably part of the political process, through direct lobbying and/or by influencing public opinion on contemporary policy issues such as poverty and discrimination against disadvantaged groups. The distinction, that their involvement in public debate is properly directed towards influencing public policy, not voting trends is commonly held, but not necessarily pure. ‘The difference between a charity and a political party or movement is that a charity pursues lobbying for charitable purposes, not with a view to advancing the political fortunes of any party or candidate.’ This statement is common to many NGOs. It is used as a device to villainise the politician and glamorise the charity. Are the charity CEO’s prospects not enhanced by successful lobbying? Are the objects of the lobbying not political? The distinction is not so great as ACOSS makes out. The argument that charities remain at arms-length from partisan politics while participating in the broader policy process is more apparent than real.

ACOSS argues that if lobbying is defined, Clause 8 may require the ATO and the courts to draw a line between ‘acceptable’ and ‘unacceptable’ lobbying. The Charity Commission of England and Wales attempts to draw this line by distinguishing between ‘reasoned advocacy’ and political activity that is not firmly grounded in reasoned argument.

According to its guidelines on *Political activity and campaigning by charities*, ‘acceptable’ lobbying includes:

*seeking to influence Government or public opinion through well-founded, reasoned argument based on research or direct experience of issues;*  
*providing supporters, or members of the public with material to send to Members of Parliament or the Government, provided the material amounts to well reasoned argument;*  
*organising petitions;*  
*responding to proposed changes in Government policy.*

‘Unacceptable’ lobbying includes:

*basing arguments for policy change on a distorted selection of data in support of a pre-conceived position;*  
*claiming public support for its position without adequate justification;*  
*influencing Government on the basis of material which is merely emotive;*  
*inviting its supporters to take action such as writing to their Members of Parliament, without providing them sufficient information to advance a reasoned argument;*  
*participating in a public demonstration that is not well controlled and peaceful.*

These definitions are paternal, they also insult the political process by implying that political parties only broadcast propaganda, that they cannot have reasoned argument. The IPA agrees with ACOSS that this approach is intrusive and paternalistic in character. It requires the administering body (the Charity Commission) to oversee the political activity of charities, to ensure that they do not overstep the mark by engaging in 'unacceptable' activity. Such definitions should not apply to non-partisan lobbying.

Should lobbying only form a *minor* part, or at least not the substantial part, of a charity's purposes or activities, this opens up the possibility that an arbitrary formula might be used to restrict the lobbying activities of charities. This approach is adopted in the United States and Canada. Charities in the United States can engage in lobbying provided they devote no more than a fixed proportion of their annual budget to such activity, usually 10%. On the surface, this may seem like a neat compromise between allowing charities to engage in lobbying as they see fit and regulating these activities in detail. Charities are free to engage in lobbying up to a certain point, beyond which they pay more tax.

A series of elaborate formulae apply to determine the proportion of the annual budget that can be devoted to lobbying without a (tax) penalty. Special rules apply to member communications, mass media activity, and non-partisan analysis. Special rules apply to organisations that are part of 'affiliated groups' engaged jointly in lobbying. The Canadian rules appear to be simpler. However, at least the first three steps above are followed. There are at least three different classifications of political activity, and two separate formulae applied to calculate whether expenditure on certain political activity falls within allowable limits. The attempt to impose arbitrary restrictions on the extent to which charities can use their resources for lobbying purposes in the US and Canada has generated elaborate rules of extraordinary complexity, and high compliance costs for charities.

The IPA accepts that any distinction between partisan and non-partisan lobbying requires a debate about definitions. This cannot be avoided, however, some of the burden of regulation and the necessity for arbitrary limits can be avoided by establishing categories of activity, which are to be disclosed to donors. Such a tool places power in the hands of the donors who are able to make judgements as to the acceptable behaviour of charities.

### **Proposed Approach**

The fundamental issue should be not *how much* lobbying a charity engages in, but whether or not lobbying furthers or aids the organisation's dominant charitable purpose. The issue is who is to decide these questions. The answer lies in providing the donors with sufficient information. The donors consist of individuals and the government, on behalf of the taxpayer. Rather than set limits on lobbying, the Bill should ensure that each charity must supply information about its activities, and make this information accessible to all donors.

The key pieces of information are, the percentage of funds devoted to raising funds, a measure of the efficiency of the organisation, and the percentage of funds expended by whatever methods, including lobbying. Unfortunately for the charities, this may involve

extra work in terms of keeping good records, but no more so than any well-managed organisation. An exemption could be granted to the smaller organisations that would find such an exercise a significant burden.

The detail of the data to be gathered is the most interesting challenge. The measurement of the efficiency of fund-raising and the variety of activities are matters that will require industry standards. The main issue is that these are accepted across the sector. There are such measures available and indeed the monitoring can be undertaken by the sector itself. The key is that donors will have sufficient information to make an informed decision about whether to support a charity.

The IPA is aware, as is ACOSS that the ATO is not presently resourced to scrutinise the activities of charities. Once a charity is accepted, it is rarely investigated. This does not mean that the ATO is unable to conduct an audit from time to time, in order to send a signal to the sector about what is and what is not acceptable behaviour.

Our submission is that the resources for scrutiny could be vastly expanded if charities were required to make certain disclosures to the public, or to the Government, who could make these available to the public. The strengths of this approach are that the donor market, and not the government alone would share the scrutiny load. Second, although there would have to be agreed standards of disclosure and definitions of activities to be costed, the government would not need to specify what is acceptable and what is not, nor any particular level of acceptable expenditure.

### **Illegal Activity**

The draft Charity bill also lists as a disqualifying purpose engaging in conduct constituting a serious offence. The IPA supports this inclusion.

The main purpose of a charity is to advance the public benefit and the purpose of the proposed legislation is to provide access to taxpayers' funds to carry out this function.

Committing a serious offence in Australia is not a public benefit nor is it an acceptable charitable activity nor should taxpayers funds be provide for such activity.

ACOSS and other charities have argued in their submission to this review against the inclusion of the illegal actions as a disqualifying purpose on two grounds. First, that illegal actions are best determined and treated under other, broader laws. Second, that it would put the ATO in the impossible position of having to determine whether a serious offence had been committed. Both arguments are faulty in the context of the Bill under consideration.

The determination of a serious offence is clearly best determined under other broader laws rather than the Charities Act and by courts rather than the ATO. However, once the courts make a conviction of a serious offence, it is both appropriate and straightforward for the ATO to act on the decision of the court regarding the charity status of an

organisation. Similar requirements are imposed on other institutions and professions that are given special status by the community such as lawyers, doctors, accountants and corporations.

The Bill does however need to be amended to make clear that the disqualifying offence must relate to actions taken by the organisation in pursuit of its charitable purpose(s) and not, for example, by malfunctioning staff or processes.