



THE UNIVERSITY OF
SYDNEY

The University of Sydney Law School

Legal Studies Research Paper Series

No. 20/11

March 2020

When charity no longer begins and ends at home: The Australian Government's regulatory response to charities operating overseas

Natalie Silver

This paper can be downloaded without charge from the
Social Science Research Network Electronic Library
at: <http://ssrn.com/abstract=3548343>

WHEN CHARITY NO LONGER BEGINS AND ENDS AT HOME: THE AUSTRALIAN GOVERNMENT'S REGULATORY RESPONSE TO CHARITIES OPERATING OVERSEAS

ABSTRACT

In a world in which charitable activities are increasingly crossing national borders, the Australian Government has had to reconsider its regulation of cross-border charity. Recent developments have resulted in a number of proposed regulatory reforms and a new tax ruling directly impacting Australian charities operating overseas. This article evaluates the government's existing and proposed measures to regulate Australian cross-border charity in a changing global landscape. In doing so, it examines whether the promised reforms will enable the government to fulfil its policy goals of reducing the administrative complexity for Australian charities operating overseas and safeguarding their charitable assets, while ensuring that public trust and confidence in these charities is preserved.

I INTRODUCTION

In a world in which charity has become globalised,¹ governments have had to confront the reality that charity no longer begins and ends at home. In 2017 more than 4,500 charities,² or almost 10% of all charities in Australia, reported operating overseas³ — a significant increase from 6.1% of charities in 2013.⁴

* Lecturer, The University of Sydney Law School. I would like to thank Myles McGregor-Lowndes, Simon Rice and the anonymous referees, for their valuable comments on earlier drafts of this paper.

¹ See Lester M Salamon, S Wojciech Sokolowski and Regina List, 'Global Civil Society: An Overview' in Lester M Salamon and S Wojciech Sokolowski (eds), *Global Civil Society: Dimensions of the Nonprofit Sector* (Kumarian Press, 2004) vol 2, 3; Lester M Salamon, *New Frontiers of Philanthropy* (Oxford University Press, 2014) 5.

² Charities are a subset of not-for-profit (or nonprofit) organisation that meet the statutory definition of charity under the *Charities Act 2013* (Cth).

³ This includes transferring funds or goods, or delivering programs, outside Australia. Data is derived from the Australian Charities and Not-for-Profits Commission's ('ACNC') Annual Information Statement: see ACNC, *Australian Charities Report 2017* (Report, 2018) 8.

⁴ Natasha Cortis et al, *Australian Charities Involved Overseas 2014* (Report, 2016) 11.

More than three-quarters of these charities report transferring funds overseas,⁵ with payments to non-resident organisations amounting to more than \$1 billion annually.⁶ While the growth in Australian charities operating overseas has brought widespread benefits to the global community, it has also created regulatory concerns for the Australian government regarding the potential for such charities to be misused for terrorist financing and other criminal purposes.⁷ As a result, the government has had to reconsider the regulation of cross-border charity. In doing so, it has announced new tools to regulate charities operating overseas as part of a reform package for charities with deductible gift recipient ('DGR') status to 'strengthen governance arrangements, reduce administrative complexity and ensure continued trust and confidence in the sector',⁸ allocating \$5.7 million for this purpose in 2017.⁹

Regulation of the charitable sector is similar to regulation of the for-profit sector in that it can be broadly conceptualised as both preventing the occurrence of certain undesirable activities that may occur (a 'red light' or 'prohibitive' concept), while enabling the sector to thrive (a 'green light' or 'facilitative' concept).¹⁰ However, regulation of the charitable sector is distinct from regulation of other sectors in that charities are not primarily engaged in profit-making activities, but are 'ultimately driven by pursuit of public or community benefit'.¹¹ The concept of 'public benefit' is central to the legal definition of charity in Australia;¹² charities are defined as

⁵ Abigail Powell et al, *Australian Charities Report 2016* (Report, 2017) 11.

⁶ Australian Bureau of Statistics, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012–13* (Catalogue No 5256.0, 28 August 2015) table 10.1.

⁷ See Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr, 'Should Tax Incentives for Charitable Giving Stop at Australia's Borders?' (2016) 38(1) *Sydney Law Review* 85, 109–13.

⁸ Kelly O'Dwyer, 'Reforming Administration of Tax Deductible Gift Recipients' (Media Release, Department of Treasury, 5 December 2017). Following changes to the federal Government's ministry in August 2018, Kelly O'Dwyer, who was sponsoring these reforms, is no longer the Minister responsible. The new Minister is Senator Zed Seselja, who has responsibilities for the ACNC and other aspects of charity policy.

⁹ See Scott Morrison and Mathias Cormann, 'Mid-Year Economic and Fiscal Outlook 2017–18' (Budget Release, December 2017) 110–11.

¹⁰ See Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy and Practice* (Oxford University Press, 2nd ed, 2012) 3. See also Oonagh B Breen, Patrick Ford and Gareth G Morgan, 'Cross-Border Issues in the Regulation of Charities: Experiences from the UK and Ireland' (2009) 11(3) *International Journal of Not-for-Profit Law* 5, noting that for the nonprofit sector regulation may be 'controlling' or 'facilitative': at 6.

¹¹ Joyce Chia et al, 'Regulating the Not-for-Profit Sector' (Working Paper, The University of Melbourne Law School, July 2011) 5. See also Susan Pascoe, 'Regulating the Not-for-Profit Sector' (State Services Authority, January 2008) 5.

¹² This originated in the common law model of charity as enunciated by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531, 583: "Charity" in its legal sense comprises four principal divisions:

not-for-profit organisations with charitable purposes that are for the public benefit.¹³ Since 2012, the Australian Charities and Not-for-Profits Commission ('ACNC'), has served as Australia's national charity regulator.¹⁴ Registration as a charity with the ACNC, while voluntary, is a necessary precondition to access federal tax concessions from the Australian Taxation Office ('ATO'),¹⁵ including exemption from income tax, goods and services tax concessions, fringe benefits tax concessions and gift deductibility.¹⁶ As the gatekeeper of the charitable tax concessions, the ATO also plays a significant role in the regulation of the charitable sector.

The concept of public benefit underlies these tax concessions, based on the rationale that charities are entitled to tax relief because they are supplying underfunded public goods that would not otherwise be supplied by the private marketplace or the state.¹⁷ Under this rationale, tax concessions represent government subsidies, and their role is to support the charitable sector to provide public goods within the fiscal state.¹⁸

trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads'.

¹³ *Charities Act 2013* (Cth) s 5. The Act has codified the common law definition of charity and expanded the definition of a 'charitable purpose' (s 12) to include health, education, public welfare, religion, culture, reconciliation, human rights, security, animal welfare and the environment, as well as a general catch-all provision in s 12(1)(k).

¹⁴ The ACNC was established as Australia's first national regulator on 3 December 2012: see ACNC, 'Not-for-Profit Reform and the Australian Government' (Guide, January 2013) 4.

¹⁵ See *Australian Charities and Not-for-Profits Commission Act 2012* (Cth) s 10-5 ('ACNC Act').

¹⁶ There are also refunds of franking credits. Tax concessions are also available at the state level relating to stamp duty, payroll tax and land tax: 'Charity Tax Concessions', ACNC (Web Page, 19 June 2017) <<https://www.acnc.gov.au/tools/factsheets/charity-tax-concessions>>.

¹⁷ This is based on Burton Weisbrod's 'public goods theory of nonprofit organisations': see Burton Weisbrod, 'Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy', in Edmund S Phelps (ed), *Altruism, Morality, and Economic Theory* (Russell Sage Foundation, 1975) 171, 171–96. Weisbrod's theory has been expanded and revised over the years. See in particular, Henry Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89(5) *Yale Law Journal* 835; Henry Hansmann, 'Economic Theories of Non-Profit Organisations' in Walter W Powell (ed), *The Nonprofit Sector: A Research Handbook* (Yale University Press, 1987) 27, 29. Hansmann proposed a contract failure theory pursuant to which nonprofits arise as trustworthy alternatives to meet the demand for their goods due to 'contract failure' between consumers (who cannot accurately assess the public goods provided) and for-profit firms (that have 'both the incentive and the opportunity to take advantage of customers by providing less service to them than was promised and paid for'): at 29.

¹⁸ See Miranda Stewart, 'The Boundaries of Charities and Tax' in Matthew Harding, Ann O'Connell and Miranda Stewart (eds), *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 251–2. See also Rick

Indeed, until recently the government's longstanding policy has been that apart from a few exceptions, charitable tax concessions should directly benefit the Australian public,¹⁹ leaving little scope for tax relief for charities operating outside Australia.

With the ultimate goal of public benefit, the government has three stated objects for charity regulation by the ACNC. These are:

- (a) to maintain, protect and enhance public trust and confidence in the Australian not-for-profit sector;
- (b) to support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector; and
- (c) to promote the reduction of unnecessary regulatory obligations on the Australian not-for-profit sector.²⁰

These broad objectives can be achieved through facilitative 'green light' regulation, in which a supportive framework is created to promote a flourishing charitable sector, as well as through prohibitive 'red light' regulation, restricting activities that do not conform to the strict standards imposed by the law.²¹ The ATO's regulatory objectives are focused primarily on fiscal concerns relating to the taxpayer funded charitable concessions, by limiting access to these tax concessions or restricting the rights of registered charities to engage in certain activities. A recent review of the legislative framework regulating the charitable sector highlighted the need to find a balance between these potentially competing objectives of red tape reduction and support for the sector on the one hand, and public expectations of transparency, accountability and good governance on the other.²²

While the government has not articulated a specific regulatory approach with clearly stated objectives for the subsector of charities operating overseas, it is possible to derive objectives for this subsector based on the objectives for the wider charitable

Krever, 'Tax Deductions for Charitable Donations: A Tax Expenditure Analysis' in Richard Krever and Gretchen Kewley (eds), *Charities and Philanthropic Institutions: Reforming the Tax Subsidy and Regulatory Regimes* (Comparative Public Policy Research Unit, Monash University, 1991) 5.

¹⁹ See Silver, McGregor-Lowndes and Tarr (n 7) 88; Stewart (n 18) 244.

²⁰ *ACNC Act* (n 15) s 15-5(1).

²¹ See Oonagh B Breen, Alison Dunn and Mark Sidel, 'Regulatory Waves: An Introduction' in Oonagh B Breen, Alison Dunn and Mark Sidel (eds), *Regulatory Waves: Comparative Perspectives on State and Self-Regulation Policies in the Nonprofit Sector* (Cambridge University Press, 2017) 4.

²² Department of Treasury, *Strengthening for Purpose: Australian Charities and Not-for-Profits Commission Legislation Review* (Report, 22 August 2018) 8 ('*ACNC Legislation Review*'), which evaluated the effectiveness of the *ACNC Act* (n 15) and the *Australian Charities and Not-for-Profits Commission (Consequential and Transitional) Act 2012* (Cth).

sector. The first object, of maintaining and enhancing public trust and confidence, can be further distilled into mitigating the risk of charities operating overseas being misused for terrorist financing and other criminal purposes.²³ The second and third objects, of sustaining the vibrancy and independence of the charitable sector, while promoting the reduction of unnecessary regulatory obligations, can be further refined into the objectives of facilitating efficient and legitimate cross-border charitable flows. Like the broader charitable sector, for the subsector of charities operating overseas the government must balance the objectives of reducing the regulatory burden and allowing this subsector to thrive, while ensuring adequate oversight of cross-border charity. However, recent developments, detailed below, indicate that the government has not been effective in maintaining this balance. In recognition of this, there has been an increased regulatory focus on this subsector.

The first of these developments can be traced to criticism of the government for its inadequate monitoring of cross-border charity from the Financial Action Task Force ('FATF'), an intergovernmental body that promotes the implementation of measures for combating terrorist financing and money laundering in compliance with its recommendations.²⁴ FATF assesses terrorist financing vulnerabilities and threats faced specifically by the nonprofit sector through its Recommendation 8, which serves as an international policy standard influencing the domestic regulation of charities operating overseas. In an evaluation report of Australia in 2015, FATF rated Australia 'non-compliant' with Recommendation 8, finding that 'Australia has not implemented a targeted approach nor has it exercised oversight in dealing with nonprofit organisations that are at risk from the threat of terrorist abuse'.²⁵ It concluded that Australia's supervisory framework for nonprofits was wanting, leaving them 'vulnerable to misuse by terrorist organisations'.²⁶

The government responded to this criticism by conducting a National Risk Assessment into the charitable sector in 2016.²⁷ Based on an evaluation of more than 250,000 registered nonprofits, the Assessment found that while there were few proven instances of money laundering and terrorism financing, there remained a 'medium' risk level of organisations being misused for such purposes.²⁸ Recommendations from the Assessment focused on measures to strengthen the oversight and monitoring of international charitable activities.²⁹ FATF subsequently amended

²³ See Silver, McGregor-Lowndes and Tarr (n 7) 109, 113.

²⁴ Australia is a founding member of FATF, which was established in 1989. See 'Australia', *FATF* (Web Page, 2019) <<http://www.fatf-gafi.org/countries/#Australia>>.

²⁵ FATF, *Anti-Money Laundering and Counter-Terrorist Financing Measures — Australia, Mutual Evaluation Report* (Report, April 2015) ('*FATF Report 2015*').

²⁶ *FATF Report 2015* (n 25) 16.

²⁷ ACNC and Australian Transaction Reports and Analysis Centre ('AUSTRAC'), *Australia's Non-Profit Organisation Sector: Money Laundering and Terrorism Financing Risk Assessment* (Report, August 2017) ('*National Risk Assessment*').

²⁸ *Ibid* 39.

²⁹ *Ibid*.

Recommendation 8, after finding that the nonprofit sector's vulnerability to terrorist abuse may previously have been overstated given that 'not all [nonprofits] are inherently high risk (and some may represent little or no risk at all)'.³⁰ In its revised Recommendation 8, FATF emphasised the need for governments to adopt 'effective and proportionate measures, which should be commensurate to the risks identified through a risk-based approach' and that 'respects countries' obligations under the *Charter of the United Nations* and international human rights law'.³¹ In a follow-up report on Australia in 2018, FATF found that Australia was 'largely compliant' with the revised Recommendation 8, commending the 'comprehensive risk assessment' Australia had taken of its nonprofit sector.³²

At the same time, the need for additional oversight of the subsector of charities operating overseas was raised in connection with a new tax ruling by the ATO in connection with charities classified as public benevolent institutions.³³ This tax ruling directly impacts the ability of Australian charities to receive tax deductible donations for their international activities.³⁴ It addresses the requirement in the income tax legislation that an organisation must be resident 'in Australia' to obtain DGR status.³⁵ Under a previous ruling, the ATO had interpreted this 'in Australia' condition strictly, requiring that a DGR 'be established, controlled, maintained and operated in Australia' and have 'its benevolent purposes' in Australia.³⁶ This interpretation significantly restricted the ability of Australian organisations operating overseas to use tax deductible donations for their international activities. Signalling a shift in approach, the ATO withdrew this ruling in May 2017,³⁷ citing a statement by the ACNC Commissioner that an organisation 'is not precluded from being registered as a [public benevolent institution] subtype of charity if it has a main purpose of providing benevolent relief to people residing overseas'.³⁸ In March 2018, the ATO announced it was developing a new

³⁰ FATF, *International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations* (Report, June 2019) 54.

³¹ *Ibid* 52–3.

³² FATF, *Anti-Money Laundering and Counter-Terrorist Financing Measures — Australia: 3rd Enhanced Follow-Up Report* (Report, July 2018) 4 ('*FATF Report 2018*').

³³ Australian Taxation Office, *Income Tax: The 'in Australia' Requirement for Certain Deductible Gift Recipients and Income Tax Exempt Entities* (TR 2019/6, 18 December 2019). Public benevolent institutions are a type of charity whose main purpose is to be a charitable institution with a main purpose of providing benevolent relief to people in need: see *ACNC Act* (n 15) s 25-5(5) col 2, item 6.

³⁴ See Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr, 'Delineating the Fiscal Borders of Australia's Nonprofit Tax Concessions' (2016) 14(3) *eJournal of Tax Research* 741, 764.

³⁵ See *Income Tax Assessment Act 1997* (Cth) s 30-15 ('*ITAA 1997*').

³⁶ Australian Taxation Office, *Income Tax and Fringe Benefits Tax: Public Benevolent Institutions* (TR 2003/5, 4 June 2003) [129].

³⁷ Australian Taxation Office, *Income Tax and Fringe Benefits Tax: Public Benevolent Institutions: Notice of Withdrawal* (TR 2003/5W, 17 May 2017).

³⁸ ACNC, *Commissioner's Interpretation Statement: Public Benevolent Institutions* (CIS 2016/03, 19 December 2016) [5.8].

public ruling on the ‘in Australia’ requirement, and in July 2018 issued a first draft for public consultation.³⁹ This draft clarified that the meaning of ‘in Australia’ simply requires that a DGR be established or legally recognised in Australia and operate in Australia,⁴⁰ without the need for its purposes or beneficiaries to be in Australia. As the sector awaited its publication (which occurred in December 2019), many Australian organisations took advantage of the existing legal vacuum by establishing public benevolent institutions with DGR status for the purposes of working overseas.⁴¹ The resulting increase in the number of Australian charities operating abroad has signified the need for increased regulatory oversight of these organisations.

The government responded to this need as part of the reform package for DGRs set out in a consultation paper released in August 2018.⁴² The most significant new reform measure introduced to regulate the subsector of charities operating overseas is the issuance of external conduct standards, which came into effect in July 2019. While the charity legislation has made provision for external conduct standards since its inception,⁴³ it was only following the DGR consultation paper in November 2018 that new regulations for the implementation of these standards were developed.⁴⁴ The stated aims of the external conduct standards are

to provide greater confidence that funds sent, and services provided, outside Australia are reaching legitimate beneficiaries and are being used for legitimate purposes ... and to prevent a registered entity from being misused by a criminal organisation.⁴⁵

The standards require charities to appropriately manage their overseas activities and control of resources, conduct an annual review of these activities, ensure they have appropriate anti-fraud and anti-corruption measures in place, and protect vulnerable individuals from exploitation or abuse.⁴⁶

This article considers whether the implementation of these new regulatory measures for Australian charities operating overseas, along with the existing measures governing

³⁹ Australian Taxation Office, *The ‘in Australia’ Requirement for Certain Deductible Gift Recipients and Income Tax Exempt Entities: Draft Taxation Ruling* (TR 2018/D1, 4 July 2018).

⁴⁰ *Ibid* [4].

⁴¹ Data from the ACNC registration database showed that the number of public benevolent institutions operating overseas steadily increased from 2013 to 2016 by an average of approximately 300 per year.

⁴² See Department of Treasury, *Deductible Gift Recipient (DGR) Reforms* (Consultation Paper, August 2018) <<https://treasury.gov.au/consultation/c2018-t321162/>>.

⁴³ *ACNC Act* (n 15) s 50.

⁴⁴ See *Australian Charities and Not-for-Profits Commission Amendment (2018 Measures No 2) Regulations 2018* (Cth) (*‘ACNC Regulations 2018’*).

⁴⁵ *Ibid* s 50.1.

⁴⁶ *Ibid*.

this subsector, achieve the appropriate balance between addressing the government's regulatory concerns while facilitating legitimate and efficient cross-border charity. Part II outlines the regulatory framework that provides the theoretical basis for this analysis. Part III uses the framework to evaluate the existing and proposed tools employed by the government to regulate Australian charities operating overseas, highlighting the challenges and opportunities for policymakers in implementing the proposed reforms. Concluding thoughts are presented in Part IV.

II REGULATORY FRAMEWORK

In their treatise on regulation, Baldwin, Cave and Lodge provide a regulatory framework that can be used to evaluate the measures adopted by governments to regulate the charitable sector.⁴⁷ From the starting point of capacity, a regulatory system for a particular industry or sector can be built around a set of desired policy objectives. Once the regulatory objectives are identified, the next step in the framework is 'to look for the particular mixture of regulatory strategies that will best meet desired objectives'.⁴⁸ In most regulatory contexts this involves determining an appropriate regulatory approach that enables the optimal combination of regulatory tools to be employed.⁴⁹

Responsive regulation, developed by Ayres and Braithwaite, has been a highly influential regulatory approach utilised around the world.⁵⁰ In contrast to a more formalistic approach to regulation, responsive regulation requires regulators to be responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required.⁵¹ Using a regulatory pyramid that responds to different levels of behaviour, this approach provides the regulator with a series of strategies to achieve compliance; from the least intrusive 'light touch' measures with minimal government intervention at the base of the pyramid, to the more intrusive 'command and control' measures with defined government powers at the apex.⁵² Responsive regulation is often used in conjunction with a risk-based

⁴⁷ See generally, Baldwin, Cave and Lodge (n 10) and Jonathon Garton, *The Regulation of Organised Civil Society* (Hart, 2009).

⁴⁸ Ibid 132.

⁴⁹ Ibid. See also Lester Salamon, 'The New Governance and the Tools of Public Action: An Introduction' (2000) 28(5) *Fordham Urban Law Journal* 1611, defining tools or instruments of public action as 'an identifiable method through which collective action is structured to address a public problem': at 1641–2

⁵⁰ Robert Baldwin and Julie Black, 'Really Responsive Regulation' (2008) 71(1) *Modern Law Review* 59, 61.

⁵¹ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992). See also John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford University Press, 2002) 29–34.

⁵² Ibid 35–9.

regulatory approach.⁵³ A risk-based approach targets compliance resources based on an assessment of the risks that a regulatee poses to the regulator's objectives, enabling resources to be targeted in a manner that prioritises the highest risks.⁵⁴ While it emphasises intervention rather than responsiveness,⁵⁵ like the responsive regulatory pyramid it requires regulators to

take account of an entity's compliance performance and tailor its requirements with 'light touch' expectations for compliant and low risk bodies, moving to higher levels of monitoring and intervention for non-compliant or high risk bodies.⁵⁶

In doing so, both of these approaches seek to encourage good behaviour in regulatees, while focusing the regulators' resources on bad behaviour. Both approaches have been employed by charity regulators,⁵⁷ enabling a range of tools to be utilised for direct regulation of this sector.⁵⁸

Jonathan Garton has identified tools that the state can use to regulate the charitable sector.⁵⁹ It is useful to consider these tools as a hierarchy from the most facilitative, at the base of the regulatory pyramid, through to the most prohibitive, at the top of the pyramid. The most facilitative tool, appearing at the base of the pyramid, is the provision of education and advice. As a 'light touch' regulatory instrument, education and advice promotes the 'green light' concept of fostering sector growth and development in a cost-effective manner and can also serve as a preventative measure by ensuring that information regarding laws and best practice is available to the sector. However, there is no mechanism for compliance.⁶⁰

On the next level of the pyramid is disclosure regulation, a moderate form of 'red light' regulation, encompassing registration and reporting requirements for charities. This has been a longstanding form of regulation used by the Charity Commission of

⁵³ Baldwin and Black (n 50) 65. See also Julia Black, 'The Emergence of Risk-Based Regulation and the New Public Risk Management in the UK' [2005] (Autumn) *Public Law* 512.

⁵⁴ See Baldwin and Black (n 50) 66.

⁵⁵ *Ibid.* For a critique of both approaches see at 62–4, 66–7.

⁵⁶ See Pascoe (n 11) 4.

⁵⁷ The Charity Commission of England and Wales emphasises risk-based regulation. See Alison Dunn, 'Eddies and Tides: Statutory Regulation, Co-Regulation and Self-Regulation in Charity Law in Britain' in Breen, Dunn and Sidel (eds) (n 21) 28. The ACNC focuses on both risk-based and responsive regulation: see ACNC, *ACNC Regulatory Approach Statement* (Statement, 20 December 2018) <www.acnc.gov.au/raise-concern/regulating-charities/regulatory-approach-statement> ('*ACNC Regulatory Approach Statement*').

⁵⁸ Baldwin, Cave and Lodge (n 10) 105–36.

⁵⁹ See Garton (n 47) 207–20.

⁶⁰ *Ibid* 218.

England and Wales.⁶¹ With its wide reach and relatively low cost, this tool represents a targeted and efficient use of charitable resources, and can create strong incentives for compliance. If excessive, it can also create unnecessary red tape and compliance costs for regulatees, and requires sufficient resources on the part of the regulator to monitor the submission and accuracy of the information provided.⁶²

Moving up the pyramid is regulation by contract, which is based on the idea ‘that formal agreements render explicit the required performance standards and the acceptable level of costs, so that performance can be monitored’.⁶³ The adoption of New Public Management theory in Australia has led to the outsourcing of government services through contracts,⁶⁴ for services such as health, education, and welfare.⁶⁵ While the regulatory aspects of a contract are typically peripheral to its main purpose, they enable the government to use its spending power to achieve its desired regulatory objectives.⁶⁶

At the second highest level of the pyramid is incentive-based regulation, the foundational tool for regulating the charitable sector, given that all other regulatory measures derive from the preferential tax treatment granted to charities and their donors. Under incentive-based regulation, the government imposes negative or positive taxes or deploys grants and subsidies from the public purse.⁶⁷ This important regulatory instrument allows the government to guide the sector towards (or away from) certain activities. These charitable tax concessions come with their own inspection and enforcement mechanisms in the form of investigations and audits.

At the apex of the pyramid is ‘command and control’ regulation, employed through imposing strict standards, and prohibiting activities which do not conform to those standards through penalties and sanctions for non-compliance.⁶⁸ This strict form of ‘red light’ regulation has the benefit of outlawing some forms of behaviour and in doing so, provides a means for ensuring compliance. At the same time, it can produce a proliferation of complex and inflexible rules resulting in over-regulation,⁶⁹ presenting particular challenges for the charitable sector where many organisations do not have the capacity or resources to navigate onerous and costly regulation.⁷⁰

⁶¹ Ibid 217.

⁶² Baldwin, Cave and Lodge (n 10) 120–1.

⁶³ Hugh Collins, *Regulating Contracts* (Oxford University Press, 2002) 303.

⁶⁴ See Myles McGregor-Lowndes, ‘Australia: Co-Production, Self-Regulation and Co-Regulation’ in Breen, Dunn and Sidel (eds) (n 21) 178–9.

⁶⁵ See Debra Morris, ‘Charities in the Contract Culture: Survival of the Largest?’ (2000) 20(3) *Legal Studies* 409.

⁶⁶ Baldwin, Cave and Lodge (n 10) 114.

⁶⁷ Ibid 111.

⁶⁸ Ibid 107.

⁶⁹ Ibid 108.

⁷⁰ See Pascoe (n 11) 5.

Outside state regulation, at the base of the pyramid is self-regulation, which occurs when entities regulate their own affairs and behaviour.⁷¹ Self-regulation has emerged as a strong presence in the charitable sector,⁷² particularly because charities are philosophically focused on their beneficiaries, creating a natural level of self-regulation.⁷³ While self-regulation lacks the enforceability of hard law regulatory instruments, its quasi-legal status can serve as an important facilitative measure to flexibly promote sector efficiency and accountability.⁷⁴ Peak bodies that mandate and monitor member compliance are able to promote best practice in the sector, and in doing so provide a strong basis for achieving regulatory objectives.

For government, the task becomes balancing prescriptive regulatory tools to prevent the misuse of charitable funds and safeguard the public purse, while promoting facilitative tools that enable the sector to flourish.⁷⁵ By combining elements of both, the government can realise the operational and relational advantages of the latter, while retaining the accountability and enforcement benefits of the former. Using this framework, the next Part evaluates the specific regulatory tools used to regulate the subsector of Australian charities operating overseas.

III THE REGULATORY REGIME IN AUSTRALIA FOR CHARITIES OPERATING OVERSEAS

Following Baldwin, Cave and Lodge's regulatory framework, a regulatory system for the subsector of charities operating overseas can be built around a set of desired policy objectives. The government does not have clearly stated objectives for these charities. Articulating objectives would facilitate the introduction of a regulatory approach and tools that could better demonstrate the public benefit these charities provide, and therefore justify their entitlement to the tax concessions available. To do so, the government would first need to adopt an expansive view of the charitable tax concessions beyond the traditional three-sector subsidy model that

⁷¹ Baldwin, Cave and Lodge (n 10) 137.

⁷² See generally, Breen, Dunn, and Sidel (eds) (n 21). See also Angela Bies, 'Evolution of Nonprofit Self-Regulation in Europe' (2010) 39(6) *Nonprofit and Voluntary Sector Quarterly* 1057; Susan Phillips, 'Canadian Leapfrog: From Regulating Charitable Fundraising to Co-Regulating Good Governance' (2012) 23(3) *VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations* 808; Oonagh B Breen, 'Minding the Pennies: Global Trends in the Regulation of Charitable Fundraising' in Susan Phillips, Jenny Harrow and Tobias Jung (eds), *The Routledge Companion to Philanthropy* (Routledge, 2016) 229.

⁷³ Pascoe (n 11) 18.

⁷⁴ Baldwin, Cave and Lodge (n 10) 140.

⁷⁵ See Debra Morris, 'The Case of England and Wales: Striking the Right Balance of "Hard" Law versus "Soft" Law' in Susan Phillips and Steven Rathgeb Smith (eds), *Governance and Regulation in the Third Sector: International Perspectives* (Routledge, 2011) 37; Phillips (n 72); Breen (n 72) 229.

supports the provision of public goods within the fiscal state.⁷⁶ This would provide a policy rationale for extending the tax concessions to Australian charities operating overseas, which would more appropriately reflect the shift in the ATO's position of allowing public benevolent institutions operating overseas to qualify for DGR status. A compelling rationale for the provision of tax incentives to these charities is that they foster pluralism through a decentralised decision-making and production process for public goods that is more concerned with promoting a diverse charitable sector, wherever that may be.⁷⁷ This pluralism rationale suggests that the public benefiting from charity should be geographically expansive enough to enable private citizens to support a broad cross-section of organisations throughout global civil society. With no geographic limitations, the pluralism rationale would enable the government to recognise the growth in the number of Australian charities operating overseas, reflecting the changing global charitable landscape.

With this broad conception of public benefit, it is possible to identify three objectives for the regulation of this subsector based on the objectives for the charitable sector as a whole.⁷⁸ The first is to mitigate the risk of charities operating overseas being misused for terrorist financing and other criminal purposes, thereby maintaining public trust and confidence in these charities.⁷⁹ The second objective is to facilitate legitimate cross-border charity to sustain the vibrancy and independence of the subsector. The third is to create efficiencies by reducing unnecessary red tape for these charities. To ascertain whether these objectives are being met requires an examination of the approaches and tools used by the plethora of federal government agencies involved in regulating cross-border charity. These include the ACNC as the national charity regulator; the ATO with its significant regulatory role through charitable tax concessions; the Department of Foreign Affairs and Trade ('DFAT'), which is involved in the regulation of international development and relief organisations; and the Department of the Environment and Energy ('DEE'), which regulates environmental organisations operating overseas. In addition to governmental regulation, Australian

⁷⁶ See Silver, McGregor-Lowndes and Tarr (n 7) 88; Stewart (n 18) 244.

⁷⁷ See Rob Reich, 'Toward a Political Theory of Philanthropy' in Patricia Illingworth, Thomas Pogge and Leif Wenar (eds), *Giving Well: The Ethics of Philanthropy* (Oxford University Press, 2011) 187–90; Krever (n 18) 27; Stewart (n 18) 251–2; David Duff, 'Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform' (2004) 42(1) *Osgoode Hall Law Journal* 47, 59. Another justification without geographic limitations is that they are a reward to individuals who choose to support socially valued undertakings and thereby contribute to a more altruistic society. See Rob Atkinson, 'Altruism in Nonprofit Organizations' (1990) 31(3) *Boston College Law Review* 501.

⁷⁸ These are derived from the objectives for the charitable sector as a whole. See *ACNC Act* (n 15) and accompanying text.

⁷⁹ See Silver, McGregor-Lowndes and Tarr (n 7) 109, 113.

international development and relief organisations engage in self-regulation through their peak body, the Australian Council for International Development ('ACFID').⁸⁰

A *The Role of the ACNC*

To meet its regulatory objectives for the charitable sector as a whole, including the subsector of charities that operate overseas, the ACNC has adopted a combination of approaches. For the first objective of mitigating the risk of charities operating overseas being misused for terrorist financing and other criminal purposes, it has adopted a risk-based approach, allocating its resources to 'those areas that present the greatest risk to public trust and confidence.'⁸¹ In doing so, the ACNC has flagged money laundering and terrorism as continuing areas for directing compliance resources.⁸² Because the charitable sector is 'not directly covered by the anti-money laundering and counter terror financing regime and is only regulated by AUSTRAC in limited circumstances',⁸³ the ACNC has gradually expanded its role in identifying terrorist financing and money laundering risks for the sector, establishing partnerships with AUSTRAC, the Australian Federal Police and the Australian Criminal Intelligence Commission ('ACIC') to share information.⁸⁴ In 2016, the ACNC partnered with AUSTRAC to conduct a risk assessment into the charitable sector, finding that while there were few proven instances of money laundering and terrorism financing (consistent with other assessments),⁸⁵ there remained a 'medium' risk level of

⁸⁰ Depending on their legal status, other federal government agencies such as the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission may also be involved in regulating these charities, as well as state and territory agencies through licensing and reporting obligations.

⁸¹ ACNC, *ACNC Regulatory Approach Statement* (n 57). In its DGR reform package, the Commonwealth Government announced that it will provide funding to support additional reviews of charity and DGR eligibility based on risk. See O'Dwyer (n 8) 1.

⁸² See ACNC, *Charities Compliance Report 2017* (Report, March 2018) <<https://www.acnc.gov.au/tools/reports/charity-compliance-report-2017>>.

⁸³ See Department of Treasury, *ACNC Legislation Review* (n 22) 84. The legislative framework governing this regime includes the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) and *Financial Transaction Reports Act 1988* (Cth), supplemented by the *Criminal Code Act 1995* (Cth), which create a number of offences that are particularly relevant to charities engaged in humanitarian activities abroad, including getting funds to, from or for a terrorist organisation, providing support to a terrorist organisation, and associating with terrorist organisations.

⁸⁴ Department of Treasury, *ACNC Legislation Review* (n 22) 85–6.

⁸⁵ See AUSTRAC, *Terrorism Financing in Australia 2014* (Report, 2014) 15; AUSTRAC, *Regional Risk Assessment on Terrorism Financing 2016: South East Asia and Australia* (Report, 2016). See also Department of Treasury, *ACNC Legislation Review* (n 22), which received briefings from ACIC and AUSTRAC advising of 'a small number of charities of interest with links to terrorism-related activities in the Middle East and Western Africa' and 'a number of [persons responsible for the governance of registered charities] who are members of nationally significant organised crime groups with a suspected involvement in a range of criminal offending including the importation and distribution of illicit drugs, money laundering, tax fraud and people smuggling': at 84.

organisations being misused for such purposes.⁸⁶ Recommendations from the *National Risk Assessment* focused on measures to strengthen the oversight and monitoring of international charitable activities, particularly for smaller organisations that undertake activities in high-risk countries.⁸⁷ In its 2018 report, FATF noted ‘concerns that some smaller charities, which are identified as potentially higher-risk, are not subject to adequate monitoring’ and recommended increased monitoring for these charities by the ACNC.⁸⁸ To this end, legislation enacted in May 2018 provided the ACNC with direct access to AUSTRAC’s criminal intelligence database, enabling it to better detect and monitor money laundering and terrorist financing involving registered charities.⁸⁹ The first five-year review of Australia’s charity legislation recommended that the ‘ACNC’s regulatory approach to high-risk registered entities continue to be further developed.’⁹⁰

At the same time, the ACNC has also adopted a regulatory approach that follows Ayres and Braithwaite’s responsive regulation. In doing so, it has developed a five-level ‘pyramid of support and compliance’, incorporating a range of regulatory tools.⁹¹ With its regulatory pyramid, the ACNC seeks to ‘[prevent] problems by providing information, support and guidance to help charities stay on track’,⁹² signifying a focus at the lower, non-interventionist levels of the pyramid. At the same time, the ACNC has clarified that it ‘will not hesitate to use its powers when charities do not act lawfully and reasonably’ and ‘[i]n serious cases, the appropriate response may be near or at the top of pyramid’.⁹³ This is consistent with an overall approach of encouraging good behaviour by charities, while focusing its resources on those charities who are at risk or evidence bad behaviour.

At the base of the ACNC’s regulatory pyramid is the facilitative regulatory tool of education and support, which includes the provision of guidance material and advice services. With its wide reach and relatively low cost, this tool represents a targeted and efficient use of charitable resources. For charities operating overseas, the ACNC conducts briefings on terrorist financing risks and issues guidance to assist these

⁸⁶ ACNC and AUSTRAC, *National Risk Assessment* (n 27).

⁸⁷ *Ibid.*

⁸⁸ *FATF Report 2018* (n 32) 6.

⁸⁹ The *Crimes Legislation Amendment (International Crime Cooperation and Other Measures) Act 2018* (Cth) made the ACNC a ‘designated agency’ for the purposes of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth).

⁹⁰ Department of Treasury, *ACNC Legislation Review* (n 22) 88.

⁹¹ ACNC, *Regulatory Approach Statement* (n 57).

⁹² *Ibid.* 6.

⁹³ *Ibid.* 7. This language is stronger than earlier versions, which stated that ‘[i]n most cases, [the ACNC begins] at lower levels of the pyramid and [moves] upwards only when circumstances require it. However, in serious cases the appropriate action to address an issue may be near the top of the pyramid.’ See ACNC, *Regulatory Approach Statement* (Statement, 29 February 2016) 6.

charities to minimise the risk of being used for terrorist financing.⁹⁴ In its most recent report on Australia, FATF found that there was room for the ACNC to develop further best practice materials for these charities.⁹⁵

Further facilitative measures occur at the second level of the pyramid, with the ACNC providing more targeted regulatory advice and agreed actions to ensure compliance.

The third level is where a shift occurs from less facilitative to more prohibitive ‘proactive compliance’, whereby the ACNC uses its information gathering and monitoring powers through a number of important regulatory tools. For charities operating overseas, information gathering typically occurs at the registration stage. In order to register with the ACNC an organisation must meet the legal definition of a ‘charity’, be in compliance with the ACNC’s governance standards, and not have been listed as an organisation engaging in or supporting terrorist or other criminal activities.⁹⁶ This registration process enables the ACNC to assess compliance risks against its governance standards, a set of high level principles ‘that require charities to remain charitable, operate lawfully, and be run in an accountable and responsible way.’⁹⁷ The ACNC has identified charities operating overseas as requiring increased scrutiny at the registration stage, taking the position that ‘an organisation operating overseas will generally find it more challenging to demonstrate its compliance with the governance standards than an organisation operating solely in Australia’.⁹⁸ Consistent with its risk-based approach, this assessment includes a determination of the level of risk associated with the jurisdiction in, and local partners with which, the organisation operates, and whether appropriate safeguards are in place to ensure that funds sent overseas will be applied to their charitable purposes.⁹⁹

The ACNC’s monitoring powers at this third level are employed through disclosure regulation. The charity legislation governing the ACNC contains reporting requirements for registered charities (unless they are subject to an exception) via the submission of an annual information statement and financial reports.¹⁰⁰ The annual

⁹⁴ ‘Protecting Your Charity Against the Risk of Terrorism Financing’, *ACNC* (Web Page, 2015) <<https://www.acnc.gov.au/for-charities/manage/managing-charity-risk/protecting-your-charity-against-risk-terrorism-financing>>; ‘Checklist: Protecting Your Charity Against the Risk of Terrorism Financing’, *ACNC* (Web Page) <<https://www.acnc.gov.au/for-charities/manage-your-charity/checklist-protecting-your-charity-against-risk-terrorism-financing>>; ‘Factsheet: Overseas Aid and Development Charities’, *ACNC* (Web Page) <<https://www.acnc.gov.au/tools/factsheets/overseas-aid-and-development-charities>>.

⁹⁵ See *FATF Report 2018* (n 32) 5.

⁹⁶ *ACNC Act* (n 15) s 25-5.

⁹⁷ *Ibid* s 50-5.

⁹⁸ *ACNC, Commissioner’s Interpretation Statement: Public Benevolent Institutions* (CIS 2016/03, 19 December 2016) 11 <http://acnc.gov.au/ACNC/Publications/Interp_PBI.aspx>.

⁹⁹ See *ACNC, Factsheet: Overseas Aid and Development Charities* (n 94).

¹⁰⁰ *ACNC Act* (n 15) s 60-5.

information statement requires some information on cross-border charity. When reporting on the jurisdiction in which they ‘conduct activities’, charities can select ‘overseas’ and are then required to state the countries in which they operate.¹⁰¹ Charities can also report ‘international activities’ as either their ‘main’ or ‘other’ activity,¹⁰² and are then directed to specify whether the international activities involved transferring funds or goods overseas, operating overseas (including delivering programs), or ‘other’ (requiring a description).¹⁰³ Charities are also required to indicate any grants and donations outside Australia.¹⁰⁴

Additionally, the ACNC now has four external conduct standards as a regulatory tool specifically directed towards the subsector of charities operating overseas.¹⁰⁵ As part of its DGR reform package, and to ensure compliance with its international obligations under FATF Recommendation 8,¹⁰⁶ particularly given the increased numbers of public benevolent institutions operating overseas, the government stated its intention to issue the external conduct standards ‘[t]o strengthen oversight of overseas activities’.¹⁰⁷ The object of the external conduct standards is to give the public confidence that funds sent outside Australia by registered charities and activities of registered charities operating outside Australia, are legitimate and are not contributing to terrorist or other criminal activities.¹⁰⁸ These standards apply to a registered entity if it operates outside Australia, or works with third parties that operate outside Australia, unless its overseas activities are ‘merely incidental’ to its operations and pursuit of its purposes in Australia.¹⁰⁹

Standard one requires registered charities take reasonable steps to ensure that their activities outside Australia are carried out appropriately, maintain reasonable internal controls around their resources, and take reasonable steps to ensure that resources given to third parties are used in a way that is consistent with their purpose, with

¹⁰¹ See Powell et al (n 5) 24.

¹⁰² Ibid 26–8.

¹⁰³ This was introduced to obtain greater detail about the nature of the international activities of Australia’s charities: see ibid 29.

¹⁰⁴ Ibid 11, 59.

¹⁰⁵ See *ACNC Act* (n 15) div 50; and *ACNC (Web Page)* <<https://www.acnc.gov.au/for-charities/manage-your-charity/governance-hub/acnc-external-conduct-standards>>.

¹⁰⁶ Department of Treasury, *Exposure Draft, Explanatory Materials: Australian Charities and Not-for-profits Commission Amendment Regulations (No 2) 2010* (Explanatory Materials, 2018) 5 <<https://static.treasury.gov.au/uploads/sites/1/2018/08/Explanatory-materials-t317739.pdf>> (‘*Explanatory Materials*’).

¹⁰⁷ O’Dwyer (n 8).

¹⁰⁸ *ACNC Act* (n 15) s 50-5(1).

¹⁰⁹ See *ACNC Regulations 2018* (n 44) s 50.4; *ACNC (Web Page)* <<https://www.acnc.gov.au/for-charities/manage-your-charity/governance-hub/acnc-external-conduct-standards>>.

reasonable controls and risk management processes in place.¹¹⁰ The explanatory materials note that ‘what is reasonable depends on the circumstances’ and this may include a charity’s size, and the location and nature of its overseas activities.¹¹¹

Standard two requires registered charities to undertake an annual review of their overseas activities and engage in record-keeping of activities on a country-by-country basis.¹¹² Given that this standard is worded in general terms, the explanatory materials state that ‘the ACNC will release guidance on the records that should be obtained and kept prior to this standard commencing’.¹¹³ The explanatory materials further state that

the purpose of requiring records to be obtained and kept assists an entity to review their overseas activities and to complete an ‘overseas activity statement’, which will form part of the entity’s annual information statement that is required to be provided to the Commissioner.¹¹⁴

While the exposure draft made provision for an ‘overseas activity statement’ to be provided by a registered charity as part of its annual information statement,¹¹⁵ there is no reference to such a statement in the proposed legislation.

Standard three requires that registered charities ‘take reasonable steps to minimise any risk of corruption, fraud, bribery, or other financial impropriety’ by those governing them, including by board members and trustees, and by employees, volunteers and third parties outside Australia. The standard also requires charities ‘to document any perceived or actual material conflicts of interest’.¹¹⁶

Standard four requires registered charities to take reasonable steps ‘to ensure the safety of vulnerable individuals outside Australia’ who receive services or benefits from the charity, or a third party in collaboration with the charity, or who ‘provide services or benefits on behalf of the charity or the third party’ to minimise the risk of these vulnerable individuals being exposed to exploitation and abuse.¹¹⁷ Again, ‘reasonable steps’ for standards three and four will depend on the circumstances and the risks posed to the vulnerable individuals.¹¹⁸ The Department of Treasury has

¹¹⁰ *Ibid* s 50.20.

¹¹¹ *Explanatory Materials* (n 106) 6.

¹¹² *ACNC Regulations 2018* (n 44) s 50.25.

¹¹³ *Explanatory Materials* (n 106) 8.

¹¹⁴ *Explanatory Materials* (n 106) 7.

¹¹⁵ See *Explanatory Materials* (n 106) 7; *ACNC Act* (n 15) s 40-1; *ACNC Regulations 2018* (n 46) s 50.25(4).

¹¹⁶ *ACNC Regulations 2018* (n 44) s 50.30(3)(b).

¹¹⁷ *Ibid* s 50.35.

¹¹⁸ *Explanatory Materials* (n 106) 9–10.

stated that the ACNC ‘will develop guidance materials to support charities to comply with the standards.’¹¹⁹

At the fourth level of the ACNC’s regulatory pyramid, graduated and proportionate sanctions are introduced for charities with significant non-compliance, including enforceable undertakings and compliance agreements, injunctions, suspension of a member of a charity’s governing body, and administrative penalties to address this non-compliance.¹²⁰

At the top of the pyramid is revocation of charitable status and removal of a member of a charity’s governing body,¹²¹ the ACNC’s most interventionist ‘command and control’ regulatory tools. These may be used when charities have significantly and persistently failed to comply with ACNC’s governance standards, the external conduct standards (when implemented) or reporting obligations under the *ACNC Act*, particularly where other enforcement options are not available.¹²² If a charity’s registration is revoked, it loses its charitable status, including its access to federal tax concessions.

B *The Role of the ATO*

The ATO is responsible for ensuring the tax compliance of charities through its review and auditing processes, adopting a responsive regulatory approach — with facilitative tools of education and advice at the base of the regulatory pyramid, moving up the pyramid to undertaking enquiries and audits, through to imposing penalties and finally revocation of DGR and tax exempt status at the apex.¹²³ In administering and enforcing tax law for charities, the ATO also utilises the important ‘red light’ tool of incentive-based regulation, located towards the top of the regulatory pyramid. For charities operating overseas, as part of the endorsement process of accessing federal tax concessions of income tax exemption and gift deductibility, the ATO assesses

¹¹⁹ Department of Treasury, *External Conduct Standards FAQs* (Document, 2018) 3 <<https://static.treasury.gov.au/uploads/sites/1/2018/08/FAQs-t317739-1.pdf>>.

¹²⁰ For criminal sanctions enforcement is through the courts.

¹²¹ *ACNC Regulatory Approach Statement* (n 57) 7. Compliance agreements are a recent addition to the pyramid, introduced in the most recent iteration in December 2018. A compliance agreement is an action plan developed in consultation with a charity to address identified governance issues. If the ACNC is not satisfied with a charity’s progress in addressing the concerns set out in a compliance agreement, it will consider using formal enforcement powers: see ‘Compliance Agreement’, *ACNC* (Web Page) <<https://www.acnc.gov.au/tools/topic-guides/compliance-agreement>>.

¹²² *ACNC Act* (n 15) s 45-5, note 1; s 50-5, note 1; s 35-10(1)(c)(ii).

¹²³ See Valerie Braithwaite, ‘Responsive Regulation and Taxation: Introduction’ (2007) 29(1) *Law & Policy* 3, 4–6.

whether a charity meets the requirements contained in the tax legislation, including that an organisation be ‘in Australia’.¹²⁴

For income tax exempt entities, the ‘in Australia’ requirement states that an organisation must have ‘a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia.’¹²⁵ The ATO has clarified that operating through a division in Australia is sufficient to constitute ‘physical presence’,¹²⁶ while ‘principally’ should mean more than 50%.¹²⁷ The practical consequence is that charities with income tax exemption can only operate and have beneficiaries outside Australia provided that these overseas activities represent no more than 50% of the organisation’s total expenditure, excluding offshore distributions of gifts and government grants.¹²⁸ For organisations with DGR status, the ‘in Australia’ requirement states that ‘the fund, authority or institution must be in Australia’.¹²⁹

For more than 50 years the ATO interpreted this ‘in Australia’ requirement to mean that a DGR must ‘be established, controlled, maintained and operated in Australia’ and have ‘its benevolent purposes’ in Australia, as expressed through a public ruling for public benevolent institutions.¹³⁰ In practical terms this meant that donations by Australian taxpayers made directly to a charity outside Australia were never tax deductible. It also meant that donations made to an Australian DGR for its own overseas programs were not tax deductible unless such activities were relatively minor or incidental to its Australian operations.¹³¹

However, there are some limited exceptions to this ‘in Australia’ requirement for DGR status; an organisation can obtain DGR status and use tax deductible donations

¹²⁴ For endorsement as an income tax exempt entity, the charity must also (i) comply with the substantive requirements in its governing rules and (ii) apply its income and assets solely for the purpose for which it was established. For endorsement as a DGR, it must fall within a category of DGR described in s 30-B of the *ITAA 1997* (having acceptable rules for transferring surplus gifts and deductible contributions on winding up or revocation of endorsement and maintain a gift fund): see *ITAA 1997* (n 35) s 30-BA.

¹²⁵ *ITAA 1997* (n 35) s 50-50(1)(a). There are limited exceptions to this ‘in Australia’ provision for institutions specifically prescribed by the regulations to be tax exempt.

¹²⁶ Australian Taxation Office, *Income Tax: Endorsement of Income Tax Exempt Charities* (TR 2000/11, 28 June 2000) [12]–[13].

¹²⁷ *Ibid* [15]–[17].

¹²⁸ If the charity has a physical presence overseas, then the overseas activities related to the physical presence outside Australia are not included.

¹²⁹ *ITAA 1997* (n 35) s 30-15.

¹³⁰ Australian Taxation Office, *TR 2003/5* (n 36) [129]. For a discussion of the historical development of this interpretation of the ‘in Australia’ provisions, see Silver, McGregor-Lowndes and Tarr (n 34) 757–60.

¹³¹ *Ibid* [130].

for its activities outside Australia if it establishes an overseas aid fund,¹³² a developed country disaster relief fund,¹³³ a public fund on the Register of Environmental Organisations,¹³⁴ or if it is specifically listed by name in the tax legislation under the category of international affairs.¹³⁵ The majority of charities that have obtained DGR status pursuant to these exceptions, albeit few in number, are overseas aid funds established by organisations undertaking development and humanitarian activities outside Australia through the Overseas Aid Gift Deduction Scheme,¹³⁶ and environmental organisations operating overseas that are on the Register of Environmental Organisations (discussed below).¹³⁷

These ‘in Australia’ requirements served to constrain Australian charities from operating overseas by providing strong incentives for charities and donors wishing to obtain charitable tax relief to direct their charitable activities and funds domestically. At the same time, they created challenges for monitoring cross-border charitable flows because qualified DGRs have been used by other Australian charities without DGR status as intermediaries to channel tax deductible funds abroad.¹³⁸ These channelling arrangements, known as ‘auspicing’, typically involve a servicing fee being paid to the intermediary DGR.¹³⁹ The use of this fee-paying workaround has not only stifled legitimate cross-border charitable flows and created inefficiencies, but by providing a means to circumvent the strict ‘in Australia’ DGR requirement, has also compromised the government’s ability to regulate cross-border charity through tax laws.

Two significant judicial decisions have challenged the legislative efficacy of the geographic restrictions placed around the charitable tax concessions. In *Federal Commissioner of Taxation v Word Investments Ltd*,¹⁴⁰ the High Court found that

¹³² *ITAA 1997* (n 35) s 30-85.

¹³³ *Ibid* s 30-86. Deductible gift recipient status for these funds is limited to two years from the date specified in a Treasury Minister’s declaration of the disaster. The ATO maintains a list of disasters that have been recognised by the Treasury since this provision was enacted in 2006. There are currently 10 disasters on this list. See Australian Taxation Office, *List of Disasters* (Web Page, 27 February 2015) <<https://www.ato.gov.au/Non-profit/Gifts-and-fundraising/In-detail/Disasters/List-of-disasters/#Developedcountrydisasterrelieffund>>.

¹³⁴ *ITAA 1997* (n 35) s 30-55.

¹³⁵ *Ibid* s 30-80. Parliament may amend the *ITAA 1997* (n 35) specifically to list individual organisations by name as a deductible gift recipient. There are currently 23 deductible gift recipients listed by name under the category of international affairs, although time limits for six of these organisations have expired.

¹³⁶ See Australian Taxation Office, *Income Tax: Overseas Aid Gift Deduction Scheme* (TR 95/2, 1 June 1995) [2]–[6].

¹³⁷ Explanatory Memorandum, *Taxation Laws Amendment Bill (No 5) 1992* (Cth), 43–44. See *ITAA 1997* (n 35) s 30-55(1) item 6.1.1.

¹³⁸ See Silver, McGregor-Lowndes and Tarr (n 34) 95.

¹³⁹ *Ibid*.

¹⁴⁰ (2008) 236 CLR 204.

sending funds abroad through a suitably qualified organisation meets the ‘in Australia’ requirement for income tax exemption. This was followed in *Federal Commissioner of Taxation v The Hunger Project Australia*,¹⁴¹ where the Federal Court determined that Hunger Project Australia, which operated primarily as a fundraising arm for a global network of entities that provided hunger relief outside Australia, qualified as an Australian ‘public benevolent institution’¹⁴² and was therefore eligible to apply for income tax exemption and DGR status. Following these decisions, the ATO, in consultation with its Not-for-Profit Stewardship Group,¹⁴³ adopted a more permissive approach to the tax treatment of cross-border donations.¹⁴⁴ This culminated in May 2017 when the ATO withdrew its public ruling for public benevolent institutions on the ‘in Australia’ requirements,¹⁴⁵ and issued a new public ruling in December 2019.¹⁴⁶ Importantly, this new ruling clarifies that the meaning of ‘in Australia’ in the tax legislation refers to DGRs that are ‘established or legally recognised in Australia’ and ‘makes operational or strategic decisions mainly in Australia,’¹⁴⁷ without requiring that their purposes or beneficiaries be in Australia. In the interim, many Australian organisations established public benevolent institutions with DGR status for the purposes of working overseas.¹⁴⁸ This increase in the number of Australian charities operating abroad has signified a need to ensure that there is appropriate oversight and monitoring for these organisations.

C DFAT and the DEE

DFAT administers the Overseas Aid Gift Deduction Scheme for Australian organisations undertaking international development and relief work that establish overseas aid funds in order to qualify for DGR status under this exception to the ‘in Australia’ DGR requirement.¹⁴⁹ To qualify as an overseas aid fund under the scheme, the organisation must be registered as a charity with the ACNC, have a voluntary governing body, and be declared an ‘approved organisation’ by the Minister for

¹⁴¹ (2014) 221 FCR 302.

¹⁴² Public benevolent institutions are charities that provide direct services to those in need of benevolent relief, or raise funds for the purpose of providing benevolent relief. See *ACNC Act* (n 15) s 25-5(5) col 2, item 6.

¹⁴³ See ‘Not-for-Profit Stewardship Group’, *Australian Taxation Office* (Web Page, 5 August 2019) <<https://www.ato.gov.au/General/Consultation/Consultation-groups/Stewardship-groups/Not-for-profit-Stewardship-Group/>>.

¹⁴⁴ See Silver, McGregor-Lowndes and Tarr (n 34) 763–4.

¹⁴⁵ Australian Taxation Office, *TR 2003/5W* (n 37).

¹⁴⁶ Australian Taxation Office, *TR 2019/6* (n 33).

¹⁴⁷ Australian Taxation Office, *TR 2019/6* (n 33) 3 [7].

¹⁴⁸ Data from the ACNC registration database as at 24 May 2017 shows that the number of public benevolent institutions operating overseas has been steadily increasing since 2013–2016 by an average of approximately 300 per year.

¹⁴⁹ Australian Taxation Office, *Income Tax: Overseas Aid Gift Deduction Scheme* (n 136) [2]–[3], [4]–[6]; DFAT, *Overseas Aid Gift Deduction Scheme: Guidelines* (Guidelines, February 2016).

Foreign Affairs. This is a lengthy and costly process,¹⁵⁰ resulting in less than 1% of all active DGRs qualifying as overseas aid funds.¹⁵¹ DFAT also undertakes an accreditation process for Australian aid and development organisations which are subject to grant agreements with DFAT under the Australian NGO Cooperation Program, which provides funding to Australian organisations working in developing countries.¹⁵² In addition to this rigorous accreditation process, funding under the program is subject to the Commonwealth Grants Rules and Guidelines, and implemented through a grant agreement, which contains detailed contractual provisions for ongoing monitoring and compliance, including annual reporting requirements.¹⁵³ The extensive accreditation process and contractual requirements result in considerable legal and administrative costs for the charities involved. Given that these charities are already regulated by the ACNC and ATO, they are subject to a particularly heavy regulatory burden.

Additionally, the DEE administers the Register of Environmental Organisations for Australian environmental organisations operating overseas that then qualify for DGR status under this exception to the ‘in Australia’ DGR requirement.¹⁵⁴ For an organisation to be entered on the Register of Environmental Organisations, the Department undertakes an initial assessment to determine whether certain legal requirements are met, including that the organisation has a principal purpose of protecting and enhancing the natural environment, after which it is passed to the Treasurer for approval.¹⁵⁵ These entry barriers have served to discourage qualifying organisations, with just over 2% of all active DGRs listed on the Register of Environmental

¹⁵⁰ To be an ‘approved organisation’, the organisation must: (i) deliver overseas aid activities (including development and/or humanitarian assistance) in developing countries; (ii) have the capacity to manage and deliver overseas aid activities; (iii) delivered these activities in partnership with in-country organisations; and (iv) have appropriate safeguards in place and manage risks associated with child protection and terrorism: DFAT (n 149) 8–15.

¹⁵¹ Australian Taxation Office, ‘Taxation Statistics 2012–13’ (Web Page, 28 June 2019) <<https://data.gov.au/dataset/taxation-statistics-2012-13>>.

¹⁵² Other programs delivered through partnerships with NGOs include the Humanitarian Partnership Arrangement, the Africa Australia Community Engagement Scheme and the Civil Society Water, Sanitation and Hygiene Fund.

¹⁵³ DFAT, *Evaluation of the Australian NGO Cooperation Program Final Report* (Report, August 2015) 62 <<https://dfat.gov.au/aid/how-we-measure-performance/ode/Documents/ode-evaluation-australian-ngo-cooperation-program-final-report.pdf>>.

¹⁵⁴ Explanatory Memorandum, Taxation Laws Amendment Bill (No 5) 1992 (Cth), 43–4. See *ITAA 1997* (n 35) s 30-55(1) item 6.1.1.

¹⁵⁵ *ITAA 1997* (n 35) s 30-265(1).

Organisations.¹⁵⁶ These charities are subject to additional reporting requirements through the Register,¹⁵⁷ creating significant red tape.

The increased regulatory burden experienced by both Australian aid organisations and environmental organisations operating overseas was recognised by the government as part of the DGR reforms announced in December 2017. The government stated its intention to integrate the Overseas Aid Gift Deduction Scheme and the Register of Environmental Organisations with the ACNC charity register and abolish duplicative reporting requirements ‘to provide a streamlined experience’.¹⁵⁸ When integration of the registers occurs in 2020, the ACNC will assume all administrative responsibilities for these registers, such that DGRs listed on them will satisfy their reporting requirements by completing the ACNC’s annual information statement.¹⁵⁹

D *The Role of the ACFID*

In Australia, nonprofits involved in international development and humanitarian work are subject to additional regulation in the form of sector-led self-regulation through the Australian Council for International Development (‘ACFID’). The ACFID has developed a code of conduct with which its members (representing more than 80% of private international aid in dollar terms)¹⁶⁰ must comply to ensure appropriate governance and control and risk management mechanisms are in place.¹⁶¹ Lauded as ‘the most developed and pure self-regulatory nonprofit code in Australia’,¹⁶² it represents a voluntary, self-regulatory code of good practice for Australian organisations involved in international development and humanitarian work, which aims to increase transparency and accountability and encourage effective regulation.¹⁶³ This is achieved through annual self-assessments and the provision of information demonstrating their continued compliance with the code.¹⁶⁴ The success of ACFID’s code as a co-regulatory tool is evidenced by its integration into DFAT’s accreditation

¹⁵⁶ Australian Taxation Office, *Taxation Statistics 2012–13* (n 151).

¹⁵⁷ See, eg, Department of the Environment, *Register of Environmental Organisations: 2013 Statistical Return* (Online Form, 2013) <<http://www.environment.gov.au/system/files/pages/53ca6702-48ad-414a-bf24-60e253d5ad0d/files/statistical-return-2013.pdf>>.

¹⁵⁸ O’Dwyer (n 8).

¹⁵⁹ The integration, originally scheduled for July 2019, is now scheduled to take place in July 2020: see Morrison and Cormann (n 9).

¹⁶⁰ See McGregor-Lowndes (n 64) 188.

¹⁶¹ ACFID, *ACFID Code of Conduct* (Report, 1 January 2019) <<https://acfid.asn.au/sites/site.acfid/files/ACFID%20Code%20of%20Conduct%20-%20Revised%201JAN19.pdf>> (*ACFID Code of Conduct*).

¹⁶² See McGregor-Lowndes (n 64) 190.

¹⁶³ *ACFID Code of Conduct* (n 161) 2–3.

¹⁶⁴ *Ibid* 6–7.

and funding processes.¹⁶⁵ As a co-regulatory tool, it provides significant efficiency advantages, with relatively low monitoring and enforcement costs.

E *Evaluating the Regulatory Regime*

Analysing the regulatory regime for Australian charities operating overseas reveals the extensive array of bodies and tools that exist in Australia to regulate this subsector, illustrated in the regulatory pyramid in Figure 1 below.

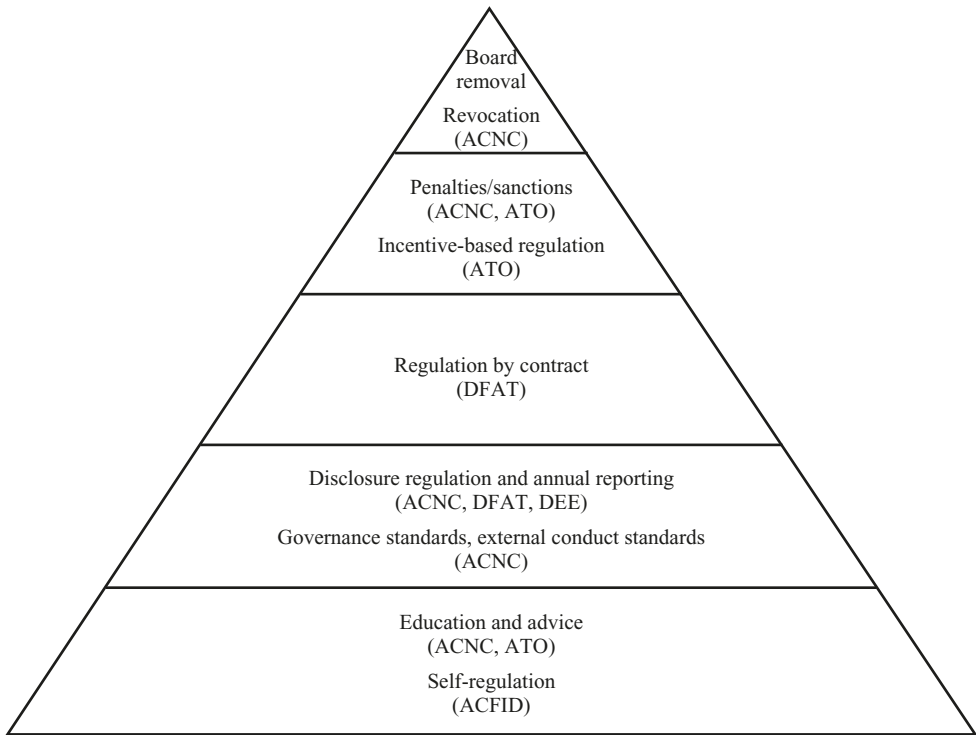


Figure 1. Regulatory Pyramid for the Subsector of Charities Operating Overseas

From this holistic perspective, it becomes clear that there is a fragmented and complex regulatory regime governing this subsector with significant regulatory overlap, which is particularly concerning given the resource constraints of many of these organisations. This suggests that broad brushstrokes applying to the entire charitable sector may not be appropriate for what is a unique group of charities. The analysis also reveals the degree to which the various agencies involved in the regulation of this subsector have emphasised ‘red light’ measures appearing at the higher levels of the regulatory pyramid, which have contributed to the regulatory issues plaguing

¹⁶⁵ See McGregor-Lowndes (n 64) 193.

this subsector. Two significant regulatory changes have been identified that have the potential to resolve these issues.

1 *Implications of the New Tax Ruling*

Until recently, the most notable ‘red light’ measure affecting Australian charities operating overseas has been incentive-based regulation through the ‘in Australia’ requirements contained in the tax legislation. The ATO’s longstanding interpretation of the DGR requirement served as a disincentive for charities and their donors to engage in charitable activities overseas, stifling legitimate cross-border charitable flows. Judicial decisions precipitating a shift by the ATO towards a more permissive approach have exposed the shortcomings of this prescriptive approach that disproportionately affected the subsector of charities operating overseas. The deep flaws in this approach were exposed through the workarounds of the tax laws undertaken by organisations operating overseas who were unable to obtain DGR status as a result, creating challenges for regulators. The ATO’s shift to a less prescriptive approach, culminating in the new tax ruling for charities classified as public benevolent institutions, alleviates the need for these workarounds. At the same time, this shift creates a new regulatory concern in that there is now a two-tier system for Australian charities that operate overseas based on their classification by the ACNC for the purposes of assigning tax concessions.

On the first tier are charities operating overseas who obtained DGR status pursuant to one of the exceptions to the ‘in Australia’ requirements by establishing an overseas aid fund under the Overseas Aid Gift Deduction Scheme, or by qualifying for the Register of Environmental Organisations. To qualify, these charities are required to undertake lengthy eligibility and assessment processes that go beyond risk management.¹⁶⁶ Some of these organisations are also subject to DFAT’s accreditation process. With multiple supervisory government agencies, these organisations have also been subject to overlapping reporting requirements. While the ACNC provides a centralised regulatory infrastructure, as the ‘repository of financial and governance data’,¹⁶⁷ these organisations are subject to further disclosure regulation through DFAT or the DEE. Many of the larger international aid organisations are also subject to regulation through contractual requirements in grant agreements with DFAT, as well as self-regulation through ACFID. The result is unnecessary and excessive red tape for these organisations in terms of both assessment processes and reporting requirements, resulting in over-regulation.

On the second tier are charities operating overseas who have obtained DGR status by simply being classified as a public benevolent institution subtype of charity in the wake of the existing legal vacuum resulting from the ATO’s shift in approach on this issue.¹⁶⁸ Public benevolent institutions are not subject to the same stringent eligibility

¹⁶⁶ For a discussion of these processes, see Silver, McGregor-Lowndes and Tarr (n 7) 96–8, 100–1.

¹⁶⁷ See McGregor-Lowndes (n 64) 197.

¹⁶⁸ See *ACNC Act* (n 15) s 25-5(5) col 2, item 6.

criteria as first tier charities, creating regulatory inequities for charities operating overseas and raising concerns that some of these public benevolent institutions may be under-regulated. This was highlighted in FATF's 2018 report,¹⁶⁹ noting that some of these smaller charities present a potentially higher risk for terrorist financing and money laundering, yet were not subject to adequate monitoring by regulators.

The government's proposed reforms, if implemented successfully, can overcome some of these concerns by ensuring that regulatory controls are consistent across all Australian charities operating overseas. Integrating the registers for the Overseas Aid Gift Deduction Scheme and the Register of Environmental Organisations with the ACNC charity register provides an opportunity to streamline the registration processes for first tier charities, while ensuring that charities across both tiers are subject to the same disclosure regulation. As this synchronisation occurs, it is critical that the ACNC apply the same eligibility criteria for first and second tier charities to achieve an appropriate balance between the stringent criteria applied to first tier charities under the Overseas Aid Gift Deduction Scheme and the Register of Environmental Organisations, with the more lenient criteria applied to second tier charities.

2 Introducing the External Conduct Standards

The external conduct standards represent a new and untested 'red light' regulatory tool for post-registration monitoring. This regulatory control is particularly critical for second tier charities, as it provides an opportunity for the ACNC to engage in risk management post-registration. Some of the smaller second tier charities will need to ensure that appropriate policies and processes are put in place to comply with these standards. At the same time, the ACNC must take into consideration that many first tier charities are already subject to DFAT's accreditation and contracting processes and ACFID's code of conduct and so are likely to be in compliance with these standards. Recognition by the ACNC of these co-regulatory tools would reduce the red tape for these first tier charities, while providing cost savings for the ACNC.

The external conduct standards also provide an opportunity for the ACNC to ensure that its disclosure regulation in the form of its annual information statement adequately accommodates these standards through appropriate reporting on overseas activities. Treasury has stated that

the ACNC will begin to collect some additional information from charities' compliance with the new standards as part of the 2019–20 annual information statement ... Reporting to the ACNC on overseas activities may be required for reporting periods commencing on or after 1 July 2019.¹⁷⁰

While there is no longer provision for an external activities statement, the ACNC has the opportunity to redesign its annual information statement to include detailed questions on cross-border activities and financing conducted outside Australia. Given

¹⁶⁹ FATF, *FATF Report 2018* (n 32).

¹⁷⁰ Department of Treasury, *External Conduct Standards FAQs* (n 119).

that all charities operating overseas will be tracking this information for the external conduct standards, the additional regulatory burden would be minimal. At the same time, it will assist the ACNC in identifying at risk charities operating overseas and prioritising them for compliance reviews in line with its risk-based approach.

With the increased regulatory control affecting smaller charities operating overseas, it is critical that the ACNC continue to focus on the ‘green light’ facilitative measures at the base of the pyramid. The provision of education and guidance to these charities serves as a low cost and efficient means of disseminating information. The issuance of the external conduct standards will necessitate further guidance materials to support smaller charities in complying with these standards. A detailed compliance toolkit, containing information on how to manage risks when working internationally through due diligence and monitoring of funds sent overseas, would be a useful addition to the existing materials.

IV CONCLUSION

A changing global charitable landscape combined with an unsatisfactory domestic regulatory regime has challenged the government to rethink its regulation of the subsector of charities operating overseas. Baldwin, Cave and Lodge emphasise that regulatory approaches must respond to changes over time in order to meet new challenges, requiring ‘that regulators ... assess their own performance but also that they are able to institute the orders of change that are required for optimal regulation’.¹⁷¹ The ACNC has assessed its own performance by conducting a national risk assessment on money laundering and terrorism financing in the nonprofit sector, concluding that there is a medium risk level of nonprofits being misused for these purposes.¹⁷² Following two significant judicial decisions, the ATO has reassessed its approach to the ‘in Australia’ requirements, resulting in a shift to a more permissive approach and a new tax ruling. At the same time, Treasury has undertaken an assessment of the regulatory regime affecting charities operating overseas as part of its DGR reform package, and announced a series of reforms that will directly impact this subsector.

The promise of substantial regulatory reforms, particularly the recent introduction of the external conduct standards and integration of the DGR registers with the ACNC’s charity register, in combination with a new tax ruling, provide a timely opportunity for the government to institute the orders of change that are required for optimal regulation of Australian charities operating overseas. With disclosure regulation becoming the primary tool for regulating Australian charities operating overseas, this moderate form of ‘red light’ regulation, if implemented consistently across all Australian charities operating overseas, promises to solve some of the issues that have plagued the regulation of this subsector. In its role as the central repository for information on Australian charities operating overseas, the ACNC has the

¹⁷¹ Baldwin, Cave and Lodge (n 10) 132–3.

¹⁷² *National Risk Assessment* (n 27).

opportunity to consolidate its position as the ‘certifier of charity trustworthiness’¹⁷³ and to achieve the government’s policy aims of reducing administrative complexity for this subsector, while ensuring that public trust and confidence in these charities is preserved.

¹⁷³ Myles McGregor-Lowndes and Bob Wyatt (eds), *Regulating Charities: The Inside Story* (Routledge, 2017) 263.