



**SUBMISSION TO THE
BOARD OF TAXATION
ON**

EXPOSURE DRAFT: CHARITIES BILL 2003

The Independent Schools Council of Australia (ISCA) is the peak national body covering the independent school sector. It comprises the State and Territory Associations of Independent Schools. Through these Associations it represents a sector with over 1,000 schools and almost 443,000 students accounting for some 12 per cent of Australian school enrolments.¹

Independent schools are a diverse group of non-government schools serving a range of different communities. Many independent schools provide a religious or values-based education. Others promote a particular educational philosophy or interpretation of mainstream education. Independent schools include:

- *Schools affiliated with larger and smaller Christian denominations, for example, Anglican, Catholic, Lutheran, Uniting Church and Presbyterian schools*
- *Non-denominational Christian schools*
- *Islamic schools*
- *Jewish schools*
- *Montessori schools*
- *Rudolf Steiner schools*
- *Schools constituted under specific Acts of Parliament, such as Grammar schools in some states*
- *Community schools*
- *Indigenous community schools*
- *Schools that specialise in meeting the needs of students with disabilities.*

Independent schools are not-for-profit institutions founded by religious or other groups in the community and are registered with the relevant state or territory education authority. Most independent schools are set up and governed independently on an individual school basis. However, some independent schools with common aims and educational philosophies are governed and administered as systems, for example the Lutheran system. Systemic schools account for nearly 20 per cent of schools in the independent sector.

¹ This data is inclusive of Catholic independent schools.



INTRODUCTION

1. The Independent Schools Council of Australia (ISCA) welcomes the opportunity to make a submission to the Board of Taxation on the Exposure Draft: Charities Bill 2003. ISCA appreciates the effort made by the Board of Taxation to consult with the independent schools sector. The recent meeting between key representatives of the sector and representatives of the Board was valuable in clarifying aspects of the draft legislation and identifying possible issues for independent schools.
2. The proposed legislative definition of charities is of considerable concern to the independent school sector. If the draft legislation becomes law, independent schools will be moving from a situation of certainty as to their charitable status to one of considerable uncertainty. This could lead to schools facing a situation where charitable status is determined on a case-by-case base. With this increased uncertainty there is also the strong probability that at least some independent schools will face increased compliance costs in demonstrating their eligibility for charitable status. As currently drafted some schools may be at risk of losing charitable status.

CURRENT SITUATION

3. The certainty that independent schools have enjoyed under the common law arises from the general presumption that, prima facie, the element of public benefit is satisfied in the case of institutions with a predominant charitable purpose of advancement of education. The practical effect of this presumption has been that in terms of administration by the Australian Taxation Office, the charitable status of independent schools has been routinely endorsed and there has been no substantive review of the charitable status of individual schools. Accordingly schools have operated with a high degree of certainty as to their charitable status and compliance costs for schools in determining and demonstrating their charitable status have been negligible.

DRAFT LEGISLATION

4. The draft legislation appears to reflect an objective of changing the definition of charitable institutions in certain significant respects, such as expanding the definition of charitable purposes and requiring the explicit application of the public benefit test in all circumstances, but otherwise replicating the common law.
5. Fundamentally the Government must recognise that the policy shift to require all entities to explicitly demonstrate public benefit will increase uncertainty for some charitable institutions at least in the short term and most probably over the longer term as well. Further, ISCA is not confident that the legislation as currently drafted will succeed in minimising uncertainty by effectively replicating, where appropriate, the common law. The common law contains complexities and nuances that are not easily captured in legislative drafting or a limited Explanatory Memorandum. Accordingly there is a strong likelihood that the proposed legislative definition will create a greater level of uncertainty than anticipated by the Government, with attendant administration costs for government and compliance costs for charities.

Core Definition and Dominant Purpose

6. ISCA is concerned about two aspects of the Core Definition as defined by section 4, namely

(1) (c) does not engage in activities that do not further, or are not in aid of its dominant purpose.

(1) (e) does not engage in, and has not engaged in, conduct (or an omission to engage in conduct) that constitutes a serious offence.

7. ISCA is also concerned about sections 6 (1) (b) and (2) (b) which appear to require any ancillary or incidental purpose to be in aid of the dominant charitable purpose.

Section 4 (1) (c) and sections 6 (1) (b) and 6 (2) (b)

8. ISCA is concerned that sections 6 (1) (b) and 6 (2) (b) as currently drafted involve a more restricted definition of dominant purpose than exists in common law and than recommended by the Inquiry into the Definition of Charities and Related Organisations. As currently drafted sections 6 (1) (b) and 6 (2) (b) require any ancillary or incidental purpose to be in aid or furtherance of the dominant purpose. The common law and the recommendations of the Inquiry into the Definition of Charities and Related Organisations provide for other purposes that are not necessarily in aid or furtherance of the dominant purpose, as long as they are ancillary or incidental to the dominant charitable purpose.

9. ISCA is also uncertain as to the purpose of section 4 (1) (c) and is concerned that it will be a source of ambiguity. It would appear that the section is directed at re-enforcing and/or clarifying the requirement that charitable entities have a dominant charitable purpose. ISCA considers that this requirement would be adequately addressed in a modified definition of dominant purpose at section 6 and that section 4 (1) (c) should be deleted. Specifically, ISCA is concerned that the focus of provision is the activities, rather than the purposes, of the entity. ISCA believes that, as is the case under common law, purposes should continue to be at the centre of any legislative definition of charity, with activities considered only in so far as they clarify the actual purposes of the entity.

10. ISCA is concerned about these provisions because of the possible implications for various ancillary activities of independent schools such as the operation of uniform shops, canteens, provision of recreation facilities and the provision of consultancy services to other schools in, say, areas of curriculum or professional development.

Section 4 (1) (e)

11. Again ISCA is concerned that this provision is specified in terms of activities rather than purposes. It is clearly appropriate that charitable institutions do not have illegal purposes, but this would appear to be satisfactorily addressed in section 8 (1), which defines disqualifying purposes.

12. In the modern context a plethora of legal requirements surround the activities of any entity. Breaches of certain of these requirements can constitute a serious

offence, for example requirements surrounding occupational health and safety. ISCA believes that a charitable organisation which breaches such legal requirements in conducting its day-to-day activities directed to its dominant purpose should not be excluded from charitable status. In many instances entities inadvertently commit such offences because of a lack of expertise or knowledge. ISCA believes that appropriate sanctions against such offences already exist and do not need to be further re-enforced through the loss of charitable status. The current provision is particularly harsh in that it indefinitely excludes an entity from charitable status.

The Public Benefit Test

13. ISCA considers that in all probability independent schools will be judged to meet the requirements of the first two elements of the Public Benefit test.
 - In regard to “achieving a universal or common good” there is a community consensus about the desirability of young people receiving school education, with this most clearly indicated by the legislative requirement for compulsory schooling or education. While from time to time, critics of non-government schooling raise the question of the desirability of religious based schools, the confirmation of advancement of religion as a charitable purpose would *prima facie* suggest that religious based schools would also be judged to be “aimed at achieving a universal good”. This is clearly indicated in the Explanatory Memorandum, which states, “The other six categories (*which includes the advancement of religion*) of charitable purposes have been included on the basis that they represent a significant benefit to the community.”²
 - The “practical utility” of schools as a means of providing education to young people and thus advancing education would seem to be clearly established. This is further re-enforced by current state and territory government requirements for the registration of schools.

Sections 7 (1) (c) and 7(2)

14. ISCA’s concern focuses on the third element of the Public Benefit test: the requirement for the entity to be “*directed to the benefit of the general community or a sufficient section of the general community*” and the related provision that “*beneficiaries must not be numerically negligible*”.
15. ISCA is concerned that section 7(1) (c) together with section 7(2) establishes a new, higher threshold test of public benefit than currently exists in the common law. Under the common law a charitable purpose is required to benefit the “community or a section of the community”. The inclusion of the word “sufficient” in section 7 (1) (c) is suggestive that a specific number of members of the community need to benefit from an institution before it is considered to be charitable.
16. Similarly, ISCA is concerned by the inclusion of section 7 (2): the requirement that beneficiaries “*must not be numerically negligible*”. This provision appears to establish “not numerically negligible” as a binding test of whether an entity is in the public

² Explanatory Memorandum page 17, paragraph 1.83.

benefit, which appears to be contrary to the common law. Gino Dal Pont in Charity Law in Australia and New Zealand states

*“It has been suggested that the phrase “section of the community” dictates two requirements, first that the possible beneficiaries or objects of disposition ‘must not be numerically negligible’ and secondly, that the ‘quality which distinguishes them from other members of the community, so that they form by themselves a section of it must be a quality which does not depend on their relationship to a particular individual’. **At the outset it must be noted, however, that the first such requirement is unlikely of itself to be a disqualifying factor, but rather is more likely to provide a useful indication of the absence of the second requirement.**”³*

17. ISCA’s concerns are reinforced by the failure of the Explanatory Memorandum to make reference to aspects of the interpretation of the requirement to benefit the “community or a section of the community” that exist in the common law. For example, at common law a “section of the community” can be limited by reference to charitable purpose, geographic area or other criteria so long as this is consistent with the charitable need being pursued for the public benefit. Further in common law both direct and indirect benefits are considered in determining if the entity is in the public benefit.
18. ISCA believes that it is essential that these nuances and complexities surrounding the common law Public Benefit test be retained in any legislative definition of charity. In this context, ISCA is concerned that the Bill as currently drafted is somewhat ambiguous in the guidance it provides administering agencies and the Courts on the role of the existing common law in interpreting its provisions. Reference is made to a “code” in the Explanatory Memorandum, which ISCA understands has a specific legal meaning, with the implication that the common law may not always be used in the interpretation of section 7. ISCA believes that the any legislation defining charity should unambiguously direct administering agencies and the Courts to use the common law in force at the time of the passage of the legislation in interpreting its provisions, except in those instances where the common law is inconsistent with the express provisions of the Act.
19. These issues are of particular importance in terms of the possible impact of the draft legislation on independent schools given the nature of Australia (for example geographical isolated communities) and the particular characteristic of school education and some independent schools.
 - Compared to some other charitable activities, the relationship between schools and individual direct beneficiaries is not transient and can extend over period of up to 13 years, with this limiting the absolute number of direct beneficiaries at one time or over a given period. Further in terms of effectiveness of school provision there needs to be some limit on a school’s enrolments at any given time.
 - A significant number of independent schools have relatively small enrolments. Some 86 independent schools have an enrolment of 25 or less,

³ Gino Dal Pont, Charity Law in Australia and New Zealand, Oxford University Press, Australia, 1999, page 16. Emphasis added.

while a further 113 have enrolments between 25 and 50. Important among these are

- **Faith-based schools.** In Australia some faiths generally have a relatively small overall population. In other cases the faith community in a particular town or district, especially in regional centres or small towns, may have a small population. Schools serving these faith communities generally have low enrolments. While the majority of faith-based schools allow enrolments of students from families outside their faith community, a critical mass of students of the particular faith is necessary if the school is to achieve its dual purposes of promotion of education and promotion of religion. It would be inappropriate and contrary to the Australian Constitution for Commonwealth legislation to indirectly discriminate against these religions by inhibiting the capacity for these faith communities to establish and maintain schools by withholding charitable status.
 - **Indigenous community schools.** Some independent sector community aboriginal schools serve remote locations with small populations. While the school might have small enrolments, in some instance they are the only form of locally based school provision.
 - **Special schools.** Of the 86 independent schools with enrolments of 25 or less students some 23 are special schools, with some having fewer than 10 students. These schools are critical to parents having choice in the education of their children with disabilities or other special needs and to the quality of education provision for these students. They can also be important centres of expertise, which support teaching and learning for students with disabilities and special needs in regular school settings.
 - **Schools with a specific education philosophy, such as Montessori and Rudolf Steiner Schools.** A number of schools based on Montessori and Rudolf Steiner philosophies and located in smaller population centres have quite small enrolments.
20. In light of these concerns ISCA considers that section (7) (1) (c) should be amended to remove the word “sufficient” and that section 7 (2) be deleted. Considerations regarding “numerically negligible” would be sufficiently addressed by the requirement to benefit a “section of the community”. Further, ISCA considers that references to “a code” should be deleted from the Explanatory Memorandum and that the legislation contain a direction that the common law existing at the time of the passage of the legislation be used in interpreting its provisions except in circumstances where the common law is inconsistent with the express provisions of the Act.

School Fees and the Public Benefit Test

21. A key area of uncertainty for independent schools is how the levying of fees will impact on the assessment of whether an individual school is judged to be “serving the general community or a sufficient section of the general community”. There is

a risk that the legislation will, over time, have the unintended effect of excluding certain non-government schools from charitable status on the grounds that their fees limit accessibility by section of the general community. However, in large measure the relative financial accessibility of individual non-government schools is a function of government policy.

22. The provision of quality school education is not a low cost activity. Further it can be expected that the current trend towards increasing costs of school provision will continue as a result of new technology, more diverse curriculum, increased accountability and compliance costs, and increasing parental expectations. In the absence of a government subsidy any school providing a reasonable quality education will have to charge significant fees.
23. The wide differentials in school fees, which characterise the non-government school sector in Australia, reflect both differences in size (and hence the scope to exploit economies of scale), the level of provision at individual schools and the extent of government (both Commonwealth and state and territory) subsidy. In general, schools with nominal or low fees tend to have the highest level of government subsidy. Schools that receive a lower level of subsidy tend to charge higher fees. While all schools have some diversity in the socio economic profile of their parental community, such fees can limit financial accessibility of individual schools and thus potential direct beneficiaries. However, these schools provide significant indirect benefits to the community: the low level of government subsidy enables savings in government expenditure, which can be directed to an improved quality of school provision for others or other community priorities. Traditionally the common law application of the public benefit test has taken into account both direct and indirect benefits and it is essential that this continues.
24. Many independent schools provide scholarship programmes, fee remissions and discounts to widen the accessibility of families to schools of their choice. The scope for schools to do this is obviously constrained by financial viability and by the paradox that the more they offer scholarships the higher the fee levels for other students, tending to reduce the accessibility of the school to the general community.
25. If the ATO or other Commonwealth agencies were to subject individual schools to an explicit and individual assessment of their public benefit, compliance costs would be increased significantly for the affected schools. A fair assessment of public benefit would require a very detailed evaluation of a school's operations and financial structure, and also a more sophisticated understanding of the cost of government school provision. If the assessment were to rely on crude indicators, such as fee levels and arbitrary cut off points, it would inevitably result in unintended inequities and anomalies and is also likely to become frozen in time, unresponsive to the continuously changing demands of what constitutes quality school provision.
26. More generally the sector as a whole would face increased uncertainty because of the need for each school to continuously review its circumstances making fine judgements as to whether it continued to satisfy the requirements for charitable status.

27. It is essential that the legislation allow administering agencies to treat non-government schools as a class of institution that satisfies the public benefit test. To do otherwise would raise uncertainty and compliance costs within the non-government schools sector, undermining the plurality of school provision so valued by the Australian community and detracting from the capacity of non-government schools to provide a quality education. It would also increase costs to administering government agencies without a commensurate increase in community benefits.

Implications of the Loss of Charitable Status

28. At present independent schools are exempt from income tax, as a result both of their charitable status and their status as public education institutions. The financial impact on independent schools as a result of the loss of charitable status would crucially depend, therefore, on whether changes are also made to the specific provisions in the Income Tax Act relating to public education institutions. ISCA notes that the Report of the Inquiry into the Definition of Charities and Related Organisations suggested the possibility of changes in this area also.
29. Liability for income taxation would have a significant impact on the capacity of independent schools to develop an appropriate capital infrastructure to support teaching and learning. Operating surpluses play a crucial role in financing capital infrastructure development within schools, the surplus either being used directly to finance capital expenditure or alternatively to repay debt. The demands on schools, both new and existing, for ongoing capital development is considerable as a result of enrolment growth, the need to replace infrastructure, to provide for information technology, meet safety and regulatory requirements, and support a more diverse curriculum which requires specific investment in equipment and facilities (for example, VET, science, drama).
30. Loss of charitable status would also have implications for fringe benefit liability, putting upward pressure on school costs. It would also have implications for the GST liability of irregular fund raising activities (such as fetes) undertaken by non-government schools. The GST legislation provides specific arrangements for charitable institutions and government schools. Loss of access to such provision would be significant in terms of both the returns from vital fundraising activities and additional compliance costs.
31. In the context of the states and territories adopting the Commonwealth definition, the impact of the loss of charitable status would vary across states and territories. In some states and territories exemptions for rates, payroll tax, stamp duty and concessions for utilities are a function of charitable status and in other cases the provisions relate specifically to schools. Loss of these types of concession could have very significant implications for the operating cost structure of individual schools and hence their financial viability.

Recommendations

32. In regard to the draft legislation ISCA recommends that
- (a) Sections 6 (1) (b) and (2) (b) is amended to “any other purposes that it has are purposes that further or are in aid of or are ancillary or incidental.....”;
 - (b) 4 (1) (c) is deleted with this issue adequately addressed under the modified section 6 (see recommendation (a));
 - (c) Section 4 (1) (e) is deleted with the issue of illegal activities adequately addressed by section 8 (1) which defines disqualifying purposes;
 - (d) reference to codifying the common law is removed from the Explanatory Memorandum and the legislation include a formulation which provides that the common law existing at the time of the passage of the legislation should remain in force except in so far as it might be inconsistent with the express provisions of the Act;
 - (e) section 7(2) is deleted with this aspect adequately dealt with by section 7(1) and the use of the existing common law in the interpretation of the Act (see previous recommendation);
 - (f) the legislation provide for non-government schools to be a class of institution that satisfies the public benefit test.

ALTRUISM

33. ISCA does not support the extension of the public benefit test to include the requirement that the dominant purpose of a charitable entity be altruistic.
34. Including explicit reference to altruism will further increase uncertainty surrounding the definition of the charitable organisations, contrary to a key objective of the Government in moving to a legislative definition. “Altruistic” does not have an established judicial meaning and while it would appear that the Inquiry into the Definition of Charities and Related Organisations intended “altruistic” to be understood by its ordinary English usage, even in this context the term has a number of different interpretations. A key issue of interpretation will be the extent of “otherness” required to satisfy the altruistic criterion. It can be expected therefore that certainty as to its meaning will be achieved only over time, through court decisions.
35. In the absence of a precise definition there is a risk that the interpretation established by the courts may not be consistent with expectations of the Government or of charities. The inclusion of such a reference to “altruism” is unlikely to be seen as clarifying the meaning of what is meant by “directed to the public benefit” but be interpreted as signalling that the Government is seeking to alter in some significant, but unspecified way, the definition of charity. In this context, it is unclear what practical criteria administering agencies and the Courts would look to in evaluating whether the requirement for altruism is satisfied. ISCA

concur with the assessment of the Inquiry into the Definition of Charities and Related Organisations that a test focused on the extent of volunteer activity would be inappropriate in the modern context.

36. In the case of schools there are some difficult nuances that any test of altruism would need to satisfactorily accommodate. If a school is to succeed in its charitable purpose of providing an education to young people its focus must necessarily be on meeting the needs of current and future students, that is, its focus must substantially be on activities within the school. In the context of a school the “concern for others” that is at the heart of charity is the concern to educate the young people attending the school. Many independent schools do, nonetheless, have community service programmes as an integral part of school life, consistent with the underlying philosophies and values the school is seeking to engender as part of the education it provides its students.

Recommendation

37. **ISCA recommends that the public benefit test not be extended to include the requirement that the dominant purpose of a charitable entity be altruistic.**

Bill Daniels
Executive Director
Canberra
26 September 2003