Chapter 4

Tax Laws Amendment (Special Conditions for Not-For-Profit Concessions) Bill 2012

4.1 This chapter analyses the provisions of the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (the TLAB). As chapter 1 noted, the TLAB has also been called the 'In Australia' bill. It restates the 'in Australia' special conditions for income tax exempt entities and for deductible gift recipients (DGRs).[1]

4.2 The TLAB contains proposed amendments to 12 Commonwealth Acts to standardise 'in Australia' special conditions for income tax exempt entities and DGRs. The bill would also introduce a consistent definition of not-for-profit entities throughout the tax laws. The following Acts would be amended: the *Income Tax Assessment Act 1997* (ITAA); the *Income Tax (Transitional Provisions) Act 1997;* the *Tax Laws Amendment (2011 Measures No. 2) Act 2011*; the *Income Tax Assessment Act 1936*; the *Taxation Administration Act 1953*; the *A New Tax System (Australian Business Number) Act 1999*; the *A New Tax System (Goods and Services Tax) Act 1999*; the *Extension of Charitable Purpose Act 2004*; the *Fuel Tax Act 2006*; the *Income Tax Act 1986;* the *Income Tax Rates Act 1986*; and the *Fringe Benefits Tax Assessment Act 1986*.

Provisions of the bill

'In Australia' special conditions for deductible gift recipients

4.3 Schedule 1 would commence on the day after Royal Assent, and would:

- reverse the effect of the High Court of Australia's decision in the *Federal Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* (2008) 236 CLR 204 (*Word Investments*);
- apply a standard set of preconditions for all categories of income tax exempt entities;
- harmonise relevant Commonwealth legislation through introducing a standard definition of, and terminology to, refer to not-for-profit entities; and

1 Deductible gift recipient (DGR) status is granted by the government to eligible not-for-profit entities to promote philanthropic giving from individuals and businesses to these organisations. Organisations must be endorsed by the ATO or listed by name in the tax law. Donations made to an organisation with DGR status are tax-deductible.

- codify the 'in Australia' special conditions for DGRs.[2.]

4.4 Schedule 1, Part 1, Items 1 and 2 would amend the ITAA to codify the 'in Australia' special conditions for DGRs with the effect that the core principles for income tax identities would apply similarly to deductible gift recipients but with existing higher thresholds.[3] A DGR would satisfy the 'in Australia' conditions if located in Australia, operating solely in Australia and pursuing its purposes solely in Australia.[4] Activities outside Australia will not preclude an entity from meeting the 'in Australia' requirements provided the activities are incidental or are minor when compared with the entity's Australia-based operations.[5] The Explanatory Memorandum (EM) to the bill notes that the following scenario would not satisfy the bill's proposed 'in Australia' requirements:

> A public museum is incorporated in New Zealand and has a branch in Australia.
>
> It is not 'in Australia'. It cannot be endorsed as a deducible gift recipient.[6]

4.5 In contrast, the EM provides the following example of minor and incidental activities that would be considered to fall within the bill's proposed 'in Australia' requirements:

> A public benevolent institution provides medical assistance to children in Australia with a particular disability but, to a minor extent, it also brings children from other countries to receive treatment in Australia.
>
> The institution would still meet the 'in Australia' special conditions.[7]

4.6 Part 1, Schedule 1 would also establish exceptions to the 'in Australia' conditions that would apply to DGRs. Despite undertaking overseas activities, DGRs under the 'international affairs' category, such as overseas aid funds, or listed on the Register of Environmental Organisations would be exempt from the 'in Australia' special conditions. An entity may appeal to the Administrative Appeals Tribunal decisions of the Secretary of the Environment Department regarding the Register of

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2 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.52.

3 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1.123-1.128.

4 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Schedule 1, Part 1, Item 2, section 30–18.

5 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Schedule 1, Part 1, Item 2, subsection 30–18(2).

6 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Example 1.13: Pursuit of purposes, paragraph 1.129.

7 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Example 1.17: The institution would still meet the 'in Australia' special conditions: Minor and incidental activities, paragraph 1.130.

Environmental Organisations.[8] However, such entities would still be required to satisfy the 'in Australia' test for any activities not related to the 'international affairs' or the Register of Environmental Organisations exemptions.[9]

4.7 Schedule 1, Part 1, Item 13, subsection 30–80(2) would streamline existing provisions in the ITAA by ensuring that all entities currently approved to operate overseas are listed in the 'international affairs' category in Division 30 of the Act. Schedule 3, Items 1 to 3, subsection 30–8(2) and section 30–315 would amend the 'international affairs' category to include the Australian Chamber Orchestra Pty Ltd and the Sydney Dance Company. The EM notes that to remain on the 'international affairs' list each entity would be required to ensure that the international activities remain under 25 per cent of the entity's overall activities. The inclusion of both entities on the international affairs list would be reviewed in three years' time.[10]

4.8 Schedule 1, Part 1, Item 23 would amend the Income Tax (Transitional Provisions) Act to allow certain medical research institutions to be prescribed in regulations as satisfying the 'in Australia' special conditions.[11] The government has announced its intention to examine options to establish a permanent DGR category for medical research institutions for which a significant proportion of their activities are conducted overseas.[12]

Income tax exempt entities

4.9 Schedule 1, Part 2, Item 38, section 50–50 would amend the ITAA to reverse the High Court of Australia's decision in *Word Investments*. The EM argues that the proposed legislative amendments restate the policy operative prior to the High Court's judgement.[13] To qualify as tax-exempt, an entity would be required to:

- operate principally in Australia;
- pursue its purposes principally in Australia;
- comply with all substantive requirements in its governing rules;

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8 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1.131-1.151.

9 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1. 143-1.144.

10 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1. 151.

11 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.149.

12 The Hon. David Bradbury, Second Reading Speech, Assistant Treasurer, *House of Representatives Hansard*, 23 August 2012, pp5-7.

13 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.55.

- apply income and assets solely to pursue the purposes for which it was established; and
- be a not-for-profit entity.[14]

4.10 'Principally' is not defined in the bill. However, the EM notes that principally 'means mainly or chiefly. Less than 50 per cent is not considered principally'.[15]

4.11 The EM notes that the proposed provisions are a departure from the law as it existed prior to *Word Investments*. Currently, there is an expenditure test which considers where the entity incurs its expenditure. The EM states that the existing expenditure-based test would be substituted with an 'operates' and 'pursues its purposes' based test. The EM outlines that the amendments would allow a broader range of circumstances to be taken into account, enhance the integrity of the rules, give greater effect to the policy intent and better align the income tax exempt entities test with the proposed DGR 'in Australia' special conditions test.[16] According to the EM, the following scenario would satisfy the 'operates in Australia' test:

> An organisation is established as a Bible college in Australia, and runs weekly lessons for children in Australia.
>
> The organisation fundraises in Australia, but purchases much of the supplies and equipment (such as religious books) from overseas.
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> Whilst this organisation may not have met the expenditure test in the previous law, depending on the other facts and circumstances of the organisation (such as possible assets and employees in Australia, and management control in Australia), the entity may now meet the 'in Australia' special conditions.[17]

4.12 However, the following scenario would not satisfy the 'in Australia' requirements for income tax exemption:

> In Word Investments, the entity distributed its money to Wycliffe Bible Translators, which then expended the money offshore. If an entity such as Word Investments now provides money to another entity, it must consider the location of the final spending of this money when determining whether it is operating and pursuing its purposes solely in Australia. The money Word Investments provided to Wycliffe was sent overseas, so Word Investments would need to consider the amounts of money provided to

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14 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.53.

15 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.58.

16 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1.59–1.60.

17 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1. 60.

> entities such as Wycliffe (which are ultimately spent offshore) when considering whether it is operating and pursuing its purposes principally in Australia.
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> 1.81 If Word Investments provides all its funds to Wycliffe, who continues to pass these funds overseas, Word Investments will no longer be considered to be operating and pursuing their purposes solely in Australia, and will not be income tax exempt.
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> In addition, if Wycliffe Bible Translators do not operate principally in Australia (because they pass all fund offshore), they will no longer be entitled to be income tax exempt.[18]

4.13 This is in contrast to the High Court's ruling in *Word Investments*.

Definition of not-for-profit

4.14 Part 1 of Schedule 1 of the Tax Laws Bill would also amend the ITAA to standardise terminology relating to not-for-profit entities. References to 'non-profit company' would be substituted with 'company that is a not-for-profit entity'.[19] Part 4, Schedule 1 contains consequential amendments to Commonwealth legislation to ensure that the terminology 'not-for-profit entity' is used throughout.[20]

4.15 Part 3 of Schedule 1 would introduce a uniform definition of a not-for-profit entity for the purposes of Commonwealth taxation laws. 'Not-for-profit entity' would be defined as an entity that:

- is not carried on for the profit or gain of its owners or members; and
- is prohibited under Australian law, a foreign law, or the entity's governing rules from distributing, and does not distribute, its profits and assets to owners or members.[21]

Regulation making power

4.16 Schedule 1, Part 2, Item 38, paragraph 50-51(2)(c)-(d) would introduce regulation making power that would allow certain overseas entities, and entities that while located in Australia principally conduct activities overseas, to be prescribed in

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18 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1.80-1.82.

19 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Schedule 1, Part 1, Items 11-12.

20 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Schedule 1, Items 3,4,6, 11, 12, 35, 46 to 107, 111, 118 to 121, and 126 to 165; Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.116.

21 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, Schedule 1, Part 3, Item 44, subsection 995-1(1).

regulations as income tax exempt entities. The EM notes that regulation making power is intended to be used 'only in exceptional circumstances, at the discretion of the Governor-General in Council'. The EM further notes that it is expected the Governor-General would 'consider matters such as whether the entity will be providing a broad benefit to the Australian community, national interest, tax system integrity, the risk of the entity being utilised for money-laundering or terrorist financing'.[22]

Context of the bill

4.17 Established in 1989 by the G-7, the Financial Action Task Force on Money Laundering (FATF) determines international standards for legal, regulatory and operational measures to deter money laundering, terrorist financing and other activities that may threaten global financial integrity. The task force's 49 recommendations are recognised as the international standard for national regulation and deterrence measures.

4.18 Recommendation 8 has implications for Australia's regulation of not-for-profit entities. Under a broad directive to 'review the adequacy of laws and regulations that can be abused for the financing of terrorism', countries are directed to focus on the 'particular vulnerability' of not-for-profit entities. FATF considers that the not-for-profit sector is vulnerable to exploitation by terrorist organisations due to public confidence in the entities within the sector, the sector's access to finance and its international reach, and the reduced regulation and formal government scrutiny under which not-for-profit entities can operate. Accordingly, as detailed in the recommendation's accompanying explanatory material, Recommendation 8 urges countries to promote transparency within the sector and 'prevent and prosecute as appropriate terrorist financing and other forms of terrorist support':

> Recommendation 8: Non-profit organisations
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> Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:
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> - by terrorist organisations posing as legitimate entities;
> - to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and
> - to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.

4.19 A founding member of the FATF, Australia has agreed to periodic reviews of its compliance with FATF standards. The results of the most recent review were

22 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraph 1.120.

published in 2005. While noting that, as at the date of the report, there were no demonstrated links between terrorist groups and Australia's not-for-profit sector, FATF concluded that Australia's compliance with Recommendation 8 could be strengthened.

4.20 In 2008, the High Court of Australia changed the taxation framework applying to not-for-profit organisations registered as charities with the Australian Taxation Office (ATO). Effective from 1 July 1997, registered charities operating 'in Australia' may be classified under Division 50 of the ITAA as 'income tax exempt entities'. To qualify, not-for-profit organisations were to be physically located in Australia and pursue their activities principally in Australia. The geographical nexus to Australia was intended to minimise the risk of income tax exempt entities operating as vehicles to finance terrorist activities.[23] The High Court of Australia's ruling in *Federal Commissioner of Taxation of Commonwealth of Australia v Word Investments Ltd* effectively broadened the 'in Australia' test. A four to one majority held that test is satisfied where an entity distributes funds to a second charitable entity that, while located in Australia, conducts its activities overseas.[24]

4.21 The Second Reading Speech to the TLAB stated the Australian Government's concern that the Word Investments ruling will undermine Australia's capacity to protect the not-for-profit sector from abuse by terrorist organisations. Accordingly, the government announced its intention to 'amend the "in Australia" requirements in Division 50 of the ITAA to ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities'.[25]

4.22 Concurrent to these developments, successive reviews of the not-for-profit sector argued for the need for consistent definitions and terminology to apply across the not-for-profit sector.[26] In 2001, the Committee for the Inquiry into the Definition of Charities and Related Organisations recommended '[t]hat the term "not-for-profit"

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23 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, paragraphs 1.7 – 1.11.

24 *Federal Commissioner of Taxation of Commonwealth of Australia v Word Investments Ltd* (2008) 236 CLR 204 Gummow, Hayne, Heydon and Crennan JJ, at 70.

25 The Hon. David Bradbury, Second Reading Speech, House of Representative Committee Hansard, 2012, pp 5-7.

26 See, for example, Productivity and Commission, *Contribution of the not-for-profit sector*, January 2010, Recommendations 5.1 and 5.2, which recommended the Australian Bureau of Statistics oversee implementation of an Information Development Plan for the not-for-profit sector and that Australian government should adopt a common framework for measuring the contribution of the not-for-profit sector; Senate Economics References Committee, *Investing for good: the development of capital market in the not-for-profit sector in Australia*, November 2011, Recommendations 7.1 and 7.2, which recommended the introduction of a uniform measurement framework to analyse the sector's performance.

be adopted in place of the term 'non-profit' for the purposes of defining a charity.'[27] In 2011, the government undertook consultations on options to implement this recommendation.[28]

4.23 In May 2011, the government released the consultation paper *Better targeting of not-for-profit tax concessions* for public comment.[29] This six-week consultation period was followed by the release of two public exposure drafts of the measures contained in the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012.[30]

Views on the purpose of the bill

4.24 World Vision has argued that the policy objectives of counter-terrorism and fighting money laundering should not be dealt with through the proposed TLAB. As Mrs Tanya Fletcher of World Vision told the committee:

> We have argued consistently that we do not actually believe that this bill is the appropriate place to address external conduct standards because counterterrorism and anti-money-laundering measures are dealt with by the Attorney-General under different legislation. We are very much in favour of those areas being regulated; we just do not see that they need to be re-regulated within this bill, but could be left up to the Attorney-General to deal with.[31]

4.25 World Vision was asked what it viewed as the purpose of the TLAB. Ms Seak-King Huang responded:

> We do not know, other than the view that seems to have emerged that regulations around anti-terrorism and anti-money-laundering are weaker with the not-for-profit sector. Yet we do not see any evidence of that. World Vision Australia, for example, is accredited with AusAID, and AusAID has fairly tough guidelines around these areas. We are also a signatory to the ASIC code of conduct, which has similar requirements.

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27 Committee of Inquiry, *Report into the inquiry into the definition of charities and related organisations,* June 2001, Recommendation 1.

28 Treasury, *Submission 32*, p. 31, submission to House of Representatives of Standing Committee on Economics' enquiry into the Australian Charities and Not-for-profits Commission Bill 2012 and the Australian Charities and Not-for-profits Commission (Consequential and Transitional) Bill 2012.

29 The Hon Bill Shorten MP, Minister for Financial Services and Superannuation, 'Next stage for not-for-profit reforms announced', Media release 083, 27 May 2011.

30 Explanatory Memorandum, Australian Charities and Not-for-profits Commission Bill 2012 and the Australian Charities and Not-for-profit Commission (Consequential and Transitional) Bill 2012, paragraph 1.35.

31 Mrs Tanya Fletcher, Legal Counsel, World Vision Australia, *Proof Committee Hansard*, 3 September 2012, p. 40.

> Both of them are in line with the Charter of the United Nations Act as well as the other pieces of legislation around this area.[32]

Committee view

4.26 To the committee, this criticism seems misplaced. It is perfectly normal for governments to seek to achieve policy objectives through a number of legislative (and other) means. The objective of counterterrorism is an obvious priority for the government and, particularly in light of the concerns raised in the 2005 FATFA report, Australia should be doing more to prevent terrorist organisations from using not-for-profit entities as a front for their activities. The committee thereby contests World Vision's argument that the TLAB unnecessarily duplicates Australia's existing counter-terrorisms regulations.

The tracing provisions

4.27 Schedule 1, item 38 (proposed section 50-50(4)) of the TLAB relates to the conditions that a donating charity must meet to satisfy the 'in Australia' test and income tax exempt status. The threshold for this status is that the recipient must spend the funds 'principally' in Australia. The provision states:

> Subject to subsection (5), if an entity provides money, property or benefits to another entity that is not an exempt entity, the use of the money, property or benefits by the recipient (or any other entity) must be taken into account when determining whether the first mentioned entity satisfies the requirements in paragraphs (2)(a) and (b).[33]

4.28 Proposed subsection 30-18(3) relates to the conditions that a donating charity must meet to satisfy the 'in Australia' test and meet DGR status. The threshold for DGR status is far higher in that the recipient must spend the funds solely in Australia. The provision states:

> If a fund, authority or institution provides money, property or benefits to another entity that is not a *deductible gift recipient, take into account the use of the money, property or benefits by that other entity (or any other entity) when determining whether the fund, authority or institution satisfies June the conditions in paragraphs (1)(b) and (c).[34]

4.29 World Vision was highly critical of both provisions. In terms of the provisions for DGR payer entities, it posed the following questions:

> There is no discussion as to what is expected in terms of tracing funds. How does the Payer Entity make sure how funds are used? What is meant by the

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32 Ms Huang, Company Secretary and General Counsel, World Vision Australia, *Proof Committee Hansard*, 3 September 2012, p. 43.

33 Tax Laws Amendment (Special Conditions for Not-For-Profit Concessions) Bill 2012, p. 11.

34 Tax Laws Amendment (Special Conditions for Not-For-Profit Concessions) Bill 2012, p. 3.

> use of the phrase "(or any other entity)". This suggests having to trace through where the gift goes. How far? There is nothing in the Bill to indicate what happens if, despite the best efforts by a donor to satisfy itself re the use of funds, it is subsequently determined that they were used in a manner considered to be inappropriate? Is DGR status lost on a "go forward" basis? Is it lost on a retrospective basis? If so, do all donors need to be advised of same and amend their returns?[35]

4.30 Neumann and Turnour also drew the committee's attention to the adverse affect that it claimed the tracing provisions would have on not-for-profit entities. Mr Mark Fowler, a Director at the firm, described the amendment as 'an entirely new provision' that is not currently in the ITAA.[36] He argued that there is 'great uncertainty' in how the provisions would operate, that they will be an added administrative burden and that they may penalise donors for the actions of a third party. Specifically, Mr Fowler foresaw the following possibility:

> ...if charity A gives funds to non-exempt entity B under the understanding that they will be expended in Australia and then two years later entity B changes its intent with those funds and sends them overseas, charity A may lose its charitable endorsement.[37]

4.31 Mr Fowler posed the following questions to the committee to illustrate his concern with how the provision will operate and the administrative burden it would pose on NFPs ensuring they retain tax exemptions and DGR status:

> If charity A is a DGR, the question arises: at what date should it lose its endorsement? Should it be the date on which it provided the funds to entity B, or should it be the date that entity B sends the funds overseas? If it is the date on which it first provided the funds, what happens to all those individuals who gave on a deductible basis? Is their deductibility written back to that date and do they have to resubmit returns for that applicable period? Is there a cut-off period in the consideration of when entity B sends the funds off overseas, so do we wipe the slate clean at year 2 or year 5 or year 10? For how long does entity A need to trace the hands in the funds of entity B?
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> ...
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> If charity A gives funds to an entity that is endorsed as exempt but it is later discovered that that entity should not have been endorsed, should there also

35 World Vision Australia, *Submission 29*, p. 18.

36 Mr Mark Fowler, Director, Neumann and Turnour, *Proof Committee Hansard*, 3 September 2012, p. 32.

37 Mr Mark Fowler, Director, Neumann and Turnour, *Proof Committee Hansard*, 3 September 2012, p. 32.

> then be a backdating even though charity A relied upon the knowledge that it had at the relevant time in giving the gift?[38]

4.32 Neumann and Turnour advocated that if subsection (4) of the TLAB remains, it should be replaced with a deeming provision that requires a charity to show it has made sufficient investigation and it was satisfied on reasonable grounds that the money will be spent in Australia. In this way, it argued, the backdating provisions and administrative burdens are avoided.

4.33 As Neumann and Turnour itself noted in evidence to the committee, this standard is established in the EM. The EM states that a donor entity will generally give money for a particular purpose or cause, and the entity will know where this purpose or cause is intended to be carried out.[39]

Committee view

4.34 The committee believes that the concerns of those submitters who claim the tracing provisions in the TLAB will be too onerous and too complex are overstated. The committee highlights the EM's clear guidance that 'the requirement should present no greater an obligation on entities than already exists under charity law and the existing ATO endorsement framework'. Further, the EM states that if an income tax exempt entity gives money to another income tax exempt entity, the receiving entity will itself have met the 'in Australia' special conditions and be operating principally in Australia. In this case, an entity does not need to take account of the eventual use of the funds.[40]

4.35 The committee does believe that the ATO should release guidance material for the not-for-profit sector on the tracing provision. This material should clarify that a not-for-profit entity that passes funds to another need not rigorously check the use of those funds by the recipient for a prolonged period to meet the 'in Australia' conditions. Rather, the test should be that the donor has reasonable grounds—having made inquiries—that the funds spent by the recipient are principally 'in Australia'. To this end, the guidance material should contain examples which go to the concerns of stakeholders.

4.36 The EM is clear that the ultimate intent of the provision is to prevent the situation that the High Court accepted in its 2008 Word Investments finding. In other words, there is a responsibility for the donor to check that the funds are being used principally in Australia if it is to have tax exempt status. The committee does not

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38 Mr Mark Fowler, Director, Neumann and Turnour, *Proof Committee Hansard*, 3 September 2012, p. 32.

39 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012paragraph 1.76.

40 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, p. 20.

believe that this responsibility involves backdating and ongoing monitoring of a recipient not-for-profit entity's expenditure.

Recommendation 4.1

4.37 The committee recommends that the Australian Taxation Office circulate guidance material relating to Schedule 1, Item 38 of the Taxation Laws Amendment (Special Conditions for Not-for-Profit Concessions) Bill 2012. This material should be developed in consultation with stakeholders and should provide examples which illustrate the responsibilities of donors in checking recipient entities' expenditure.

The definition of a not-for-profit entity

4.38 Clause 44 of the TLAB contains a definition of a 'not-for-profit entity' for tax law purposes. An entity is a not-for-profit entity if:

(a) it is not carried on for the profit or gain of its owners or members, neither while it is operating nor upon winding up; and

(b) under an Australian law, foreign law, or the entity's governing rules, is prohibited from **distributing, and does not distribute**, its profits or assets to its owners or members (whether in money, property or other benefits), neither while it is operating nor upon winding up, unless the distribution:

(i) is made to another not-for-profit entity with a **similar purpose**; or

(ii) is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.[41]

'Does not distribute its profits to its members'

4.39 Some witnesses expressed concern at the phrase 'does not distribute its profits or assets to its owners or members'. They argued that there are many legitimate examples of charities and not for profits distributing profits to their members that would, under the proposed legislation, lose their tax exempt status.

4.40 The Salvation Army expressed concern that the EM states that the definition of the word 'distributing' in clause 44 takes the broader dictionary definition and not the definition in the ITAA. It argued that by widening the definition of distribution:

> ...there is a risk an organisation will be in breach of the definition if they provide their charitable services to a ‘member’ as these services could fall within either the definition of ‘property’ or ‘other benefits’ (it is noted

41 Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, pp 14–15. Emphasis added.

> intangible property and benefits would be caught in these definitions) of the organisation.[42]

4.41 The Salvation Army gave the example of a church congregation where the members of the church are the users of the church 'property' and recipients of the benefits of the organisation on a frequent and regular basis. It feared that the church would lose its tax exempt status. The Salvation Army did note that it is possible that this type of example is an unintended consequence of the definition.[43]

4.42 The law firm Neumann and Turnour gave the example of:

> An indigenous corporation [that] provides accommodation for homeless; it provides around 300 meals per month and uses its bus to transport people to and from its facilities. It does not discriminate between members and non-members in using these facilities. In fact, it encourages everyone it touches to become a member and have a say in its governance structures. The charity will lose exemption.[44]

4.43 In evidence to the committee, Mr Mark Fowler of Neumann and Turnour gave the example of an organisation raising $70 000 for flood victims. He argued that under the proposed definition in the TLAB, the organisation would lose its tax exempt status because it did not discriminate between members and non-members in the area and it provided more than half of the funds to people who were members.[45]

4.44 World Vision expressed the same concern:

> Our view is that the proposed definition of "not-for-profit entity" in the proposed sub-section 995-1(1)(a) of the Tax Bill is too narrow. To be a "not for profit entity", the entity must not be carried on for the profit or gain of its owners or members while operating or upon winding up. If an organisation has members who fall into the category of beneficiaries that the organisation has been established to assist, this would preclude the organisation from assisting such members.[46]

4.45 World Vision argued that a better definition of a 'not for profit entity' is an entity:

> ...whose assets and income are applied solely in furtherance of its objects and not distributed directly or indirectly to the owners or members of the organisation except as bona fide benefits in furtherance of its objects, compensation for services rendered or expenses incurred on behalf of the

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42 The Salvation Army, *Submission 34*, p. 4.

43 The Salvation Army, *Submission 34*, p. 4.

44 Neumann and Turnour, *Submission 22*, p. 3.

45 Mr Mark Fowler, Director, Neumann and Turnour, *Proof Committee Hansard*, 3 September 2012, p. 35.

46 World Vision, *Submission 29*, p. 19.

> organisation; and profits are used to carry out its purposes and not distributed as profits to its owners, members or another party.[47]

'Similar purpose'

4.46 The Australian Catholic Bishops Conference raised a query about the expression 'similar purpose' in proposed subsection 995-1(1) of the ITAA. Father Brian Lucas told the committee:

> The explanatory memorandum, in paragraph 1.86 gives an example of a distribution from charity to charity. What is not so clear in the legislation—this could be improved—is that we are talking about charity to charity, not a particular purpose of charity.[48]
>
> ...
>
> It might be that some tweaking of the wording in defining 'similar purpose' will solve that problem. It also does not address the two different capacities in which a person may get a benefit from a charity: their capacity as citizen like any other citizen; and their capacity as a member or director or committee member or trustee, which can be a different capacity, and that could give rise to different tests.[49]

Treasury's view

4.47 The committee asked Treasury for its response to these criticisms of the proposed definition of a 'not-for -profit entity'. Treasury drew the committee's attention to the definition of a not-for-profit company in various Acts including the *Fringe Benefits Tax Act* and the *Income Tax Act 1986*. In these statutes, the definition is a company that is not carried on for the purposes of profit or gain to its individual members and is prohibited from making any distribution to its members. Treasury told the committee: 'We would contend that the intention that is there in the proposed bill is to restore the intention in the current law'.[50]

4.48 Moreover, Treasury contended that the criticism of the proposed definition is based on a misunderstanding of how the provision should be interpreted. It told the committee:

> In effect, a not-for-profit entity that makes a surplus does not mean that it is not a not for profit. So long as the surplus is applied for the not-for-profit purposes and the profit does not accrue to the benefit of identifiable members either directly or indirectly. That is a long-standing concept of what are not-for-profit entities. In the past, not-for-profit entities have been

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47 World Vision, *Submission 29,* p. 19.

48 Father Brian Lucas, *Proof Committee Hansard,* 3 September 2012, p. 24.

49 Father Brian Lucas, *Proof Committee Hansard,* 3 September 2012, p. 29.

50 Mr Martin Jacobs, Acting Principal Adviser, Indirect, Philanthropy and Resource Tax Division, Treasury, *Proof Committee Hansard,* 3 September 2012, p. 48.

> prohibited from distributing to owners and members and this requirement is nothing new and is effectively at the heart of what a not-for-profit entity is.[51]

The committee's view

4.49 The committee believes that the criticisms of the proposed definition of a 'not-for-profit' entity' in clause 44 of the TLAB are overstated. That said, it is important to allay any stakeholder concerns. Accordingly, the committee considers that that the Treasury should issue clear guidance material that:

- states the intent and the intended consequence of the definition;
- states that the definition is intended to align with definitions of a 'not-for-profit company' in other statutes; and
- clarifies that where entities return any surplus to the not-for-profit purpose, the entity shall not lose its tax exempt status.

Recommendation 4.2

4.50 The committee recommends that Treasury issue guidance material in relation to proposed section 995-1(1) of the *Income Tax Assessment Act 1997*. This material should:

- **state the intent and the intended consequence of the definition;**
- **state that the definition is intended to align with definitions of a 'not-for-profit company' in other statutes; and**
- **clarify that where entities return any surplus to the not-for-profit purpose, the entity shall not lose its tax exempt status.**

4.51 The committee believes that the EM's definition of the words 'similar purpose' makes clear that this encompasses a charity that gives to another regardless of their individual charitable purposes. It clearly states that a charity can utilise a different not-for-profit as a means to carry out or give effect to its charitable purpose.[52]

A final comment

4.52 The committee notes that the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill is in its third iteration having undergone two drafts and consultative processes before this inquiry. While it was important that stakeholders had an opportunity to voice their concerns, the committee does not believe that the bill itself should be amended or delayed. It is important that the

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51 Mr Martin Jacobs, Acting Principal Adviser, Indirect, Philanthropy and Resource Tax Division, Treasury, *Proof Committee Hansard*, 3 September 2012, p. 48.

52 Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, p. 21.

guidance material that the committee has recommended is based on careful consultation with stakeholders to clarify any areas of confusion.

Recommendation 4.3

4.53 The committee recommends that the Tax Laws Amendment (Special Conditions for Not–for-profit Concessions) Bill 2012 be passed.

Ms Deborah O'Neill MP

Chair