Neumann & Turnour
LAWYERS

Neumann & Turnour Submission on *New definition of 'not-for-profit entity'*

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

30 August 2012

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INTRODUCTION

Neumann and Turnour Lawyers is a Brisbane based law firm with a division specialising in Not-for-Profit ("NFP") law. We provide advice to many not-for-profit organisations, particularly charities.

This submission is limited to a discussion of issues arising from the proposed new definition of 'not-for-profit entity'. Time permitting, a separate submission will be provided in relation to other aspects of the Bill.

DEFINITION OF "NOT-FOR-PROFIT ENTITY"

Under the proposed changes to the definition of 'not-for-profit', charities and other income tax exempt NFPs will lose their entitlement to income tax exemption if they assist their members. Despite clear issues with the definition being flagged in April by Moores Legal,[1] no changes have been made.

The Bill provides that, to be entitled to income tax exemption, an entity must be a 'not-for-profit entity'.[2] Under the new regime, this will mean an entity that:[3]

(a) 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.

The requirement in (a), that the organisation 'is not carried on for the profit or gain of its owners or members', properly limits the scope of allowable activities. This is not a new concept, and most NFPs are familiar with this constraint.

No distribution to owners/members

The words creating the challenges lie in (b), in the phrase: "and does not distribute its profits or assets to its owners or members (whether in money, property or other benefits)". Frequently indigenous, welfare and religious organisations assist members that are in need. Doing so under the proposed new definition would breach the new s.50-50. Organisations will lose income tax exemption even where (a) is satisfied.

Examples of impact

The likely impact of this change is illustrated by three typical examples, adapted from the activities of real organisations. An indigenous corporation provides accommodation for homeless; it provides about 300 meals per month and uses its bus to transport people to and from courses at its facilities. It does not discriminate between members and non-members

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[1] Moores Legal, [2012] *Submission on the Tax Laws Amendment (2012 Measures No.4) Bill 2012: tax exempt body "in Australia" requirements,* at 2.11.

[2] *Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012* s.26, inserting a new s.50-50 into the *Income Tax Assessment Act 1997.*

[3] *Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012* s.44, inserting new s.995-1(1) into the *Income Tax Assessment Act 1997.*

in providing any of these services. In fact, it encourages everyone it touches to become a member and have a say in its governance structures. The charity will lose exemption.

Following floods in Ipswich, Queensland, the management committee of a small welfare charity virtually empties its bank accounts to assist victims. In all, $70,000 is given to victims from the initial funds and further funds raised. It does not discriminate against members in distributing the funds; it distributes according to need. Consequently, as members were some of the worst affected, they receive more than half of the funds. It will also lose its exemption because it now provides the bulks of its services to members.

A church operating in relatively poor areas has what it calls a 'Family Care Fund'. Attenders make donations expressly for the purpose of helping families that fall upon hard times to meet expenses. These are often medical expenses, but could be car repairs – particularly where the car is integral to the bread winner getting to work. This church, too, will lose its exemption.

These are not atypical examples. Bill Shorten, when Assistant Treasurer, quoted Henry Lawson to sum up this spirit: 'If a man's in a hole you must pass round the hat— Were he jail-bird or gentleman once." [4] If the Hat is passed around and banked to an NFP, and the NFP distributes the funds to members, that NFP will lose its income tax exemption.

Likely unintended consequences of the amendment

These amendments are of great concern to all leaders of not-for-profit organisations that enjoy income tax exemption. We anticipate that if this amendment is passed in its current form, many organisations will take one or more of the following steps:

1. Reduction in membership

Organisations like the indigenous corporation can reduce the number of members to the bare minimum necessary to satisfy legal requirements, allowing them to serve a greater pool of non-members. This will undermine principles of inclusiveness, accountability and transparency, but will enable the organisation to continue to pursue its purposes of assisting those in need.

2. Reciprocal arrangements

Secondly, reciprocal arrangements may well be set up by organisations like those assisting flood victims. For example, the local Anglican church might agree with the local Catholic church to support the members of the other church, rather than their own.

3. Conversion of simple arrangements into formal trusts

Thirdly, arrangements such as the Family Care Fund will need to be converted into formal trust arrangements, with the additional administrative burden that will bring.

'Similar purpose'

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[4] Bill Shorten, Assistant Treasurer and Minister for Financial Services & Superannuation 14 September 2010 - 14 December 2011 Speech of 27/05/2011 NO.019 Passing Round the Hat for Change: This Labor Government and the Not-For-Profit Sector National Press Club, Canberra 27 May 2011 available at http://minscl.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2011/019.htm&pageID=005&min=brsa&Year=&DocType=1

We remind the Committee of the other issue produced by (b), as raised by Moores Legal in their submission on the April Exposure Draft. The Explanatory Memorandum still does not adequately explain which purposes will be 'similar' enough to justify gifts between charities, exempt entities, and even different arms of the same parent body.

Best principles for amendments

From the outset, submissions drew attention to the radically different approach now proposed, and argued that if a gift was "in furtherance of the purpose for which the entity was established and operated", it should continue to be exempt from income tax.[5] There is an inherent logic resting upon centuries of charity law that affirms the importance of focussing on *purpose*, rather than particular gifts to persons who may be members.

It is arguable that the problematic words in (b) are unnecessary and could be deleted. Before approving the sub-clause, the Parliament would need to be satisfied that the decision in *Co-operative Bulk Handling Limited v Commissioner of Taxation*[6] **was not sufficient to prevent members benefiting in their capacity as members under the drafting of sub-clause s.995**-1(1)(a). The Parliament would also need to be satisfied that the form of drafting of sub-clause s.995-1(1)(b) could not and would not be construed by a court very narrowly, and thus add little, if anything, to (a).

Prohibiting distribution to the needy on artificial basis

Even if it is argued that there is a need to further delimit the legislation, the drafting challenge is not in preventing members from benefiting where they are in need. It is to prevent NFPs being used for personal benefit.

For centuries, altruism has been recognised as the "mark or test of what is truly charitable".[7] The Australian Taxation Office *Guide to Endorsement* states: "A charity is a charitable institution or charitable fund established for altruistic purposes that the law regards as charitable".[8] In each of the three examples given, the members benefit as persons who are properly the beneficiaries of altruistic assistance, not because they are members.

The Parliament should not be prohibiting members from benefiting where there is genuine need; but rather ensuring that any gifts are made for altruistic purposes, and are not simply methods of private inurement. Drafting in the United States might provide a useful model in this regard.

Conclusion

Australia has the opportunity to provide world leadership in NFP law reform, and draw from the best international examples. Amending the definition in this way falls well short of ideal

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[5] Moores Legal, [2012) *Submission on the Tax Laws Amendment (2012 Measures No.4) Bill 2012: tax exempt body "in Australia" requirements* [2.11.5]

[6] *Co-operative Bulk Handling Limited v Commissioner of Taxation* [2010] FCA 508.

[7] *Baptist Union of Ireland (Northern) Corporation Ltd v Commissioners of Inland Revenue* 26 Tax Cas 335 [1945] NI 99, 357 (MacDermott J). Whilst altruism as a word was only introduced into the English language in 1853 the concept was established before T V Grant MR famously held in 1805 that the word charity 'in its widest sense denotes all the good affections, men ought to bear towards each other; in its most restricted and common sense, relief of the poor' but that in 'neither of these senses is it employed in this Court. In Australia see *William Taylor and Another v Mathew Taylor and Others* [1910] CLR 218, 225, 227 (Griffith, Barton and Isaccs JJ); *Barby and Others v Perpetual Trustee Company (Limited) and Another* (1937) 58 CLR 316, 324 where it was held that to be charitable the 'gift must proceed from altruistic motives or from benevolent or philanthropic motives' (Dixon J).

[8] http://www.ato.gov.au/nonprofit/content.aspx?doc=/content/00213302.htm&page=2&H2

legislation and it is arguably an opportunity squandered. It may have the effect of some of the more quick-acting and generous charities losing exemption; others reducing their memberships and thus accountability; and still others engaging in quite sophisticated 'partnerships' to help one another's members. None of this seems a wise allocation of charitable resources or in the best interests of the Australian community.

We thank the Committee for the opportunity to make submissions in respect of the standardisation of the special conditions for tax concession entities. Our submissions should not be considered to express a satisfaction with the proposed amendments, and the existing legislative framework unamended is in our opinion, the preferred position.

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1. INTRODUCTION

Neumann and Turnour Lawyers is a Brisbane based law firm which specialises in the area of Not for Profit ("NFP") law. We provide advice to an extensive number of not for profit organisations, particularly charities.

We write in response to the *Tax Laws Amendment (Special Conditions for Not-for-Profit Concessions) Bill 2012* which proposes to reform and standardise the 'in Australia' requirements for exempt entities and deductible gift recipients found within the Income Tax Assessment Act 1997 (ITAA).

For the purposes of illustration, we address the effect of the proposed reforms upon those entities within the NFP sector that are conducting overseas aid relief within what is commonly referred to as an 'auspicing' model. Due to the various charitable endorsements employed within such an arrangement, adopting a focus on such a model enables this submission to illustrate the practical effect of the proposed amendments on a range of charitable entities.

Typically an auspicing model entails an entity which operates a Developing Country Relief Fund (DCRF) under Division 30-80 of the *Income Tax Assessment Act 1997* (Cth) (ITAA) entering into contractual engagements with other charities for the purpose of 'auspicing' those separate charities for the conduct of fundraising. Under that model, the resultant funds are paid to the Developing Country Relief Fund, and then expended in the conduct of various overseas aid development projects. Charities engaging with an entity operating a DCRF under an auspicing model are typically themselves charities, and either:

1. Operate a Public Ancillary Fund which raises donations and then pay those donations to the DCRF; or
2. Do not operate a Public Ancillary Fund, but operate to raise donations which are paid directly by donors to the DCRF.

Whilst it is evident that certain of our prior submissions on the previous April 2012 Exposure Draft have been incorporated in the draft Bill, we remain concerned about the potential effects of the Bill as set out herein.

2. PROPOSED AMENDMENTS TO SECTION 50-50 ITAA

A. Tracing of funds given by an Exempt Entity to another Exempt Entity

Subsection 50-50(4), which requires an exempt entity to ensure that any money, property or benefits it provides to another entity are used 'in Australia', will be highly problematic in operation. When the practical application of such a section is considered, several questions arise that demonstrate the difficulty of its implementation:

1. What is the cut-off-date for ensuring the funds are used in Australia by the recipient? Conceivably, donor entities could be forced to track fund use by recipient entities for years after the date of a gift.

2. As the giving entity has no control over the operations of the recipient, how can the giving entity possibly affirm that the funds will be used in Australia? The comments of Lord Justice Oliver in *Inland Revenue Commissioners v Helen Slater Charitable Trust* [1981] 3 W.L.R. 377, 382 (Court of Appeal), are salient in this regard:

> The Crown's proposition is a startling one; it involves this, that the trustees of a grant-making charity, although they may discharge themselves as a matter of law by making a grant to another properly constituted charity, are obliged, if they wish to claim exemption under the subsections, to inquire into the application of the funds given and to demonstrate to the Revenue **how those funds have been dealt with by other trustees over whom they have no control and for whose actions they are not answerable. Anything more inconvenient would be difficult to imagine**....(emphasis added)

3. If it is determined at a later date that at the date of the supply of funds the recipient entity was recorded as exempt but was not entitled to that exemption at the time of the supply, will the giving entity be entitled to rely on the knowledge it held at the time of the supply, or will it be exposed to the loss of its exemption?

4. The Bill states that existing prescribed entities will be 'grandfathered' and that organisations may be prescribed under Regulation as satisfying 50-50(2) (see 50-51(2)(d)). What is the application of the 50-50(4) where the supplier gives to an prescribed entity that expends the funds outside of Australia? Would organisations fundraising under an auspicing model lose endorsement as an exempt entity for their operations within Australia where they give to another exempt entity that is a prescribed institution under Regulation?

'Provide' vs 'give'

The Bill encompasses the *providing of money, property or benefits*, as compared with the 'giving' of money or property proposed in the April 2012 Exposure Draft. This change renders the clause extremely expansive in operation. What are 'benefits'? Are supplies made under a routine contractual engagement (such as information technology contractors or office equipment service providers) to be taken into account? The April Exposure Draft confined the necessary consideration to *gifts* made to non-exempt entities, and was more workable in this regard.

Proposed solution

The simplest means of resolving these uncertainties is to remove subsection 50-50(4) entirely. However, if the subsection is to remain, the Bill must provide a positive deeming clause in order to remove this uncertainty. Drafting that will address this is as follows, to be inserted as new 50-51(3):

> "(3) An entity satisfies the conditions in subsection (2) (about operating and pursuing its purposes in Australia) to the extent that it provides money or property or benefits to another entity that is an *exempt entity at the date of the provision."

Furthermore, should an exempt entity give to a Developing Country Relief Fund, there is currently no provision in the Bill which states that the donor entity would be deemed to satisfy the 'in Australia' requirements to the extent that the donor's operations comprise that giving. An appropriate further subsection to address this would be new 50-51(4):

"(4) An entity satisfies the conditions in subsection (2) (about operating and pursuing its purposes in Australia) to the extent that it provides money, property or benefits to a fund, authority or institution that is a deductible gift recipient."

B. Regulatory Power

Proposed subsection 50-50(5) provides that the use of certain amounts (including gifts and government grants) may be disregarded, provided that the entity satisfies the precondition that it 'complies with the conditions (if any) prescribed in the regulations for the purposes of this subsection'. The Explanatory Memorandum provides some direction as to these conditions, at paragraph 1.138; however, no certainty is offered. Access to the disregarding provision in 50-50(5) (and the equivalent existing provision, s 50-75) is critical for entities seeking to maintain exempt status where operating an auspicing model.

We are concerned about the potential effect of the delegated legislation further anticipated by the Bill. To leave the conditions unstated in the legislation is to introduce significant uncertainty for the sector. It also delegates the ability to the executive government to effectively frustrate the ability to rely upon 50-50(5). Without sufficient clarity within the legislation itself, the net effect of that delegated power may be the effective frustration of Australia's contribution to overseas development through such private sector engagements. The proposed conditions should therefore be stated in the Bill itself and opportunity should be granted for the making of submissions upon those conditions.

3. PROPOSED AMENDMENTS TO 30-18 ITAA 1997

A. Tracing of funds given by DGR to a non-DGR

The requirements in proposed section 30-18(3) that require an entity to trace funds are unworkable for the reasons stated in our submissions in respect of s 50-50(4) above.

B. Gifts made by a Public Ancillary Fund to a Developing Country Relief Fund

International Affairs Deductible Gift Recipients are exempt from the 'in Australia' requirements under proposed 30-18(5). The 'in Australia' test for Public Ancillary Funds is stated in proposed 30-18(1):

(1) Subject to subsections (4) and (5), a fund, authority or institution satisfies the conditions in this section if:

(a) it is established in Australia; and

(b) it operates solely in Australia; and

(c) it pursues its purposes solely in Australia.

Where a Public Ancillary Fund's operations principally encompass the giving of funds to a Developing Country Relief Fund (DCRF), the requirement that the entirety of the Public Ancillary Funds' operations be taken into account under 30-18(1) may require that the activity of giving to a DCRF is also to be taken into account.

Whilst the DCRF is exempt from the requirements that it operate solely in Australia, the Public Ancillary Fund is not. This introduces the possible interpretation that the overseas use of the funds by the DCRF is to be taken into account in determining the nature of the operations of the Public Ancillary Fund.

Again, we are of the opinion that a specific legislative presumption must be introduced to remove this possibility. We consider that the following additional sub-section 30-18(8) is required:

> "(8) A fund, authority or institution satisfies the conditions in subsection (1) (about operating and pursuing its purposes in Australia) to the extent that it provides money, property or benefits to a fund, authority or institution covered by section 30-80 (international affairs deductible gift recipients)."

C. CONCLUSION

By way of conclusion, we thank the Committee for the opportunity to make submissions in respect of the standardisation of the special conditions for tax concession entities. For the avoidance of doubt, our submissions should not be considered to express a satisfaction with the proposed amendments. In our opinion, the existing legislative framework is the preferred position.

The current legislation has enabled significant contributions to Australia's overseas aid efforts by organisations conducting auspicing arrangements similar to that described herein. Should any further amendments be proposed, it is requested that the specific engagement of organisations conducting such auspicing arrangements be sought in the consultation process, to ensure that such amendments do not inadvertently detract from those operations.

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