TREASURY

SENATE ECONOMICS COMMITTEE QUESTION
(Question On Notice: Tax Laws Amendment (Public Benefit Test) Bill 2010)

Senator Xenophon asked Treasury on 29 June 2010:

Senator XENOPHON—I have a supplementary question for Mr Hardy and also Treasury to take on board. In terms of an organisation that has tax-free status here in Australia remitting money overseas to a head office …where do you draw the line? Are there any guidelines in relation to that? Is there a policy position on the part of Treasury that it has to be a reasonable amount that goes overseas to the head office for their administration and that there must be some benchmark or some line in the sand?
Ms Roussel—Before we get into how it is administered, the government has made an announcement in this space in response again to the Word Investments case. The issue of how much money can be spent in Australia was considered in that case. There was some lack of clarity, potentially, coming out of that case. The government has stated that it will reclarify the law, to clarify that charities must spend their moneys in Australia—that there will be an in-Australia test. We are developing that at this point.
…
Ms Roussel—There are some provisions in the law to enable that; I can let Michael Hardy talk about them. There is a balance there—there is a principal purpose: you must spend your principal amount in Australia.
Senator XENOPHON—Would you mind giving the committee further information on that?
Ms Roussel—Sure.
Senator XENOPHON—And also: if an organisation is not there for the purpose of overseas aid but is remitting a fair proportion of its revenue overseas, is that a factor that is taken into account? And what line in the sand do you draw? Again, I am happy for that question to be taken on notice.
Ms Roussel—Yes.

Treasury has provided the following answer to the honourable senator's question:

Current law

The income tax exemption available for charitable and religious institutions is subject to the 'in Australia' special conditions in section 50-50 of the *Income Tax Assessment Act 1997*. The 'in Australia' special conditions require charitable and religious institutions to both have a physical presence in Australia and, to extent of that physical presence, to pursue their objectives and incur their expenditure principally in Australia, in order to be income tax exempt.

Institutions that are deductible gift recipients (DGRs) are exempt from these conditions as the gift provisions in the *Income Tax Assessment Act 1997* contain alternate (stricter) 'in Australia' special conditions. The Governor-General may also exempt an institution from the 'in Australia' special conditions by listing them in the *Income Tax Assessment Regulations 1997*.

The 'in Australia' special conditions were introduced in 1999 to effectively remove the tax exemption for income tax exempt entities unless: they operated principally in Australia, were prescribed as exempt in the *Income Tax Assessment Regulations 1997* or were a deductible gift recipient.

The purpose of the amendments, which took effect retrospectively from 1 July 1997, was to address tax avoidance arrangements which used charitable trusts and certain other not-for-profit organisations to shift untaxed funds overseas. Subsequently, the 'in Australia' special conditions have also operated to minimise the risk of income tax exempt entities being used for terrorist financing and money laundering.

Further information on the 'in Australia' special conditions is at pages 28 to 30 of the Australian Taxation Office's publication *Income Tax Guide for Non-profit Organisations* (available at www.ato.gov.au).

2009-10 Budget announcement

In *Federal Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* [2008] HCA 55 (3 December 2008) the High Court of Australia found that charities are considered to be pursuing their objectives principally 'in Australia' if they merely operate to pass funds within Australia to another charity that conducts its activities overseas. This finding was inconsistent with the Commissioner of Taxation's interpretation and with the policy intent underlying the special conditions.

The then Assistant Treasurer announced in the 2009-10 Budget (Media Release No. 043) that the Government would amend the 'in Australia' special conditions in Division 50 of the *Income Tax Assessment Act 1997* to ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities. This measure will have effect from the date of Royal Assent of the amending legislation.

The measure will reverse the High Court's decision that charities and other income tax exempt entities can direct funds to overseas projects outside the current restrictions. The measure will reinstate the principles underlying the current integrity rules. The proposed changes will be subject to public consultation.

An exposure draft of the amending legislation is currently under development.