THE UNIVERSITY OF MELBOURNE

SUBMISSION TO THE TREASURY, *RESTATING AND STANDARDISING THE SPECIAL CONDITIONS FOR TAX CONCESSION ENTITIES (INCLUDING THE 'IN AUSTRALIA' CONDITIONS)* (EXPOSURE DRAFT, 17 APRIL 2012)

BY THE NOT-FOR-PROFIT PROJECT, UNIVERSITY OF MELBOURNE LAW SCHOOL

INTRODUCTION

The University of Melbourne Law School's Not-for-Profit Project is a three-year research project funded by the Australian Research Council which began in 2010. This project will be the first comprehensive Australian analysis of the legal definition, taxation, and regulation of not-for-profit organisations (NFPs). Further information on the project and its members is attached to this submission as Appendix A.

This submission details our concerns with the provisions in the revised Exposure Draft of the Tax Laws Amendment (2012 Measures No. 4) Bill 2012 ('Revised Exposure Draft'), as explained by the accompanying Explanatory Material and Fact Sheet. (References in this submission in paragraphs refer to the corresponding paragraphs in the Explanatory Material). We previously made a submission in response to the original Exposure Draft released in 2011, and where our comments from that submission remain relevant, we have made those points again in this submission.

We begin by welcoming the Government's decision to revise the Exposure Draft in light of the significant concerns raised by the original Exposure Draft. We acknowledge that a number of our earlier concerns are addressed by the revision, including in particular:

- The unintended consequences of the definition of 'not-for-profit' proposed in that Draft;
- The prohibitions on donations to entities that do not have deductible gift recipient (DGR) or income tax exempt status;
- The retention of the provision discounting government grafts and gifts in the operation of the 'in Australia' requirements;
- Clarification of the application of the 'in Australia' conditions to income tax exempt entities that operate funds with DGR status;

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- Inclusion of a mechanism to except certain environmental organisations from the 'in Australia' conditions;
- Inclusion of a mechanism to except other Australian income-tax exempt from the 'in Australia' conditions; and
- Modification of the requirement to comply with all governing rules to ensure that procedural irregularities do not undermine an entity's not-for-profit status.

We welcome the fact that Treasury has listened to the sector, and other stakeholders, with regard to the difficulties in the earlier Exposure Draft. Nevertheless, we retain some significant concerns about both the policy and drafting of the revised Exposure Draft.

We begin by addressing the substantive policy issues, including: the awareness of the sector of the implications of this measure; the very restrictive nature of the conditions compared to the treatment of international activities in other countries; the adequacy of the justifications of the measure; the burdens imposed on the sector; and the interaction of this measure with the other not-for-profit reforms, including in particular the establishment of the Australian Charities and Not-for-Profits Commission (ACNC).

We then address the framing of the measure, including: the qualitative nature of the test; the fit between the policy and the design of the test; the differing thresholds between deductible gift recipients (DGRs) and income tax exempt entities; and the capacity to prescribe organisations which are not required to comply with some or all of the rules. We also raise some continuing concerns with the requirement to comply with governing rules, the definition of not-for-profit entities, as well as the apparent unintended omission of an exception for developed and developing country funds.

In our view, the underlying policy of this measure **adopts an unduly insular view of the appropriate role of the NFP sector** that fails to reflect both the globalising nature of the world and the national interest in engaging with this world. It also results in **one of the most geographically restrictive regimes of tax concessions** in the developed world, which does not appear to be sufficiently recognised.

Our first preference, therefore, would be for this measure to be **replaced by a more sophisticated and targeted approach through regulation** of overseas activities, as is done elsewhere. We note in this regard the absence of discussion of the interaction of this measure with the establishment of the ACNC. In discussions of countries' responses to the nexus between charities and terrorism, we note that the Charity Commission's approach of a counter-terrorism strategy and guidance has been praised as 'best practice' internationally. It would be a lost opportunity for this measure, which at its heart involves supervision of the activiites and governance of NFPs, to operate independently of the ACNC. Further, it would also contradict the Government's policy of reducing the regulatory burden on the ACNC.

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We recognise that the ACNC will not initially have responsibility for non-charitable NFPs. Nevertheless, we consider that it is more coherent to **confer on the ACNC powers to supervise the international engagement of charities**, and in the interim **require other tax-exempt NFPs to report to the ATO on its international activities in line with the policy developed by the ACNC** in this regard. Such an approach would enable proportional regulation, would involve greater consultation with the sector, and would strike a balance between facilitating the international engagement of the sector and ensuring that funds are not inappropriately used overseas

We recognise that this would be a significant departure from the existing policy. We also therefore make other, less preferred, recommendations to ameliorate the effect of the current policy while achieving the implicit aims of the current policy. These include the following:

- International activities and operations should not undermine the tax-exempt status of the NFP entity entirely. A more proportional response would be to provide **that tax concessions do not apply to the extent that such income is used overseas**. For example, New Zealand provides that business income that is used for purposes overseas (not, however, 'overseas activities') is not eligible for income tax exemption.

- **Prohibiting DGRs from merely 'passing on funds' for the use of entities overseas**. This would merely reverse the effect of the *Word Investments* decision, and is in line with US {and Canadian} prohibitions on mere 'conduits' (although there remain difficulties with this concept).

- Reframing the conditions so that the requirement is not as to where they operate or pursue their purposes, but rather whether their **purposes or activities are principally 'in the interests of Australia'.** This could be defined to include: where their beneficiaries are in Australia or Australian;[1] where the purpose is to benefit Australian society;[2] or where their purpose relates to overseas beneficiaries or purposes, that this purpose promotes international engagement that is in the broader interest of Australia.[3] This would better effect the purposes of ensuring that the aims are broadly to benefit the Australian community, while recognising that international engagement may well be of benefit to the Australian community.

[1] The first condition ensures that those entities serving migrants and refugees in Australia would remain eligible. The second condition would remedy the situation where a Canadian entity seeking to provide scholarships to Australians (an example given in the Explanatory Material) would not be tax-exempt unless, it appears, it had employees in Australia administering the scheme.

[2] This would cover organisations that do not aim to benefit individual groups, but rather Australian society more generally, such as arts and culture.

[3] A similar requirement exists in Germany.

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- To the extent that entities engage in or fund overseas activities, there is a common **regulatory requirement that they have adequate governance processes** to ensure oversight of those activities or expenditure. This approach is reflected in part the measure, where oversight requirements are included as conditions for certain parts of the sector. However, to the extent that these can be enforced, we recommend that they are enforced by the ACNC to the extent that it has jurisdiction, and that the ATO adopt an equivalent policy for other tax-exempt NFPs.

We have made other recommendations throughout this submission, which for the sake of convenience we collate in Appendix B.

AWARENESS OF 'IN AUSTRALIA' AND OTHER CHANGES

We reiterate our general concern, expressed in the earlier submission, that these changes have been insufficiently flagged to the NFP sector. This concern has been substantiated in some of the discussions we have had with NFP representatives. Some proposed changes, such as the definition of not-for-profit, may affect NFPs that do not operate overseas, who may therefore be unaware of this measure. Other organisations may operate mostly in Australia but engage in multiple incidental activities overseas that may be affected. As we discuss below, the measure appears to underestimate the breadth and extent of overseas activities conducted by the not-for-profit sector. Finally, as with much of the not-for-profit agenda, we are aware that many smaller organisations are simply unaware or only vaguely aware of the entire process of not-for-profit reform.

This concern is amplified by the broad definition of 'overseas activities' encompassed in the measure. One of the examples given in the Explanatory Material considered purchases of books overseas as an overseas activity. Given the global nature of trade, it is easy to see how many Australian-based organisations may not realise that this constitutes 'overseas activities' that may be relevant to their income tax exemptions.

Finally, we express concern that this measure will commence from Royal Assent and apply to the income years immediately following ([1.121]), with an exception for DGRs for whom the current law will apply to the year immediately following ([1.123]). Our understanding is that these conditions are intended to be passed in the current financial year. Given that most NFPs are likely to be planning any overseas activities already for 2012-2013 and that the new 'in Australia' conditions may require adjustment of, and accounting for, such activities, we recommend that there should be a longer transitional period. We note that such provision has been made for entities to amend governing rules (at [1.124]) in relation to the definition of 'not-for-profit', although whether sufficient publicity has been given to this requirement is an issue. Further, we raise for consideration the question of whether satisfying the not-for-profit definition will create difficulties for organisations that have been created by wills, legislation or letters patent, and suggest that this be provided for in the transitional provisions as well.

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Recommendations

1. We recommend that, given the lack of awareness of the impact of this measure, **the measure (or, at the least, its implementation) should be delayed by at least a year** to enable NFPs to assess the impact of the measure on their operations, to be properly consulted, and to enable them to comply with the measure.

2. We recommend that the **Australian Taxation Office alert NFPs more widely to the impact of this measure,** preferably at the time it informs them of the transfer of some of its functions to the ACNC.

HIGH BARRIERS TO CROSS-BORDER PHILANTHROPY

Our earlier submission did not have the benefit of research we have since undertaken on the treatment of cross-border giving in other countries, although it referred briefly to the law and practice of other countries. We did, however, observe that the policy imposed **some of the highest barriers to cross-border philanthropy in the world**, a point which has been reinforced by our subsequent research.

Barriers to cross-border giving have been the topic of considerable research. As long ago as 1963, the European Cultural Foundation called for "[n]ew efforts in the direction of fiscal assistance to donors and the extension of fiscal privileges to international charitable organizations".[4] In 1969, the International Fiscal Association concluded that there is "hardly an objection to a removal of such obstacles", although several rules may be necessary to enable this.[5] More recently, the topic has gained momentum with increasing restrictions as a result of anti-terrorist measures, and also in Europe as a result of the growing interactions in the European Union and case law of the European Court of Justice.

We note that, in contrast to some of the other aspects of the not-for-profit reform, the accompanying material for this measure has not referred to comparative practice or to 'best practice' with reference to comparable countries. Appendix B sets out in more detail a comparative overview of the treatment of foreign activities and foreign NFPs in other jurisdictions.

There are four key issues in relation to the taxation treatment of foreign activities and NFPs:

1. Can domestic entities work overseas? That is, do overseas activities affect the tax exemptions of a domestically incorporated entity?

2. Can entities incorporated overseas access tax exemptions?

[4] Quoted in Ineke A Koele, *International Taxation of Philanthropy: Removing Tax Obstacles for International Charities* (International Bureau of Fiscal Documentation, 2007) 13.

[5] Quoted in Ibid 14.

3. Can donors access tax deductions for contributions to a domestic entity that conducts operations overseas (are tax deductions available for donations for foreign activities?)

4. Can donors access tax deductions for contributions to a foreign entity?

OVERSEAS ACTIVITIES OF DOMESTIC NFPS

There are only a small handful of countries that impose limitations on the overseas activities of NFPs. Most comparable jurisdictions, including the US, the UK, Canada and the vast majority of European States do not condition income tax exemption on domestic operations. There are a few exceptions to this general principle, principally Austria and Germany. However, Germany does allow tax exemption for charities whose overseas activities may contribute to the reputation of Germany abroad, and Austria's geographical limitation applies only to entities established outside the European Union and the European Economic Area (as discussed below).

An interesting example is New Zealand. New Zealand does not impose any geographical limitation in respect of non-business income. However, the income tax exemption only applies to business income if the entity has charitable purposes in New Zealand. Importantly, this rule is directed to whether the purposes are 'New Zealand purposes', rather than the activities being conducted in New Zealand. Further, if an entity has both New Zealand and foreign charitable purposes, the business income is apportioned on a reasonable basis and the income tax exemption applies only to the extent the business income is apportioned to the New Zealand purposes.

Therefore, **the proposed measure, which restricts income tax exempt entities to both operating and pursuing its purposes 'principally in Australia', will be one of the stringent restrictions on the engagement of NFPs internationally in the world**. In particular, we note that, unlike the New Zealand example, the conduct of overseas entities does not merely disentitle the entity from tax exemption in respect of the 'foreign' aspect of their activities, but rather imperils their tax-exempt status itself. Combined with the qualitative nature of the 'in Australia' test, **this will create a very significant disincentive to engage in any international charitable activities**.

TAX EXEMPTIONS FOR FOREIGN NFPS

The picture in respect of tax exemptions for foreign NFPs is more mixed. In many countries, including the US, the UK, {New Zealand and Canada}, foreign NFPs that would otherwise be entitled to exemption can access income (and probably other) tax exemptions.

The practice in Europe varies. Many of the Western States (Belgium, Denmark, Poland, the Netherlands, Sweden, Switzerland) also permit foreign-based NFPs access to tax exemptions provided they meet the other conditions for tax exemption. The key exceptions are Austria, France, and Germany. A number of other countries require either formal registration or the

establishment of a branch in that jurisdiction. Some others restrict such access to entities based in other EU or EEA countries (Bulgaria, the Czech Republic, Ireland). A number of European jurisdictions, typically those who entered the EU later, do not grant such access.

However, European law restricts in important ways the capacity of States to deny tax exemptions to equivalent NFPs based in other EU/EEA jurisdictions (which explains the nature of some of the restrictions). The European Court of Justice has held that in some circumstances this will violate European treaties that establish the freedom of movement of capital.

As well, income tax exemptions may be available to NFPs under bilateral taxation treaties. For example, the US has provisions allowing tax exemption to equivalent entitie in respect of Canada, Mexico and Israel.

DONATIONS OVERSEAS BY DOMESTIC NFPS

Many jurisdictions do impose geographical limits in respect of deductions available for donors. However, a distinction is often made between tax deductions for entities incorporated in the home State and those incorporated elsewhere.

In contrast to Australia, many major jurisdictions permit domestic NFPs to donate overseas, although there are some restrictions. The United Kingdom allows its charities to donate overseas. Its guidance states that, to qualify as 'charitable expenditure', expenditure overseas must be either to pay a foreign supplier of goods or services in the ordinary course of the charity's activities, or the charity should take reasonable steps to ensure that the payment is applied for charitable purposes.

The US, for example, does allow tax deductions for domestic NFPs that donate overseas, which is subject to a test as to whether the domestic NFP exercises real discretion and control over the expenditure (in which case tax deductions are allowable) or whether it is merely a conduit for funds earmarked for particular activities (in which case they are not). The former are commonly known as 'friends of' organisations.

In Canada, two issues may arise. First, where a charity uses an intermediary to carry out its charitable activities overseas, transferring resources to the intermediary may cause difficulties if the NFP does not either 'direct or control' the use of its resources, or fails to meet other conditions including investigating the status and activities of the intermediary. Further, a charity cannot act as a conduit by transferring money or property to a foreign entity without any direction or control.

In contrast, New Zealand restricts its tax credits and deductions for donations geographically.

DONATIONS TO FOREIGN NFPS

Again, the picture here is mixed. For some jurisdictions, including the US, donations to foreign NFPs are not deductible. In other jurisdictions, including the UK, donations are tax-deductible but generally speaking the receiving organisation must be registered or formally recognised and meet equivalent conditions.

THE POSITION OF AUSTRALIA

By requiring both income tax exempt entities and DGRs to be established in, operate principally or solely, and pursue its purposes principally or solely in Australia, the Australian Government is **proposing some of the most geographically restrictive conditions on NFPs in the world.** This is not acknowledged in any of the accompanying material or discussion concerning this measure.

The measure is by some way more restrictive than comparable restrictions in most major jurisdictions, in the following ways:

- The restrictions apply even to the international activities of domestic NFPs, unlike in most countries;
- The restrictions effectively preclude domestic entities wishing to obtain tax deductions from expending money overseas, unlike most countries;
- The restrictions apply in relation to the place of establishment, the place of activities, and the place of the purposes, unlike most restrictions which generally refer to one or two of these elements;
- The restrictions do not merely affect entitlement to tax exemption in respect of foreign activities, but instead imperil the tax-exempt status of the entire entity;
- The restrictions impose a cumulative and qualitative test of being 'in Australia', unlike most restrictions which require one or more conditions to be satisfied independently.

Recommendations

3. We recommend that the policy should be considered again in light of comparable practice which is significantly less restrictive than that proposed. In particular, we recommend that consideration should be given to removing the restriction on overseas activities by domestic NFPs.

UNDERLYING POLICY OF 'IN AUSTRALIA'

JUSTIFICATIONS

In our previous submission, we expressed reservations concerning the adequacy of the underlying justifications for these measures. Three justifications are set out in the Explanatory Material: first, the idea that entities must be operated "for the broad benefit of the Australian community" (see [1.2]); second, to address tax avoidance by entities shifting untaxed funds overseas (see [1.7], [1.47); and third, to mitigate the risk of terrorist financing and money laundering (see [1.8], [1.48]-[1.49]). However, the policy implicit in these justifications has not been properly consulted upon or discussed.

'FOR THE BENEFIT OF AUSTRALIA'

In our previous submission, we questioned the validity of the first justification. As we stated there, our view is that in the current global era, the underlying policy of confining the benefits of tax concessions to operations 'in Australia' is generally inappropriate. Most commentators are agreed that this justification is "completely archaic", and indeed even in 1969 it was argued that such restrictions "constitute … an obstacle to the furthering of interests which in the present world are no longer nationally bound".[6] In our globalised world, it is difficult to argue that only entities benefiting Australians should receive tax concessions.

It is true that the current measure excepts specifically overseas aid organisations. However, in our view overseas aid is not best conceptualized as a well-known exception to the underlying policy of benefiting Australians, but illustrates the artificiality of the distinction between 'benefit to Australia' and 'public benefit' generally.

We note that the accompanying material to this measure makes no attempt to understand the practical context in which the NFP sector operates internationally. International statistics illustrate the growing importance of international activities and funding. For example, the US Foundation Center reports that in 1982, the share of grant dollars and the share of grants by foundations being expended internationally amounted to less than 5%, compared to 2008 when the share of grant dollars was close to 25% and the share of grants just under 10%.[7] In 2008, nearly $7 billion was granted overseas by US foundations.[8] Private philanthropy from OECD countries grew from approximately $5 billion in 1991 to $53 billion in 2008. Importantly, international giving in 2008 in the US spanned a wide range of causes,

[6] Ibid 8. See also similar criticisms by Harvey P Dale, 'Foreign Charities' (1995) 48 *Tax Lawyer* 655; Joannie Chang, Jennifer I Goldberg and Naomi J Schrag, 'Cross-Border Charitable Giving' (1997) 31 *University of San Francisco Law Review* 563; David E Pozen, 'Remapping the Charitable Deduction' (2006) 39 *Connecticut Law Review* 531.

[7] Foundation Center, *International Grantmaking Update: A Snapshot of US Foundation Trends* (December 2010) 2 <http://foundationcenter.org/gainknowledge/research/pdf/intl_update_2010.pdf>.

[8] Ibid 3.

although health dominated with 39% of total dollars. Apart from health, 20% of total dollars was donated to causes that are not intended to be excepted from 'in Australia' conditions.[9]

In discussions with sector representatives, we have heard how common it is for organisations that are primarily domestic to engage in activities overseas. Entities often assist or contribute to sister organisations overseas, or individuals club together to help a particular charity with which they have some knowledge. Cultural institutions engage in international collaborations; university academics traffick across borders to collaborate, exchange and teach. We are concerned that this measure **does not properly consider the diversity, breadth and extent of the international activities of NFPs**, and that its practical implications are more extensive than intended.

History of 'in Australia'

As we discussed in our previous submission, a historical analysis of the provisions show that 'benefit to Australians' was not the original meaning of the 'in Australia' test, and indeed (as in other countries) there were no 'in Australia' conditions imposed on income tax exempt entities, as opposed to DGRs, until 1997. As we also noted, Parliament had an opportunity to rectify this situation following *University of Birmingham v Federal Commissioner of Taxation* (1938) 60 CLR 572, when the High Court held that an overseas charity was eligible for income tax exemption in Australia, but did not do so. Further, the distinction between income tax exempt entities and DGRs in this context was expressly approved in 1952 by the Commonwealth Committee of Taxation.[10]

We also drew attention to the fact that, although the DGR provisions did include an 'in Australia' requirement from the beginning, this appears to have relied upon the predecessor Victorian provision which required the entity to be 'situated in Victoria', but did not otherwise confine the scope of activities of the organisation. Further, the original charitable deduction provision existed alongside a deduction for gifts to public funds "established in any part of the King's Dominions or in any country in alliance with Great Britain for any purpose connected with the current war". Together with the longstanding deductions available for various organisations involved in international affairs, disaster funds, and for defence forces,[11] this clearly demonstrates that the **tax concessions have not traditionally been restricted to a parochial notion of 'benefit to the Australian public'**. Nor has charity law ever attempted to confine 'benefit' to the public territorially.[12]

Poor fit between design and policy

In any event, if the policy is intended to ensure tax concessions are restricted to those organisations for the 'benefit of the broader Australian community', we suggest that the

[9] Ibid 5.

[10] Commonwealth Committee on Taxation, *Report on Exemption of Income of Certain Bodies and Funds (Reference No. 25)* (Parliamentary Paper, No 136, 12 August 1952), [7].

[11] See item 5.1.2 of s 30-50.

[12] G E Dal Pont, *Law of Charity* (LexisNexis Butterworths, 2010) [3.53].

proposed conditions are a poor fit. There is not necessarily a straightforward connection between establishment and operation in Australia, and benefit *to* Australia. For example, one of the overseas activities discussed in the examples in the Explanatory Material is the activity of arranging an exhibition to an overseas museum (Example 1.15). This would be an 'overseas activity' that would not preclude DGR status as it is 'minor' or 'incidental'. Nevertheless, the circulation of art exhibitions as part of reciprocal arrangements is clearly 'of benefit to Australia' even though it involves overseas activities. Similarly, the activities of academics overseas—in the form of study, collaborations, partnerships and other engagement—is similarly of benefit to Australia by (for example) enhancing reputation, and improving and transferring knowledge and networks. If one is to prefer the interests of Australians over those overseas, the appropriate **policy should not focus on whether the activitiy is conducted in Australia but rather whether the purposes are in the interests of Australia.** This would encompass a broader understanding of how entities may benefit Australians.

For example, the proposed test would exclude overseas entities whose intention is to benefit Australians. The Explanatory Material gives as an example a Canadian charity whose purpose is to provide educational scholarships to Australians. In our view, this already accords with the policy of benefiting Australians, whether or not the entity then establishes an office in Australia or hires employees in Australia. As well, this would enable tax exemption intended to benefit Australians resident overseas (such as defence employees). One aspect of the 'in the interests of Australia' test would therefore include whether the purpose is to benefit Australians.

We would emphasise, however, that this should not be restricted to citizens of Australia. If the purpose is to benefit migrants or refugees in Australia, for example, this would equally be in the interests of Australia. Another aspect therefore is whether the purpose is to benefit those in Australia.

We also suggest that it is in the 'interests of Australia' where the entity's purposes are to benefit Australian society, broadly conceived. For example, the purpose of arts or culture organisations may be to enrich Australian society generally, rather than to benefit particular groups of people in Australia.

Finally, we suggest that it is also in the 'interests of Australia' where an organisation's purposes or activities is to promote international engagement that is in the broader interests of Australia. For example, organisations designed to foster ties between Australia and China are clearly in the interests of Australia. Human rights organisations and development organisations that aim to assist those overseas are, in our view, still acting in a way so as to promote the broader interests of Australia in promoting Australian values of human rights and equality. This is clearly seen where overseas aid organisations facilitate the Australian Government's broader foreign aid agenda, which is also in the interests of Australia.

Recommendations

4. We recommend that the policy of restricting benefits geographically be reconsidered in light of globalisation, our moral obligations to fellow humans, and our interests in international engagement.

5. If a policy of restricting benefits geographically is adopted, it should extend more broadly to a concept of entities whose purposes or activities are 'in the interests of Australia'. This would include where these are to benefit those in Australian or Australians, where the purpose is to benefit Australian society more generally, or where the organisation promotes international engagement that is in the broader interests of Australia.

OVERSIGHT

The rationale that has been accepted as the strongest for geographical limitations by scholars is that of the need for oversight of such entities.[13] [14] As noted above, this is a primary justification given for the current measure (in the specific context of terrorism and money-laundering, which we discuss further below).

Even if one accepts the rationale, however, it does not justify simply excluding all foreign entities and restricting foreign activities. Typically, the need for oversight is met in other jurisdictions by requiring reporting, registration with the domestic authority, establishment of a local branch,[15] and/or imposing upon either the domestic donor or the domestic entity obligations of proof or oversight.[16]

While we would not necessarily endorse some of the intrusive regimes that have been adopted elsewhere in the world, we observe that other jurisdictions have not imposed geographical restrictions in order to address the challenges of terrorism and money-laundering. This is a measure that is both over-inclusive (catching many legitimate entities) and under-inclusive (not catching any that fund terrorism in Australia or which launder money in Australia), and is not equipped to meet the challenge.

Instead, other regimes have generally adopted models based on **better oversight by funding entities**—in the US, by the way of Treasury guidelines and in the UK, in the form of operational guidance and a counter-terrorism strategy. Given the establishment of the

[13] Pozen, 'Remapping the Charitable Deduction' above n 6, 594–595; Koele, *International Taxation of Philanthropy*, above n 4, 9.

[14] Pozen, 'Remapping the Charitable Deduction,' above n **Error! Bookmark not defined.**, 594–595.

[15] I. Koele, 'Tax Privileges of NPOs and Their Benefactors: A Landlocked Privilege' [2004] *The Tax Treatment of NGOs The Hague: Kluwer Law International* 323, 327.

[16] Ibid 326.

ACNC and the many criticisms of the US Treasury Guidelines, we suggest that a better measure for addressing terrorism should be through development of policy by the ACNC to guide the sector as to better compliance.

We note that, to some extent, this is the intention behind some of the provisions in the Exposure Draft, which would allow prescription on the basis that the entity has, among other things, governance processes that ensure legal compliance and oversight of funding entities. In our view, a better process would be to provide that **entities accessing tax concessions must report to the ACNC with regard to funding overseas entities and conducting overseas activities according to policies developed by the ACNC**, and utilize the existing powers and sanctions of the ACNC to address concerns regarding terrorism and money-laundering.

We appreciate that this option will not be available to non-charitable NFPs, at least in the interim. To remedy this problem, however, it would be better to impose a condition that the **entity must report to the ATO with regard to funding entities overseas or conducting overseas activities (using the same policy developed by the ACNC)** in the interim. To the extent that the entity is complicit in terrorism or money-laundering, it would either fall foul of the proposed requirement in this proposal that its purposes are not that which entitle it to tax exemption, or could be appropriately referred to prosecutors in respect of criminal charges.

Recommendations

6. We recommend that the 'in Australia' conditions be replaced by requirements on charities to report overseas activities or funding to the ACNC, which will supervise such activities in accordance with the development of an appropriate policy in consultation with the sector. In the interim, other tax-exempt NFP entities should be required to report to the ATO in accordance with the same policy, and appropriate action can be taken by the ATO to revoke its status under the definition of 'not-for-profit', or by referral to appropriate agencies responsible for the enforcement of criminal laws.

REGULATORY IMPLICATIONS

The accompanying material does not address the regulatory duplication that will occur as a result of the imposition of such conditions with the pending establishment of the ACNC. The intention behind the establishment of the ACNC is to provide a 'one stop shop'. However, if charities will still be required to submit evidence of all their overseas activities to the ATO as well, this will clearly compromise the policy intention.

This is particularly problematic because, as already noted, **at heart the 'in Australia' conditions are attempting to address concerns that are properly dealt with as a matter of**

governance and regulation. This is clearly evident in the conditions upon entities that will be excepted from the conditions, which are entirely regulatory. As we have stated many times, such issues should be left to the ACNC rather than the ATO.

The issue of regulatory duplication also has the potential to undermine support from the sector for the establishment of the ACNC. For many entities, the promise of **reducing the regulatory burden** is the key benefit of the ACNC. We understand that other elements of the reform package, such as the unrelated business income tax, are already undermining support for the ACNC and the government's agenda. We consider that this measure will further undermine such support.

We assume, also, that in the lead-up to the establishment of the ACNC the section of the ATO that previously dealt with such assessments has been considerably reduced. As a result, we **question whether the ATO has the administrative capacity to adequately police these conditions**, particularly given their qualitative nature. It will no longer be an assessment of the financial report and the expenditure allocated overseas, which would be relatively quick, but rather a more in-depth assessment of purposes, activities, and other connections to Australia.

THE 'IN AUSTRALIA' CONDITIONS

The key 'in Australia' conditions envisaged in the revised Exposure Draft remain the same as in the earlier Exposure Draft. For income tax exempt entities, the entity must 'operate principally in Australia' and 'pursue its purposes principally in Australia' (proposed s 50-50(2)). DGRS are required to be 'established in Australia', 'operate solely in Australia' and 'pursue its purposes solely in Australia'.

In addition to our concerns about the adequacy of the underlying policy, we also consider that these conditions raise practical issues of compliance and enforcement. In particular, the new qualitative requirement of 'operating' solely or principally in Australia stands in contrast with the current quantitative requirement of 'incurring expenditure' in Australia. We note that while there are already some entities required to 'pursue their objectives' principally in Australia, the standardised condition will also extend the application of this qualitative test to other entities.

While the qualitative nature of the requirement does increase the capacity of the Commissioner to consider "a wider range of circumstances" ([1.56]), this shift also increases the discretion of the Commissioner and consequently **creates a high degree of uncertainty for income tax exempt entities**. This is exacerbated by the fact that the 'factors' in the Explanatory Material will be based in the Commissioner's policy, rather than in legislation.

Further, it will **increase compliance costs** as we move from a relatively simple accounting regime of ensuring expenditure in Australia exceeds that overseas to a more flexible test that will take into account a variety of circumstances that are likely to change from year to

year. This increased flexibility will also make **enforcement of the 'in Australia' conditions more resource-intensive** on the part of both the entity and the Commissioner. Given the limitation of resources, it is also likely that this increased enforcement cost will lead to patchy enforcement and the risk of arbitrariness.

We recognise that, in order to address this, the Explanatory Material contains a range of examples to illustrate the intended operation of this principle, as well as an inclusive list of factors that will be considered.

Nevertheless, in our view, **the examples only illustrate the difficulty of applying the test** in practice and the distortions that might result. If, for example, the sporting program in Example 1.2 had directed 60% of its money to the Brazilian operation, would this mean it fails the 'in Australia' conditions? If so, does this mean that for one income year (for example, where the Brazilian operation is being established), the entity will not meet the 'in Australia' test, but the next year it might?

In Example 1.3, the 'overseas' acivities is that of purchasing books from overseas. In a globalizing economy, it seems that whether the books are purchased overseas or in Australia can hardly be the key question on which tax exemption is based. If, for example, the entity purchased the majority of its books overseas in order to effect cost savings, would this mean it no longer met the 'in Australia' test, even though it was more effectively fulfilling its purposes?

In Example 1.4, if the facts were changed so that the Australian branches exercised a degree of autonomy, would it meet the 'in Australia' conditions? If so, would this effectively create incentives to 'decentralise' institutions (with large ramifications for governance of multinational entities)?

In Example 1.5 (dealing with Canadian organisations providing scholarships to Australians), would the entity still meet the test if it did not employ Australians or establish a separate Australian entity? If not, this appears to distort the choices made regarding resources by multinational entities. For example, it could easily be more resource-effective for the Canadian organisation to utilise its own employees to manage the program, but this would create a tax incentive to the contrary. Nevertheless, the ultimate benefit to Australians would clearly remain.

In Example 1.7 (dealing with a division of an overseas aid agency), it appears the key distinguishing factor would be the establishment of a separate entity in Australia. Again, this has little relevant to the ultimate benefit to Australia of such activities.

In our view, these examples **do not reflect the policy intent of ensuring 'benefit to Australia'**. There is either no, or merely a marginal, benefit to Australia because management or control is located in Australia, or because one person is employed in Australia, or because the purchase of items necessary to fulfil a purpose is made from an

overseas supplier. Further, these factors will distort resource allocation by income tax-exempt entities and increase compliance costs.

The uncertainty caused by this more wide-ranging test is also likely to create incentives to be over-cautious by not-for-profit entities, and therefore will likely **inhibit engagement with overseas activities**. If, for example, one was advising the entity in Example 1.2, it is likely that you would suggest, in an abundance of caution, that they minimise their activities in Brazil to ensure that they did not fail the 'in Australia' conditions.

This effect is likely to be even more pronounced because the 'tipping point' between operating 'principally' or not has an **all-or-nothing consequence** with very serious ramifications—namely, the loss of any entitlement to tax exemption. We contrast this, for example, to the New Zealand provision exempting business income of charities from income tax (non-business income is not subject to any 'in New Zealand' condition). That provision requires the entity to 'carry out' its charitable purpose in New Zealand, but to the extent that it also carries out charitable purposes overseas, the business income is "apportioned reasonably" between the New Zealand and the overseas purposes, and the exemption is applied only to the New Zealand income.[17] In our view, this is a preferable approach if the policy of 'benefiting Australians' is to be adopted.

Recommendations

7. We recommend that, if the underlying policy is adopted, the legislation should spell out more clearly what is required of the 'in Australia' conditions, rather than leaving this to policy.

8. We recommend that, if the underlying policy is adopted, better guidance should be given in the Examples as to the relative weighting of factors.

9. We recommend that, if the underlying policy is adopted, the legislation should simply disapply income tax exemptions to the extent that the purposes or activities are not in Australia, rather than jeopardising the tax-exempt status of the entire entity.

DGR status

Another issue is the justification for the higher 'in Australia' threshold for DGR status. This is not expressly explained in the Explanatory Material. However, we assume that one reason for this may be that the extra tax relief entitles the Government to demand a greater benefit to 'Australia', or that DGR status is assumed to be linked to a higher risk of tax avoidance.

We question both of these suggested reasons. We agree that DGR status may be conceived of as a 'preferred pool' of entities, which are entitled to greater relief because of greater

[17] NZ, 'Income Tax Act' (2007).

public benefit (although we note that this is not necessarily reflected in the current patchwork of entitlements). Nevertheless, there are several difficulties with that argument. First, as noted above, there is likely to be benefit in activities conducted overseas for Australians, which is not captured in the draft requirements. As is also discussed above, it is far from clear that Australians conceive of 'public benefit' so narrowly that they would agree that (for example) a charity for the blind in Australia is necessarily more beneficial than a charity to perform eye surgery in poor countries. Indeed, given the health systems in such countries there is a very good argument that the latter charity addresses a greater need.

Third, we question whether an organisation that 'principally' operates in Australia is necessarily of lesser benefit than one which 'solely' operates in Australia. For example, an organisation that seeks to defend the environment which operates solely in Victoria is not necessarily more beneficial than a similar organisation which (for example) chooses to spend some of its money overseas on activities such as advocating for changes to international laws regulating the environment.

Finally, as we have previously noted in other submissions, however, DGR status may be sought for reasons other than for tax-deductible donations, such as to access philanthropic funding, to comply with government grant criteria, or for enhanced legitimacy. In this context, entities may be forced to choose between (for example) access to philanthropic funds and changing its activities to fit within the higher 'in Australia' threshold.

In relation to the possibly higher risk of tax avoidance, we assume that this would be because donors would use DGRs to access tax deductions. However, this risk will vary greatly between different DGRs and if it is a tax avoidance issue, it appears that a tax avoidance measure may be more appropriate. Alternatively, if this is the real concern, then a prohibition on DGR 'conduits' (as is done in the US) may be more appropriate, although this is far from a problem-free test.

The differing thresholds between DGRs and income tax exempt entities, in our view, creates **needless complexity and confusion**. Many income tax exempt entities operate DGR funds and will be required to operate to both thresholds. Differing thresholds will distort decisions about where activities should be allocated and whether DGR status is preferred.

Recommendations

10. We recommend that, if the underlying policy is adopted, the differing thresholds between DGRs and income tax exempt entities should be harmonised. This will reduce the complexity and confusion caused.

11. If the differing threshold is designed to address tax avoidance, then this should be addressed either by tax avoidance measures or by prohibiting 'conduit' DGRs, rather than imposing a strict 'in Australia' requirement on all DGRs.

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ACCOUNTING FOR DONATIONS

While we welcome the removal of the prohibition of entities donating to entities that are either not DGRs or income tax exempt entities, we are concerned about the suggestion that the "income tax exempt entity must satisfy itself about how the entity it has donated money or property to uses this property" if it is donating to a non-income tax exempt entity ([1.71]) and similarly if a DGR donates money or property to a non-DGR ([1.119]).

We note that this requirement is not express in the Exposure Draft, which instead merely requires the use of those donations to be taken into account for the purposes of the 'in Australia' conditions. There is a significant difference between these two statements. First, the suggestion seems to imply an obligation on income tax exempt entities and DGRs to 'trace' money donated to other organisations even where those other organisations operate solely in Australia for Australian purposes. Such an interpretation clearly extends well beyond the purpose of the 'in Australia' conditions.

Second, the legislation does not directly impose an obligation upon the income tax exempt entity or DGR itself an obligation to trace the money, but rather would take into account the use of that money in determining whether the 'in Australia' conditions were fulfilled.

In our previous submission, we also observed that there are many practical and legal reasons which may affect an organisation's decision to seek endorsement as an income tax exempt entity or as a DGR. The present requirements would create another incentive for organisations to undergo the difficult and resource-intensive process of obtaining DGR status even where they do not seek public funds, in addition to the existing incentive to gain access to philanthropic funding. The reason for this is that, all else being equal, a DGR is likely to prefer funding a DGR for whom it does not have to account to the ATO in respect of overseas activities, in contrast to funding a non-DGR which may have minor or incidental overseas activities for which the DGR has to account and which may imperil its own status as a DGR (given the uncertainty of the 'minor or incidental' restriction). It may similarly distort the funding choices of income tax exempt entities.

We understand that the policy intent is to prevent circumvention of the 'in Australia' conditions by way of donating money to another entity not under similar obligations. Nevertheless, there is a more direct way of achieving this aim than in the current Exposure Draft. The legislation could instead provide that, where an entity donates money or property to another entity which will use the money or property for overseas activities, that entity must itself satisfy the same 'in Australia' conditions as applies to the funding entity, unless the receiving entity is not required by the legislation to fulfil them. This would create a level playing field for funding (which could also take into account other 'in Australia' factors such as management or control, compared to non-income tax exempt entities which could not), and would allow the receiving entity to rely on other 'in Australia' factors such as management or control to offset the use of the money overseas. There is a precedent in the

legislation already for this in s 50-60, as noted in our previous submission. Further, s 50-60 also provides a safeguard by requiring that the donation be to an entity that, to the "best of the trustee's knowledge", satisfies those requirements. We recommend that a similar safeguard be included here.

Such a provision would also be enhanced if, as suggested, the differing thresholds between DGRs and income tax exempt entities were harmonised. As we discussed in our previous submission, we do not see why DGRs should not donate money to income tax exempt entities, which already provide a public benefit. As discussed above, we do not see any real rationale for the distinction between the 'sole' and 'principal' threshold in Australia conditions.

We also note the discussion in [1.76]-[1.77] regarding the need for a charity to make gifts which pursue its own purposes as a charity. This issue is one of charity law which will be regulated by the ACNC, and should not be conflated with the present provision.

Recommendations

12. If the underlying policy is adopted, we recommend that where a DGR or income tax exempt entity donates money to another entity, that entity must meet the same 'in Australia' requirements as apply to the funding entity, unless it is expressly excluded from meeting such requirements.

13. In such a provision, we recommend that a safeguard to protect innocent donating entities, where 'to the best of its knowledge' the other entity meets the 'in Australia' conditions.

PRESCRIBED INSTITUTIONS

While we welcome the re-inclusion of existing powers to prescribe institutions that are not required to fulfil the 'in Australia' conditions in proposed s 50-51(2(c), (d)), as well as specifically in relation to environmental organisations, we question the mechanisms employed.

It is well-known that the present process of obtaining DGR status outside the restrictive legislative categories is already very time-consuming, labour-intensive and in important respects a result of political power. Similar comments apply to the listing of environmental organisations under the Register. These same features will apply to a process of 'prescription'. This is reinforced by the statement that any such prescription would "be made only in exceptional circumstances" ([1.82], [1.100]), at the discretion of the Governor-General in Council and subject to disallowance in Parliament ([1.100]). We note also that there are no legislative conditions for such prescription, although some general factors expected to be considered are set out in [1.100]. This establishes a resource-intensive

mechanism which will repose power in a virtually unchecked executive, replicating the same problems in the existing DGR process.

We also note also the disparity between DGRs and income tax exempt entities in this respect. There is no similar general power to prescribe DGRs that do not operate and pursue their purposes 'solely' in Australia, but rather that power is limited to environmental organisations. That power, in contrast, is a reviewable determination (see proposed s 30-19) based on requirements to be set out in regulations ([1.114]). While we recognise that environmental organisations are likely to need to conduct activities overseas, there may well be other organisations that will, by their nature, be required to conduct activities overseas. For example, Amnesty International is a listed DGR which is likely to pursue purposes offshore, given its advocacy in international organisations. We see no reason why there should not be a similar general power to prescribe in relation to DGRs, and why the general power in relation to both should not be based on explicit criterion set out in regulations, with a right of review.

Recommendations

14. If the underlying policy is adopted, we recommend that there should be a general power for both DGRs and income tax exempt entities (regardless of purpose) to be excluded specifically from complying with the 'in Australia' conditions. Such a power should be conditioned on explicit criteria set out in regulations, with a right of review.

UNDRAFTED REGULATIONS

A related issue is the references to undrafted regulations which will support these changes in the Explanatory Material. While we note that the language in the Explanatory Material is not suggested as legislation, we have some comments on the drafting of the suggested criteria.

While we welcome the re-inclusion of the substance of s 50-75 (discounting government grants and non-tax deductible donations), the Exposure Draft conditions its application upon the entity meeting certain criteria set out in regulations. At [1.69], the Explanatory Material sets out the following expected criteria:

- Demonstration that overseas activities or use of money or property outside Australia "is effective in achieving the entity's purpose";
- Demonstration that the entity must "comply with all Australian and foreign laws, Australia's international treaty obligations, and uphold the high reputation of Australia and It's not-for-profit sector"; and

- Demonstration of "current and appropriate governance arrangements for the proper monitoring of any overseas activities undertaken by both it and any in-country partners".

These criteria are similar to those expected to apply to environmental organisations which are prescribed as not required to fulfil the 'in Australia' conditions (see [1.115]). These include:

- A "genuine need" to conduct activities in order to further its purpose;
- Demonstration that those overseas activities "are effective in achieving its purpose";
- Demonstration that it "effectively interacts and coordinates activities with its in-country partner";
- A requirement to comply with "all Australian and foreign laws, Australia's international treaty obligations, and uphold the high reputation of Australia and It's not-for-profit sector"; and
- Demonstration of "current and appropriate governance arrangements for" monitoring overseas activities and "any in-country partners to ensure that any money and property is being used in a proper and effective manner."

Our first point is that these criteria are regulatory, and satisfaction of these should be assigned to the ACNC rather than to the ATO, as discussed above.

Our second point is that much of this language is questionable. 'Effectiveness', for example, is a highly contestable concept. We also suggest that a "genuine need" is too prescriptive. Instead, the test should be whether conducting overseas activities is "reasonably directed at further its purpose". The requirement to "uphold the high reputation of Australia and it's not-for-profit sector", in our view, is both entirely too subjective for legislation and would appear to prevent Australian NFPs from criticising Australian Government policies (for example) in international fora directly relevant to their purposes.

We also note that the requirement to comply with all Australian and foreign laws and treaty obligations is an impossible requirement, because it is highly likely that at least some of the foreign laws will be incompatible with either Australian law or treaty obligations. For example, Australia's treaty obligations include a raft of human rights obligations which are directly contradicted by the laws of many of the States in which not-for-profits wish to engage in. Australian law may also be incompatible with its treaty obligations. We recommend that entities should only be required to comply with Australian laws and, to the extent to which they are compatible, Australian treaty obligations and foreign laws.

Recommendations

15. We recommend that further thought be given to the conditions for excluding the application of 'in Australia' conditions, in particular the use of the term 'effectiveness', 'genuine need' and 'upholding the reputation of Australia'.

16. We recommend that the condition in relation to compliance with laws should refer to Australian laws, and to the extent that they are compatible Australian treaty obligations and foreign laws.

GOVERNANCE REQUIREMENTS

We acknowledge that Treasury has modified the previous requirement that entities comply with "all governing rules" in proposed s 50-50(3), so that compliance is now required only with "all the substantive requirements" in its governing rules. Further, para (b) now requires that the income and assets are used solely not only for the purposes for which the entity is established, but also "operated and for which it is entitled to be exempt from tax".

We do not feel, however, that this modification cures the problem we identified in our earlier submission. First, as pointed out in our earlier submission, the ACNC should be in charge of issues relating to governance, not the ATO. The ACNC will be established in a way that enables it to take proportionate action in relation to governance. Where appropriate, it may result in the loss of 'not-for-profit status', which itself will trigger a loss of tax exemption. To the extent that it is intended to apply to entities not initially within the jurisdiction of the ACNC, we suggest that it be imposed as a condition only to the extent that the entity is not regulated by the ACNC.

Second, para (a) means that any breach of a 'substantive' requirement, or an inadvertent use of income and assets for other purposes, will result in the loss of all tax exemptions. As noted in our previous submission, in a context where there are many volunteer and part-time directors in the sector, there are likely to be many sistuations in which such people innocently and/or unwittingly breach the governing rules, or apply income and assets to purposes that, while not strictly authorised by their rules, are broadly similar to those purposes. This provision continues to take no account of the severity, frequency, innocence or significance of the breach.

We note that the explanation of 'substantive' in [1.86] of the Explanatory Material is meant to refer to the entity's object and purpose and those relating to an entity's not-for-profit status. We have no difficulty in requiring entities, not otherwise subject to regulation by the ACNC, to continue to pursue the purposes for which it has been granted tax exemption. This is already captured in para (b). In relation to rules governing its not-for-profit status, we note that the proposed definition of not-for-profit entity already imposes a continuing obligation in respect of the non-distribution clauses ("is prohibited from distributing, and does not distribute" …). We are not sure what other breaches of governing rules are intended to be captured therefore by para (a). Further, in our view, the tax exemption is

granted because of the purposes and the not-for-profit status of the entity. Breaches of governing rules that do not touch these should not disentitle an entity from tax exemption.

As we also noted in our earlier submission, the provision as it stands is virtually unenforceable, since it would require the ATO to monitor every act of an income tax exempt entity that may breach a substantive rule of their governing rules.

In relation to the extension of para (b), we note that the explanation of this addition is that entities are "expected to operate in a manner consistent with those rules and purposes to remain eligible" (at [1.84]). Again, in our view, this is properly a matter for the ACNC and not the ATO. While we understand that the concern may be to replicate those powers in relation to entities that will not initially be under the jurisdiction of the ACNC, we would prefer that this be imposed as a special condition separate from the definition of 'not-for-profit entity', which would apply only to entities that are not regulated by the ACNC.

Recommendation

17. Proposed s 50-50(3) should not be included in the forthcoming Bill. Instead, a condition should be imposed on entities that are not subject to the jurisdiction of the ACNC that the entity continues to pursue the purposes for which it is entitled to tax exemption.

DEFINITION OF NOT-FOR-PROFIT

We welcome the significant changes to the definition of 'not-for-profit entity', which largely accord with our recommendations in the previous submission. However, we note that the phrasing does not include the term 'individual members', as we had recommended.

This recommendation was made to replicate the phrase considered by the Full Federal Court in the case of *Commissioner of Taxation v Co-operative Bulk Handling Limited* [2010] FCAFC 155. The Court concluded that an entity could be 'not carried on for the purpose of profit or gain to individual members' even where the members derived a benefit or gain, as long as that gain was not produced *by reason of individual membership*. Although the members in that case received particular benefits from the existence of that organisation, those benefits were similarly open to others in the community.[18] As we noted, the omission may cause uncertainty and have the unintended effect of reversing the Court's decision in *Co-operative Bulk Handling*. If this effect is intended, then it should be clearly stated.

Recommendation

[18] *Commissioner of Taxation v Co-operative Bulk Handling Limited* [2010] FCAFC 155, [94].

18. The definition of not-for-profit should include reference to 'individual owners and members' to ensure the effect of the Federal Court's decision in *Co-operative Bulk Handling* is preserved.

DEVELOPING COUNTRY/DEVELOPED COUNTRY FUNDS

We note here some issues with the Exposure Draft that appear to be unintended. Proposed section 30-18(4) excepts a fund, authority or institution covered by s 30-80 (international affairs DGRs) from the requirements of operating and pursuing its purposes solely in Australia. At [1.110] of the Explanatory Materoial, however, it states that DGRs that are also exempt include "overseas aid funds, developed country relief funds and similar deductible gift recipients". We note, however, that the Exposure Draft **does not except developing country relief funds** (under s 30-85) or **developed country disaster relief funds** (under s 30-86) which we assume by the Explanatory Material, and by the obvious offshore purposes of such funds, should have been similarly excepted under proposed s 30-18.

Recommendation

19. Proposed s 30-18(4) should extend also to developing country relief funds and developed country disaster relief funds, as well as international affairs DGRs, as appears to be intended.

CONCLUSION

This submission has addressed a range of important issues raised by the RevisedExposure Draft. While we acknowledge the efforts to address some of the major concerns we expressed in the previous submission, we consider that there are still issues with the Revised Exposure Draft.

We hope these issues will be reconsidered in light of our submission. Please feel free to contact us if you wish to discuss any matters further, or would like access to any of the material to which we have referred. Our contact details are listed in Appendix A. We look forward to engaging further with Treasury.

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APPENDIX A: NOT-FOR-PROFIT PROJECT, MELBOURNE LAW SCHOOL

A group of academics from the University of Melbourne Law School is undertaking the first comprehensive and comparative investigation of the definition, regulation, and taxation of the not-for-profit sector in Australia (the Not-for-Profit Project). The Australian Research Council is funding this project for three years, beginning in 2010. The project aims to identify and analyse opportunities to strengthen the sector and make proposals that seek to maximise the sector's capacity to contribute to the important work of social inclusion and to the economic life of the nation. In particular, the project aims to generate new proposals for the definition, regulation and taxation of the not-for-profit sector that reflect a proper understanding of the distinctions between the sector, government, and business.

The project investigators of the Not-for-Profit Project are:

Professor Ann O'Connell

Ann is Co-Director of Taxation Studies and teaches taxation and securities regulation at the Law School. She is also Special Counsel at Allens, Arthur Robinson and is a member of the Advisory Panel to the Board of Taxation.

Professor Miranda Stewart

Miranda is Co-Director of Taxation Studies and teaches tax law and policy at the Law School. She is an International Fellow of the Centre of Business Taxation at Oxford University and is on the Tax Committee of the Law Council of Australia. She has previously worked at New York University School of Law, US and as a solicitor and in the Australian Taxation Office.

Associate Professor Matthew Harding

Matthew is an Associate Professor at the University of Melbourne. His published work deals with issues in moral philosophy, fiduciary law, equitable property, land title registration, and the law of charity. Matthew has also worked as a solicitor for Arthur Robinson & Hedderwicks (now Allens, Arthur Robinson).

Dr Joyce Chia

Joyce is the Research Fellow on the Not-for-Profit Project. She has worked at the Australian Law Reform Commission, the Federal Court of Australia, and the Victorian Court of Appeal.

More information on the project can be found on the website of the Melbourne Law School Tax Group Not-for-Profit Project.

APPENDIX B: RECOMMENDATIONS

1. We recommend that, given the lack of awareness of the impact of this measure, the measure (or, at the least, its implementation) should be delayed by at least a year to enable NFPs to assess the impact of the measure on their operations, to be properly consulted, and to enable them to comply with the measure.

2. We recommend that the Australian Taxation Office alert NFPs more widely to the impact of this measure, preferably at the time it informs them of the transfer of some of its functions to the ACNC.

3. We recommend that the policy should be considered again in light of comparable practice which is significantly less restrictive than that proposed. In particular, we recommend that consideration should be given to removing the restriction on overseas activities by domestic NFPs.

4. We recommend that the policy of restricting benefits geographically be reconsidered in light of globalisation, our moral obligations to fellow humans, and our interests in international engagement.

5. If a policy of restricting benefits geographically is adopted, it should extend more broadly to a concept of entities whose purposes or activities are 'in the interests of Australia'. This would include where these are to benefit those in Australian or Australians, where the purpose is to benefit Australian society more generally, or where the organisation promotes international engagement that is in the broader interests of Australia.

6. We recommend that the 'in Australia' conditions be replaced by requirements on charities to report overseas activities or funding to the ACNC, which will supervise such activities in accordance with the development of an appropriate policy in consultation with the sector. In the interim, other tax-exempt NFP entities should be required to report to the ATO in accordance with the same policy, and appropriate action can be taken by the ATO to revoke its status under the definition of 'not-for-profit', or by referral to appropriate agencies responsible for the enforcement of criminal laws.

7. We recommend that, if the underlying policy is adopted, the legislation should spell out more clearly what is required of the 'in Australia' conditions, rather than leaving this to policy.

8. We recommend that, if the underlying policy is adopted, better guidance should be given in the Examples as to the relative weighting of factors.

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9. We recommend that, if the underlying policy is adopted, the legislation should simply disapply income tax exemptions to the extent that the purposes or activities are not in Australia, rather than jeopardising the tax-exempt status of the entire entity.

20. We recommend that, if the underlying policy is adopted, the differing thresholds between DGRs and income tax exempt entities should be harmonised. This will reduce the complexity and confusion caused.

10. If the differing threshold is designed to address tax avoidance, then this should be addressed either by tax avoidance measures or by prohibiting 'conduit' DGRs, rather than imposing a strict 'in Australia' requirement on all DGRs.

11. If the underlying policy is adopted, we recommend that where a DGR or income tax exempt entity donates money to another entity, that entity must meet the same 'in Australia' requirements as apply to the funding entity, unless it is expressly excluded from meeting such requirements.

12. In such a provision, we recommend that a safeguard to protect innocent donating entities, where 'to the best of its knowledge' the other entity meets the 'in Australia' conditions.

13. If the underlying policy is adopted, we recommend that there should be a general power for both DGRs and income tax exempt entities (regardless of purpose) to be excluded specifically from complying with the 'in Australia' conditions. Such a power should be conditioned on explicit criteria set out in regulations, with a right of review.

14. We recommend that further thought be given to the conditions for excluding the application of 'in Australia' conditions, in particular the use of the term 'effectiveness', 'genuine need' and 'upholding the reputation of Australia'.

15. We recommend that the condition in relation to compliance with laws should refer to Australian laws, and to the extent that they are compatible Australian treaty obligations and foreign laws.

16. We recommend that further thought be given to the conditions for excluding the application of 'in Australia' conditions, in particular the use of the term 'effectiveness', 'genuine need' and 'upholding the reputation of Australia'.

17. We recommend that the condition in relation to compliance with laws should refer to Australian laws, and to the extent that they are compatible Australian treaty obligations and foreign laws.

18. The definition of not-for-profit should include reference to 'individual owners and members' to ensure the effect of the Federal Court's decision in *Co-operative Bulk Handling* is preserved.

19. Proposed s 30-18(4) should extend also to developing country relief funds and developed country disaster relief funds, as well as international affairs DGRs, as appears to be intended.

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APPENDIX C: COMPARATIVE OVERVIEW

EUROPE

The European Foundation Centre provides an excellent comparative resource of elegal regimes governing the tax exemption of public benefit entities.[19] Apart from extended country profiles, these include helpful comparative charts, from which we draw the following summary, together with the account given in Sabine Heidenbauer, *Charity Crossing Borders: The Fundamental Freedoms' Influence on Charity and Donor Taxation in Europe* (Kluwer Law International, 2011). As discussed extensively there, European Union law has had a significant impact on the availability of tax reliefs across Europe.

Tax exemptions—Domestic entities and foreign activities

In the vast majority of European States, activities abroad do not put the tax-exempt status of a public benefit foundation at risk.[20] Austria is apparently an exception, although a fuller account reports that since January 1998, the "Austrian Federal Tax Code no longer confines attainment of charitable purposes to Ausrian territory – the charitable entity is free to unfold its purposes abroad without losing its charitable status." Previously, the entity was required to carry out "exclusively and directly the fulfillment of those stated purposes mainly in Austria, unless the purpose pursued is to aid the Third World."[21]

Germany requires that the exemption must advance idnviduals with their domicile or habitual abode in Germany, or that the activites of the entity may contribute to the reputation of the Federal Republic of Germany.[22] The situation in Latvia is unclear, with some suggestion that it would be difficult to obtain public benefit status if all activities were performed abroad.[23]

In Portugal, the notion of a legal entity of public utility depends upon the entity pursuing aims of general interest for domestic benefit within a national or local scope.

Tax exemptions—Foreign entities

In relation to the tax treatment of foreign-based foundations, the picture is more mixed. In eight countries, foreign-based foundations are not entitled to similar tax benefits.[24] In other

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[19] Sabine Heidenbauer, *Charity crossing borders: the fundamental freedoms' influence on charity and donor taxation in Europe* (Kluwer Law International; Sold and distributed in North, Central, and South America by Aspen Publishers, 2011) 42, fn 177.

[20] The States to which this applies include: Bulgaria, Cyrpus, the Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Ireland, Italy, Lithuania, Luxembourg, the Netherlands, Poland, Romaia, Slovakia, Slovenia, Spain, Sweden, United Kingdom, Switzerland, Turkey and the Ukraine.

[21] International Bureau of Fiscal Documentation, *The tax treatment of cross-border donations: including the tax status of charities and foundations.* (International Bureau of Fiscal Documentation, 1994) 5..

[22] Heidenbauer, *Charity crossing borders*, above n 19, 42–43.

[23] Ibid 43. However, the European Foundation Centre says it does not jeopardize the status, but the exemption does not apply to activities abroad.

[24] Latvia; Lithuania; Luxembourg; Malta; Romania; Slovenia; Turkey; the Ukraine. However, Lithuania is also

countries, registration under domestic law or a local branch is required.[25] In some cases, this is available only to other EU or EEA states,[26] or is based on reciprocity.[27] In other cases, they are entitled to exemption if they pursue similar purposes to those already exempt.[28] In only two cases, Germany[29] and France, is there a requirement to have a public benefit purpose in the domestic State.

In Belgium, foreign charities are subject to non-resident tax to the extent they have Belgian sourced income. As Belgian charities cannot pursue profit-making activities without losing tax-exempt status, a foreign entity's taxable base would largely correspond with that of domestic charities.[30]

Charitable contribution deduction—domestic entities

GERMANY

Charitable deductions are available to a German philanthropic organisation, even if it pursues all of its objectives abroad. The organisation may have its seat of management elsewhere, as long as it is incorporated in Germany.[31] The organisation must, however, specify the amount of the donation it will expend abroad and whether this expenditure will be through activites conducted directly or through supporting other organisations.[32]

Donations to German feeder organizations are tax deductible if certain requirements are met, including: 1) the governing documents must include a purpose of distribution to foreign philanthropic organisations; 2) for certain entities, specification of the receiving entity; 3) the receiving entity must be a corporation and provide translated organizational documents; and 4) there must be proof that the foreign corporation engages in activities that would have been exempt from tax if that corporation were resident in Germany.[33]

THE NETHERLANDS

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reported to allow tax exemptions in relation to entities with a permanent presence in the country: Ibid 44. Further, in practice Malta appears to apply a permanent presence requirement: Ibid 45.

[25] Estonia; Finland; Slovakia; Spain. Cyprus, Hungary and Poland also apparently require approval and the activities must be pursued through a branch: Heidenbauer, *Charity crossing borders*, above n 19, 44–45.

[26] Bulgaria; the Czech Republic; the United Kingdom; and Ireland (subject to a waiting period). However, in respect of Bulgaria, it is also reported that if there is a branch with permanent presence this is entitled to equivalent tax status: Ibid 44.

[27] Greece.

[28] Austria; Belgium; Denmark; the Netherlands; Poland; Sweden; the United Kingdom; Switzerland. However, entiites resident in non-EU/EEA countries are only granted preferential treatment if the charitable purposes are pursued on Austrian territory: Heidenbauer, *Charity crossing borders*, above n 19, 47.

[29] However, this requirement is not referred to in other accounts, which state that Germany restricts tax benefits to EU or EEA resident foundations: Ibid 47–48.

[30] Ibid 43.

[31] Koele, *International Taxation of Philanthropy*, above n 4, 201.

[32] Ibid 200.

[33] Ibid 202.

Donations are deductible to Dutch organisations even where the public benefit is to serve a foreign population and to advance a cause not necessarily approved of by the Dutch, provided it did not support violence.[34] This is subject to proof that it is pursuing exempt purposes, but there is no specification of how this is to be proved.[35]

However, the definition of 'gift' means that if the Dutch entity acts merely as a conduit for an earmarked international purpose, then it is arguable that no gift has occurred.[36]

Charitable contribution deduction—foreign entities

In relation to tax deductible donations, 10 European countries do not allow donations to foreign-based public-benefit organisations.[37] In most of the other countries, donations are allowed to EU/EEA resident foundations,[38] but there are generally rules requiring the receiving organisation to be recognized or registered,[39] 'comparable' to domestic organisations,[40] prove entitlement,[41] or meet certain conditions.[42] In Austria, donations to EU/EEA resident foundations are deductible except in certain areas such as research and education, and are more widely available in relation to disaster relief.[43] In Slovakia and Sweden, there is no local incentive for giving, so there is no discrimination.

CANADA

Tax exemptions—Domestic entities and foreign activities

Canadian charities can carry out activities abroad through its staff or an intermediary, or can make gifts to qualified donees (organisations that can issue official donation receipts for gifts). However, the guidance of Canada Revenue Agency (CRA) notes that there are three conditions that must be met when transferring resources to a non-qualified donee which is an intermediary: the nature of the property can only be reasonably used for charitable

[34] Ibid 267–268.

[35] Ibid 272.

[36] Ibid 272–273.

[37] The countries that do not include: Cyprus, Hungary, Lithuania, Malta, Portugal, Romania, Spain, Switzerland, Turkey, Ukraine. Lithuainia however allows deductions for subsidiaries and in a prescribed list: Heidenbauer, *Charity crossing borders*, above n 19, 88. In relation to Malta, this is the consequence of donations only being allowed to specifically named entities, which are all domestic, but other domestic entities are not entitled to such relief: Ibid 88.

[38] Ireland extends its deductibility to Switzerland as well. The Netherlands allows donations also to Dutch overseas and territories, an other country exchanging information with the Netherlands or elsewhere where the entity has been endorsed by the competent Minister: Heidenbauer, *Charity crossing borders*, above n 19, 90.

[39] The Czech Republic; Denmark; Finland; Ireland; the Netherlands; the United Kingdom.

[40] Belgium; Estonia; the United Kingdom.

[41] Bulgaria; Germany; Luxembourg; Poland; Slovenia.

[42] Austria; Germany; the Netherlands.

[43] Heidenbauer, *Charity crossing borders*, above n 19, 89.

purposes; both parties understand and agree the property is to be used for specified charitable activities; and it is reasonable for the charity to have a strong expectation that the organisation will use the property for those activities, based on an investigation into the status and activities of the receiving donee. (These do not apply where the transfer is directly to proper beneficiaries of the charity.)

Otherwise, when an entity acts through an intermediary overseas, the charity must direct and control the use of its resources. The test of direction and control is whether charity is the one that "makes decisions and sets parameters on significant issues related to the activity".[44] The CRA recommends adopting measures such as creating a written agreement, communicating a detailed description of the activity, monitoring and supervising the activity, segregating funds for agency relationships, and making periodic transfers of resources based on demonstrated performance.[45]

Charitable contribution credits—domestic entities

A charity that receives donations and funnels money without 'direction or control' to an organisation to which a Canadian taxpayer could not make a gift and acquire tax relief is a 'conduit', and this jeopardizes the charity's registered status.

A charity cannot be registered solely to support the activities of a non-qualified donee.. However, if the non-qualified donee's activities are at least partly charitable, the applicant could carry out the portion of charitable work and have the non-qualified donee act as an intermediary, subject to the 'direction and control' requirement. This requirement also applies even for branches of foreign organisations. The CRA accepts that charities with a head body which transfers small amounts (the lesser of 5% of the total expenditures or $5,000) to a head body, and has access to internationally produced material, will not generally require further substantiation of benefits fo the charity.

Charitable contribution credits—foreign entities

The tax legislation includes as part of its list of qualified donee prescribed universities outside Canada, the United Nations and its agencies, and certain charitable organisations outside Canada to which Her Majesty in right of Canada has made a gift. Under new measures proposed in the Budget, these organisations are to be maintained on a publicly available list nad must be required to keep books and records for official donations receipt. There are currently 13 entities on this list.

[44] Guidance to help charities (and applicants for charitable status) with foreign activities comply with the Income Tax Act., Canada Revenue Agency, Government of Canada, *Canadian Registered Charities Carrying Out Activities Outside Canada* (8 July 2010) [7] <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>.

[45] Ibid [7.1].

Terrorism

Under the *Charities Registration (Security Information) Act* and the *Income Tax Act,* A charity's status may be revoked if it operates in such a way as to make its resources available, either directly or indirectly, to **listed entity** as defined in subsection 83.01(1) of the *Criminal Code*; or to any other entity (person, group, trust, partnership, or fund, or an unincorporated association or organization) that engages in terrorist activities or activities in support of them. It is also subject to general anti-terrorist legislation.

Canada Revenue Agency has produced a checklist to help Canadian charities identify vulnerabilities to terrorist abuse. The checklist includes: awareness of the listed individual as and entities and laws dealing with terrorism; understanding of the background and affiliations of those involved in the organisation; awareness of CRA guidance; understanding of oversight and verification controls; knowledge of sources and ultimate beneficiaries of resources; and written agreements with overseas operators.

NEW ZEALAND

Tax exemptions—Domestic entities and foreign activities

Non-business income is not subject to any geographical limitation. Business income must be carried on for charitable purposes "within New Zealand", but if an organisation pursues only part of its purposes in New Zealand, the amount is apportioned between the domestic and foreign purposes, and that relating to foreign purposes is taxed. Importantly, however, the test turns upon where the charitable purposes are directed, *not* where the charity pursues its activities.[46]

Tax exemptions—Foreign entities

A 'tax charity' specifically includes an approved non-resident trust, society and institution carrying out its purposes outside New Zealand.[47]

Charitable contribution credit and deduction

New Zealand imposes geographical limitations in respect of charitable contributions. Tax credits (for individuals) and deductions (for companies) are available in respect of donations either to those listed in Schedule 32 of the *Income Tax Act 2007* (Cth) or if the entity fulfils one of the following criteria:

> *(a) a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic, or cultural purposes within New Zealand:*
>
> *(b) a public institution maintained exclusively for any 1 or more of the purposes within New Zealand set out in paragraph (a):*

[46] International Bureau of Fiscal Documentation, *The tax treatment of cross-border donations*, above n 21, 14.

[47] *Income Tax Act 2007* (NZ) s CW 41(5)(c).

(bb) a Board of Trustees that is constituted under Part 9 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(bc) a tertiary education institution that is established under Part 14 of the Education Act 1989 and is not carried on for the private pecuniary profit of any individual:

(c) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:

(d) a public fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a).[48]

Organisations may, however, set up funds for New Zealand purposes and receive tax deductions in respect of those.

UNITED KINGDOM

Tax exemptions—Domestic entities operating overseas

There is no limitation on domestic entities operating overseas. However, the Charity Commission provides guidance on issues charities working internationally should consider.[49]

Tax exemptions—Foreign entities

After the commencement of the *Finance Act 2010*, the United Kingdom allows tax reliefs to charitable entities established in EU states or in a 'relevant territory' (Iceland or Norway), to comply with European Union law.

Gift Aid—Domestic and foreign entities

Gift Aid is dependent upon the definition of 'charity'. There are no additional geographical restrictions. As the Gift Aid system depends on the registration of a 'charity', other EU-resident entities can access Gift Aid if they meet the conditions for tax exemption.

Terrorism

The Charity Commission has remained central to counter-terrorism, and has recently revised its Counter-Terrorism Strategy. This takes a four-strand approach: building awareness of the risks, safeguards and governance processes in the sector; monitoring higher-risk activities and analyzing trends and profiles; co-operating with regulators domestically and internationally; and intervening robustly in certain cases. In the previous year, the Charity

[48] NZ, 'Income Tax Act' above n 17, LD3.

[49] The Charity Commission for England and Wales, *Charities Working Internationally Index Page* <http://www.charitycommission.gov.uk/Charity_requirements_guidance/Your_charitys_activities/Working_internationally/Charities_working_internationally_index.aspx?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+CharityCommissionUpdates+%28Charity+Commission+updates%29>.

Commission investigated 16 terrorist cases. The Commission also provides an online toolkit which provides guidance to trustees on managing the risks.

The Charity Commission's work in this space has been praised widely. Sidel notes that the "British approach has, at least in part, relied on charity regulators as partners and, often but not always, 'first responders' in the anti-terrorist enterprise … The Charity Commission … has played a core role in investigating, resolving, and where necessary collaborating in prosecuting ties between charities, terrorism, and terrorist finance."[50] He concludes:

> *The Charity Commission has played an exceptionally useful role in England in cooperation with police and security forces, bringing to bear a detailed knowledge of the sector and ofo individual charitable organizations based on years of reporting and experience. … This maintenance of a central role for oa charity regulator, combined with the intensive focus on a small number of organizations suspected of terrorist finance links, has arguably resulted in both better targeting and better information for British law enforcement than for some of its international counterparts.*[51]

UNITED STATES

For a detailed account, see Ineke Koele, *International Taxation of Philanthropy: Removing Tax Obstacles for International Charities* (International Bureau of Fiscal Documentaiton, 2007).

Income tax exemption—Foreign entities

Foreign charities are eligible for income tax exemption.[52] However, few foreign charities apply because of the cost of legal expenses and reporting requirements, the limited amount of US-source income, and because recognition does not carry with it a right to receive deductible gifts.[53]

Charitable contribution deduction—domestic entities and overseas activities

A domestic entity can use the funds to pursue activities overseas, and indeed all its employees, activities and assets can be overseas, without jeopardizing individuals' charitable contribution deduction for income tax.[54] However, contributions by corporations to charity are generally deductible only if the gift is to be used within the US or its possessions,[55] but the restriction does not apply where the recipient is itself a corporation.[56]

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[50] Mark Sidel, *Regulation of the voluntary sector□: freedom and security in an era of uncertainty* (Routledge, 2010) 36.

[51] Ibid 50.

[52] Internal Revenue Service, *Revenue Ruling 66-177* (No 1966-1 CB 132,).

[53] Pozen, 'Remapping the Charitable Deduction' above n 6, 541, fn 41.

[54] Bilingual Montessori School of Paris, Inc v Comm'r, 75 TC 480 (1980).

[55] IRC § 170(c)(2). This limitation does not apply to small business corporations.

[56] Bruce R Hopkins, *The Law of Tax-Exempt Organizations* (John Wiley & Sons Inc, 2007) 997.

Charitable contribution deduction—foreign entities

Individuals or corporations can access the charitable contribution deduction in respect of income tax only if the donee is "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States."[57]

There are exceptions, however, under bilateral tax treaties for entities incorporated in Canada, Mexico, or Israel, to the extent that the donor has income from sources in that country.[58]

There are ways in which this rule is tempered so international activity and philanthropy is not inhibited. First, as noted above, US charities can freely engage in activities abroad.

Second, US charities can also re-donate received funds to foreign charities. However, corporate deductions are not available if the donee uses or sends the funds abroad, unless the done is also a corporation.[59] Importantly, too, tax deductions are not available if the US entity is as a mere 'conduit', that is, where the US entity has no discretionary authority and must transmit earmarked funds to the foreign charity (as opposed to a right to review and approve grants or where the foreign entity is a controlled subsidiary). The test is whether "the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes".[60] Tax deductibility may be available even where the entity gives funds only to a particular named entity (known as a 'friends of' organization).[61]

Gift and estate tax deductions

In respect of deductions for gift tax, there is no requirement that the donee be established in the US. However, the donee must be domestic and non-corporate donees must use the gift exclusively in the US.[62] In respect of deductions for gift tax, there is also no requirement that the donee be established in the US, but charitable bequests by foreign donors to trustees are limited to domestic use.[63] The gift must fall within the purposes of the US entity and the US entity must exercise ongoing scrutiny unless it can show that the foreign donee meets the terms of the income tax exemption section in the US Internal Revenue Code.

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[57] US, 'Internal Revenue Code' US Code.

[58] Ineke A. Koele, *International Taxation of Philanthropy: Removing Tax Obstacles for International Charities* (2007).

[59] Internal Revenue Service, *Revenue Ruling 69-180* (No 1969-1 CB 65,). The exception for corporate donees has never been explained and is thought to be a drafting error: Pozen, 'Remapping the Charitable Deduction' above n 6, 241, fn 43.

[60] Rev Ru 66-79, 1966-1 CB 48, 51.

[61] Internal Revenue Service, *Revenue Ruling 74-229* (No 1974-1 CB 142,); Internal Revenue Service, *Revenue Ruling 66-79* (No 1966-1 CB 48,).

[62] US, 'IRC, Internal Revenue Code' above n 57, s 2522(b)(2)–(3).

[63] *Ibid 2106(a)(2)(A)(ii).*

Anti-Terrorist Guidelines

The US Treasury has developed voluntary best practices for those engaging in foreign grantmaking or operations.[64] These guidelines recommend maintaining and publishing a current list of branches, subsidiaries and/or affiliates receiving resources and services from the charity. In relation to supply of charitable resources, the charity is responsible for determining that the recipient has the ability to accomplish the charitable purpose and protect its resources from diversion to noncharitable purposes, including any activity that supports terrorism; should sign a written agreement as to the terms of the grant with the recipient; should commit to ongoing monitoring of the grantee and funded activities; and is responsible for correcting misuse of resources and terminating the relationship with the grantee. In relation to supply of charitable services, the guidelines require the charity to be responsible for adopting appropriate measures to reduce the risk its assets would be used for noncharitable activities, including any activity that supports terrorism, and impose sufficient auditing or accounting controls to trace services or commodities between delivery by the charity and/or service provider and use by the grantee. The guidelines suggest that charities should obtain certain information about the potential recipient before distributing funds or in-kind items, conduct 'basic vetting' of recipients and their key employees, and review financial and programmatic operations.

These Guidelines were revised after sector criticsm of the original 2002 Treasury Guidelines concerned about the "potentially unachievable due diligence requirements".[65] As a result, sector representatives convened to develop an alternative framework, known as the 'Principles of International Charity'. These Principles emphasise, inter alia, that charitable organisations, while they must comply with US and foreign laws, are "non-governmental entities that are not agents for enforcement of US or foreign laws or the policies reflected in them"; that the responsibility for observing laws and adopting and implementing practices "ultimately lies with the governing board"; that an "orgnaizations commitment to the charitable use of its assets must be reflected on the part of the provider"; and that fiscal responsibility usually requires ensuring the recipient can achieve the charitable purpose and protect resources from diversion, creating a written agreement, ongoing monitoring of the recipient, and seeking correction of misuse of resources; and that charities must "safeguard its relationship with the communities it serves".[66]

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[64] *US Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.s.-Based Charities* (November 2005) <http://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/guidelines_charities.pdf>.

[65] Sidel, *Regulation of the voluntary sector*, above n 50, 17.

[66] Sharon P Light, 'The Principles of International Charity: An Effective Alternative to the Voluntary Guidelines' (2005) 72 *International Date* See generally <http://www.cof.org/files/Documents/Newsletters/InternationalDateline/2005/legaldimension_Sharonlight.pdf>.

APPENDIX C: INTERNATIONAL RESPONSES TO TERRORISM AND MONEY-LAUNDERING

US

The Treasury Anti-Terrorist Financing Guidelines require the governing instruments to state, inter alia, that the charity will comply with all applicable federal, state and local law. It also requires a statement that the board of directors of a charitable organisation is responsible for the organisation's compliance with relevant laws. the organisation's basic goal(s) and purpose(s); its structure;

THE UNIVERSITY OF MELBOURNE

SUBMISSION TO THE TREASURY, *'IN AUSTRALIA' SPECIAL CONDITIONS FOR TAX CONCESSION ENTITIES* (EXPOSURE DRAFT, 4 JULY 2011)

BY THE NOT-FOR-PROFIT PROJECT, UNIVERSITY OF MELBOURNE LAW SCHOOL

INTRODUCTION

The University of Melbourne Law School's Not-for-Profit Project is a three-year research project funded by the Australian Research Council which began in 2010. This project will be the first comprehensive Australian analysis of the legal definition, taxation, and regulation of not-for-profit organisations (NFPs). Further information on the project and its members is attached to this submission as Appendix A.

This submission details our concerns with the provisions in the Exposure Draft of the Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) 2011 ('Exposure Draft'), as explained by the accompanying Explanatory Material, 'Restating the "in Australia" special conditions for tax concession entities' ('Explanatory Material').

We are deeply concerned that, although the Explanatory Material conveys the impression that the Exposure Draft largely 'standardises', 'restates' and 'codifies' existing requirements, in fact the Exposure Draft makes potentially far-reaching changes to current legal requirements. In our view, these changes will have significant adverse and, in many cases, apparently unintended, consequences on the not-for-profit (NFP) sector. We are concerned that, due to this misleading impression and the complexity and technical detail involved, many organisations in the not-for-profit sector may be unaware of the significance of the possible consequences of this reform.

We recognise that the Government has already adopted a policy position to restrict tax benefits on a geographical basis, and therefore primarily direct our remarks to specific aspects of the proposals. We do, however, express reservations concerning the adequacy of the underlying justifications for these measures. In particular, we question whether these measures can be justified in our globalised era, where institutions are increasingly enmeshed in international networks and where concepts of 'public benefit' are no longer territorially bound. We note that no evidence of systemic avoidance issues has been presented to justify these new measures. We also regret that these tax reforms continue to

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be developed in isolation from the broader regulatory reform which will inevitably be introduced by the new Australian Charities and Not-for-Profits Commission (ACNC).

This submission first addresses in some detail the implications of the proposed 'standardised' definition of 'not-for-profit entity'. It then addresses the new 'in Australia' conditions, and in particular:

- the imposition of stricter conditions for deductible gift recipients (DGRs);
- strict restrictions on distributions to other entities;
- the draconian consequences for failing to comply with governing rules or misappropriation; and
- the repeal of a provision that excludes overseas distributions in respect of gifts or government grants from the 'in Australia' conditions.

DEFINITION OF NOT-FOR-PROFIT

The Exposure Draft proposes to introduce a standardised definition of 'not-for-profit entity' as s 955-1 of the *Income Tax Assessment Act 1997* (Cth). We are deeply concerned that this proposed definition significantly changes the current law, despite the stated policy intention to the contrary, and that these changes would have significant unintended consequences, including:

- removing the not-for-profit status of commercial subsidiaries and conduit NFPs, and thus in effect reversing entirely the effect of the High Court's decision in *Federal Commissioner of Taxation v Word Investments Ltd* (2008) 236 CLR 204;
- precluding the transfer of assets upon winding up to other charitable entities, and
- preventing the payment of reasonable remuneration and reimbursement of expenses.

PROPOSED AND CURRENT DEFINITIONS

The definition proposed by the Exposure Draft is set out below:

> ***not-for-profit entity*** means an entity that:
>
> (a) does not carry on its activities for the purposes of profit or gain for particular entities, including its owners or members, either while it is operating or upon winding up; and

(b) does not distribute its profits or assets to particular entities, including its owners or members, either while it is operating or upon winding up.[1]

The Explanatory Material explains that this proposed definition is based on a similar provision in the exposure draft of the Charities Bill 2003 (Cth),[2] with the only change that reference is made to 'entities' rather than 'persons'.[3] According to the Explanatory Material, this definition is not intended to effect any substantive change.[4]

However, the proposed definition does substantively change the current position. First, there is presently no statutory requirement that any of the institutions or funds in s 50-5 (dealing with charity, education, science and religion) must be not for profit, although (as discussed below) the common law does impose a similar requirement in relation to charities. As a result, the proposed definition adds a new statutory requirement for many income tax exempt entities.

Second, the proposed definition substantively changes the nature of the not-for-profit requirement. Currently, federal legislation consistently defines 'non-profit' and like terms to the following effect:

> *a body that is not carried on for the purposes of profit or gain to its individual members* (the 'purpose' requirement) *and is, by the terms of the body's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members* ('the non-distribution requirement').[5]

Similar definitions are also used in Australian state and territory legislation. Appendix B sets out in full the definitions of 'not-for-profit' and like terms in current Australian legislation.

The proposed definition extends the scope of the present requirements in the following ways:

- It extends the scope of both the purpose and non-distribution requirements beyond members to include other (undefined) 'particular entities', including owners;

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[1] *Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) Exposure Draft 2011* Sch 1 it 7.

[2] Treasury, *Restating the "in Australia" Special Conditions for Tax Concession Entities* (Exposure Draft, Explanatory Material, 4 July 2011) <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID =2053>, [1.76]. The Board of Taxation Inquiry on the Charities Bill 2003 (Cth) included some comments on the breadth of this provision, but these were overshadowed by other concerns: The Board of Taxation, *Consultation on the Definition of a Charity* (December 2003) <http://www.taxboard.gov.au/content/ content.aspx?doc=reviews_and_consultations/definition_of_a_charity/default.htm&pageid=007>, [4.7]-[4.8].

[3] This would extend the scope of the definition beyond that proposed in the earlier bill so that it would also include partnerships and trusts.

[4] Treasury, *Explanatory Material*, above n 2, [1.76].

[5] *Electronic Transactions Act 1999* (Cth) s 3. The same definition is used in the mirror legislation of the States and Territories.

- It removes the critical word 'individual' before that of 'members' in the requirement of purpose;
- It alters the purpose requirement by introducing a focus on carrying on 'activities'; and
- It removes the requirement that the organisation must have a non-distribution requirement in its constituent documents.

We discuss the effects of each of these changes further below.

Extension to 'Particular Entities'

Currently, the definition of 'not-for-profit' in almost all Australian legislation prohibits only profit to members.[6] The proposed definition extends the scope of the purpose and non-distribution requirements to 'particular entities'. However, there is no definition of a 'particular entity', and no indication of what is intended by that expression other than that it will include 'owners' and 'members'. This drafting is very unclear and could lead to absurd consequences, if it is interpreted to include (for example) beneficiaries, employees, creditors, or suppliers.

The Explanatory Material clarifies to some extent the intended scope of 'particular entities' in the following paragraph:

> *Additionally, a not-for-profit entity must not provide any benefit directly or indirectly to a related party such as a trustee, member, director, employee, agent or officer of a trustee, donor, founder, or to an associate of any of these entities (other than reasonable remuneration for services provided or re-imbursement of related costs).*[7]

Unfortunately, the proposed definition does not specifically identify the entities named in this statement, instead referring generally and unhelpfully to 'particular entities'. Nor does the proposed definition exclude reasonable remuneration or reimbursement of expenses.

The statement in the Explanatory Material appears to derive from the discussion in the *Report of the Inquiry into the Definition of Charities and Related Organisations* (2001) ('Sheppard Inquiry').[8] The reference to 'particular entities' therefore appears intended to prohibit excessive benefits to 'related' parties to an organisation, in a manner similar to that of Chapter 2E of the *Corporations Act 2001* (Cth), which imposes procedural requirements in the case of 'related party transactions'.

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[6] There is a single exception which refers also to 'relatives' of members: *Income Tax Assessment Act 1936* (Cth) s 103A(2). This is set out in Appendix B.

[7] Treasury, *Explanatory Material*, above n 2, [1.75].

[8] Ian Fitzhardinge Sheppard, Robert Fitzgerald and David Gonski, *Report of the Inquiry into the Definition of Charities and Related Organisations* (2001) <http://www.cdi.gov.au/html/report.htm>, Ch 11.

There are several problems with this extension of the definition. First, the proposed definition confuses the statutory not-for-profit requirement with the prohibition on 'private profit' in the common law definition of charity, which is the context of the discussion in the Sheppard Inquiry.

Under the common law, the generation or distribution of private profit or benefit is inconsistent with the notion of charity.[9] This is intimately linked with the requirement of 'public benefit' under the common law. 'Private profit' in this sense

> *does not refer to the payment of wages or allowances to employees of, or other service providers to, the charity, but to the distribution of the profit and/or capital of the institution to private individuals (or non-charitable entities), whether during the operation of the institution or on its winding up.*[10]

The focus of the common law is on the concept of 'private gain'. This idea of 'private profit' does not preclude distribution of profits to charitable entities or to entities furthering the charitable purposes of the organisation itself. An illustration of that is provided by *Incorporated Council of Law Reporting of the State of Queensland v Commissioner of Taxation* (1971) 125 CLR 659. In that case, the High Court considered whether the publication of law reports by the Council was charitable. Barwick CJ, examining whether there was a "lack of private gain by the members of the Council", relevantly observed:

> *Here there are two significant matters. First, the memorandum of association forbids any distribution of the profits of the Council to or amongst its members. … Second, the actual distributions of the Council's profits have been confined to grants to the libraries of the Supreme Court of Queensland. Those libraries are themselves important adjuncts to the administration of the law. They facilitate the very purpose the production of the law reports is designed to achieve. … The application of the profits of the Council to the support of the Supreme Court libraries is itself, in my opinion, an application to charity.*[11]

The proposed definition in the Exposure Draft goes beyond the common law by proscribing benefits to 'particular entities' including charitable entities, and also because it does not exclude payment of reasonable remuneration or reimbursement of expenses from its scope.[12]

The extension of the definition to 'particular entities' has the following consequences. First, commercial subsidiaries and 'conduit' NFPs would clearly fall outside the definition. The purpose of these entities is to generate profits or gains for other NFPs. These entities also distribute profits to other NFPs. These other NFPs will clearly qualify as 'particular entities' if

[9] G E Dal Pont, *Law of Charity* (LexisNexis Butterworths, 2010) [5.22].

[10] Ibid [3.24].

[11] *Incorporated Council of Law Reporting (Qld) v Federal Commissioner of Taxation* (1971) 125 CLR 659, 670.

[12] We discuss the issue of excessive remuneration or reimbursement below.

they own these entities. Based on the discussion in the Explanatory Material, this is not intended by the Treasury.[13]

Second, currently the constituent documents of most not-for-profit organisations include a winding up clause that distributes surplus assets to other NFPs. Potentially, this could violate the requirement in the proposed definition that the entity does not distribute its assets to 'particular entities' upon winding up, especially if the successor NFP was 'related' or, depending upon the interpretation of 'particular', if it was specifically named in the clause.

Third, the definition appears to preclude NFPs from remunerating or reimbursing trustees, directors or others potentially within the scope of 'particular entities'. Even if the definition was changed to exclude 'reasonable remuneration or reimbursement', a definition that referred to 'excessive remuneration or reimbursement' would still substantively change the nature of the 'not-for-profit' requirement. Currently, the 'non-profit' requirement involves a simple inspection of the constituent documents for the appropriate clauses. Including an 'excessive remuneration' requirement changes this to a qualitative and ongoing requirement. It has the potential to deprive an organisation of its not-for-profit status if it enters upon a single transaction deemed to be 'excessive', a consequence which would be draconian and unjust to the innocent beneficiaries of the NFP.[14]

It is submitted that it is the function of the ACNC to review ongoing governance and regulatory functions. While removal of tax-exempt or DGR status may be a last resort, it is more appropriate for the regulator to provide a staged, compliance process before triggering this 'terminating' breach of status.

'Individual' Members

As Appendix B shows, current legislative definitions tend to exclude the purpose of profit or gain for 'individual' members. This phrase was recently considered by the Full Federal Court in the case of *Commissioner of Taxation v Co-operative Bulk Handling Limited* [2010] FCAFC 155, which helpfully collected the relevant case law on this phrase. The Court concluded that an entity could be 'not carried on for the purpose of profit or gain to individual members' even where the members derived a benefit or gain, as long as that gain was not produced *by reason of individual membership*. Although the members in that case received particular benefits from the existence of that organisation, those benefits were similarly open to others in the community.[15]

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[13] See, esp, Treasury, *Explanatory Material*, above n 2, [1.60]-[1.67].

[14] The problem of 'excessive benefits' is partly regulated already through fiduciary duties, the definition of charity law, and corporations law. Distinguishing between 'excessive' and 'normal' benefits is a difficult exercise and would require a much more sophisticated regulatory regime: compare the detail in Ch 2E of the *Corporations Act 2001* (Cth).

[15] *Commissioner of Taxation v Co-operative Bulk Handling Limited* [2010] FCAFC 155, [94].

The proposed definition omits the key word 'individual', an omission which will cause uncertainty and possibly provoke further litigation. More importantly, it may have the unintended effect of reversing the Court's decision in *Co-operative Bulk Handling*. If this effect is intended, then it should be clearly stated.

From 'Purposes' to 'Activities'

The proposed definition also restates the purpose requirement so that an organisation cannot '*carry on its activities* for the purposes' of profit or gain (emphasis added). This reference to activities is not used in current legislative definitions.

There is an important distinction between not carrying on a *company* for purposes of profit or gain (which is currently required), and not carrying on *activities* for purposes of profit or gain. For example, many NFPs will pursue activities for the purposes of profit or gain to raise funds, although their ultimate purposes are charitable or for the public benefit. Further, commercial subsidiaries and 'conduit' NFPs clearly carry on all their activities on for the purposes of profit or gain, although (again) their ultimate purposes is not profit or gain. This change in language will generate uncertainty in the sector and potentially preclude commercial subsidiaries and conduits NFPs, and NFPs which engage in fundraising activities, from not-for-profit status.

Removal of Reference to Constituent Documents

The non-distribution requirement in current legislative provisions generally refers to a requirement in the body's constitution or constituent documents that prohibits distribution. However, there is no equivalent reference in the proposed definition.

This has the effect of changing the non-distribution requirement from a simple check that the organisation has the required non-distribution clause in its documents to an ongoing and operational prohibition on distribution. We query whether this change is intended and note that it will qualitatively change the nature of the requirement.

Arguably, as well, this could mean an organisation could become a not-for-profit even where it did not have the required clause in its constitution, as long as it could prove that in fact it did not distribute assets or profits. This would have disadvantages for the governance of the organisation and increase the risk of distribution or assets for private profit at a later stage.

Recommendation

The current legislative definitions of 'non-profit' in Commonwealth legislation (set out above) should be used as the standard definition. This language has already been judicially considered and is used consistently across Commonwealth legislation and in most state and territory legislation.

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If the policy intent is merely to preserve existing requirements, then it makes sense simply to retain the existing language. If the policy intent goes beyond this, then further consultation is required on the significant implications of the change.

'IN AUSTRALIA' REQUIREMENT

The Explanatory Material conveys the impression that the intention is only to "restate" "traditional" conditions for tax concession entities in light of court decisions that have "raised doubts about the proper application" of those conditions.[16] This impression is, in our view, misleading.

It is true that the provision for tax deductions for charitable gifts has 'traditionally' required the institution to be 'in Australia'. However, in contrast, no geographical restriction was placed on income tax exempt entities until 1997. This was not a mere oversight, for in *University of Birmingham v Federal Commissioner of Taxation* (1938) 60 CLR 572, the High Court had held that an overseas charity was eligible for income tax exemption in Australia, relying particularly on the distinction drawn between the provisions for charitable deductions and income tax exemptions. As discussed below, this distinction is maintained by other jurisdictions today, including the US, Canada and New Zealand.

The policy behind this distinction was also approved in 1952, when the Commonwealth Committee of Taxation observed:

> *that this exemption is not limited to institutions in Australia, and [the Committee] considers that if an institution is so constituted and controlled, and carries on such activities that it falls within the scope of the exemption, the place of residence is not material.*[17]

The restriction for income tax exempt entities was introduced in 1997 by an amendment to former s 23(e). This amendment inserted the following additional conditions:

> *(i) has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia; or*
>
> *(ii) is an institution to which a gift by a taxpayer is an allowable deduction because the institution is referred to in a table in subsection 78(4);*[18] *or*
>
> *(iii) is a prescribed institution which is located outside Australia and is exempt from income tax in the country in which it is resident; or*

[16] Treasury, *Explanatory Material*, above n 2, [1.1]-[1.4].

[17] Commonwealth Committee on Taxation, *Report on Exemption of Income of Certain Bodies and Funds (Reference No. 25)* (Parliamentary Paper, No 136, 12 August 1952), [7].

[18] Section 78(4) of the 1936 Act at that time provided that a gift by a taxpayer to a fund, authority or institution in Australia listed in 12 tables was an allowable deduction if certain conditions were met.

(iv) is a prescribed charitable or religious institution that has a physical presence in Australia but which incurs its expenditure and pursues it [sic] objects principally outside Australia.

The restriction in (i) was re-enacted in s 50-50(a), in the same terms.

UNDERLYING POLICY

The Explanatory Memorandum introducing the geographical restriction for income tax exempt entities explained its purpose as follows:

The measures will address avoidance arrangements which take advantage of the tax exempt status of charitable trusts and close off the possibility of certain organisations which also currently enjoy an income tax exemption from being used for tax avoidance purposes. Additionally, they will prevent, in particular circumstances, the transfer of revenue from Australia to a foreign country where Australia foregoes its taxing right by providing an income tax exemption for the Australian source income of an offshore organisation but the organisation is not exempt from tax on this income in its home country.[19]

The Explanatory Material to the Exposure Draft further states that, subsequently, the conditions

have also operated to minimise the risk of income tax exempt entities being used for terrorist financing and money laundering, and to ensure the proper operation of not-for-profit entities and their use of public donations and funds.[20]

It is submitted that in the current global era, the underlying policy of confining the benefits of tax concessions to operations 'in Australia' is generally inappropriate, although it is accepted that an Australian 'threshold' requirement is appropriate.

There are important issues of principle involved in a policy that establishes a strict 'in Australia' requirement which are not clearly articulated in the Explanatory Material. Cross-border philanthropy is becoming increasingly significant in a globalised world, and there are policy and practical issues involved in such a geographical restriction.[21] The Explanatory

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[19] *Taxation Laws Amendment Bill (No. 4) 1997 Explanatory Memorandum* <http://www.austlii.edu.au/au/legis/cth/bill_em/tlab41997285/memo1.html>, [5.2].

[20] Treasury, *Explanatory Material*, above n 2, [1.6].

[21] For a general discussion, see Paul Bater, 'Introduction: International Tax Issues Relating to Non-Profit Organisations and Their Supporters' in Paul Bater, Frits W Hondius, and Penina Kessler Lieber (eds), *The Tax Treatment of NGOs: Legal, Fiscal, and Ethical Standards for Promoting NGOs and Their Activities* (Kluwer Law International, 2004) 1; Ineke A. Koele, *International Taxation of Philanthropy: Removing Tax Obstacles for International Charities* (2007); David Moore and Douglas Rutzen, 'Legal Framework for Global Philanthropy: Barriers and Opportunities' (2011) 13 *The International Journal of Not-for-Profit Law* <http://www.icnl.org/knowledge/ijnl/vol13iss1/special_1.htm>.

Material does not address this. Second, the Explanatory Material and associated government policy does not acknowledge that the Exposure Draft will impose some of the highest barriers to cross-border philanthropy in the developed world.

Comparable countries tend to apply geographical restrictions only in relation to charitable contribution deductions, and not in relation to income tax exempt entities generally. In the US, an organisation can generally be tax-exempt if it is created overseas,[22] and a domestic organisation can carry on all of its activities in foreign countries.[23] In Canada, a registered charity can conduct its own activities abroad, including through relationships of control and supervision with foreign partners, or it can transfer funds or assets to another qualified donee (an entity eligible for charitable contribution credits).[24] In New Zealand, a 'tax charity' specifically includes an approved non-resident trust, society and institution carrying out its purposes outside New Zealand.[25] Countries in the European Union are now required by law to extend their tax benefits to charities in other European Union States.[26] These countries deal with terrorism and money-laundering without relying upon 'in Australia'-type conditions on tax exempt entities.

We also draw attention to our recent literature review on the taxation of charities which included discussion of articles relating to geographical restrictions on charitable contributions in the US.[27] These articles concluded that the restrictions were ultimately unjustified,[28] and that the issue ofo regulatory oversight could be more appropriately dealt with in other ways.[29]

In our view, there is a real question as to whether the proposed restrictions are necessary to achieve the stated purposes. This is particularly so since no evidence has been offered to

[22] There are specific restrictions on certain types of entities in s 501 of the Internal Revenue Code, but not in relation to organisations under s 501(c)(3). See also Revenue Ruling 66-177, 1966-1 CB 132.

[23] Revenue Ruling 71-460, 1971-2 CB 231.

[24] M. Blumberg, 'Canadian Charities and Foreign Activities' (2009) 21 *The Philanthropist* 311; Canada Revenue Agency, Government of Canada, *Canadian Registered Charities Carrying Out Activities Outside Canada* (No CG-002, 8 July 2010) <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>; Canada Revenue Agency Government of Canada, *Using an Intermediary to Carry Out a Charity's Activities Within Canada* (Guidance, No CG-004, 20 June 2011) <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/ntrmdry-eng.html?=eml20110621>.

[25] *Income Tax Act 2007* (NZ) s CW 41(5)(c).

[26] *Persche v Finanzamt Lüdenscheid (C-318/07)* [2009] ECR I-359; Theodore Georgopoulos, 'Can Tax Authorities Scrutinise the Ideas of Foreign Charities? The ECJ's *Persche* Judgment and Lessons from US Tax Law' (2010) 16 *European Law Journal* 458.

[27] Joyce Chia et al., *Taxing Charities: A Literature Review* (Not-for-Profit Project, Melbourne Law School, 28 February 2011) <http://tax.law.unimelb.edu.au/index.cfm?objectid=053E24C1-B048-8204-A721A46DFB996924&flushcache=1&showdraft=1#Publications>.

[28] Harvey P Dale, 'Foreign Charities' (1995) 48 *Tax Lawyer* 655; Joannie Chang, Jennifer I Goldberg and Naomi J Schrag, 'Cross-Border Charitable Giving' (1997) 31 *University of San Francisco Law Review* 563.

[29] Chang, Goldberg, and Schrag, 'Cross-Border Charitable Giving' above n 27; David E Pozen, 'Remapping the Charitable Deduction' (2006) 39 *Connecticut Law Review* 531, 596.

support the assertion that tax avoidance is a systemic issue in the sector, and in light of the pending establishment of the ACNC. We also draw attention to the broader issue of whether these measures are consistent with a globalising and internationally oriented Australia. Unfortunately, the Government has chosen not to consult on these important and substantive questions of policy.

SIGNIFICANT CHANGES TO THE 'IN AUSTRALIA' REQUIREMENT

1. DIVISION 30: CHANGES TO THE 'IN AUSTRALIA' REQUIREMENTS FOR DGRS

Original function of the 'in Australia' requirement

The Explanatory Material sets out some of the legislative history relating to the 'in Australia' requirement in relation to charitable deductions.[30] However, some of these paragraphs ([1.16]-[1.20]) are misleading.

It is true that the *Income Tax Assessment Act 1915* (Cth) provided for deductions for gifts to public charitable institutions 'in Australia', as stated in [1.16] of the Explanatory Material. It is worth noting, however, that this provision existed alongside a deduction for gifts to public funds "established in any part of the King's Dominions or in any country in alliance with Great Britain for any purpose connected with the current war". Indeed, the Bill as originally introduced only contained such a provision. In its origin, therefore, the deduction provision was international in orientation. The federal charitable deduction itself drew upon earlier Victorian provisions included the words "situated in Victoria".[31] The limitation, therefore, was originally directed to the location of the institution, and not the operational activities of the institution.

Paragraphs of the Explanatory Material ([1.17]-[1.20]) are confusing because they conflate the various 'in Australia' phrases, although it is acknowledged that the phrases occur in "separate contexts". The phrase 'expenses actually incurred in Australia', which was examined in *The Alliance Assurance Co Ltd v Federal Commissioner of Taxation* (1921) 29 CLR 42, is contextually very different from the phrase 'public charitable institutions in Australia'. Further, we point out that the *Income Tax Assessment Act 1922* (Cth) did not reword the gift deduction for public charitable institutions as a result of *The Alliance Assurance* case, as suggested. The only change the 1922 Act made to the provision was that it required the gift to be made in the year the income was derived.

New operational focus

We note these historical details because the Explanatory Material seems to imply that these 'in Australia' conditions are of ancient vintage and that the proposed Exposure Draft language merely 'restates' or 'codifies' these conditions as they once operated. In fact, the

[30] Treasury, *Explanatory Material*, above n 2, [1.16]-[1.32].

[31] *Administration and Probate Duties Act 1907* (Vic) s 3(2); *Income Tax Act 1907* (Vic) s 3. This phrase was inserted at a late stage by the Government, and occasioned no comment in the parliamentary debates.

present provisions mark a significant change in policy not only from the original limitation, but from current legal requirements.

The Explanatory Material wrongly states that currently DGRs must "generally operate solely in Australia (unless exempted from the condition)". Presently, the key limitation on DGRs requires only that the DGR is 'in Australia', under s 30-15, item 1.[32]

The Explanatory Material misleadingly suggests that the words 'solely in Australia' have been "interpreted as requiring deductible gift recipients to be established and operated only in Australia (including control, activities and assets) and must have their purpose and beneficiaries only in Australia".[33]

This is wrong in several respects. First, the legislation does not presently require deductible gift recipients to be 'solely in Australia', merely 'in Australia'. Second, this interpretation does not derive from any judicial decision, but rather from the Australian Taxation Office's Rulings.[34]

There is a strong argument that the Rulings in this respect are incorrect. As noted above, the legislative history suggests the intention was to refer to location or establishment, and this appears to be the ordinary meaning of the words. It is difficult to see how the words 'institutions in Australia' could be extended to require not only that the institutions be established or managed in Australia, but also that all purposes, activities and beneficiaries must be located in Australia.

Indeed, several provisions in Subdivision 30-B indicate the contrary, and clearly contemplate overseas beneficiaries. Most obviously, ss 30-80 (international affairs), 30-85 (developing country relief funds), 30-86 (developed country disaster relief funds) specify that the beneficiaries must be outside Australia. Item 5.1.2 of s 30-50 (defence) allows tax deductibility for:

> *a public institution or public fund established and maintained for the comfort, recreation or welfare of members of the armed forces of any part of Her Majesty's dominions, or of any allied or other foreign force serving in association with Her Majesty's armed forces*.

The legislative history also indicates that the provision was not historically confined to beneficiaries in Australia. Specific provision was made, for example, the United Nations Appeal for Children, intended to help starving children internationally.[35]

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[32] However, those DGRs which are also tax exempt entities under s 50-50 will need to fulfill the additional requirement that they "incur … [their] expenditure and pursue [their] objectives principally in Australia".

[33] Treasury, *Explanatory Material*, above n 2, [1.92].

[34] Australian Taxation Office, *Income Tax: Public Funds* (Taxation Ruling, No TR 95/27, 2 August 1995) <http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR9527/NAT/ATO/00001>, [14]; Australian Taxation Office, *Income Tax and Fringe Benefits Tax: Charities* (Taxation Ruling, No TR 2005/21, 21 December 2005) <http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR200521/NAT/ATO/00001>, [128]-[129].

[35] *Income Tax Assessment Act 1936* (Cth) s 78(a)(xi). This was inserted by s 8(b) of the *Income Tax Assessment*

Further, several provisions within Subdivision 30-B specify that the fund must be for the relief of 'people in Australia' (s 30-45, items 4.1.3, 4.1.5), 'individuals in Australia' (s 30-70) or memorials 'located in Australia' (s 30-50, item 5.1.3). Ordinary principles of statutory interpretation indicate therefore that the other provisions are not similarly restricted. We note, however, that the stated intention to require Australian beneficiaries is not reflected in the language of the proposed provision in the Exposure Draft.

The Exposure Draft therefore imposes entirely new and significantly more restrictive 'in Australia' conditions for DGRs that limit the extent of their activities, purposes and beneficiaries. To that extent, the Explanatory Material's references to "[s]tandardising the core elements" and "minimis[ing] compliance costs" are misleading. Indeed, for many organisations, these provisions are likely to increase compliance costs.

'Solely' in Australian and 'Incidental' or 'Minor' Activities

As noted above, the use of the word 'solely' is new, despite the impression conveyed by the Explanatory Material. This imports a very high threshold. In particular, this can be contrasted with the use of 'principally' (meaning more than 50%) in relation to income tax exempt .

There is, however, some capacity to engage in 'merely incidental' or 'minor' activities, in proposed new s 30-18(2). The Explanatory Material incorrectly states that this exception applies "if the overseas activities are merely incidental to the Australian activities of the entity, and the overseas activities are minor in extent …",[36] rather than 'or'. This does not accurately reflect the language of the proposed provision.

We are concerned that this exception is unduly narrow and is likely to cause great uncertainty and impede international engagement by not-for-profit entities in a globalising age. Global networks of non-governmental organisations, international partnerships and engagements, and international collaboration of many kinds could be affected by this higher threshold. For example, international touring by cultural organisations, scientific collaborations of universities with international or overseas research organisations, and international travel and study trips are all examples of overseas activities that may imperil an organisation's DGR status. For example, the United States Studies Centre is a specifically named DGR intended to promote study of the United States.[37] It is easy to imagine how their overseas activities may fall foul of such a provision.

RECOMMENDATION

We recommend that the Treasury consult further on the implications of this changed threshold on the activities of DGRs. If the Government continues to adopt this policy

Act 1948 (Cth).

[36] Treasury, *Explanatory Material*, above n 2, [1.93].

[37] *Income Tax Assessment Act 1997* (Cth) s 30-40, item 3.2.13.

position, we consider that the 'solely' threshold should be liberalised to ensure that NFPs can continue to engage globally.

2. Restrictions on Distributions Dependent on Income Tax Status

The Exposure Draft also restricts the types of entities to which income tax exempt entities and DGRs can donate money (and, in the case of the latter, property). Under the proposed section 50-50(2)(c), an income tax exempt entity falling within the scope of s 50-50(1) can only donate money to an "exempt entity", namely another income tax exempt entity.[38] Under the proposed section 30-19(3), a deductible gift recipient must not "donate money or property to any entity that is not a deductible gift recipient", although international affairs deductible gift recipients are excluded. The policy intent is to prevent entities from pursuing purposes "by merely passing funds to other entities" which do not meet the 'in Australia' provisions, so reversing that part of the decision in *Word Investments*.[39]

This restriction clearly imposes significant new restrictions on the power of income tax exempt entities and DGRs to distribute money or property, which may have adverse impacts on the funding of the sector. We express the following concerns about these restrictions.

First, the apparent purpose underlying these provisions is to ensure that the income of tax exempt entities and DGRs is spent in Australia rather than overseas. However, these provisions exceed that purpose by further restricting the power to donate to entities depending upon their income tax status. There may be many practical and complex legal reasons which may affect an organisation's decision to seek endorsement as an income tax exempt entity or as a DGR.

For example, an income tax exempt entity may not seek public donations and therefore not require DGR status. However, under these proposals, if they seek any form of funding from a DGR, no matter how minor, they would be required to undergo the lengthy and complex administrative process of obtaining DGR status. Similarly, a founder of a new organisation may seek seed funding from an income tax exempt entity, but would be unable to do so until they had applied for income tax exemption, even though the organisation may not yet have any taxable income.

There are significant administrative delays in obtaining DGR status. Under present rules, for example, disaster relief funds can only obtain DGR status where there is a written determination from the Minister. Other DGRs therefore would be prevented from contributing to disaster relief funds until such DGR status is obtained, impeding a timely response to disasters.

[38] This is defined as: (a) an entity all of whose ordinary income and statutory income is exempt from income tax because of this Act or because of another Commonwealth law, no matter what kind of ordinary income or statutory income the entity might have; or (b) an untaxable Commonwealth entity: *Income Tax Assessment Act 1997* (Cth) s 995-1.

[39] Treasury, *Explanatory Material*, above n 2, [1.67].

In particular, it is not clear to us why, as a matter of policy, DGRs should be prevented from donating money or property to income tax exempt entities that are not DGRs. There are many income tax exempt entities that provide a public benefit but which cannot satisfy the more restrictive eligibility criteria for DGRs. As well, there will be income tax exempt entities that have not chosen to apply for DGR status as they do not seek public donations or for other practical or administrative reasons, but which may be eligible. The Explanatory Material does not address the rationale for restricting the power to donate more strictly for DGRs than for income tax exempt entities.

We note that the Explanatory Material also does not explain why DGRs cannot donate money or property, while income tax exempt entities are prevented only from donating money. In fact, the Explanatory Material incorrectly states that the provision means that DGRs must "donate money only to deducible [sic] gift recipients".[40]

Another matter that is not explained is why an income tax exempt entity should be prevented from donating money to a DGR that is not an exempt entity. While DGRs are normally also income tax exempt entities, it is possible for a DGR not to be an exempt entity. DGRs can be specifically named in the Act and there does not appear to be any necessary connection between DGR status under Div 30 and income tax exemptions under Div 50 (exempt entities).

It is useful in this regard to draw attention to the 'in Australia' requirement that presently applies to charitable trusts and funds established by will after 1 July 1997, set out in s 50-60. Such entities are income tax exempt only if they apply the fund for the purposes for which it was established and if they fulfill one of three conditions. First, they incur expenditure principally in Australia and pursue their purposes solely in Australia. Second, they are a deductible gift recipient. Third, they distribute solely to either or both of the following:

(i) a charitable fund, foundation or institution which, *to the best of the trustee's knowledge*, is *located in Australia and incurs its expenditure principally in Australia and pursues its charitable purposes solely in Australia*;

(ii) a charitable fund, foundation or institution that, to the best of the trustee's knowledge, meets the description and requirements in item 1 or 2 of the table in section 30-15.

This provision is more generous than the proposed 'in Australia' conditions applying to DGRs in several important ways. First, if the entity was itself a deductible gift recipient, the 'in Australia' requirements applicable to income tax exempt entities do not apply. Second, the entity can distribute to any charitable fund, foundation or institution which itself meets the 'in Australia' test. Unlike the proposed provision, such an entity does not have to be itself income tax exempt or a DGR. The underlying policy of restricting the benefits to Australia is

[40] Ibid [1.91].

achieved whether or not the donee organisation is an income tax exempt entity or DGR, addressing some of our concerns in this respect. Third, the provision also provides a safeguard in that it allows a defence for trustees if they distribute 'to the best of their knowledge' to an organisation which meets the 'in Australia' test or is a DGR.

RECOMMENDATION

If the Government continues to adopt this policy position, it should consider allowing income tax exempt entities and DGRs to give money to entities that, to the best of the donor's knowledge, themselves operate and pursue their purposes principally in Australia. The Government should also allow DGRs to donate money to income tax exempt entities as well as DGRs.

3. Compliance with Internal Governance Rules

Proposed subsection s 50-50(3) states that an entity must:

(a) comply with all the requirements in its governing rules; and

(b) use its income and assets solely to pursue the purposes for which it was established.

If the entity does not fulfil these conditions, it does not satisfy the 'special conditions' required for income tax exemption under s 50-50.

As a matter of principle, all entities ought to comply with their governing rules and use their property for the proper purposes of the entity. However, this new statutory requirement would deprive an entity of its income tax exemption for even a single, minor breach of its governing rules or improper use of income and assets. In our view, this provision is unnecessarily harsh. This provision takes no account of the severity, frequency, innocence or significance of the breach.

This provision, if enforced strictly, would have dramatic effects on the NFP sector, especially because there are many volunteer and part-time directors in the sector. There are likely to be many sistuations in which such people innocently and/or unwittingly breach the governing rules, or apply income and assets to purposes that, while not strictly authorised by their rules, are broadly similar to those purposes. The regulatory principle of proportionality should be applied in such cases.

This provision is undesirable in light of the pending establishment of the ACNC. In our view, issues of internal governance should be regulated by the proposed regulatory authority, and not by the tax authority. We also note that the provision as it stands is virtually unenforceable, since it would require the ATO to monitor every act of an income tax exempt entity that may breach a rule of internal governance.

RECOMMENDATION

Proposed s 50-50(3) should not be included in the forthcoming Bill. Instead, approaches to regulatory compliance n the sector should be determined under the authority of the ACNC in consultation with the sector.

4. Repeal of Section 50-75

Item 24 of Sch 1 of the Exposure Draft repeals several sections, including s 50-75. Section 50-75 applies so that distributions of gifts and government grants offshore are disregarded for the purposes of the current 'physical presence' and 'activity' test for income tax exempt entities. The section also confirms that this applies to gifts to a gift deductible fund operated by an inistutiotn which is noto itself a DGR.[41]

This provision was introduced alongside the 'in Australia' special conditions applying to income tax exempt entities. The accompanying Explanatory Memorandum explained that gifts received by Australian or offshore organisations which are not made in relation to an income-producing activity will not constitute 'income' in the hands of the organisation and will not be assessable.[42] It explained that these gifts, and also government grants, would be disregarded for the purposes of the expenditure and pursuit of objects test being introduced.[43]

There is no explanation of the repeal of this section in the Explanatory Material. We draw attention to this omission and submit that the Government should explain what is intended by repeal of this subsection. It appears that, if the subsection is repealed, gifts and government grants will be included in assessing whether an organisation meets the new 'in Australia' conditions. This could have significant practical implications for some organisations.

RECOMMENDATION

The Government should reconsider the repeal of s 50-75 or, in the alternative, clearly explain the intended effect of the repeal in the accompanying Explanatory Memorandum.

Other Changes to Language

Finally, we also draw attention to some changes in the usual drafting language which may generate uncertainty. These include the use of the term 'operate' rather than 'carrying on' (see proposed ss 30(1)(b), 50-50(2)(a)), and the use of 'donate' rather than 'gift' (see proposed ss 30-18(3), 50-50(2)(c)). We also query whether the term 'entity' in s 30-18(4) would cover a fund.

[41] See also Australian Taxation Office, *Income Tax: Endorsement of Income Tax Exempt Charities* (Taxation Ruling, No 2000/11, 28 June 2000), [52]-[55].

[42] *Taxation Laws Amendment Bill (No. 4) 1997 Explanatory Memorandum*, above n 18, [5.43].

[43] Ibid [5.44].

CONCLUSION

This submission has addressed a range of important issues raised by the Exposure Draft. We consider that the Exposure Draft, as currently framed, significantly changes requirements on income tax exempt entities and DGRs. In our view, all of these changes may have significant adverse consequences for the sector. Further, most of these changes are inadequately justified and explained, and in some cases appear unintended. Many of the changes we have addressed here are not apparent on the face of the Explanatory Memorandum and we are concerned that this will result in inadequate consultation with the sector.

We hope these issues will be reconsidered in light of our submission. Please feel free to contact us if you wish to discuss any matters further, or would like access to any of the material to which we have referred. Our contact details are listed in Appendix A. We look forward to engaging further with Treasury as our work progresses on this project.

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APPENDIX A: NOT-FOR-PROFIT PROJECT, MELBOURNE LAW SCHOOL

A group of academics from the University of Melbourne Law School is undertaking the first comprehensive and comparative investigation of the definition, regulation, and taxation of the not-for-profit sector in Australia (the Not-for-Profit Project). The Australian Research Council is funding this project for three years, beginning in 2010. The project aims to identify and analyse opportunities to strengthen the sector and make proposals that seek to maximise the sector's capacity to contribute to the important work of social inclusion and to the economic life of the nation. In particular, the project aims to generate new proposals for the definition, regulation and taxation of the not-for-profit sector that reflect a proper understanding of the distinctions between the sector, government, and business.

The project investigators of the Not-for-Profit Project are:

Associate Professor Ann O'Connell

Ann is Co-Director of Taxation Studies and teaches taxation and securities regulation at the Law School. She is also Special Counsel at Allens, Arthur Robinson and is a member of the Advisory Panel to the Board of Taxation.

Associate Professor Miranda Stewart

Miranda is Co-Director of Taxation Studies and teaches tax law and policy at the Law School. She is an International Fellow of the Centre of Business Taxation at Oxford University and is on the Tax Committee of the Law Council of Australia. She has previously worked at New York University School of Law, US and as a solicitor and in the Australian Taxation Office.

Associate Professor Matthew Harding

Matthew is an Associate Professor at the University of Melbourne. His published work deals with issues in moral philosophy, fiduciary law, equitable property, land title registration, and the law of charity. Matthew has also worked as a solicitor for Arthur Robinson & Hedderwicks (now Allens, Arthur Robinson).

Dr Joyce Chia

Joyce is the Research Fellow on the Not-for-Profit Project. She has worked at the Australian Law Reform Commission, the Federal Court of Australia, and the Victorian Court of Appeal.

More information on the project can be found on the website of the Melbourne Law School Tax Group Not-for-Profit Project.

APPENDIX B — STATUTORY DEFINITIONS OF 'NOT-FOR-PROFIT'

COMMONWEALTH

Broadcasting Services Act 1992 (Cth) s 212A
non-profit body means an incorporated body that:

(a) is not carried on for the purposes of profit or gain to its individual members; and

(b) is prohibited by its constituent document from making any distribution of money or property to its individual members.

Electronic Transactions Act 1999 (Cth) s 5(1)
non-profit body means a body that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the body's constitution, prohibited from making any distribution, whether in money, property or otherwise, to its members.

Fringe Benefits Tax Assessment Act 1986 (Cth) s 136
non-profit company means a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members.

Income Tax Act 1986 (Cth) s 3
non-profit company means:

(a) a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members; or

(b) a friendly society dispensary;

Income Tax Assessment Act 1936 (Cth) s 103A(2)
(2) For the purposes of subsection (1), a company is, subject to the succeeding provisions of this section, a public company in relation to the year of income if: …

(c) the company has not, at any time since its formation, been carried on for the purposes of profit or gain to its individual members and was, at all times during the year of income, prohibited by the terms of its constituent document from making any distribution, whether in money, property or otherwise, to its members or to relatives of its members

Income Tax Assessment Act 1997 (Cth) s 995-1
non-profit company has the meaning given by section 3 of the *Income Tax Act 1986.*

Income Tax Rates Act 1986 (Cth) s 3

non-profit company means:

(a) a company that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of the company's constituent document, prohibited from making any distribution, whether in money, property or otherwise, to its members; or

(b) a friendly society dispensary.

National Transmission Network Sale Act 1998 (Cth) s 3

non-profit body means an incorporated body that:

(a) is not carried on for the purposes of profit or gain to its individual members; and

(b) is prohibited by its constituent document from making any distribution of money or property to its individual members.

Insurance Regulations 2002 (Cth) s 7A

non-profit body means a body that:

(a) is not carried on for the purposes of profit or gain to its individual members; and
(b) by its constitution, is prohibited from making any distributions in money, property or otherwise, to its members.

AUSTRALIAN CAPITAL TERRITORY

Liquor Control Act 2010 (ACT) Dictionary

non-profit organisation means an organisation that—

(a) is not carried on for profit or gain to its individual members; and

(b) does not make any distribution, whether in money, property or otherwise, to its members.

Land Tax Act 2004 (ACT) s 11

not-for-profit housing corporation means a corporation registered under the Corporations Act or the Cooperatives Act 2002 with a constitution that—

(a) states that the main objective of the corporation is the provision of housing; and

(b) prohibits the corporation from making a distribution (whether in money, property or another way) to its members.

NEW SOUTH WALES

Lotteries and Art Unions Act 1901 (NSW) s 4

Non-profit organisation means an organisation not formed or conducted for private gain.

QUEENSLAND

Education (Accreditation of Non-State Schools) Act 2001 s 7

For this Act, a school is *not operated for profit* only if any profits made from the school's operation are used entirely to advance the school's philosophy and aims, as stated in the school's statement of philosophy and aims.

Food Act 2006 (Qld) Sch 3 Dictionary

non-profit organisation means an organisation that-

(a) is not carried on for the profit or gain of its individual members; and

(b) is engaged in activities for a charitable, cultural, educational, political, social welfare, sporting or recreational purpose.

Integrity Act 2009 (Qld) s 41

non-profit entity is an entity that is not carried on for the profit or gain of its individual members.

Major Sports Facilities Act 2001 (Qld) s 30B

non-profit organisation means an organisation that is not carried on for the profit or gain of its individual members.

Residential Tenancies and Rooming Accommodation Act 2008 (Qld) Sch 2 Dictionary

non-profit corporation means a corporation formed for a purpose other than the purpose of making a profit.

Right to Information Act 2009 (Qld) Sch 6 Dictionary

non-profit organisation means an organisation that is not carried on for the profit or gain of its individual members.

Electrical Safety Regulation 2002 (Qld) s 83

non-profit organisation means an organisation that is not carried on for the profit or gain of its individual members.

Legal Profession Regulation 2007 (Qld) Sch 2 Dictionary

non-profit corporation means a corporation formed for a purpose other than financial gain for its members.

Rural and Regional Adjustment Regulation 2000 (Qld) s 230

non-profit organisation means an organisation that is not carried on for the profit or gain of its individual members.

Rural and Regional Adjustment Regulation 2000 (Qld) ss 301, 315, 326, 340
non-profit organisation—1 A non-profit organisation is an incorporated charitable or other organisation that—a) is not operating for the profit or gain, either direct or indirect, of its individual members; and (b) provides a benefit to community.

2 Paragraph 1(a) applies—

(a) while the organisation is operating; and

(b) when it winds up, as if it were still operating.

3 Also, any profit made by the organisation must go back into the operation of the organisation to carry out its purposes and not be distributed to any of its members.

SOUTH AUSTRALIA

Gaming Machines Act 1992 (SA) s 3
non-profit association means incorporated association or some other kind of body corporate as to which the Commissioner is satisfied that profits cannot be returned to members or shareholders

Gaming Machines Act 1992 (SA) s 72
non-profit business means a business carried out under a gaming machine licence held by or on behalf of a body corporate or association, where the Minister is satisfied that the profits of the business cannot be returned to the members or shareholders of the body corporate or association;

Local Government Act 1999 (SA) ss 74(6), 120(8)
non-profit association means a body (whether corporate or unincorporate)—

(a) that does not have as its principal object or one of its principal objects the carrying on of a trade or the making of a profit; and

(b) that is so constituted that its profits (if any) must be applied towards the purposes for which it is established and may not be distributed to its members,

and includes the LGA.

Local Government Act 1999 (SA) s 163
(4) For the purposes of subsection (3)—

(a) a body will not be regarded as incorporated on a not-for-profit basis—

(i) if a principal or subsidiary object of the body is—

(A) to secure a pecuniary profit for the members of the body or any of them; or

(B) to engage in trade or commerce; or

(ii) if the constitution or rules of the body provide that the surplus assets of the body on a winding-up are to be distributed to its members or to another body that does not have identical or similar aims or objects;

District Court (Fees) Regulations 2004 (SA), *Magistrates Court (Fees) Regulations 2004* (SA) s 3, *Supreme Court (Fees) Regulations 2005* (SA) s 3
not-for-profit organisation means a corporation that is not for the purpose of trading or securing a pecuniary profit for its members from its transactions;

State Procurement Regulations 2005 (SA) reg 6(2)
non-profit body means a body that does not carry on operations for the purposes of profit or gain to its individual members.

TASMANIA

Gaming Control Act 1993 (Tas) s 3
"not-for-profit organisation" means an organisation, association, society, club, institution or other body, whether corporate or unincorporate, that is formed or carried on primarily for charitable purposes and not for purposes of trading or securing a profit for its members or another body;

VICTORIA

Child Employment Act 2003 (Vic) s 3
non-profit organisation means an organisation established for any cultural or charitable purpose, the constitution of which prohibits the distribution of profits to the individual members of the organisation

Housing Act 1983 (Vic) s 6
non-profit body means—

(a) a corporation limited by shares or by guarantee that by its constitution is prohibited from carrying on its business for profit; or

(b) a body that—

(i) is not carried on for the purposes of profit or gain to its individual members; and

(ii) is, by its constitution or rules, prohibited from making any distribution, whether in money, property or otherwise, to its members—

but does not include a Government agency;

Land Tax Act 2005 (Vic) s 72
non-profit organisation means a body (whether incorporated or not) that—

(a) applies its profits in promoting its purposes or objectives; and

(b) prohibits the payment of any dividends to members—

but does not include a body that promotes or controls horse racing, pony racing or harness racing in Victoria.

Local Government Act 1989 (Vic) s 76AA
not-for-profit organisation means a body or organisation that—

(a) operates exclusively for charitable, civil or other social purposes; and

(b) does not share or allocate the funds or profits of the body or organisation with the owners, shareholders or executives of the body or organisation;

Prevention of Cruelty to Animals Regulations 2008 (Vic) s 103
For the purposes of regulations 107 and 108, a not-for-profit organisation means an organisation that—

(a) is not established for the purposes of profit or gain; and

(b) has a primary purpose or objective that it is operated not for profit or gain; and

(c) does not distribute any part of the profit or gain made in the conduct of activities by the organisation to any entity; and

(d) has wholly charitable, benevolent, philanthropic or recreational purposes; and

(e) is not a school or an educational institution; and

(f) is not a body which promotes or is funded by horse racing or greyhound racing.

WESTERN AUSTRALIA

Land Tax Assessment Act 2002 (WA) s 1
non-profit association means a society, club or association that is not carried on for the purpose of profit or gain to its individual members;

Pay-roll Tax Assessment Act 2002 (WA) s 1
non-profit organisation means body corporate, society or association formed otherwise than for the purpose of profit or gain to individual members of the body, society or association;

Civil Judgments Enforcement Regulations 2005 (WA) reg 104

non-profit association means a society, club, institution or body that is not for the purpose of trading or securing pecuniary profit for its members from its transactions;

District Court (Fees) Regulations 2002 (WA) reg 3

non-profit association means a society, club, institution, or body that is not for the purpose of trading or securing pecuniary profit for its members from its transactions;

Magistrates Court (Fees) Regulations 2005 (WA) reg 3

non-profit association means a society, club, institution or body that is not for the purpose of trading or securing pecuniary profit for its members from its transactions