



Neumann & Turnour
Submission on
New definition of 'not-for-profit entity'
Tax Laws Amendment (Special Conditions for Not-for-Profit
Concessions) Bill 2012

30 August 2012

Individual liability limited by a scheme approved under Professional Standards Legislation

INTRODUCTION

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

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

DEFINITION OF "NOT-FOR-PROFIT ENTITY"

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

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

- (a) is not carried on for the profit or gain of its owners or members, neither while it is operating nor upon winding up; and
- (b) under an *Australian law, *foreign law, or the entity's governing rules, is prohibited from distributing, and does not distribute, its profits or assets to its owners or members (whether in money, property or other benefits), neither while it is operating nor upon winding up, unless the distribution:
 - (i) is made to another not-for-profit entity with a similar purpose; or
 - (ii) is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.

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

No distribution to owners/members

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

Examples of impact

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

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

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

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

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

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

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

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

Likely unintended consequences of the amendment

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

1. Reduction in membership

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

2. Reciprocal arrangements

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

3. Conversion of simple arrangements into formal trusts

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

'Similar purpose'

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

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

Best principles for amendments

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

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

Prohibiting distribution to the needy on artificial basis

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

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

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

Conclusion

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

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

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

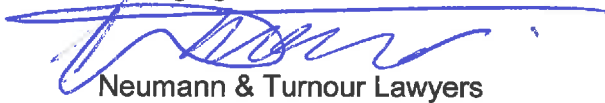
⁷ *Baptist Union of Ireland (Northern) Corporation Ltd v Commissioners of Inland Revenue* 26 Tax Cas 335 [1945] NI 99, 357 (MacDermott J). Whilst altruism as a word was only introduced into the English language in 1853 the concept was established before T V Grant MR famously held in 1805 that the word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

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

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

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

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