

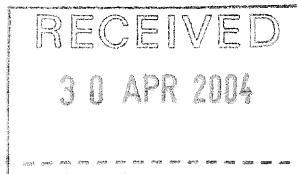


**Australian Government**

**The Treasury**

29 April, 2004

Dr Sarah Bachelard  
Committee Secretary  
Economics Committee  
Australian Senate  
Parliament House  
CANBERRA ACT 2600



Dear Dr Bachelard

**TAX LAWS AMENDMENT (2004 MEASURES NO.1) BILL 2004**

I refer to the Senate Hearing held in relation to the above matter on 1 April 2004.

At the hearing, I agreed to seek legal advice on issues raised in a submission to the Senate Committee by Mr John Wardle, Special Counsel at Corrs Chambers Westgarth. Mr Wardle's submission relates to Schedule 10 of the Bill, which requires charities to be endorsed by the Commissioner of Taxation to be entitled to various tax concessions. That advice has been forwarded to the Committee under a separate covering letter dated 28 April 2004.

At the hearing, we also undertook to seek confirmation and advice, where relevant, from the Australian Tax Office (ATO). In response to the issues and questions on notice raised by members of the Committee, the ATO has provided the following information and comment.

**1. Page E26 – Senator Stephens requested information on the relevant tax ruling covering the conditions that attend the granting of a gift.**

Relevant ATO information on this issue includes:

- (i) *Goods and Services Tax Ruling – Grants of financial assistance* (GSTR 2000/11) issued 12 May 2000 - paragraphs 57 to 68 inclusive refers (see Attachment A).

The relevant extracts of this ruling explain the conditions that must be met in order for a grant to be considered a gift for the purposes of the tax law. The ruling applies the leading income tax law case (*McPhail's case*) to the test of what a gift is, which requires that two limbs of the *McPhail* test must be satisfied in order for a grant to be considered a gift; namely that:

- a grant cannot be the result of a prior contractual obligation to transfer the grant; and
- the grantor may not receive an advantage of a material character by way of return in making the grant.

However, the Ruling also allows that in some instances, a grant may have conditions attached to it that flow from the grantor's right to influence the disposal of the grant and still be considered a gift. The Ruling also provides examples to illustrate this interpretation. Whether or not a grant is a gift will depend on the particular circumstances and the individual facts surrounding the grant.

(ii) *Draft Taxation Determination (TD 2003/D16) at Attachment B.*

This determination deals with donors to a Public Fund directing their donations to a particular deductible gift recipient (DGR) under certain conditions. The Determination puts beyond doubt that for gifts to be tax deductible, the trustee of a public fund (to which donations are made) cannot be under any obligation to apply the moneys donated in accordance with the donors' wishes, and that the trustee does not make a promise or give an assurance that it will comply with the donors' requests.

Where a trust deed merely allows a donor to express a preference for the gift to be applied to particular eligible charities, or to provide regular reports to the donor advising how the amounts of gifts have been used, the necessary elements of a public fund are preserved and donations in those instances are tax deductible.

### 3. **Pages E27-E28 – Issues relating to the Australian Sports Foundation (ASF)**

Concern was raised by Senator Stephens that the ASF website specifically invites donors to 'nominate a project as a preferred beneficiary'. The Committee sought advice on whether donations made in such instances would still meet the conditions of a gift; and what audit processes have been used by the ATO to ensure that these conditions are adhered to by the ASF and other organisations.

A Press Release issued by the Commissioner of Taxation on 3 September 1996 (Attachment C), which addresses the issue of when a gift is or is not tax deductible in the context of donations made to the Australian Sports Foundation, states explicitly that:

*"Donors to the Foundation can indicate a preferred beneficiary on the understanding that the Foundation will take this preference into consideration when distributing funds. In these cases, donations will be tax deductible."*

However,

*"Where the donor insists, or the Foundation guarantees that a donation will necessarily be applied to a particular beneficiary, then the donation will not be tax deductible."*

This makes clear that while donations to the ASF cannot be made with strings attached, donations can indicate a 'preferred beneficiary' but without any formal commitment from ASF. This is also consistent with the interpretation of the law in TD 2003/D16.

Further, the ASF guidelines specifically allow for 'preferred beneficiary' arrangements for projects to be approved by the ASF. Information to prospective donors available on the ASF web site explicitly states that, "Donations must be made unconditionally".

Based on the information from the ASF website, a 'project' is established by ASF and donations may also be solicited by the 'project' volunteers and receipts issued in the name of "ASF for the project".

The ATO monitors the activities of ASF, but there has not been action regarding the way the ASF has been operating over the past several years.

The ATO's Compliance Plan for 2003-04 sets out on pages 30 and 31 its approach and compliance focus. To further expand upon the Compliance Plan, the ATO advises that the audit program for non-profit organisations (including DGRs) is driven by intelligence gathered from a number of sources including Austrac information, media reports, community information, and other assessment of risks. If a sham arrangement is suspected, and the ATO advises there have been several over the past couple of years, direct audit action is undertaken and, where necessary, the entity's endorsement concessions including DGR status may be revoked. In some instances and where appropriate, further legal action may also be taken.

**4. Page E28 – Senator Murray asked if the way an entity is structured would have any ramifications with respect to the PBI and DGR classification**

There is no particular structure prescribed for a public benevolent institution but it must be capable of being separately identified. An organisation that merely manages property and makes distributions to other organisations is not an institution within the meaning of a public benevolent institution. (refer paragraph 20 of TR 2003/5 – *Income tax and fringe benefits tax: public benevolent institutions*)

For some categories of DGR appearing in Division 30 of the *Income Tax Assessment Act 1997*, the structure of a particular DGR is stated. For example, a public or prescribed private fund must be established under a will or an instrument of trust. Alternatively, an organisation engaged in research into the causes, prevention or cure of disease in human beings, animals or plants under item 1.1.4 must be a 'public authority' whereas an 'approved research institute' under item 3.1.1 must be a university, college, institute, association or organisation.

Many categories require the entity to have a fund, for example cultural and environmental organisations under items 12.1.1 and 6.1.1 respectively.

**5. Page E28 – Senator Murray requested information as to the availability of publicly available information for people wishing to know how to set up DGRs and PBIs.**

The ATO's web site contains a number of publications relating to DGRs and their establishment, which include:


- The *GiftPack* for deductible gift recipients & donors (NAT 3132-5.2003)
- Various Public Rulings/determinations including:
  - TR 95/27 public funds
  - TR 2003/5 public benevolent institutions
  - Tr 2000/11 endorsement of income tax exempt charities

- TR 95/2 overseas aid gift deduction scheme
- TR 92/2 scientific research (approved research institutes)
- TR 2000/12 the gift fund requirement
- TR 2000/10 public libraries, museums and art galleries
- TR 96/8 school and college building funds
- TR 2000/9 necessitous circumstances funds
- TR 96/1 deductions for gifts made under the taxation incentives for the arts scheme
- Fact sheet: The endorsement process for DGRs (NAT 3193)
- Fact sheet: Application for endorsement as a DGR - Instructions (NAT 2949)
- Fact sheet: Application for endorsement as a DGR - sample application form (NAT 2948)
- Fact Sheet: Cultural gifts program and tax deductible gifts (NAT 8236)
- Fact sheet: Register of cultural organisations and tax deductible gifts (NAT 8235)
- Fact sheet: Environment and heritage organisations and tax deductible gifts (NAT 8237)
- Fund raising dinners and similar events (NAT 5045)

While no manual per se exists, the material contained in the *GiftPack* and on the ATO web site provides information that would assist non-profit organisations interested in attaining tax concessions to establish entities that would meet the requirements of a PBI or DGR. The references explain the requirements in terms of the organisation's constituent documents and rules. These requirements are discussed at length in *GiftPack* and the Tax Ruling on PBIs (TR 2003/5) and similarly, for other categories of DGRs such as public libraries, art galleries, museums (TR 2000/10). Specific public rulings are also available to give guidance on the issue for the majority of the general categories.

Please don't hesitate to contact me on (02) 6263 3215, if there are any issues that require further information.

Yours sincerely

  
Christine Barron  
Manager  
Individuals Tax Unit  
Individuals and Entities Tax Division

**GSTR 2000/11: issued 12 May 2000****Extract from the Goods and Services Tax Ruling - Grants of financial assistance***Meaning of gift*

57. The term 'gift' is not defined in the GST Act, and thus takes on its ordinary meaning. The ATO considers that for the purposes of the GST guidance is provided in income tax cases relating to gifts. The income tax similarly gives special treatment to gifts to some charitable and non-profit type bodies.

58. *FC of T v. McPhail* (1968) 117 CLR 111 is the leading income tax case on the test of what a gift is. There are two limbs to the *McPhail* test. If either of the two limbs is not established the grant will not be a gift. Whether or not this is the case will depend on the particular circumstances and the individual facts surrounding the grant.

59. The first limb of the test is that the grant is transferred voluntarily by the grantor to the grantee. To be a gift, a grant would not be the result of a prior contractual obligation to transfer the grant.

60. The second limb of the test is that the grantor may not receive an advantage of a material character by way of return in making the grant. It does not matter if the advantage returned is of less than equal value to the grant<sup>F45</sup>. An advantage of a material character would not include mere recognition for making the grant.

61. A further characteristic of a gift is that it essentially arises from benefaction, and the gift proceeds from the detached and disinterested generosity of the grantor<sup>F46</sup>. A grant that is made as a function of government, and does not have the characteristics of benefaction and detached, disinterested generosity, is not a gift.

62. A grant may have conditions attached to it that flow from the grantor's right to regulate the disposal of the grant and still be a gift<sup>F47</sup>. Such conditions reflect the terms on which the donor intends to make the grant and the grantee's understanding of the terms on which the grant will be made<sup>F48</sup>. Such conditions create equitable rights that are enforceable by equitable remedies. Nevertheless, the grant may still be a gift where the equitable rights arise as part of the grant transaction and do not directly or indirectly provide a material benefit to the grantor or an associate.

*Example 1-material benefit to the giver*

63. Arthur is the owner of a yacht, the 'Southern Cross', who wants to enter it into the 'Australia Cup', a prestigious yachting race. Arthur makes a donation of \$100,000 to the Australian Sports Foundation (ASF), a non-profit organisation. In making his donation, Arthur expresses a preference that the \$100,000 be forwarded to the Australian Yachting Club (AYC). The AYC is a body that organises the management, sponsorship and entry into the 'Australia Cup' of all competitors. Prior to making the donation, Arthur had entered into an agreement with AYC which places a positive contractual obligation on Arthur to indemnify AYC against Arthur's costs in entering the race. The agreement provides a choice to Arthur of either making a direct payment to AYC or of making a tax deductible donation to the ASF with a preference that it be passed on to AYC.

64. The donation of \$100,000 is not a gift. This is because there is a direct link between the payment of the \$100,000 and Arthur's contractual liability to AYC. Arthur has a positive obligation to pay AYC to fund his yachting expenses one way or the other. The material advantage received by

Arthur in making the donation is the relief from his liability under the indemnity to AYC. Consequently, neither limb in the *McPhail* test of what is a gift is satisfied<sup>F49</sup>.

*Example 2-material benefit to the giver*

65. A grant is made to a non-profit body for the purpose of the non-profit body conducting specific research and providing a report on the results of that research to the grantor, which the grantor intends to use in its business. The report may be expected to provide a material benefit to the grantor. In this situation the grant does not have the characteristics of a gift. Notwithstanding that the recipient of the grant is a non-profit body, a supply is made by the grantee in the provision of the report. The grant will be consideration for the supply of the report.

*Example 3-mere recognition of the gift*

66. Bruce Michael, a wealthy philanthropist, decides to make a gift of \$5,000,000 to the public hospital in his area for the purpose of building a new wing on the hospital to deal with people suffering from alcoholism. As part of the gift Bruce gives the money to the hospital with the stipulation that the money must be used for the purpose of constructing the new wing.

67. In order to recognise Bruce's generosity, the hospital will name the new wing in his honour. In further recognition, the hospital will also acknowledge the gift by placing a plaque in the foyer of the new building. These acts by the hospital would not affect the status of the donation as it still possesses the characteristics of a gift, i.e., the grant was made voluntarily and no material benefit accrued to the grantor. The fact that public recognition is obtained by Bruce or was a condition of the gift does not constitute a material benefit. Thus, as the public hospital is a non profit body, the donation will not be the provision of consideration in respect of the supply pursuant to paragraph 9-15(3)(b).

*Example 4-acquittal report that is not a material benefit*

68. Bruce donates money to a university to conduct cancer research and to disseminate the results in the usual way by publication in academic journals. An agreement is entered into between Bruce and the university under which the university will account for the expenditure of the gift on cancer research. If the university is a non-profit body then the gift will not be the provision of consideration, because the supply of information in accounting for the grant does not provide a material benefit to the grantor<sup>F50</sup>.




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## Draft Taxation Determination

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**Income tax: Where a trustee of a public fund under item 2 of the table in section 30-15 of the *Income Tax Assessment Act 1997* (ITAA 1997) has an obligation or otherwise gives an assurance to apply funds in accordance with requests from a donor, is a separate fund created and, if so, is the separate fund a public fund entitled to be endorsed as a deductible gift recipient?**

### *Preamble*

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the *Taxation Administration Act 1953*. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. In these circumstances, a separate fund is created which does not satisfy the requirements for a public fund to which tax deductible gifts may be made. The separate fund is not entitled to be endorsed as a deductible gift recipient.

### **Separate fund**

2. An obligation on the trustee to comply with requests from a donor may arise from the trust deed itself. This can occur where the trust deed contains clauses, the effect of which is that the trustee is required to hold and apply a gift and any resulting income:

- in accordance with requests from the donor;
- on the basis or conditions outlined by the donor; or
- subject to arrangements with the donor.

3. Alternatively, an obligation on the trustee may arise from a course of action taken by the trustee. An obligation may arise from undertakings or assurances given by the trustee. For example, assurances in promotional material or through other arrangements with the donor may state that the trustee will always comply with the donor's requests provided they come within the purpose of the fund. In some cases the donor's requests or recommendations are made through an advisory committee and the trustee gives a similar

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assurance or other undertaking that it will always follow the recommendations of the committee.

4. Some arrangements between the trustee and a donor are such that the trustee is not permitted to distribute the amount of the gift or resulting investment income without first obtaining and considering a recommendation from the donor or the donor's advisory committee, and the trustee is required to inform the donor if it intends to depart from the donor's recommendations. In effect, the trustee needs the consent or acknowledgement of the donor before it can implement decisions on the application of the gift and resulting income. This feature is consistent with an obligation or assurance from the trustee to comply with the donor's ongoing requests.

5. Where the trustee of a public fund accepts a gift subject to such obligations or assurances, we consider that there is a relevant legal distinction between that gift and other gifts made to the fund without those features. There is a legally binding relationship, with ongoing, variable rights and obligations, between the trustee and the donor that does not apply to persons who make contributions without those features. In these cases, a separate fund or sub-fund is created.

**Separate fund is not a public fund**

6. Public funds under item 2 of the table in section 30-15 of ITAA 1997 are required to be established and maintained under a will or instrument of trust solely for the establishment of, or the purpose of providing money, property or benefits to, other funds, authorities or institutions which are deductible gift recipients that are included by name, or under one of the categories of recipient, in the tables in Subdivision 30-B of ITAA 1997. These other funds, authorities or institutions are referred to as 'eligible charities' in this Determination.

7. The term, 'public fund' is not defined in the Act but is accepted to be a fund in relation to which:

- (a) the promoters or founders of the fund intend that the public will contribute to the fund;
- (b) the public, or a significant part of it, does in fact contribute to the fund; and
- (c) the public participates in the administration of the fund.<sup>1</sup>

8. A public fund under item 2 of the table in section 30-15 of the ITAA 1997 operates by pooling gifts from the public and then the fund's trustee decides how the gifts, and any income derived therefrom, are to be allocated to eligible charities. In many cases the amount of the gift is retained in the fund and invested, and periodic distributions are made only from the investment income.

9. If the trustee has an obligation or gives an assurance to a donor to hold and apply the gift or resulting income for purposes other than for eligible charities, the trustee fails to maintain the fund solely for the benefit of eligible charities. Accordingly, the fund is not a public fund entitled to be endorsed as a deductible gift recipient.

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<sup>1</sup> See Taxation Ruling TR 95/27 Income Tax: Public Funds.



10. Where the trustee's obligation or assurance is to comply with the donor's requests for particular eligible charities to benefit from the gift and any resulting income, the only contributors to the separate fund or sub-fund are the initial donor and in some cases, associates of the donor. The public is not invited to contribute to the sub-fund and does not contribute.

11. Accordingly, the sub-fund lacks the necessary elements for a public fund that are outlined in paragraph 7.<sup>2</sup> The sub-fund is not a public fund entitled to be endorsed as a deductible gift recipient.

### **Not a separate fund**

12. In contrast, a separate fund or sub-fund is not created where the trust deed merely allows:

- a donor to express a preference for the gift and/or investment income to be applied to particular eligible charities;
- the trustee to maintain a named management account to record the gift from the donor, the investment income and grants made. The bank account and investments are not separate from those for the public fund; and/or
- the trustee to provide regular reports to the donor advising how the amounts of the gift and investment income have been used.

13. To ensure that a separate fund is not created, it must be clear in the trust deed (and in other material in relation to gifts, such as promotional material and donor forms and receipts) that the trustee is not under an obligation to apply moneys in accordance with donors' wishes, and that the trustee does not make a promise or give an assurance that it will comply with donors' requests. This must be the genuine arrangement between the trustee and the donor and it is not acceptable for contrary 'understandings' to be entered into, even if orally.

## **Examples**

### *Example 1 - Separate fund*

14. The trust deed of X Community Foundation includes a clause that a donor, in making a gift, may request that particular eligible charities are to benefit from the gift and that the Trustee will advise the donor if it will accept and hold the gift in accordance with that request.

15. In this case, where the trustee has advised the donor that it will hold the gift in accordance with the request, the Trustee is under an obligation to comply with the donor's request. As such, a separate fund is created, distinct from the X Community Foundation's

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<sup>2</sup> Where the requirement for public contributions cannot be met, a donor who wishes to establish their own fund to benefit eligible charities can consider applying for approval for a prescribed private fund. For more information about prescribed private funds, see *Guidelines for Prescribed Private Funds* (available on the ATO website at [www.ato.gov.au](http://www.ato.gov.au))

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public fund. The separate fund does not meet the public fund requirements and is not entitled to be endorsed as a deductible gift recipient. The donor is not entitled to a deduction for a gift to this separate fund.

***Example 2 - Not a separate fund***

16. The trust deed of Z Community Foundation includes a clause indicating that the Trustee may accept a gift from a donor who expresses an initial preference for particular eligible charities to benefit from their gift. The trust deed states that the Trustee may take the donor's request into account when making decisions, but the Trustee is not to give any assurance that it will comply with the donor's request. When making a gift, donors use a donor form to express their initial preference and to acknowledge that they understand that the trustee is under no obligation and gives no assurance that their request will be complied with. Receipts contain similar information.

17. The trustee maintains a named management account to record the gift from the donor and the resulting investment income and distributions. However, the trustee maintains one bank account for all gifts from the public, including those where the donor expresses an initial preference. All gifts are pooled for investment purposes.

18. In this case, the management account is not considered to be a separate fund and its existence does not prevent Z Community Foundation from being a public fund entitled to be endorsed as a deductible gift recipient.

**Date of Effect**

19. When the final Determination is issued, it is proposed to apply to both before and after its date of issue. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

**Your comments**

20. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

**Comments by Date:** 5 November 2003  
**Contact Officer:** Julie Martin  
**E-mail address:** [julie.martin@ato.gov.au](mailto:julie.martin@ato.gov.au)  
**Telephone:** (03) 9215 3722 **Facsimile:** (03) 9215 3700

**Address:**                                **Julie Martin**  
    **Non-Profit Centre**  
    **Australian Taxation Office**  
    **P O Box 9990**  
    **DANDENONG VICTORIA 3175**

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**Commissioner of Taxation**

15 October 2003

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*Previous draft:*

Not previously issued in draft form.

*Related Rulings/Determinations:*

TR 95/27; TR 92/20

*Subject references:*

- ancillary funds
- charitable trusts
- deductible gift recipients
- gifts & donations
- public funds
- sub-funds
- trusts

*Legislative references:*

- ITAA 1997 30-15
- ITAA 1997 Subdiv 30-B
- ITAA 1997 30-125
- TAA 1953 Pt IVAAA

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ATO References

NO:                    2003/13249  
ISSN:                1038-8982

*Attachment C*



Nat 95/44

***Income tax deductibility for preferred donations and the Australian Sports Foundation***

Donations to a football club or any other third party are not made tax deductible simply by channelling them through the Australian Sports Foundation (ASF), according to the Taxation Commissioner, Mr Michael Carmody, today.

"Recent media reports have incorrectly suggested that people who wish to make gifts, for example, to a football club, may channel them through the Australian Sports Foundation and so make them tax deductible," Mr Carmody said.

"Donors to the Foundation can indicate a preferred beneficiary on the understanding that the Foundation will take this preference into consideration when distributing funds. In these cases, donations will be tax deductible.

"Where the donor insists, or the Foundation guarantees, that a donation will necessarily be applied to a particular beneficiary, then the donation will not be tax deductible," Mr Carmody added.

The ATO has worked closely with the ASF in clarifying the circumstances where donations to the ASF are tax deductible.

The Foundation, which was established in February 1986 to assist the development of Australian sport, is listed under section 78 of the Income Tax Assessment Act 1936.

CANBERRA  
3 September 1996

Media Contact: Corporate Communications Branch  
Phone: (06) 216 1901 (bh)  
(06) 285 6116 (pager)