missions interlink
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Manager
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The Treasury
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By Email: NFPReform@treasury.gov.au

RE: EXPOSURE DRAFT: 'IN AUSTRALIA' SPECIAL CONDITIONS FOR TAX CONCESSION ENTITIES

Dear Sir/Madam

The Australian Evangelical Alliance Inc (Missions Interlink) (AEA MI) welcomes the opportunity to put forward its views on Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) 2011: tax exempt body "in Australia" requirements.

About AEA MI

AEA MI is a network of Australian Christian organisations with a role in cross-cultural and global mission. AEA MI and its Member organisations are entities that are registered and controlled in Australia. However, many of these Member organisations operate principally outside Australia. In addition, these organisations support numerous individuals who are serving in Christian ministry and welfare outside Australia.

Organisations first apply to become Associates of AEA MI. Once accepted, organisations can then seek to become accredited as Members. AEA MI currently has approximately 130 fully accredited Member organisations. To become and remain a Member, organisations must meet stringent governance and audit requirements.

Although involved in mission to some degree, Member organisations undertake substantial overseas humanitarian work, such as medical assistance, literacy programs, vocational training and community support. For various reasons, these organisations are not public benevolent institutions and are unable to establish a developing country relief fund. Accordingly they do not have deductible gift recipient (DGR) status. Nevertheless they operate many overseas assistance projects, usually with low administration costs. Individuals and entities give to these institutions knowing and wanting their donations to be used offshore.

Member organisations receive most of their revenue from donations made by individuals and churches within Australia. It is important to note much of these donations are sourced from individuals from their after tax dollars. They are not seeking a tax deduction for their donations.

Summary of Concerns

We raise the following concerns regarding the Exposure Draft: Restating the "In Australia" special conditions for tax concession entities:

1. The exemption currently provided in section 50-50(d) for Australian resident prescribed institutions has been removed. There is no explanation provided for why this removal has occurred. In fact, it seems contrary to comments made in the Explanatory Material.

2. The requirement that entities cannot give any amounts to entities that are not tax exempt has significant consequences for many not-for-profit entities, including a substantial reduction in revenue and a loss of control over the application of funds overseas. Ultimately there will also be a loss of employment for people in this sector and a reduction in life changing programs being provided to needy communities overseas.

3. A specific test based on expenditure has been replaced with a far less measurable test of operations and reduces certainty to organisations. The removal of the ability to use gifts and donations outside Australia has serious ramifications for many organisations.

Further, we contend that the reforms be delayed as they should be considered in the context of the broader charities reform agenda currently being undertaken by the Government. The Government should approach all elements of the reforms to the regulation of charities and not-for-profit entities as part of a cohesive package of reforms, rather than as a number of separate consultations, exposure drafts and bills. These reforms should follow the announced establishment of the ACNC, the independent regulator that will then be best placed to engage in effective consultation with the sector and amass the quantifiable data needed to determine the appropriate reforms.

Issue One: Removal of Income Tax Exemption Pursuant to Section 50-50(d)

Existing Income Tax Exemption

Section 50-50 of the Income Tax Assessment Act 1997 (the Act) states that a charitable or religious institution is not exempt from income tax unless the entity meets at least one of four conditions. Specifically the section is as follows:

> *An entity covered by item 1.1 or 1.2 is not exempt from income tax unless the entity:*
>
> *(a) has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia; or*
>
> *(b) is an institution that meets the description and requirements in item 1 of the table in section 30-15; or*
>
> *(c) is a prescribed institution which is located outside Australia and is exempt from income tax in the country in which it is resident; or*
>
> *(d) is a prescribed institution that has a physical presence in Australia but which incurs its expenditure and pursues its objectives principally outside Australia.*

Therefore an institution that operates principally outside Australia and is not eligible to be a DGR must meet condition (d) in order to be income tax exempt.

Regulation 50.50.02 lists prescribed institutions pursuing objectives principally outside Australia for the purposes of paragraph 50-50(d) of the Act. AEA MI has been listed as a prescribed institution under this regulation since 1 July 1997. As such AEA MI is currently exempt from income tax. Also prescribed by this regulation is any member of an institution listed as a prescribed institution. Accordingly, AEA MI's fully accredited Members that incur their expenditure and pursue their objectives principally outside Australia are also exempt from income tax under section 50-50(d).

Removal of Income Tax Exemption under Draft Legislation

Under the proposed rewrite of the tax exemption provisions, 50-50(a) has effectively been rewritten in the new section 50-50(2). Section 50-51(3)(a) provides an exemption from the in Australia requirements for entities that are DGRs. This section equates to the previous section 50-50(b). Section 50-51(3)(b) provides an exemption from the in Australia requirements for foreign residents that are prescribed institutions and equates to the existing section 50-50(c).

However, the draft legislation has completely removed the income tax exemption for entities that are currently income tax exempt pursuant to section 50-50(d). There is no provision in the draft legislation for Australian resident prescribed institutions that operate principally outside Australia.

Accordingly entities currently exempt under section 50-50(d) will no longer be income tax exempt. In addition, there will be the loss of the FBT rebate and GST concessions. It should be noted that few, if any, of our Member organisations derive substantial profits or income from investments and therefore the taxation revenue raised from the removal of the income tax exemption would be minimal. However, there will be a substantial cost to our Members in understanding and complying with complex taxation law and meeting their tax lodgement requirements.

Retention of Income Tax Exemption

AEA MI contends that the draft legislation should be amended to include the same income tax exemption currently available pursuant to section 50-50(d) of the Act.

The Government has stated that it wants to reinstate the clear policy intent of the in Australia special conditions for tax concession entities. At paragraph 1.13 of the Explanatory Material to the draft legislation, it states the intent of the original law was only to allow a charity to be able to pass funds to an overseas charity that was endorsed as a DGR or an entity specifically prescribed in the regulations.

By removing the exemption currently available pursuant to section 50-50(d) of the Act, the Government has actually overridden the original intent of the law that prescribed institutions are to be exempt from tax.

The fact that prescribed institutions operating outside Australia are an important category within Government policy is further confirmed by the amendments that were made to section 23AG of the Income Tax Assessment Act 1936 in 2009. Specific allowance was made for the foreign earnings of employees of prescribed institutions exempt under section 50-50(d) of the Act to remain income tax exempt if the other requirements of the section are met. The inclusion of the new section 353-30 of the Taxation Administration Act 1953 overcomes any concerns that may have existed about the regulation of such prescribed institutions.

Discussions and correspondence with Treasury have indicated that Treasury believes that all prescribed institutions are income tax exempt under the draft legislation but this is clearly not the case.

Accordingly we recommend that the draft legislation be amended to reinstate the income tax exemption for Australian resident prescribed institutions.

Suggested Changes to the Draft Legislation

We propose that a new subsection 50-51(3)(c) be added to the draft legislation as follows:

(c) an entity that:

(i) is an Australian resident; and

(ii) is prescribed in the regulations for the purpose of this subsection; and

(iii) satisfies the conditions (if any) prescribed in the regulations for the purpose of this subsection.

The word "or" should be added at the end of 50-51(3)(b)(iii). The transitional provisions in section 114(2) should also be amended to include reference to new subparagraph 50-51(3)(c)(ii).

Further the Explanatory Material should be amended to reflect this new subsection including the table at 1.43.

New Law	Current Law
The new law continues the exemptions for all prescribed institutions listed in the current regulations.	Institutions that are prescribed institutions listed in regulations 50-50.01 and 50-50.02 are exempt from income tax.

Issue Two: Donation of Funds Only to Tax Exempt Entities

The draft legislation at 50-50(2)(c) introduces the requirement that in order to retain income tax exemption, not-for-profit entities which operate and pursue their purposes principally in Australia must not donate money to any entity that is not tax exempt. The existing legislation has no such limitations.

Impact on Australian Resident Prescribed Institutions

Currently many of our Members receive donations from churches and other community organisations. Should the tax exemption for Australian resident prescribed institutions not be reinstated, many of our Members will not only have to pay income tax on their taxable income but they will also lose a significant component of their funding. Churches and other organisations will be prevented from giving to any of our Members that are not tax exempt as to do so would result in the loss of their own income tax exemption. We reiterate the need for the income tax exemption for Australian resident prescribed institutions to be reinstated to fulfil the original policy intent of the law.

Impact on Entities Operating and Pursing their Purposes Principally in Australia

Some Members and Associates of AEA MI are currently exempt from income tax as they incur their expenditure and pursue their purposes principally in Australia. The proposed changes to the legislation will mean that many organisations will be severely restricted in their operations.

The proposed section 50-50(2)(c) prohibits an income tax exempt entity from making donations to an entity that is not income tax exempt.

Section 960-100 of the Act defines 'entity' to include an individual. The new section 50-50(c) would appear to prevent not-for-profit entities from even donating funds to individuals. Assisting individuals in need is one of the primary functions of the not-for-profit sector. Presumably this is an unintended consequence and section 50-50(2) should be amended to clarify its meaning.

Not-for-profit entities will also on occasions make donations to organisations both in Australia and overseas. These donations are often small and incidental to the not-for-profit entity's principal purpose. AEA MI believes that any such donation should not immediately result in the loss of an entity's tax-exempt status.

The proposed changes might also result in a greater risk of unwittingly financing illegal operations. Many individuals currently make their donations directly to our Members or to church and community organisations knowing those funds will be directed to offshore organisations. This ensures there is some level of control over the distribution of those funds as the Australian organisations generally undertake a high degree of due diligence over the process. There is regular reporting to donors who tend to have a high level of knowledge and connection with the projects. If Australian organisations lose their income tax exemption, it is possible that many individuals will simply choose to give directly offshore. Accordingly there will be little, if any, control over the application of those funds increasing the risk of funds being used for unintended purposes.

Once for all Time Test

Under the draft legislation, an entity that (intentionally or inadvertently) gives even one dollar to an individual or an entity that is not income tax exempt results in the loss of the first entity's income tax exemption for all time. This sanction is unworkable and should be amended to

- exclude small or inadvertent breaches of the subsection
- allow an entity to rectify a breach and
- allow an entity to reapply for exemption at some point following a loss of exemption.

At the very least, donations to individuals should be permitted where such donations are in furtherance of the purposes of the organisation and a de minimis threshold should be included in the legislation. Further, entities should be entitled to rely on the Australian Business Register or the public information portal to be established by the ACNC to determine whether another entity is income tax exempt.

Issue Three: Operate Principally in Australia

Section 50-50(a) of the Act currently provides an exemption for endorsed charitable and religious institutions that have a physical presence in Australia and, to that extent, incur their expenditure and pursue their objectives principally in Australia. In addition, section 50-75 states that in determining whether an entity incurs its expenditure in Australia and pursues its objectives principally in Australia, distributions of any amount received as a gift (whether of money or other property) or by way of government grant are to be disregarded.

The draft legislation replaces the expenditure test with an "operating in Australia" test. Section 50-75 of the Act is to be repealed.

Principally in Australia Test

Some of our Member organisations operate both in Australia and overseas. Although not without its difficulties, the expenditure test is at least measurable and easily applied. The new operating in Australia test creates significant uncertainty and confusion for organisations, both at the time of applying for endorsement for income tax exemption and in self-assessing their compliance with the conditions for their endorsement on a continuing basis.

The fact that most of the examples provided in the Explanatory Material reach a conclusion on application of the test using the words "on balance" highlights how difficult this test will be to apply in practice. Further, the examples provided in the Explanatory Material do not provide consistent information and do not appear to have been consistently applied. Particularly in this regard, we note Examples 1.4 and 1.5 and the seeming inconsistency in application of these examples.

This test therefore creates a huge compliance burden for organisations in seeking to comply with their requirements for exemption.

If the exemption currently available in section 50-50(d) of the Act is reinstated in the new legislation, much of the concern for our Members will be addressed. Generally they will either be tax exempt pursuant to the new section 50-50 or be income tax exempt as a prescribed institution. However, organisations that are not prescribed institutions will face considerable difficulty in determining their income tax status under the proposed new test.

Disregarded Amounts

The current legislation provides that amounts received from gifts or government grants are to be disregarded in determining whether an entity incurs its expenditure and pursues its objectives principally in Australia. The Exposure Draft proposes to repeal this section.

The Explanatory Material provides no discussion on why section 50-75 has been removed from the draft legislation although we understand it is because it is no longer thought to be necessary due to the removal of an expenditure based test. This reasoning argues that, as the test is now a holistic consideration of all the relevant factors of where the organisation principally operates and pursues its objectives, tracing of the income and expenditure of the entity is no longer necessary. This reasoning however ignores the impact of the proposed section 50-50(2)(c) which, despite the holistic enquiry, will result in loss of income tax exemption to an entity making a single payment to an entity that is not income tax exempt.

Not-for-profit entities should still be able to distribute offshore those amounts received by way of gifts in accordance with the terms of the gift and for the purposes for which the entity is established. Government grants are generally well regulated and it is unlikely that distributions overseas would result in a risk of income tax exempt entities being used for terrorist financing and money laundering. It is noted again that many of the donations received by our Members from individuals are made out of after tax dollars. Donors are not making donations to DGRs and are not seeking a tax deduction for those funds. There is no suggestion of money laundering occurring. Accordingly we contend that a provision equivalent to the existing section 50-75 should be included in the new legislation.

Should you wish to discuss any of the above further, please do not hesitate to contact us.

Yours sincerely

Pam Thyer
National Director