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Manager
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Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By Email: NFPReform@treasury.gov.au

Dear Sir/Madam

Exposure Draft – "In Australia" Special Conditions for Tax Concession Entities

Saward Dawson 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 and the accompanying Explanatory Material (EM).

We are a chartered accounting firm with numerous clients involved in the not-for-profit sector. The draft legislation as currently drafted will have an adverse impact on many of these clients and we outline our concerns below.

Requirement to donate money only to tax exempt entities

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. This requirement will have far reaching implications for many of our clients.

The EM seems to imply that this requirement will be limited to entities that pursue their purposes through donations of monies to other entities. However there is no such restriction actually written into the legislation. There is also no definition of donation in the legislation. Therefore it is unclear when amounts will be considered to be donations and when the amounts will be considered to be payments in the normal course of operations.

Section 960-100 of the Income Tax Assessment Act defines "entity" to include individuals. Therefore section 50-50(2)(c) has the potential to prevent a not-for-profit entity from even making donations to individuals in need. Presumably this is an unintended consequence and section 50-50(2)(c) should be amended to clarify its meaning.

The inability to direct funds to individuals and to entities that are not tax exempt will severely limit the activities of many of our not-for-profit clients. Many of our clients direct amounts to offshore entities as part of fulfilling their charitable purposes. Often these amounts are small and incidental. For example, a school in Australia may have a relationship with a school in a poorer

country. Funds raised by the school and the school community in Australia are donated to the overseas school to assist with providing resources to students. Under the proposed legislation, it would appear that such donations are no longer possible if the Australian entity is to retain its tax exempt status.

We recommend that section 50-50(2)(c) be redrafted to clarify its intention and to limit its application. We also recommend that a definition of donation be included. Small and inadvertent breaches of this subsection should not automatically result in the loss of an entity's income tax exemption.

Governing Rules

Subsection 50-50(3) as currently drafted requires an entity to comply with all the requirements in its governing rules and to use its income and assets solely to pursue the purposes for which it was established. This section is too broad in its application and has the potential to catch minor non-compliance with the entity's governing rules, including instances where the contravention is an administrative issue only, such as form of notice of meetings.

In addition, the term "governing rules" is not defined. No doubt it includes the organisation's constitution but whether it extends beyond this is unclear.

Accordingly we recommend that subsection 50-50(3) be redrafted to clarify the meaning of governing rules and to limits its scope to material contraventions of the organisation's objects and distribution clauses.

Australian resident prescribed institutions

In drafting the new section 50-51 the income tax exemption currently available for Australian resident prescribed institutions has been omitted. Under the current legislation, section 50-50(d) exempts an entity from income tax if it is a prescribed institution and has a physical presence in Australia but incurs its expenditure and pursues its objectives principally outside Australia. This exemption has not been replicated in the draft legislation.

Our firm acts for a number of clients who are currently income tax exempt pursuant to section 50-50(d). The removal of this exemption would severely restrict their ability to fulfil their charitable purposes and threaten their very existence.

The EM states that the intent of the original law was to allow a charity to pass funds to an entity specifically prescribed in the legislation. We call for this section to be reinstated in the new section 50-51.

Disregarded Amounts

Section 50-75 of the Act currently allows amounts received from gifts or government grants to be disregarded in determining whether an entity incurs its expenditure and pursues its objectives principally in Australia. This section.is to be repealed on the basis that the expenditure test is to be replaced with an operating test.

However, as a result of the new section 50-50(2)(c), not-for-profit entities will no longer be able to remit any donations or government grants overseas. We contend that such entities should still be able to distribute offshore those amounts received by way government grants. The use of government rants is usually well monitored and it is highly unlikely that distributions of grants overseas would result in funds being used for inappropriate purposes. Further, in our view, gifts

received from donors, where the donor has not received a tax deduction for the donation, should also be capable of being used offshore withouth any impact on the entitiy's tax exempt status.

DGR Solely Test

Under the proposed subsection 30-18(1), a DGR must operate solely in Australia and pursue its purposes solely in Australia at all times. Entities covered by section 30-80 of the Act are excluded from these requirements. In addition, a DGR will not fail the "solely in Australia" test if its overseas activities are merely incidental to the Australian activities or are minor in extent and importance when considered with reference to the Australian activities (subsection 30-18(2)).

Many of today's DGRs have connections with overseas charities and organisations. Charitable purposes such as the improving the environment are global issues and it is inappropriate for Australia to seek to restrict such DGRs to operating solely in Australia and pursuing their purposes solely in Australia.

In our view, the solely test for DGRs should be amended to limit its application and the categories of entities that are exempted from the "solely in Australia' requirements should also be significantly widened. In addition, greater clarity should be provided on the meaning of "merely incidental to the Australian activities" and "minor in extent and importance".

If you require further details on any of the above, please do not hesitate to contact us.

Yours sincerely

Bruce Saward

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