Anglican Church Diocese of Sydney
Level 2, St Andrew's House
SYDNEY SQUARE NSW 2000
Phone: 9265 1671
Fax: 9265 1621
Email: rjw@sydney.anglican.asn.au

Submission to Treasury regarding the Exposure Draft inserts for the *Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) 2011:* tax exempt body "in Australia" requirements

By the Standing Committee of the Synod of the Anglican Church Diocese of Sydney

Table of contents

1 Summary of submission

(a) We appreciate the opportunity to comment on the Exposure Draft for the *Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) 2011*: tax exempt body "in Australia" requirements (**Exposure Draft**) and its accompanying explanatory memorandum.

(b) While we broadly support the policy considerations of the Government in the Exposure Draft, we are concerned that the means proposed for achieving these policy outcomes are not appropriate and will result in bona fide Australian organisations losing their entitlement to endorsement as tax exempt or deductible gift recipient entities.[1]

[1] Discussed further at part 2.2

(c) We understand that the ultimate aim of the Government in carrying out the proposed reforms to the charities and not-for-profit sector is to improve accountability and reduce red tape. In light of this, we submit that the Government should approach all elements of the proposed reforms as part of a cohesive package, rather than as a number of separate consultations, exposure drafts and bills.[2]

(d) In relation to the specific amendments proposed by the Exposure Draft:

(i) We are deeply concerned that, as presently drafted, the Exposure Draft will result in institutions which are currently prescribed under 50-50(d) of the Income Tax Assessment Act 1997 (Cth) (**ITAA 97**) losing their income tax exempt status. The proposed section 50-51(3) should be amended to ensure that institutions which have a physical presence in Australia but incur their expenditure and pursue their objects principally overseas can continue to be prescribed as exempt from the "in Australia" requirements as reformulated under the proposed section 50-50(2).[3]

(ii) There are a number of problems with the restrictions on making donations under proposed subsections 30-18(3) and 50-50(2)(c). An obvious problem is that these restrictions would prevent charities from making cash payments to individuals in need. These problems warrant the proposed restrictions being withdrawn at this time and reconsidered after the Australian Charities and Not-for-Profit Commission (**ACNC**) has been established and given the opportunity to form a view about the necessity of the restrictions and, if necessary, how they should be framed.[4]

(iii) The Exposure Draft creates a "once for all time" type test in a number of areas. The prospect of disendorsement should only arise after repeat breaches of a material nature.[5]

(iv) Distributions of gifts or government grants which, under section 50-75 of ITAA 97, are currently disregarded in determining whether an organisation is "in Australia" should continue to be disregarded despite the reformulation of the "in Australia" test, particularly in determining whether the organisation has donated moneys to an organisation that is not income tax exempt under proposed section 50-50(2)(c).[6]

---

2 Discussed further at part 2.3
3 Discussed further at part 2.4
4 Discussed further at part 2.5
5 Discussed further at parts 2.5 and 2.7
6 Discussed further at part 2.6

(v) The requirement that an organisation comply with all the requirements of its governing rules, without limitation to the objects, non-profit and dissolution clauses, is unworkable and may be unnecessary.[7]

(vi) The requirement that an organisation use its income and assets solely to pursue the purposes for which it was established is unnecessary in view of the existing requirement for a non-profit clause in an organisation's governing rules and the proposed requirement in section 50-50(3)(b) to comply with its governing rules. It is also unclear how this requirement will interact with the proposed removal of tax concessions in respect of retained profits from the unrelated commercial activities of not-for-profit entities.[8]

(vii) Greater clarity is required in relation to the holistic consideration of whether an organisation is "in Australia" and the relevant factors and relative weights to be provided to each factor. Only the Australian structure and operations of an organisation should be taken into account in determining whether the "in Australia" requirement is met.[9]

(viii) The proposed statutory definition of "not-for-profit entity" may preclude all charitable funds and some charitable institutions which engage in commercial activity from being income tax exempt entities. We recommend that the Common Law definition is retained or the proposed definition modified to include reference to *private* profit or gain.[10]

(e) We discuss these issues in more detail in part 2 below.

2 Submission

2.1 Who we are

(a) The name of our organisation is the Anglican Church Diocese of Sydney (**Diocese**).

(b) This submission is made by the Standing Committee of the Synod of the Diocese. The Standing Committee is the executive of the Synod. The Synod is in turn the principal governing body of the Diocese constituted under the *Anglican Church of Australia Constitutions Act 1902* (NSW)[11]. The Diocese is the oldest and largest of the 23 Anglican dioceses which together form the Anglican Church of Australia.

---

7 Discussed further at part 2.7

8 Discussed further at part 2.8

9 Discussed further at part 2.9

10 Discussed further at part 2.10

11 The Synod has 719 members, the majority of which are appointed or elected representatives from our 267 parishes.

(c) The Diocese is an unincorporated voluntary association comprising various bodies constituted or incorporated under the *Anglican Church of Australia Trust Property Act 1917* (NSW) and the *Anglican Church of Australia (Bodies Corporate) Act 1938* (NSW). These bodies, together with the diocesan network of 267 parishes, are accountable to the members of the Church through the Synod of the Diocese[12].

(d) The Diocese, through its various component bodies and through its congregational life is a provider of a wide range of programs including in social welfare, education, health and aged care, youth work, and for the homeless.

(e) In addition to the congregational life of the Diocese, the bodies which provide services to the community across the Diocese include large social welfare institutions such as Anglicare[13] and Anglican Retirement Villages[14], as well as other charitable institutions including Anglican Youthworks[15], and 40 Diocesan schools[16].

(f) The importance of the parishes and their networks of people within congregations to the provision of these services should not be underestimated. These are real communities of people within local communities. They are a natural social infrastructure which is an effective base for the provision of services which contribute to social inclusion.

(g) Our contact details are –

Mr Robert Wicks
Diocesan Secretary
Anglican Church Offices
PO Box Q190
QVB Post Office NSW 1230
Phone: (02) 9265 1671
Fax: (02) 9265 1621
Email: rjw@sydney.anglican.asn.au

2.2 Policy considerations

(a) We broadly support the policy considerations of Government in seeking to ensure that appropriate protections exist to prevent money-laundering of Australian funds or their use for terrorism. We further recognise the importance of ensuring that Australia does

---

[12] In the last ABS Census 837,917 people in the Sydney region identified as being Anglican. The regular combined membership of our 270 parishes is about 80,000 people.

[13] **Anglicare** relates to approximately 40,000 clients on an annual basis with counselling, children and youth services, emergency relief, family relationships and aged care.

[14] **Anglican Retirement Villages** operates 37 residential facilities (both Independent Living and Residential Care) and 40 community based services throughout the greater Sydney region, caring for more than 6,000 residents and clients and regularly relating to a further 12,000 people (families, staff, volunteers) in the course of its service delivery.

[15] **Anglican Youthworks** is the co-ordinator of work amongst children and young people and provides materials to 300,000 students, supports 4,000 volunteer and employed scripture teachers, and 8,000 youth leaders attending training events. 50,000 mostly young people and children attend outdoor programs and centres.

[16] Attended by approximately 33,000 students.

not relinquish its taxing rights in respect of income that may be taxed in overseas jurisdictions by providing income tax exemptions to foreign entities that are not exempt from income tax in their country of residence. We also support the aims of Government seeking to discourage "inappropriate conduct" within charities and tax exempt entities.

(b) However we are not convinced that the tax measures proposed in the Exposure Draft are an effective and targeted means of contributing to existing anti-money laundering and counter-terrorism regimes which have been put in place through agencies such as AUSTRAC and the Federal police.

(c) Further we consider that tax law is a blunt tool for discouraging "inappropriate conduct" within charities and other tax exempt entities. We believe that appropriate regulatory oversight by the ACNC would be a more effective means of achieving this outcome with less potential for unintended consequences.

(d) Fundamentally we are concerned that the measures proposed in the Exposure Draft will unjustifiably result in bona fide Australian organisations losing their entitlement to endorsement as tax exempt or deductible gift recipient entities.

(e) We note that despite the suggestion in the title of the Exposure Draft that these amendments are limited to determining whether an organisation is "in Australia", the Exposure Draft also includes requirements in respect of compliance with governing rules and the use of income and assets which will apply to all income tax exempt organisations in Australia, whether they engage in activities principally within or outside Australia. The policy considerations behind these broader requirements are quite different to those that apply to the "in Australia" requirements. Given the wide-ranging impact of these broader requirements and the fact that they may not be widely known or understood in the sector, we believe that they warrant a separate and more detailed consideration than is evident in the explanatory memorandum.

2.3 Broader reforms

(a) We recognise that the Exposure Draft is directly concerned only with the entitlement of organisations to endorsement as income tax exempt or deductible gift recipient entities. However we submit that reforms of this nature must be considered in the context of the broader reform agenda announced by the Government in the 2010 and 2011 Federal Budgets.

(b) We submit that in order to achieve targeted and appropriate reform to the charities and not-for-profit sector with the ultimate aim of improving accountability and reducing red tape, the Government should approach all elements of the reforms as part of a cohesive package, rather than as a number of separate consultations, exposure drafts and bills.

Further, the need for reforms of this nature should be confirmed from quantifiable data following the establishment of the ACNC.

(c) Structuring the proposed reforms in this way will make it easier for the Government to strengthen the sector and assist charities and not-for-profits to help those who need it for the ultimate benefit of the Australian community.

2.4 Prescribed Institutions

(a) We are deeply concerned that, as presently drafted, the Exposure Draft will result in institutions currently prescribed as income tax exempt entities under section 50-50(d) of the ITAA 97 losing their income tax exempt status.

(b) Proposed item 114(2) of the Exposure Draft, which purports to grandfather entities currently prescribed under section 50-50 of the ITAA 97, fails to effectively do so for all prescribed entities when read in conjunction with the proposed section 50-51(3)(b). Consequently, under the proposed draft entities currently prescribed under section 50-50(d) will cease to be entitled to endorsement as income tax exempt entities.

(c) Section 50-50 of the ITAA 97[17] currently provides that, in addition to the exemption from income tax for an institution that is:

(i) physically in Australia and to that extent incurs its expenditure and pursues it objectives principally in Australia[18];

(ii) endorsed as a deductible gift recipient[19]; and

(iii) a prescribed institution that is a foreign entity and is exempt from income tax in its country of residence[20];

a charitable or religious institution is exempt from income tax where it is prescribed in the regulations and has a physical presence in Australia but incurs its expenditure and pursues its objects principally outside Australia[21].

(d) Institutions of this nature are prescribed by regulation 50-50.02 of the ITAR, which provides that each of the listed institutions, and each institution that is a member of a listed institution, is a prescribed institution for the purposes of section 50-50(d) of the ITAA 97.

---

17 Originally enacted as section 23(e) of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 36**) as amended by the *Taxation Laws Amendment Act (No. 4) 1997* (Cth) and rewritten in section 50-50 of the ITAA 97

18 Section 23(e)(i) of the ITAA 36; rewritten as section 50-50(a) of the ITAA 97

19 Section 23(e)(ii) of the ITAA 36; rewritten as section 50-50(b) of the ITAA 97

20 That is, institutions prescribed under regulation 50-50.01 of the *Income Tax Assessment Regulations 1997* (Cth) (**ITAR**) - section 23(e)(iii) of the ITAA 36; rewritten as section 50-50(c) of the ITAA 97

21 Section 23(e)(iv) of the ITAA 36; rewritten as section 50-50(d) of the ITAA 97

(e) The proposed section 50-51(3)(b) provides that subsection (2) of the proposed section 50-50 (that is, the requirement for an entity to operate and pursue its purposes principally in Australia and not donate to any other non-tax exempt entity) does not apply to an entity that:

(i) is a foreign resident that is exempt from foreign income tax in its country of residence; **AND**

(ii) is prescribed in the regulations for the purposes of this subsection; **AND**

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

(f) The proposed transitional provision in the Exposure Draft (Item 114(2)) provides that regulations made for the purposes of section 50-50 and in force at the time of commencement of this item have effect from that commencement as if they had been made for the purposes of subparagraph 50-51(3)(b)(ii) of the ITAA 97.

(g) In applying these proposed sections, entities that are prescribed institutions by virtue of regulation 50-50.02 of the ITAR will not be exempt from the requirements to apply the proposed section 50-50(2) as, despite the transitional provisions, they do not meet the requirements of part (i) of the proposed subsection 50-51(3)(b), that is that the entity is a foreign resident exempt from income tax in its country of residence.

(h) It appears from the wording of the transitional provisions and explanatory memorandum that this is an unintended consequence of the draft provisions. Further, we understand from Treasury that it is intended that all entities currently prescribed in the regulations under section 50-50 of the ITAA 97 will be grandfathered and are therefore unaffected by the changes to the "in Australia" special conditions. Consequently, we submit that amendment should be made to the proposed subsection 50-51(3) to address this unintended consequence and include exemption from the requirements of the proposed section 50-50(2) for entities that are prescribed institutions that are not foreign residents but have a physical presence in Australia and incur their expenditure and pursue their objects principally outside Australia. New institutions should also be able to be prescribed in the ITAR for this purpose.

(i) It should be noted that many of the organisations that are prescribed institutions under regulation 50-50.02 are Christian missionary organisations which rely heavily on donation funding from churches in order to undertake their activities in furtherance of their charitable objects. Under the current law, such organisations may also be considered to be "in Australia" by virtue of the ability to disregard certain expenditure

under section 50-75[22]. Consequently if these entities are no longer prescribed institutions and section 50-75 is repealed as proposed in the Exposure Draft, churches will no longer be able to contribute to these organisations without risking their own tax exemption due to the operation of proposed section 50-50(2)(c).[23] This would give rise to a further limit on the ability of these organisations to raise funds for their charitable purposes.

(j) We submit that the establishment of the ACNC and the imposition of reporting requirements for income tax exempt entities will provide greater transparency in relation to the use of funds by all income tax exempt bodies, including those that are prescribed institutions under regulations 50-50.01 and 50-50.02 of the ITAR. Such transparency should sufficiently address any residual concerns about how institutions prescribed under regulations 50-50.01 and 50-50.02 use their funds.

Recommendation

(k) We submit that the proposed subsection 50-51(3) should be amended to include exemption from the requirements of the proposed section 50-50(2) for entities that are prescribed institutions that have a physical presence in Australia but incur their expenditure and pursue their objects principally outside Australia. Consequential amendments should also be made to the grandfathering provisions in item 114(2) of the Exposure Draft.

2.5 Donations

(a) As currently proposed, subsection 50-50(2)(c) denies income tax exemption to any organisation that, at any time, donates money to any other entity, unless the other entity is an exempt entity. A similar restriction is proposed in subsection 30-18(3) preventing DGRs from making donations to any other entity unless the other entity is a DGR. In this regard it is noted that the definition of "entity" in the tax law[24] includes individuals.

(b) We understand the policy reasons for the proposed introduction of these restrictions on making donations. However we consider that there are a number of problems with the restrictions as currently framed that warrant these measures being withdrawn at this time and given further consideration after the ACNC has been established and given an opportunity to form a view about the necessity of these restrictions and, if necessary, how they should be framed.

(c) We outline below some of the problems we see with the restrictions.

---

[22] Discussed further at part 2.6 below

[23] Discussed further at part 2.5 below

[24] As defined in section 960-100 of the ITAA 97

Donations made to individuals in need

(d) If it is appropriate to retain some form of restriction on making donations, there must be an exception for donations made to individuals in need. This is because part of the work of charities such as churches and community organisations is to respond to need in the Australian community by making cash payments to individuals in direct furtherance of their charitable purposes. Although individuals are "entities", they are usually not DGRs or income tax exempt.

Donations made in direct furtherance of charitable purposes

(e) We submit that a distinction should be drawn between donations made to non-tax exempt entities which are merely acting as a conduit for funds and donations made to non-tax exempt entities which give effect to the charitable or other purposes for which the funds were donated. Charities and other income exempt entities who advance their purposes by making donations should be able to rely on undertakings given by donee entities concerning the use of such donations without having to determine the tax status of the donee entity.

Donations made from gifts

(f) We submit that any restriction under 50-50(2)(c) should exclude donations which are made from gifts received by the entity for that purpose. We can see no policy reason why gifts, which have already been fully taxed in Australia, cannot be aggregated by an entity and on-donated to another entity which is not income tax exempt.

Once for all time test

(g) We are concerned that, as currently drafted, the restriction on donations is a "once for all time" test, meaning that a single breach of this provision by an organisation, at any time in the life of the organisation, will risk the entitlement of the organisation to endorsement as an income tax exempt or deductible gift recipient entity for all time.

(h) We submit that, if it is appropriate to retain this restriction in any form, disendorsement should only apply after repeat breaches of a material nature. Consequently, we submit that organisations which are in breach of this rule should be given a reasonable time to rectify the breach.[25] We further submit that a *de minimis* test should apply allowing immaterial, and possibly inadvertent, distributions to occur without the risk of an organisation losing its income tax exempt or deductible gift recipient status for all time.

---

[25] We note that such a measure is not unprecedented – the Private Ancillary Fund Guidelines (**Guidelines**) provide for a minimum distribution requirement and give the Commissioner of Taxation recourse if the guidelines are breached, but provide that upon notice of a failure to meet the distribution requirement the Trustee is not immediately subject to administrative penalties by has 60 days to rectify the breach. Similar rectification provisions also apply in other legislative regimes, resulting in penalties for failure to protect against and address breaches that arise, rather than immediate sanction for the first breach.

(i) Further, we submit that an organisation that has at some time not been entitled to become or remain endorsed as an income tax exempt or deductible gift recipient entity should be able to later reapply for endorsement following changes to the organisation to remedy the reasons for its disentitlement to endorsement.

Compliance

(j) From a compliance perspective, the requirement that a tax exempt entity not donate money to any other entity unless the other entity is an exempt entity will require the tax status of all recipients of donations to be ascertained before any donations are made. This may also necessitate an extensive audit and on-going compliance regime for all distributions made from charitable funds and by charitable institutions.

(k) A consequence of these measures is therefore a likely increase in the cost of compliance for charitable organisations, including Diocesan organisations and churches in the Diocese.

(l) At this stage it is unclear whether reasonable enquiry and reliance on the Australian Business Register (or the public information portal of the ACNC once established) will be sufficient to enable an organisation to make donations to another organisation, or whether some further enquiry beyond these public information portals will be necessary to provide certainty to the organisation making the donation. If the former is sufficient, some amendment is required to the Exposure Draft to provide clarity in this regard.

Recommendations

(m) We submit that the proposed restrictions on making donations should be withdrawn at this time and reconsidered after the ACNC has been established and given the opportunity to form a view about the necessity of the restrictions and, if necessary, how they should be framed.

(n) If these restrictions are not withdrawn, they should be modified to address the problems outlined in paragraphs (d) to (l) above.

2.6 Disregarded amounts

(a) We are concerned that the repeal of the "disregarded amounts" section, especially concurrently with the amendment to the "in Australia" test by including subsection 50-50(2)(c), removes the ability of organisations to respond to global need and removes certainty in relation to the distribution of amounts received as donations for a specific purpose.

(b) Under the current law, section 50-75 applies to disregard from consideration of whether an entity is "in Australia" distributions of amounts received by way of gifts or government grants.

(c) The policy reasoning for this provision as stated in the explanatory memorandum to the Act introducing the original provisions[26] is that "voluntary payments of money such as donations, tithes, plate money and the like or transfers of property from one person to another are generally not income in the hands of the recipient. . . accordingly, gifts received by either Australian or offshore organisations which are not made in relation to some activity of the organisation of an income producing character will not constitute income in the hands of the organisation and will not be assessable"[27]. Consequently, the Government concluded that such gifts, and the application of such gifts, should be disregarded in characterising whether an organisation is "in Australia".

(d) The Exposure Draft repeals this section and provides no alternative provision. In this regard, we note that no specific mention of this provision and its repeal is included in the explanatory memorandum and consequently no policy reasons have been given.

(e) We submit that the policy consideration applied by the Government in 1997 should continue to apply today in respect of gifts received and distributed by an income tax exempt entity. Such distributions should not be taken into account in determining whether an entity operates and pursues its purposes principally in Australia, nor should they be taken into account in determining whether an entity has donated money to a non-tax exempt entity on the basis that these amounts have already been taxed in full in Australia.

(f) While we understand the amendments to the "in Australia" test (that is, section 50-50(2)(a) and (b)) change the test from an enquiry of where an organisation incurs its expenditure to enquiry of where the organisation principally operates and pursues its purposes, the effect of proposed section 50-50(2)(c) is that an organisation that primarily operates and pursues its purposes in Australia is still prohibited from providing a donation of any amount to an overseas entity unless such entity is an exempt entity in Australia (of which we note there are very few organisations prescribed).

(g) Further, while moneys raised in an appeal for a specific purposes are arguably only "money in transit" and are not the funds of the income tax exempt entity, the removal of this provision creates some uncertainty for organisations in this regard.

(h) Consequently, we submit that this exemption remains necessary and appropriate to allow charitable organisations to continue the work that they are doing and respond to need on a global scale. Further, we submit that this exemption provides no loss to Australian revenue as no tax deduction is provided for the donations given and the funds have therefore been taxed in full in Australia.

---

[26] *Taxation Laws Amendment Act (No. 4) 1997* (Cth)

[27] *Taxation Laws Amendment Bill (No. 4) 1997*, Explanatory Memorandum at paragraphs [5.41] to [5.44]

Recommendations

(i) We submit that section 50-75 as currently in force should not be repealed and should continue to apply such that distributions of gifts received or government grants should be disregarded in determining whether the requirements of the proposed section 50-50(2) have been met, particularly in relation to proposed subsection 50-50(2)(c).

(j) We submit that, in the event that the repeal of section 50-75 is not removed, discussion should be included in the explanatory memorandum to provide certainty for organisations that moneys collected under a specific appeal may still be distributed to non tax exempt entities on the basis that it is merely "money in transit" and not money of the income tax exempt organisation.

2.7 Compliance with governing rules

(a) We are concerned that subsection 50-50(3)(a) of the Exposure Draft, as currently drafted, raises the prospect of many bona fide organisations providing services to the community losing their income tax exempt status for minor procedural and administrative breaches of their governing rules. This measure therefore creates a great deal of uncertainty for organisations in the sector.

(b) As stated above, we support the aims of Government seeking to discourage "inappropriate conduct" within charities and tax exempt entities. However we submit that the proposed section 50-50(3)(a) as currently drafted is unworkable. We further submit that tax legislation is not the appropriate vehicle for governing the management of charities and not-for-profit organisations.

(c) The proposed section 50-50(3)(a) as it is currently drafted requires an entity to, at all times, "comply with **all** the requirements in its governing rules" (our emphasis). While the term "governing rules" is not defined, we would assume at a minimum it would include an entity's constitution, or in the case of a diocesan body, its constituting ordinance. It may also extend to other governing documents or rules, which in the case of the Diocese may include ordinances and rules governing the operation and administration of Diocesan bodies[28].

(d) Broadly, these documents primarily constitute an agreement between the members and other stakeholders in an organisation and the board (or governing council) of the organisation as to the way the organisation will be managed and the division of responsibility between such parties. Consequently, while these documents include the objects, non-profit and dissolution clauses for an organisation, they also include more

[28] For instance, the *Accounts, Audits and Annual Reports Ordinance 1995*.

detailed procedural and administrative matters, such as, *inter alia*, the way in which the governing council will be constituted and the way meetings will be held and conducted.

(e) While directors and officers of an organisation generally seek to act in accordance with the agreed procedural requirements, it is not always possible to do so and consequently, even in a well managed organisation, procedural irregularities do arise.

(f) We recognise that it is unlikely that it is the intention of Government that an organisation would be required to be disendorsed for a minor procedural breach. We submit however that the proposed section 50-50(3)(a) as currently drafted would appear to result in a requirement for such disendorsement.

(g) Further, we submit that a breach or failure of one person linked to the organisation or a one-off error by an organisation even in a more substantive requirement of its governing rules should not result in immediate loss of entitlement of the organisation to income tax exemption - rather, the organisation should be given some ability to rectify the breach. As currently drafted this requirement is a continuing requirement and consequently a single breach would be sufficient to disentitle an organisation to endorsement for its entire future.

Recommendations

(h) We submit that the proposed section 50-50(3)(a) should be removed or amended to limit the requirement to compliance with the objects, non-profit and dissolution clauses of the organisation's constituent documents. We note that the self-assessment regime[29] requires a company to notify the Commissioner if it ceases to be entitled to be endorsed. In our view this requirement is sufficient to require an organisation that has breached its objects, non-profit or dissolution clauses to notify the Commissioner of its loss of entitlement to endorsement.

(i) We further submit however that any test imposed of this nature should not be a once for all time test, but should provide some scope for an organisation to rectify a breach prior to disendorsement. Such disendorsement should only apply in respect of prolonged or consistent unrectified breaches.

(j) Further, some provision should exist for an organisation that has lost its entitlement to endorsement to later reapply for endorsement following rectification of the breaches.

2.8 Use of income and assets

(a) The proposed section 50-50(3)(b) requires that, at all times, an entity must "use its income and assets solely to pursue the purposes for which it was established." While

[29] Under section 426-45 of the *Taxation Administration Act 1953* (Cth)

we recognise that the policy consideration for this provision is to prevent "inappropriate conduct" of endorsed entities, we question the need for this specific provision.

(b) In order to obtain endorsement, the Commissioner of Taxation already requires that the organisation have a non-profit clause requiring the income and assets of the organisation to be used in furtherance of its objects. Consequently, this section is unnecessary if section 50-50(3)(a) requires compliance with the objects and non-profit clause included in the governing rules of the entity.

(c) Further, it is not clear how section 50-50(3)(b) relates to the proposed measures to remove tax concessions in respect of unrelated commercial activities of charities. In particular, it is not clear at this stage whether the retention of profits from an unrelated commercial activity of a not-for-profit entity will be regarded as a failure to use its assets and income to pursue the purposes for which it was established and hence raise the prospect of disendorsement of the whole entity – rather than the removal of tax concessions just in respect of the retained profit from its unrelated commercial activities.

(d) Such provision will arguably also prevent an income tax exempt entity from commencing or restructuring such businesses – which may, it appears, prevent compliance with the future restructuring that may be required in respect of unrelated commercial activities. As discussed above[30], any reform of this nature has to be undertaken as part of a cohesive package of reforms for the charities and not-for-profit sector.

Recommendations

(e) We submit that proposed section 50-50(3)(b) should be removed on the basis that it is unnecessary.

(f) Alternatively, we submit that the proposed section 50-50(3)(b) should be removed from this bill as it may be better addressed by the future reforms in respect of unrelated commercial activities and therefore the inclusion of this provision should be deferred until the consultation process in respect of such reforms has been completed.

2.9 Holistic enquiry of "in Australia" test

(a) We are concerned that the holistic enquiry of how the proposed "in Australia" test in applied may be difficult and create uncertainty for organisations based on the lack of clarity of the matters that are relevant to such a determination and the weight to be given to each factor. While the explanatory memorandum suggests the change from an expenditure based test is a broadening of the test, the change for a quantifiable expenditure based test to a holistic consideration of various factors removes certainty for

[30] At part 2.3

organisations with respect to activities they undertake and will significantly hamper their ability to self-assess compliance with this requirement.

(b) In particular, we note some confusion with the distinction between Examples 1.4 and 1.5 of the explanatory memorandum and the matters that appear to result in the organisation in Example 1.4 failing the "in Australia" test while the organisation in Example 1.5 passes.

(c) In both Examples, it would appear that central management and control of the organisation remains offshore although both organisations have Australian divisions that are run by and employ Australians – however in Example 1.4 "control" as a factor appears to have been given greater emphasis than in Example 1.5.

(d) Further, in Example 1.4, while more than 50% of the income derived is used in Australia for the benefit of those that attend the religious seminars in Australia, estimated to be approximately 500 people per branch – a total of approximately 2,500 persons, the explanatory memorandum concludes that "relatively few Australians are benefiting from the activities of the Australian branch and there is a lack of flow on indirect benefit to the wider community."

(e) This statement creates uncertainty in determining what quantum of persons in Australia must benefit in order for an organisation to satisfy the "in Australia" requirement, and ignores the public benefit presumption existing for charities for the advancement of religion. By contrast, in finding that the organisation is "in Australia", Example 1.5 provides no indication of the number of people who will benefit from the organisation and therefore forms no view on whether this is "relatively few", and applies the public benefit presumption applying in relation to charities for the advancement of education.

(f) The similarities and distinctions between these two examples create significant uncertainty for organisations, particularly for religious organisations operating both in Australian and overseas. Consequently, we submit that greater clarity is required in relation to how the holistic consideration of whether an organisation is operating and pursuing its purposes principally in Australia will be applied for the purposes of the proposed section 50-50(2)(a) and (b).

(g) We note further that paragraph 1.58 of the explanatory memorandum is unclear, and ignores the relative size of Australia to other countries in the world – we therefore submit that only the Australian structure and operations should be taken into account in determining whether the "in Australia" requirements are met, rather than the structure and operations of the organisation globally.

Recommendations

(h) We submit that greater clarity is required in relation to the holistic consideration of whether an organisation is "in Australia" and the relevant factors and relative weights to be provided to each factor.

(i) Further, we submit that only the Australian structure and operations of an organisation should be taken into account in determining whether the "in Australia" requirement is met.

2.10 Definition of not-for-profit entity

(a) We note that the proposed definition of "not-for-profit entity" in item 27 of the Exposure Draft does not reflect the Common Law meaning of this term.

(b) On its face, the proposed definition appears to prevent a not-for-profit entity from carrying on an activity for the purposes of generating revenue that can be distributed or donated to another entity to advance charitable purposes. If so, the proposed definition would preclude all charitable funds being treated as not-for-profit entities. It would also preclude charitable institutions being treated as not-for-profit entities if they engage in any commercial activities for the purposes of distributing the profit to another entity for charitable purposes.

Recommendation

(c) We submit that a statutory definition of "not-for-profit entity" is unnecessary since the Common Law meaning is well understood. However if a statutory definition is to be pursued, we recommend that it reflect the meaning given in the ATO's Draft Ruling TR 2011/D2 (at paragraphs 212 to 225). In particular any statutory definition has to make it clear that the concept of not-for-profit is a prohibition on activities carried on for the purposes of or distributions made for *private* profit or gain.

2.11 Conclusion

As indicated above, we appreciate the opportunity to comment on the Exposure Draft and would be willing to discuss further the matters raised in this submission with Government representatives if that would be of assistance.

12 August 2011