



## **SUBMISSION TO TREASURY**

### **1 Executive Summary**

The Australian Red Cross Society ('Red Cross') has considered the Exposure Draft legislation in the context of the existing requirements for deductible gift recipients ("DGR") and exempt entities.

Red Cross recognises that, following the decision in *Federal Commissioner of Taxation v Word Investments* [2008] HCA 55, the Government is seeking to more closely review any tax exempt or deductible monies or property which are transferred out of Australia by a DGR or exempt entity.

The Exposure Draft primarily codifies the existing 'in Australia' requirements for DGRs and exempt entities as applied by the Commissioner of Taxation.

The Exposure Draft also introduces significant new limitations on the use of money or property by DGRs and exempt entities (whether within or outside of Australia).

Red Cross considers that these proposed new limitations are likely to have considerable and wide-reaching adverse impacts on the not-for-profit sector.

#### ***Prohibition on donations***

In particular, draft subsections 30-18(3) and 50-50(2)(c) effectively prohibit DGRs and exempt entities from making certain donations where the recipient entity is not itself a DGR or exempt entity. **Many DGRs and exempt entities are established for the sole purpose of making donations of this type.** It is these donations which lead to a number of entities being characterised as DGRs or exempt entities.

**The Exposure Draft provisions would result in several categories of DGRs and exempt entities being unable to continue their ordinary operations.**

Red Cross requests Treasury reconsider these particular provisions and not enact any additional restrictions without further consultation with the not-for-profit sector.

#### ***Consideration of overseas activities***

Red Cross understands that an entity is to be permitted to undertake activities outside of Australia where those activities are incidental or minor in extent and importance when referenced to the Australian activities. Red Cross requests that the associated Explanatory Memorandum to the proposed Bill provide further guidance on the scope of activities which may be undertaken outside of Australia in this regard.

In particular, it may be useful to clarify that only the precise activities actually undertaken by the Australian entity outside of Australia are relevant to the assessment. This may be particularly important where an Australian entity assists in the delivery of project outside of Australia in conjunction with international partner organisations.

Red Cross' concerns are set out in more detail below.

## **2 Introduction**

### **2.1 Australian Red Cross Society**

Red Cross is a significant humanitarian organisation that cares for the vulnerable in society and is also involved in the development of social welfare initiatives.

Red Cross is endorsed as DGR and a charitable institution ("CI") on the basis that it is a public benevolent institution ("PBI") under item 4.1.1 of the table in section 30-45 of Subdivision 30-B of the *Income Tax Assessment Act 1997* ("1997 Act").

Red Cross is a member organisation of the International Federation of Red Cross and Red Crescent Societies (the "Federation"). The Federation is the world's largest humanitarian organisation, with many millions of volunteers in 186 countries.

Red Cross considers the taxation regime applicable to the not-for-profit sector to be particularly complex. Red Cross has engaged closely with Treasury and the Commissioner of Taxation on these matters previously.

### **2.2 Codification of the "in Australia" requirements**

There are existing provisions within the 1997 Act which seek to impose certain limits on activities carried out overseas by DGRs and exempt entities.

Red Cross understands that the Commissioner of Taxation has advised the Government that, while the policy is clear, there is considerable doubt as to whether the law is achieving the objectives of ensuring activities are primarily carried out "in Australia".

The Assistant Treasurer's 2009-10 Budget Media Release No. 043 provides:

*"that the Government will amend the "in Australia" requirements in Division 50 of the Income Tax Assessment Act 1997 to ensure that parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities."*

## **3 Exposure Draft DGR provisions (Division 30)**

### **3.1 Existing law - "in Australia" requirement for DGRs**

Red Cross is required to carry out its activities in Australia (subject to limited exceptions) under the existing law.

For the Red Cross the "in Australia" requirement is set out in the existing section 30-15(2) paragraph (a) of table in item 1, column headed special conditions. The Commissioner of Taxation has also provided guidance on the application of this provision.

Taxation Ruling 2003/5 "Income Tax and Fringe Benefits Tax: public benevolent institutions" (TR 2003/5) provides the Commissioner's interpretation of this provision. Paragraph 25 of that ruling states:

*"25 For endorsement as a deductible gift recipient so that it can receive tax deductible gifts, the public benevolent institution must be 'in Australia'. This involves a range of factors including establishment, control, maintenance and operation in Australia and the providing of public benevolence in Australia."*

Paragraphs 128-131 further provide:



**"Gift deductibility - 'in Australia'**

*"128. To be accepted as a public benevolent institution, an organisation need not be in Australia. However, for the public benevolent institution **to be endorsed as a deductible gift recipient and so eligible to receive income tax deductible gifts, it must be 'in Australia': special condition (a) of item 1 in the table in section 30-15 of the ITAA 1997.** If a public benevolent institution is not in Australia it will still be eligible for fringe benefits tax concessions, but it will not be entitled to endorsement as a deductible gift recipient and donors will not be entitled to income tax deductions under section 30-15.*

*129. To be in Australia a public benevolent institution **must be established, controlled, maintained and operated in Australia and its benevolent purposes must be in Australia.** Because the purpose of public benevolent institution is to provide direct relief to persons in need, this will mean that relief will be provided to people located in Australia.*

*130. However, we accept that where a public benevolent institution conducts an activity outside Australia that is **merely incidental** to providing relief in Australia, or is insignificant, **it will not disqualify the institution from endorsement.** For example, if a public benevolent institution provides medical assistance to children in Australia with a particular disability but, **to a minor extent**, it also brings children from other countries to receive treatment in Australia, it still meets this condition for endorsement.*

*131. Where a public benevolent institution provides public benevolence outside Australia it might establish a public fund to provide for those services. Income tax gift deductibility may be available for the public fund under the Overseas Aid Gift Deduction Scheme provided for by item 9.1.1 of section 30-80 of the ITAA 1997."*  
[emphasis added]

This test applies to all DGRs which are either a fund, authority or institution covered by an item in any of the tables in Subdivision 30-B. These are the general categories of DGRs, and include PBIs. The test does not apply to entities which are specifically listed in the 1997 Act.

It is this same class of DGRs which will be subject to the proposed new rules in the Exposure Draft (see item 1 of the Amending Bill).

### **3.2 Exposure Draft provisions relevant to DGRs**

***New provisions which are consistent with the current position***

The primary draft subsections are broadly consistent with the existing law (as it is applied by the Commissioner) set out above.

In particular, draft subsections 30-18(1),(2) and (4) seek to generally codify the existing "in Australia" requirement, as interpreted by the Commissioner in TR 2003/5.

Those subsections provide that:

- subsection (1) - the relevant entity must operate solely in Australian and pursue its purposes in Australia;
- subsection (2) - there is an exception for incidental and minor activities carried out overseas; and
- subsection (4) - there is a general exception for international affairs deductible gift recipients.

***New provision which is a substantial departure from the current position***

Red Cross considers draft subsection 30-18(3) to be a significant addition to the existing law and a substantial departure from the current position. The draft subsection provides:

"The fund, authority or institution must not donate money or property to any entity that is not a \*deductible gift recipient."

Paragraph 1.38 of the Draft EM consider the scope of the term "donate". The paragraph states:

*"1.38. A donation does not include a payment for goods and services to another entity incurred in the normal course of operating or pursuing the purposes for which an entity was established. For example, a hospital buying relevant supplies or a library purchasing books is not considered to be donating funds."*

Draft subsection 30-18(3) effectively prohibits DGRs from donating money or property to any entity that is not itself a DGR.

This means DGRs are not able to contribute monies or property to any overseas entity or to an Australian entity that is not also a DGR.

### **3.3 Significant adverse consequences to DGRs**

DGRs ordinarily make a number of transfers of money or property which would be prohibited by the Exposure Draft provision. That is the ordinary transfers are:

- (a) not made to another DGR or tax exempt entity; and
- (b) are not made in payment for goods or services.

These transfers of money and property are normal and appropriate having regard to the nature of the relevant entity and the entity's status as a DGR.

For example, Red Cross provides a regular breakfast for school children who might otherwise go without via the Red Cross' Good Start Breakfast Clubs. Red Cross also conducts food security programs for homeless and disadvantaged persons, such as the Soup Patrol Service and Food CENTS program in Western Australia, the Night Café in Queensland and Roadhouse in the Australian Capital Territory. These activities all include contributions of property to individuals.

Many DGRs are established and are endorsed as DGRs on the basis that they provide money or property to particular persons. **It is the donation of money or property to these persons which is the primary purpose of the DGR. It is these activities which enable an entity to be characterised as a DGR.**

The general categories of DGR entities, which are set out in the tables in Division 30-B, highlight a number of examples, including:

- **(item 2.1.13 - scholarship funds)** - scholarship funds must be established solely for providing money for certain scholarships, bursaries or prizes. These funds provide monies to a recipient to be applied by that recipient for the relevant course etc. The payment is not a payment for a good or service;
- **(item 4.1.1 - public benevolent institutions ("PBI"))** - PBIs, like Red Cross, are entities which, broadly, provide direct benevolent relief to particular classes of persons. The provision of direct benevolent relief will often involve the transfer of money or property to those persons (including for example, food, clothing, shelter, etc.). In order to qualify as a PBI the entity must provide a form of relief directly to the relevant persons, rather than generally making payments to other persons (see TR 2003/5).



- **(item 4.1.3 - necessitous circumstances funds)** - necessitous circumstances funds provide monies to people in necessitous circumstances. The provision of the funds is not provided in return for a good or service. It is a donation. Taxation Ruling 2000/9 "Income Tax: necessitous circumstances funds" at paragraph 15 states:

*"A fund's most common method of providing relief to a person in necessitous circumstances is by direct distributions of money or goods to the person."*

- other examples of DGRs which may provide money or property directly to persons include disaster relief funds (item 4.1.5), public funds for the environment (item 6.1.1) family counselling funds (item 8.1.2) and public cultural organisations (item 12.1.1).

#### **4 Exposure Draft exempt entity provisions (Division 50)**

Red Cross is not subject to the "in Australia" requirements applicable to certain exempt entities (either under the proposed draft provisions or the existing law).

This is because:

- (a) under the existing law (see section 50-50(b)), Red Cross is exempt on the basis that it is a PBI (more particularly, as a PBI Red Cross meets the requirements in the table under item 1 of the table in section 30-15);
- (b) under the Exposure Draft (see draft subsection 50-51(3)(a)), Red Cross is exempt on the basis that it is a DGR.

The issues set out above in relation to DGRs also apply equally to certain exempt entities. These issues are discussed briefly below for completeness.

##### **4.1 Existing law - "in Australia" requirement for exempt entities**

Exempt entities, including CIs which are not DGRs, are subject to "in Australia" requirements under the existing law. This requirement must be satisfied in order for the CI to be entitled to be characterised as a tax exempt entity.

The "in Australia" conditions are set out in **Subdivision 50-A** of the 1997 Act.

Under section 50-50 of the 1997 Act, for example, a CI must either:

- (a) have a physical presence in Australia and, to that extent, incur its expenditure and pursue its objectives principally in Australia; or
- (b) be an institution that meets the description and requirements in item 1 of the table in section 30-15 (*this incorporates the "in Australia" test discussed above in respect of DGRs*); or
- (c) be a prescribed entity of a certain type.

The requirements set out above are broadly consistent between the various forms of tax exempt entities.

##### **4.2 Exposure Draft provisions relevant to tax exempt entities**

Draft subsections 50-50(2)(a) and (b) seeks to codify the existing law set out above.

Draft subsection 50-50(2)(c) extends the existing law. The draft subsection provides:



"The entity must: ...

(c) not donate money to any other entity, unless the other entity is an \*exempt entity."

Draft subsection 50-50(2)(c) effectively prohibits specified exempt entities (including charitable institutions) from donating money (*but not property*) to any entity that is not an exempt entity.

An exception to this prohibition is provided for in draft subsection 50-51(3) in relation to DGRs and certain foreign residents.

#### **4.3 Significant adverse consequences to tax exempt entities**

There are a range of exempt entities that may make donations of money in the ordinary course of their operations. These entities may make donations of money in support of particular persons or programs, which are not payments for goods or services.

These entities may include a large number of CIs that do not qualify for DGR status (for example because not all of their activities provide "direct relief").

Under the existing law a CI may provide money to a person (which is not an exempt entity) for the alleviation of poverty or to enable a person to pay for education. There is a risk that this activity would be prohibited under the draft subsection 50-50(2)(c).

### **5 Further consideration of Exposure Draft**

Red Cross proposes that draft subsection 30-18(3) and draft section 50-50(2)(c) be removed.

The draft subsections should be removed on the basis that:

- (a) the draft subsections substantially limit the ordinary and appropriate activities carried out by a wide range of DGR and exempt entities;
- (b) there is adequate protection, and opportunity for scrutiny, under the existing legislation. The existing legislation allows the Commissioner to remove an entity's endorsement where its activities are not consistent with the particular character of that entity (for example, its character as a PBI or CI);
- (c) the provisions do not act as a codification of the 'in Australia' requirements. The limitations on the application of monies or property (to other DGRs or exempt entities) have never formed part of the 'in Australia' requirement. These new prohibitions are far more restrictive. They operate equally within and outside of Australia; and
- (d) the provisions create confusion with other aspects of the existing law on the use of money and property. This is because many DGRs and exempt entities are not entitled to donate money or property to another DGR or exempt entity under the existing law. For example, it would not be consistent with the character of an entity as a "necessitous circumstances fund" if it were to provide money or property to a DGR which is a cultural organisation. The draft subsections indicate that such transfer may be made.

Further consultation should be undertaken with the not-for-profit sector before any further restrictions are enacted.

## **6 International activities of DGRs**

### **6.1 Australian entities may provide limited support to overseas projects**

A number of exempt entities and DGRs may carry out international activities in their own capacity. These activities are permitted, to a limited extent, under the Exposure Draft provisions (see sub-sections 30-18(2) and (4)).

Alternatively, a number of DGRs may support the work carried out overseas by another organisation, by providing money, staff or services, to that organisation, for example.

For example, as a member of the Federation, Red Cross may make contributions to a member of the Federation in another country, to support the programs and work of that member in that country. As a member of the Federation Red Cross will also make contributions to the International Committee of the Red Cross ("ICRC") in support of the ICRC's exclusively humanitarian mission to protect the lives and dignity of victims of armed conflict and other situations of violence.

Red Cross contributions to those programs may include provision of financial assistance, or providing supporting, human resources, technical assistance, goods and equipment or administrative services to the other member of the Federation for particular projects of that other member. In addition, staff of Red Cross may be seconded to the Federation in connection with a particular project of another member of the Federation. Similar contributions are made to support the work of the ICRC as part of ICRC projects.

These arrangements are entered into because it is generally more appropriate for another Federation member to carry out particular activities in its own country (that is, a particular foreign location) which is done either in partnership with the Federation or on its own behalf. On occasion, multilateral support for projects of a Federation member will be provided in these ways by Red Cross in conjunction with another member of the Federation.

Red Cross also coordinates international volunteering opportunities by identifying and selecting volunteers to participate in various programs overseas.

Red Cross activities in this regard are minor in extent and importance when considered with reference to Red Cross' Australian activities.

### **6.2 Clarification in explanatory materials**

It should be clarified in the explanatory materials that there is a distinction between work carried out to support an overseas project and the carrying out of that project itself. It should be made clear that these are separate activities.

That is, an Australian entity should not be treated as having carried out an overseas project where it has merely made a contribution in some form to that project.

This may be important for determining to what extent an activity is 'incidental' or 'minor in extent and importance' for the purposes of draft section 30-18(2) (a) and (b).

The following example in the Explanatory Memorandum could be included in this regard:

#### **Example 1.15: Identifying relevant activities**

An Australian public benevolent institution carries out substantial work in Australia. A minor part of its operation involves sending staff overseas to a foreign organisation to assist that foreign organisation carry out certain operations in a foreign location.

The staff which are employed by the Australian public benevolent institution provide administrative, direct service delivery and technical advisory services for the foreign organisation.





These services assist the foreign organisation carry out a water sanitation project in the foreign location, staff a field hospital or arrange distribution of relief supplies.

The activities of the Australian public benevolent institution are limited to sending the staff overseas and the administrative and technical advisory services they carry out. The water sanitation project as a whole, the field hospital and its activities or the provision of the relief supplies as a whole is not regarded as the activity of the Australian public benevolent institution.

Only those activities actually undertaken by the relevant Australian entity are taken into account for the purposes of section 30-18(2)(a) and (b).

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