2013-2014

EXPOSURE DRAFT: TAX LAWS AMENDMENT (2014 MEASURES NO. #) BILL 2014

EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	*Definition*
FATF	Financial Action Task Force
ICCPR	International Covenant on Civil and Political Rights
ITAA 1997	*Income Tax Assessment Act 1997*
OAGDS	Overseas Aid Gift Deductibility Scheme
Commissioner	Commissioner of Taxation
Word Investments	*Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* (2008) 236 CLR 204

General outline and financial impact

Re-stating and centralising the special conditions for tax concession entities

Schedule # to the Tax and Superannuation Laws Amendment (2014 Measures No. #) Bill 2014 :

- re-states the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community (with some exceptions);

- centralises the other special conditions entities must meet to be income tax exempt, such as complying with all the substantive requirements in their governing rules; and

- codifies the 'in Australia' special conditions for deductible gift recipients ensuring that they must generally operate solely in Australia, and pursue their purposes solely in Australia (with some exceptions, such as overseas aid funds, some environmental organisations, some touring arts organisations and medical research institutes).

Date of effect: This Bill commences on the day after Royal Assent, and applies to determine whether an entity is entitled to be income tax exempt or remain income tax exempt for income years starting the day after Royal Assent, and to determine whether an entity is entitled to be a deductible gift recipient or remain a deductible gift recipient from the day after Royal Assent. Transitional arrangements apply to existing deductible gift recipients that are not currently meeting the 'in Australia' special conditions.

Proposal announced: The former Government announced in the 2009-10 Budget that it would amend the 'in Australia' special conditions 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.

The current Government announced on 14 December 2013 that it would proceed with this measure.

Financial impact: This Bill has an unquantifiable but expected to be small impact on the forward estimates, but also protects material amounts of revenue that and would otherwise be forgone.

Human rights implications: This Bill does not raise any human rights issue. See Statement of Compatibility with Human Rights — see paragraphs 2.1 to 2.23.

Compliance cost impact: Low

Chapter 1
Re-stating and centralising the special conditions for tax concession entities

Outline of chapter

1.1 Schedule # to this Bill re-states and centralises the special conditions for tax concession entities.

1.2 In particular, this Bill re-states the 'in Australia' special conditions by ensuring that:

- income tax exempt entities generally must be operated principally in Australia and for the broad benefit of the Australian community; and
- deductible gift recipients generally must be operated solely in Australia and for the broad benefit of the Australian community.

Context of amendments

1.3 Traditionally, entities cannot be income tax exempt unless they are operated principally in Australia, are prescribed as exempt in the *Income Tax Assessment Regulations 1997* or are a deductible gift recipient.

1.4 While both income tax exempt entities and deductible gift recipients are subject to 'in Australia' special conditions, they are subject to different thresholds (with the 'in Australia' conditions for deductible gift recipients applying a stricter test).

1.5 Recent court decisions have raised doubts about the proper application of both of these tests.

Income tax exempt entities

1.6 The purpose of the introduction of 'in Australia' special conditions for income tax exempt entities, which took effect from 1 July 1997, was to address international tax avoidance arrangements which used charitable trusts and certain other not-for-profit (or non-profit) organisations to shift funds overseas to avoid Australian taxation.

1.7 Subsequently, the 'in Australia' special conditions have also operated to minimise the risk of income tax exempt entities being used for terrorist financing and money laundering, and to ensure the proper operation of not-for-profit entities and their use of public donations and funds.

1.8 The key principle used by the Australian Taxation Office in determining whether a charity was eligible for endorsement included that a charity, its expenditure and the purpose of its activities be defined in terms of their location in Australia.

1.9 Recently, the High Court of Australia, in *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* (2008) 236 CLR 204 (*Word Investments*) found that charities are considered to be pursuing their objectives principally 'in Australia' if they merely operate to pass funds within Australia to another charity that conducts its activities overseas.

1.10 This finding was inconsistent with the Commissioner of Taxation's (Commissioner) interpretation and with the clear policy intent underlying the special conditions. Prior to the High Court's decision a charitable institution needed to meet two requirements to be exempt from income tax: first, it must have a physical presence in Australia; and second, to the extent it has a physical presence in Australia, it must incur its expenditure and pursue its objectives principally in Australia.

1.11 A broad interpretation of 'physical presence' had been adopted - all that was required was for an organisation to operate through a division, sub-division or the like in Australia. The structure of the institution was immaterial as was whether it had its central management and control or principal place of residence in Australia. 'Physical presence' did not apply where an institution merely operated through an agent based in Australia.

1.12 An institution had, however, to the extent of its physical presence in Australia, only to incur its expenditure and pursue its objectives 'principally' in Australia. Therefore, it may incur its expenditure and pursue its objectives outside Australia to a lesser extent. Where there was some doubt whether the 'in Australia' special conditions were satisfied it became necessary to examine each institution's individual circumstances.[1]

1 Explanatory Memorandums to the Taxation Laws Amendment Bill (No. 4) 1997 and Taxation Laws Amendment Bill (No. 7) 1997.

1.13 In *Word Investments*, once the Court had accepted that Word Investment's charitable purposes could be fulfilled by it making payments to other charitable institutions, the High Court's conclusion was that Word pursued its objectives principally in Australia by making payments to those institutions in Australia, even if the other institutions ultimately expend those funds outside Australia.

1.14 Ignoring minor overseas activities, the policy intent of the 'in Australia' special conditions was only to allow a charity to be able to pass funds to an overseas charity that was endorsed as a deductible gift recipient (operating a developing or developed country relief fund), or an entity specifically prescribed in the regulations. The High Court's decision on *Word Investments* highlighted that the law is not achieving Parliament's objective.

1.15 Consequently, charities can now be found to be pursuing their objectives principally 'in Australia' if they merely pass funds in Australia to another charitable entity that conducts its activities overseas, reintroducing a loop hole through which tax avoidance arrangements, and other inappropriate conduct can be undertaken once again.

1.16 Similar rules apply to other tax concession entities; however, stricter rules apply under the *Income Tax Assessment Act 1997* (ITAA 1997) to charitable funds. Charitable funds can only claim income tax exemptions where they provide money, property and benefits solely to charities based in Australia.

Deductible gift recipients

1.17 The deductibility of gifts to public charitable institutions 'in Australia' was first introduced in section 18 of the *Income Tax Assessment Act 1915*.

1.18 The phrase 'in Australia' occurred in three separate contexts in the original section: income from all 'sources in Australia'; expenses 'actually incurred in Australia'; and institutions 'in Australia'.

1.19 In the *Alliance Assurance Co Ltd v Federal Commissioner of Taxation* (1921) 29 CLR 424, the High Court held that the limitation 'actually incurred in Australia' in section 18 as a matter grammatical construction, did not apply to the phrase 'all losses and outgoings' and probably only applied to the concept of expenses.

1.20 As a result of the Alliance Assurance decision, the deduction provision was slightly reworded and included as section 23 in the *Income Tax Assessment Act 1922*, allowing 'gifts … to public charitable institutions in Australia if the gifts are verifiable to the satisfaction of the Commissioner'.

1.21 The Explanatory Memorandum to the Bill that became the *Income Tax Assessment Act 1922* notes that the amendment was for the purpose of limiting deductions to those actually incurred in Australia which is interpreted as meaning 'decided upon in Australia by the controlling authority, although the actual expenditure might be made outside Australia' and also included expenditure actually made in Australia.

1.22 The 1932-34 Ferguson Royal Commission on Taxation, considered deductibility of gifts and donations to charitable institutions. The Royal Commission recommended in its third report that a deduction be allowed for gifts of one pound and upwards made during the year of income to charitable institutions which carry on their functions within the jurisdiction of the taxing authority.[2] In this event, the Commonwealth would allow deductions to a charitable institution in Australia, and each State would allow donations to similar institutions within the State. A provision was drafted by the Royal Commission to give effect to the recommendation, containing the requirement that there be an allowable deduction for gifts to certain funds, authorities or institutions *in Australia*.

1.23 The Conference of Commonwealth and State Commissioners of Taxation to discuss the recommendations of the 1934 Royal Commission on Taxation[3] considered the recommendations concerning gifts, and the draft provision.

1.24 The Report of Proceedings for the Melbourne Conference in 1935 questioned whether it was intended that deductions to a public fund would include contributions to funds raised in other countries, as in the case of an earthquake in Japan. The Victorian Commissioner of Taxation indicated that contributions to World Funds should not be allowed.

1.25 The New South Wales Commissioner of Taxation drew attention to the fact that the NSW equivalent provision included a requirement that a public fund must be established for the relief of persons 'in the State' who were in necessitous circumstances. The Commonwealth Commissioner of Taxation noted that the Federal law covered only charitable institutions in Australia, and drew attention to the words 'in Australia' in the Commonwealth draft. However, the Conference resolved to adopt the NSW drafting.

2 See paragraph 617 and 618 of the *Report of the Royal Commission 1934*.

3 Report of the Conference of Commonwealth and State Commissioners of Taxation to discuss the recommendations of the 1934 Royal Commission on Taxation held in Melbourne on 8th, 12th and 23rd August 1935.

1.26 In 1935, the gift deductibility provisions were moved to a separate provision in section 78 of the *Income Tax Assessment Act 1936*.

1.27 This provision allowed gifts of the value of one pound and upwards paid to certain 'funds, authorities or institutions in Australia' to be deductible.

1.28 The Explanatory Memorandum to the Income Tax Assessment Bill 1935 notes that the words 'in Australia' were added in order to make the intention of the law clear (as a result of the resolution of the State and Commonwealth Commissioners of Taxation noted above).

1.29 The gift deduction provisions remained in section 78 and were extensively amended over the years (the majority of the amendments were technical, to include, replace or remove named institutions or funds to the lists of deductible gift recipient, such as the addition of the United Nations Appeal for Children in 1948), before finally being rewritten in 1993.

1.30 An amendment was included in the Income Tax Law Amendment Bill 1981 to allow a deduction for gifts to certain overseas aid organisations, with the explanatory memorandum stating 'one extension will introduce a scheme to authorise deductions for gifts to certain public funds maintained for the relief of persons in developing countries'.

1.31 The current gift deductibility provisions are located in Division 30 of the ITAA 1997.

International obligations

1.32 As a member of the Financial Action Task Force (FATF) (an inter-governmental body dedicated to combating money laundering and terrorist financing), Australia has agreed to comply with FATF recommendations. FATF Recommendation 8, and in particular, the Interpretive Note to the Recommendation, requires FATF members to 'combat the misuse of NPOs (non-profit organisations) for the purpose of terrorism financing'. In FATF's recent review of Australia's progress, it found that Australia was only partially compliant with this Recommendation.

1.33 The 'in Australia' special conditions provide one of Australia's substantive measures to address possible abuse of not-for-profit entities for the purposes of money laundering and terrorist financing, and ensure the proper operation of not-for-profit entities, their use of public donations and funds, and the protection of their assets. By limiting the use of monies to specified areas, in conjunction with greater regulatory screening, this ensures those monies are expended appropriately and in a manner consistent with the eligibility for tax concession status.

Re-stating and centralising the 'in Australia' special conditions

1.34 To overcome the *Word Investments* decision, the former Government announced changes in the then Assistant Treasurer's 2009-10 Budget Media Release No. 043. The release stated "that the Government will amend the 'in Australia' requirements in Division 50 of the ITAA 1997 to ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities."

1.35 The former Government issued two public exposure drafts on 4 July 2011 and 17 April 2012.

1.36 Following consultation, the former Government introduced the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 into Parliament on 23 August 2012. The Bill lapsed at the dissolution of Parliament on 5 August 2013. The Bill proposed to:

- re-state the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community (with some exceptions);
- standardise the other special conditions entities must meet to be income tax exempt, such as complying with all the substantive requirements in their governing rules and being a 'not-for-profit' entity (with some exceptions);
- standardise the term 'not-for-profit', replacing the defined and undefined uses of 'non-profit' throughout the tax laws; and
- codify the 'in Australia' special conditions for deductable girt recipients, ensuring that they must generally operate solely in Australia, and purse their purposes solely in Australia (with some exceptions, such as overseas aid funds and some environmental organisations).

1.37 Prior to the Bill lapsing, some of its provisions were enacted in the *Tax Laws Amendment (2013 Measures No. 2) Act 2013*, namely, those provisions that standardised the other special conditions that entities must meet to be tax exempt, such as complying with all the substantive requirements in their governing rules. The *Tax Laws Amendment (2013 Measures No. 2) Act 2013* received Royal Assent on 29 June 2013.

1.38 The Government announced on 14 December 2013 that it did not intend to proceed with defining and standardising the uses of 'not-for-profit' throughout the tax laws.

Summary of new law

Income tax exempt entities

1.39 Income tax exempt entities must operate and pursue their objectives principally in Australia unless they are deductible gift recipients (which are subject to separate requirements) or are prescribed in the regulations as exempt from these special conditions.

1.40 The new law reverses the effect of the decision that charities and other income tax exempt entities can direct funds to overseas projects outside the current policy intent and reinstates the principles underlying the current integrity rules.

1.41 The new law replaces the existing special conditions that are linked to the various exempt entity categories with a new consolidated and standardised provision clearly articulating the 'in Australia' special conditions.

1.42 If an entity pursues its purposes by conducting activities that directly advance those purposes, the entity is not entitled to be income tax exempt unless it operates principally in Australia.

1.43 Where an entity provides money or property (to further its purpose) to other entities that are not entitled to be income tax exempt, the use of those funds by those other entities should be taken into account when determining whether or not the entity giving the money has met the 'in Australia' special conditions. This addresses the recent court decision and ensures that tax exempt entities cannot avoid the special conditions by having other entities use its funds to undertake activities it itself cannot undertake.

1.44 This will require an income tax exempt entity to satisfy itself, to the extent that it is reasonable to do so, about how the entity it has given money or property to is using, or intends to use, these funds, and ensures that the use of these funds is included when determining whether the entity is pursuing purposes that are principally in Australia.

1.45 If an entity gives money to another income tax exempt entity to further its purpose, the money does not need to be traced, as the receiving entity should itself be meeting the in Australia special conditions (including being expressly exempt).

1.46 This ensures that any tax concessional money stays within the exempt entity framework and gets used principally in Australia for the broad benefit of Australians, and is not being passed on through entities and then spent overseas outside of the authorised categories.

1.47 Entities prescribed in the regulations are exempt from the 'in Australia' special conditions and are considered on a case-by-case basis. To be eligible to be considered for prescription, these entities must be either overseas not-for-profit entities exempt from foreign tax in their resident country, or be resident in Australia and operate and pursue their objectives principally outside Australia.

1.48 Entities prescribed in the regulations in the current law will continue to be prescribed for the purposes of the new law.

Deductible gift recipients

1.49 The new law also codifies the 'in Australia' special conditions for deductible gift recipients so that the core principle for income tax exempt entities is applied similarly to deductible gift recipients but with a differing (stricter) threshold test, ensuring that deductible gift recipients need to operate solely in Australia (unless expressly exempt).

1.50 If a deductible gift recipient provides money, property or benefits to a non-deductible gift recipient entity to further its purpose, the spending of the entity's funds should be taken into account, to the extent that it is reasonable to do so, when determining whether or not that entity meets the 'in Australia' special conditions for deductible gift recipients.

1.51 This will remove doubt about the operation of the current law that has been the subject of recent litigation.

1.52 Re-stating the 'in Australia' special conditions will provide support to the anti-avoidance measures in the tax law which limit tax concession entities expending money offshore and ensure tax supported funds remain in Australia for the broad benefit of Australia and Australians.

Comparison of key features of new law and current law

New law	*Current law*
The 'in Australia' special conditions are standardised and apply consistently across different categories of income tax exempt entities. The new law uses 'operates' and 'pursues its purposes' based tests, which are broader than the existing 'expenditure' based test. If an entity pursues its purposes by conducting activities that directly advance those purposes — the entity is not entitled to be income tax exempt unless it operates principally in Australia (with some exceptions). Deductable gift recipients must generally be established in Australia, operate solely in Australia and pursue their purposes solely in Australia. Minor and incidental activities outside Australia will not breach this requirement. Some organisations are exempt (including certain medical research institutes, certain environmental organisations, and certain touring arts organisations). The spending of the monies given to other entities to further an entity's purpose must be included, to the extent that it is reasonable to do so, when considering whether the donating entity 'operates' and 'pursues its purposes' in Australia.	The 'in Australia' special conditions are contained in various sections throughout Division 50 of the ITAA 1997. Each of the special conditions applies to different classes/categories of income tax exempt entity in a similar way but with some minor differences. The differences mostly reflect differences in entities eligible under particular categories. Factors for determining whether a tax concession entity is eligible to be income tax exempt or be a deductable gift recipient includes that an entity, its expenditure and the purpose of its activities is defined in terms of the entity's location in Australia and the extent to which it incurs its expenditure and pursues its objectives principally (in the case of income tax exempt entities) and solely (in the case of deductable gift recipients) in Australia. Following recent judicial decisions, tax concession entities are considered to be pursuing their objectives 'in Australia' if they merely operate to pass funds within Australia to another entity that conducts its activities overseas.

Detailed explanation of new law

1.53 The new law:

- re-states the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community with some exceptions – see paragraphs 1.54 to 1.101;

- centralises all the other special conditions entities must meet to be income tax exempt, with some exceptions; and
- codifies the 'in Australia' special conditions for deductible gift recipients so that the core principle for income tax exempt entities is applied similarly to deductible gift recipients, but with the existing stricter threshold – see paragraphs 1.102 to 1.139.

Income tax exempt entities

1.54 In order to become income tax exempt, an entity must usually:

- operate principally in Australia;
- pursue its purposes principally in Australia;
- comply with all the substantive requirements in its governing rules;
- apply income and assets solely for the purpose for which it is established; and
- be a non-profit entity.

[Schedule #, item 31, subsections 50-50(1) to (3)]

1.55 Entities that do not meet the first two dot points ('in Australia' special conditions) can instead be either prescribed in the *Income Tax Assessment Act Regulations 1997* (see paragraphs 1.97 to 1.101) or be endorsed as a deductible gift recipient (subject to separate requirements, see paragraphs 1.102 to 1.139). A prescription in the regulations is a legislative policy decision, not an administrative decision.

1.56 The third, fourth and fifth dot points are not new requirements imposed by this Bill, they are existing requirements in Division 50 of the ITAA 1997 that are being centralised into a consolidated provision setting out the special conditions for income tax exempt entities. ***[Schedule #, item 31, subsections 50-50(1) to (3)]***

1.57 The new law re-states the policy intent and centralises the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community with some exceptions. ***[Schedule #, items 20 to 33]***

Principally in Australia

Activity based entities

1.58 If an entity pursues its purposes by undertaking activities, it must operate principally in Australia and pursue those purposes principally in Australia to qualify as income tax exempt (the 'in Australia' special conditions). ***[Schedule #, item 31, subsection 50-50(2)]***

1.59 While no one factor is conclusive, in determining whether an entity is 'operating in Australia' and 'pursing its purposes principally in Australia' the Commissioner is expected to consider all surrounding circumstances: including factors such as where the entity incurs its expenditure; where it undertakes its activities; where the entity's property is located; where the entity is managed from; where the entity is resident or located; where its employees or volunteers are located; and who is directly and indirectly benefiting from its activities.

1.60 'Principally' means mainly or chiefly. Less than 50 per cent is not considered principally.

1.61 By substituting the existing 'expenditure' based test with an 'operates' and 'pursues its purposes' based test, a wider range of circumstances can be considered to be 'in Australia'.

1.62 This will enhance the integrity of the rules, better reflect the policy intent and bring the test into better alignment with the test applied to deductible gift recipients.

Example 1.1: Expenditure versus operates test

An organisation is established as a Bible college in Australia, and runs weekly lessons for children in Australia.

The organisation fundraises in Australia, but purchases much of the supplies and equipment (such as religious books) from overseas. Whilst this organisation may not have met the expenditure test in the previous law, depending on the other facts and circumstances of the organisation (such as possible assets and employees in Australia, and management control in Australia), the entity may now meet the 'in Australia' special conditions.

1.63 To be operating principally in Australia, an entity will be expected to be an Australian resident or have a sufficient connection and presence in Australia (a comparison can be drawn with the test for determining the existence of a permanent establishment).

1.64 Generally, the test for residency of a non-individual entity is the location of the entity's central management and control.

Example 1.2: Operating principally 'in Australia'

A sporting program designed to foster team building skills is established by an association in Australia.

The program holds various sporting clinics at schools throughout Victoria during school holidays. The clinics are funded through the fundraising initiatives organised by the association. After a few years the association decides to expand the reach of the program and so they set up a Brazilian division. The overseas division is run by locals who are employed by the Australian division. They receive managerial oversight from the Melbourne branch. Local sporting premises are rented by the Australian division and it also supplies all the equipment from Australia.

There is no fundraising activity in Brazil, and thus the Brazilian division is wholly dependent on the income it receives from the Australian division. At the end of the most recent financial year, 60 per cent of income was directed towards Australian based activities, with the remaining 40 per cent directed towards Brazilian activities.

On balance, the program meets the 'in Australia' special conditions. Even though 40 per cent of all monies are sent overseas, significant expenditure is incurred in Australia. Further factors considered include that Australian students are still benefiting from the activities of the program and thus there are direct and indirect benefits to the Australian community.

Example 1.3: Operating principally 'in Australia'

A literary society is set up in Australia to promote indigenous writing, both in Australia and abroad. The entity operates out of and is managed from Melbourne. Most of its expenditure is directed towards donating books to local schools and libraries. Occasionally it incurs expenditure purchasing books from other indigenous culture organisations overseas.

The society will meet the 'in Australia' conditions. The occasional overseas expenditure will not prevent this criteria being met. While no one factor is determinative, the society is overall principally pursuing its purposes in Australia and is principally operating in Australia because it is managed in Australia, most of the expenditure is benefiting Australians and any assets and employees are in Australia.

Example 1.4: Global organisation funding overseas divisions

A Chinese religious society is set up in Beijing and establishes branches worldwide. Five such branches are set up in Australia. The branches are run by Australians and employ Australian religious instructors. The centres fundraise and collect donations for local events and activities as well as the international centres.

Head management in Beijing describes how the divisions are to be run, in a financial and administrative sense.

The religious society operates for the benefit of those that attend the religious seminars. It is estimated that approximately 500 people attend the seminars held by each branch. Each year, approximately 40 per cent of all income derived is sent back to Beijing, with 60 per cent used in Australia.

On balance, the Australian branches will not meet the 'in Australia' conditions. Whilst more than half of all income is kept in Australia, the head office exercises such a high degree of control over the Australian branches that the entity cannot be said to be operating principally in Australia. Moreover, 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.

Example 1.5: Overseas control

An entity which manages assets to provide educational scholarships to disadvantaged young people around the world, based in Canada, wishes to start providing scholarships to Australian citizens, to study both in Australia and abroad.

The scholarships will pay a weekly amount to the recipients to go to an Australian university or an overseas university.

The organisation sets up a local Australian division (as a separate entity) with two employees who vet applications and choose recipients. However, the central management and control of the whole organisation remains located overseas.

Although most of the money from the scholarships will be going overseas (by being paid weekly to Australian citizens studying overseas), the scholarships are benefiting Australians, and the organisation has a subsidiary located in Australia, with Australian employees.

It is likely that on balance the Australian branch of the organisation will meet the 'in Australia' special conditions. Although central management and control remains overseas, the amount of expenditure, operations and beneficiaries located in Australia could satisfy the special conditions.

1.65 An organisation does not have a sufficient connection with Australia if it is present in Australia only through an agent, or it merely owns investment property in Australia.

1.66 However, what assets the organisation has in Australia are a consideration for the special conditions.

1.67 A further factor to consider is what employees the organisation has in Australia.

1.68 The pursuit of purposes in Australia can include things done offshore if they are only a means of pursuing those Australian purposes.

Example 1.6: Pursuing purposes by offshore means

QUU Charity, which is a resident of Australia, and operates 60 per cent in Australia, had decided to send some employees to an offshore conference to aid their efficiency for the Australian purposes.

This would be considered 'pursuing purposes in Australia' and will not result in QUU failing the 'principally in Australia' test.

1.69 The extent of the entity operating and pursuing its purposes principally in Australia will depend on the amount of relative monies and activities that are in Australia relative to the whole organisation.

1.70 All the factors relevant to the special conditions need to be considered to determine whether overall, on balance, an entity could be considered to be operating 'in Australia' and thus meet the special conditions.

Example 1.7: Overseas control

An overseas aid agency is established in France and has a division in Australia. French staffers are sent over to Australia to manage the Australian office. The French agency purchases a building within the city and organises the Australian fundraising activities from there. The Australian branch conducts fundraising activities in Australia and uses the funds to support Australian aid initiatives within Australia. Ten per cent of all monies are sent back to the head office in France each year, to go towards the costs of international administration.

The Australian branch will not meet the in Australia test. This is because it is a branch and has not been set up as a separate Australian entity and therefore given the entities overall activities, it is not operating principally or pursuing its purposes principally 'in Australia'.

> If, however, an entity is established or incorporated in Australia to undertake the branch's activities then the entity would meet the 'in Australia' special conditions as, on balance, the fact that the organisation owns assets, conducts fundraising, employs Australian individuals and spends money in Australia would likely lead to it meeting the 'in Australia' special conditions.

1.71 However, certain distributions may be made overseas and disregarded when considering whether an entity meets the 'in Australia' special conditions relating to income tax exempt entities.

1.72 These are distributions received by way of government grant and distributions received as a gift or contribution (money or other property) in circumstances where the provider is not an income tax exempt entity, and is not entitled to a deduction under Division 30 of the ITAA 1997 in respect of the gift or contribution. ***[Schedule #, item 31, subsection 50-50(5)]***

1.73 In order for such gifts to be disregarded, the entity must ensure that they meet any requirements set out in the regulations, if there are any requirements. ***[Schedule #, item 31, subsection 50-50(5)]***

1.74 These requirements are expected to include such things as:

- the entity must take reasonable steps to obtain evidence that shows that any activities undertaken outside Australia are a genuine attempt to give effect to its purposes, and the use of any money or property outside Australia is effective in achieving the entity's purpose;
- if the entity works with another person (however described) on activities outside Australia, the entity must demonstrate that it effectively interacts and coordinates activities with the other person;
- the entity must not commit a serious infringement of Australian laws; and
- the entity must have in place reasonable governance processes for the proper monitoring of any overseas activities to ensure that any money and property is being used in an proper and effective manner.

1.75 A slightly narrower test is applied to deductible gift recipients – see paragraphs 1.102 to 1.139.

Conduit not-for-profit entities

1.76 If an entity provides money, property or other benefits to another entity that is not an income tax exempt entity, the use of the money, property or other benefits by the recipient (or any other entity) must be taken into account when determining whether the entity satisfies the 'in Australia' special conditions. ***[Schedule #, item 31, subsection 50-50(4)]***

1.77 As such, if an income tax exempt entity provides money, property or other benefits to another entity to further its purpose, if the receiving entity is not income tax exempt, the income tax exempt entity must satisfy itself about how the entity it has provided money, property or other benefits to, uses these funds, and take account of the use of this money, property or other benefits for the purposes of determining whether it is operating principally in Australia.

1.78 When an entity provides money, property or benefits to another entity, it will generally give the money for a particular purpose or cause, and the entity should have a reasonable knowledge of where this purpose or cause is intended to be carried out.

1.79 However, the entity need only take all those steps that are reasonable to confirm or trace the use of money, property or benefits by the other entity (or any other entity) outside Australia. ***[Schedule #, item 31, subsection 50-50(4A)]***

1.80 Provided that the entity takes all reasonable steps to have or obtain knowledge of the use of the funds, and is satisfied that the use of the funds does not change its status as income tax exempt, if it later transpires that the funds were spent in such a manner that would result in the loss of status of the providing entity, the entity will be able to rely on the reasonable and genuine steps it has taken to demonstrate compliance with the special conditions.

Example 1.8: Taking account of money provided to other entities

Thoughtful Church received a non-tax deductible donation of $20,000.

The Church provides $5,000 to a project in outback Australia. The money is provided to build a library.

The Church confirms that the library is being built in regional Australia, and that building has commenced.

This would be adequate in confirming that the funds provided are spent in Australia.

Example 1.9: Taking account of money provided to other entities

Myra Charity receives donations and income of $10,000 in an income tax year. They are not a deductible gift recipient.

Myra provides $8,000 to West Charity. West Charity is located in Australia and is not income tax exempt. West Charity passes the money to its local partner in Africa to build a school.

Myra Charity would not meet the 'in Australia' special conditions, as it is not operating principally in Australia, and incurring its expenditure principally in Australia. Although Myra provides the $8,000 to an entity in Australia, Myra must consider the use of this money offshore when considering whether it is meeting the 'in Australia' special conditions.

1.81 The requirement should present no greater an obligation on entities than already exists under charity law and the existing Australian Taxation Office endorsement framework.

Example 1.10: Taking account of money provided to other entities

Milo Ltd is an income tax exempt charity established for the purpose of preventing and relieving suffering of animals. It receives $50,000 in donations and income in an income tax year. They are not a deductible gift recipient.

Milo Ltd provides $40,000 to another entity with the aim of giving effect to its purpose, Rescue Puppies Veterinary Services Ltd, which is located in Australia and is not income tax exempt. Before providing the money, Milo Ltd made inquiries about how Rescue Puppies Veterinary Services Ltd would use the money, and developed an agreement with them, which provided that the funds had to be used only to care for abused puppies in South Australia.

Rescue Puppies Veterinary Services Ltd, in breach of their agreement, and unbeknownst to Milo Ltd, provides the money to Rogue Ltd, which operates overseas. Rescue Puppies Veterinary Services Ltd did not make any inquiries about how Rogue Ltd intended to spend the money. Rogue Ltd uses the money to conduct illegal activities overseas.

It would not be reasonable for Milo Ltd to have knowledge about the use of the money outside Australia, as they took appropriate steps to satisfy themselves that the money would be used in Australia in accordance with their agreement, and were genuinely deceived about its ultimate use. Milo Ltd would not breach the 'in Australia' conditions.

1.82 If an income tax exempt entity provides money to another income tax exempt entity, the receiving entity will itself have met the 'in Australia' special conditions and be operating principally in Australia, or be expressly exempt. An entity therefore does not need to take account of the eventual use of these funds by the donee entity.

Example 1.11: Taking account of money provided to other entities

Jones Charity is a not-for-profit entity operating for the relief of poverty.

Floods hit a certain area, and many people are forced from their homes. Jones Charity gives a portion of its funds to a tax exempt charity local to the area of the floods. This entity is income tax exempt.

Jones charity does not need to trace the final use of the funds, as the entity it has provided the money to is itself income tax exempt, and Jones Charity has confirmed this by checking the Australian Business Register.

1.83 This fixes the problem that arose in *Word Investments*, that entities are considered to be pursuing their objectives principally 'in Australia' if they merely operate to pass funds within Australia to another charity that conducts its activities overseas, and ensures that tax exempt entities cannot avoid the special conditions by having other entities use its funds on activities it itself cannot undertake.

1.84 In a *Word Investments* scenario, the entity distributed its money to WBT, which then expended the money offshore. If an entity such as *Word Investments* now provides money to another entity that is not income tax exempt, it must consider the location of the final spending of this money when determining whether it is operating and pursuing its purposes solely in Australia.

1.85 Whether WBT is income tax exempt will depend on whether it meets the 'in Australia' special conditions in a particular income year. If, for example, WBT does not operate principally in Australia in a particular year (because they pass all funds overseas in that year), WBT would no longer be income tax exempt.

1.86 In this case, the entity would need to consider the amounts of money provided to entities such as WBT (and whether they are ultimately spent offshore) when considering whether it is operating and pursuing its purposes principally in Australia.

1.87 If the entity provides all its funds to WBT, who continues to pass these funds overseas, the entity will no longer be considered to be operating and pursuing their purposes solely in Australia, and will not be income tax exempt.

1.88 This test works to ensure that the core test (as described in paragraph 1.58 above), that requires an entity to operate and pursue its purposes principally in Australia, takes account of all relevant circumstances and cannot be avoided by having another entity conduct activities that the primary entity cannot do itself.

1.89 For example, an entity that advances its charitable purposes by undertaking commercial activities with the purpose of generating surpluses that are donated to another entity with similar charitable purposes must consider the charitable spending of the donated funds when determining if it meets the 'in Australia' special conditions.

1.90 Under existing charity law, for a charity to make a gift, it would need to ensure that the entity receiving the donation had similar or identical purposes. If it did otherwise, the entity making the donation could no longer itself be considered exempt.

1.91 Similar purposes would include a charity giving to another charity, regardless of their individual charitable purposes. However, a charity gifting money to an entity established for the encouragement of sport, for example, or an entity established for the encouragement of sport gifting money to an entity established for the promotion of agriculture, would not be considered similar purposes.

1.92 This, however, should not be read as preventing a charity from utilising a different not-for-profit as a means to carry out or give effect to its charitable purpose. For example, a charity may be able to give to a sporting group for the purposes of a program introducing disabled people to learn the benefits of exercise.

Example 1.12: Unrelated commercial activities for charitable purposes

Putter Ltd runs a commercial bread business, with the objective of helping the poor (and donating all profits to SWS, a charitable company that is not income tax exempt, who run homeless shelters around Australia and Asia).

SWS do not operate principally in Australia, as 75 per cent of any funding goes to aiding shelters in the Asian region.

Putter Ltd would not be considered to be income tax exempt if it distributes all surplus funds to SWS, as Putter Ltd would not be considered to be operating principally in Australia, given that SWS expends 75 per cent of all funds overseas.

While Putter Ltd operates in Australia, and has staff in Australia, the spending of the money for charitable purposes occurs primarily overseas, even though SWS operates in Australia.

For Putter Ltd to be income tax exempt, they could provide a smaller portion, such as 60 per cent, of their income to SWS, so that overall, they are considered to be operating principally in Australia. The rest of the money would need to be donated and spent within Australia, to further their charitable purpose of helping the poor.

Example 1.13: Passive investment activities for charitable purposes

SmithJones operates a passive investment income fund in Australia, with Australian staff, with the objective of helping abandoned animals.

SmithJones donates all of their returns to BlackBrown, who also have a purpose of helping abandoned animals. BlackBrown is established and set up in Australia and is not income tax exempt.

Every income year, BlackBrown donates all money they receive to an entity overseas, for spending on abandoned animals, and SmithJones is aware that BlackBrown does so. The overseas entity was not listed in the regulations as income tax exempt in Australia. The donation includes the money gifted from SmithJones.

SmithJones do not meet the 'in Australia' special conditions. Although they donated all surplus funds to an organisation located and operating in Australia, the gifted funds were ultimately spent overseas.

SmithJones would be expected to know what the final charitable spending of the funds they donated to BlackBrown is, and include the spending when considering whether they meet the 'in Australia' special conditions.

1.93 If an entity pursues its purposes through a combination of direct activities and donations to other similar entities, one or both elements of the test respectively need to be applied to the respective 'activities' of the entity.

1.94 Restating this element of the test overcomes the High Court's decision in *Word Investments* by applying an adjusted test to entities that pursue their purposes by merely passing funds to other entities.

Exceptions from the 'in Australia' special conditions

1.95 Entities categorised as primary and secondary resources, and tourism are exempt from the 'in Australia' special conditions. In order to be income tax exempt they must continue to be non-profit entities.

1.96 Government and most Government related entities are also exempt from the 'in Australia' special conditions, but must meet the other special conditions attached to exempt entities.

Regulation making power

1.97 Overseas entities, or entities which are resident in Australia but operate and pursue their objectives principally outside Australia, which do not meet the 'in Australia' special conditions, but do meet the other special conditions to become income tax exempt (they are non-profit entities, and comply with all their substantive governing rules, and apply their income and assets solely to pursue the purposes for which they are established) may be prescribed in the regulations as income tax exempt entities in special circumstances. ***[Schedule #, item 31, paragraphs 50-51(2)(c) and (d)]***

1.98 This power is intended to be applied only in exceptional circumstances, at the discretion of the Governor-General in Council. The Governor-General is expected to consider matters such as whether the entity will be providing a broad benefit to the Australian community, the national interest, tax system integrity, the risk of the entity being utilised for money laundering or terrorist financing and any other relevant considerations. This power is subject to Parliamentary scrutiny, by way of disallowance.

1.99 However, an entity may not be prescribed if the entity is a foreign resident and it is not exempt from foreign income tax in the country in which it is resident. ***[Schedule #, item 31, subparagraph 50-51(2)(c)(i)]***

1.100 This ensures that Australia does not extend a concession to an entity that does not receive such a concession in its home jurisdiction. If the entity was not required to be exempt from income tax in the country which it is resident, the outcome would be that Australia gives up its taxing rights over the entity's Australian sourced income to a foreign jurisdiction.

1.101 In prescribing an entity, the Governor-General may set conditions for the exemption to order to ensure the exemption is not misused.

Deductible gift recipients

1.102 Deductible gift recipients (or entities endorsed as deductible gift recipients for the operation of a fund, authority or institution, to the extent that they operate that fund, authority or institution) are exempt from the 'in Australia' special conditions for income tax exempt entities in Division 50 of the ITAA 1997 because deductible gift recipients are subject to a separate test. ***[Schedule #, item 31, paragraphs 50-51(2)(a) and (b)]***

1.103 The new law codifies the 'in Australia' special conditions for deductible gift recipients so that the core principle for income tax exempt entities is applied similarly to deductible gift recipients but with a differing (stricter) threshold test. ***[Schedule #, items 1, 2 and 18, subsection 30-15(2), section 30-18 and paragraph 31-10(2)(a)]***

1.104 Standardising the core elements of the special conditions will minimise compliance costs on deductible gift recipients and simplify the tax framework applying to not-for-profit entities.

1.105 The 'in Australia' special conditions for deductible gift recipients are set out in Division 30 of the ITAA 1997.

1.106 Deductible gift recipients generally must:

- be established in Australia;
- operate solely in Australia; and
- pursue their purposes solely in Australia.

[Schedule #, item 2, subsection 30-18(1)]

1.107 'Solely in Australia' is to be interpreted as requiring deductible gift recipients to be established and operated only in Australia (including control, activities and assets) and must have their purpose and beneficiaries only in Australia.

Example 1.14: Pursuit of purposes

A public museum is incorporated in New Zealand and has a branch in Australia.

It is not 'in Australia'. It cannot be endorsed as a deducible gift recipient.

Example 1.15: Pursuit of purposes

A fund is set up and operates in Australia. It makes its donations for the construction of schools run by a religious institution in Europe.

The fund is not 'in Australia'. It cannot be endorsed as a deductible gift recipient unless covered by an exempt category.

1.108 Each entity seeking endorsement as a deductible gift recipient status must be assessed according to its own facts and circumstances and not those of any other member of a group of entities to which it is a part. However, if it provides money or property to other members of the group, it may have to take account of the eventual use of that money. Therefore, if a deductible gift recipient conducts substantial activities outside Australia, it may consider establishing a separate subsidiary to undertake these activities. This would enable the deductible gift recipient to easily demonstrate that it is operating solely in Australia, and may also provide other benefits (for example, a risk mitigation strategy to enable the protection of its Australian assets).

1.109 The majority membership of an Australian subsidiary by an overseas entity will not of itself contravene the 'in Australia' requirement.

1.110 A deductible gift recipient does not fail the 'operating solely in Australia' and 'pursuing purposes solely in Australia' if the overseas activities are merely incidental to the operation and pursuit of the entity's purposes in Australia, or the overseas activities are minor in extent and importance when considered with reference to the operations and pursuit of the entity's Australian activities. Further, the overall quantum of an entity's overseas expenditure should also be considered by reference to current public expectations about what is considered minor. ***[Schedule #, item 2, subsection 30-18(2)]***

Example 1.16: Minor and incidental activities

A large public museum operating in Australia has a large permanent collection of artwork in Australia, as well as collections which tour around Australia.

The museum has made an arrangement to send temporarily, a collection of artwork overseas, along with an individual who is an expert in the collection era, in return for receiving a temporary exhibition of artwork from overseas.

This would be considered to be incidental when considered with reference to the museum's operations and pursuit of purposes in Australia.

Example 1.17: Minor and incidental activities

A public benevolent institution is set up in Australia to help Australians suffering from cancer. A small part (about five per cent of the overall cost) of the treatment it provides involves travel to Canada. The institution would still meet the 'in Australia' special conditions.

Example 1.18: Minor and incidental activities

Sophie is a 10 year old Australian girl with cancer. The most appropriate treatment for Sophie is not available in Australia, and is only available at a clinic in Germany. Sophie's family cannot meet the costs of this treatment, and a necessitous circumstances fund is established to help support Sophie, including her treatment in Germany.

As the individual receiving relief from the necessitous circumstances fund is an Australian, the management and control of the fund is in Australia, and the fund is also used to support Sophie's other needs in Australia, the fund would still meet the 'in Australia' special conditions.

Example 1.19: Minor and incidental activities

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.

The institution would still meet the 'in Australia' special conditions.

Example 1.20: Minor and incidental activities

A youth orchestra undertakes an overseas tour for one week to undertake performances. The youth orchestra is supported by a public fund on the Register of Cultural Organisations.

This tour would be considered merely incidental to the pursuit of the purposes of the orchestra in Australia.

The public fund would still meet the 'in Australia' special conditions.

Example 1.21: Minor and incidental activities

A visual arts organisation which is a deductible gift recipient tours Australia with exhibitions and undertakes no overseas activities for three years. The visual arts organisation is supported by a public fund on the Register of Cultural Organisations.

The following year they undertake a tour overseas which lasts three months.

This tour would be considered minor and incidental when considered with reference to the organisation's operations and pursuit of purposes in Australia, and the public fund would not lose its deducible gift recipient status.

Example 1.22: Minor and incidental activities

An orchestra is a deductible gift recipient. In one year, it undertakes over 100 concerts in Australia attended by over 200,000 people, as well as some educational activities and workshops. The orchestra is supported by a public fund on the Register of Cultural Organisations.

The orchestra undertakes an overseas tour comprising of 10 performances, attended by 18,000 people.

This overseas tour would be considered to be incidental when considered with reference to the orchestra's operations and pursuit of purposes in Australia, and the public fund would not lose its deducible gift recipient status.

Example 1.23: Minor and incidental activities

A dance company which is a deductible gift recipient employs around 100 Australian dancers. At any one time, around 80 dancers are performing only in Australia, and about 20 dancers are performing overseas as part of a tour. The dance company is supported by a public fund on the Register of Cultural Organisations.

The performances held in Australia are attended by about 160,000 people, and the overseas performances are attended by about 40,000 people.

The dance company's assets (comprising several dance studios) are all located in Australia, and all 100 employees are Australian. The company is managed from its headquarters in Melbourne.

The overseas performances are likely to be minor and incidental, when considered with reference to the fact that the company is managed from Australia, has all of its assets in Australia and all of its employees are Australian. The public fund would not lose its deductible gift recipient status.

1.111 Entities that are deductible gift recipients under the category of 'international affairs' are exempt from the deducible gift recipient 'in Australia' special conditions. ***[Schedule #, item 2, subsection 30-18(5)]***

1.112 This includes entities which are specifically listed under the 'international affairs' category. Organisations that are specifically listed in other sections of Division 30 must continue to meet the 'in Australia' special conditions.

1.113 These deductible gift recipients include overseas aid funds, developed country relief funds and similar deductible gift recipients where their activities are clearly intended to be undertaken overseas. This is in recognition that although some organisations are not operating in Australia, it is considered that they nonetheless further Australia's overseas aid objectives and therefore contribute to the broad public benefit of the Australia community.

1.114 Entities in this category include those granted assistance through the Overseas Aid Gift Deductibility Scheme (OAGDS). Consistent with Australia's broader overseas aid program, the OAGDS is aimed at development initiatives which aim to improve the wellbeing of whole communities.

1.115 The OAGDS has appropriate integrity requirements in place to ensure that this taxpayer funded concession is directed to the causes that it was donated for, and not at risk of being misdirected to inappropriate and unauthorised operations. These integrity requirements are supported by special administrative arrangements because of the difficulties associated with monitoring activities undertaken outside of Australia.

1.116 In addition, entities on the Register of Environmental Organisations, which the Environment Minister determines as being exempt from the 'in Australia' special conditions, may also undertake overseas activities. This reflects the need for a number of environmental organisations to operate more broadly in order to effect change that will be of benefit to the Australian public. However, in order to ensure the integrity of the deductible gift recipient regime, an exemption from the 'in Australia' conditions will be limited to certain entities listed on the register. ***[Schedule #, items 2 and 9, subsections 30-18(7) and 30-280(1)]***

1.117 The Environment Minister must make his or her decision about granting an exemption based on the requirements detailed in the regulations. ***[Schedule #, item 2, subsection 30-19(1)]***

1.118 These requirements are expected to include such things as:

- the entity must have a genuine need to conduct activities outside Australia in order to further its purpose;
- the entity must take reasonable steps to obtain evidence that shows those activities undertaken outside Australia are an effective means of achieving its purpose;
- if the entity works with another person (however described) on activities outside Australia, the entity must take

reasonable steps to obtain evidence that it effectively interacts and coordinates activities with the other person;

- the entity must not commit a serious infringement of Australian law; and

- the entity must take reasonable steps to put in place appropriate governance arrangements for the proper monitoring of any overseas activities to ensure that any money and property is being used in an proper and effective manner.

1.119 This ensures appropriate integrity requirements are in place to ensure that the deductible gift recipient concession is directed to the causes that it was donated for, and not at risk of being misdirected to inappropriate and unauthorised operations.

1.120 A fund or the organisation that maintains it may apply to the Administrative Appeals Tribunal for review of a decision to make or not make a determination to provide an exemption to the 'solely in Australia' condition. ***[Schedule #, item 2, subsection 30-19(4)]***

1.121 Deductible gift recipient includes both entities that are themselves deductible gift recipients and entities that are deductible gift recipients because they operate a certain type of public fund. However, these conditions only apply to the portion of the entity or public fund that is endorsed as a deductible gift recipient. Similarly, the part of the entity that is a deductible gift recipient is disregarded when applying the income tax exemption special conditions.

1.122 If an organisation subject to the 'in Australia' special conditions operates a fund, authority or institution that is covered by the 'international affairs' category or the group of Register of Environmental Organisations allowed to operate overseas, the organisation need only consider its operations, ignoring the approved overseas component, when assessing the entity against the special conditions. ***[Schedule #, item 2, subsection 30-18(7)]***

1.123 For example, an entity may be a public benevolent institution, which is a deductible gift recipient, but operate an overseas aid fund covered by the international affairs category. In this case, only the overseas aid fund should be exempt from the 'solely in Australia' requirements. The public benevolent institution portion of the organisation should still be able to be a deductible gift recipient, subject to the 'solely in Australia' requirements.

Example 1.24: Solely 'in Australia'

An entity is endorsed as a charitable institution in Australia. It operates a public fund which is as a deductible gift recipient under the Register of Cultural Organisations.

Only the funds relating to the public fund are required to meet the deductible gift recipient 'in Australia' special conditions, not the entire entity.

The charitable entity is required to operate principally 'in Australia' in order to be income tax exempt. This consideration does not include funds related to the deductible gift recipient portion of the organisation.

1.124 If a fund, authority or institution provides money, property or other benefits to another entity (that is not itself a deductible gift recipient) to further its purposes, then the fund, authority or institution must take into account the use of the money, property or other benefits by the receiving entity or any other entity when determining whether it meets the 'in Australia' special conditions for deductible gift recipients ***[Schedule #, item 2, subsection 30-18(3)]***.

1.125 This ensures that entities cannot be considered to be pursuing their objectives solely 'in Australia' if they merely operate to pass funds within Australia to another entity that conducts its activities overseas.

1.126 When considering the provision of money, property or other benefits to another entity, the fund, authority or institution need only take all reasonable steps to trace the use of the funds. This includes if the entity in receipt of the funds passes the provided funds on to another entity.

1.127 The fund, authority or institution need only take all those steps that are reasonable to have knowledge of, or obtain knowledge of, the use of the money, property or benefits by the other entity (or any other entity) outside Australia. ***[Schedule #, item 2, subsection 30-18(4)]***

1.128 Provided that the fund, authority or institution takes all reasonable steps to trace the use of the funds, and is satisfied that the use of the funds do not change its status as a deductible gift recipient, if it later transpires that the funds were spent in such a manner that would result in the loss of status of the providing entity, the entity will be able to rely on the genuine steps it has taken to demonstrate compliance with the special conditions.

1.129 When an entity gives money to another entity, it will generally give the money for a particular purpose or cause, and the entity will know where this purpose or cause is intended to be carried out. For example, a public benevolent institution deductible gift recipient may provide money to an entity to build a homeless shelter in Melbourne CBD.

1.130 However, if a fund, authority or institution gives money, property or other benefits to another deductible gift recipient, the receiving entity will itself have met the 'in Australia' special conditions and be operating solely in Australia, or be expressly exempt. The fund, authority or institution therefore does not need to take account of the eventual use of these funds by the donee deductible gift recipient.

1.131 A fund, authority or institution established and maintained solely for the purpose of providing money for scholarships, bursaries or prizes to which section 30-37 of the ITAA 1997 applies needs only to be established in Australia, and does not need to operate solely in Australia, or pursue its purposes solely in Australia. This is consistent with the current law. ***[Schedule #, item 2, subsection 30-18(5)]***

1.132 Under section 30-37 of the ITAA 1997, the scholarships, bursaries or prizes can only be awarded to Australian citizens or permanent residents for pre-approved courses, and are monitored and properly assessed. The overseas component of the scholarship is by way of study of a component of certain courses only, so while it is likely that the overseas portion would be considered an activity which is merely incidental to the operations and purposes of the entity, or minor in extent and importance when considered with reference to the operations and purposes of the entity, this removes any doubt about the outcome.

1.133 When determining whether they meet the 'in Australia' special conditions, a fund, authority or institution may disregard payments received from a government entity by way of a grant or contractual arrangement, when the payment was specifically provided with the purpose for being spent overseas. For example, a public benevolent institution enters into a contractual arrangement with the Government to provide support to asylum seekers in Nauru. ***[Schedule #, item 2, subsection 30-18(10)]***

1.134 As medical research is an international collaboration activity, the new law creates a new deductable girt recipient category for medical research institutions that operate outside Australia. Medical research institutions listed in this new deductable girt recipient category will still be required to be established in Australia, but will be exempt from the remainder of the 'in Australia' special conditions. ***[Schedule #, item 7, subsection 30-80(1)]***

1.135 In addition, touring arts organisations on the Register of Cultural Organisations, which the Arts Minister determines as being exempt from the 'in Australia' special conditions, may also undertake overseas activities. This reflects the need for a number of touring arts organisations to operate more broadly in order to give effect to their purposes and enhance Australia's international reputation in the performing arts. However, in order to ensure the integrity of the deductible gift recipient regime, an exemption from the 'in Australia' conditions will be limited to certain touring arts organisations that meet the requirements set out in the regulations. ***[Schedule #, items 2 and 10, subsections 30-18(9), 30-19(2), (3) and 30-305(1)]***

1.136 The fund or organisation must have the principal purpose of promoting the performing arts ***[Schedule #, item 2, paragraph 30-19(3)(b)]***. The 'performing arts' includes theatre, circus, contemporary dance, Aboriginal dance, classical ballet, classical music, opera, and musicals. It is not intended to include visual arts, craft and design.

1.137 The requirements in the regulations are expected to include such things as:

- the entity must have a genuine need to conduct activities outside Australia in order to further its purpose, and must enhance Australia's international reputation in the performing arts;
- the entity must take reasonable steps to obtain evidence that shows those activities undertaken outside Australia are an effective means of achieving its purpose;
- if the entity works with another person (however described) on activities outside Australia, the entity must take reasonable steps to obtain evidence that it effectively interacts and coordinates activities with the other person;
- the entity must not commit a serious infringement of Australian law; and
- the entity must take reasonable steps to put in place appropriate governance arrangements for the proper monitoring of any overseas activities to ensure that any money and property is being used in an proper and effective manner.

1.138 This ensures appropriate integrity requirements are in place to ensure that the deductible gift recipient concession is directed to the causes that it was donated for, and not at risk of being misdirected to inappropriate and unauthorised operations.

1.139 A fund or the organisation that maintains it may apply to the Administrative Appeals Tribunal for review of a decision to make or not make a determination to provide an exemption to the 'solely in Australia' condition. ***[Schedule #, item 2, subsection 30-19(4)]***

Consequential amendments

1.140 The new law replicates the arrangements allowing the Commissioner to check the status of specifically listed deductible gift recipients, and extends it to entities prescribed in the regulations as income tax exempt even though they fail the 'in Australia' special conditions. ***[Schedule #, item 37, section 353-30 in Schedule 1 to the Taxation Administration Act 1953]***

1.141 The Commissioner may require an entity prescribed in the regulations to give him or her information relevant to the entity's status as a prescribed entity.

1.142 This allows the Commissioner to review whether a prescribed entity continues to be eligible to be income tax exempt, reflecting the Commissioner's current power to review the eligibility of specifically listed entities.

1.143 This provision does not remove the privilege against self-incrimination.

1.144 The Commissioner is to review and advise the Minister if the entity is or is not operating consistently with the obligations imposed on its listing. ***[Schedule #, item 37, subsection 353-30(2) in Schedule 1 to the Taxation Administration Act 1953]***

1.145 The conditions for eligibility for a refund of franking credits to certain not-for-profit entities currently mirror the existing 'in Australia' special conditions in Division 50 of the ITAA 1997. The new law replicates the Division 50 changes for the refund of franking credit rules for not-for-profit entities by cross referencing the newly re-stated special conditions. ***[Schedule #, item 36, section 207-117]***

1.146 The definition of 'overseas charitable institution' in the *Income Tax Assessment Act 1936* references a section now brought within the standardised new special conditions, and the reference is updated

accordingly. The section refers to the previous 'in Australia' special conditions, referring to a foreign resident institution, the income of which would be exempt from section 50-5 if the institution had a physical presence in Australia and incurred its expenditure and pursued its purposes principally in Australia. This will now reference the new 'in Australia' special conditions. ***[Schedule #, item 35, section 121C of the Income Tax Assessment Act 1936]***

1.147 There are a number of specifically listed entities which were approved to operate overseas but are not listed in the international affairs category. The new law relocates these listings from their current place in Division 30 to the 'international affairs' category. ***[Schedule #, items 3 to 6, 8, 11, 12 and 13 to 17, subsections 30 25(2), 30-40(2), 30-45(2), 30-55(2), 30-80(2) and section 30-315]***

Application and transitional provisions

1.148 The measure commences on the day after Royal Assent, and applies to determine whether an entity is entitled to be income tax exempt or remain income tax exempt for income tax years starting the day after Royal Assent. ***[Schedule #, subitem 38(3)]***

1.149 Any regulations made under the existing legislation will remain in force as if made under the new law until they can be re-made. Entities listed in the regulations prior to commencement of this measure will be transitioned, and hence unaffected by the changes. ***[Schedule #, item 39]***

1.150 The measure applies to determine whether an entity is entitled to be a deductible gift recipient or remain a deductible gift recipient from the day after Royal Assent. ***[Schedule #, subitem 38(1)]***

1.151 Funds, authorities and institutions that are endorsed as deductible gifts recipients prior to introduction of the Bill, and are not meeting the 'in Australia' special conditions, have a transitional period of 12 months in which to comply with these new rules. ***[Schedule #, subitem 38(2)]***

Chapter 2
Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Restating and standardising the special conditions for tax concession entities

2.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.2 This Bill:

- re-states the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community (with some exceptions); and
- centralises the other special conditions entities must meet to be income tax exempt, such as complying with all the substantive requirements in their governing rules (with some exceptions); and
- codifies the 'in Australia' special conditions for deductable gift recipients ensuring that they must generally operate solely in Australia, and pursue their purposes solely in Australia (with some exceptions, such as overseas aid funds and some environmental organisations).

Human rights implications

Right to privacy

2.3 Article 17 of the *International Covenant on Civil and Political Rights* (ICCPR) provides that no one shall be subjected to arbitrary or unlawful interference with their privacy. Privacy guarantees a right to secrecy from the public of private characteristics, actions or data.

2.4 Collecting, using, storing and sharing personal information amount to interferences with privacy.

2.5 In order for an interference with privacy not be 'arbitrary', the interference must be for a reason consistent with the ICCPR and reasonable in the particular circumstances.

2.6 'Reasonableness', in this context, incorporates notions of proportionality to the end sought and necessity in the circumstances. Generally, this means that provisions interfering with privacy should be precise, that they should not give decision-makers too much discretion in authorising interferences, and that they should provide proper safeguards against arbitrary interference.

2.7 Proposed section 353-30 in Schedule 1 to the *Tax Administration Act 1953* provides that the Commissioner of Taxation (Commissioner) may require an entity that is prescribed in the regulations to give him or her information relevant to the entity's status as a prescribed entity. Such information may include personal information, however, this is unlikely.

2.8 The information gathered must be relevant to the status of an entity in its capacity as a prescribed entity. The information may be necessary for determining whether an entity is still meeting the conditions of its prescription.

2.9 The decision to prescribe an entity as income tax exempt under the *Income Tax Assessment Act 1997* is a policy decision. An entity's prescription is usually contingent on certain activities of the entity, or subject to certain conditions. When the entity is prescribed, they would usually receive a letter outlining the conditions on their ability to be income tax exempt. Section 353-30 allows the Commissioner of Taxation to check that an entity is abiding by any conditions that it's tax exemption is contingent on (and hence still eligible to be income tax exempt), and if it is not, to disclose this information to the Minister.

2.10 The wording in section 353-30 mirrors that already in section 353-20 in Schedule 1 to the *Taxation Administration Act 1953*. The current law allows the Commissioner to check the status of specifically listed deductible gift recipients. Both specifically listed deductible gift recipients and prescribed entities are listed in the tax laws based on a policy, rather than an administrative decision, and the listing is often subject to certain conditions. For this reason, section 353-30 was kept consistent with the Commissioner's current powers for deductible gift recipients, and extended to cover income tax exempt entities.

2.11 The Commissioner must disclose to the Minister if there is a change in the principal purpose of the entity, or the entity is not complying with any rules or conditions that were required in order for the entity to remain a prescribed entity. The Minister may only disclose information provided by the entity (as requested by the Commissioner) for a purpose relating to the entity's status as a prescribed entity.

2.12 As such, this provision would not be considered be 'arbitrary'.

Presumption of innocence

2.13 Article 14 of the ICCPR provides that all persons shall be equal before the courts and tribunals and everyone charged with a criminal offence shall have the right to be presumed innocent until proven guilty according to law.

2.14 This Article imposes on the prosecution of an offence, the burden of proving the charge, guarantees that no guilt can be presumed until the charge has been proved beyond reasonable doubt and ensures that the accused has the benefit of doubt.

2.15 As per paragraph 30 of UN Human Rights Committee, General Comment No. 32 (2004), this human right is normally engaged where public authorities make public statements affirming the guilt of the accused, shackle or keep defendants in cages during trials indicating that they may be dangerous criminals or allow the media to show news coverage that undermines the presumption of innocence.

2.16 It could be argued that where legislation places a legal burden on the defendant, this may engage the right to a presumption of innocence under Article 14 of the ICCPR.

2.17 It is very unlikely that subsection 353-30(6) would result in a person being convicted of the relevant offence despite reasonable doubt as to their guilt. The purpose of the section is to confirm that an entity is meeting the conditions (if any) required for it to remain tax exempt.

However, if such a situation arose, given the risks to revenue (resulting from an incorrect tax exemption), and that the evidence would be uniquely held by the defendant, it would be appropriate for them to prove that the defences are available to them.

2.18 Subsection 363-30(6) makes two defences available to persons. This may require an entity to prove that it:

- did not aid, abet, counsel or procure the act or omission because of which the offence is taken to have been committed; and

- was not in any way, by act or omission, directly or indirectly, knowingly concerning in, or party to, the act or omission because of which the offence is taken to have been committed.

2.19 Information required under section 353-30 is necessary for determining whether an entity is still meeting the conditions of its prescription. This may affect the collection of revenue.

2.20 The tax system operates on a largely self-assessment basis. For this reason, the burden on proof largely falls on taxpayers in relation to disputes with the taxation authorities because it is the taxpayer who possesses all the evidence of their compliance or non-compliance with the tax law.

2.21 It is common amongst Commonwealth revenue regimes to place the legal burden on the defendant where the defendant seeks to rely on an exception or defence to the general prohibition on disclosure of information (an offence specific defence).

2.22 This is appropriate because the defendant (in these situations) holds all of the evidence which is uniquely in their possession.

Conclusion

2.23 This Bill is compatible with human rights.