

## **EXPLANATORY STATEMENT**

### **Issued by authority of the Assistant Treasurer**

*Income Tax Assessment Act 1997*

*Tax Laws Amendment (2014 Measures No. #) Regulation 2014*

Section 909-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The purpose of this Regulation is to put in place integrity rules that certain entities must meet in order to be either exempt from the ‘in Australia’ special conditions that would otherwise apply to tax exempt entities or deductible gift recipients (DGRs), or to be able to disregard certain amounts when considering whether those entities meet the ‘in Australia’ special conditions. The Regulation also remakes existing regulations under the new centralised special conditions that apply to tax exempt entities, and lists certain entities by name as exempt from the ‘in Australia’ special conditions. Further details of the amendments are provided in the [Attachment](#).

In order to become and remain a DGR or an entity exempt from income tax under the ITAA 1997, an entity must fall within the categories of entity set out in either Division 30 or Division 50 of the ITAA 1997 (respectively) and meet a number of special conditions. One of the special conditions is that the entity must operate solely or principally (respectively) in Australia (the ‘in Australia’ special conditions).

Previous court decisions have altered longstanding views of the Australian Taxation Office about the proper application of the ‘in Australia’ special conditions applying to income tax exempt entities and DGRs. To address the issues raised in the Court decisions, the previous Government announced in the 2009-10 Budget that it would restate the ‘in Australia’ special conditions.

The Government announced on 14 December 2013 that it would proceed with this measure. This would ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities.

The *Tax and Superannuation Laws Amendment (2014 Measures No. #) Act 2014* amended the ITAA 1997 to restate the ‘in Australia’ special conditions, and centralise the other special conditions applying to tax concession entities.

The Regulation:

- sets out integrity rules that DGRs listed on the Register of Environmental Organisations must meet in order for the Environment Minister to authorise them as being exempt from the ‘in Australia’ special conditions;
- sets out integrity rules that DGRs that are touring arts organisations listed on the Register of Cultural Organisations must meet in order for the Arts Minister to authorise them as being exempt from the ‘in Australia’ special conditions;

- sets out integrity rules that entities must meet in order for them to be able to disregard distributions received by way of government grant and distributions received as a gift (money or other property) that is not tax deductible when considering whether they meet the ‘in Australia’ special conditions; and
- remakes existing regulations under the new centralised special conditions.

### **Conditions**

The ITAA 1997 does not specify any conditions that need to be met before the power to make the Regulation can be exercised.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

### **Description of Consultation**

The Regulation was released for a four week public consultation in January 2014.

The associated Bill has been the subject of extensive consultation, including two public consultation periods, one-on-one consultations with sector representatives, and consultation undertaken as part of a Parliamentary Committee inquiry.

### **Commencement**

The Regulation commences on the day after it is registered on the Federal Register of Legislative Instruments.

### **Financial impact**

The measure to which this Regulation gives effect 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.

**ATTACHMENT****Details of the Tax Laws Amendment (2014 Measures No. #) Regulation 2014****Section 1 – Name of Regulation**

The name of the Regulation is the *Tax Laws Amendment (2014 Measures No. #) Regulation 2014*.

**Section 2 – Commencement**

The Regulation commences on the day after it is registered on the Federal Register of Legislative Instruments.

**Section 3 – Authority**

The Regulation is made under the *Income Tax Assessment Act 1997* (ITAA 1997).

**Section 4 – Schedules**

Schedule 1 amends the *Income Tax Assessment Regulations 1997* in relation to determinations made by the Environment Minister under subsection 30-19(1) of the ITAA 1997, and determinations made by the Arts Minister under subsection 30-19(2) of the ITAA 1997.

Schedule 2 amends the *Income Tax Assessment Regulations 1997* in relation to special conditions under Division 50 of the ITAA 1997.

**Schedule 1 – Amendments relating to determinations*****Environmental Organisations***

Under section 30-19 of the ITAA 1997, the Environment Minister may exempt a fund on the Register of Environmental Organisations (REO), and the organisation that maintains it, from the ‘in Australia’ special conditions in Division 30 of the ITAA 1997 if the Minister considers that fund or organisation meets the requirements in the regulations.

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. It also ensures the integrity of the DGR regime, by limiting the exemption from the ‘in Australia’ conditions to certain entities listed on the register that meet specified criteria in the Regulations.

If a fund listed on the REO, or the organisation that maintains the fund, seeks an exemption from the ‘in Australia’ special conditions in Division 30 of the ITAA 1997, it must apply to the Environment Minister for the exemption in the approved form.

In completing an application form for an exemption, the fund or organisation must, as a minimum, do all of the following:

**The fund or organisation must have a genuine need to conduct one or more activities outside Australia in order to give effect to its purposes.**

The fund or organisation's need to conduct activities outside Australia must be genuine and reasonable in the circumstances.

For example, an organisation listed on the REO established for the sole purpose of protecting the wetlands in New South Wales, would unlikely have a genuine need to conduct activities overseas.

However, another organisation listed on the REO established for the sole purpose of protecting an endangered native bird species that migrates overseas for part of the year, may have a genuine need to conduct activities outside Australia, in order to protect the migrating species.

**The fund or organisation must take reasonable steps to obtain evidence showing that its activities outside Australia have been a genuine attempt to achieve its purpose, and the activities it is conducting outside Australia are an effective means of achieving its purpose.**

This requirement is intended to ensure the efficacy of valuable Australian taxpayer funds.

An activity will not be effective, where there are practical alternate activities that could achieve the purpose faster, or achieve the purpose to a higher degree, using less time, money and other resources.

From time to time, it is possible that a fund or organisation may undertake activities that subsequently prove to be less successful than initially envisaged, for example, because a particular overseas venture fails. This will not, in isolation, necessarily lead the fund or organisation to breach this requirement. Rather, all the particular circumstances need to be taken into consideration, including whether there is an established pattern of a fund or organisation carrying out activities that are not effective in achieving its purpose or that are truly aimed at achieving a different purpose.

**If the fund or organisation works with another person (however described) on activities outside Australia, it must take reasonable steps to obtain evidence showing that it effectively interacts and coordinates those activities with that other person.**

A fund or organisation may often work with in-country partners to achieve its purpose. This requirement is intended to ensure that such work is undertaken effectively, with a view to minimising risks to the misuse or misappropriation of funds and the duplication of activities or wastage of resources.

**The fund or organisation must provide information demonstrating that it has not committed a serious infringement of Australian laws, which may be dealt with as an indictable offence, or by way of a civil penalty of at least 60 penalty units.**

The purpose of this requirement is to uphold the reputation of the Australian not-for-profit sector, by ensuring that a fund or organisation is complying with Australian laws.

The requirement is intended to apply to a serious infringement of Australian law, namely, indictable offences or those infringements that attract a civil penalty of at least 60 penalty units, rather than minor or inadvertent breaches. A penalty unit is currently \$170.

While the fund or organisation is required to comply with all applicable Australian laws, a breach of a law mentioned in subsection 30-19.01(6) of the Regulation means that the fund or organisation is not eligible to be exempted from the 'in Australia' special condition in Division 30 of the ITAA 1997.

**If the fund or organisation is registered with the Australian Charities and Not-for-profits Commission (ACNC), it must provide information demonstrating that it is in compliance with the ACNC governance standards.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct). The Environment Minister may obtain this information directly from the ACNC through the Charities Passport.

**If the fund or organisation is not registered with the ACNC, it must provide information demonstrating that it has reasonable processes in place to ensure it is giving effect to its purposes, to manage the risk of a breach of its governing rules, and manage the risk of fraud or misconduct by those managing or administering it.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct).

### *Touring arts organisations*

Under section 30-19 of the ITAA 1997, the Arts Minister may exempt a touring arts organisation on the Register of Cultural Organisations (ROCO), and the fund it maintains, from the 'in Australia' special conditions in Division 30 of the ITAA 1997 if the Minister considers that fund or organisation meets the requirements in the regulations.

This reflects the need for a number of touring arts organisations to operate more broadly in order to give effect to their purposes and advance Australia's international profile. It also ensures the integrity of the deductible gift recipient regime, by limiting the exemption from the 'in Australia' conditions to certain touring arts organisations listed on the ROCO that meet specified criteria in the Regulations.

If a fund listed on the ROCO, or the organisation that maintains the fund, seeks an exemption from the 'in Australia' special conditions in Division 30 of the ITAA 1997, it must apply to the Arts Minister for the exemption in the approved form.

In completing an application form for an exemption, the fund or organisation must, as a minimum, do all of the following:

**The fund or organisation must have a genuine need to conduct one or more activities outside Australia in order to give effect to its purposes, and must enhance Australia's international reputation in the performing arts.**

The fund or organisation's need to conduct activities outside Australia must be genuine and reasonable in the circumstances.

For example, an organisation listed on the ROCO established for the sole purpose of providing musical education to West Australian school children is, in the absence of any other relevant factors, unlikely have a genuine need to conduct activities overseas.

However, another organisation listed on the ROCO established for the sole purpose of promoting Australian culture overseas is likely to have a genuine need to conduct activities outside Australia to give effect to its purposes.

To limit opportunities for misuse of the exemption and to ensure tax concessions provide a broad benefit to the Australian public, the fund or organisation must enhance Australia's international reputation in the performing arts. For example, a touring fund or organisation that promotes Australian performing arts overseas may enhance Australia's international reputation by creating cultural relationships, projecting a creative and diverse image of Australia, and fostering creative collaboration with key international partners. This, in turn, provides a broad benefit to the Australian public.

**The fund or organisation must take reasonable steps to obtain evidence showing that its activities outside Australia have been a genuine attempt to achieve its purpose, and the activities it is conducting outside Australia are an effective means of achieving its purpose.**

This requirement is intended to ensure the efficacy of valuable Australian taxpayer funds.

An activity will not be effective, where there are practical alternate activities that could achieve the purpose faster, or achieve the purpose to a higher degree, using less time, money and other resources.

From time to time, it is possible that a fund or organisation may undertake activities that subsequently prove to be less successful than initially envisaged, for example, because a particular overseas venture fails. This will not, in isolation, necessarily lead the fund or organisation to breach this requirement. Rather, all the particular circumstances need to be taken into consideration, including whether there is an established pattern of a fund or organisation carrying out activities that are not effective in achieving its purpose or that are truly aimed at achieving a different purpose.

**If the fund or organisation works with another person (however described) on activities outside Australia, it must take reasonable steps to obtain evidence showing that it effectively interacts and coordinates those activities with that other person.**

A fund or organisation may often work with in-country partners to achieve its purpose. This requirement is intended to ensure that such work is undertaken effectively, with a view to minimising risks to the misuse or misappropriation of funds and the duplication of activities or wastage of resources.

**The fund or organisation must provide information demonstrating that it has not committed a serious infringement of Australian laws, which may be dealt with as an indictable offence, or by way of a civil penalty of at least 60 penalty units.**

The purpose of this requirement is to uphold the reputation of the Australian not-for-profit sector, by ensuring that a fund or organisation is complying with Australian laws.

The requirement is intended to apply to a serious infringement of Australian law, namely, indictable offences or those infringements that attract a civil penalty of at least 60 penalty units, rather than minor or inadvertent breaches. A penalty unit is currently \$170.

While the fund or organisation is required to comply with all applicable Australian laws, a breach of a law mentioned in subsection 30-19.02(6) of the Regulation means that the fund or organisation is not eligible to be exempted from the 'in Australia' special condition in Division 30 of the ITAA 1997.

**If the fund or organisation is registered with the Australian Charities and Not-for-profits Commission (ACNC), it must provide information demonstrating that it is in compliance with the ACNC governance standards.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct). The Arts Minister may obtain this information directly from the ACNC through the Charities Passport.

**If the fund or organisation is not registered with the ACNC, it must provide information demonstrating that it has reasonable processes in place to ensure it is giving effect to its purposes, to manage the risk of a breach of its governing rules, and manage the risk of fraud or misconduct by those managing or administering it.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct).

EXPOSURE DRAFT



## Schedule 2 – Amendments relating to special conditions

### **Section 50-50.01 of the Regulation**

Under subsection 50-50(5) of the ITAA 1997, an entity can disregard certain amounts in determining whether it meets the ‘in Australia’ special conditions, provided it complies with the conditions set out in the regulations.

These amounts are government grants, and the receipt of gifts or contributions that are not tax deductible for the donor.

If an entity meets the criteria in Schedule 2 of the Regulation, it can self-assess these amounts to be excluded in determining whether it meets the ‘in Australia’ special conditions, and does not need to apply to have these amounts disregarded.

The integrity rules contained in Schedule 2 are similar to those applying to environmental DGRs in Schedule 1.

The entity must, as a minimum, do all of the following:

**The entity must take reasonable steps to obtain evidence showing that its activities outside Australia are a genuine attempt to give effect to its purposes, and its use of money or property outside Australia is effective in achieving its purposes.**

For example, an entity established for the sole purpose of protecting the abused puppies in South Australia, would be unlikely to demonstrate that conduct activities overseas would be a genuine attempt to give effect to its purposes.

An activity will not be effective, where there are practical alternate activities that could achieve the purpose faster, or achieve the purpose to a higher degree, using less time, money and other resources.

From time to time, it is possible that an entity may undertake activities that subsequently prove to be less successful than initially envisaged, for example, because a particular overseas venture fails. This will not, in isolation, necessarily lead the entity to breach this requirement. Rather, all the particular circumstances need to be taken into consideration, including whether there is an established pattern of the entity carrying out activities that are not effective in achieving its purpose.

**If the entity works with another person (however described) on activities outside Australia, it must take reasonable steps to obtain evidence showing that it effectively interacts and coordinates those activities with that other person.**

An entity may often work with in-country partners to achieve its purpose. This requirement is intended to ensure that such work is undertaken effectively, with a view to minimising risks to the misuse or misappropriation of funds and the duplication of activities or wastage of resources.

**The entity must not have committed a serious infringement of Australian laws, which may be dealt with as an indictable offence, or by way of a civil penalty of at least 60 penalty units.**

The purpose of this requirement is to uphold the reputation of the Australian not-for-profit sector, by ensuring that an entity is complying with Australian laws.

The requirement is intended to apply to a serious infringement of Australian law, namely, indictable offences or those infringements that attract a civil penalty of at least 60 penalty units, rather than minor or inadvertent breaches. A penalty unit is currently \$170.

While the entity is required to comply with all applicable Australian laws, a breach of a law mentioned in subsection 50-50.01(4) of the Regulation means that the entity is not eligible to be exempted from the 'in Australia' special condition in Division 50 of the ITAA 1997.

**If the entity is registered with the Australian Charities and Not-for-profits Commission (ACNC), it must be in compliance with the ACNC governance standards.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct). The Commissioner of Taxation is expected to obtain this information directly from the ACNC through the Charities Passport so as to minimise any compliance costs.

**If the entity is not registered with the ACNC, it must have reasonable processes in place to ensure it is giving effect to its purposes, to manage the risk of a breach of its governing rules, and manage the risk of fraud or misconduct by those managing or administering it.**

This requirement is intended to ensure that reasonable governance processes exist for the proper monitoring of any overseas activities, and that resources are being used in a proper and effective manner (and not, for example, in furtherance of fraud or misconduct).

### **Sections 50-51.10 and 50-51.11 of the Regulation**

Paragraph 50-51(2)(c) of the ITAA 1997 provides that a prescribed foreign resident that is exempt from foreign income tax in its home country is exempt from 'in Australia' special conditions in Division 50 of the ITAA 1997.

Sections 50-51.10 and 50-51.11 of the Regulation prescribe these entities. These entities were previously prescribed in the *Income Tax Assessment Regulations 1997*, and their prescription continues under a new regulation making power.

**Section 50-51.20 of the Regulation**

Paragraph 50-51(2)(d) of the ITAA 1997 provides that a prescribed entity that is an Australian resident and operates and pursues its purposes principally outside Australia is exempt from the 'in Australia' conditions, if it satisfies the conditions prescribed in the regulations (if any).

Section 50-51.20 of the Regulation prescribes these entities. A member of an entity prescribed under section 50-51.20 of the Regulation is also prescribed. These entities were previously prescribed in the *Income Tax Assessment Regulations 1997*, and their prescription continues under a new regulation making power.

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## **Statement of Compatibility with Human Rights**

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

### **Tax Laws Amendment (2014 Measures No. #) Regulation 2014**

This Legislative Instrument 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 of the Legislative Instrument**

This Regulation:

- puts in place the integrity rules that entities on the Register of Environmental Organisations must meet in order for the Environment Minister to be able to determine that they are exempt from the ‘in Australia’ special conditions;
- puts in place the integrity rules that touring arts organisations on the Register of Cultural Organisations must meet in order for the Arts Minister to be able to determine that they are exempt from the ‘in Australia’ special conditions;
- puts in place the integrity rules that entities must meet in order for them to be able to disregard distributions received by way of government grant and distributions received as a gift (money or other property) that is not tax deductible when considering whether they meet the ‘in Australia’ special conditions; and
- remakes existing regulations under new regulation making powers.

#### **Human rights implications**

This Legislative Instrument does not engage any of the applicable rights or freedoms.

#### **Conclusion**

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.