MOORESLEGAL

# Submission on the *Tax Laws Amendment (2012 Measures No.4) Bill 2012*: *tax exempt body "in Australia" requirements*

## 1. INTRODUCTION

1.1 Moores Legal is an Australian law firm with a team that practises exclusively in the area of Not for Profit ("NFP") law and governance and advises a wide range of organisations in the NFP sector.

1.2 This submission is based on our understanding of the history, policy, case law and client needs of the NFP sector and the application of NFP law.

1.3 It is the view of Moores Legal that the exposure draft should be withdrawn entirely.

1.4 A summary of our opinion is expressed below. Insofar as our comments address the policy objectives and current law, we refer to the details set out in our lengthy submissions made in relation to the first exposure draft. If you have any queries as to the basis upon which our views rest, please contact us.

## 2. SUBMISSION

2.1 This legislation does **far more than "restate"** the special conditions for tax concession entities.

2.2 It represents a **new policy objective** of benefitting Australians which is fundamentally different from the current arrangement and, in our observation, is not consistent with the views of the Sector.

2.3 Insofar as the explanatory material suggests that there is a "traditional" requirement that an entity cannot be exempt unless it "operates" in Australia in the way suggested by the examples, **it is not accurate.** We are not aware of any relevant legislation or case law that uses the "operation" test as described in these materials.

2.4 The implicit suggestion that the tax avoidance purposes of the special conditions enacted in July 1997 have been frustrated by the decision in *Word Investments* is **not consistent** with the actual findings in that decision. In fact the High Court of Australia noted that the Commissioner of Taxation's claims in this regard were **exaggerated** because the Commissioner already has ample information-gathering powers backed by criminal sanctions and the power to revoke endorsement (*FCT v Word Investments Ltd* (2008) 236 CLR 204, 238).

2.5 Further, we **disagree** with the suggestion that there is any "doubt" about the "proper" application of the "in Australia" special conditions.

2.6 Insofar as the legislation purports to address the decision in *Word Investments,* **it fails.** Had this legislation been in place at the time of that decision, it would not have led to a different outcome in that case.

2.7 Insofar as the explanatory material suggests that this legislation merely reflects the original intention of the relevant provisions as enacted in the *Income Tax Assessment Act 1936* ("the 1936 Act"), it is **unpersuasive:**

2.7.1 The Ferguson Royal Commission on Taxation appears to have recommended that gifts to charities were to be tax-deductible. As far as we are aware, this recommendation was never adopted. The

recommended wording for a provision for deductibility which was never adopted by any Commonwealth legislature is quite simply **not relevant**, even if it did have an "in Australia" component.

2.7.2 The reference (paragraph 1.29) to the Explanatory Memorandum of the *Income Tax Assessment Bill 1935* ("the 1935 Bill") is **misleading**. The Explanatory Memorandum to the Bill refers to the requirement that a particular type of fund (a necessitous circumstances fund) be established for the relief of persons "in Australia". It has no general application to tax concession entities.

2.8 The requirements in s 50-50(4) and 30-18(3) that require an entity to trace funds are **unworkable.** We refer to the following statement by Lord Justice Oliver in *Inland Revenue Commissioners v Helen Slater Charitable Trust* [1981] 3 W.L.R. 377, 382 (Court of Appeal), which reflects the position at common law (emphasis added):

> The Crown's proposition is a startling one; it involves this, that the trustees of a grant-making charity, although they may discharge themselves as a matter of law by making a grant to another properly constituted charity, are obliged, if they wish to claim exemption under the subsections, to inquire into the application of the funds given and to demonstrate to the Revenue **how those funds have been dealt with by other trustees over whom they have no control and for whose actions they are not answerable. Anything more inconvenient would be difficult to imagine**….

2.9 The suggestion that new legislation is necessary to combat terrorism appears to us to be similarly **unsubstantiated**. The explanatory material suggests that the legislation is necessary because the Financial Action Task Force (FATF) review concluded that Australia was only "partially compliant" with their recommendations. We note that in actual fact the review found "to date there have been no substantiated links between terrorist groups and non-profit organisations in Australia." Further, we are unable to identify any recommendation that, to acquit its obligations, Australia should limit the extent to which NFPs can expend money overseas. We also note that removing tax concessions does not prevent terrorism funding - the appropriate mechanism to deal with this is criminal legislation. Accordingly it is **uncompelling** as a justification for this legislation.

2.10 There are numerous organisations which are currently entitled to whole-of-entity endorsement as a DGR (such as a PBI), and which also have endorsement for the operation of a fund (such as an approved fund administered pursuant to the Overseas Aid Gift Deduction Scheme (OAGDS). Section 30-18 as currently expressed would result in those organisations losing their entitlement to whole-of-entity endorsement because most of their work is conducted overseas. At a practical level, this would mean that organisations which carry out the activities that are necessary for a fund to receive its AusAID endorsement under s 30-18(4) would lose their whole-of-entity endorsement and endorsement as a charitable institution. Accordingly s 30-18(4) **should be amended** to provide:

"A fund, authority or institution that operates a fund referred to in the table of s30-80 satisfies the conditions in this section if it satisfies the conditions in paragraph (1)(a)."

2.11 The definition of "not-for-profit" entity in s 995-1(1) is **problematic**.

2.11.1 It prohibits distribution to another not-for-profit entity that is an owner or member unless the distribution:

(i) is made to another not-for-profit entity with a similar purpose; or

(ii) is genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity.

2.11.2 It begs the question as to what is a similar purpose. It is common for a NFP to structure itself as a number of separate legal entities that operate in concert. Sometimes the different entities have different purposes. For example, it is common for religious institutions to have a welfare arm that is incorporated as a separate entity. Similarly a welfare institution may have an education arm. The current definition would prohibit distributions among the different entities, even in cases where it was a distribution legitimately made in furtherance of the purpose for which the entity is endorsed or established.

2.11.3 We appreciate that the explanatory material asserts that a distribution from one charity to another would constitute a distribution for a similar purpose. However the assertion in the explanatory material is inadequate for such a fundamental question. It also fails to address transfers between exempt entities which may be not be charities.

2.11.4 This problem is further compounded by the proposed unrelated business income tax ("UBIT"). The UBIT (on at least one of the models proposed) envisages that NFPs will create a separate legal entity to undertake commercial operations. The assurance is that if business surplus is immediately applied to a charitable purpose (through a related charitable entity) the surplus will be untaxed. However the proposed definition would in some cases restrict the ability of the income-generating entity to distribute across a number of different charitable purposes.

2.11.5 **The definition of not-for-profit entity should be amended** to allow an entity to make a gift "in furtherance of the purpose for which the entity was established and operated and for which it is entitled to be exempt from tax".

2.12 We refer to the "operate principally" test set out in the proposed s 50-50(2)(a). There is a degree of subjectivity about this test which is not present in the current "expenditure" test. The **vagueness** of the operation test creates a dilemma for an organisation which is required to disclose to the Commissioner where its operations cross the line to be principally outside Australia.

2.13 We refer to the proposed s 50-50(5). This is a **critical** provision. However, it is unduly complex and will be difficult to interpret and apply. Further, it relies on yet unpublished regulations which could have a significant impact on its application. It would effectively give legislative power on policy issues in delegated legislation. In our view the wording of s 50-75 is to be preferred.

2.14 It appears that another **casualty** of the new 'in Australia' test will be Australian Scholarship funds for overseas study. Expenditure for such a purpose will be overseas although money will change hands in Australia when the Scholarship is awarded. However the tracing required by s 50-

50(4) and 30-18(3) will require inclusion of any money spent overseas such as tuition and accommodation to be traced and clawed back into the calculation for the “in Australia” test.

## 3. CONCLUSION

3.1 Moores Legal thanks the Treasury Department for the opportunity to comment on the second exposure draft to amend the “in Australia” special conditions.

3.2 Moores Legal notes that a number of concerns in the initial draft were taken into account in producing this second draft.

3.3 However, it is the view of Moores Legal that the draft legislation remains **flawed**. The absence of a proper justification for its enactment and the practical difficulties inherent in its adoption lead to the conclusion that it should be withdrawn.

## 4. ACKNOWLEDGEMENTS

4.1 This submission has been written by Elizabeth Turnour and Suhanya Mendes, lawyers in the Moores Legal Not for Profit team.

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