



Neumann & Turnour Submission on 'In Australia' Requirements

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1. INTRODUCTION

Neumann and Turnour Lawyers is a Brisbane based law firm, which specialises in the area of Not for Profit (“NFP”) law. We provide advice to an extensive number of not for profit organisations, particularly charities.

We write in response to the Assistant Treasurer’s 17th April 2012 call for submissions upon the exposure draft of legislation that will restate and standardise the ‘In Australia’ requirements for exempt entities and deductible gift recipients found within the ITAA.

In particular, we wish to address the effect of the proposed reforms upon those entities within the NFP sector that are conducting overseas aid relief within what is commonly referred to as an ‘auspicing’ model. Typically that model entails an entity operating a Developing Country Relief Fund (DCRF) under Division 30-80 of the *Income Tax Assessment Act 1997* (Cth) (ITAA) entering into contractual engagements with other charities for the purpose ‘auspicing’ those separate charities for the conduct of fundraising. Under that model the resultant funds are paid to the Developing Country Relief Fund and then expended in the conduct of various overseas aid development projects. Charities engaging with an entity operating a DCRF under an auspicing model are typically themselves charities, and either:

1. Operate a Public Ancillary Fund which is raises donations and then pay those donations to the DCRF; or
2. Do not operate a Public Ancillary Fund, but operate to raise donations which are paid directly by donors to the DCRF.

We are making these submissions as we are concerned about the probable effect of legislation upon such a model. The net effect of the amendments will have an extremely deleterious effect upon Australia’s contribution to overseas development through such private sector engagements.

2. PROPOSED AMENDMENTS TO SECTION 50-50 ITAA

A. Treatment of funds given by and Exempt Entity to another Exempt Entity

The Explanatory Material accompanying the draft legislation provides that (at paragraph 172):

If an income tax exempt entity gives 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.

Furthermore, Example 1.11 provides:

Commercial activities for charitable purposes

Pass-it-on Ltd is a commercial not-for-profit business controlled and operated in Australia, with employees in Australia, for the purpose of using profits to help fund religious education overseas. This is done by donating profits to WYV Ltd.

WYV is listed in the income tax regulations as an income tax exempt entity.

Pass-it-on Ltd can meet the ‘in Australia’ special conditions by donating all profits to WYV, because WYV is an income tax exempt entity.

The draft legislation proposes that existing prescribed entities will be ‘grandfathered’ and that organisations may be prescribed under Regulation as satisfying 50-50(2) (see 50-51(2)(d)).

It is our conclusion therefore that the Explanatory Material proposes that gifts made to an exempt entity are presumed to be ‘in Australia’. This is consistent with the position enunciated by the High Court in the *Word Investment Case* at paragraphs 71-74. However it is not at all clear that this intention is reflected in the proposed amendments to the ITAA.

Proposed sub-section 50-50(2) requires that the whole of the operations of an exempt entity be taken into account when determining whether the entity satisfies the ‘in Australia’ test. Proposed sub-section (4) requires an entity to trace funds given to a non-exempt entity. There is however no provision within the proposed legislation that would bring into effect the statements made in the Explanatory Material, and upon which a court may rely in determining that gifts made to an exempt entity are presumed to be ‘in Australia’.

The concern is held that it then may be arguable, given the requirement to consider all of the charities operations under 50-50(2), that the charity must trace the use of the funds in the hands of the exempt recipient. Whilst the Explanatory Material makes clear this is not the intention, the legislation does not positively state that such giving will be deemed to be ‘In Australia’. In light of 50-50(2), the legislation must provide a positive deeming clause in order for an exempt entity to rely upon this. The consequence for organisations fundraising under an auspicing model would be that they would lose endorsement as an exempt entity for their operations within Australia where they give to another exempt entity that is for example, a prescribed institution under Regulation.

Drafting that will address this is as follows, to be inserted as new 50-51(3):

“(3) An entity satisfies the conditions in subsection (2) (about operating and pursuing its purposes in Australia) to the extent that it gives money or property to another entity that is an * exempt entity.”

Furthermore should an exempt entity give to a Developing Country Relief Fund there is no provision that states that the donor entity would be deemed to satisfy the ‘in Australia’ requirements to the extent that the donor’s operations comprise that giving. An appropriate further subsection to address this eventuality would be new 50-51(4):

“(4) An entity satisfies the conditions in subsection (2) (about operating and pursuing its purposes in Australia) to the extent that it gives money or property to a fund, authority or institution that is a deductible gift recipient.”

B. Interaction between subsections 50-50(4) and (5)

There is an apparent inconsistency in the operation of subsections (4) and (5) of proposed 50-50. Subsection (4) requires that the giving of funds by an exempt entity to a non-exempt entity *must* be taken into account. Subsection (5) provides that the *use* of an amount given to an exempt entity as a gift or contribution where the provider was not entitled to a deduction under Division 30 must be *disregarded*. As a consequence of their fundraising activities, many charities operating within an auspicing model will themselves receive funding directly (and not to any associated public ancillary fund, and not directly into a DCRF). Those funds are then gifted by the exempt entity directly to a developing country partner that is not itself an exempt entity. Whilst subsection (4) requires that the funds gifted to the overseas partner *must* be taken into account, subsection (5) states that the *use* of the funds gifted in Australia to the exempt entity are to be disregarded.

The following example provides the net position under the proposed legislation:

	Amount	Effect of legislation
Gift in Australia to exempt entity:	\$100.00	Disregard
Exempt entity's resultant gift to overseas partner	\$100.00	\$100.00
Net effect		Net operation by exempt entity is payment of \$100.00 to an overseas entity

Under this worked example the entity would no longer be exempt under the proposed legislation. This is the case regardless of whether the exempt entity also operates a Public Ancillary Fund, as the operation of the Fund by the exempt entity is to be disregarded under proposed 50-51(2). It is not considered that this is the intended effect of the legislation. In order to address the inconsistency we propose that the following be inserted at the commencement of subsection (4): 'Subject to sub-section (5)'.

Similarly, where an entity operates a DCRF, proposed 50-51(2)(b) operates to the effect that the activities of the entity are to be disregarded to the extent that 'it operates that fund' in determining whether the conditions under proposed s 50-50(2) are to apply. Where the exempt entity operating the DCRF receives donations that are not deductible in its own right (as opposed to funds that are paid to the DCRF), it may itself lose its exempt status were it to fall within the factual circumstances described above.

3. PROPOSED AMENDMENTS TO 30-18 ITAA

A. Gifts made by a Public Ancillary Fund to an Developing Country Relief Fund

International Affairs Deductible Gift Recipients are exempt from the 'In Australia' requirements under proposed 30-18(4). The 'In Australia' test for Public Ancillary Funds is stated in proposed 30-18(1):

- (1) A fund, authority or institution satisfies the conditions in this section if:
- (a) it is established in Australia; and
 - (b) it operates solely in Australia; and
 - (c) it pursues its purposes solely in Australia.

Where a Public Ancillary Fund's operations principally encompass the giving of funds to a Developing Country Relief Fund (DCRF), the requirement that the entirety of the Public Ancillary Funds' operations be taken into account under 30-18(1) may require that the activity of giving to a DCRF is also to be taken into account. Whilst the DCRF is exempt from the requirements that it operate solely in Australia, the Public Ancillary Fund is not. This introduces the possible interpretation that the overseas use of the funds by the DCRF is to be taken into account in determining the nature of the operations of the Public Ancillary Fund. Again we are of the opinion that a specific legislative presumption must be introduced to remove this possibility. Therefore, consistent with our submissions concerning the preservation of exempt status where an exempt entity gives to another exempt entity, we consider that the following additional sub-section 30-18(6) is required:

- “(6) A fund, authority or institution satisfies the conditions in subsection (1) (about operating and pursuing its purposes in Australia) to the extent that

it gives money or property to a fund, authority or institution covered by section 30-80 (international affairs deductible gift recipients).”

4. CONCLUSION

By way of conclusion, we thank the Assistant Treasurer for the opportunity to make submissions in respect of the standardisation of the special conditions for tax concession entities. For the avoidance of doubt, our submissions should not be considered to express a satisfaction with the proposed amendments, and the existing legislative framework unamended is in our opinion, the preferred position. The current legislation has enabled significant contributions to Australia’s overseas aid efforts by organisations conducting auspicing arrangements similar to that described herein. Should any further amendments be proposed it is requested that the specific engagement of organisations conducting such auspicing arrangements be sought in the consultation process to ensure that such amendments do not inadvertently detract from those operations.

For further comment, contact Mark Fowler.