

# TREASURY'S NOT-FOR-PROFIT REFORM FACTSHEET

## RESTATING AND STANDARDISING THE SPECIAL CONDITIONS FOR TAX CONCESSION ENTITIES

17 April 2012

### AT A GLANCE

The Assistant Treasurer, The Hon David Bradbury MP, today released for public consultation a revised exposure draft of legislation that will restate and standardise the special conditions for tax concession entities. The revised exposure draft can be found at [www.treasury.gov.au](http://www.treasury.gov.au).

Submissions to the paper are due on 11 May 2012. Queries and submissions should be sent to [NFPReform@treasury.gov.au](mailto:NFPReform@treasury.gov.au).

### WHAT DOES THE REVISED DRAFT COVER

The exposure draft:

- 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);
- standardises 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);
- standardises the term 'not-for-profit', replacing the defined and undefined uses of 'non-profit' throughout the tax laws; 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).

### KEY FACTS

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.

While both income tax exempt entities and deductible gift recipients are subject to 'in Australia' special conditions, they are subject to different thresholds.

Recent court decisions have raised doubts about the proper application of the 'in Australia' special conditions. 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.

The publicly funded taxpayer concession was primarily meant to be used principally in Australia for the broad benefit of Australians, and not be passed on through entities and then spent overseas.

In addition, where money is sent overseas there is an increased risk of the funds being misdirected to inappropriate and unauthorised operations, such as money laundering and terrorist financing.

The 'in Australia' special conditions provide additional measures to address possible abuse of not-for-profit entities for purposes other than those intended, including the risk that the money be used for 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.

There has also been confusion over the application of the various tests required to be an income tax exempt entity, which were not in one location in the tax laws. The draft standardises the special conditions that apply to income tax exempt entities.

### PROCESS FOR CONSULTATION

An initial round of public consultation on an exposure draft and explanatory materials was held between 4 July and 12 August 2011. Following public consultation, changes have been made to the exposure draft and explanatory materials.

Submissions on the revised exposure draft are due 11 May 2012.

Introduction of the draft legislation is expected into Parliament in mid-2012.

## MAIN CHANGES FROM THE PREVIOUS EXPOSURE DRAFT

- The exemption from the 'in Australia' special conditions for deductible gift recipients has been expanded to allow for certain environmental organisations to operate overseas, subject to certain integrity requirements.
- The 'in Australia' special conditions have been altered so that an entity may give money or property (to further its purpose) to another entity that is not entitled to be income tax exempt, however 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.
- The 'in Australia' special conditions that apply to deductible gift recipients have been altered so that if a deductible gift recipient gives 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 when determining whether or not that entity meets the 'in Australia' special conditions for deductible gift recipients.
- An income tax exempt entity will be allowed to disregard the spending of government grants and non-tax deductible donations when applying the 'in Australia' special conditions, but only in cases where the entity demonstrates adherence to some basic governance principles (to be set out in the regulations) about how they operate overseas.
- It has been made clear in the revised exposure draft that public hospitals and public schools are not subject to the not-for-profit entity condition where they are a government entity.
- The revised draft makes it clear that the deductible gift recipient rules only apply to an entity to the extent it is a deductible gift recipient. The more lenient tests (within the income tax exemption rules) apply to the other operations of the entity.
- Entities that are currently prescribed in the regulations under section 50-50 of the *Income Tax Assessment Act 1997* will be grandfathered, and therefore unaffected by the changes to the 'in Australia' special conditions. In addition, the existing prescription process will be maintained.
- It has been made clear in the draft that an entity must comply with only the substantive governing rules (e.g., those setting out an entity's purpose and not-for-profit status) to maintain a tax exemption, and that the Australian Taxation Office would not be expected to remove an entity's tax exemption for a minor and insignificant breach of its governing rules.
- The definition of 'not-for-profit' has been rewritten, and now expressly allows transfers of profits or assets between not-for-profit entities with similar purposes, as well as payments for genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the not-for-profit.
- Further detail has been added to the explanatory materials.

# FREQUENTLY ASKED QUESTIONS

## ***Are entities currently listed in the regulations as income tax exempt affected by the changes?***

No. Entities that are currently prescribed in the regulations under section 50-50 of the *Income Tax Assessment Act 1997* will be grandfathered, and therefore unaffected by the changes to the 'in Australia' special conditions.

## ***Will an entity automatically lose its income tax exemption if it fails to comply with a procedural element of its governing rules?***

No. In the draft legislation, a special condition is generally imposed on exempt entities that they must operate only in a manner consistent with their substantive governing rules and purpose to remain eligible for income tax exemption, to ensure that entities continue to operate in a manner consistent with which the tax concessions were granted.

However, requiring an exempt entity to comply only with their *substantive* governing rules and purposes allows an entity to keep its income tax exempt status for minor procedural irregularities, such as an absence of quorum at a meeting or missing a required lodgement date. Breaches of procedure irregularities will not, of themselves, affect an entity's continued entitlement to be income tax exempt.

Substantive governing rules are those rules of core importance to the operation of the entity and would include those related to an entity's object and purpose and those relating an entity's not-for-profit status.

## ***Do the 'in Australia' special conditions stop Australians from helping entities overseas?***

No. Entities that are deductible gift recipients under the category of 'international affairs' are exempt from the deductible gift recipient 'in Australia' special conditions. These deductible gift recipients include overseas aid funds and developed country relief funds 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 Australia's broad public benefit.

In addition, the new law will allow certain entities under the 'Register of Environmental Organisations' to be allowed to operate overseas, subject to appropriate integrity requirements.

Entities that are income tax exempt (but not deductible gift recipients) only need to operate principally in Australia. 'Principally' means mainly or chiefly. Less than 50 per cent is not considered principally.

## ***Why are there limits on money sent overseas?***

Publicly funded taxpayer concessions are meant to be used principally in Australia for the broad benefit of Australians, and not be passed on through entities and then spent overseas.

In addition, where money is sent overseas there is an increased risk of the funds being misdirected to inappropriate and unauthorised operations, such as to money laundering and terrorist financing.

The 'in Australia' special conditions provide additional 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.

Deductible gift recipients which are allowed to operate overseas are covered by appropriate integrity requirements 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.

## ***When will the changes start?***

The measure commences from Royal Assent, and applies to determine whether an entity is entitled to be income tax exempt or remain income tax exempt, or to be a deductible gift recipient or remain a deductible gift recipient for income years following Royal Assent.

Introduction into Parliament is expected to be mid-2012.

## ***Who will be administering these provisions?***

The Australian Taxation Office (ATO) will maintain responsibility for administering the tax system, including tax concessions, as the ATO is the Government's principal revenue collection agency.

The Australian Charities and Not-for-profits Commission (ACNC) will be responsible for regulation of charities at the Commonwealth level with the intention to increase its scope to other parts of the NFP sector over time.

The ATO will accept the ACNC's determination of charitable status, and will only assess any further conditions that are specific to eligibility for certain tax concessions, such as the 'in Australia' special conditions.