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Manager
Philanthropy And Exemptions Unit
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The Treasury
Langton Crescent
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By Email: NFPReform@treasury.gov.au

RE: EXPOSURE DRAFT:
'IN AUSTRALIA' SPECIAL CONDITIONS FOR TAX CONCESSION ENTITIES

Introduction

We are a Chartered Accounting firm with have a strong interest in the not-for-profit sector, including churches, charities and other community groups, providing taxation, audit and management advisory services.

We make this submission drawing on our experience in this sector and on behalf of our clients.

Summary of Concerns

1) Significant changes to the legislation, such as proposed in the draft, should be introduced in conjunction or, at least in consultation, with other pending reforms such as the launch of the Australian Charities and Not-for-Profits Commission (ACNC).
2) Implications for not-for-profit entities principally operating and pursuing purposes in Australia under section 50-50:
    a) Replacement of quantifiable expenditure test with a subjective operating in Australia test will make it more difficult for organisations to self-assess eligibility for ongoing income tax exemption.
    b) Barring the donation of money to non-exempt entities in section 50-50(2)(c) will impede the legitimate work of charitable organisations.
    c) The requirement to comply with all governing rules is burdensome. It does not take into account the nature of some governing rules, nor existing legislation and regulatory oversight.
3) The exemption for not-for-profit entities prescribed under section 50-50(d) of the current law has been removed. No explanation has been given for this remove which appears to be a departure from the intent of the draft.

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1) Not-for-profit sector reforms

Budget announcements, multiple consultation papers and draft changes to relevant legislation are creating some insecurity within the sector not-for-profit sector. Not-for-profit organisations are looking forward to the introduction of the Australian Charities and Not-for-profits Commission (ACNC) to help them manage these reforms and establish some certainty.

The ACNC is scheduled to commence operation from 1 July 2012. Its aims as stated in the recent consultation paper include to:

- *place minimal costs on NFPs in order to allow better direction of NFP resources to philanthropic objectives.*
- *remove current regulatory duplication;*

It is our belief that the re-write of section 50-50 would both increase costs and further duplicate regulation so it appears to be at cross-purposes with other reforms. For a consistent approach we suggest that it would be more appropriate to address changes such as these after the ACNC has been established.

2) Not-for-profit entities principally in Australia

a) Operating in Australia" test

Section 50-50(a) of the *Income Tax Assessment Act 1997* (the Act) currently provides an exemption for endorsed charitable and religious institutions with a physical presence in Australia, incurring its expenditure and pursuing objectives in Australia. Further, under section 50-75, organisations could disregard the distribution of gifts and government grants while assessing eligibility.

Although flawed, using this expenditure test it has been possible for organisations to be confident in their self-assessment of continued income tax exemption.

The proposed 'operating in Australia' test is far more subjective and emphasis on a particular factor could sway a decision either way. The use of the phrase "on balance" in the examples given in the explanatory memorandum demonstrates this difficulty.

As the consequences of making an incorrect judgement on this matter are significant, we argue that determining whether or not an organisation is income tax exempt should not be so reliant on a subjective assessment. Not-for-profit organisations need certainty to so that they can focus their efforts on their charitable purposes.

b) Donation Restriction under section 50-50(2)(c)

Section 50-50(s)(c) of the draft requires that in order to retain income tax exemption, not-for-profit entities can only donate money to other exempt entities.

The Act definition of an 'entity' in section 960-100 clearly includes individuals. Many *bona fide* charities provide emergency funding for Australians in need, but this new provision would prevent this. We trust this is an unintended consequence of the draft and will be clarified before the bill is presented to parliament.

This restriction would also mean that small or incidental donations from not-for-profits to non-exempt organisations here and overseas would result in immediate loss of income tax exemption for all time.

Many not-for-profit organisations are audited at least annually. The risk associated with even a $1 donation to the wrong entity, has the potential to technically raise tax liabilities, including as a result of loss of fringe benefit concessions, of much greater amounts. Auditors will need to test 100% of donations (and potentially 100% of all expenditure) to ensure that donations have only been made to exempt entities and be satisfied that the exemption still applies. This will be a time consuming process that adds significant administration cost to a not-for-profit entity for very little value.

We note that there is some administrative burden in establishing the income tax status of beneficiaries of such donations. We would expect organisations to rely on resources such as the Australian Business Register to determine whether an organisation is exempt, however this is somewhat problematic as registration changes can be made retrospectively and could result in organisation giving to non-exempt entities despite exercising due care.

We believe for the legislation to be workable, it needs to allow for the following without an organisation losing their income tax exemption:

- small, incidental gifts by way of a *de minimis* threshold.
- the rectification of breaches
- donations made to individuals in accordance with the purposes of the organisation

c) Compliance with governing rules under section 50-50(3)

Governing rules contain all manner of rules relating to the governance of an organisation. These will include the objects, not-for-profit and dissolution clauses that are currently relevant to tax status, as well as other clauses dealing with matters such as conflict resolution and how meetings are to be conducted.

The requirement to comply with 'all' governing rules at 'all' times may result in the loss of income tax exemption for a minor breach of the rules. It will encourage organisations to adopt very basic governing rules to limit exposure to this risk.

The *Incorporated Associations Act* in each state or territory, the *Corporations Act 2001* and the bodies that govern them such as ASIC, already have provisions that deal with breaches and currently allow for concessions such as the postponement of an Annual General Meeting that may not be specifically allowed under the governing rules. This regulatory framework appears to have been disregarded in the draft.

We contend that there is currently sufficient regulation this area and so this provision should be removed, or at the very least, limited to key clauses relevant to tax status.

3) Prescribed Organisations pursing objectives principally outside Australia

The exemption for prescribed organisations under section 50-50(d) of the Act has not been retained in the draft. These prescribed organisations have been assessed as *bona fide*, and specifically permitted under the current law to pursue objectives principally overseas.

Item 1.13 of the explanatory material points out the intent of the original law was to restrict overseas charitable giving to deductible gift recipients and prescribed organisations. Removing this category of

prescribed organisations is a departure from the original intent, not a restatement in order to restore original intent as the draft purports to be.

Amongst those prescribed organisations are many faith-based mission organisations that are largely funded by donations from after-tax money from individuals and churches. Operating principally outside Australia, they would no longer be eligible for income tax exemption.

The loss of this prescription combined with the restriction on donations in section 50-50(2)(c) would also prevent exempt organisations such as churches from giving to these missions. Although generally ineligible for DGR status, these organisations employ thousands of people here and abroad in humanitarian activities including literacy, agricultural, and medical projects usually in developing countries. Loss of income and income tax exemption will ultimately put this charitable work at risk.

It is unclear whether donations would be taxable in the hands of these prescribed organisations but if so, there would be an incentive for individual donors to make their donations directly to the overseas projects they support to avoid double taxation. Maintaining the current exemption for s50-50(d) organisations would allow the management and supervision of these funds to remain in the hands of bona fide, reputable organisations. This appears a more desirable result than thousands of individual donors taking matters into their own hands.

We have addressed this matter directly with Treasury and have been assured that the prescribed institutions will retain their current income tax exemption. This is not the case in the draft as it stands so we call for the addition of subsection 50-51(3)(c), specifically exempting Australian resident, prescribed institutions.

Conclusion

The draft as it stands contains a number of provisions that are very concerning to the not-for-profit sector. Significant revisions need to be made in order for the amendments to be workable.

Please contact us should you wish to discuss any of these matters further.

Yours faithfully,

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