Submission to Australian Government

Prepared by

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Concerning the *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014*: Restating and centralising the special conditions for tax concession entities released for public comment by the Government on 12 March 2014

Dated 7 April 2014

Contents

Executive Summary

The proposed alterations to the law concerning exempt entities arguably imposes additional burdens on charities by requiring charities to have regard to a wider range of factors than required under the existing law, so increasing regulatory burden and uncertainty for charities attempting to determine whether they continue to be exempt. We therefore submit that the existing test for income tax entities should be retained.

The proposal that charities (both exempt entities and DGRs) who give funds to other entities are to be required to track any offshore use of funds by recipients which do not share the same tax status introduce a degree of uncertainty and fail to appropriately address the prospect that the charity will be held responsible for the breach of any understanding between the charity and the recipient that the funds stay in Australia. Whilst the simplest means of resolving the uncertainties we raise is to not progress with the proposed amendments, if the proposal is to be progressed, we have suggested drafting which focusses on the knowledge and intent of the provider charity at the time of provision of the supply as the relevant test. This will ensure that charities will not be penalised for the actions of third parties. The requirement to trace funds into the hands of any further additional entity by the inclusion of the words 'or any other entity' at proposed 50-50(4) should be removed.

We also consider that the kinds of supplies that a charity must trace under the proposed legislation is very expansive and is likely to capture routine engagements a charity may have with its contractors that may operate overseas. In the context of a globalised market that is increasingly seeing Australian enterprises engage the provision of services from overseas entities, the proposal that such charities should be excluded from such routine engagements is unrealistic and antiquated and arguably breaches principles of competitive neutrality. The conclusions reached on the proposed tracing requirements also extend to the equivalent provisions concerning DGRs.

The new requirement that in order to disregard gifts from non-charities, the income tax exempt entity must now comply with new conditions which require the charity to evidence that its offshore operations are effective in achieving its purposes is highly problematic and inconsistent with the centuries-honoured practice of the common law courts (and common-sense) in determining what is charitable at law by reference to the 'purposes' of an entity. The Explanatory Materials leave open the possibility that a charity may lose its endorsement when it is deemed, by the ATO, to not have been effective. Is the ATO to now determine whether a religious institution is effective in achieving its purposes? The Regulations represent an inordinate level of state incursion into the affairs of religious charities. We conclude that the existing subsection 50-75 is to be preferred and that the proposed Regulations should not progress.

The requirement that Basic Religious Charities (BRCs) operating in part overseas now must comply with the ACNC administered governance standards is inconsistent with the policy intent underlying the creation of the particular exemptions for BRCs and should be removed. In total, our submission in relation to tax exempt entities is therefore that the law should remain unchanged.

In relation to prescribed entities, the proposed legislation allows for the making of regulations which must be complied with in order to retain exemption. Those requirements are not disclosed by the proposed legislation currently released. If, contrary to our submissions, the legislation is to be progressed, the conditions to be imposed upon prescribed entities must be sighted prior to the introduction of the legislation at this stage to allow for comment upon their effect.

In relation to Deductible Gift Recipients, it is recognised that currently, the principal legislated condition which must be satisfied in order for a contribution to be deductible is simply that the 'institution must be in Australia'. We agree that greater certainty is required, but do not agree that the proposed amendments propose the solution that is best suited to the needs and

operation of the sector. In our opinion the existing law under 50-50 should be applied to deductible gift recipients, namely that they have a physical presence in Australia and, to that extent, incur expenditure and pursue objectives principally in Australia and that they are entitled to disregard gifts and grants in the same fashion as tax exempt entities may currently do. This will remove the administrative burden that results from an entity that is both exempt and a deductible gift recipient (or operates a deductible gift recipient fund) being required to comply with two differing standards.

Finally, if contrary to our submissions, the legislation is to be progressed, we conclude that there is an unintended drafting error at subsection 30-18(3), which does not state that that subsection is subject to subsection 30-18(10). The effect is that grants are not regarded on receipt by a DGR, but the payment of funds received under a grant from a DGR to a non-DGR will be regarded for determining whether the DGR satisfies the 'in Australia' requirement. Subsection (3) should be said to be subject to subsection (10), as is the case in the equivalent provisions pertaining to income tax exempt entities.

Introduction

The Australian Christian Lobby ('ACL') represents a significant constituency in the Australian community. Its supporters are mainly Christians who come from a wide range of Christian denominations across the Catholic, Orthodox, Evangelical and Pentecostal traditions. We provide herein our submissions on the proposed amendments to the 'in Australia' requirements contained in the *Income Tax Assessment Act 1997* (Cth) released for public comment by the Australian Government on 12 March 2014. Those proposed amendments contained in the *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014* accompanying Explanatory Materials and *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Regulation 2014* and accompanying Explanatory Statement.

We are making these submissions on our very real concern that the effect of the proposed legislation upon such religious institutions operating both within Australia and overseas has not been taken into consideration in the drafting of the proposed legislation. In our opinion, the net effect of the amendments would have a deleterious effect upon the Australian charity sector's contribution to overseas development. They also introduce a level of uncertainty and additional regulatory burden that is unwarranted and in our opinion has not been properly identified in the materials released by the Government.

Income Tax Exemption

The types of entities considered in this first section of our submissions include tax exempt charities that have a degree of overseas operation or control, and may include tax exempt missionary organisations or Christian development or relief organisations.

Operate principally in Australia and pursue its purposes principally in Australia

Under the proposed amendments, the central test for an entity to be entitled to income tax exemption will change from:

1. 'a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia', to
2. You must operate principally in Australia and pursue its purposes principally in Australia.

There is no guidance in the draft Act itself as to what 'operate' means, but the draft Explanatory Materials suggest that regard could be had to factors such as:

> 'While no one factor is conclusive, in determining whether an entity is 'operating in Australia' and 'pursing its purposes principally in Australia' the Commissioner is expected to consider all surrounding circumstances: including factors such as where the entity incurs its expenditure; where it undertakes its activities; where the entity's property is located; where the entity is managed from; where the entity is resident or located; where its employees or volunteers are located; and who is directly and indirectly benefiting from its activities.' [paragraph 1.59]

The Explanatory Materials also list the location of the assets of the organisation and the extent of overseas control as relevant factors. The new test arguably imposes additional burdens on charities as it requires that charities have regard to a wider range of factors than required under the existing law. By introducing a greater range of factors to which they must have regard, the draft legislation also potentially increases uncertainty for charities attempting to determine whether they continue to be exempt.

The Explanatory Materials gives a number of examples of the intended operation of the amendments. Attention is drawn to the decision of the Full Federal Court in *Sea Shepherd Australia Limited v Commissioner of Taxation* [2013] FCAFC 68 (3 July 2013) (the *Sea Shepherd case*), wherein Besanko J in reference to examples contained in Explanatory Materials held:

> [4] The applicant referred to examples 11.15, 11.16 and 11.17. The respondent referred to examples 11.14, 11.15 and 11.18.
>
> [5] None of these examples provide any real assistance in relation to the ground upon which Gordon J decides this case, and with which I agree. In any event, in the circumstances they constitute a distraction from the task of construction which the court must undertake. Unless the example matches exactly the facts before the court (a circumstance which is likely to be very rare) examples should be approached with caution. I say that because of the temptation to reason by analogy from an example to the facts before the court and in the process to bypass the actual words to be construed by the court. To make this observation is perhaps to do no more than reiterate the point made generally about the use of extrinsic material by Heydon J in *SAEED v Minister for Immigration and Citizenship* (2010) 241 CLR 252 at 277–278 [74].

The Federal Court's reasoning is that only organisations which precisely satisfy the factual conditions outlined in one of the examples may take guidance from the example. The examples fail therefore to offer certainty for charities. Where an organisation happens to satisfy an example but contemplates an alteration in its activities, the effect of that variation is also therefore uncertain. It will therefore be more difficult to ascertain whether a charity remains compliant with the in Australia requirements. It is then our submission that the existing law, which is largely settled and understood by the sector, should remain unchanged.

Tracing Requirements

The proposed legislation (at draft section 50-50) requires exempt entities to track any offshore use of funds by recipients which do not share the same tax status, and so focusses on payments between income tax exempt and other entities. Funds sent overseas by another body

will be treated as if they were sent by the donor charity itself. This may effect whether the donor charity continues to satisfy the 'in Australia' requirement. Subsection 50-50(4) and (4A) state:

> (4) Subject to subsection subsections (4A) and (5), if an entity provides money, property or benefits to another entity that is not an *exempt entity, the use of the money, property or benefits by the recipient (or any other entity) must be taken into account when determining whether the first mentioned entity satisfies the requirements in paragraphs (2)(a) and (b).
>
> (4A) For the purposes of applying subsection (4), take into account the use of the money, property or benefits by an entity outside Australia only to the extent that it would be reasonable to expect the first mentioned entity to have knowledge of, or to obtain knowledge of, the use of the money, property or benefits outside Australia.

The Explanatory Materials provide:

> 1.78 When an entity provides money, property or benefits to another entity, it will generally give the money for a particular purpose or cause, and the entity should have a reasonable knowledge of where this purpose or cause is intended to be carried out.
>
> 1.79 However, the entity need only take all those steps that are reasonable to confirm or trace the use of money, property or benefits by the other entity (or any other entity) outside Australia. [Schedule #, item 31, subsection 50 50(4A)]
>
> 1.80 Provided that the entity takes all reasonable steps to have or obtain knowledge of the use of the funds, and is satisfied that the use of the funds does not change its status as income tax exempt, if it later transpires that the funds were spent in such a manner that would result in the loss of status of the providing entity, the entity will be able to rely on the reasonable and genuine steps it has taken to demonstrate compliance with the special conditions.

The Explanatory Materials then provide a series of examples, including the example of a charity that enters into a contract with a donee which provides that the donee must use the funds in Australia (Example 1.10). The charity is then later deceived and does not know about the application of the funds overseas. The example does not cover circumstances where the donor becomes aware of the overseas application of the funds in breach of the understanding, but is not able to prevent the application overseas, because of time restrictions or the like. As noted

above, in the *Sea Shepherd* case the Federal Court has held that examples provided in Explanatory Materials are only indicative of the Parliament's intent to the extent that they actually state the specific facts that are before the Court.[1]

Under the Federal Court's reasoning in the *Sea Shepherd* case, to the extent that a charity steps outside of the facts stated in Example 1.10, the proposed legislation introduces the prospect that charities can lose their endorsement due to the operations of a third party which are beyond their control. If Charity A gives to a non-exempt entity (Entity B) on the understanding that that entity will use the funds in Australia, and Entity B then breaches that understanding and moves the funds offshore in circumstances that do not directly fall within Example 1.10, Charity A will be exposed to loss of its own exempt status. *This is inequitable, giving rise to the prospect that Charity A is penalised for the actions of a third party over whom it has no control.*

Consequently, several questions arise that demonstrate the difficulty of the implementation of this proposal. Matters which are not addressed by Example 1.10 include:

1. What is the cut-off-date for consideration of where the funds have been directed by Entity B? When can Charity A rest assured that it will not lose its own endorsement? There is no timeframe stated in the proposed legislation. Is it two years, five years, ten years? Presumably the timeframe applies until the funds are exhausted. Conceivably, donor entities could be forced to track fund use by recipient entities for years after the date of a gift.
2. The comments of Lord Justice Oliver in *Inland Revenue Commissioners v Helen Slater Charitable Trust* [1981] 3 W.L.R. 377, 382 (Court of Appeal), are salient:

> 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

[1] *Sea Shepherd Australia Limited v Commissioner of Taxation* [2013] FCAFC 68 (3 July 2013).

> 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….

3. If it is determined at a later date that at the date of the supply of funds the recipient entity was recorded as exempt but was not entitled to that exemption at the time of the supply, will the giving entity be entitled to rely on the knowledge it held at the time of the supply, or will it be exposed to the loss of its exemption? Does the subsection operate to back-date to the date that the entity stopped being entitled to be exempt? If so, should the supply to Entity B (who was incorrectly considered to be a charity) then be taken into account under subparagraph 50-50(4)? The legislation does not address these concerns.

4. There is an absence of clarity on the date for which Charity A may lose its endorsement where Entity B sends the funds it received from Charity A overseas. If Entity B sends the money overseas what is the date for loss of the endorsement?

    i. The date of provision of funds by Charity A to Entity B, or

    ii. The date Entity B sends the funds overseas?

    This is not clear from the proposed legislation.

5. If the loss of Charity A's endorsement is backdated, what happens:

    iii. To those who have made a distribution to Charity A on the basis that it is an exempt entity (for example in the case of a family discretionary trust contributor)? Are they in breach of trust, as at the time of the making of the payment, Charity A was not exempt?

iv. Where Charity A is a DGR, to those who have made a deductible gift to Charity A? Do donors need to reconsider tax returns submitted in prior years in which deductible claims were made?

The proposed legislation leaves these questions open.

6. Of particular concern is the proposition under both subsections that Charity A must trace the funds in the hands of Entity B 'or any other entity'. What is the length of investigation required? How many layers of on-payment must be traced? How is Charity A to acquit this obligation? Does the legislation realistically expect that Charity A should be held accountable for the actions of both Entity B and Entity C, to whom Entity B further supplies the funds? In the absence of privity of contract, how is Charity A to obtain access to records of Entity C in order to ensure its own (Charity A's) obligations have been acquitted? To acquit this Charity A would need to contract with Entity B and any other further Australian entities the funds are supplied to. This contemplates an unrealistic regulatory burden. The words 'or any other entity' should be deleted.

From the above, it is clear that again these requirements may serve to increase administrative burden on charities. They also operate to introduce an unwarranted level of uncertainty for charities. They therefore impose additional costs on charities that would otherwise be allocated for the attaining of their good works in the community.

If our proposal to not progress the amendments is not adopted, an appropriate means to reduce that uncertainty and administrative burden would be to, instead of introducing a reasonableness test that requires the charity to monitor on an ongoing basis the use of the funds by Entity B and Entity C, introduce a test that the Charity must act reasonably in taking an undertaking from Entity B at the time of the provision of money, property or benefits to Entity B, but that having done so, it will not be punished for the actions of Entity B (or Entity C) in breach of that agreement. The requirements must be satisfied at the time of the provision of the money, property or benefits, and once satisfied Charity A can be assured that subsequent contrary

actions by Entity B will not affect its charitable status. In requiring Charity A to act reasonably at the date of the undertaking from Entity B, Charity A may rely on that undertaking, unless there was reason to believe that the statement that the funds would be kept in Australia was not accurate.

The simplest means of resolving these uncertainties is to not progress with the proposed amendments. However, if the proposal is to be progressed, suggested drafting to address this concern, to be inserted at the end of 50-50(4A) is as follows:

> (4A) For the purposes of applying subsection (4), take into account the use of the money, property or benefits by an entity outside Australia only to the extent that it would be reasonable to expect the first mentioned entity to have knowledge of, or to obtain knowledge of, the use of the money, property or benefits outside Australia *at the time of the provision of money, property or benefits to another entity*.

The knowledge and intent of the provider Charity A at the time of provision of the supply should be the relevant test. This will ensure that Charity A will not be penalised for the actions of third parties, and address the concerns raised above. As noted above, the words 'or any other entity' should be deleted.

'Provide' vs. 'give' and inclusion of 'benefits'

In addition the kinds of supplies that a charity must trace under the proposed legislation is very expansive. The Bill encompasses the providing of money, property or benefits, as compared with the 'giving' of 'money or property' proposed in the April 2012 Exposure Draft. The inclusion of 'benefits' and the removal of 'gives' was not proposed in former drafts of the amending legislation but was introduced in the Bill introduced into Parliament in 2012. 'Benefits' is likely to capture routine engagements a charity may have with its contractors that may operate overseas, such as payments made for the use of intellectual property, administrative services,

printing, office supplies, internet supply services or the like. These payments must be taken into account in the calculation of whether the exempt entity is 'in Australia' under the amendments.

In the context of a globalised market that is increasingly seeing Australian enterprises engage the provision of services from overseas entities, the proposal that such charities should be excluded from such routine engagements is unrealistic and antiquated. The proposal is that charities should be effectively penalised by being excluded from such engagements. To that extent the proposal is anti-competitive, and breaches principles of competitive neutrality. The April 2012 Exposure Draft confined the necessary consideration to gifts of money or property made to non-exempt entities and did not encompass benefits. It would therefore not have caught these routine contractual engagement and therefore was more workable in this regard. We propose as a solution that the Bill inserting 'providing a gift' in the place of 'provide' and by removing reference to 'benefits' at 50-50(4) and (4A).

Disregarding of Gifts

Similar to the existing regime contained at section 50-75, the draft legislation also proposes that the use of certain amounts (including gifts from non-charities and government grants) may be disregarded in determining whether a charity satisfies the 'in Australia' requirements. The draft legislation provides at 50-50(5):

> (5) If the entity complies with the conditions (if any) prescribed in the regulations for the purposes of this subsection, disregard the use of the following amounts in determining (for the purposes of this Subdivision) whether an entity operates and pursues its purposes in Australia:
>
> (a) an amount received by the entity as a grant from a *government entity;
>
> (b) an amount received by the entity as a gift or contribution (whether of money or other property) in circumstances where the provider:
>
> (i) was not entitled to a deduction under Division 30 in respect of the gift or contribution; and
>
> (ii) is not an *exempt entity.

The proposed law requires that any gift from another exempt entity or deductible gift recipient must now be taken into account. This is likely to affect payments to missionary organisations from other charities, as may occur within a particular denomination that has a separately incorporated but affiliated missionary body. It is not clear that this is the type of transaction that the proposed legislation is intending to address.

Gifts or contributions from a non-exempt entity to Charity A will be disregarded in the determination of whether Charity A is 'in Australia'. Those funds will not be considered in the calculation of where Charity A directs its funds, effectively being removed from consideration for the supply of funds to Entity B. The determination of whether Charity A satisfies the 'in Australia' requirements then becomes a determination as to what proportion of Charity A's income is comprised by gifts. The overseas direction of any non-disregarded income will then be used as a relevant factor in determining whether Charity A satisfies the 'in Australia' test.

However, a new requirement is that in order to disregard these amounts, the charity must now comply with new conditions. These conditions have not been previously released for comment. They are stated in the Regulation that accompanies the Bill as follows:

> (2) The entity must take reasonable steps to obtain evidence showing that:
>
> (a) the activities it conducts outside Australia are a genuine attempt to give effect to its purposes; and
>
> (b) the use by the entity of money or property outside Australia is effective in achieving the entity's purposes.
>
> (3) If the entity works with another person (however described) that:
>
> (a) is located in a country in which the entity conducts an activity; and
>
> (b) works with the entity on the activity;
>
> the entity must take reasonable steps to obtain evidence showing that it effectively interacts and coordinates the conduct of the activity with that person.

The Explanatory Materials to the draft Regulation provide:

> 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.

In the context of the charity sector, courts have long declined to take the responsibility for deciding whether a charity is 'effective' in carrying out its purposes. So long as the purpose is for the public benefit, and there is net benefit rather than net detriment, the focus is on ensuring that those running the charity in question are 'effecting the purpose', rather than being 'effective' in doing so. This is especially the case in relation to religious charities and religious purposes and activities. Dal Pont cites as an example the case of *Estate of Hadji*, in which Chief Justice Murray-Aynsley commented that even though a yearly feast for the Muslim poor: 'is not an ideal or even a satisfactory method of relieving the poor in the absence of any regular system of poor relief', this did not mean the purpose was not for public benefit and the entity was not charitable.[2]

While the judiciary's approach to determining benefit in the context of questions of charitable purpose is not directly applicable to legislative decisions of whether a particular method for pursuing a charitable purpose is effective, we submit that it provides useful insights which should not be dismissed out of hand.

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[2] Dal Pont: G E Dal Pont, *Law of Charity* (LexisNexis Butterworths, 1st ed, 2010), para 3.41.

Currently, the decision about 'effectiveness' is contained in the Regulation, and presumably an ultimate determination would be made by the executive branch, and in particular, the Australian Tax Office (ATO). The courts have historically identified that vexed questions of public policy, such as whether a charity is effective in its mission, or what kinds of charitable activity a polity wishes to support, should be left to the legislature. In Australia, this is the Parliament. If it is inappropriate for courts to make value judgements about whether a particular method of carrying out a charitable purpose is effective or not, it is surely inappropriate for such judgements to be made on criteria established by the executive branch under Regulations. At the bare minimum, such standards should be placed in the legislation itself and properly debated by the full Parliament.

Further, it has long been recognised that benefit to the public may be indirect and intangible, particularly in the religious context. This is linked to the common law doctrine that, unless evidence to the contrary is brought, charities existing for the purpose of the advancement of religion, the advancement of education or relief of poverty are presumed to provide net benefit to the public. The difficulty of measuring public benefit has been recognised by legislatures as well, which is why the *Charities Act 2013* (Cth) does not disturb the common law presumption. The UK's experience with legislative abolition of the presumption has thus far been fairly negative and mostly counterproductive: see Plymouth Brethren[3] and Independent Schools Council[4] cases.

In light of the centuries-honoured practice of the common law courts in determining what is charitable at law by reference to the 'purposes' of an entity, the focus on effectiveness would

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[3] Charities Commission, Application for Registration of the Preston Down Trust: Decision of the Commission, 3 January 2014
http://www.charitycommission.gov.uk/media/591398/preston_down_trust_full_decision.pdf>

[4] Independent Schools: *The Independent Schools Council v The Charity Commission* [2011] UKUT 421

appear to be a divergence to a focus upon a charity's achievements, as opposed to its intentions. The Explanatory Materials leave open the possibility that a charity may lose its endorsement when it is deemed, by the ATO, to not have been effective.

Further, the standards as currently drafted are extremely vague. What is the standard by which effectiveness is to be determined? We are given no direction. Is the ATO now to begin determining the effectiveness of religious institutions in effecting their purposes? How is it to determine whether the spiritual purposes of a religious missionary organisation are being effected? The amount or length of prayers? The results of prayer? The number of persons who have read a religious writing or heard a sermon? The proposal leads to possibly unintended, but palpably absurd outcomes. In addition the proposal raises the question of what is the applicable date on which ineffectiveness may be determined to have arisen? Can this be backdated so as to give rise to a taxation liability? Again these are matters not addressed.

In a society which is governed using the fundamental liberal democratic doctrine of the rule of law, laws must be easy to obtain, capable of being understood, and capable of being obeyed. The 'effectiveness' conditions as currently drafted do not satisfy the latter two criteria. While we appreciate the need to draft conditions in a general manner so as to make them suitable for application in a wide range of circumstances, conditions should not be so general as to invite confusion about what a charity's obligations actually are. As drafted, we submit that charities will either inadvertently undercomply with the conditions and be exposed to the risk of loss of their concessions, or overcomply in their desire to prevent such a risk from eventuating, and therefore incur unnecessary regulatory and compliance burdens.

It is well established that the Australian charity sector is generally eager to comply with its obligations. As such, we are concerned that the conditions as drafted will prompt excessive gathering of records and reports and impose the very red tape burden on charities that the current Government says it is trying to remove.

Under the proposal a charity would also be required to demonstrate that there are not 'practical alternate activities that could achieve the purpose faster, or achieve the purpose to a higher degree, using less time, money and other resources'. How is a religious charity to demonstrate that there are not more effective ways to call its adherents to prayer? Does the ATO propose itself as the arbiter of such spiritual matters? We are concerned that the drafters of the Regulations, in so far as the Regulations focus on effectiveness, have not contemplated such consequent eventualities.

We also note that any gifts supplied to an exempt entity from an individual taxpayer would be drawn from after-tax funds. To require their inclusion in the determination of whether a charity should remain exempt is to open the possibility that the funds will be effectively taxed twice. The existing subsection 50-75 is then to be preferred as it does not give rise such an eventuality.

Intimate supervision of how an entity uses its funds, merely because that entity chooses to use some of its funds overseas, is an extraordinary intervention into charities' affairs. Australian regulation of charities has always centred on protecting the public and those charities obeying the law from the predations and abuses of the unscrupulous and fraudulent. Intervention to prevent 'mismanagement' of funds has centred on inappropriately high levels of remuneration. Laws already exist to deal with these problems.

More prescriptive requirements have always been reserved to the realm of contractual arrangements between governments and charities, when government wishes to ensure that funding designated for a particular project is used in the intended manner. Tax exemption and deductible gift recipient status are not contracts with government where government is entitled to enquire as to the particular way in which a charity spends its money. The existing law recognises this, in placing government grant funds (which are usually the subject of contracts) and donations in the category of 'disregarded amounts' for the purposes of income tax exemption without requiring more.

Tax exemption and DGR are tools to encourage private philanthropy and promote public good without the need for direct intervention from the state. This has been the rationale for tax 'concessions' since the earliest days of colonial income and land taxes. They have not historically been a method for supervising how a charity chooses to do its work. Importing conditions akin to those found in government funding contracts is a radical reimagining of how government administers these concessions and what they are for. If the government wishes to replace indirect tax concessions with direct grants, as has been canvassed in numerous enquiries, including the most recent *Not-for-Profit Sector Tax Concession Working Group's Fairer*, simpler and more effective tax concessions for the not-for-profit sector report (Final Report, May 2013)[5] this should be done with a frank discussion of the advantages and disadvantages. It is not appropriate to introduce elements of direct grants into tax concessions by stealth.

In light of the above concerns, we conclude that the existing subsection 50-75 is to be preferred and that the proposed Regulations do not progress.

Basic Religious Charities Included

Regulation 50-50.01(5) provides the following:

> (5) If the entity is a registered entity under the Australian Charities and Not-for-profits Commission Act 2012, it must be in compliance with the governance standards under that Act:
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> (a) to which it is subject; or
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> (b) to which it would be subject but for any provision of that Act limiting the application of those standards to it.

[5] NFP report: Not-for-Profit Sector Tax Concession Working Group, Fairer, simpler and more effective tax concessions for the not-for-profit sector, (Final Report, May 2013) http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

The effect of draft Regulation (5)(b) is to render a Basic Religious Charity (as that term is defined under the *Australian Charities and Not-for-profits Commission Act 2012*) obliged to comply with the ACNC governance standards, which it is otherwise exempt from, if that charity seeks to rely upon the disregarding provisions. This is inconsistent with the policy intent of exempting Basic Religious Charities from the governance standards. The intent of that exemption was, in part, to exempt Basic Religious Charities from additional regulatory requirements that were seen as burdensome. The inclusion of Basic Religious Charities that undertake overseas operations as entities that must now comply with the governance standards is inconsistent with that policy intent.

Existing Prescribed Entities

The Bill proposes that existing prescribed entities will be 'grandfathered' and that organisations may be prescribed under Regulation as satisfying the in Australia requirements. A new requirement for prescribed entities is contained at proposed section 50-51(2)(d)(iv), which allows for the making of regulations which must be complied with in order to retain exemption. Those requirements are not disclosed by the proposed legislation currently released. Given the concerns we raise above regarding the new conditions to be imposed upon the disregarding of gifts, the conditions to be imposed upon prescribed entities should be sighted prior to the introduction of the legislation at this stage to allow for comment upon their effect.

We are concerned by the potential effect of the delegated legislation further anticipated by the Bill. To leave the conditions unstated in the legislation is to introduce significant uncertainty for the sector. It also delegates the ability to the executive government to effectively frustrate the ability of prescribed entities to rely upon section 50-51. Without sufficient clarity within the

legislation itself, the net effect of that delegated power may be the effective frustration of Australia's contribution to overseas development through such charitable sector engagements. The proposed conditions should therefore be stated in the Regulation itself and opportunity should be granted for the making of submissions upon those conditions.

Deductible Gift Recipients

In this section we address Public Benevolent Institutions that have operations outside of Australia. Currently, the principal legislated condition which must be satisfied in order for a contribution to be deductible is simply that the 'institution must be in Australia'. This is the only requirement stated in legislation concerning the operation of DGRs in Australia. The requirement to be 'In Australia' does not apply to international affairs deductible gift recipients (including overseas aid funds). We agree that greater certainty is required, but do not agree that the proposed amendments propose the solution that is best suited to the needs and operation of the sector. In our opinion the existing law under 50-50 should be applied to deductible gift recipients.

The exposure draft legislation provides that a new section 30-18 be inserted in the following terms:

> (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.

This is a stricter control than that required for income tax exemption where the entity must operate and pursue its purposes 'principally' in Australia. Sub-section (2) provides that:

> (2) Despite subsection (1), a fund, authority or institution that operates or pursues purposes outside Australia does not fail the conditions in paragraphs (1)(b) and (c) if:
>
> (a) its activities outside Australia are merely incidental to its activities in Australia; or
>
> (b) its activities outside Australia are minor in extent and importance when considered with reference to its activities in Australia.

The exposure draft attempts to enshrine the ATO's interpretation (as contained in TR 2003/5) in legislation (meaning it is no longer a mere interpretation), with the additional requirement that a DGR/PBI must operate and pursue its purposes *solely* in Australia. The proposed legislation also states that mere incidental or minor activities will not disqualify the DGR/PBI.

The government has not offered any alternative interpretations to that of TR 2003/5. It similarly has not provided a reason why deductible gift recipients should be required to satisfy a higher standard than that of exempt entities. We consider that to remove the administrative burden that results from an entity that is both exempt and a deductible gift recipient (or operates a deductible gift recipient fund) needing to comply with two differing standards, that the test for deductible entities should be aligned with the existing test for exempt entities.

Tracing Requirements

The tracing requirements imposed upon tax exempt entities (as outlined above) also apply to DGRs, with the exception that the obligation to trace payments made extends to any entity that that is not a DGR. The issues raised above in relation to tracing therefore apply *mutatis mutandi* to this provision and our recommendations for amendment should also be adopted at sections 30-18(3) and (4).

Interaction between subsections 30-18(3) and (10)

There is an inconsistency in the operation of subsections (3) and (10) of proposed section 30-18. Subsection 30-18(10) permits DGRs to disregard certain gifts in making a determination as to whether they satisfy the 'in Australia' requirements as follows:

> (10) Disregard the use of the following amounts in determining whether a fund, authority or institution satisfies the conditions in this section:
>
> (a) a grant from a *government entity for the purpose of allowing the fund, authority or institution to carry on activities outside Australia;
>
> (b) a payment under a contractual arrangement from a government entity for the purpose of allowing the fund, authority or institution to carry on activities outside Australia.

Subsection (3) requires that the giving of funds by a DGR to a non-DGR *must* be taken into account. Subsection (10) provides that the *use* of any funds supplied in certain circumstances as a grant or under a government contract must be *disregarded*. Whilst subsection (3) requires that the funds supplied to the DGR under grant or contract *must* be taken into account, subsection (10) 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**
Grant in Australia to DGR:	$100.00	Disregard
DGR's resultant gift to overseas partner	$100.00	$100.00
Net effect		Net operation by DGR is payment of $100.00 to an overseas entity

Under this worked example the DGR would no longer be entitled to deductible gift recipient status under the proposed legislation. It is not considered that this is the intended effect of the legislation.

We therefore conclude that there is an unintended drafting error at subsection (3), which fails to state that that subsection is subject to subsection (10), effectively meaning that grants are not regarded on receipt by a DGR, but the payment of funds received from a grant from a DGR to a non-DGR will be regarded for determining whether the DGR satisfies the 'in Australia' requirement. The anomaly has been addressed in the equivalent provisions pertaining to exempt entities (by the statement at 50-50(4): 'Subject to subsections (4A) *and (5)*'), but it is not addressed in the provisions relating to DGRs. In order to address the inconsistency we propose that the following be inserted at the commencement of subsection (3): 'Subject to sub-sections (4) *and (10)*'.

Aligning Disregarding Tests

The test for disregarding monies by DGRs is more restrictive than the types of gifts and contributions that may be disregarded by an exempt entity. Proposed 50-50(5) states that exempt entities may disregard:

(a) an amount received by the entity as a grant from a *government entity;

(b) an amount received by the entity as a gift or contribution (whether of money or other property) in circumstances where the provider:

(i) was not entitled to a deduction under Division 30 in respect of the gift or contribution; and

(ii) is not an *exempt entity.

To reduce administrative burden, and to align the requirements for exempt entities with those for DGRs, DGRs should also enjoy the benefit of disregarding gifts made by non-exempt entities. This will permit DGRs to use their funds in any way that is consistent with their charitable purposes and avoid unnecessary regulatory burden.

'Provide' vs. 'give' and inclusion of 'benefits'

We also note that our comments above concerning the inclusion of the words 'provide' and 'benefits' also apply to subsection 30-18(3) and 30-18(4). We propose the same solution as proposed for exempt entities above.

Entities Operating Both Overseas Aid Funds and PBIs

Proposed section 30-18(7) provides that where an entity that is a whole of organisation PBI also operates an overseas aid fund, the operation of that overseas aid fund is to be disregarded for the purposes of determining whether the PBI is 'In Australia'. We consider this requirement to be potentially problematic. We understand that many entities who fit this description are consolidating the operations of the PBI and overseas aid fund for financial reporting purposes. If this is so, further administrative burden will be imposed upon charities due to the requirement to prepare separate accounts.

Conclusion

In concluding, we wish to thank the Australian Government for the opportunity to make submissions in respect of the centralising of the special conditions for tax concession entities.

Considered as a whole, our recommendation in relation to income tax exempt entities is that the proposed amendments do not progress as the existing law, which is largely settled and understood by the sector, should remain unchanged. Principally we are concerned with the additional level of administrative burden, the uncertainty entailed in the existing drafting and by the proposal that an assessment by the state of the effectiveness of religious institutions will determine their ability to retain tax exemption. In relation to deductible gift recipients, we conclude that further clarification of the in Australia requirements is warranted, but rather than a sole operating test, the appropriate test is that for exempt entities. Should you have any questions in relation to these submissions, please do not hesitate to contact the writer.

Yours sincerely

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