
CPA AUSTRALIA CONFERENCE

PERTH 6 DECEMBER 2007

“BUILDING CAPABILITIES IN THE NOT FOR PROFIT SECTOR”

TAXATION UPDATE:

GST Changes:

From 1 July 2007, the tax threshold for obligatory GST registration has been lifted from \$100,000 to \$150,000 for non-profit organisations. For businesses, the threshold is now \$75,000 (previously \$50,000).

Also from 1 July 2007, ATO advise a valid Tax Invoice is not required in order to claim GST credits for purchases of \$82.50 or less (including GST).

PAYG Changes:

Where a supplier has not provided an ABN, the threshold for obligatory PAYG Withholding Tax has been increased from \$50 to \$75 (GST exclusive).

This means that if you make a payment to a supplier greater than \$75 and you have no paperwork, or the invoice does not quote an ABN, you have an obligation to deduct PAYG Withholding Tax. The current rate for PAYG Withholding Tax is the ceiling income tax rate of 46.5%. If you do not deduct the Withholding Tax and pay the invoice in full, ATO require that you pay the Withholding Tax in addition to the payment already made. The only other option is to attach to your paperwork a Statement by Supplier from the supplier giving the reason why they do not need an ABN. (See attachment to these notes for sample).

Bare Trusts and GST:

ATO have just released Draft Ruling GSTR 2007/D3 “GST and Bare Trusts”. This explains the ATO present attitude to transfers of property involving Bare Trusts where the Trustee has limited active duties and acts solely at the direction of the beneficiary. The ruling differentiates between the actions of a Trustee and the actions of an agent. ATO are seeking comments by 11 January 2008.

Political activities can be detrimental for charities:

To ensure continuance of Tax Concession Charity (TCC) endorsement, it is important that charities understand that in most circumstances, political lobbying and advocacy are inconsistent with charitable status. However, where the political lobbying or advocacy is incidental to the Objects of the organisation, and this can be clearly demonstrated, then such activities would normally be in order. There is a legal distinction between political purposes and political activities. Therefore, political Objects in your Constitution, where those objects are not ancillary or

incidental to the charitable objects would be sufficient to deny TCC status. Similarly, political activities which are not consistent with your Objects and/or are not merely ancillary will be deemed non-charitable.

More information is available in Taxation Ruling TR 2005/21.

Review of Tax Status:

ATO have reminded charities recently that they are expected to review their DGR and TCC status periodically, preferably annually. ATO have provided worksheets to assist in such a review on the ATO website. TCC endorsement is available at "NAT 7967. DGR Review is available at "NAT 3132". With the TCC review you need to understand the difference between a charitable institution and a charitable fund.

Word Investments:

The full bench of the Federal Court handed down a unanimous judgment on 14 November 2007, in favour of Word Investments Ltd (a Company Limited by Guarantee). This judgment creates a dilemma for ATO in respect to Taxation ruling TR2005/22. The Word Investments decision means that an entity, which is a fund-raising arm of a charity, can, in certain circumstances, be eligible for TCC status, notwithstanding the fact that it is operating predominantly a commercial activity.

The full judgment is available as Commissioner of Taxation -v- Word Investments Ltd (2007) FCAFC 171.

Word Investments is an entity controlled by Wycliffe Bible Translators Australia, which was without question, accepted as a TCC. The Objects in Word's Memorandum of Association were religious. Both in its Objects and its activities and also in the approach of the Directors of Word, the judges found that the focus was not on commercial enterprise but on furthering the religious objectives of Wycliffe.

The activities of Word changed over time. Initially, it was borrowing money at low or no interest, investing it and paying the surplus to Wycliffe. Later, as this area of activity ceased to be of significant benefit, they established and operated a funeral business. This business operated profitably and again, the profits were commonly paid to Wycliffe, but some part of the profits were sometimes paid to other religious institutions with similar Objects to Wycliffe. The full bench supported the conclusions of the original trial judge in saying the mere fact that an entity made a profit did not of itself deny TCC status. Nor did the fact that it was operating an activity, which for-profit businesses would also operate necessarily, deny TCC status. It hinged more upon other matters with strong emphasis on the Objects. In their judgments, they differentiated between the circumstances in Glebe Administration Board – v – Commissioner of Payroll Tax, which is another entity controlled by a religious institution. In Glebe, it was decided that charitable status was not appropriate.

The decision of the Court, in Word, provides a significant dilemma for ATO. They are currently considering whether they will appeal to the High Court of Australia. Given the importance of the decision and that it stands strongly against a long held view of ATO, it is probable a High Court appeal will eventuate if there are grounds. However, in this case, ATO lost with the Administrative Appeals Tribunal, lost before a single judge and then lost against the unanimous decision of the full bench of the Federal Court. Therefore, being granted leave to appeal to the High Court may be a difficult journey.

TR2005/22 states that corporations operating a type of commercial activity that are controlled entities of a TCC, will not in themselves be eligible for TCC endorsement. It affirmed that each individual corporate entity must be examined for TCC endorsement on its own, and no regard should be given to the other related entity.

This Ruling is also closely related to TR 2005/21, which identifies the meaning of “Charitable Institution” and “ Funds established for public charitable purposes”. TR2005/21 also is affirming that a corporate entity operating a commercial business undertaking is not eligible for TCC endorsement.

The Word case introduces some other interesting and helpful commentary, including a reference to the meaning of “in Australia”. The judgment also infers that the meaning of the term “charity” is not rigid but movable and adapts to changing community values.

Gifts of shares valued at \$5,000 or less:

A gift of shares in listed public companies can now be made to a DGR and the donor receive a tax deduction for the market value on the day the gift is made. This is conditional on the shares being owned for at least 12 months prior to the making of the gift and the shares having a market value of \$5,000 or less. The gift maybe subject to Capital Gains Tax (CGT) provisions. This means that the donor may be able to claim a deduction for the gift BUT may also be liable to pay CGT because of the disposal of the shares.

Gifts of property may also be deductible for donations of the following: -

- Any property purchased less than 12 months before the gift was made (at cost);
- Property valued at more than \$5,000 at ATO valuation, purchased more than 12 months prior to the gift.
- Therefore, property valued at less than \$5,000 other than listed shares purchased more than 12 months prior to the gift **are NOT deductible.**

Tax deduction at fund-raising events:

Donors are eligible to receive a tax deduction for donations to DGRs where a minor benefit is received at a fund-raising event. The deduction is available where the payment is more than \$150 (previously \$250) and the minor benefit received is no more than \$150 (previously \$100) or 20% of the donation – whichever is the less. The explanatory memorandum provided as an example -

“the person bids \$2,000 for a T-shirt at a DGR auction. The T-shirt has a market value of \$120. The value of the T-shirt is less than \$150 and less than 20% of the donation, so a tax deduction of \$1,880 is available.”

Simplified Gift Fund Rules:

In April 2007, royal assent was given to changes in the Deductible Gift Fund (DGR) rules regarding the operation of the Gift Fund. A summary of the changes is set out below:

- DGRs that are listed by name in the Act are now subject to review by ATO on the same basis as those DGRs that have been endorsed. Listed DGRs that do not comply with the Gift Fund obligations may lose their DGR status, (subject to Parliamentary decision).
- Most entities that have DGR status for all of their activities, will no longer have to maintain a separate Gift Fund bank account; provided clear accounting records are kept. Exceptions to this change are Cultural and Environmental DGRs, Harm Prevention Charities and entities with specific obligations under State Laws.
- Entities that have DGR status for a part only of their activities will continue to be obliged to maintain a separate Gift Fund bank account, as before. An example is an Educational Building Fund.
- Entities that maintain multiple Gift Funds will be able to consolidate them into one Fund—thus eliminating much administrative work.
- Gifts received will, as before, continue to be applied only for the specific purpose for which DGR status was granted. Therefore, with multiple purpose funds the accounting records must continue to be clear so that the gift can be traced from donor to approved task.
- The obligations on winding up of a Gift Fund remain.
- The need for a specific Gift Fund Committee is removed, but not the obligation to ensure gift monies are accurately applied.
- Where DGR status is lost, for whatever reason, there remains an obligation to transfer surplus assets in the Gift Fund to another appropriate DGR.
- **Where the Gift Fund has been established under an entity’s Constitution, the new provisions cannot be applied until the Constitution has been changed. There are currently moves to make major changes to the WA Associations Incorporations Act, so consideration should be given to both matters together, where possible.**

THE MEANING OF “INSTITUTION”

Pamas Foundation -v- DCT (1992) 23ATR189

This was an appeal from an Administrative Appeals Tribunal (AAT) hearing to the Federal Court under the provisions of the *Debits Tax Assessment Act 1982(DTAA)*.

The Pamas Foundation (Pamas) was an association incorporated in WA. Its Objects were religious and charitable. The appeal focussed on the key issue of whether Pamas was a “religious institution”. The AAT and also the Court considered the terms “religious institution” and “institution”. Within the specific Act the defining clause read “a public benevolent or a religious institution ...”.

The appeal judges’ decision, in summary is –

- (i) The term “religious institution” is connected in the Act with the term “public benevolent institution” which suggests that the word “institution” is to be given a meaning greater than a structure controlled and operated by family members and friends. (Pamas members were a medical practitioner, his wife, their four adult children, a religious practitioner and the practitioner’s wife. The religious practitioner was a friend.)
- (ii) Incorporation under the WA Associations Incorporation Act does not mean a corporation is automatically an institution within the meaning of the relevant taxation laws. In this instance the Foundation had a small and exclusive membership and its activities were relatively small.
- (iii) The terms “religious” and “institution” are ordinary words in English language and the term “religious institution” has an ordinary meaning.
- (iv) The DTAA Act used the term “religious institution” as referring to those significant religious institutions, which are a recognised part of society, the operation of which is seen to provide a public benefit justifying fiscal exemption.
- (v) Pamas had the potential to become a religious institution due to the value of its activities. However at present it had a character analogous to that of a private charitable trust.

The appeal was dismissed.

In the judgement Davies J states that the DTAA used the term “religious institution” in the same sense in which the term has been used in taxing statutes for many years and cites – Oxford English Dictionary – “an establishment, organisation, or association instituted for the promotion of some object, especially one of public or general utility, religious, charitable, educational, etc

...”. The Macquarie Dictionary emphasises the current, ordinary use of the term where “institution” can be used in ordinary parlance in a much wider sense than it is used in the expression “religious institution” in fiscal statutes. Webster’s Dictionary gives the term “institution” a definition as “an organisation having a social, educational, or religious purpose, such as a school, church, hospital, reformatory, etc.”.

Davies also states, at 191 para 35 “There is no principle of law that every body established for religious purposes is a religious institution”.

The key issues arising from this case that are relevant for TCC endorsement appear to be the issues of small membership and tight control. The *bona fides* of the founder and members was in no way in question. The Court decision confirmed the AAT decision that Pamas was not a religious institution. The Court also examined the meaning of the term “institution” and the range of case decisions in respect to that term. It is clear that ATO have taken this subsidiary matter arising from the more detailed judgement in Pamas as having significance when considering TCC endorsement applications. However comments relating to the term “religious institution” are also of considerable significance.

In examining the term “institution” the Court referred to other jurisdictions and other Acts of Parliament. Consequently the specific language will be subject to some variation. In one case cited as ‘WN (PT2)(NSW) 119) the Judge in that case states that the fact the appellant had only seven members did not bar the entity from being defined as a “religious society”. However he then referred to the Franciscan Order and states “it may well be that, in the ordinary use of language, one would speak of the Franciscans as being now, but not being in those early days, an “institution””. Therefore in this particular judgement the entity was deemed to be a religious society and not a charitable institution.

The judges in Pamas concluded that the word “institution” should be applied to an entity with a greater structure than one controlled and operated by family members and friends.

For charitable entities generally this means ATO will seriously consider disallowing TCC endorsement from charitable entities which have a small membership and/or committee members who are related by blood or marriage?” I have seen the clear actions of ATO in this regard in recent decisions they have made. However they have been willing to review these matters once there has been a re-structuring.

There are a large number of charities, mainly smaller ones, operating within Australia that derive their energy and drive in achieving their charitable object through their small committed team of members. It may well be that to force such entities to develop a much wider membership base may well mean the immediate loss of the energy, commitment and drive that arises from the sound operating team currently working at the coalface. Nevertheless a reasonable question raised through such a case as Pamas is whether one family group should receive significant taxation concessions when there is no effective public

accountability. The question of public accountability itself is not a significant issue in Pamas. The issues for the Court appeared to be –

- an expectation that an institution is a significant body (but no clear definition emerges), and
- it is not the end result that is the issue but the method of control (so tight control by one family group or even a group of close friends, creates the problem).

And now, a very recent case, with its own issues –

SIMAID – AAT Case 2007 AATA 1443, re SIM Australia as Trustee for SIMAID Trust.

This case focussed on the difference between a charitable institution and a charitable fund or trust. It was an application for PBI endorsement by an overseas aid fund. It failed as it was held that it was not an “institution” within the meaning of taxing laws.

Section 50-5 of ITAA 1997, the provision providing income tax exemption for charities, refers to both “charitable institutions” and “charitable funds”.

A “charitable fund” always needs to be structured as a trust. It cannot be an association or a company limited by guarantee. However some charitable trusts qualify as being charitable institutions because of their function. This is because, in such instances, the difference is not in the structure, but in the function.

A charitable fund is either a conduit or a passive investment trust. It is normally restricted to the receipt of investment income or gifts. (There are some exceptions, such as a Necessitous Circumstance Fund established under Section 30-45, Item 4.1.3 where the Fund Trustee(s) provides direct financial type aid to a particular disadvantaged person or class of persons.) However most charitable funds are established to provide financial support to a specific charity or group of charities. Many are also Deductible Gift Recipients (DGRs) – such as a Foundation set up to support a specific charity.

SIMAID is a Trust established as an overseas aid fund and had DGR status under Section 30-80 Item 9.1.1 of the ITAA 1997. It was seeking recognition as a PBI under the FBT PBI provisions, as it wanted to provide FBT exemption benefits to its employees. However its problem was that it could not demonstrate that it was actually carrying out direct aid and this is a specific requirement of the law for PBIs.

SIMAID operated in close co-operation with SIM Australia, a Christian missionary organisation. Changes in its operation had occurred over a period of time. At the relevant time, it had no staff either in Australia or involved in its projects overseas. Instead, it accessed SIM Australia personnel, either on an agency basis for its overseas activities, or on secondment within Australia. When SIMAID’s activities were closely examined, it was held that it had become a promotional and fund-raising organisation, which was no longer involved in direct benevolent activities, as it had been previously.

Land Tax Exemption: - exemption when owned for charitable or benevolent purposes.

Section 37 of the Land Tax assessment Act 2002 reads:

“Land owned by public charitable or benevolent institutions:

Land is exempt for an assessment year if –

- a) At midnight on 30 June in a previous financial year, it is owned by, vested in or held in trust for a public charitable or benevolent institution; and
- b) It is used solely for the public charitable or benevolent purposes for which the institution was established.

Brightwater - v – Commissioner of State Revenue (2006) WA SAT 276 is a case where Brightwater Care Group (formerly Home of Peace) appealed against the disallowance of their objection to the State Administrative Tribunal (SAT). The objection related to land held on 30 June 2004 and 30 June 2005.

Brightwater is an approved Public Benevolent Institution by Australian Taxation Office. Its status as a benevolent institution was not in dispute. What was in dispute was the use of the subject land being land, which at the relevant times was vacant land.

The Brightwater property in Inglewood has for many years been used for aged care purposes, which is a benevolent activity. The facilities on the site were ageing and needed upgrading or replacing. Certain buildings were demolished in 2001 and a plan was lodged with the Council for development of independent living units on the land. Some of the land was on a separate title which at all relevant times had no buildings on it, the previous buildings having been demolished. An application to develop independent living units was lodged with the Council in October 2002. The Council approved it in March 2003. In January 2004, the Board of Brightwater deferred the development due to the necessity to allocate their priorities elsewhere. The Board then became concerned about whether they may be in breach of the Crown Grant conditions in respect to the proposed use of the land. They sought legal advice and it was some time before there was resolution in respect to this issue.

The question before the SAT was whether the land was being used solely for public charitable or benevolent purposes within the meaning of the relevant Act. The Commissioner for State Revenue contended there was a clear break in the continuation of relevant purpose in respect to the land. The SAT held, in allowing the appeal by Brightwater, that there was consistent evidence that there had always been an intention to proceed with the establishment of the proposed facility but the Board had been forced by circumstances beyond their control to defer the development.

The charitable purpose was confirmed.

Rates Exemption:

Uniting Church Homes Inc. and City of Stirling (2005) WASAT191, was a test case taken by a number of Aged Homes organisations. It related to the

entitlement to rates exemption under the Local Government Act, regarding well-aged units.

The relevant section of the Local Government Act describes land which is not rateable land at 6.26 (2) (g) as “land used exclusively for charitable purposes”. This wording has remained constant for many years.

There has been a significant upgrading of well-aged units in recent years. It appears that, until recently, local government had viewed well-aged units, controlled by a charitable entity, as being acceptable as exempt property, but more recently have come to realise that the sumptuous nature of many of these properties and the fact that they are being sold and bought in the real estate market as significant assets, has changed matters. The original concept was that aged homes were seen to be a facility providing a benefit for the aged and needy. In the changed circumstance, a lease-for-life for such facilities was not viewed by local government as charitable. Key terms argued before the SAT were the terms “exclusively” and “charitable purposes”. The case confirmed that the Statute of Elizabeth continued to be the authoritative source of understanding of the meaning of ‘charity’.

SAT reviewed the aged home complex which was the subject of the appeal. It was providing a specific model of well-aged units, providing for a transfer to hostel and subsequently, to nursing home. (This point needs to be kept in mind in viewing the result of the case). The case also identifies that the average age of the residents in these complexes exceeded 80 years, even though the rules stated that the minimum age for acceptance was 55 years. SAT formed the view that the provision of resources to the aged clearly qualifies under the heading of charitable purposes. The case argued before the SAT concerned people over the age of 80 predominantly. With reference to the term “exclusively”, SAT held that the age was not in itself the issue but the principle purpose of the not-for-profit entity was the key. If it provides facilities such a recreation rooms, these facilities are ancillary to and supporting the principle purpose and do not detract from the charitable nature of the entity.

The Uniting Church Homes succeeded in their appeal.

In this case and other cases, the Court are asked to pay significant attention to terms like “exclusively”, and “ancillary” and “incidental”.

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