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## Federal Court Discourages Political Activity for Charities

The judgement in the case of [Commissioner of Taxation v Aid/Watch Incorporated 2009](#) FCAFC 128 was delivered by the Full Court of the Federal Court of Australia 23 September 2009.

It characterised Aid/Watch as having a main purpose of political activity and said it was disqualified from being a charity.

Aid/Watch is a non government aid organisation that "monitors, researches, campaigns and undertake activities to ensure that aid projects are appropriate for their local communities and environmentally effective." Although relief of poverty was a major objective of the organisation, the Federal Court found that the main object was to change government policy.

Moores Legal considers that the court failed to distinguish between means and ends and it is hoped that the High Court will consider the matter further.

**Murray Baird**  
Principal  
Not for Profit Group

## ATO Publishes Compliance Program 2009-2010

The ATO Compliance Program 2009-2010 was issued 6 August 2009.

The [Non-Profit News Service No. 0250](#) provides information and a link to the Compliance Program.

The Compliance Program is an annual publication and includes a specific compliance program directed at not for profit organisations.

### Key issues are as follows:

- emphasis on voluntary compliance with information, guidance, support and audit activity;
- ATO will explore ways to reduce costs of compliance and monitor eligibility;
- ATO will check all endorsement applications and all claims for refunds of franking credits.

### Targets

The 2009-2010 focus will be on the following:

- misuse of tax concessions insuring understanding of obligations including obligations as employers;
- closely-controlled organisations;
- activities not consistent with any special exemption;

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- integrity of business systems and record keeping;
- involvement with tax avoidance arrangements such as distributions from trusts with only nominal amounts being paid out.

### Moore's Legal's Response

The sector will be encouraged by the continued emphasis on information, guidance and support combined with a firm but fair approach to abuse of concessions.

Organisations with not for profit status should conduct an annual review of their status. This year they should pay particular attention to the compliance issues set out in the compliance program 2009-2010.

**Murray Baird**  
Principal

## Payroll Tax Investigations for Charities

Are you confused about whether you are eligible for exemption from payroll tax? Do you have a niggling uncertainty about whether you need to apply for an exemption? Or reapply?

The State Revenue Office ("SRO") has been very active in challenging not for profit organisations in relation to payroll tax. They appear to be conducting a systematic review of not for profits, looking at whether they are eligible for exemption, and whether the exemption applies to all employees.

The [State Revenue Office Victoria - Overview \(Payroll Tax\)](#) website provides some information about payroll tax. However, it is advisable to seek advice about your particular circumstances rather than take the SRO website at face value. In particular, we point out that contrary to popular perception:

- It is **advisable** rather than **mandatory** to apply to the SRO for exemption from payroll tax.
- Staff engaged in an activity which generates income for your organisation **can fall within your exemption** from payroll tax.

### Common questions

#### 1. What exactly is the exemption?

Exemption from payroll tax arises as a result of section 48 of the [Payroll Tax Act 2007 \(Vic\)](#) which reads:

48(1) Subject to subsection (2), wages are exempt wages if they are paid or payable by any of the following—

- a religious institution;
- a public benevolent institution (but not including an instrumentality of the State);
- a non-profit organisation having as its sole or dominant purpose a charitable, benevolent, philanthropic or patriotic purpose (but not including a school, an educational institution, an educational company or an instrumentality of the State).

48(2) The wages must be paid or payable—

- for work of a kind ordinarily performed in connection with the religious, charitable, benevolent, philanthropic or patriotic purposes of the institution or body; and
- to a person engaged exclusively in that kind of work.

There is controversy over the interpretation of subsection 48(2) (above) regarding how far the exemption extends. The SRO states on its website that "there are qualifications on payroll tax exemptions available to organisations engaging in commercial activities."<sup>1</sup> However, it can be argued that income generation is "work ordinarily performed in connection with benevolent purposes", regardless of the nature of the income generating activity. Moore's Legal strongly

<sup>1</sup> Accessed 8 August 2009

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advocates this argument. However the matter is not finally settled. We are aware of several charities currently in dispute with the SRO over this issue.

2. Is there a requirement to apply for an exemption?

In our opinion, charitable organisations are not required under the *Payroll Tax Act 2007* (Vic) to apply for exemption from payroll tax. There used to be a requirement under section 10 of the *Payroll Tax Act 1971* (Vic) that charities satisfy the Commissioner that they were eligible for exemption, however that legislation has been superseded by the 2007 Act.

The SRO maintains that employers who believe that they are exempt from payroll tax “should apply to the SRO for a private ruling”. They make this statement in their “Payroll Tax General Information Circular” dated 2008, and maintain this line generally in their dealings with charities.

3. What if we don't apply?

There are substantial risks if you self-assess as eligible and are later found not to be. The risks are that you will incur costs in having a dispute with the SRO, and that you may be subject to penalties.

**Check up**

You may consider seeking a private ruling from the State Revenue Office if some or all of the following apply to you:

- You do not have a letter of exemption from the State Revenue Office, or it was issued more than 2 years ago;
- You have a letter from the State Revenue Office confirming your exempt status, but since you received that letter you have changed your organisation's purpose or objective, and/or its activities;
- You conduct income-raising activities and you have a number of staff engaged in those activities for whom you are not paying payroll tax;
- You are concerned about the potential for an audit and penalties, and want reassurance that you are exempt.

If in doubt, we suggest you seek advice with a view to potentially requesting a private ruling from the State Revenue Office.

*Libby Klein*  
Senior Lawyer

## Losing your Charitable Status

There are two alerts which point to the danger of losing endorsement as a tax concession charity.

- recent tax office reviews of charities
- recent Federal Court decision in [Federal Commissioner of Taxation v Bargwanna](#)

### Tax Office Review

A recent tax office review concentrated on funds that were not applied for charitable purposes including:

- investment that benefits private entities;
- excessive accumulation on investment income (rather than distribution for charitable purposes);
- making distributions for non-charitable purposes.

More details are available on the [ATO Non-Profit News Service No.0252](#).

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**Bargwanna case**

The Federal Court has affirmed this approach in the case of [Federal Commissioner of Taxation v Bargwanna 2009 \[2009\] FCA 620](#), where a closely held family charitable trust was subject to sloppy administration and gave significant benefits to family members who were not the objects of the charitable trust.

Earlier, the Administrative Appeals Tribunal had taken a "broad brush approach" and held that some irregularities in the fund did not disqualify the fund from being categorised as "applied for the purposes of its establishment".

Edmonds J in the Federal Court took a stricter view:

*"... there is much to be said for the view that the privileged status of exemption for income tax on the income of funds which aspire to that status demands strict adherence to the requirements that must be met before that status is conferred".*

**Moore's Legal's Comment**

The Bargwanna case, the ATO reviews and the [2009-2010 ATO Compliance Program](#) (see article in this Briefing) all signal a strict approach to charitable funds being applied only for charitable purposes.

**Murray Baird**  
Principal

## A Postscript to Word

The Australian Taxation Office has released a [Decision Impact Statement \("DIS"\)](#) in response to the December 2008 High Court decision [Commissioner of Taxation v Word Investments Limited](#) ("the *Word Case*"). The DIS provides some guidance for charitable, religious, scientific or public educational institutions involved in trading activities.

In the *Word Case*, the majority of the High Court found that charitable activities of an organisation can be found in the "natural and probable consequence" of the organisation's immediate activities. Such a "natural and probable consequence" may be simply the passing of funds raised by a charitable entity through trading activities onto another charitable entity. The *Word Case* has been discussed in previous editions of the Not for Profit Briefing.

In the DIS, the Australian Tax Office ("ATO") accepts that an entity can be a charitable institution even if it does not directly carry out charitable activities but instead, gives its trading surplus to institutions that do.

However the ATO maintains that each case must be decided on its merits. Whether an entity conducting trading activity can be characterised as a charitable institution will require examination of the constituent documents and (according to the DIS) the "purported effectuation" of that purpose in the entity's activities. That is, the activities, policies and decisions of the entity must be consistent with furthering the entity's declared charitable purpose.

We agree with the ATO that each case must be decided on its merits. We also agree that the circumstances of a charitable institution may change. We particularly note the warning issued "to avoid doubt in the future" by the majority of the High Court in the *Word Case*. The majority stated "...it would not be enough that the purpose or main purpose of an institution were charitable if *in fact* (our italics) it ceased to carry out that purpose."

Based on the decision in the *Word Case* we think there is a reasonable basis for charitable, religious, scientific or public educational institutions to engage in trading activities to further their charitable purposes. We think this is so, even if the trading activities themselves could not be characterised as being charitable.

However charitable institutions must ensure their trading activities are conducted predominantly to generate surplus to directly further their charitable purposes, or to distribute to other institutions undertaking charitable work. Because each case will be decided upon its merits by the ATO, we

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recommend persons wishing to establish or increase trading activities for their particular charitable, religious, scientific or public educational institution to seek further specific advice.

Please contact the Not for Profit team at Moores Legal for further advice on trading activities for charitable institutions.

*Derek Mortimer*  
Lawyer

## Are You Getting Your Franking Credits?

Many income tax exempt entities and deductible gift recipients are entitled to a refund of franking credits for share investment dividends.

If your organisation has investments in shares and is not receiving a refund of franking credits it should refer to the following:

- [ATO Fact Sheet on eligibility to claim a refund \(NAT 6716\)](#);
- [Application form for income year 1 July 2008 - 30 June 2009 \(NAT 4131\)](#);
- [Instructions on how to complete the form \(NAT 6715\)](#).

*Murray Baird*  
Principal

## The New Age of Industrial Relations

### Introduction

The new financial year 2009/2010 heralded a new age in industrial relations in Australia. On 1st July 2009 substantive parts of the [Fair Work Act 2009 \("FWA"\)](#) came into operation. The balance of the FWA will come into operation on 1 January 2010. The FWA does not distinguish between for profit and not for profit organisations. It applies in the same way to both.

### Changes from 1 July 2009

The first parts of the FWA to come into operation include provisions relating to unfair dismissal and agreement making. Provisions relating to Fair Work Australia, the organisation that replaces the Australian Industrial Relations Commission, the Workplace Authority and the Workplace Ombudsman, also commenced on 1 July 2009.

In terms of agreement making, emphasis has shifted from individual agreement making to collective agreements.

The legislation also provides greater protection for employees in relation to unfair dismissal. Previously, only employees working for employers with 100 or more employees were able to bring an unfair dismissal claim. All employees can now bring an unfair dismissal claim. However, small business employers (those with fewer than 15 employees) will be protected from an unfair dismissal claim if they have complied with the small business fair dismissal code. Employees must also have worked for the employer for 6 months (12 months in the case of a small business employer) before they can make an unfair dismissal claim.

### Changes from 1 January 2010

The FWA also provides for a revamp of the Award system. All non enterprise awards are being reviewed as part of an Award modernisation process. There are currently around 2,500 awards. It is expected that by the time the award modernisation process is completed on 31 December 2009 that there will be around 100 new modern awards created to replace the existing 2,500 awards. There will also remain around 900 enterprise specific awards. It is expected that the new modern awards will commence operation on 1 January 2010.

1 January 2010 will also see the introduction of 10 national employment standards. These standards, together with the modern awards and minimum wage setting form a safety net below which

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employment standards cannot fall. The national employment standards are comprised of the following 10 standards:-

1. Maximum weekly hours;
2. Requests for flexible working arrangements;
3. Parental leave and related entitlements;
4. Annual leave;
5. Personal/Carer's leave and compassionate leave;
6. Community service leave;
7. Long service leave;
8. Public holidays;
9. Notice of termination and redundancy pay;
10. Fair work information statement.

The government has also passed additional legislation that provides for the transition from the old IR regime to the FWA. The transitional stage commenced on 1 July 2009 and will continue until 1 January 2010 when the balance of the FWA will come into operation.

We would be happy to provide advice concerning the impact of the FWA on your organisation. Should you require assistance please contact Peter Andrew of our office on 03 9843 2121.

**Peter Andrew**  
Consultant  
Workplace Relations Group

## The "PAF" has plenty of Puff

Private Tax Deductible Funds previously known as Prescribed Private Funds will now be known as Private Ancillary Funds and regulated by the Australian Taxation Office rather than Treasury.

Amendments to legislation due to take effect from 1 October 2009 will also have an impact on the structure and operation of Private Ancillary Funds ("PAF").

Legislation to be amended includes parts of the *Income Tax Assessment Act 1997* ("ITAA 97") and the *Taxation Administration Act 1953* ("TAA 53"). The amendments are set out in the [Tax Laws Amendment \(2009 Measures No. 4\) Bill 2009](#). [Related Parliamentary explanatory documents](#) also help shed light on this legislation.

Amendments to the ITAA 97 include changing the name of Prescribed Private Funds to Private Ancillary Funds, a requirement that a PAF complies with rules in certain *Private Ancillary Fund Guidelines*, and an amendment that in effect, requires the trustee of a PAF to be a company.

In anticipation of the amendments coming into effect, these requirements are being applied from 1 July 2009.

Amendments to the TAA 53 will permit the Commissioner of Taxation to communicate to State and Territory Attorney Generals information relating to non-compliance of a PAF or trustee of a PAF. The Commissioner is further empowered to suspend trustees of a PAF if the Commissioner is satisfied that trustees have breached the *Private Ancillary Fund Guidelines* or Australian laws. In our opinion these amendments give the Commissioner some standing where there is an alleged breach of trust by PAF trustees under trust law.

Power is given to the Registrar of the Australian Business Register to enter a statement on that Register that an entity with an ABN is a PAF. We think this will be of great assistance to PAF trustees. At the least it will help prevent PAF trustees from incorrectly making a distribution to another PAF.

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Amendments to the TAA 53 will also create an obligation on the Minister for Tax Law Administration to formulate [Private Ancillary Fund Guidelines](#) ("the Guidelines") and provide for administrative penalties that may apply to a PAF trustee for non-compliance. The Guidelines have been drafted and released for public consultation. The Guidelines are due to commence on 1 October 2009.

The Guidelines begin with a "General Principle" of questionable utility, namely that a PAF be "open, transparent and accountable to the public (through the Commissioner)". In reality a PAF remains essentially private in nature; its books of account and decisions its trustees make could not generally be obtained by the public at large. A PAF is also prohibited from soliciting donations from the public. However without doubt, the decisions of PAF trustees will be capable of greater scrutiny and sanction by the Commissioner of Taxation.

The PAF trustee is required under the Guidelines to in essence, meet the "prudent person test" found in trust law. This test requires a trustee to act prudently when investing trust assets. Trustees of Prescribed Private Funds were required to meet the prudent person test under trust law. However the inclusion of this test in the Guidelines may give the Commissioner standing to seek remedies for breach of the test by PAF trustees.

The Guidelines require a PAF to distribute at least 5% of the market value of the PAF assets as at the end of the previous financial year. Under certain transitional arrangements, PAFs approved prior to 25 June 2009 do not need to meet this 5% p.a. distribution requirement until the end of the 2013-2014 financial year (at the latest).

Accordingly a PAF trustee must undertake a market valuation of PAF assets annually. There are some particular requirements in regard to market value of land held by a PAF. A PAF trustee must prepare a current investment strategy for the PAF and a disbursement strategy. These strategies must be committed to writing.

Whilst a PAF is prohibited from soliciting donations from the "public", the Guidelines add that a PAF must not accept donations totalling more than 10% of the value of its assets from the PAF "founder", "associates" or "employees". In our opinion these parts of the Guidelines when read together, permit PAF trustees to receive donations from a wider class of persons than the PAF founder's immediate family.

The Guidelines also permit a PAF to be converted into an Ancillary Fund if trustees do wish to primarily solicit donations from the public.

Amendments to the TAA 53 oblige the Minister for Tax Law Administration to formulate the Guidelines by "legislative instrument". The previous "Guidelines" for Prescribed Private Funds had no such requirement.

A "legislative instrument" under the *Legislative Instruments Act 2003* is a power delegated by Parliament to a rule maker to make laws. The legislative instrument must be tabled in both houses of Parliament and can be disallowed on a motion and resolution. In our opinion the *Legislative Instruments Act 2003* is a safeguard against the possibility of ill considered Guidelines creating unreasonable obligations upon PAF trustees.

In summary, the legislative amendments and the Guidelines formalise obligations of PAF trustees and provide a new means for the Commissioner to enforce those obligations. However the requirement for a corporate trustee, a minimum distribution amount and valuation of assets each year will impose additional administrative burden on those who manage a PAF. Whether this burden discourages persons to establish and operate PAF's remains to be seen.

Trustees of PPF's (now PAF's) should review the application of the new requirements to their fund.

For more information about PAFs and the new scheme, look at the following documents:

- The [Non-Profit News Service No. 0253](#) provides a basic overview of the most recent changes (10 September 2009)
- The [recent Press Release](#) from the Assistant Treasurer titled "Important Philanthropic Tax Law Reforms Pass Through Parliament" provides useful information concerning the recent changes.

**Derek Mortimer**  
Lawyer

## Reporting of Exempt Fringe Benefits and Voluntary Superannuation Contributions for Social Security Purposes

It has long been the case that Ministers of Religion who receive exempt fringe benefits under section 57 of the *Fringe Benefits Tax Assessment Act* may be required to disclose/report the value of benefits received for social security income test purposes. Whether or not disclosure is required largely depends on the nature of the fringe benefit in question, and whether or not the relevant income test arises under the *Family Assistance Act* or the *Social Security Act*. (Under the *Social Security Act*, "income amount" includes "valuable consideration" and encompasses fringe benefits received for a religious practitioner's own use.)

Changes to the definition of income under Social Security law from 1 July 2009 have not affected this position. However, as a result of those changes, in addition to these disclosure requirements, ministers of religion under pension age may also be required to include voluntary salary sacrificed contributions to superannuation when reporting their income to Centrelink.

Moore's Legal is able to review your current disclosure protocols and advise on any amendments that may be required as a result of this amendment.

**Fiona Thomas**  
Senior Lawyer

### The Moore's Legal Not for Profit Team

We have a range of practitioners who are able to assist with any minor queries or major issues you may have. If you require further information, please contact a member of our Team

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**DISCLAIMER:** This Not for Profit Briefing is of a general nature only. Specific legal advice should be sought rather than relying on this Briefing.

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