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When Does a Charity Become a Commercial Business?

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“With the decline of the welfare state, charitable organisations are expected to do more with the same resources. Reliance on donations alone will, in many cases, be insufficient. Hence many charitable organisations have established business ventures to generate the income necessary to support their activities. There may appear to be a vast difference between selling lamingtons at a Church fete and selling funeral services, but where the object of raising the funds is the same, ...[there is] no reason to draw a legal distinction between the two.” [Commissioner of Taxation v. Word Investments Limited](#)

In [Commissioner of Taxation v. Word Investments Limited](#) which was reported on in our [December 2006 Not for Profit Briefing](#), the Federal Court found that the running of a funeral business for fundraising could advance religion and therefore could be part of a charitable enterprise. In that case the Federal Court held that the **purpose** of an organisation was to raise money for the advancement of religion and the **manner** of raising the money was not the issue. The Court said that there ought not be a distinction drawn between **active and passive investment** by a charitable organisation.

The case is important for a number of reasons:

1. The Court observed that the distinction between active and passive investments was at odds with the practice of contemporary charitable organisations.
2. The decision of the Federal Court appears to be at odds with [Taxation Ruling TR2005/21](#) where the Australian Taxation Office said:

“The purpose of carrying on a business or commercial enterprise as such is not charitable”.

The ATO Attitude

The Australian Taxation Office in its [non-profit news service No. 0158](#) has announced that it is appealing the decision in Word Investments but in the meantime will continue to apply its long held view consistent with TR2005/21 ie. that the manner of commercial enterprise can still determine whether an organisation is charitable or commercial.

Put this together with the targets for the [ATO compliance program for non-profit organisations 2006-2007](#) where the emphasis will be on “testing compliance with our view of the law explained in recently released tax office rulings on charities, and companies controlled by exempt charities”.

What is the Law and who decides?

The Federal Court has declared its view of the law which is now on appeal. In the meantime the Tax Office intends to target organisations that may be acting inconsistently with the Tax Office Rulings on charities and will apply those rulings despite the current state of the law which suggests those rulings are wrong.

It is our view that the ATO should await the outcome of the appeal before making charities a target to be judged by a dubious set of tax rulings.

Murray Baird

Principal, Head of Not for Profit Group

ASX Principles of Good Corporate Governance & Best Practice Amendments

The ASX Good Corporate Governance and Best Practice Principles are currently under review. Now that submissions have closed (February 2007), those in the corporate governance sector await the final version of the document.

The 10 principles have been reduced to eight, partly through a process of redistribution of existing materials. For example, previous principle 10 (recognise the legitimate interests of stakeholders) has been redistributed between principles 3 (promote ethical and responsible decision making) and seven (recognise and manage risk).

Another significant proposed change is cessation of the use of the phrase "best practice". This was changed to recognise that the recommendations themselves are not prescriptive.

Whilst the ASX principles on good corporate governance and best practice (to be changed to "good practice") were originally prepared to apply to listed companies, their governance principles are equally applicable to public companies that are not listed (not for profit companies limited by guarantee) and incorporated association boards.

Since the National Safety Council case of 1991, the law has been clear that the standard expected of a – in that case – part time non-executive director of a not for profit company, is the same as the standard expected of a profit making company. The law provides that both such directors are required to exercise a reasonable degree of care and diligence in the exercise of their powers and the discharge of their duties.

This is confirmed by other governance material, such as the Australian Standard on Good Governance Principles (AS 800-2003). This Standard specifically applies to not for profit organisations and other public and private companies.

To read the current principles and the proposed changes as well as the explanatory paper, please visit the ASX website at www.asx.com.au. To obtain the Australian Standard, visit the Australia Standards website at www.standards.com.au, where you should be redirected to the online shop.

Cecelia Irvine-So
Lawyer

Accumulations in Charitable Funds (Can You Keep Growing Your Funds?)

There are a range of factors that determine whether or not a Charitable Fund (including a Deductible Gift Recipient Fund, such as an Ancillary Fund) will be considered income tax exempt under Australian tax law. Sections 50-57 and 50-60 of the Income Tax Assessment Act 1997 provide that a Fund will only be exempt from income tax if its funds are actually "applied for the purpose for which it was established".

This is interpreted by the Australian Taxation Office (as explained in [Taxation Ruling TR 2000/11](#)) to prohibit excessive accumulation of investment income: the ATO regards as essential the distribution of "a substantial part" of a Fund's income each year.

A "substantial part" of a Fund's income is not defined or reduced to an acceptable percentage. It is a matter of what the ATO considers acceptable in the circumstances. TR 2000/11 specifically states that it may be acceptable for a Fund to:

- Use some of its income to acquire assets which, in the future, will produce more income for its purposes; and
- Accumulate some of its income for later distribution.

Factual examples provided in the Ruling indicate that accumulation of income in the following circumstances may be acceptable:

- Accumulation of all of a Fund's income for a specified period of limited duration (2 years).
- Investment of a major part of a Fund's income for a limited, specified period (3 years) for the purpose of generating additional future income, particularly if the Fund has a prior history of distributing all income.
- Retention of 10% of annual income as a means of preventing erosion of capital in times of inflation.

However, the general rule is that a Fund "must apply all or substantially all of its annual income for public charitable purposes and avoid excessive accumulation and investment if it is to continue to be regarded as being exempt from income tax" (Para 105, TR 2000/11).

Fiona Thomas
Senior Lawyer

Recent Amendments to the Tax Laws - DGRs

Recent amendments to tax laws should reduce some administrative and compliance costs for Deductible Gift Recipients (DGR's). On the flip side the amendments more explicitly require recording of transactions by a DGR to show that donated funds are in fact being used for its principal purpose.

The *Tax Laws Amendment (2006 Measures No. 7) Act 2007* amends tax law:

- to remove the 'gift fund' requirement for certain DGRs
- to consolidate multiple gift funds
- to require DGRs to maintain records relevant to their status as a DGR; and
- to allow the Tax Commissioner to review DGRs listed by name in the tax law.

Previously all DGRs were required to maintain a gift fund to hold deductible gifts. The tax law amendments remove the requirement to maintain a separate gift fund for an entity *that is itself* a DGR. For example, XYZ Institution is a public benevolent institution. XYZ institution is not required to maintain a gift fund because all income is used to further DGR purposes.

Where an entity is not itself a DGR but *operates* a deductible fund, authority or institution, the requirement to maintain a separate gift fund still remains. All deductible gifts must be placed in a gift fund maintained separately to other accounts of the entity.

Where an entity operates multiple gift funds it can now consolidate them into a single gift fund. For example, ABC Church is endorsed to operate a school building fund. ABC also operates a refuge centre endorsed as a public benevolent institution with its own gift fund. ABC can consolidate both gift funds into a single gift fund.

The amendments should reduce gift fund administrative costs.

The amendments explicitly require all DGRs to maintain adequate accounting records so that deductible gifts can be identified and show how the gifts have been used. The records must show that the DGR in fact uses donations for its principal purpose.

Where a number of gift funds have been consolidated into one gift fund, records will need to be kept to identify gifts made to each gift fund and to show how those gifts have been used to further the principal purpose of that particular gift fund. These records must be maintained for at least 5 years after the completion of the transactions to which they relate.

The amendments also allow the Commissioner to review those DGRs listed by name in the *Income Tax Assessment Act 1997* to determine if they continue to meet the conditions of their DGR status. Previously the Commissioner only had power to review a DGR endorsed by the Tax Office. A DGR must comply with the Commissioner's request for information. Failure to comply is an offence.

For information on how these amendments may impact on a specific DGR please call Moores for further advice. Moores would be delighted to help a DGR to take advantage of the amendments to reduce compliance and administrative costs, and to advise on adequate recording of DGR related transactions.

Derek Mortimer
Lawyer

Tax Guides:

New Income Tax Guide for NFPs:

The ATO has released a new version of the [Income Tax Guide for Non Profit Organisations](#). The Guide takes into account the following developments in recent years:

1. Statutory Extension To Meaning Of Charity

Effective from 1 July 2004, new categories of organisations are considered charities for the purposes of all Commonwealth legislation, including:

- (a) Organisations providing child care to the public on a non profit basis;
- (b) Self-help bodies with open and non-discriminatory memberships that are for charity purposes only; and
- (c) Closed or contemplative religious orders that offer prayerful intervention to the public.

The change allows these entities to meet the "public benefit test". However to be considered charities, these entities must also satisfy all the other characteristics of a charity.

2. Extended Endorsements Requirement For Charities

Effective from 1 July 2005, additional endorsement requirements commenced for charities. A charity will need to be endorsed to access charity tax concessions available under fringe benefits tax and GST laws. This is in addition to the endorsement requirements for income tax exemption which applies to charities from 1 July 2000. The requirements to be eligible for endorsement to access FBT and GST charity concession include that the organisation:

- (a) Be a charity; and
- (b) Have an ABN.

3. Public Access to Certain Information

From 1 July 2005, a charity's endorsements for tax concessions can be viewed by the public via the Australian Business Register at www.abr.business.gov.au. The information will disclose the following details:

- (a) The type of charity;
- (b) The charity tax concessions (income tax exemption, GST concessions and/or FBT rebate or exemption); and
- (c) The date of effect of each endorsement.

ATO Publishes "How To" Guide for Endorsement

New categories of DGRs were introduced in the *Tax Law Amendments (2006 Measures No. 3) Act 2006*. Taxpayers may claim an income tax deduction for certain gifts of money or property to the following types of new organisations which may be endorsed as DGRs:

- Scholarship funds - public funds established to provide money for eligible scholarships, bursaries or prizes;

- Australian disaster relief funds - public funds for relief of people in distress as a result of a declared disaster which occurred in Australia;
- Animal welfare charities - charitable institutions that provide short term direct care and/or rehabilitate certain animals;
- Charitable services institutions - charitable institutions that would be a public benevolent institution but for the health promotion and/or harm prevention activities;
- War memorial repair fund - public funds established and maintained for the reconstruction or critical repair of a qualifying war memorial; and
- Developed country disaster relief funds - public funds established by a public benevolent institution for relief of people in distress as a result of a declared disaster in a developed country.

The Guide sets out the 6 new products and details of how to apply for endorsement. See [Non-Profit News Service No. 0149](#).

Tina Lau
Lawyer

DGRS:....Have Your Dinner and Deduct it too

In our last issue we covered the hot topic of deductions for fundraising dinners including the special rules relating to tickets and auction items for fundraising dinners and shows.

On 1 December 2006, the government announced changes to the caps and restrictions on deductions for fundraising dinners. The changes apply from 1 January 2007. The minimum contribution threshold has been changed from \$250.00 to \$150.00 and the proportion of the benefit allowed will increase to 20% of the ticket price not exceeding \$150.00 (it used to be 10% not exceeding \$100.00).

An example used by the Tax Office is the following: if the fundraising dinner ticket costs \$200.00 then the market value of the benefit (ie. the cost of the meal) could be up to \$40.00 and participants would be entitled to a tax deduction for the balance of approximately \$160.00.

DGRs need to remember that this change to the law does not change the rules about compliance with fundraising legislation nor does it change the more general rule that tickets of less than \$150.00 or tickets to events that are not "one off fundraising dinners" will still be not capable of giving rise to a deduction if the cost is not properly split between the meal cost and an optional additional donation.

Cecelia Irvine-So
Lawyer

Trade Marks For NFPs

Not for profits frequently perceive themselves as being outside of the sphere of commerce. This may explain why they generally do not place the same weight on securing the hallmarks of their identity, namely their name and logo, by means of registering them as trade marks.

Sometimes, this can cause them to become unstuck. Such as one organisation that had a disgruntled long-time board member, who decided to register the organisation's name as a trade mark for himself.

While such conduct was clearly illegal, and the organisation had various legal remedies available, some of them were all likely to cost substantially more than it would have cost for the organisation to register its name as a trade mark in the first place. On top of that, the adverse publicity that would have been generated would have adversely affected the good public standing of the organisation.

In hindsight, the dispute would have been best avoided by the organisation securing its name through trade mark registration beforehand.

Nils Versemann
Senior Lawyer

Dealing With Wills & Estates

If the NFP is to receive a share of the residue of the estate, the usual time frame for notification is within a reasonable time of the executor obtaining Probate of the Will.

The process for obtaining Probate usually takes a number of months. During this period the executor seeks to ascertain the full nature and extent of the assets of the estate and any outstanding liabilities. Prior to completing this process, an estimate of the net estate for distribution is unknown.

Further, it is not until the Will is proved by the Court that the executor has the authority to commence collecting and dealing the assets of the estate.

There is also the possibility that the validity of the Will naming the NFP as a beneficiary may be challenged.

Such a challenge may be made on the basis that the Willmaker did not have the necessary testamentary capacity to make the document or that the Will was the result of undue influence placed on the Willmaker by a third party at the time of preparing the Will.

If a challenge of this nature is successful, the Will is deemed to be invalid and the estate distributed according to the provisions of an earlier Will that may not name the NFP as a beneficiary. If there is no earlier Will, the intestacy provisions will apply.

It is for this reason that most executors wait until the Will is proved and a reasonable understanding of the estate has been ascertained before contacting charitable beneficiaries.

If the Will specifies that the NFP is to receive the personal chattels of the deceased, the executor may notify the NFP prior to the Grant of Probate being obtained to discuss the NFP's intentions in relation to the chattels. In many cases, the personal chattels of the deceased are of no commercial value and the executor is usually eager to commence the removal of personal chattels so as to prepare real estate for sale. If the executor is of the view that the personal chattels are of significant value, he/she may wait until the Will is proved before distributing the chattels.

In terms of what amounts to "a reasonable time", in most estates, the executor should be in a position to have a discussion with an NFP beneficiary within 4 to 8 weeks of the Grant of Probate being obtained. However, this will vary from one estate to the next.

Andrew Simpson
Principal

The Moores 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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