

IN A NUTSHELL

1. Retained earnings for unrelated commercial activities of charities will be taxed.
2. A new independent regulator will be set up to be known as The Australian Charities and Not-for-Profits Commission (ACNC).
3. A legislative definition of "charity" will be introduced.
4. School chaplaincy survives and thrives.
5. Medicare Locals \$45million boost

Editorial comment

When *Australia's Future Tax System Review* ("the Henry Review") was released in 2010, Prime Minister Kevin Rudd and Treasurer Wayne Swan promised not to harm the Not-for-Profit sector, or remove the benefit of tax concessions.

A year later, the Treasurer has apparently had a change of heart. Budget measures which will limit the ability of the Sector to raise funds and will raise little revenue.

This is a budget where health, training, education, mental illness, homelessness and help for struggling families are prevailing themes. However, the Sector that delivers these effective services on a not for profit basis will be saddled with greater compliance costs and higher taxes.

Suhanya Ponniah
Editor—Not for Profit Briefing

Special Budget Edition: Federal Budget 2011

The "do no harm promise" - Does the Budget measure up?

"We will not implement any changes that harm the not for profit sector, including removing tax concessions"

- Government response to Henry Review

Commercial Activities

From 1 July 2011, retained earnings from new unrelated commercial activities will be taxed. The arrangements affect activities commenced after 10 May 2011. However, this measure is projected to yield Nil new revenue over the forward estimates period.

NFPs will not have access to fringe benefits tax exemptions or rebate, GST concessions, or use of tax deductible gifts in relation to the unrelated commercial activities.

Exceptions are made for small-scale, low-risk activities – for example op-shops, lamington drives, school fetes, passive investments and hiring out a church hall.

Existing activities will be subject to "transitional arrangements". The Government will consult over these arrangements for existing activities with a view to phasing them in over time.

Existing Government contractors and National Rental Affordability Scheme participants will be excluded from the measures.

Moores Legal Comment

If you operate a charity and are about to launch a commercial activity within your charitable structure, the tax implications of the activity will be unclear until we see the detail.

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New Regulator

A new independent regulator will be established from 1 July 2012. A budget of \$53.6M is being set aside to establish the regulator over four years. The regulator is expected to have the following mandate:

- Determine whether an entity meets the legal definition of “charity” or other NFP categories and therefore has access to applicable tax concessions.
- Implement a ‘report-once use-often’ reporting framework for charities
- Provide education and support to the sector on technical matters
- Establish a public information portal

The ATO will provide corporate service support to the ACNC.

The Australian Charities and Not-for-profits Commission (“the Commission”) will have powers to investigate the finances of organisations claiming income tax exempt status.

A Commissioner will be appointed to drive all the changes, who will be fully independent and report directly to Parliament via the Assistant Treasurer.

Moores Legal Comment

We welcome the establishment of an independent regulator – an initiative which has been recommended and sought for over a decade.

The Treasury also welcomes the ACNC because Treasury estimates that closer scrutiny of the Sector will yield \$41.0m over four years as a result of increased compliance activity. This should pay the lion’s share of the cost of ACNC.

In our view the Commission will need to decide whether it will be an enabler of the Sector or merely a revenue raiser for the purpose of paying its own upkeep.

The functions of the Commission will first be allocated to the Australian Taxation Office in preparation for the establishment of ACNC.

The close corporate service support function of the ATO for the ACNC suggests that the ACNC may not have its much vaunted independence.

<from page 1>

It is Moores Legal’s view that this policy:

1. Will not contribute any revenue but will burden charities with high transition costs;

Experience from overseas shows that the revenue raised by this tax is likely to be low because charities will restructure to avoid the imposition of the tax.

Where an “Unrelated Business Income Tax” (“UBIT”) exists in the United States it yields insignificant revenue. So much so, in fact, that United States academics Evelyn Brody and Joseph Cordes in their seminar series “The Unrelated Business Income Tax: All Bark and No Bite?” conclude that **the UBIT is effectively a voluntary tax** in the United States.

While the revenue raised is Nil, there will be high transition costs for charities as they undertake the restructuring process.

Charities undertaking commercial activities will have options to restructure. However this development adds a complex consideration into the mix when making decisions about structuring – charities will need to weigh up the income tax, fringe benefits tax, risk and revenue implications of particular options.

2. Will create artificial distinctions and inconsistencies in the law of charities;

We are disappointed that the Government has seen fit to effectively wind back the view of the High Court in [Commissioner of Taxation v Word Investments \[2008\] HCA 55](#) (3 December 2008) by making it harder for a charity to undertake commercial activities.

The introduction of a new unrelated commercial activities tax blurs the line between “purpose” and “activity” – a fundamental distinction in charity law:

“the making of a profit through trade or business is not necessarily inconsistent with a charitable purpose and that the true question to be asked is the purpose of the making of the profit. If the purpose is commercial then the exclusive purpose of the organisation is not charitable; if the purpose is selfless then it may be.”

Justice Sundberg of the Federal Court in [Commissioner of Taxation v Word Investments Ltd \[2006\] FCA 1414](#) (3 November 2006) [37].

The unrelated business income tax will also add complexity to a charity’s affairs and lead to uncertainty about what is or is not “unrelated business activity”. There are a lot of grey areas between what is, and is not, unrelated business activity. For example, when a university charges students a tuition fee, this is a related business activity. If the university ran a children’s book publishing business to raise funds for its facilities, this is likely to be an unrelated business activity. If the university ran a publishing business to publish the papers and reports of its academics, is this related or unrelated? Given the scope of an institution like a university, where do you draw the line?

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Chaplaincy Funding

The National School Chaplaincy Program will be extended and expanded with \$222.0m over three years with 1,000 additional schools accessing the program.

This will be targeted to disadvantaged, regional and remote communities.

We note, however, that this initiative was announced in August 2010, and the allocation of funding for this program in the Budget is not a new announcement.

The Australian Financial Review prognosis of 6 May 2011, that chaplaincy funding would be cut appears without foundation.

<from page 2>

Justice Sundberg of the Federal Court commented in *Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414 (3 November 2006) that:

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 funds is the same, I can see no reason to draw a legal distinction between the two. [60].

3. Flies in the face of Government-commissioned expert reports and inquiries;

The Government has commissioned several reports into the Not-for-Profit sector in recent years. Two reports stand out. Neither support this policy.

The 2010 [Productivity Commission Report](#) into the Contribution of the Not for Profit Sector said that Not-for-Profits have greater difficulty than commercial entities in accessing funds for investment and that this constrains innovation.

The [Henry Tax Review](#) released last year stated:

The income tax and GST concessions [of charities] generally do not appear to violate the principle of competitive neutrality where NFP organisations operate in commercial markets."

The current Treasurer responded to the Henry Review that the Government would not implement any changes that would harm the Not for Profit sector including removing tax concessions. He has had a change of heart.

4. Is inconsistent with Government policy and promises;

The Government's [National Compact](#) recognised the need for an "innovative, appropriately resourced and sustainable" Not-for-Profit sector. The rhetoric does not match the policy.

The following comments from Justice Sundberg of the Federal Court in *Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414 provide the context for charities' revenue raising activities:

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 [60].

5. Is inconsistent with the principles for the taxation system set out in the Henry Review.

The Henry Tax Review provided the following principles for the design of the Australian taxation system: efficiency, equity, complexity, sustainability, and consistency with policy.

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Political Implications

The Government must pass legislation to ratify these policy announcements. If legislation is passed, the legislation will take effect from budget night. Given the fine balance of political power in the Australian Parliament, this may not be a fait accompli. Charities (including conservation groups) who have structured fundraising to rely on active business activities will be upset. If the sector is vocal about these changes, it may make the passage of the legislation through Parliament difficult.

In the meantime, NFPs will need to arrange their affairs under threat of an ill-defined policy and impending legislation without detail. It is an impossible situation to have to predict the boundaries of the new law on commercial activities.

<from page 3>

In light of comments 1-4 above, we suggest that the proposed unrelated commercial activities tax is contrary to these principles.

6. Prevents Capacity Building

The unrelated commercial activities tax inhibits an innovative, appropriately resourced and sustainable Not-for-Profit sector as promised in the National Compact by preventing accumulation of retained earnings for working capital.

7. Unfairly discriminates against charities who do not hold Government contracts and have to rely on public fundraising

Not-for-Profits that have entered into a Government service delivery contract as at 10 May 2011 will be permitted to use their tax concessions in support of that contract.

8. Winds back all taxation concessions

Not-for-Profits will not have the benefit of Fringe Benefits Tax ("FBT") exemptions or rebate, GST concessions or Deductible Gift Recipient status in relation to their unrelated commercial activities.

In relation to the FBT rebate, there is a real impact on Public Benevolent Institutions ("PBIs") and Health Promotion Charities ("HPCs"). At present a PBI and HPC can salary package for employees. As the law stood, a PBI or HPC could run a commercial activity and salary package the remuneration of employees involved in the commercial activity. With the new changes, to retain income tax exempt status such activities must be conducted without PBI or HPC status and therefore the ability for these organisations to provide competitive remuneration packages is diminished. Unless you have a Government contract! Did we hear mention of a level playing field?

Definition of Charity

A statutory definition of "charity" is to be introduced from 1 July 2013. The definition is to be based on the 2001 [Report of the Inquiry into the Definition of Charities and Related Organisations](#), and take into account the judgments in recent cases such as *Aid/Watch Incorporated v Commissioner of Taxation [2010] HCA 42* (1 December 2010) ("Aid/Watch").

The Government will consult with the States and Territories on the new definition.

A budget of \$2.9m is being set aside over 4 years to the ACNC to develop guidance for the Sector, implement system changes, and reassess the charitable status of entities using the new definition.

In summary the 2001 Inquiry recommended that a charity:

- Be a not-for-profit entity; and

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Update on review of tax rulings

We reported in the last NFP Briefing that three Tax Rulings were due to be revised and issued:

- TR 2005/21 concerns charities, including their commercial activities
- TR 2005/22 concerns the subsidiaries of charities, including their commercial activities.
- TR 96/8 concerns school building funds.

The release dates of the first two Rulings have been delayed a number of times since the Australian Tax Office announced in 2008 that they would be revised to be consistent with the law. It may be that the ATO has lived in expectation that the law would be changed to support its view on commercial activities. In the meantime, the ATO has continued to apply Rulings which no longer represented the law.

Taxation Rulings 2005/21 and 2005/22 regarding charities and income tax exemption were due to be re-released on 16 March 2011. As of today, 10 May 2011, the due date showing on the ATO's website is 4 May 2011, that is a week ago.

The indication is that the first ruling is in the final stages of approval and is to "clarify the ATO view regarding commercial activities conducted by charitable institutions".

TR 2005/22 is in draft form and being written and reviewed. We understand that it is likely to be another month before both rulings are released.

Taxation Ruling 96/8 is due to be withdrawn and a new draft ruling issued. The due date showing at present is 25 May 2011 and the draft is being written and released. Again we understand that this deadline may be pushed out a further month.

The new legislation on unrelated commercial activities will impact on the charity tax rulings. All in all it is disappointing that this has dragged on given that TR 2005/21 ought to have been revised after *Word Investments* was handed down over 2 years ago. Revisions are also required in light of *Aid/Watch* and *Victorian Women Lawyers*.

The situation is unsatisfactory.

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Lawyer

<from page 4>

- Have a dominant purpose or purposes that are:
 - charitable;
 - altruistic; and
 - for the public benefit.

The following were recommended as charitable purposes:

- the advancement of health;
- the advancement of education;
- the advancement of social and community welfare;
- the advancement of religion;
- the advancement of culture;
- the advancement of the natural environment; and
- other purposes beneficial to the community.

Moore's Legal Comment

The proposed statutory definition of charity is consistent with the historical common law development of charity law. While we need to see the exact wording of the proposed definition, we believe that the above represents a sensible codification of the common law.

However we wonder why a law which has developed over centuries to respond to changing needs should be frozen by legislation.

A relevant observation by High Court Justice Gummow during argument in the *Aid/Watch* case illustrates the need for the law to adapt over time:

"One of the problems is that governments now have such an enlarged role in poverty, education, religion that pursuit of those charitable objectives at one stage or another is going to have an intersection with government activity....[This] was not true 150 years ago".

A consistent definition of charity across all jurisdictions will, at least, bring uniformity and harmonisation to the plethora of definitions adopted in States and Territories.

Sector Reform

The Budget announcement of the establishment of an independent regulator is a huge step forward for the Sector. This initiative has been recommended by numerous Government enquiries for over a decade and will combat the perceived conflict of interest of the Commissioner of Taxation in its revenue collection focus and role as default NFP Commissioner.

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Medicare Locals

Medicare Locals have been given a boost with \$45m earmarked to enable 15 Medicare Locals to start on 1 January 2012, provision of after hours GP services by Medicare Locals, and a key role for Medicare Locals in major mental health initiatives.

The regulator will open its doors on 1 July 2012.

A lot of work will continue in the background to facilitate this. Here is a summary of the steps taken to date:

- The Office of the Non-Profit Sector was established in October 2010. The mandate of the Office is to drive and coordinate reform across all Government Departments.
- In March, Helen McDevitt was announced as the Head of the Office. Helen McDevitt's background is as a social policy and reform adviser to the Department of Prime Minister and Cabinet which is where the Office is located.
- Helen McDevitt will work with Paul Ronalds whose previous role was in operations at World Vision.
- Treasury released a Consultation Paper in January, being a Scoping Study for a national regulator. 162 formal responses were received, with overwhelming support for an independent regulator.
- A Non-Profit Sector Reform Council was created in October 2010 and four working groups have been created in these areas:
 - Red tape – ie. procurement, grants etc
 - NFP Regulator
 - Fundraising
 - Other recommendations of the [2010 Productivity Commission Report](#)

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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.

Moores Legal is a law firm servicing companies and businesses, Not for Profit organisations and individuals across Melbourne in the areas of Commercial Law, Workplace Relations, Property Law, Not for Profit Law, Aged Care, Elder Law, Estate Planning, Superannuation & Structuring, Dispute Resolution, Family Law and Personal Injury Law.

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