

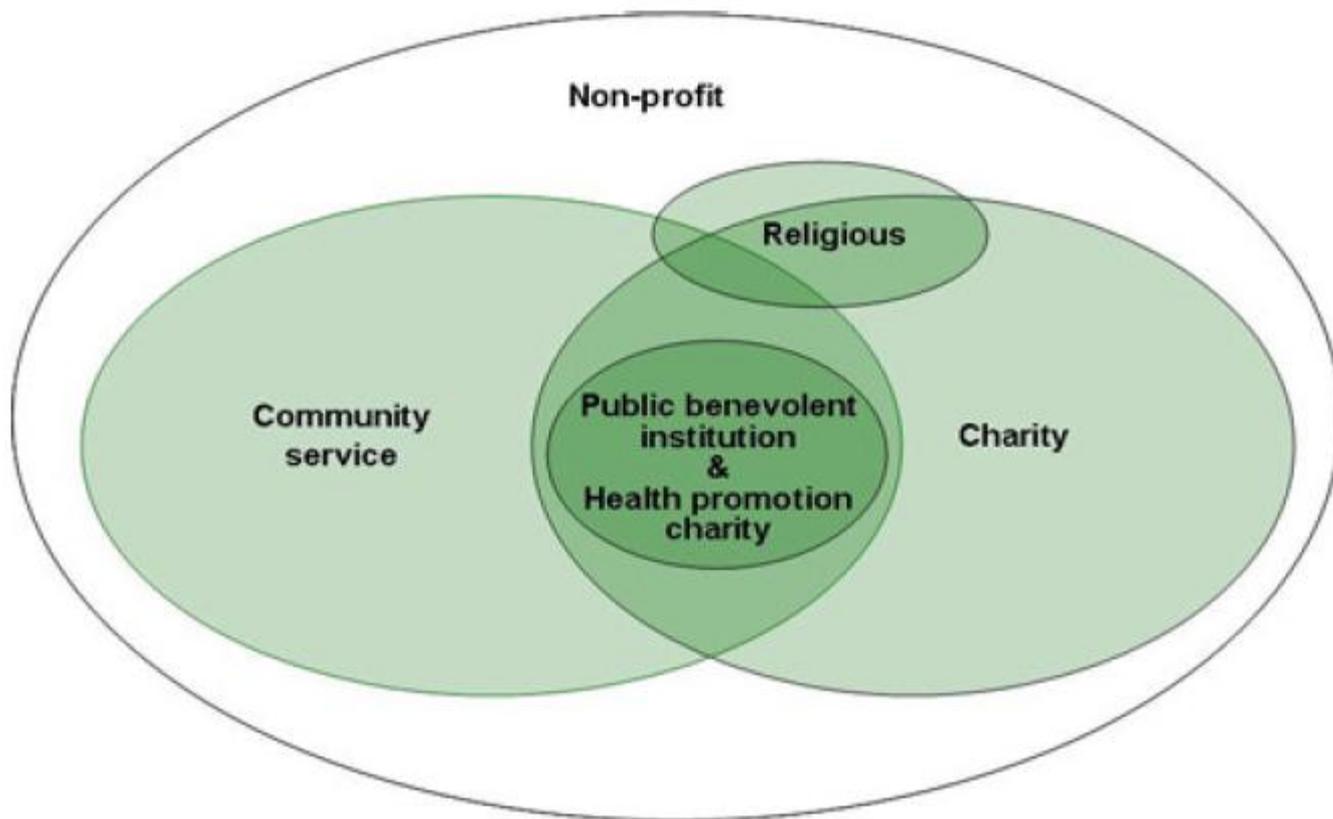
Charities & Commercial Activities

Current Position with ACNC and TR 2011/4



UCA – What is left....





Source: The Treasury Final Report- Scoping Study For a national Not-for-Profit Regulator (April 2011)

Latest news.... Re UCA- Unrelated Commercial Activities

The government has announced (3/4/2012) that it has delayed the commencement of operation of amendments which will tax earnings generated by 'unrelated commercial activities' of not-for-profit (NFP) organisations. However, there is still no draft legislation and, as a result, still great uncertainty about the likely impact of the proposed measure on NFPs.

The government has bowed to concerns expressed by the not-for-profit (NFP) sector and announced that it has delayed the commencement of operation of amendments which will tax earnings generated by 'unrelated commercial activities' of NFP organisations.

There is still no draft legislation and, as a result, still great uncertainty about the likely impact of the proposed measure on NFPs. Confusion will continue to exist within the NFP sector until draft legislation is issued.

We have to get it right... Sector stats

- 600,000 entities ... includes...
 - 60,000 charities,
 - 5,000 coys limited by guarantee
 - 136,000 Incorporated associations
 - 440,000 Unincorporated associations
 - 21,000 with DGR status
- \$43 billion contributed to GDP pa.
- Employs over 1 million people
- NFP sector grew 7.7% annually between 2000 & 2007
- Govt contributes \$25.5 billion
- Philanthropic over \$7 billion
- Plus volunteer time estimated at \$14.9 billion

Not-for-Profit – Tax Reforms

- Federal Budget 2011- ACNC
- Better targeting of NFP tax concessions
- “In Australia” special conditions
- Definition of “charity”
- Standardisation of the term “not-for-profit” & other terms
- Review of NFP governance
- Fund raising reforms
- COAG NFP Reform Working Group
- Improving integrity of public ancillary funds

NFP Tax Concessions - Background

- Past 17 yrs – 6 separate reviews of charitable & NFP sector
- Inquiry into the definition of charities and related orgs – 2001
- Senate inquiry into the disclosure regimes for NFP's – 2008
- Review of Australia's Future Tax System – 2009
- Productivity Commission inquiry into contribution of NFP sector – 2010
- Senate inquiry into the Tax Laws Amendment (Public Benefit Test) Bill 2010
- Budget 2011
- Consultation Paper – scoping study for a national NFP regulator – 27 May 2011

NFP Tax Concessions - Background

- 2010 Productivity Commission said NFP regulatory frameworks governing the sector is
 - Complex
 - Lacks coherence
 - Sufficient transparency
 - Is costly
 - Inconsistent Financial Statements
 - Different state fund raising legislation

TR 2011/4 Income tax & fringe benefits:charities – as at 12th October 2011

What is this ruling all about...

This Ruling sets out the Commissioner's views on the meaning of 'charitable' in the terms 'charitable institution' and

It explains the Commissioner's view on:

- the features that distinguish a charitable institution from a charitable fund;
- the circumstances in which an institution or fund will be considered charitable;
- determining whether the purpose of an institution or fund is charitable; and

But now we have ACNC who will be issuing a definition of charity.

TR 2011/4 - Contents

Paras 1-73 The binding public ruling

Paras 74-104 15 examples

Appendix 1 – Explanation of ATO view & how it is reached

Paras 105-294

Appendix 2 – Court decisions on 4 heads of charity

Ruling Compendium – Summary of issues raised by external parties to the draft ruling and ATO responses

Definitions

'charity'

'charitable purpose'.

'public charitable purposes

'purpose' and 'objects'

'sole purpose

'Statute of Elizabeth'

Charitable Purposes... 4 head of charity

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- other purposes beneficial to the community.

Public benefit & charitable purpose

If unsure look at...

If the objects or objectives in the constituent documents of an institution indicate it has a sole purpose which is charitable, but its activities and other relevant factors indicate the substance and reality is to the contrary, the institution will not be charitable. Other relevant factors can include:

- other elements in the constituent documents of the institution such as its powers, rules, not for profit and winding up clauses, and clauses governing who can benefit from the institution's activities and in what ways;
- how the institution is operated;
- any legislation governing its operation;
- the circumstances in which it was formed;
- its history; and
- its control.

Profit Making & Power to accumulate

- A charitable institution that endeavours to make a profit from its activities can still be charitable if its **profit making goal** is only in aid of its charitable purpose.
- An institution with a **power to accumulate profits** can still be charitable, as long as the profits are being accumulated in order to augment the funds available to effect the institution's charitable purpose.
- However, an institution that accumulates most of its profits over a number of years will need to be able to show that this accumulation is still consistent with it having a charitable purpose.

Purposes which are not charitable

- Purposes will not be charitable if they lack the required public benefit or are not within the spirit and intendment of the Statute of Elizabeth.
- The purpose is to confer private benefits
 - Distributions to owners or members
- The purpose is social, recreational or sporting
- The purpose is commercial - an end in itself

Paras 46-55

But if commerciality is charitable

- its sole purpose is charitable and it carries on a business or commercial enterprise to give effect to that charitable purpose. In these circumstances it does not matter that the activities themselves are not intrinsically charitable;
- the sole purpose of the institution is charitable and the commercial activities directly carry out the charitable purpose;
- it has a business or commercial purpose that is simply incidental or ancillary to its charitable purpose; or
- its activities are intrinsically charitable but they are carried on in a commercial or business-like way.

Para 61

Examples

Paras 74-102 ... 15 examples both +ve & -ve

S Enterprises Ltd has a purpose of encouraging the Christian faith by promoting or conducting evangelistic services and other religious gatherings, bible study for children and the production and distribution of evangelistic literature. S Enterprises Ltd itself does not undertake any of these activities. Instead, its objects state it is to carry on a commercial activity (selling musical instruments and recordings) to generate funds for S Campaigners, an unincorporated association that is an endorsed charity established for the advancement of religion. S Campaigners conducts religious services and other religious events.

The fact that S Enterprises Ltd raises funds by commercial means will not detract from it being considered a charitable institution. Its commercial activity is merely a means to give effect to its charitable purpose.

Accumulation of profits consistent with charitable purpose

S Enterprises Ltd's constitution contains a clause enabling its directors to **reserve profits** in order to **maintain the company's property**, to **meet contingencies** or for any other reason consistent with its charitable purpose. S Enterprises Ltd **retains all of its profits for several years** to finance an evangelical event which is scheduled to be held at the end of that period of accumulation.

The **accumulation of profits** by S Enterprises Ltd to finance the scheduled evangelical event is consistent with its charitable purpose of encouraging the Christian faith.

NFP Tax Concessions - Background

“It is our hope that the ACNC will bring about a new level of governance and transparency and expose the tiny minority of unethical fund-raisers that can sully the sector’s reputation.”

Tim Costello – World Vision CEO

NFP Tax Concessions - Background

NFP entities will be required to pay income tax on profits from their unrelated commercial activities that are **not directed back to their altruistic purpose**. That is, entities who do not direct their earnings back to their altruistic purposes will have to bear a measure of income tax on those earnings. Those NFPs entities who undertake unrelated commercial activities will also not have access to FBT, DGR or GST concessions in support of those unrelated activities.

Bill Shorten MP Treasury NFP Reform Newsletter #1 14/10/11

NFP Tax Concessions - Background

“Reform of tax concessions available for unrelated commercial activities serves two core purposes: it prevents the gradual erosion of the tax base through concessional treatment for activities that do not bear no relationship to a 'charitable' or a core not-for-profit activity, and it ensures that valuable tax concessions are not provided to organisations that choose, for all intents and purposes, to run a purely commercial business.

This in no way means the Government does not support not-for profits diversifying into commercial activities to supplement and strengthen their revenue streams. In fact, we encourage it.

Bill Shorten MP 23/9/2011 at Australian Charity Law Association Annual Conference

NFP Tax Concessions - Background

...entities who do not direct their earnings back to their **altruistic purposes** will have to bear a measure of income tax on those earnings. Those not-for-profit entities who undertake unrelated commercial activities will also not have access to FBT, DGR or GST concessions in support of those unrelated activities.

Religious institutions are, and will always be, important in the fabric of Australian society. I am confident that these reforms will not cause detriment to the ability of churches to continue to deliver the vital community services that they have done for hundreds of years.

Bill Shorten MP 23/9/2011 at Australian Charity
Law Association Annual Conference

NFP Tax Concessions - Background

...The sector should be comfortable that work related to a core not-for-profit or charitable purpose will continue to receive the benefit of tax concessions, and other unrelated commercial activities will also receive concessions if the earnings are being directed to an **altruistic purpose**.

Bill Shorten MP 23/9/2011 at Australian Charity
Law Association Annual Conference

NFP Tax Concessions - Background

I am also aware of concerns around timing issues that may arise when profits are temporarily retained in an unrelated commercial entity. Namely, that there are situations where a not-for-profit will be required to retain earnings in its commercial arm for a period greater than one financial year. We have heard these concerns and will consider them as we begin the process of developing exposure draft legislation

Bill Shorten MP 23/9/2011 at Australian Charity
Law Association Annual Conference

NFP Tax Concessions - Background

It is designed to protect the integrity of the sector by ensuring that valuable tax concessions are utilised to further the **altruistic** aims of the sector, rather than being used to provide an **uncompetitive advantage to a purely commercial activity**.

But the Government has acted based on the strong advice of the Treasury and ATO that the loophole created by *Word Investments* posed a significant risk of exploitation and presents a risk to revenue for all levels of Government.

Bill Shorten MP 27/5/2011 at National Press Club Canberra

NFP Tax Concessions - Background

...these reforms will raise a number of legitimate questions about the application of these measures to the diverse and innovative activities that the sector engages in. Sometimes the line between what is 'related' or 'unrelated' may be blurred. Some organisations may structure their activities in a certain way that might not automatically gel with these reforms. And we understand that it may hard to determine what constitutes a 'low risk' activity.

Bill Shorten MP 27/5/2011 at National Press Club Canberra

NFP Tax Concessions – Background (cont)

- Submissions – 8 July 2011
- No exposure draft yet – expected mid to late 2012
- Consultation forums and face-to-face meetings
- Commencement date – 1 July 2012 (deferred from 1 July 2011)
- Applies to UCA's commenced after 10 May 2011 Budget
- Transitional arrangements apply to existing unrelated commercial activities before 10/5/2011
- Deferrals will allow further time for consultation on design stage of tax concessions

New NFP Sector Tax Concession Working Group

- On 12 February 2012 the Minister for Social Inclusion and the then Assistant Treasurer announced the membership and terms of reference of a working group to consider ideas to better deliver the support currently provided through tax concessions to the NFP sector.
- Linda Lavarch, the chair of the NFP Sector Reform Council, is chair of the working group, which includes a diverse range of representatives from the NFP sector and technical experts.
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New NFP Sector Tax Concession Working Group

- The working group is a response to discussions at the 2011 Tax Forum about whether current support provided through tax concessions to the sector can be better delivered.
- The working group is examining NFP tax concessions in terms of their **fairness, simplicity and effectiveness**. It is also examining previous inquiry recommendations and ideas presented at the Tax Forum.

New NFP Sector Tax Concession Working Group

- The working group will release a discussion paper later in the year that will examine options for reform and offsetting savings. There will be opportunities for interested parties to provide input to the working group, and more information will be made available through this newsletter as the work progresses.

Tax basics for non-profit organisations

- NAT 7966-06.2011- Tax basics for non-profit organisations
- Addendum 7966ADD-01.2012 following TR 2011/4 incorporating decisions in Word Investments and Aid Watch cases.
- Restating and standardising the special conditions for tax concession entities (including the 'in Australia' conditions)
Submissions closed 11th May 2012 – Watch this space

Tax basics for non-profit organisations

Note 1:

In limited circumstances, an institution or fund that has commercial/business enterprises, may still have a charitable purpose where:

- activities, such as commercial fundraising, are carried out in furtherance of a charitable purpose
- an entity conducting investment, trading or commercial activities is doing so only to effectuate its purposes
- profits derived from the unrelated activities must be applied to the entity's purposes.

These principles may also apply to religious, scientific and public educational institutions.

Better Targeting of NFP Tax Concessions

- Tax on profits from unrelated commercial activities (“UCA”) that are not directed at altruistic activity
- FBT and GST concessions generally not available in relation to UCA
- Exceptions
 - Related commercial activities
 - Passive investment activities
 - Small-scale and low risk UCA
 - Mutual income

Issues for consideration

- What is “related commercial activity” and “UCA”
- Increased compliance costs, administrative, legal and financial burden
- What will be considered “small-scale” or “low risk” activities
- When will the new activities be considered as “commenced”
- Widening franking credit rules?

Tax Ruling TR 2011 / 4

- This is ATO view
- But wait for ACNC view and LAW...
- ACNC will determine an entity's charitable status
- In the past ATO has had a conflict of interest

Word Investments and High Court

- “Charitable status of an institution is not affected if it carries on a business or commercial enterprise to give effect to its charitable purpose”
- Previously ATO view was that commercial enterprise was not charitable.
- Charities can run business to produce income for the public, rather than private and
- the profit-making activity is merely incidental to the charitable activities

Key Dates

- ACNC – ~~1 July 2012~~ Now 1 October 2012
- Statutory definition of charitable purpose – 1 July 2013
- NFP Tax Concessions – ~~1 July 2011~~ Now 1 July 2012
- Governance Standards and Financial Reporting – 1 July 2013

Unrelated business income tax

2011 Budget announced a tax on unrelated business income

- No tax on altruistic purposes
- Tax only on profits not directed back to parent body or their altruistic purposes
- The government is yet to settle on a model upon which to base the legislative changes, and this will largely determine the impact on the sector.
 - UK model regards only mid to large scale UCA's

The concept of “altruism”

- Not defined anywhere in papers or law.
- Different courts, legislators or regulators may draw upon different factors to inform them of how much, or how little, altruism is evident in a particular purpose.

Charity

Self interest



Presentation Sources

- ACNC
- ICA Business forum May 2012
- Tax Institute NFP seminars
- websites
 - www.ato.gov.au/nonprofit
 - www.treasury.gov.au
 - www.notforprofit.gov.au
 - acnctaskforce.treasury.gov.au
 - www.irs.gov/publications/p598/ch03.html

The Canadian experience and RULES....



Questions

