

26 September 2014

Our ref NFP/30

Mr Jeremy Khaw
Australian Taxation Office
PO Box 9977
Box Hill VIC 3128

By Post and Email to: [REDACTED]

Dear Mr Khaw

ATO draft taxation ruling TR 2014/D5: Income tax: special conditions for various entities whose ordinary and statutory income is exempt

Thank you for the opportunity to provide comment on the ATO draft taxation ruling TR 2014/D5 (the draft ruling). This submission has been prepared with the assistance of our NFP Law Committee.

The Society acknowledges the difficulties that the Commissioner has in preparing this ruling given the challenges arising under the legislation, the *Tax Laws Amendment (2013 Measures No. 2) Act 2013*. This submission identifies three of the more significant issues arising under the legislation and makes recommendations as to how the Commissioner might improve the proposed ruling. For completeness we mention that the Society has recommended to the Government that the legislation be repealed.

1. Explaining the Explanatory Memorandum, the ill to be remedied and how it is to be remedied

The Explanatory Memorandum (EM) to the *Tax Laws Amendment (2013 Measures No. 2) Act 2013* at 11.59 states that the amendments are, inter alia, to maintain the operation of minor tax integrity requirements by addressing 'inappropriate conduct', which 'does not always manifest in the pursuit of an alternate purpose but nonetheless should result in an entity no longer being entitled to endorsement'. Some explanation of the 'inappropriate conduct' which is being referred to would assist the sector and those who must advise charities, as it is not immediately apparent from the legislation or the EM what this offending conduct is. None of the examples state that they are illustrations of 'inappropriate conduct' and it is not clear that any of them seem to be directed clearly to conduct that is 'inappropriate' so as to warrant this legislation.

2. Explaining how the law affirms the Bargwanna case

The EM also states at 11.64 that the 'law confirms the Court's interpretation in *Commissioner of Taxation v Bargwanna* [2012] HCA 11, relating to whether a charitable trust is applied for the purposes for which it was established.'

How this is so is not immediately apparent from the legislation nor the EM. The community might reasonably expect that the Commissioner's ruling would at least make some reference to the case that the legislation is evidently affirming, but the ruling does not even mention the case. This is particularly concerning because one of the more important points made by the High Court in that case was that in revenue law matters the benign construction usually applied to charitable trusts did not apply. If it is the Commissioner's view that this is the relevant point applied by the statute, it would be helpful to say this explicitly. If that is not the case it would be helpful for the Commissioner to spell out what point from the judgement is confirmed by the legislation. In any case, it seems anomalous that the Commissioner would make no reference to the case that the legislation is intended to confirm in his ruling interpreting the legislation. The draft ruling would be improved by an explanation of how the case law is confirmed.

3. Enforceable contracts and unenforceable compacts

The draft ruling appears to be premised on the assumption that the constitutions of unincorporated associations are enforceable contracts, rather than unenforceable compacts. As a matter of law, this is, we submit a doubtful premise. It is a well-established legal principle that the courts will only intervene in internal governance of churches and other unincorporated associations where there are property rights, trust law infringements or other exceptional arrangements.¹ If this is so the substrate of the first section of the draft ruling may call for some clarification so far as it applies to unincorporated associations. As unincorporated associations constitute the majority of sector entities in number, and probably also in members when major religious denominations are taken into account, this may be reasonably important.

4. The test for 'sole purpose'

There are also at least two concerns around the application of the test for 'sole purpose'. The first is whether the pursuit of incidental or ancillary purpose can ever lead to loss of income tax exempt status and, if so, why or why not. The second related issue is what (if anything) the effect is of including incidental or ancillary purposes as expressly stated purposes in constituent documents. We consider each in turn.

(a) Loss of income tax exempt status

In the draft ruling, the Commissioner states that the assets of the entity must be applied "solely" to its charitable purpose. To this end, it is unclear as to whether if a charity pursues ancillary or incidental purposes this will lead to a revocation of an NFP's charitable status. In

¹ For the general principle, see *Cameron v Hogan* (1934) 51 CLR 358. For exceptions, see cases such as *McKinnon v Grogan* [1974] 1 NSWLR 295; *Mitchell v Royal NSW Canine Council Ltd* [2001] NSWCA 162.

the non-legally binding material, at paragraphs 132 – 136, the draft ruling includes ancillary and incidental purposes to charitable organisations as coming under the 'purposes' head. That suggests that the pursuit of incidental or ancillary purposes will not vitiate exempt status. However, the legally enforceable section of the draft ruling contains no mention of incidental or ancillary purposes and requires that assets be applied solely to the purpose – inferentially that is not incidental or ancillary purposes. If it is the Commissioner's view that a charity that is carrying out purposes incidental or ancillary to its charitable purpose does not lose entitlement to income tax exemption by pursuing such incidental or ancillary purposes, *ever*, then this should be stated clearly in the legally binding section of the ruling. If the Commissioner is of the view that carrying out incidental or ancillary purposes may, *in some cases*, lead to a loss of income tax exemption then the ruling should spell out when carrying out incidental or ancillary purposes will lead to loss of tax exempt status.

(b) Including incidental or ancillary purposes in constituent documents

The second issue is a subset of the last and that is: What is the effect of listing in constituent documents incidental or ancillary purposes as purposes of the entity. The vast majority of charities engage in pursuit of incidental or ancillary purposes. Sometimes they have set out in their constituent documents that the pursuit of incidental or ancillary purposes is a purpose of the charity. On one reading of the ruling it seems the charities that have listed in their constituent documents the pursuit of incidental and ancillary purposes will not lose their exemption. That is because they are only carrying out their stated purposes. Conversely, on a strict reading of the ruling those entities that do not list incidental and ancillary purposes as purposes of the entity will not be pursuing their charitable purposes 'solely'. They arguably therefore lose exempt status. There is, therefore, a justifiable level of concern that a NFP could lose its tax-exempt status through the application of its income to previously understood ancillary or incidental purposes. The ruling would be more helpful if it carried the Commissioner's view on this matter.

Thank you for the opportunity to provide comment on the draft ruling.



President