

*Catholic Health Australia is a member of the ACBC Tax Working Group that consulted with the ACBC for the preparation of this submission, which was due 30 September 2015.*

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## **ATO DISCUSSION PAPER**

### **Current operation of the “in Australia” special condition for certain deductible gift recipients and income tax exempt entities**

The Australian Catholic Bishops Conference (ACBC) is a permanent institution of the Catholic Church in Australia and the instrumentality used by the Australian Catholic Bishops to act nationally and address issues of national significance.

The Catholic Church contributes in a wide variety of ways across the spectrum of Australian society. As an integral part of its core mission, the Church seeks to assist people experience the fullness of life. It is concerned with all that impacts on human wellbeing. It comprises many thousands of different entities which have different purposes and modes of governance.

The Catholic Church in Australia, through various religious institutes and lay organisations, provides assistance to Church entities overseas as well as providing humanitarian aid to places of need.

The consultation on the operation of the “In Australia” special conditions in Division 30 and Division 50 of the *Income Tax Assessment Act 1997* is timely and welcome.

The ACBC has participated in previous consultations on the legislative proposals affecting this area. It notes that issues relating to the policy underlying the law are outside the scope of this consultation. Accordingly the comments will be confined to the substance of the Discussion Paper. The views of the ACBC on the policy questions have been set out in submissions to previous consultations.

The language in Division 30 imposes the following special condition on all DGR's:

“a fund, authority or institution, must be in Australia”

The language in Division 50 imposes the following special condition on certain income tax exempt entities:

“an entity is not exempt from income tax unless it has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objective principally in Australia”

## **Summary of discussion questions and ACBC Responses**

### **Q1. What is the ordinary meaning of “in Australia” in Division 30?**

The ordinary meaning of "in Australia" in Division 30 needs to be considered by reference to the fuller text in item 1 of the table in section 30-15 i.e. "(a) the fund, authority or institution **must be in Australia**" (our emphasis).

The words "must be in Australia" imply a meaning that requires a physical presence of some sort in Australia by the fund, authority or institution.

(a) Does the ordinary meaning require "purposes and beneficiaries" to be in Australia?

The ordinary meaning does not require purposes and beneficiaries to be in Australia, but rather the ordinary meaning of the words "be in Australia" requires that the entity has a form of physical presence within Australia.

(b) Does the ordinary meaning require that funds, institutions and authorities must be "established and operated" in Australia?

The ordinary meaning requires that there be a physical presence in Australia. In our view this requires an organisation to either:

- be established and operate in Australia, or
- operate through a division, subdivision or other entity which is established or recognised in Australia.

The structure of the organisation is immaterial as is whether it has its central management and control or principal place of activity in Australia. A non-Australian organisation operating only through an agent based in Australia would not satisfy the ordinary meaning but a non-Australian organization that has established a presence in Australia, for example an international religious institute that has established a community in Australia, would satisfy the ordinary meaning.

Q2. Do the words "in Australia" in the subparagraphs of certain funds in Subdivision 30-B have more work to do than the words "in Australia" in the special condition?

The words "in Australia" in the special condition are preceded by the word "be" which requires a physical presence.

The words "in Australia" in the subparagraphs of subdivision 30-B do not relate to the physical presence of the organisation but rather they provide limitations on the geographic area within which the purposes of the organisation can be undertaken, depending upon the provisions of the relevant subparagraph.

For example, institutions engaged in international affairs covered by the tables in section 30-80 would need to have a physical presence in Australia (thereby satisfying the "in Australia" special condition) but could carry out (and are in fact required to carry out) their purposes outside Australia. The fact that the purposes were undertaken outside of Australia would not contravene the "in Australia" requirement in the special condition.

The approach as outlined in paragraphs 64 and 65 is logical.

Q3. What are the consequences of PBIs which provide relief outside of Australia (not limited to international affairs recipients) being entitled to endorsement as a DGR?

Q4. What are the implications for DGRs other than PBIs pursuing their purposes outside Australia?

**Q5. Are there further implications of the current operation of the “in Australia” special condition in Division 30 for DGRs?**

The current arrangements are workable. The Catholic Church in Australia has a strong tradition of provision of financial support to a wide variety of charitable and missionary activities in developing countries. Funds are raised and transferred through large organisations such as Caritas Australia, Aid to the Church in Need, and Catholic Mission as well as smaller parish or diocesan-based initiatives, and religious institutes. The Church’s experience is that these activities are overwhelmingly positive in their impact and that the current layers of accountability are appropriate.

**Q6. Is the current guidance on the meaning of “physical presence” in the “in Australia” special condition in Division 50 sufficient and appropriate?**

Yes, the current guidance requires more than the company law test of whether a company is “carrying on business” in Australia to establish “physical presence”. The company law test of carrying on business catches any company which has a place of business, or conducts a share transfer office, or manages property within Australia, even if by an agent. It does not extend to an entity that merely holds or invests in property, or operates a bank account within Australia.

Tax Ruling 2000/11 paragraphs 50 and following pick up language from the Explanatory Memorandum of the *Taxation Laws Amendment Bill (no 7) 1997*, and acknowledges, in the absence of a definition, the ordinary or everyday meaning, should apply. The Tax Ruling applies a broad interpretation allowing an organisation to operate through a division or sub-division: it is immaterial whether the organisation has its central management and control or principal place of residence in Australia. The EM excludes an organisation that merely operates through an agent based in Australia.

**Q 7: How are the words “to that extent” being applied in practice?**

Tax Ruling 2000/11 in paragraph 51 and following analyses the meaning of “to that extent” by ignoring any activity of the organisation outside Australia, and measuring its expenditure against the organisation’s pursuit of objectives in Australia. The Ruling in paragraph 51 cites the example of an international charity with missions in 20 countries, and the majority of activity and expenditure outside Australia, but finds the Australian mission still satisfying the test, because the Australian mission effected its expenditure and pursued its objectives principally in Australia. The international charity need not act solely within Australia, nor need the Australian mission pursue its objects solely within Australia.

The Tax Ruling also analyses “principally” and measures this by words “mainly” “chiefly” and against a percentage of “more than 50%”. It is difficult to refer to percentages in other than expenditure terms, but, perhaps “principally” should be tested separately against both expenditure and non expenditure actions, and the charity only retain its tax exemption if a “yes” can be answered to both limbs of the test ie

- 1 whether the destination of local expenditure is within Australia compared to overseas; and.
- 2 whether objectives being pursued can be measured by:
  - Number of recipients of a service locally compared to numbers which the charity may assist overseas from its Australian base
  - Frequency of delivery of a service locally compared to delivery overseas from its Australian base eg health clinic days per week

- Number of persons employed locally compared to overseas by the Australian base
- Number of volunteers locally compared to overseas volunteers working for the Australian operation

Q8. What effect (if any) has the Word Investments decision had on broadening the eligibility for income tax exemption?

The ATO's interpretation of the Word Investments decision is consistent with current prudential standards across the Catholic Church.

Q9. Does an entity that has a physical presence in Australia but passes funds directly overseas meet the "in Australia" special condition in Division 50?

Yes. The ATO's comment in paragraph 84 is supported.

Q10. What are the consequences of the differing thresholds of the "in Australia" special condition in Division 30 and Division 50?

Q11. Are there further implications of the current operation of the "in Australia" special condition in Division 50 for income tax exempt entities?

Q12. What is the most appropriate advice or guidance product(s) for the Commissioner to prepare to address the residual uncertainty of the "in Australia" special conditions in Division 30 and Division 50?

It is important that the ATO advises the not-for-profit sector of the differing thresholds for tax concessions and DGR status. However, not-for-profits and their legal and financial advisers should have no difficulty working within the current interpretation of the law.

The ACBC appreciates the opportunity to participate in this consultation and further contact can be made with

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