



Law Council
OF AUSTRALIA

Tax Laws Amendment (2013 Measures No. 2) Act 2013

Treasury

19 October 2016

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Acknowledgement

The Law Council acknowledges the work of the Not-for-Profit Legal Practice and Charities Committee of the Legal Practice Section in the preparation of this submission.

About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

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The Secretariat serves the Law Council nationally and is based in Canberra.

Executive Summary

1. The Not-for-Profit Legal Practice and Charities Committee of the Legal Practice Section of the Law Council of Australia (the **Committee**) requests Treasury to recommend the repeal of the amendments made to the Income Tax Assessment Act 1997 (**ITAA 97**) by Schedule 11 of Part 5 to the *Tax Laws Amendment (2013 Measures No. 2) Act 2013* (the **Amendments**).
2. The Amendments inserted two additional special conditions in sections 50-15, 50-50, 50-55, 50-65, 50-70 and 50-72. The conditions came into effect from 1 July 2013 and require that to maintain income tax exemption through any tax year, an exempt entity must:
 - comply with all the substantive requirements in its governing rules, (the **governing rules condition**); and
 - apply its income and assets solely for the purpose for which the entity is established (the **solely condition**).
3. The Committee requests the repeal of the Amendments on the basis they do not currently meet best regulatory practice as they:
 - go beyond the stated policy intent, and go beyond matters relevant to taxation;
 - are difficult to interpret, apply and enforce;
 - lack fairness and equity as to consequence of breach, which may be minor or unintended, and result in the same consequence as a major or deliberate breach; and
 - result in unnecessary increase in and duplication of regulation on the not-for-profit (**NFP**) and charity sector.
4. We recommend the urgent repeal of the Amendments in the light of the issues detailed in this paper.

Introduction

5. The Committee has prepared this submission for the Law Council of Australia (**Law Council**).
6. The aims of the Committee include:
 - to engage with financial accountability and taxation laws and policies that affect NFP organisations;
 - to promote the administration of justice and the development and improvement of laws and policies affecting NFP organisations; and
 - to contribute to the implementation of the Law Council's International Strategy.
7. This paper recommends the repeal of the Amendments on the basis that they raise a number of serious compliance issues and undermine best regulatory practice.

The Legislation

8. The Amendments were passed in 2013 and have the effect of imposing additional statutory conditions on charities and NFPs in order to maintain income tax exemption.
9. The Amendments inserted two additional special conditions in sections 50-15, 50-50, 50-55, 50-65, 50-70 and 50-72. The conditions came into effect from 1 July 2013 and require that to maintain exemption through any tax year, an exempt entity must:
 - comply with all the substantive requirements in its governing rules, (the governing rules condition) and
 - apply its income and assets solely for the purpose for which the entity is established (the solely condition).

Wider than intended operation

10. The intention of the Amendments as described in the Revised Explanatory Memorandum to the Tax Laws Amendment (2013 Measures No. 2) Bill 2013 (**EM**) is explained in the following paragraphs:

9.56 Sections 50-15, 50-50, 50-55, 50-65, 50-70 and 50-72 of the ITAA 1997 are amended to standardise requirements that an entity falling within those sections must comply with all the substantive requirements in their governing rules and apply its income and assets solely for the purpose for which the entity is established. [Schedule 11, items 36, 37, 40, 41, 44, 45, 48, 49 and 52 to 54].

9.57 Endorsement of entities as exempt from income tax under a general category is decided by reference to the entity's stated purposes and objectives.

9.58 For established entities, some reference can be had to the entity's actual activities to determine whether those activities demonstrate the pursuit of alternative or inconsistent purposes and objectives. The operations of the entity are important and can be used to determine the purposes for which an entity is established.

9.59 However, this can create some difficulty for the Australian Taxation Office because 'inappropriate conduct' may not always manifest pursuit of an alternate purpose but nonetheless should result in an entity no longer being entitled to endorsement.

9.60 For this reason, a special condition generally imposed on exempt entities is that they operate only in a manner consistent with their substantive governing rules and purpose. Therefore, while an entity's governing rules and purposes may initially determine their eligibility for endorsement/eligibility for an income tax exemption, they are expected to operate in a manner consistent with those rules and purposes to remain eligible.

9.61 Requiring an exempt entity to comply only with their substantive governing rules and purposes allows an entity to keep its income tax exempt status for minor procedural irregularities, such as an absence of quorum at a meeting or missing a required lodgement date. Breaches of procedural irregularities will not, of themselves, affect an entity's continued entitlement to income tax exempt status.

9.62 Substantive governing rules are those rules of core importance to the operation of the entity and would include those related to an entity's object and purpose and those relating an entity's not-for-profit status.

9.63 This requirement applies equally to the income tax exempt categories that are not the subject of the endorsement rules. However, because the entity is not endorsed, the Commissioner will consider the same issues if he decides to issue an assessment for income tax payable because the entity is not considered to be income tax exempt.

9.64 The new 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.

11. Although the Amendments were intended to standardise (not introduce new) requirements, they go further than had previously been the case. The reasons for this are set out below, but in summary we note that:
 - The new governing rules condition is wider than the eligibility requirements for being an NFP. Eligibility for income tax exemption is not determined by reference to compliance with governance requirements or other legislation, unless they directly impact on the purposes and the NFP requirements.
 - The solely condition is not the correct test, particularly for NFPs which are not charities.
12. It is clear the Amendments go further than intended and as identified below are unnecessary and onerous in application and consequences.

Difficult to interpret and apply

13. The ATO issued a draft tax ruling TR 2014/5 from which it was clear that the ATO appreciated some of the difficulties the Amendments created for charities and NFP entities. On 25 February 2015 the ATO released the final ruling TR 2015/1 (the **Ruling**) which sought to ameliorate the impact of the legislation so far as it could do so. The ATO had clearly taken into account many if not most of the submissions

made by the charity and NFP sector. In fact it is fair to say that in many ways the ATO has done as much as is reasonably practicable to assist the sector in the approach which it takes in the Ruling.

The solely condition

Incidental and ancillary purposes

14. The Ruling provides that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established and therefore breaches of the solely condition will not occur merely due to an entity having an incidental or ancillary purpose. The difficulty with this is that it does not appear to be correct, at least for many charities that do not have constituent documents that state their objects to include incidental and ancillary purposes. If a purpose is incidental or ancillary to the original purpose, then it is arguably a purpose *other* than the purpose for which it was established, so would fail the solely condition.
15. The High Court has been very clear that words must be given their plain meaning and the ATO's attempt to ameliorate implications of a narrow interpretation of the term 'solely', does not reflect the plain and ordinary meaning of the language used.
16. The legislation states that the assets must be applied solely to the purpose for which the entity is established. Had Parliament intended that incidental and ancillary purposes were to be included in the principle purpose, a court may reasonably ask why there was no legislative provision to that effect, nor commentary in the EM.
17. We note that in the *Tax and Superannuation Laws Amendment (2014 Measures No 3) Bill 2014: in Australia special conditions* section 30-18 provided for the entity to pursue its purposes solely in Australia and then noted, in a sub-section, that an entity would not fail this condition because:
 - (a) its activities outside Australia **are merely incidental** to its operations and pursuit of purposes in Australia; or
 - (b) its activities outside Australia **are minor in extent and importance** when considered in reference to its operations and pursuit of purposes in Australia.
18. Parliament clearly considered this was necessary to spell out within the proposed legislation.
19. The reference to 'solely' was also the subject of numerous submissions relating to the definition of charity, which resulted in the expression not being used in the *Charities Act 2013*.
20. The ATO's previous ruling on the definition of charitable purposes explains the law clearly in paragraph 26 of TR 2011/4:

An institution is charitable if:

- *Its only, or its 'main or predominant or dominant' purpose is charitable in the technical legal meaning; and*
- *It was established and is maintained for that charitable purpose.*

In this Ruling, we typically refer to the required purpose as the 'sole purpose' of the institution because a charitable institution cannot have an independent non-

charitable purpose (regardless of how minor that independent non-charitable purpose may be).

21. The EM and the Ruling suggest the solely condition will be applied as the previous condition applied, i.e. there is no significant change in operation by changing the wording from 'applied for the purposes for which it was established'. However:
- courts will seek to find a different meaning due to the insertion of the word 'solely' implying Parliament meant to change the basis of the application, and
 - both expressions are still in use in sections 50-65 and 50-72 of the ITAA 97, so that entities covered by items 1.6 and 4.1 will not be income tax exempt unless:
 - the funds are applied for the purposes for which they are established; and
 - they apply their income and assets solely for the purpose for which they are established.

This clearly suggests that Parliament considers they have different meanings.

22. For NFPs that are not charities the sole purpose requirement is not the correct test and the 'dominant' purpose requirement has been accepted by courts¹, so this change is going beyond that set by the courts.
23. In *Central Bayside General Practice Association Limited v Commissioner of State Revenue*,² the Commissioner of State Revenue argued that the purpose of an organisation was, in effect, the discharge of government not charitable purposes. The High Court decided that carrying out a government purpose was not incompatible with carrying out a charitable purpose. It held that '[e]ven if, by fulfilling its own purpose, the appellant performed 'the work or function of government', that did not prevent it from being a charitable body'.³ The difficulty created by the Amendments is that it could be argued that a charity carrying out 'the work or function of government' is not carrying out its charitable purpose 'solely', it is also carrying out another not incompatible, overlapping purpose. If the intent of Parliament was to permit charities to continue to carry out both government and charitable purposes, provided they are compatible and overlapped (either completely or within the scope of incidental and ancillary purposes recognised by common law), the solely condition would impose an additional requirement on charities (and self assessing tax exempt NFPs under Div 50 to whom the amendments apply).

24. We submit the Amendments inserting the solely condition must be repealed.

The governing rules condition

What are the governing rules?

25. The first step that must be undertaken with the governing rules condition, as explained in the Ruling, is to identify all of the governing rules of the entity. To help determine this the Ruling provides that:

¹ *Cronulla Sutherland Leagues Club Limited v Commissioner of Taxation* (1990) 23 FCR 82

² (2006) 228 CLR 168, see particularly 175.

³ (2006) 228 CLR 168, [20] and at [46].

104. *The 'governing rules' of an entity are those rules that authorise the policy, actions and affairs of the entity. That is, governing rules of an entity consist of the rules that direct what the entity, and those who control it, are required and permitted to do in relation to the entity.*

...

109. ... *Examples of such rules that may or may not form part of an entity's governing rules include:*

- *mandatory codes of conduct*
- *regulatory State and Commonwealth laws*
- *laws applying to a particular type of entity, and*
- *other rules relating to the sector in which the entity operates.*

...

111. *A centralised set of rules which specifically applies to a group of entities or to a particular type of entity will form part of an entity's governing rules. For example:*

- *The governing rules of an entity that is a trust established by deed would include the trust deed, as well as the trust law that applies to the trust (under general law and statute).*
- *The governing rules of a corporation registered under the Corporations Act would include the applicable provisions of that Act.*
- *The governing rules of an incorporated association include the relevant state and territory legislation applicable to associations.*

26. Based on the above, the constitution or trust deed would constitute one of the governing rules of the charity. It is clear other laws may also be included but it is unclear what these might be. The Ruling states that, 'all of the features of the entity' are to be taken into account including 'any legislation governing the operation of the entity'.⁴ The Ruling states that 'not all rules that apply to an entity will form part of the entity's governing rules' and 'the *Privacy Act 1988* requirements' are not part of 'an entity's governing rules'.⁵ (The reference to the *Privacy Act* is odd until it is appreciated that a charity pointed out in its submission on the draft Ruling that the scope of the draft Ruling left this possibility open.)

27. It appears entities in specific sectors will have to include in their governing rules the relevant pieces of legislation where the function of that legislation is to authorise the policy, actions and affairs of the entity. This would include the *Australian Charities and Not for Profits Commission Act 2012 (Cth) (ACNC Act)* for charities, and will include a number of specific sector Acts such as education, health, aged care and child care.

28. Given that charities also have to comply with the ACNC Act, it would be expected that, and would reduce red tape and regulatory burden if, the meaning of 'governing rules' in ITAA 97 was the same as the meaning of 'governing rules' in the ACNC Act.

⁴ TR2015/1 [24].

⁵ TR2015/1 [13].

29. However, the definition of governing rules of an entity in the ACNC Act:

means written rules that:

- (a) govern the establishment or operation of the entity; and*
- (b) can be enforced against the entity.*

30. The ACNC have provided guidance in a fact sheet entitled 'Governing Documents' which states that the governing documents are the formal documents that set out:

- the charity's charitable purpose or purposes;
- that the charity operates on an NFP basis; and
- the way that the governing body of the charity makes decisions and consults any members.

31. The ACNC provides a table of common entity structures and what the governing documents are generally called (e.g. constitution, rule book, trust deed, etc). There is no reference to including State or Commonwealth legislation that may govern that entity through their structure or their operations, as appears in the Ruling.

32. The Ruling goes further than the ordinary understanding of governing rules and further than necessary for regulating eligibility for tax concessions. In doing so it creates uncertainty, unnecessary complications and regulatory duplication.

What are substantive and what are procedural rules?

33. An entity has to comply only with the substantive requirements in its governing rules to maintain exemption.

34. The EM states:

123. The 'substantive' requirements in an entity's governing rules are those rules that define the rights and duties of the entity....

35. Some examples of substantive requirements given in paragraphs 124 and 125 of the Ruling are:

- Objects/purposes;
- Non-profit status;
- Powers and duties of directors;
- Accounts and audits;
- Winding up;
- Criteria of admission as a member (but not the process of admission);
- Maintenance of a members register;
- Holding of meetings (but not how the meeting is conducted or whether it is valid by quorum or notice); and
- Voting rights of members (but not how they are to vote).

36. It is beyond the intention expressed in the EM that the failure of an entity to maintain a register of members should result in the loss of tax concessions where there may be little or no penalty by the other relevant regulator (e.g. ASIC) and where the members waive the non-compliance and ratify any action taken to rectify the breach.
37. In the Committee's view it is difficult to say that any legislative requirement is not substantive. See three hypothetical examples in **Attachment A**.
38. The three examples in **Attachment A** are illustrative of other pieces of legislation imposing substantive obligations on NFPs and charities. According to the Ruling, all three of these charities may have breached rules that are substantive governing rules because the state laws are a regulatory regime that is targeted to a particular entity or type of entity. The consequence, if this is correct, is that these entities would lose their tax exemptions for the relevant periods.
39. It is unlikely that when a breach of legislation, which could be a substantive governing rule, occurs the entities or their advisors would be aware that the ATO is also a relevant regulator, in addition to the regulator of the specific Act. The entities may not be aware that any disclosure to the ATO is required (in addition to the disclosure to the relevant regulator) or that tax may be payable. This is an unintended duplication and increase of red tape as well as being uncertain and unexpected in the application beyond the intended policy and beyond matters relevant to taxation.
40. Therefore we submit that the governing rules Amendment be repealed.

Lack fairness and equity in consequence

41. On 17 April 2012 in its Fact Sheet: *Treasury's Not-For-Profit Reform Fact Sheet: Restating and Standardising the Special Conditions for Tax Concession Entities*, Treasury stated:

It has been made clear in the draft that an entity must comply with only the substantive governing rules (e.g., those setting out an entity's purpose and not-for-profit status) to maintain a tax exemption, and that the Australian Taxation Office would not be expected to remove an entity's tax exemption for a minor and insignificant breach of its governing rules.⁶

42. This statement infers:
 - (a) Treasury was of the view that the ATO had some discretion as to the consequences of breach relative to the significance of the breach; and
 - (b) Treasury had a view as to how the ATO would exercise that power.

There is no basis in the legislation for either of these inferences.

43. In addition, the Ruling and particularly TR2015/1EC (the **Ruling Compendium**) makes it clear this is not the case. The legislation removes or denies the tax exemption by operation of the statute and the ATO has no discretion or powers to affect this outcome. The Ruling Compendium states at paragraph 5.1:

⁶ See: <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/In-Australia-Special-Conditions-for-Tax-Concession-Entities> page 2 dot point 8. Accessed 23 June 2015. The same lack of concern and belief that the ATO has some discretion is implicit in the relevant paragraphs of the Explanatory Memorandum. See explanatory Memorandum to *Tax Laws Amendment (2012 Measures No. 4) Bill 2012.1.87*.

The Commissioner does not have the power to exempt or excuse breaches. TR2015/1 paragraph 38 makes it clear that a breach of either or both special conditions will result in a loss of income tax exemption.

44. The ATO could therefore do nothing to save an entity from 'minor and insignificant breach of its governing rules' provisions.
45. It is possible that an entity may breach legislation which comes within the meaning of governing rules under the ITAA 97 and the regulator of that legislation decides to take no action due to the minor nature of the breach or issues a small fine as a penalty, but the entity loses its tax concessions as a result of the breach for the year this occurs.
46. In footnotes 7, 12 and 47 of the Ruling, the Commissioner draws to the attention of charities that may have inadvertently lost exemption the application of Schedule 2D (Tax exempt entities that become taxable) of the *Income Tax Assessment Act 1936 (ITAA 1936)* and points out he or she is powerless to remedy breaches. The Commissioner states in paragraph 3.1 of the Ruling Compendium that the ATO will in certain cases not allocate resources to investigate. This however is of no assistance to directors or auditors that must sign certificates of compliance with legal and tax obligations.

Substantive requirements cannot be substantively fulfilled

47. In relation to minor technical breaches of substantive requirements, there appears to be no relief. Once a governing rule is established as substantive, a failure to comply with it disentitles the charity to exemption in the relevant period. This is because the legislation itself does not permit it.
48. We submit that if there is a substantive breach of the state law, for example the *Grammar School Act* in Queensland, it is for the Queensland government through its own mechanisms to enforce performance, not for technical breaches to result in loss of income tax exemption.
49. The ATO has turned its mind to this question. It was raised at the draft Ruling stage. The ATO's detailed response to this issue is in the Ruling Compendium. At 1:13 it states:

Issue No.	Issue raised	ATO Response/Action taken
1.13	Regarding the questions that must be considered to determine whether an entity satisfies the governing rules condition (in paragraph 8 of the draft ruling), the third question should be: <ul style="list-style-type: none"> • Has the entity substantively complied with all of the substantive requirements in its governing rules? <p>This is because there are degrees of non-compliance and while the rule may be substantive, the non-compliance may be trivial.</p>	Adding the term 'substantively' to the interpretation of the provision is reading words into the law that change the intent of Parliament. No change.

This point is reinforced later in a comment on a separate issue.

Issue No.	Issue raised	ATO Response/Action taken
3.1	The distinction between a remediation <i>post factum</i> and a rectification <i>ab initio</i> as set out in paragraphs 152 to 154 of the draft ruling is valid but for practical purposes not relevant. The fact that a breach has occurred and has been remedied ought not to disqualify the entity from its tax exemption status where there has been no loss and the ongoing charitable purposes are being satisfied. It should only be in a case where the charitable purpose is no longer being fulfilled that loss of tax exemption should apply.	<p>As the special conditions apply at all times during the income year, a breach of the conditions that is remedied at a later date still results in an entity being in breach of the condition for some period during the income year.</p> <p>Appendix 3 to the final ruling sets out the circumstances in which the Commissioner may consider whether or not to allocate resources to take compliance action in respect of an entity which has become taxable for a period of time due to a breach of the governing rules condition or the income and assets condition.</p> <p>No change.</p>

50. A question put by a charity and the ATO's response is set out at 5.1. It reads:

Issue No.	Issue raised	ATO Response/Action taken
5.1	The draft ruling does not state that the Commissioner has power to exempt or excuse breaches. On one construction, the legislation appears to operate in a guillotine fashion so that if there is a breach then exempt status is lost. There is nothing in the draft ruling that clarified this so to provide assurance that the income tax exempt status of the trust is not lost by inadvertent breach of substantive requirements. If in fact inadvertent breach of substantive requirements will lead to loss of income tax exempt status, this should be spelt out clearly in the draft ruling.	The Commissioner does not have the power to exempt or excuse breaches. Paragraph 38 of the final ruling makes it clear that a breach of either or both special conditions will result in a loss of income tax exemption.

51. What about prior breaches? The Commissioner explains:

*The Commissioner does not have the power to exempt or excuse breaches. Paragraph 38 of the final ruling makes it clear that a breach of either or both special conditions will result in a loss of income tax exemption.*⁷

52. The ATO is clear that in its view, if there is to be amelioration of the impact of the legislation by way of concessions, these concessions must be made by Parliament.

53. The ATO has set out in the Ruling statements to the effect that it does not intend to prosecute breaches of the legislation where they arise in certain situations provided particular conditions are satisfied. There are three points to make in relation to this.

- (a) In a rule of law democracy the integrity of the system of government is undermined by an arm of government stating that it does not intend to enforce recently enacted amending legislation. The ATO should not be placed in a position of having to declare that it will not enforce a law because it thinks it is not good or craft Rulings that test the outer limits of the law to try to save charities. It also undermines the confidence of the community in the law if large sections of the NFP community have been placed in an uncertain position regarding their tax status.
- (b) There is a (strong) possibility that in so far as the Ruling sets out, a 'generous' construction favouring charities it will not be followed by a court of law. In their joint judgment in *Commissioner of Taxation v Bargwanna*, French CJ, Gummow, Hayne and Crennan JJ held:

*The respondents submitted that the exemption provisions of Div 50 of Pt 2-15 of the Act with which this appeal is concerned should be interpreted "generously", that is to say to favour the interests of those claiming exemption. This was said to be so because "[c]harity [is] involved". The phrase is that of Barwick CJ in *Ryland v Federal Commissioner of Taxation*. The general law favours the advancement of charitable purposes in various respects so as, for example, to permit perpetual duration and to provide for cy-près schemes. But this state of the general law provides no ground for some special rule of construction of the revenue law.*⁸

The High court also held that even if a trustee had acted 'honestly and reasonably, and as trustees who ought fairly to be excused' for the breach by a court, that this was not a basis for benignly applying the revenue laws to charities and only '*de minimis* misapplications of the Trust Fund' are exempt.⁹

- (c) There is an assumption that it will be the ATO who will seek to bring tax illegality to light. But a breach is likely to be raised by an auditor, trustee or director properly performing his or her duty.

⁷ TC2015/1EC [5.1].

⁸ (2012) 244 CLR 655 [38].

⁹ *Ibid* [40]-[41].

Unnecessary increase in regulatory burden and duplication

Charities registered with the ACNC

54. As referred to in the EM, entities are determined to be exempt on their governing rules and purposes, and are therefore expected to operate in manner consistent with the rules and purposes to remain eligible.
55. For charities, the determination as to eligibility is conducted by the ACNC reviewing the governing rules, including purposes and NFP character, as well as the governance, activities and public benefit. The ACNC considers all the issues necessary to decide eligibility for registration as a charity and is the regulator for on-going eligibility as a charity.
56. The amendments to section 50-50 only apply to a charity registered with the ACNC.
57. The amendments to section 50-50 duplicate requirements in the ACNC Act for charities to comply with the following governance standards:¹⁰
 - a registered entity must be able to demonstrate, by reference to the governing rules of the entity or by other means, its purposes and its character as an NFP; and
 - a registered entity must comply with its purposes and its character as an NFP entity.
58. These are the key issues to determine eligibility as a charity and entitlement to income tax exemption, which is first based on the registration of the entity as a charity with the ACNC
59. The stated object of the above governance standard in the ACNC Regulation is also instructive: “(1) The object of this governance standard is: (a) to commit a registered entity, its members and its responsible entities to the registered entity’s purposes; and (b) to give the public, including members, donors, employees, volunteers and benefit recipients of the registered entity, confidence that the registered entity is acting to further its purposes.” This, it seems to us, is the intent of the new governing rules condition in the ITAA 1997.

Issues with duplication

60. The ACNC is already empowered to regulate and ensure these essential aspects of charitable status are complied with by charities in order to retain their registration with the ACNC and therefore their income tax exemption.
61. Being income tax exempt is one possible consequence of being a charity. The design of the ACNC and its workings with the ITAA 97 is for the charitable status to be the first step.
62. Issues with having duplication of these requirements where the policy intention of the two regulations is the same, include:

¹⁰ *Australian Charities and Not for Profit Commission Regulation 2013 (Cth)*, extract from Governance Standard 1.

- the requirements are worded differently with the Amendments being wider than that stated as the policy intent; and
- the consequences of breach differ with the result that an entity may be in breach but remain a charity due to the minor and inadvertent nature of a breach but in spite of this, the entity will have lost its income tax exemption in the year of the breach.

Overlap of regulation with many Commonwealth and State and Territory Acts

63. Due to the uncertainty and possible breadth of the meaning of governing rules introduced by the EM, the Amendments also cause duplication of regulation in all the areas the definition of governing rules brings in, such as with ASIC and Registrars of Incorporated Associations, as well as regulators for specific industries that charities operate in (e.g. aged care, education, health, etc).
64. As noted above, it is unlikely when a breach of legislation, which could be a substantive governing rule, occurs, that the entities or their advisors will be aware that the ATO is also a relevant regulator, in addition to the regulator of the specific Act. The entities may not be aware that any disclosure is required and tax may be payable. This is an unintended duplication and increase of red tape as well as being uncertain and unexpected in the application beyond the intended policy and beyond matters relevant to taxation.

Attachment A - Examples

Example 1: grammar school in Queensland

1. A grammar school in Queensland:
 - has formed the view that it can best discharge its educational objectives by working in conjunction with a religiously purposed organisation, in the teaching of a number of subjects and in competing in international sport; and
 - has carried that intent into effect in breach of the *Grammar School Act 1975* (Qld) s 46V (albeit unwittingly).

2. The *Grammar School Act 1975* (Qld) s46V provides:

46V No religious affiliation

A grammar school's board must ensure the school –

- (a) *is operated independently of a church or other body established for religious purposes; and*
- (b) *is not operated for students of a particular religion.*

3. If this legislation is considered part of the grammar school's governing rules, and the breach is considered substantive, it would have to pay tax on its income during the period of the breach. It is also unclear whether this breach has been carried out by the board, by the school or by both. If by the school and tax must be paid, it is also unclear whether the board would be liable personally for the breach of its statutory duty.

Example 2: surf lifesaving club in NSW

4. The Ruling points out that an organisation that breaches the liquor laws will not lose income tax exemption because:

The liquor licencing laws do not form part of [the exempt entity's] governing rules because they are a broad regulatory regime that is not targeted to a particular entity or type of entity.

5. The difficulty with this illustration is that many liquor licensing laws are targeted to particular entities or types of entities that are charities. The *Liquor Act 2007 (NSW)* s 36(5) provides that a surf lifesaving club must give at least 14 days notice 'before the day of the club social function, ... to the local police and the local council in whose area the function is to be held'. There are 107 charities in NSW (as at 19 October 2015) with the words 'surf lifesaving club' in their title. It is arguable that a failure by one of these charities to comply with this requirement will result in loss of income tax exemption for that charity. As the section is headed: 'Social functions held on premises of surf lifesaving clubs' the surf lifesaving clubs would seem to fall within the scope of 'a particular entity or type of entity' regulated in accordance with the Ruling.

Example 3: retirement village in NSW

6. At a retirement village, the following circumstances are in breach of the *Liquor Act 2007 NSW* s 6(3):
- (a) a member of the Residents Committee for the village, or a person nominated by the Residents Committee, is not present at the gathering to supervise the sale and supply of liquor and the conduct of the gathering,
 - (b) the liquor that is sold or supplied at the gathering has not been purchased on a retail basis,
 - (c) the gathering has been organised, or is being conducted, by the operator of the retirement village.

There are 34 charities (as at 19 October 2015) that carry the words 'retirement village' in their name in New South Wales.