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Delineating the fiscal borders of Australia's non-profit tax concessions

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submissions based on statutory context are in our opinion at best unpersuasive and at worst misconceived'.[13]

Successive recent governments have consulted widely on amendments designed to address these judicial interpretations of the 'in Australia' provisions for income tax exemption and gift deductibility in the ITAA 1997.[14] The Government's contention has been that the Court's interpretation in *Word Investments* 'was inconsistent with the Commissioner of Taxation's interpretation and with the policy intent underlying the ['in Australia'] special conditions'.[15] While the current government has indicated its intention to deal with the 'in Australia' issue, progress towards legislative amendment has stalled. Meanwhile, the ATO appears to have shifted from its traditional position, effectively reversing its former policy of a more stringent 'in Australia' requirement for DGRs as compared to income tax exempt entities. In doing so, the ATO consulted its Not-for-Profit Advisory Group and, following this consultation, announced that it is drafting a new 'in Australia' public ruling.[16]

As a result of these important recent developments, it is timely to review the history and development of the territorial boundaries of the non-profit tax concessions in Australia in terms of policy, law and administration. To provide context, we begin with a description of the geographic boundaries of public benefit in the common law. We then examine the 'in Australia' provisions for income tax exemption and gift deductibility in the early state and federal legislation. This review reveals the changes to the ATO's interpretation of 'in Australia' since the 1960s, culminating in the proposed public ruling on this issue. It also uncovers the shaky legal foundations underlying the Government's proposed legislative reforms. More practically, it highlights the implications different interpretations of the 'in Australia' provisions have had and continue to have on the ability of Australian non-profit organisations operating overseas to obtain tax exempt and DGR status.

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[13] (2014) 221 FCR 302 [40].

[14] Exposure Draft, Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No 1) 2011 (Cth): Tax Exempt Body 'in Australia' Requirements. See also: Treasury (Cth), *'In Australia' Special Conditions for Tax Concession Entities* (4 July 2011) <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/In-Australia-Special-Conditions-for-Tax-Concession-Entities>; Exposure Draft, Tax Laws Amendment (2012 Measures No 4) Bill 2012 (Cth): Tax Exempt Body 'in Australia' Requirements; Treasury (Cth), *Restating and Standardising the Special Conditions for Tax Concession Entities (Including the 'in Australia' Conditions)* (17 April 2012) <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/In-Australia-Special-Conditions-for-Tax-Concession-Entities-Revised>; Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (Cth); Treasury (Cth), *Restating and Centralising the Special Conditions for Tax Concession Entities* (12 March 2014) <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Conditions-for-tax-concession-entities>.

[15] Commonwealth, *Parliamentary Debates*, House of Representatives, 23 August 2012, 9727–8 (David Bradbury).

[16] ATO, *Completed Matters 2015–16*, Guidance Update—Interpretation of 'in Australia' (14 January 2016) <https://www.ato.gov.au/General/Consultation/What-we-are-consulting-about/2015-Completed-matters/#G201534>.

tax legislation, introduced in South Australia in 1884,[30] exempted charitable organisations from income tax. The financial requirements of Australia's participation in World War I necessitated the enactment of the first Commonwealth legislation introducing personal income tax,[31] the *Income Tax*

receive the benefit of the exemption'[57] and thereby satisfy itself that the institution was not likely to engage in tax avoidance. The Explanatory Memorandum also clarified that distributions received by an institution as a gift or government grant are to be 'disregarded when determining whether an organisation incurs its expenditure and pursues its objectives principally in Australia and, therefore, can be applied overseas without affecting an organisation's income tax exempt status.[58]

The Explanatory Memorandum briefly addressed the meaning of the phrase 'in Australia',[59] focusing on the definition of the terms 'physical presence' and 'located', rather than the extent to which expenditure must be incurred and objectives pursued principally in Australia. The Explanatory Memorandum stated that because these terms were not defined in the legislation, their ordinary or everyday meaning should be used.[60] It also provided a detailed description for each:

> In the case of "physical presence" a broad interpretation is to be adopted—all that is required is for an organisation to operate through a division, sub-division or the like in Australia. The structure of the organisation is immaterial as is whether it has its central management and control or principal place of residence in Australia. On the other hand, the term would not apply where an organisation merely operates through an agent based in Australia. A much narrower meaning is intended in relation to the term "located". A mere physical presence will not be sufficient to satisfy this requirement although it will not be necessary for an organisation to be a resident for income tax purposes. A separate centre of operations such as a branch would fall within the meaning of this term.[61]

The broad definition of 'physical presence' requires minimal Australian operations, in accordance with its ordinary meaning. The narrower definition of 'located' still does

in the ITAA 1997.[64] The 'in Australia' provisions for income tax exemption were migrated to s 50–50 of the ITAA 1997, with no effective amendments.

3.2 Judicial decisions

The Australian courts dealt with this legislation some time later, with the landmark High Court case, *Word Investments*,[65] which enshrined the destination of profits test for income tax exemption. The applicant (Word), which operated a series of businesses as a fundraising arm, distributed funds to an Australian charity (Wycliffe) conducting missionary work overseas. Word applied for income tax exemption under the ITAA 1997. This was refused. The Commissioner argued that there were four issues precluding Word from receiving tax exempt status, one of which was that it did not meet the 'in Australia' requirement of s 50–50(a) ITAA 1997 that an entity have a physical presence in Australia and, to that extent, incur its expenditure and pursue its objectives principally in Australia.[66] While the initial tribunal decision did not consider the 'in Australia' issue,[67] on appeal the Federal Court addressed this issue and found that Word satisfied the requirements of s 50–50(a). It was conceptualised as being a 'nexus' question. Word passed money to another organisation to achieve its purposes in Australia.[68] Word had a physical presence in Australia, and the fact that it knew that this other organisation operated outside Australia was not fatal, as s 50–50(a) was not a provision involving an assessment of motive such as that involved in a finding of a charitable nature. On appeal, the Full Court of the Federal Court upheld this narrow view noting that: '[I]f the Parliament desires the place of expenditure of funds b6-7.7T707070P.(e)-1.6 >>c (r)34.48aP.(e)-1.6 >>c (r) 7.973a

Section 50–50(a) does not impose a prohibition on distributing to other charitable institutions.

> [t]he ordinary contemporary meaning or understanding of a public benevolent institution is broad enough to encompass an institution, like HPA, which raises funds for provision to associated entities for use in programs for the relief of hunger in the developing world.[80]

By interpreting the meaning of 'in Australia' for income tax exemption such that the ultimate purposes or beneficiaries were not required to be 'in Australia', *Word Investments* and *Hunger Project* are consistent with the ordinary meaning of 'in Australia' as stated in the Explanatory Memorandum introducing the 'in Australia' amendments for income tax exemption.

3.3 Proposed legislative reforms

In the 2009–2010 Budget, the Australian Government announced amendments to the 'in Australia' requirements in div 50 of the ITAA 1997 in response to the *Word Investments* decision 'that charities may be pursuing their objectives *principally* "in Australia" even where they merely pass funds within Australia to another charitable institution that conducts its activities overseas'.[81] This strikes directly at conduit arrangements—what is known as 'auspicing' or 'channelling'—in Australia. The ATO has explained 'channelling' as occurring where:

> A deductible gift recipient is approached by an organisation that is seeking to raise funds. The organisation has potential donors but they will not give

incoming government announced it would continue with the 'in Australia' measures,[86] releasing its own draft Bill with 'in Australia' language for income tax exempt entities and DGRs mirroring the language in the lapsed Bill.[87]

The draft Bill amended s 50–50(a), changing the requirement from incurring expenditure and pursuing objectives principally in Australia, to requiring organisations to '*operate*

Further, the funds that an organisation provides to non-

Act 1962 (Vic),[101] are now repealed, effectively required philanthropic trust deeds to

Australia'.[117] This limited discussion indicates that donations to a fund located overseas would not be covered by the deduction provisions, but that donations to a fund located in Australia would be. Again, this appears consistent with the existing view that it is the location of the institution receiving the funds that is important, not the final beneficiary of those funds.

The Commission's work resulted in the ITAA 1936, with s 78 containing a list of the types of organisations (not necessarily charities) that would be entitled to tax deductible donations, and specific DGRs, many of which remain today. Section 78(1) stated:

> The following shall … be allowable deductions: (a) Gifts of the value of one pound and upwards made by the taxpayer in the year of income to any of the following funds, authorities or institutions *in Australia*: (i) a public hospital; (ii) a public benevolent institution; (iii) a public fund established and maintained for the purpose of providing money for public hospitals or public benevolent institutions *in Australia*, or for the establishment of such hospitals or institutions, or for the relief of persons *in Australia* who are in necessitous circumstances; (iv) a public authority engaged in research into the causes, prevention or cure of disease in human beings, animals or plants, where the gift is for such research, or a public institution engaged solely in such research; (v) a public university or a public fund for the establishment of a public university; (vi) a residential educational institution affiliated under statutory provisions with a public university, or established by the Commonwealth; and (vii) a public fund established and maintained for providing money for the construction or maintenance of a public memorial relating to the war which commenced on the fourth day of August, One thousand nine hundred and fourteen.[118]

The Explanatory Memorandum said little about the 'in Australia' provisions.[119] Early versions of the Act defined Australia as including Papua New Guinea.[120] The inclusion of 'in Australia' in s 78(1) as both a general condition for gift deductibility at the outset, as well as an express limitation for certain types of funds, requires an understanding of the legislative drafting underlying these provisions. An example is 'a public fund established and maintained for the relief of persons in Australia who are in necessitous circumstances'.[121]

where it conducts its activities, makes the second instance of the words redundant and infringes the principle of statutory interpretation that all words have meaning and effect.[123] A similar interpretative issue involving the phrase 'in Australia' in income tax legislation was presented to the High Court in 1921.[124] The Court confined the phrase 'in Australia' to the immediate words and not the whole section, preferring 'the natural construction of the words used'.[125]

Confirming this view, a 1961 Canberra Income Tax Circular from the Commissioner of Taxation noted that, in relation to PBIs, 'the words "in Australia" refer to the location of the institution and not to the persons who are to benefit from the institution's activities. If the public benevolent institution itself is in Australia, it is not essential that the granting of assistance is limited to persons in Australia'.[126] In a later paragraph the Circular stated that '[p]ublic funds providing relief for persons in necessitous circumstances will qualify for approval only if these persons are in Australia'.[127] This accords with the interpretation of the provisions above, given that necessitous circumstance funds have a secondary 'in Australia' qualification.

During this period there was an emerging global focus on international aid, led by the United Nations in 1959 declaring a 'Development Decade', with many overseas jurisdictions providing tax incentives for private donations to aid organisations. As part of this movement, in 1963 the Freedom from Hunger Campaign was supported by the Australian Government and given gift deductibility status. It raised over $2 million.[128] During this time Australian aid organisations lobbied the Government for permanent gift deductibility for activities carried on outside Australia, rather than for one-off appeals. It was not until 1981, however, that the Overseas Aid Gift Deduction Scheme (OAGDS) was legislated through an amendment to s 78 of the ITAA 1936.[129]

In 1967 another memorandum from the First Assistant Commissioner of Taxation was sent to all Deputy Commissioners on the meaning of 'in Australia'.[130] This

reflecting the growth of the charity sector and the perception of its importance,[139] the number of sub-paragraphs containing express 'in Australia' limitations grew to encompass not only necessitous circumstances funds and public hospital funds, but also public funds providing religious instruction in government schools, Australian disaster relief funds, Australian war memorial funds, public funds for family counselling or family dispute resolution, and marriage guidance funds. The express inclusion of a geographic limitation in these sub-paragraphs appears to make the 'in Australia' general condition at the beginning of s 78 redundant. Like the overseas aid exception, the only way these conflicting 'in Australia' provisions can be reconciled according to the principles of statutory interpretation is if 'in Australia' in the general condition at the beginning of the section refers only to an organisation's physical location, with the specific limitations in the sub-paragraphs extending to an organisation's purposes and beneficiaries.

With the enactment of the ITAA 1997, the listed deductible purposes and organisations were categorised into subject areas placed into div 30.[140] Under div 30, the gift deductibility provisions are extensive and detailed. The 'in Australia' requirement for DGR endorsement is set out in s 30-15 under 'Special Conditions', which states that 'the fund, authority or institution must be *in Australia*'.[141] Following its predecessor, div 30 also contains express 'in Australia' limitations for certain categories of funds, including public funds providing religious instruction or ethics in government schools,[142] Australian disaster relief funds,[143] necessitous circumstances funds,[144] Australian war memorial funds,[145] public funds for family counselling or family dispute resolution,[146] and marriage guidance funds.[147] The result is that the inconsistencies contained in s 78 of the ITAA 1936 arising from the ATO's strict interpretation of 'in Australia' remain today, creating uncertainty both for organisations seeking to engage in cross-border charitable activities and for their donors.

In 2000, the ATO produced a guide, known as GiftPack, for DGRs and donors.[148] Unlike public information documents in the mid-1990s which did not mention the geographic qualification at all,[149] the GiftPack noted that 'in Australia' generally requires 'establishment and operation in Australia, and purposes and beneficiaries in

[139] O'Connell, above n 97, 118–120, noting in particular the growth in the Australian arts and scientific communities as reflected in the legislation.

[140] Other than s 78A of the ITAA 1936. Div 30 of the ITAA 1997 applies to gifts made in 1997–98 and subsequent years of income. See *Income Tax (Transitional Provisions) Act 1997* (Cth) s 30–1.

[141] ITAA 1997 s 30–15 [emphasis added].

[142] ITAA 1997 s 30–25 items 2.1.8, 2.1.9 (religious instruction), item 2.1.9A (ethics).

[143] ITAA 1997 ss 30–45A, 30-46 and 30–45, item 4.1.5.

[144] ITAA 1997 s 30–45 item 4.1.3.

[145] ITAA 1997 s 30–50 item 5.1.3.

[146] ITAA 1997 s 30–70 item 8.1.2.

[147] ITAA 1997 s 30–70 item 8.1.1.

[148] ATO, *GiftPack: A Taxation Guide for Deductible Gift Recipients and Donors* (NAT 3132-5.2000, 2000) (*GiftPack 2000*).

[149] ATO, 'Information for Public Benevolent Institutions', [ca 1995]; ATO, 'Public Benevolent Institutions' (Sales Tax Bulletin No 5, 1 May 1997).

Australia' apart from certain special bodies such as overseas aid funds or public environmental funds.[150]

In 2003 the ATO finalised its public ruling on PBIs, enshrining its strict interpretation of 'in Australia' by writing:

> 129. To be in Australia a public benevolent institution must be established, controlled, maintained and operated in Australia and its benevolent purposes must be in Australia. Because the purpose of public benevolent institutions is to provide direct relief to persons in need, this will mean that relief will be provided to people located in Australia.
>
> 130. However, we accept that where a public benevolent institution conducts an activity outside Australia that is merely incidental to providing relief in Australia, or is insignificant, it will not disqualify the institution from endorsement. For example, if a public benevolent institution provides medical assistance to children in Australia with a particular disability but, to a minor extent, it also brings children from other countries to receive treatment in Australia, it still meets this condition for endorsement.[151]

The consequence of this public ruling is that donations made directly by Australian taxpayers to an organisation outside Australia are never tax deductible. Donations made to an Australian DGR that uses the gift for its own programs outside Australia are also not tax deductible unless its activities outside Australia are 'merely incidental',[152] fall within the *Hunger Project* circumstances,[153] or the organisation obtained its DGR status pursuant to one of the four exceptions dispersed throughout div 30.[154] These exceptions are: overseas aid funds;[155] developed country disaster relief funds;[156] public funds on the Register of Environmental Organisations;[157] and DGRs specifically listed by name in the ITAA 1997 under the category of international affairs.[158]

Following its public ruling on PBIs in 2003, the ATO's strict view of 'in Australia' requiring geographical residence as well as confining activities and beneficiaries geographically appeared to be entrenched. However, more recently the ATO's position seems to be shifting. Since 2012, the GiftPack's wording has altered, stating that 'for funds, institutions and authorities to be in Australia, they must be established

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[150] *GiftPack 2000*, above n 148, 13–14.

[151] TR 2003/5, above n 7, [129]–[131]. Note that the recent case of *Hunger Project* (2014) 221 FCR 302, decided that the ATO view about 'direct relief' was incorrect and that fundraising proceeds to be given to others to relieve the poor did satisfy the directness test.

[152] Ibid [130]: 'For example, if a [DGR] provides medical assistance to children in Australia with a particular disability but, to a minor extent, it also brings children from other countries to receive treatment in Australia, it still meets this condition'.

[153] (2014) 221 FCR 302.

[154] For a detailed discussion of these exceptions, see Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr, 'Should Tax Incentives for Charitable Giving Stop at Australia's Borders' (2016) 38 *Sydney Law Review* 85, 96–103.

[155] ITAA 1997 s 30–85.

[156] ITAA 1997 s 30–86.

[157] ITAA 1997 s 30–55.

[158] ITAA 1997 s 30–80.

'in Australia' test for DGRs that was undone by *Word Investments* and *Hunger Project*.

scholarship, bursary or prize funds,[172] some touring arts organisations[173] and a new category of medical research institutions that operate outside Australia.[174] Even with these carve outs, the Go

seems likely that an amendment will be required for div 50 to ensure that the 'in Australia' provisions are consistent for income tax exemption and gift deductibility. That is, 'principally' in Australia in s 50–50(a) will need to be removed so that the 'in Australia' requirement for tax exemption is not stricter than that for DGR status, which has never been the intention. Only a legislative amendment can rectify this inconsistency.

What the Australian Government will now do with its 'in Australia' reform agenda remains uncertain. It may prove extremely difficult for the Government to reverse its course and implement its reform agenda once PBIs with overseas charitable activities obtain DGR status. A critical juncture exists at present for the Government to clarify the law applying to the geographic parameters of income tax exemption and gift deductibility. The question is which path it will take in delineating the fiscal borders of Australia's non-profit tax concessions.