



Law Council
OF AUSTRALIA

Legal Practice Section

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Mr Dean Karlovic
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By email: Justin.Dearness@ato.gov.au

Dear Mr Karlovic

DRAFT TAXATION RULING TR 2018/D1 ('IN AUSTRALIA')

1. This submission is made by the Charities and Not-for-profits Committee of the Legal Practice Section of the Law Council of Australia (**Committee**).¹ The Committee is comprised of lawyers and academics with specific expertise in the area of the law of charity and associated tax concessions.
2. The Committee welcomes the opportunity to provide comments on Draft Taxation Ruling TR 2018/D1 (**Draft Ruling**).

Division 50 in Australia condition (section 50-50(1)(a))

3. Section 50-50(1)(a) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) stipulates that an entity will not be exempt from income tax unless it 'has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia' (unless it satisfies another paragraph of the provision).
4. The Committee broadly affirms the approach taken by the Commissioner to this provision, as set out in the Draft Ruling. In particular, the Committee affirms the sensible approach to characterisation described in paragraphs 49-52, including the following extract in paragraph 52:

This is a question of characterisation, which has regard to past and current activities of the entity, as well as its objective intentions for the future. In this context, evidence of the current activities of an entity such as their annual expenditure will be given considerable weight. Evidence of intended expenditure, or prior activities, will also be relevant, to the extent that they have a bearing on the characterisation referred to in paragraph 50 of this draft Ruling.

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

5. The Committee suggests that it would be helpful if the Division 50 examples in the Draft Ruling dealt with more examples where the services of the charity are consumed outside of Australia. Particular examples could include:
 - a cultural organisation which regularly performs overseas; and
 - an educational charity whose principal method of education is online and its website is accessed more by people overseas than in Australia.
6. The existing examples 8 and 9 raise a question as to how the test is affected when the services are being principally consumed outside of Australia. If the expenditure is not a grant made under purposes which include making grants to certain entities (example 7) and relates to a service which is consumed overseas, then the examples show that this expenditure is not incurred in Australia. The Committee queries whether this is always the case – for example, where the overseas performances are necessary for cultural development and fundraising to enable sustainability of performances in Australia or if it was not intended but the educational materials is in more demand from people outside of Australia?

Division 50 in Australia condition (section 50-75)

7. Section 50-75(1) of the ITAA 1997 states:

In determining for the purposes of this Subdivision whether an institution, fund or other body incurs its expenditure or pursues its objectives principally in Australia, distributions of any amount received by the institution, fund or other body as a gift (whether of money or other property) or by way of government grant are to be disregarded.

8. Paragraph 58 of the Draft Ruling states:

When working out what are disregarded amounts, 'gifts' are taken to include receipts from fundraising by raffles, dinners, auctions, jumble sales and the like, but do not include receipts from commercial activities or contracts for services... They do not need to be tax deductible.

9. The Committee affirms the sensible approach taken by the Commissioner to including receipts from raffles, dinners, auctions, jumble sales and the like in paragraph 58 cited above.
10. The Committee recommends further clarification is given to the meaning of 'government grants' in paragraph 59. Paragraph 59 presently states:

'Government grants' include payments made by government to entities for specific purposes, whether or not the entity is placed under an obligation to ensure that the grant is applied for those purposes, but do not include payments made by government for services provided under contract.

11. The Committee is concerned that the distinction drawn in paragraph 59 between government grants and payments for services provided under contract is not clear, and too difficult to discern in practice. Further, the Committee notes that there are a range of factors which may bear on how a payment from Government to an entity is treated, including accounting standards.
12. Unless meaningful criteria can be provided for distinguishing government grants from contracts for services, supported by appropriate case authority, it may be preferable to replace the words 'but do not include payments made by government for services provided under contract' in the Draft Ruling with the following: 'payments made by

government by way of fee for service'. The Committee suggests that these words would clarify that payments by the government for ongoing services provided to (or for) Government are not gifts, but also that grants by way of outcomes-based funding are considered to be gifts.

Division 30 'in Australia' condition

13. The Draft Ruling states in paragraph 4 that a Deductible Gift Recipient (**DGR**) will satisfy the Division 30 requirement that it be 'in Australia' at a particular time if it:

- (a) is established or legally recognised in Australia; and
- (b) operates in Australia at that time.

14. The Committee affirms the approach taken by the Commissioner to recognise that the DGR 'in Australia' condition does not require institutions to have purposes or beneficiaries located in Australia (paragraph 14), and to acknowledge that it does not matter where the physical assets or money of a fund are located (paragraph 8).

15. The Committee notes the Commissioner's view that:

8. ...[A] fund is in Australia if all or a substantial part of its store of assets or money is... managed by a trustee or other entity located in Australia... (see Examples 1 and 2 of this draft Ruling).

14. An institution is operated in Australia if it is managed on a day-to-day basis by a local committee of management or similar structure located in Australia (see Examples 5 and 6 of this draft Ruling).

16. The Committee notes that there is no case law authority offered to support the interpretation of the 'in Australia' requirement as requiring managerial and operational decision-making to occur in Australia. Footnote 15 states that the test in Division 30 is 'less than what is required by central management and control test for corporate residency in subsection 6(1) of the *Income Tax Assessment Act 1936* (Cth)'. The Committee acknowledges that the focus on day-to-day management is an attempt to step below central management and control. Nonetheless, the Committee is concerned that Division 30 occurs in a different context, and that there still seems to be an attempt to import a level of managerial and operational decision-making. It is not clear to the Committee that it is appropriate to always import those concepts here. Indeed, a focus on operations suggests that a better analogy could be with the broad approach to when an entity carries on business in Australia, which focuses on the existence of (some) day-to-day activities in Australia, rather than managerial control, albeit that managerial control will *also* indicate that the entity is carrying on business in Australia.²

17. The Committee recognises there may be sensible policy objectives underpinning the approach taken in the Draft Ruling. However, it appears to the Committee that Examples 2 and 5 are problematic, and the Committee recommends the amendment of those examples in the Draft Ruling for clarification. By way of explanation:

- (a) Example 2 concerns a public fund controlled by an executive committee made up of three Australians (all of whom are 'responsible persons'), and two Japanese members. Because the executive committee meets regularly in Japan and makes its decisions there, the public fund does not satisfy the 'in Australia'

² See, eg, TR 2018/5 [6]-[9]. Compare also: *San Paulo (Brazilian) Railway Company v Carter* (1895) 3 TC 407, 410 (Lord Halsbury LC).

requirement because the managerial and operational decisions concerning the fund are not made in Australia.

- (b) Example 5 concerns an institution in which the majority of directors are Australian residents. The other directors are resident in the United Kingdom, and full board meetings are held twice a year by telephone. However, it does not satisfy the 'in Australia' condition in Division 30 because the CEO and General Manager are located in the UK and they 'consult with the UK-based directors in the conduct of [the day-to-day management of the Australian] operation'.
- (c) It is not difficult to imagine situations where this approach becomes problematic. For example, an Australian CEO of an overseas aid charity that travels 18 days a month (more than half the time). Does the CEO fail to qualify? Does the CEO have to reserve all decision-making till an occasion when he or she is in Australia?
- (d) There are also questions over the extent to which an executive officer with delegated authority for day to day management of the Australian operations will suffice. Consider for example, a Public Benevolent Institution whose only function is to raise funds in Australia and pass them on to a Cambodian division; while the directors are all overseas, and the application of the funds is managed in Cambodia, there is a fundraising manager in Australia making the day to day decisions about the fundraising activities in Australia. It is unclear from the Draft Ruling whether such an arrangement is acceptable.
- (e) Further, what is the relevance in example 5 of the General Manager and CEO consulting with UK directors, given that a Board acts collectively and individual directors are not empowered to make decisions instead of the collective Board in the absence of specific delegations? Consider also, the processes involved in decision-making, which usually include reading and preparation in advance of board meetings, and the instructing of staff to carry out the decisions, which may happen in Australia even where a board meeting occurs overseas.

18. It may be that some of the difficulties which emerge from Example 2 and Example 5 follow from a point-in-time analysis. Paragraph 4 of the Draft Ruling states that a fund, authority or institution will be in Australia 'at a particular time' if 'it operates in Australia at that time'. It may be that a more holistic approach to characterisation, such as outlined for the Division 50 condition, would resolve some difficulties.

Contact

For further comment or clarification on any of the matters raised in the submission please contact Jennifer Batrouney QC, Chair, Charities and Not-for-profits Committee on (T) 03 9225 8528 or at (E) Jennifer_batrouney@vicbar.com.au.

Yours sincerely



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