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DOES CHARITY BEGIN AND END AT HOME FOR TAX EXEMPTIONS?

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Introduction

Charitable organisations have remained exempt from income tax in Australia since the first comprehensive state income tax legislation in 1884[1] through to the current Income Tax Assessment Act 1977.[2] The charitable exemption was also part of the English income tax legislation from its inception in 1799.[3] The Federal Treasurer has released exposure draft legislation which seeks to remove taxation exemptions from some tax exempt organisations that perform any of their activities outside Australia or make trust distributions overseas.[4] The proposed legislation is in response to alleged tax avoidance arrangements which involve tax exempt organisations and charitable trusts.

The paper begins by describing the current charity tax exemption provisions under the Income Tax Assessment Act (ITAA). It then turns to tracing the background policy history of the amendments which appear to be at odds with the form and intent of the proposed provisions. The proposed amendments and their practical consequences are then closely scrutinised and found wanting in a number of respects. Alternative strategies are suggested to arrive at an equitable solution to the avoidance mischief.

Nonprofit Taxation Exemption

Sections 23(e), (ea) and (g) ITAA exempt the income of religious, scientific, charitable or public educational institutions, public hospitals, friendly societies, organisations established for the encouragement of music, art, science, literature, games, sport, animal races or community service purposes. All income generated by these organisations is exempt provided that:

1. the organisation's main purpose or object is exempt and its actual predominant activity is directed to these purposes;
2. the organisation is nonprofit (it does not and is constitutionally prohibited from distributing its surplus to anyone or any purpose, other than its stated exempt objectives); and

[1] The first Act to impose a tax on income (dividends) was Tasmania's Real ad Personal Estate Duty Act 1880. South Australia was the first State with the Taxation Act 1884 and the Commonwealth's income tax provisions closely followed the State's exemption provision in section 23 of Income Tax Assessment Act 1936 (Cth). Some of the matters raised in this article appeared in Myles McGregor-Lowndes' and Sandra Rodman's, "Draft charitable exemption legislation and its alarming consequences" [1997] CCH Tax Week Para 242.

[2] The Income Tax Assessment Act 1997 (ITAA 1997) was enacted a part of the Tax Law Improvement Project (TLIP) rewrite of the Income Tax Assessment Act 1936 (ITAA 1936). The ITAA 1997 will be progressively amended and added to as installments of the rewrite are enacted. The parts of the ITAA 1936 which have not been rewritten are adopted directly into the ITAA 1997 by Schedule 1, 52 of the Income Tax (Consequential Amendments) Act 1997.

[3] 39 GEO.III c.13, s5.

[4] *Taxation of Charitable Trusts and the Removal of Tax Exemption for Certain Organisations Located Offshore - Exposure Draft Legislation*, February 1997, Released by the Treasurer.

3. the organisation has an appropriate dissolution clause which transfers any surplus to a similar organisation, not its members or controllers.[5]

The High Court case of *The University of Birmingham v FCT*[6] established that the provisions were not limited to Australian organisations carrying on operations in Australia, but extended to organisations that carried on their operations outside Australia.

Australia has a liberal taxation regime when compared with similar jurisdictions. Tax exempt nonprofit organisations are not subject to an unrelated business income tax such as in the United States[7] or prohibited from carrying on unrelated business such as in England.[8] Australian nonprofit tax exempt organisations are not even required to seek formal registration of their exemption or file an annual taxation return.[9] America and England are indicative of other first world nonprofit regulatory regimes which use taxation reporting as a basis for the general regulation and fidelity of nonprofit organisations. In Australia the ATO plays a minor active, or even symbolic, monitoring role.

Section 23(j) permits public charitable funds established by will or trust deed to be exempt from income tax. These funds are money or investments set aside and invested, the surplus income being capitalised, and are more commonly referred to as philanthropic trusts or foundations.[10] The income from such funds must be used solely for the 'public charitable purposes' for which the fund was established and are commonly referred to as 'distributions'. The distributions may be made to overseas organisations. The Australian Taxation Office (ATO) seeks to discourage unwarranted accumulations of income in the funds and requires an annual distribution of at least eighty-five percent of income annually.[11] Funds established for enabling scientific research to be conducted by or in conjunction with a public university or public hospital are also tax exempt. Like other section 23 exempt organisations these funds are not required to lodge tax returns under the self assessment regime.

[5] Rodman, S. & M. McGregor-Lowndes, "Income Tax Exemptions for Non-profit Associations", in *Legal Issues for Non-profit Associations*, M.McGregor-Lowndes, K. Fletcher, S. Sievers, (eds) LBC Information Services, Sydney, 1996.

[6] (1938) 60 CLR 572.

[7] *Internal Revenue Code* (USA) para 511.

[8] *Income and Corporation Taxes Act* (1988) (UK) (ICTA)s 505.

[9] Section 161 ITAA 1936 permits the ATO Commission to exempt organisations from filing a return by publishing a notice to that effect in the Commonwealth Gazette. This is done as part of the self assessment regime adopted for taxation matters in Australia. In UK, USA and Canada this is an annual requirement of all nonprofit organisations.

[10] *Associated Provident Funds Pty Ltd v Commissioner of Taxation* (Cth) 14 ATD 333.

[11] Refer Income Tax Ruling 340 and *Trustees, Executors and Agency Co Ltd v Acting FCT* (1917) 23 CLR 576.

Background

In 1987, the Commonwealth Parliament referred to the House of Representatives Standing Committee on Finance and Public Administration a reference on tax avoidance through international profit shifting and abuse of the withholding tax provisions. The Committee published three reports from its deliberations with the final report in 1991 being *Follow the Yellow Brick Road*.[12] The committee received evidence from a member of the public that tax exempt charities were making distributions to overseas charitable trusts. The distributions found their way back to the donor through a deposit to the donor's international bank accounts or to the donor's international credit card.[13]

The ATO gave evidence to the committee that it did not have any evidence of significant abuse involving charities and further indicated that it had conducted extensive inquiries into two overseas charitable bodies which had received significant income from Australian trusts.[14] No evidence could be found that these were anything else but genuine gifts. The Taxation Institute of Australia also appeared before the committee and confirmed that it was not aware of such schemes.[15]

The Committee recommended that specific anti-avoidance measures similar to section 78A be introduced to counter any potential for tax avoidance.[16] Schemes involving domestic charities had become common in the late 1970s as illustrated by *Leary v Federal Commissioner of Taxation*.[17] There a gift was made to a public benevolent institution which would normally be an allowable deduction under section 78. However, in a complex series of transactions the public benevolent institution effectively returned to the donor 98.8% of the donation. The Federal Court found that the transaction did not have the elements of a 'gift' and was not an allowable deduction. The Government introduced section 78A as a specific anti-avoidance provision for such schemes and appears to have effectively curtailed such avoidance activities involving domestic charities.

Another notable recommendation of the Committee was to redress the lack of statistics on donations for which deductibility is claimed and distributions of trust income to charitable organisations. The Committee recommended that such statistics should be kept in order to inform policy makers and as a basis for ATO audit activity.[18] The Industry Commission which shortly afterwards conducted a significant inquiry into Australian charitable organisations also commented about the lack of statistics kept by the ATO on charities and encouraged the ATO to actively monitor charity tax exemptions and donation deductibility status.[19] The ATO commented to the Commission that it would be reluctant to actively monitor tax exempt organisations,

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[12]Parliament of the Commonwealth of Australia, *Follow the Yellow Brick Road: The Final report on an Efficiency Audit of the Australian Taxation Office: International profit Shifting*, (1991), Australian Government Publishing Service, Canberra.

[13] *Ibid*, 51.

[14] *Ibid*, 53.

[15] *Id*.

[16] *Ibid*, recommendation 15, 55.

[17] 80 ATC 4438.

[18]Parliament of the Commonwealth of Australia, above n.11 p 55-56.

[19] Industry Commission, *Charitable Organisations In Australia*, Report No. 45, June, 1995, Australian Government Publishing Service, Melbourne, 309.

> "To support the system of self assessment, the ATO has a help and enforcement program, that is based on risk management principles. The ATO's research identifies areas of greatest risk to the revenue, determines the causes and develops appropriate strategies to deal with the risk. The effect of committing the ATO to a process of review of CSWOs would divert ATO resources away from areas that may be of greater risk to the revenue."[20]

The Commission also recommended that the income tax exempt status of charities should remain.[21] Many were surprised at this recommendation at the time given the reputed strong economic rationalist focus of the Commission to abolish exemptions and create a 'level playing field'. The recommendation was justified on the basis that the revenue cost from exemption was small and that there are complex conceptual issues in applying an income tax to nonprofit entities which would necessary lead to administrative complexities with little tangible fiscal or social benefits.[22]

Immediately prior to the Federal election in November 1995, the ATO drew to the attention of the Labor Government certain tax avoidance strategies which enabled high wealth individuals to enjoy lavish lifestyles, while paying little or no tax. In February, 1996 the Labor Treasurer forecast changes to the taxation regime to prevent the abuse of Australian charitable trusts and overseas organisations to disguise benefits provided by family trusts to family members. However, the Government stated,

> "... these are not techniques which are practised by the overwhelming majority of trusts operated by and for Australians. Trusts provide an appropriate structure to meet a range of legitimate needs as for charities, educational and non-profit organisations, deceased estates, a variety of family purposes, and for solicitors and other professionals. The Government will not interfere with these arrangements. The Government undertakes that the measures it will adopt will ensure that activities not involving tax avoidance are not adversely affected."[23]

On the Budget night 1996, the newly elected Treasurer in a press release included not only the taxation reform of trusts, but the removal 'of the tax exempt status for certain organisations located overseas, irrespective of whether they are subject to tax in their home country'.[24] The Treasurer further announced that 'the measure will not impact on any entity which is a resident for Australian tax purposes' and the government would consult widely to 'ensure that *bona fide* charitable organisations are not detrimentally affected'.[25] In February, 1997 the exposure draft legislation which is the subject of the following detailed examination was released by the Treasurer and attracted many criticisms. Amending legislation was introduced by the Taxation Laws Amendment Bill (No. 4) 1997 in July, 1997.

The Proposed Amendments

The proposed amendments to the exemption of nonprofit organisations from income tax fall into two categories which are considered in turn. One set of provisions concern nonprofit organisations

[20] ATO, Submission No. DR693 to the Industry Commission Inquiry into Charitable Organisations, 1995, 4.

[21] *Ibid*, 275.

[22] *Id*.

[23] Treasurer's Press Release 11 Feb., 1996.

[24] Treasurer's Press Release No 74, 20 August, 1996.

[25] *Id*.

generally; the other is concerned with public charitable funds under s 23(j) which are testamentary trusts or foundations.

The proposed amendments to section 23(e) which exempts religious, scientific, charitable or public educational institutions will require one of three additional situations to apply before an exemption will be available. These are that:

1. the organisation is located in Australia and undertaking its work solely in Australia;

or

2. the organisation is an 'institution mentioned in a table in subsection 78(4)';

or

3. the organisation is located outside Australia, is exempt from income tax in that country and has been given an exemption by the Australian authorities.

The trades union and employer associations exemption in section 23(f) is proposed to only be available if they are located in Australia and undertake their work solely in Australia. The two other limbs of being a section 78(4) donation deductible organisation or a prescribed organisation do not apply.

Each of the proposed section 23(e) additional requirements are now considered.

Australian and working solely in Australia

The requirement that the organisation be located in Australia would probably mean that the organisation had its principal place of business physically in Australia. The vast majority of tax exempt nonprofit organisations formed or incorporated in Australia would satisfy this requirement.

The second element requires the organisation to be 'undertaking its work solely in Australia'. This is not a phrase whose interpretation has been judicially or administratively settled in this context. The explanatory note uses 'undertakes its activities in Australia' to describe part of the phrase, but offers no other term for 'solely'. 'Activities' would seem to be a reasonable and ordinary interpretation of the word 'work' in this context. A nonprofit organisation's activities flowing from its constitutional objectives are its 'work'. Tax exempt nonprofits are formed for purposes, rather than to earn income for distribution to members or controllers.

The exposure draft in a proposed section 23AAAA directs that 'distributions of any amount received by the institution as a gift are to be disregarded' for the purposes of whether an institution undertakes its work solely in Australia. This means that gifts, as opposed to earned income such as interest on investments or business ventures, which are distributed, are to be disregarded. This only appears to catch gifts, rather than *quid pro quo* nonprofit arrangements such as product endorsements or sponsorships. Use of the words 'distribution of any amount' suggests amounts of money, rather than property or services. Many nonprofits receive gifts in kind rather than cash, such as donation of second hand goods or professional services and could not be classified as receiving 'distributions of any amount'.

The phrase 'solely in Australia' suggests that one hundred percent of the organisation's work must be conducted in Australia. Under this provision, even an inconsequential amount of work performed outside Australia will result in the complete loss of taxation exemption for the tax period which may be unnecessarily restrictive of *bona fide* nonprofit organisations. Many small Australian nonprofit organisations confine their activities solely to Australia, but substantial nonprofit organisations legitimately perform work overseas in meeting their objectives. For example, private schools regularly organise for a party of their pupils to represent the school at an international musical or sporting events. The pupils often give remunerated concerts or there are gate takings which are used to defray travelling expenses. The controlling bodies of national sporting codes send national teams to participate in international competitions and commonly receive a proportion of gate receipts and sponsorships. Religious bodies send missionaries overseas. A community service organisation may assist members to represent it at international gatherings.
Clearly *bona fide* nonprofit organisations which cannot rely on one of the other categories are placed at risk of being taxed on all their income, unless they desist from their overseas activities or the proposed legislation is clarified. Such organisations may decide to form another related, but separate, organisation which solely deals with overseas work. This would quarantine tax liabilities for overseas work in that separate organisation. The parent organisation might 'gift' money (section 23AAAA) which it has earned to be distributed by the related organisation which attracts the exemption under section 23AAAA.

The result of such arrangements would be that little revenue would be collected and nonprofit organisations would be faced with the increased administration costs and inconvenience of a separate organisation. As the Industry Commission noted, it is unlikely that many nonprofit organisations would face significant taxation liabilities, but the costs of altering their accounting and administrative systems to comply with ATO requirements would be significant.

Ironically, section 23AAAA could advance the very mischief that the ATO seeks to prohibit. A taxpayer could make a gift to a 'stooge' nonprofit, which then forwarded the gift overseas claiming the protection of a 'gift' under section 23AAAA.[26]

A section 78(4) institution

The second limb exempts institutions that are mentioned in a table in subsection 78(4). Section 78 defines those organisations to which gifts over $2 are allowable deductions from the assessable income of donors. Section 78(4) contains a list of specifically named organisations such as the Centre for Independent Studies or Amnesty International and classes of organisations such as public benevolent institutions or public universities or hospitals. It appears at first glance that a tax exempt organisation that is also mentioned in the table to subsection 78(4) will also be exempt from income tax. There are, however, some limiting factors.

Firstly, subsection 78(4) relates to 'funds and authorities' as well as institutions and the use of only 'institution' in the draft legislation could by implication exclude the others. Subsection 78(5) which refers to all the bodies contained in subsection 78(4) uses the phrase 'funds, authorities or institutions'. This interpretation is further supported by the proposed amendments of s 23(g) using the terms 'society, association or club' with reference to subsection 78(4). Secondly, the exposure draft uses the term 'mentioned in a table in subsection 78(4)', this may be interpreted to mean only those organisations

[26] The taxpayer would be required to establish that the payment was a gift with elements of benefaction as determined by cases such as *Cyprus Mines v Federal Commissioner of Taxation* 78 ATC 4468 or *Federal Commissioner of Taxation v McPhail* (1968) 117 CLR 111.

which are specifically named such as the Centre for Independent Studies or Amnesty International and not the general classes of organisations such as Public Benevolent Institutions. Thirdly, such institutions are restricted to being 'in Australia'. Further, the vast majority of tax exempt organisations (s 23) do not meet the requirements of a subsection 78(4) organisation and will be unable to take advantage of this exemption.

This element will allow nonprofit organisations that also qualify under section 78(4) to remain tax exempt without being restricted to containing their activities within Australia. Australia's foreign aid organisations such as World Vision and Care Australia could take advantage of this provision as they are section 78 organisations.[27] However, some types of exempt organisations are rarely section 78(4) donation deductible organisations. For example, few orthodox sporting bodies have donation deductible status or could qualify for it. Most of the donation deductible funds are channelled through the Australian Sports Foundation which is specifically mentioned in Table 10.2.1 (Sports and Recreation). There is no general class of donation deductible organisations under that heading and the specific organisations relate only to boy scouts and girl guides. Another example is private schools. While the vast majority of private schools have 'building funds' which are tax deductible, this is a separate public fund (not an institution) for the purposes of the section, and would appear not to allow the school, as a separate organisation, to claim to be a section 78(4) institution.

Such situations will lead to some quite discriminatory results, however these may be lessened by permitting Australian organisations to be 'prescribed' exempt by authorities, as may overseas organisations. This proposal is taken up under the next heading. Alternatively the scope of organisations that are included under section 78(4) could be widened as proposed in the recent Industry Commission report on Australian charities.[28]

A Prescribed Institution

This limb permits the authorities to declare an organisation exempt from taxation if it is located outside Australia and is exempt from income in the country in which it is resident. It should be noted that this is restricted to foreign organisations and not those which are located or resident in Australia. For example, an American tax exempt sporting organisation which comes to Australia to play an international series could apply to the Australian authorities to become a prescribed organisation, but not the Australian resident organisation. As noted above, allowing Australian organisations to be prescribed exempt may mitigate absurd and unjust consequences of the amendments.

The other issue of concern is on what basis would such discretion be exercised? The comments accompanying the exposure draft hint that it will 'allow the Government to grant income tax exemptions, on a case by case basis, to the most deserving of organisations which, although they operate offshore, warrant concessional tax treatment in Australia because of exceptional circumstances.'[29] Similar discretions such as adding specific organisations to donation deductibility tables in section 78(4) have been exercised very sparingly over the last decade and it is likely that it will be a very time consuming and difficult task for an overseas organisation to obtain a favourable exercise of the discretion.

The amendment of charitable funds taxation exemption

[27] Subsections 78(19)-(23) permit a register of approved foreign aid organisations to receive deductible donations from the public.

[28] Industry Commission, above n 18, 286.

[29] Treasurer, above n 3, Explanatory Notes, Clause 33, 10.

Presently, s 23(j) permits public charitable funds established by will or trust deed to be exempt from income tax. Funds established for enabling scientific research to be conducted by or in conjunction with a public university or public hospital are also tax exempt. The exposure draft legislation proposes some profound alterations. The intent is to prevent these organisations making distributions overseas which are to the benefit of the controllers of the charitable trust or donors. New eligibility criteria are mandated and if a charitable trust does not comply, then its exemption from income tax will be lost entirely and permanently. This is in contrast to section 23 tax exempt organisations which would lose exemption only for the applicable income year.

Section 23(j)(ii) will be amended to delete a fund established by an 'instrument of trust' and solely apply to 'a fund established by will before 7.30 pm by legal time in the ACT on 20 August 1996'. As a result, testamentary wills containing public charitable trusts before the 1996 budget night will retain their tax exempt status, no matter where they are located or where they make distributions.

However, section 23AAAB makes further amendments to the administration of such testamentary trusts. If a pre-budget 1996 testamentary trust receives property, other than for valuable consideration, after the 20 February 1997, then the section requires that two separate notional trusts be created. The purpose of the division is to exempt pre-budget 1996 testamentary trusts from having to be established in Australia or amending their trust deeds to prohibit making distributions overseas. However, testamentary assets acquired after budget night will lose their tax exempt status unless they comply with subsection 23(j)(iia) which is discussed below.

It is also proposed to add a new subsection 23 (j)(iia) which will exempt from taxation a fund established by will or trust for a public charitable purpose if :

- the terms of the will or trust expressly prohibit the making of distributions overseas;
- the fund or trust undertakes and has undertaken its work solely in Australia; and
- the fund or trust distributes solely and has distributed solely to institutions located in Australia and such institutions undertake their work solely in Australia.

As noted above there may be some doubt about the meaning of 'work solely in Australia' and the term 'institution' may exclude other types of organisations such as 'funds' and 'authorities'. A new issue arises with the requirement to alter the terms of the will or trust to prohibit the making of distributions overseas. Living persons who have made wills creating public charitable trusts will need to alter their wills, if in the future the proposed trusts are to be tax exempt. Wills that have already created public charitable trusts will be required to be notionally split into two trusts as described above. Charitable public trusts wishing to remain tax exempt will have to alter their trust deeds to prohibit the making of distributions overseas. This will not be a problem for many older charitable trusts as many are restricted to making distributions within the bounds of a specified State. This was a result of state death duty tax exemption provisions requiring charitable trusts to be confined to the particular state.[30] Such legislation is now repealed and most charitable trusts created in the last twenty years have been drafted to permit trustees to make distributions without a geographic limitation.

[30] For example, *Administrative and Probate Act* 1928 (Vict) s 160; *Administration and Probate Act 1953* (Vict) s 117; *Probate Duties Act* 1962 (Vict) s 21.

In the absence of any power of variation in a charitable trust deed, the terms of the trust can only be altered by the Supreme courts, usually at the relation of the Attorney General.[31] It is not known what proportion of charitable trust deeds confer powers of variation on trustees, however, it is common for this power to be omitted as the founder wishes to ensure that the specified objects are the sole focus of the trust funds. If a power of variation is not included, application will have to be made with the relevant State Attorney General to the Supreme Court for variations.

Tax mandated alterations to trust deeds have long been a feature of common, rather than charitable, trusts. All state trusts acts have special provisions following the English *Variation of Trusts Act 1958* which were specifically designed for ordinary trusts to vary their terms to accommodate new taxation restrictions. However, the primary triggering provisions do not include charitable trusts by implication[32] or expressly[33], and in the case of charities still require the intervention of the relevant Attorney General.[34] The proposed legislation will cause some charitable trusts to expend considerable money to alter their trust deeds and provide extra work for State Attorneys General. Trust funds which are established by legislation may be required to be altered by an act of Parliament. It is rare to find a restriction in the terms of the draft exposure legislation or a power of variation in such Acts. Trusts have until the 1 July 1998 to effect the changes to their trust instruments, this may not be sufficient time to identify all trusts, particularly creatures of statute and pass amending legislation.

A trust making the distributions also has to ensure that it only deals with organisations located in Australia and working solely in Australia. It is already common to require that some organisations have constitutional clauses which prevent distributions to any donee organisation that does not have a certain taxation status. The intent of the proposed legislation is not just that such restrictive clauses are placed in the donee's constitution, but requires that they have abided by their constitution. The task of vetting every organisation that is to receive a distribution will be a difficult, time consuming and expensive task, with the chance of an unintentional slip meaning the permanent end of tax exemption for the fund.

Alternative Solutions to the Mischief

The exposure draft legislation could be improved by considering the specific drafting issues raised in this paper. Even after such clarification, the proposals appear to be systemically inappropriate to the apparent mischief intended to be addressed by the amendments. Apart from the insights allowed the public in Federal Parliamentary Committee's report in *Follow the Yellow Brick Road* which were not regarded by any participant as substantial, the extent of taxation avoidance has not been made public.[35] The removal of taxation exemption from those nonprofit organisations which have activities outside Australia is excessive unless a documented case can be made that tax avoidance is on such a scale as to warrant such draconian response which will adversely affect *bona fide* nonprofit organisations. Both Treasurers involved in the policy formation of these amendments have clearly stated that *bona fide* nonprofit organisations would not be adversely affected.

Other comparable taxation regimes have been able to adopt appropriate measures to counter similar

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[31] Some jurisdiction do have administrative procedures for varying the terms of trusts through the Attorney General if they involve small amounts, *Charities Act* 1978, (Vict.) Part II.

[32] *Trustee Act* 1958 (Vict.) 63A, *Trusts Act* 1973 (Qld) s 95, *Trustees Act* 1962 (WA) s 90, *Trustee Act* (NT) s 50A.

[33] *Trustee Act* 1936 (SA) s59C(5)(a).

[34] *Re Longman's Settlement* [1962] All E R 193.

[35] Parliament of the Commonwealth of Australia, above n 11.

fraudulent activity involving exempt nonprofit organisations and overseas distributions.
In England a charity must show that it has taken reasonable steps to ensure that distributions have been applied to charitable purposes.[36] Prudent UK charities keep records to support their actions which can be produced on revenue audit of overseas distributions.[37] Similarly blunt legislation was attempted in the early 1980s in the UK to counter abuses, but was eventually greatly modified to arrive at its present form.[38]

In Canada, overseas activities are managed in a number of ways. The common attribute of the procedures is that the charity is ultimately responsible to Revenue Canada in terms of what happened to the funds. It is acceptable to be directly involved in delivering services overseas where there is an agency or joint venture agreement which is vetted by the taxation authorities.[39] Revenue Canada also keeps a list of acceptable qualified donees to which distributions can be made without reference to the taxation authorities.[40]

In the US**,** domestic organisations are not precluded from taxation exemption because they conduct all or part of their activities in foreign countries.[41] Tax exempt organisations are prohibited from engaging in activities that result in "inurement" of the organisation's net earnings to insiders such as founders, directors and officers.[42] There is also a companion doctrine of "private benefit" where no exempt organisation may provide a substantial economic benefit to anyone outside the intended beneficiaries.[43]

What sets these jurisdictions apart from Australia is that their monitoring of tax exemptions of charitable organisations is far more active and comprehensive. Such organisations are required to file annual reports to the taxation authorities about their activities. For example, the US Form 990 asks detailed questions about distributions to exempt and nonexempt entities and those associated with the organisation (see Parts 3 & 8 as examples)[44]. There is no equivalent activity in Australia. In a recent Industry Commission report the ATO has been challenged to intensify its active scrutiny and supervision of charities.[45] This is perhaps an unattractive option for the ATO as it requires increasing recurring expenditure on audit and monitoring of charities which would probably not result in any significant collected revenue increase. Given this situation, an explanation of the shape of the

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[36] *ICTA* (UK) 1988, s 506(3).

[37] Turner, R.T., K.B. Hurst, A.C. Burgess, *Tolley's Charity Manual*, Tolley Publishing Company limited, Croydon, 1992, Para 7.3

[38] *ICTA* (UK) 1988, ss 505, 506 and Schedule 20.

[39] Drache, A.B.C., *Canadian Taxation of Charities and Donations*, 8th Edition, Carswell, Ontario, 1993, 2-22.

[40] *Id*.

[41] US Revenue Ruling 71-460

[42] *Inland Revenue Code* (US) Section 501(3)(c)

[43] (US) General Counsel Memorandum 39862

[44] For example, Part 3 requires information about the organisation's program accomplishments such as number of clients served, publications issued and 'other achievements that are not measurable'. Part 8 requires an explanation of how each income generating activity contributed to the accomplishment of the organisation's exempt purposes through actual expenditure.

[45] Industry Commission, above n 18, Recommendation 12.6, 309

amendments may well be that to totally prohibit the overseas activity of nonprofit organisations protects the revenue base, without committing significant ongoing monitoring costs in vetting hundreds of thousands of nonprofit organisations. This is a cost effective solution for the ATO. It is not cost effective for Australian nonprofit organisations which will be effectively prevented from attending to their *bona fide* activities. It may well be that the cost to the taxpayer through increased ATO monitoring costs is insignificant compared to the dislocation costs of nonprofit organisations, many of whom contribute to civil society infrastructure in Australia.

If the fiscal restraints on the ATO are such that active tax avoidance monitoring or a universal annual return by nonprofit organisations is not feasible, then it may be a cost effective compromise to require annual returns from those nonprofit organisations which have activities or make overseas distributions over a certain monetary threshold. The Canadian 'approved' list of *bona fide* overseas organisations might also be a cost effective strategy for ensuring that Australian trust distributions did not go astray. In any case, a considered review of the proposed amendments is required.