Policy: Protecting the Fisc and Fiscal Oversight Authority

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Introduction[1]

Over two decades ago Professor Harvey Dale began the first comprehensive analysis of the U.S. tax treatment of U.S. donors and foreign charitable organisations by referring to the global "associational revolution" and the growth of an increasingly interconnected world economy.[2] His description of U.S. cross-border charity was frank:

> The legal – and particularly the federal tax – structure regulating such giving, however, is ancient and bizarre. It serves more to constrain than to guide or assist. It is in great need of overhaul.[3]

When Professor Dale published in 1994, Netscape Navigator was the most popular browser, only a select few were using e-mail, and Google had not been founded. Since then, significant advances in communications technology, borderless social media, an increasingly mobile workforce, particularly work tourism of young professionals, have converged with deeply integrated global markets[4] and free-trade zones, to usher in an era of "philanthropic globalization."[5] Isolated nation states are now withering in the face of globalization, but countries that harness these forces are creating untold wealth for both the established wealthy, and their rising middle classes. It is not only about wealth but meaningful relationships essential to philanthropy due to "the intensification of worldwide social relations which link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa."[6]

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[1] I acknowledge the assistance of Natalie Silver for material and comments that were very useful in compiling this paper.
[2] Dale, Harvey. 1994. "Foreign charities." *Tax Lawyer* 48: 655–704, p. 659.
[3] Ibid, p. 657.
[4] Cutbill, Clive, Paines, Alison, and Hallam, Murray (eds). 2012. *International charitable giving*. Oxford: Oxford University Press, p. 6.
[5] Anheier, Helmut, Marlies Glasius and Mary Kaldor. 2001. "Introducing global civil society." In *Global civil society*, edited by Helmut Anheier, Marlies Glasius and Mary Kaldor. Oxford: Oxford University Press, pp. 3, 16-17.
[6] Giddens, A. 1991. *The consequences of modernity*. Cambridge: Polity Press, p. 64.

A philanthropic tipping point was the creation of the Bill and Melinda Gates Foundation with its funding in over 100 countries. So significant is its contribution that in 2011 the OECD included global health grants made by the Gates Foundation in its aid data, enabling comparisons with governments.[7] The Gates Foundation is now the largest funder in the global health arena outside the U.S. and U.K. governments,[8] spending more annually on global health than the World Health Organization.[9] Few would quibble that there is significant commonly understood public benefit for the U.S., even the world, in the foundation supporting the eradication of polio in India.

The contemporary philosophical narrative about philanthropy has also shifted under these globalising influences. For example, the Australian philosopher Peter Singer has become a strong proponent of cosmopolitan ethics, arguing that regardless of proximity or distance, "if it is in our power to prevent something bad from happening, without thereby sacrificing anything of comparable moral importance, we ought, morally, to do it."[10] Singer takes the position that there is no moral justification for discriminating against those in need on geographical grounds.[11] His solution to alleviating world poverty requires that affluent individuals send a substantial amount of their income to organisations which operate internationally.[12]

> [W]e can all save lives of people, both children and adults, who would otherwise die, and we can do so at a very small cost to us: the cost of a new CD, a shirt or a

[7] Smith, Kimberly. 2011. *Statistical reporting by the Bill and Melinda Gates Foundation to the DAC*. Geneva: OECD, p. 1.
[8] Ibid.
[9] McGoey, Linsey. 2014. "The philanthropic state: Market–state hybrids in the philanthrocapitalist turn." *Third World Quarterly* 35(1): 109–110.
[10] Singer, Peter. 1972. "Famine, affluence and morality." *Philosophy and Public Affairs* 1: 229, p. 231. Singer's oft-cited application of this principle is: "if I am walking past a shallow pond and see a child drowning in it, I ought to wade in and pull the child out. This will mean getting my clothes muddy, but this is insignificant, while the death of the child would presumably be a very bad thing."
[11] Ibid. See also: Singer, Peter. 1997. "The drowning child and the expanding circle: As the world shrinks, so our capacity for effective moral action grows." *New Internationalist* 289: 28; Singer, Peter. 1999. "The Singer solution to world poverty." *The New York Times*, September 5. Accessed 2 October 2014. http://www.nytimes.com/1999/09/05/magazine/the-singer-solution-to-world-poverty.html; Singer, Peter. 2009. *The life you can save: Acting now to end world poverty*. Melbourne: Text Publishing.
[12] Singer, Peter. 1972. "Famine, affluence and morality." *Philosophy and Public Affairs* 1: 229, p. 232; see also Singer, Peter. 2006. "What should a billionaire give – and what should you?" *New York Times*, December 17: 58. Singer calculates the amount that should be given according to the incomes of America's rich and super-rich, which he defines as the top 10 percent of U.S. taxpayers.

> night out at a restaurant or concert, can mean the difference between life and death to more than one person somewhere in the world – and overseas aid agencies like Oxfam overcome the problem of acting at a distance.[13]

The world has moved on since 1994, and will continue to do so rapidly, but policies on the fiscal treatment of cross-border charity in significant donor nations appear to have very patchy development, given the significant globalisation occurring. Many reasons are advanced to restrict cross-border charity, including the risk of money laundering and the financing of terrorism, but other policy levers are available to address such mischief, as the situation in Europe demonstrates.

To aid the panel discussion, the paper first reviews how cross-border charity fiscal restrictions have been justified in different jurisdictions. For analytical clarity, charitable activities and philanthropic donations flowing across borders are divided into four inbound and outboard classifications. The reasons for fiscal restrictions are then identified under each classification. A brief summary of academic and judicial counter arguments to these positions follow. Special attention is paid to the jurisdictions of the European Union (EU), where, since 2006 there has been significant judicial re-evaluation of cross-border philanthropy, leading to divergent approaches, ranging from complete repeal of any donation tax concessions to significantly facilitative arrangements with relatively few barriers. Brief coverage is also given to the application of tax credits in double taxation alleviation schemes, which can have implications for the flow of philanthropic tax concessions.

The paper then turns to an in-depth consideration of the fiscal treatment of Australian cross-border charity. The Australian fiscal constraints on cross-border charity are regarded as strict, and are about to be made even stricter.[14] The history of fiscal regulation of cross-border charity in Australia is canvassed, from federation to the latest proposed reforms which are yet to be put before Parliament. Australian fiscal regulation is characterised by an excessive number of special classifications of tax concession entities, each with

[13] Singer, Peter. 1997. "The drowning child and the expanding circle: As the world shrinks, so our capacity for effective moral action grows." *New Internationalist* 289: 28, p. 29.
[14] Muehlmann, B. W., Stewart, M., Thömmes, O., Heidenbauer, S., Hemels, S., and Tukić, T. 2013. "Cross-border charitable giving and its tax limitations." *Bulletin for International Taxation*, 67(11), p. 21.

its own unique qualifying conditions; and this is also a feature of the fiscal regulation of cross-border charity.[15] Finally, the effectiveness of the oversight is examined. Whilst significant scrutiny occurs at the registration stage, light touch self-regulation is relied upon thereafter, and the efficacy of this approach is questionable.

How the Fiscal Restrictions on Cross-Border Charity Are Justified

Most jurisdictions intentionally encourage the creation and operation of nonprofit organisations and the giving of volunteer time, money and goods to such organisations, by enabling taxation concessions within their jurisdictions, for individuals and corporations. The tax concessions often take the form of relief from income tax, a deduction or credit for donations made to specified organisations which pursue objects for the public benefit (however defined), and concessions from various other taxes such as value added taxes, inheritance, wealth, capital and gift imposts. These concessions are administered by the fiscal authority in each jurisdiction, sometimes joined by independent charity regulators such as those operating in England and Wales, Scotland, Singapore, New Zealand and Australia. The policy reasons for these concessions are not uniform – some are unstated, and some result from political compromise without any discernible rational policy basis. There are many academic theories seeking to make sense of the current state of affairs and guide future reform.[16]

Several leading jurisdictions did not address the issue of cross-border activities or philanthropy when introducing taxation concessions. In 1891, the judges in *Pemsel's case*, relied upon across all commonwealth jurisdictions, found nothing amiss with a trust to advance "the missionary establishments among heathen nations"[17] in the context of a U.K.-wide taxing statute. In the U.S. prior to 1938 there was no geographical limitation for individual donations.[18] In Australia, it was not until 1997 that restrictive cross-border provi-

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[15] For example, while churches and schools may be income tax exempt, often it is only small, discrete parts of these entities which receive tax deductible donations; this is quite different from the fiscal concessions framework in the U.S. and elsewhere.
[16] Ibid.
[17] *Commissioners for the Special Purposes of Income Tax v Pemsel* [1891] AC 531.
[18] Dale, Harvey. 1994. "Foreign charities." *Tax Lawyer* 48: 655–704, p. 660.

sions were introduced into the *Income Tax Assessment Act 1936* (ITAA 1936) for tax exempt organisations. [19]

Justifications for geographical limitations on cross-border charitable activities and philanthropic donations that appeared later in these jurisdictions differ depending on the type of concession and the situation. Cross-border charity and philanthropy have been treated by scholars[20] as being divided into four primary types of transactions: outbound charity; outbound philanthropy; inbound charity; and inbound philanthropy.

OUTBOUND

1. Outbound charity

Description: An organisation with taxation concessions operates outside the jurisdiction of the fisc to fulfil its purpose in whole or part, using those concessions to do so in whole or part.

Restriction rationale: (a) These activities are of no public benefit to the jurisdiction, and (b) to restrict tax abusive behaviour.

2. Outbound philanthropy

Description: A donor (individual, nonprofit or business corporate) remits grants outside the jurisdiction of the fisc and receives taxation concessions.

[19] See *Taxation Laws Amendment Act (No 4) 1997* (Cth) amending s. 23(e) of the ITAA 1936 which stated: "The following incomes, revenues, and funds shall be exempt from income tax:…(d) the income of a religious, scientific, charitable, or public educational institution." The amendment added at the end of this provision: "which: (i) has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia; or (ii) is an institution to which a gift by a taxpayer is an allowable deduction because the institution is referred to in a table in subsection 78(4)[[64]]; or (iii) is a prescribed institution which is located outside Australia and is exempt from income tax in the country in which it is resident; or (iv) is a prescribed charitable or religious institution that has a physical presence in Australia but which incurs its expenditure and pursues it [sic] objects principally outside Australia."

[20] Hondius, Frits. 2004. "An enabling fiscal climate for NGOs – The role of the Europhil Trust." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 2; Koele, Ineke A. 2007. *International taxation of philanthropy: Removing tax obstacles for international charities*. Amsterdam: IBFD; Muehlmann, B. W., et al. 2013. "Cross-border charitable giving and its tax limitations," *Bulletin for International Taxation*, 67(11).

Restriction rationale: (a) There is no public benefit in subsidising gifts to those outside the jurisdiction, and (b) the grant recipient is not subject to the control of the fisc or others within the jurisdiction.

In the U.S., the government's rationale for restricting tax concessions was expressed in 1938 as:

> The exemption from taxation of money and property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and the benefits resulting from promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory.[21]

In Germany, the rationale was stated in 1987 as:

> Donations to a foreign foundation are not deductible for income tax purposes because provisions of the Tax Code do not apply to foreign foundations and because domestic tax offices may not, for legal and factual reasons, examine the activities of foreign foundations. Further, it would not be possible to impose sanctions in the event that it should turn out, subsequently, that the assets which are donated have not been used properly.[22]

In Austria the rationale was given in 2011 as:

> An extension of ...deductibility to institutions established in Member States other than the Republic of Austria...would have the consequence that part of the gifts in question...would benefit institutions which pursue objectives that are not in the interest of the Republic of Austria, which would reduce correspondingly the means of institutions established in that Member State.[23]

In Australia, the rationale, as expressed recently in respect of income tax exemption, is:

> to address international tax avoidance arrangements which used charitable trusts

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[21] Dale, Harvey. 1994. "Foreign charities." *Tax Lawyer* 48: 655–704, p. 660, quoting from H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19-20 (1938).

[22] Koele, Ineke A. 2007. *International taxation of philanthropy: Removing tax obstacles for international charities*. Amsterdam: IBFD, p. 161, quoting Circular letter of Federal Ministry of Finance of 2 February 1987, DstR 1987, p. 237.

[23] Case C-10/10, Commission v Austria, 2011 E.C.R. 1-05389, para.20 quoted in Faulhaber, Lilian. 2014. 39 *Yale Journal of International Law* 39: 87–129, p. 103.

> and certain other not-for-profit (or non-profit) organisations to shift funds overseas to avoid Australian taxation.[24]

And in respect of tax deductibility:

> Ignoring minor overseas activities, the policy intent of the 'in Australia' special conditions was only to allow a charity to be able to pass funds to an overseas charity that was endorsed as a deductible gift recipient (operating a developing or developed country relief fund), or an entity specifically prescribed in the regulations.[25]

There have been counter-challenges by commentators and the judiciary to the fiscal rationales against outbound charity and outbound philanthropy. In the U.S., doubt is cast upon the philosophy of this bargain given that religious activities are included which are not *quid pro quo*, and there appears to be a logical disconnection between denying the deduction on the basis of where the donee is organised, but permitting it for funds to be expended outside the jurisdiction by organisations within the jurisdictions.[26]

Generally, narrow definitions of public benefit (in a public policy sense) are being used, without proper quantification, in that a wider cost–benefit analysis will generally show demonstrable public benefits accruing to the donor country from alleviating poverty, promoting education, and culture in other countries.[27] One of the few attempts to calculate the direct and indirect costs is the *Feasibility Study on a European Foundation Statute – Final Report* which noted:

> The calculable cost of barriers against cross-border activities of European foundations ranges from an estimated €90,000,000 to €101,700,000 per year. Additionally, there are incalculable costs (costs of foundation seat transfer, costs of reduplication, psychological costs, costs of failure, etc.) which are certainly higher. [28]

[24] Australian Government. Explanatory Memorandum Exposure draft: Tax Laws Amendment (2014 Measures No. #) Bill 2014, para. 1.6.
[25] Ibid, para. 1.14.
[26] Dale, Harvey. 1994. "Foreign charities." *Tax Lawyer* 48: 655–704, p. 661.
[27] Jenkins, Garry W. 2007. "Soft power, strategic security, and international philanthropy." *North Carolina Law Review* 85: 773–846.
[28] Max Plank Institute for Comparative and International Private Law and the Centre of Social Investment of the University of Heidelberg. 2009. *Feasibility study on a European Foundation statute – Final report*. Accessed 9 October 2014.
http://ec.europa.eu/internal_market/company/docs/eufoundation/feasibilitystudy_en.pdf.

Evaluations of the cost to the fisc of cross-border charity, using the concept of tax expenditures,[29] which is adopted around the world as a method of shining a light on subsidies in the form of tax concessions, are scant.[30] A 2010 OECD comparison of twenty countries' tax expenditures indicated that thirteen measured and disclosed donations or gifts, but none were disaggregated to the level of cross-border tax concessions.[31] Even if such expenditures were significant, one must still deal with Andrews's criticism of donation deductible concessions being included in the calculation of tax expenditures.[32]

Common law judges have had little difficulty in finding public benefit in relation to activities pursued outside the jurisdiction or supervision of foreign activities, even in the earliest of charity cases.[33] Issues such as lack of direct or indirect public benefit to the local jurisdiction[34] or the inability of the Attorney-General to supervise such charities in a foreign jurisdiction[35] have also been brushed aside in many cases since 1891. Common law judges have drawn the line, as expected, at purposes "inimical to the interests of the local community or contrary to local public policy."[36] European judges have also had the opportunity to examine government rationales for stifling cross-border philanthropy. Although member states retain control of direct taxation[37] they must exercise this control consistently with Community law, which includes the four fundamental freedoms of the European

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[29] Surrey, Stanley S. 1973. *Pathways to Tax Reform: The Concept of Tax Expenditures* Harvard: Harvard University Press.

[30] Australia measures only 13 of 22 nonprofit tax expenditures and most of those measured are noted as having "low reliability"; see text accompanying footnote 231.

[31] OECD. 2010. "Annex A. Revenue forgone estimates of main tax expenditures in OECD countries." In *Choosing a broad base: Low rate approach to taxation*, Geneva: OECD Publishing.

[32] Andrews, William D. 1972. "Personal deductions in an ideal income tax." *Harvard Law Review*, 86: 309; McGregor-Lowndes, M., Turnour, M. D., & Turnour, E. 2011. "Not for profit income tax exemption: Is there a hole in the bucket, dear Henry?" *Australian Tax Forum*, 26: 601–631; and also Pozen, David. 2006. "Remapping the charitable deduction." *Connecticut Law Review* 39: 531, pp. 548-551.

[33] *Armenian Patriarch of Jerusalem v Sonsino* [2002] EWHC 1304 (Ch.) and see Dal Pont, Gino E. 2010. *Law of charity*, Sydney: LexisNexis Butterworths, pp. 75–78; Garton, Jonathan. 2013. *Public benefit in charity law*, Oxford: Oxford University Press, pp. 60–73.

[34] *Camille and Henry Dreyfus Foundation Inc v Inland Revenue Commissioners* [1954] Ch 672 at 684; *Re Lowin (deceased)* [1976] 2 NSWLR 140.

[35] *Re Stone (deceased)* (1970) 91 WN (NSW) 704.

[36] *Re Stone (deceased)* (1970) 91 WN (NSW) 704; *Habershon v Vardon* (1851) 64 ER 916.

[37] *Functioning of the European Union* (TFEU) article 115, Oct.26, 2012, 2012 O.J. (C326).

Union.[38] Outgoing philanthropy was classified by the judiciary as movement of capital, and any restrictive or discriminatory regulations of such movement would only be permitted if justified. To be justified the restriction on free movement must be proportionate to a permissible goal such as reasons of public policy, public security, public health or fiscal cohesion of a community member's tax system. It appears that domestic fiscal formalities such as tax substantiation will be permissible within bounds.[39] None of the arguments put to the court in support of their restrictions have been found permissible, although, as discussed shortly, others have arisen which are yet to be tested.

Koele sums up the arguments of German, Spanish, Irish and U.K. governments in one of the early outgoing philanthropy cases as:

> [G]overnments pointed out that gifts to domestic bodies and gifts in favour of bodies established in other Member States are not comparable in the sense that the Member States concerned (1) may apply different concepts of benevolence, as well as different requirements for a recognition of acts of benevolence; and (2) they are not in a position to monitor compliance with the requirements they impose other than in relation to national bodies. The German, Spanish and French governments added that if a Member State abstains from levying certain taxes by exempting gifts made for the benefit of charitable responsibilities that it would otherwise have to fulfil itself using tax revenues.[40]

The ECJ clearly rejects the subsidy theory saying:

> Whilst it is lawful for a Member State to restrict the grant of tax advantages to bodies pursuing certain of its charitable purposes, a Member State cannot however restrict the benefit of such advantages only to bodies established in that State whose activities are thus capable of absolving it of some of its responsibilities.[41]

[38] Case C-386/04, *Centro di Musicologia Walter Stauffer v, Finanzamt Munchen fur Korperschaffen*, 2006 E.C.R. I-8203para 15; Case C-10/10, *Commission v Austria*, 2011 E.C.R. 1-05389.
[39] ECJ, 27 January 2009, Case C-318/07, *Hein Persche v Finanzamt Ludenscheid (Persche)*, para 70.
[40] Koele, Ineke A. 2010. "How will international philanthropy be freed from landlocked tax barriers?" *European Taxation*, (September): 409–418, p. 411.
[41] ECJ, 27 January 2009, Case C-318/07, *Hein Persche v Finanzamt Ludenscheid (Persche)*, para 44.

And Koele concludes in a summary of the recent decisions that:

> No conceptual arguments were found to support or explain the existence of landlocked tax provisions: the landlocking is not based on conceptual differences regarding the notion of and the functioning of philanthropic organisations.[42]

The series of judicial decisions left three courses of action for members of the EU: to exempt all nonprofit organisations from European Free Trade Association (EFTA);[43] to exempt all, but with conditions proportionate to permissible public policy goals; or deny taxation concessions to their domestic nonprofit organisations. There is a spectrum of responses. At one end, Hungary no longer provides any tax incentives for charitable giving. At the other end are Ireland, the Netherlands and Sweden which allow deductions for donations to organisations in selected countries beyond the EEA.[44] At other points on the continuum are France, with conditions including that donations be for activities that "benefit France;" and Germany, where donations must be "suitable for upholding Germany's international reputation."[45] The U.K. amended its provisions for charities eligible for donation deductibility status backdated to the Persche ECJ decision,[46] requiring preliminary registration of all foreign charities. Under schedule 6 of the *Finance Act* an organisation must:

- be established for exclusively charitable purposes (as defined in English law);
- meet the jurisdiction condition, i.e. be subject to the control of a U.K. court in the exercise of its jurisdiction with respect to charities, or the equivalent under the law of a relevant EEA jurisdiction;
- meet the registration condition by complying with any requirement to be registered as a charity in the relevant EEA jurisdiction; and

[42] Koele, Ineke A. 2010. "How will international philanthropy be freed from landlocked tax barriers?" *European Taxation*, (September): 409–418, p. 415.
[43] Case C-10/10, *Commission v Austria*, 2011 E.C.R. 1-05389, para.44, found that treaties extended it to all EFTA members, so including Iceland, Lichtenstein, Norway and Switzerland.
[44] Faulhaber, Lilian V. 2014. "Charitable giving, tax expenditures, and direct spending in the United States and the European Union," *Yale Journal of International Law*, 39: 87–129, pp. 106–107.
[45] Ibid, pp. 105–106.
[46] ECJ, 27 January 2009, Case C-318/07, *Hein Persche v Finanzamt Ludenscheid (Persche)*.

- satisfy the management condition, which requires that its managers are fit and proper persons.[47]

The last condition is a new concept for the U.K. and allows HM Revenue and Customs (HMRC) to determine charity status on the propriety or otherwise of one or more individuals associated with that organisation, to protect the fisc from potential tax abusive behaviour.

Outbound cross-border philanthropy has attracted the most attention by the fisc as it seeks to constrict the benefits of the taxation concession, which donations attract, to the geographical jurisdiction; or failing that to have regulatory control over the organisation applying the donations beyond the borders. The situation which is still evolving in the EU after a series of judicial decisions shows a way forward for others, and appears not to have led to a massive leakage in countries' taxation revenue or uncontrollable taxation abuse.

INBOUND

3. Inbound charity

Description: An organisation established in and with taxation concessions from another fisc fulfils its purpose (in whole or part) within the fisc by doing activities geographically within that fisc.
Restriction rationale: (a) There is no public benefit in subsidising activities of the organisation that may not be wholly within the fisc, and (b) the organisation is not subject to the control of the fisc or others within the jurisdiction.

4. Inbound philanthropy

Description: A donor with taxation concessions from another fisc fulfils its purpose within the fisc by making grants to others geographically within that fisc.

[47] HM Revenue & Customs, "Detailed guidance on the fit and proper persons test." *Charities: Detailed Guidance Notes*. Accessed 7 October 2014. http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/fp-persons-test.htm.

Restriction rationale: (a) There is no public benefit in subsidising activities of the organisation that may not be wholly within the fisc, and (b) the organisation is not subject to the control of the fisc or others within the jurisdiction.

In relation to inbound charity and inbound philanthropy, it is possible to accept the regulation of other jurisdictions if it meets the approval of the inbound jurisdiction and provides sufficient benefit outside the narrow fiscal definition of public benefit as discussed above. For example in the Netherlands the rationale is expressed as:

> It is not required that a deductible gift indirectly serve a Dutch purpose, as under current law, gifts to domestic philanthropic organisations may be used by the latter for entirely foreign causes.[48]

Inbound charity and philanthropy fiscal objections are relatively minor and make way for higher order issues such as interference in the culture or with the position of local power elites which may give rise to social and political instability. Fiscal tools such as import duties, restriction of inward cash movements and requirements to register for taxation combined with administratively burdensome conditions to do so, are often used to implement these policies.[49]

For many countries with stable social and political environments, incoming cross-border philanthropy is a fiscal advantage as it relieves the state of some responsibility for provision of public benefit services and infrastructure. For example, charitable funds can flow into Australia without restriction.[50] The Foundation Center database in the U.S. shows that for the three years to 2013, 111 U.S. foundations made 1,187 grants worth over US$362 million to Australian organisations for medical research infrastructure, medical research, education and relief of poverty projects.[51] However, foreign charitable organ-

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[48] Koele, Ineke A. 2007. *International taxation of philanthropy: Removing tax obstacles for international charities*. Amsterdam: IBFD, p. 233 quoting Memorie van Antwood, 21335, 1989-1990, TK no.5, V-N 1990/764.

[49] ICNL, and World Movement for Democracy. 2012. *Defending civil society report*, Washington; Moore, David., and Rutzen, Douglas. 2011. "Legal framework for global philanthropy: Barriers and opportunities." *International Not-for-Profit Law* 13: 1–2, 5–41.

[50] The funds cannot be for an illegal purpose; minor notice provisions are described in Appendix D.

[51] Foundation Center, *Map of cross border giving*. Accessed on 16 September 2014. http://crossborder.foundationcenter.org/.

isations undertaking charitable activities within Australia are required to register with corporate and taxation agencies, as would any foreign corporation, with no special barriers.[52] Australia is regularly assessed by the World Bank as being within the top dozen low regulation nations for business commencement and ease of doing business.[53] If foreign charitable organisations seek tax concessions for their donors for work outside the jurisdiction, or use Australian income for their purposes outside Australia, there may be difficulties if they do not fall readily into one of the exempt categories.

A range of possible structural reforms to achieve better cross-border charity have been suggested, for example:

- Reform of individual jurisdictions' laws in relation to such matters to mitigate the barriers to cross-border charity and philanthropy, much of which is concerned with developing new rationales for tax concessions generally for such activities;[54]
- Harmonisation of laws concerning public benefit and a minimal acceptable level of regulatory assurance over the activities of organisations;[55]
- Agreed cross-border activities of international benefit recognised by jurisdictions as worthy of taxation concessions;[56]

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[52] For a survey of charitable startup procedures refer: McGregor-Lowndes, M. 2014. "Are we there yet?" In *Not-for-profit law: Theoretical and comparative perspectives* edited by M. Harding, A. O'Connell & M. Stewart, 358–386. Cambridge: Cambridge University Press.
[53] The World Bank "Doing Business" project provides objective measures of business regulations for local firms in 189 economies and selected cities at the subnational level. Accessed 7 October 2014. http://www.doingbusiness.org/rankings.
[54] Dale, Harvey. 1994. "Foreign charities." *Tax Lawyer* 48: 655–704; See also Zolt, Eric. 2012. "Tax deductions for charitable contributions: Domestic activities, foreign activities, or none of the above." *Hastings Law Journal* 63: 361, p. 368; Pozen, David. 2006. "Remapping the charitable deduction." *Connecticut Law Review* 39: 531, p. 547; Bittker, Boris. 1972. "Charitable contributions: Tax deductions or matching grants?" *Tax Law Review* 28: 37; Kelman, Mark. 1979. "Personal deductions revisited: Why they fit poorly in an 'ideal' income tax and why they fit worse in a far from ideal world." *Stanford Law Review* 31: 831; Gergen, Mark. 1988. "The case for a charitable contributions deduction." *Virginia Law Review* 74: 1393.
[55] Bater, Paul. 2004. "Introduction: International tax Issues Relating to Non-Profit Organisations and their Supporters." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 22; Infanti, Anthony C. 2002. "Spontaneous tax coordination: On adopting a comparative approach to reforming the U.S. international tax regime." *Vanderbilt Journal of Transnational Law* 35: 1105–1233, p. 1125.
[56] Bater, Paul. 2004. "Introduction: International tax Issues Relating to Non-Profit Organisations and their Supporters." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and*

- Cross-border philanthropic entities such as The European Foundation;[57]
- Spontaneous Tax Coordination;[58]
- Bilateral tax treaties which might take the form of special nonprofit treaties, or provisions in existing treaties in relation to non-discrimination;[59]
- Inserting provisions into OECD or UN model multilateral tax treaties;
- Provision within existing unions such as the European Union;[60]
- Formation of common charitable zones.[61]

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their activities, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 16.

[57] Muehlmann, B. W. et al. 2013. "Cross-border charitable giving and its tax limitations," *Bulletin for International Taxation*, 67(11): p. 12; Max Plank Institute for Comparative and International Private Law and the Centre of Social Investment of the University of Heidelberg. 2009. *Feasibility study on a European Foundation statute – Final report*. Accessed 9 October 2014. http://ec.europa.eu/internal_market/company/docs/eufoundation/feasibilitystudy_en.pdf; European Parliament Resolution of 2 July 2013 on the proposal for a Council Regulation on the Statute for a European Foundation (FE), p7_TA (2013) 0293.

[58] Infanti, Anthony C. 2002. "Spontaneous tax coordination: On adopting a comparative approach to reforming the U.S. international tax regime." *Vanderbilt Journal of Transnational Law* 35: 1105–1233, pp. 1157ff.

[59] Koele, Ineke A. 2004. "Tax privileges of NGOs and their benefactors: A landlocked privilege?" In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 327; Bater, Paul. 2004. "Introduction: International tax Issues Relating to Non-Profit Organisations and their Supporters." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 17.

[60] Koele, Ineke A. 2004. "Tax privileges of NGOs and their benefactors: A landlocked privilege?" In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 329; Bater, Paul. 2004. "Introduction: International tax Issues Relating to Non-Profit Organisations and their Supporters." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 19.

[61] Bater, Paul. 2004. "Introduction: International tax Issues Relating to Non-Profit Organisations and their Supporters." In *The tax treatment of NGOs – Legal, fiscal and ethical standards for promoting NGOs and their activities*, edited by Paul Bater, Frits Hondius and Penina Kessler Lieber, New York: Kluwer Law International, p. 21; Wheeler, J. 1994. "The tax treatment of charitable organisations." *European Taxation* 34(1): 9.

There is a fifth type of transaction where a donor has income derived from more than one jurisdiction:

5. Multiple sources of income under the credit method of dealing with double taxation

Description: A donor has income from two or more jurisdictions where the credit method is used for dealing with double taxation and a donation is made in one jurisdiction. Under this method, if the donation is made to an organisation established in the first jurisdiction, the deduction will reduce the tax liability in that first jurisdiction, and in consequence will reduce the amount of the foreign tax credit against the tax liability in the second jurisdiction and thus increase the liability to tax in the second jurisdiction.

Restriction rationale: This issue arises as the gift deduction is not recognised as a deduction occurred in the earning of taxable income.

History of Cross-Border Charity in Australia

Income Tax Exemption

As discussed above, the English common law of charity has had relatively little difficulty in finding public benefit in charitable objects achieved outside the supervising jurisdiction.[62] Garton notes that Australian judicial authority seems to have gone further than that in England, not requiring any connection with home jurisdiction benefits[63] for example in finding public benefit in the relief of distress in Europe,[64] advancement of education in Germany,[65] healthcare in Greece,[66] settlement of Jews in Israel,[67] and a musical competition in Austria.[68]

Income tax was first imposed in Australia by state governments in the 1880s.[69]

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[62] See text accompanying footnotes 17 and 33 above.
[63] Garton, Jonathan. 2013. *Public benefit in charity law*. Oxford: Oxford University Press, p. 71.
[64] *Re Piper (deceased)* [1951] VLR 42.
[65] *Estate of Schultz* [1961] SASR 377.
[66] *Kytherian Association of Queensland v Sklavos* (1958) 101 CLR 56.
[67] *Re Stone (deceased)* (1970) 91 WN (NSW) 704.
[68] *Re Lowin (deceased)* [1976] 2 NSWR 140.
[69] Tasmania imposed a tax on income (dividends) with the *Real and Personal Estate Duty Act 1880* (Tas).

Charitable organisations were exempt from income tax in Australia in the first comprehensive state income tax legislation, introduced by South Australia in 1884,[70] and remain so under the current Commonwealth *Income Tax Assessment Act 1997* (ITAA 1997).[71] The initial exemption can be explained by Australia's English legal heritage – the English tax legislation served as a model. Before responsible government was conferred on the Australian colonies, government revenue was collected through indirect taxes such as tariffs, excises and land sales. South Australia's *Taxation Act 1884* was a desperate measure to raise revenue, given the reduced income from indirect taxes caused by a serious economic recession. Most states followed South Australia's example to overcome similar difficulties.[72] The first income tax acts contained exemptions for certain nonprofit organisations. For example, Queensland exempted religious, charitable, and educational institutions of a public character, trades unions, friendly societies, and other societies and institutions not carrying on business for purposes of profit or gain.[73] Similar provisions were common in the other states.[74] When the Commonwealth levied income tax, the exemptions were largely copied.[75] There was no specific mention of cross-border activities.

The High Court case of *The University of Birmingham v Federal Commissioner of Taxation*[76] established that the income tax exemption provisions were not limited to Australian organisations carrying on operations in Australia, but extended to organisations that carried on their operations outside Australia. In that case, the two taxpayers were corporate bodies established in Great Britain for charitable purposes and carried on no activities in Australia, but derived income from Australia. The Australian Taxation Office (ATO) argued that the benefit of the exemption was limited by the Act to such institutions

[70] The *Taxation Act 1884* (SA); the Commonwealth's income tax provisions closely followed the State's exemption provision in s. 23 of *Income Tax Assessment Act 1936* (Cth).
[71] The *Income Tax Assessment Act 1997* (ITAA 1997) was enacted as 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 instalments 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*.
[72] Queensland was able to delay the introduction of income tax until 1902.
[73] *Income Tax Act 1902* (Qld), s. 12.
[74] *Income Tax (Management) Act 1912* (NSW), s. 10; *Taxation Act 1927* (SA) s. 18; *Land and Income Tax Assessment Act 1907* (WA), s. 18.
[75] *Income Tax Assessment Act 1915* (Cth), s 18h (see discussion below).
[76] (1938) 60 CLR 572.

which are institutions "in Australia" or at least to such institutions which carry on some form of activity or operate in some way in Australia. The court found that "the natural reading of the provision is that it extends to all taxpayers, independently of their place of residence or activity, who fall under the description it contains."[77]

In 1987, the House of Representatives Standing Committee on Finance and Public Administration investigated 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, *Follow the Yellow Brick Road*, released in 1991.[78] 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 account or to the donor's international credit card.[79] 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.[80] 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.[81] However, in its final report, the Committee recommended legislative controls as:

> The introduction of this measure would signal to those who consider that such tax avoidance arrangements are still effective the clear intention of the Parliament to eradicate the potential for tax avoidance hidden within the guise of donations to overseas charities.[82]

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

[77] (1938) 60 CLR 572 at 578.
[78] See Commonwealth of Australia. House of Representatives Standing Committee on Finance and Public Administration. 1991. *Follow the yellow brick road: The final report on an efficiency audit of the Australian Taxation Office – International profit shifting*. Canberra, p. 51 [4.1].
[79] Ibid, p. 51.
[80] Ibid, p. 53.
[81] Id.
[82] Ibid, p. 54 [5.16], Recommendation 15, p. 55 [4.17].

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.[83]

The ATO in an answer to Senate Committee questioning some years later indicated that abuse occurred through 'channelling' which was explained as

> 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 unless they claim tax deductions for their gifts. The organisation arranges with the deductible gift recipient for the gifts to be made to it. The deductible gift recipient gives gift receipts to the donors. It then passes on the donations substantially to the organisation.[84]

On 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."[85] 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."[86] This culminated in a 1997 Bill introducing amendments to the "in Australia" provisions in the *Income Tax Assessment Act 1936* (ITAA 1936) for tax exempt organisations.[87] The Explanatory Memorandum gave no reason for the restrictions other than potential

[83] Treasurer's Press Release No. 1, 1 February 1996.
[84] Commonwealth of Australia. Senate Economics Legislation Committee. 1999. *Report on Taxation Laws Amendment Bill (No.8) 1999*, Appendix 3, ATO, Letter to Senator Brian Gibson dated 23 November 1999.
[85] Treasurer's Press Release No. 74, 20 August 1996.
[86] Ibid.
[87] Taxation Laws Amendment Bill (No. 4) 1997 (Cth).

tax avoidance by charitable trusts. It however extended to charities generally in relation to their income tax exemption but no reasons were given for the provisions.[88]

The result of the amendments was to remove the exemption for certain organisations located offshore and for those organisations not incurring their expenditure and pursuing their objectives principally *in Australia*.[89] Until this time there had been no geographic restrictions on the activities of income tax exempt entities.

Because the Bill provided that, for an organisation to remain income tax exempt it must have a "physical presence" in Australia or be "located" in Australia, the Explanatory Memorandum addressed the meaning of the phrase "in Australia."[90] It stated that because the terms "physical presence" and "located" were not defined in the legislation, their ordinary or everyday meaning should be used.[91] 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.[92]

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[88] Commonwealth of Australia. Parliamentary Library. 1997. Bills Digest No. 54 1997-98 Taxation Laws Amendment Bill (No. 4) 1997. Accessed 7 October 2014. http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/BD9798/98BD136.

[89] See *Taxation Laws Amendment Act (No 4) 1997* (Cth) amending s. 23(e) of the ITAA 1936 which stated: "The following incomes, revenues, and funds shall be exempt from income tax:…(d) the income of a religious, scientific, charitable, or public educational institution." The amendment added at the end of this provision: "which: (i) has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia; or (ii) is an institution to which a gift by a taxpayer is an allowable deduction because the institution is referred to in a table in subsection 78(4)[[64]]; or (iii) is a prescribed institution which is located outside Australia and is exempt from income tax in the country in which it is resident; or (iv) is a prescribed charitable or religious institution that has a physical presence in Australia but which incurs its expenditure and pursues it [sic] objects principally outside Australia."

[90] See Explanatory Memorandum, Taxation Laws Amendment Bill (No. 4) 1997 (Cth) [5.28]–[5.30].

[91] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 4) 1997 (Cth) [5.28].

[92] Explanatory Memorandum, Taxation Laws Amendment Bill (No. 4) 1997 (Cth) [5.29]–[5.30].

The broad definition of "physical presence" requires minimal Australian operations, in accordance with its ordinary meaning. The narrower definition of "located" still does not require that the central operations or control of the entity be in Australia, so long as the entity sets up a branch in Australia, again, in keeping with the everyday meaning of the term. These definitions clearly do not place any limitations on the geographical scope of the Australian entity's operations, activities or beneficiaries and thereby confirm that the meaning of "in Australia" is to be taken from its ordinary meaning – being physically located in Australia, nothing more.

The courts dealt with this legislation some time later culminating in the High Court case, *Commissioner of Taxation v Word Investments Ltd*,[93] (*Word Investments*) a landmark case which enshrined the destination of profits test for income tax exemption. The applicant (Word Investments), which operated a series of businesses as a fundraising arm, distributed funds to an Australian charity conducting missionary work overseas. A majority of the High Court[94] determined that Word Investments met the "in Australia" requirements for income tax exemption pursuant to section 50-50(a) of the ITAA 1997[95] as it had a physical presence in Australia, incurred its expenditure and pursued its objectives principally in Australia; the decisions to pay were made in Australia, the payments were made in Australia to Australian organisations and Word's objectives included providing financial assistance to those organisations.[96] In reaching its conclusion the majority examined the "in Australia" test in section 50-50(a) as it applied to Word's role as a charitable intermediary, finding:

> Section 50-50(a) does not impose a prohibition on distributing to other charitable institutions. Nor does it require the money, when ultimately expended by Wycliffe and the other institutions, to be expended in Australia. Section 50-50(a) could have imposed a requirement of that latter kind, but it did not. It only imposed a requirement that Word incur its expenditure and pursue its objectives principally in Australia – not that Wycliffe and the other institutions do so. No doubt the ul-

[93] (2008) 236 CLR 204.
[94] Gummow, Hayne, Heyson and Crennan JJ.
[95] The "in Australia" requirements for DGRs are stricter than those for income tax exemption under section 50-50(a) of the ITAA 1997, which require that an entity has a physical presence in Australia and to that extent, incurs its expenditure and pursues its objectives *principally* in Australia [emphasis added].
[96] (2008) 236 CLR 204 [73].

> timate benefit to charity which Word causes is effected by Wycliffe indirectly and to some extent outside Australia, not directly and in Australia: but s 50-50(a) draws no distinction between direct and indirect effects.[97]

As a result, the "in Australia" test in section 50-50(a) is confined to "the place where the relevant conduct occurs, not to that where the ultimate purpose of that conduct is given effect, or its objective realised, by a donee's actual use of the money it receives."[98]

In his dissenting opinion, Kirby J found this to be an "erroneous reading" of the "in Australia" requirement.[99] While His Honour agreed with the majority that Word had a physical presence in Australia, he believed that the majority took "a narrow view of what is involved in Word's incurring its expenditure and pursuing its objectives *within* Australia", noting that the majority's approach "sees no difficulty in the fact that the destination of the income that is subject to the tax exemption is (and always was intended to be) principally *outside* Australia."[100] Kirby J's conclusion, that he deemed "fatal to Word's case," was that in so far as Word pursued any charitable objectives, the fact that it did so principally *outside* Australia meant that it was not entitled to exemption.[101]

The academic discourse on the *Word Investments* decision has largely ignored cross-border issues, with commentators instead focused on the issue of whether tax exempt entities can and should engage in commercial activities for profit.[102] One commenta-

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[97] (2008) 236 CLR 204 [73].
[98] Dal Pont, G. E. 2010. *Law of charity*. Sydney: LexisNexis Butterworths, p. 145.
[99] *Word Investments* (2008) 236 CLR 204 [131].
[100] (2008) 236 CLR 204 [130].
[101] (2008) 236 CLR 204 [158].
[102] See Chia. J. and Stewart, M. 2012. "Doing business to do good: Should we tax the business profits of not-for-profits?" *Adelaide Law Review*, 33: 335 (analysing the case in the context of the underlying rationales for the government's proposal to tax the unrelated commercial activities of NFPs); Gousmett, M. 2009. "Charities and business activities." *New Zealand Law Journal* p. 57 (arguing that as a result of the case, the way is now open for charities in Australia to model themselves on Word's structure in order to establish tax-exempt businesses); McGregor-Lowndes, M., Turnour, M. and Turnour, E. 2011. "Not-for-profit income tax exemption: Is there a hole in the bucket, dear Henry?" *Australian Tax Forum* 26: 601 (exploring the underlying rationale for the income tax exemption and concluding that the scope of the exemption should continue to be broad and include commercial activities); Murray, I. 2008. "Charitable fundraising through commercial activities: The final word on a pyrrhic victory." *Journal of Australian Taxation*, 11: 138 (focusing on how the case sits with the authorities on charities conducting commercial fundraising activities and addressing the potential consequences of increased commercial activity by charities); Mortimer, D. 2010. "A word about charity." *Law Institute Journal* 84: 50 (arguing that the major contribution of the case to Australian charity law is to prevent the ATO forming an impression that an entity cannot be endorsed as a charitable

tor has connected these two issues, describing them as the "commercialisation" and "globalisation" of charity, in a chapter addressing "how Australian income tax law should treat commercial profits of charities *and* how it should establish the eligibility for tax concessions for charities operating abroad and for donations abroad."[103]

The policy position on income tax exemption for cross-border charity began on the basis of there being no special provisions in relation to cross-border activities. The late 1980s saw some political attention raised in the context of tax abuse through charitable funds. Almost a decade later the income tax law was amended to give effect to a blanket prohibition on income tax exemption for those organisations that did not have an Australian physical presence or incur over fifty per cent of their expenditure or carry out their objects in Australia. There were specific exceptions to this blanket prohibition for organisations which traditionally operated across borders, such as aid and development organisations. There is no record of any significant ATO policing in this area until it was highlighted as a collateral issue in the *Word Investments case*. Reform of income tax exemption provisions to reverse the *Word Investments* decision in relation to cross-border activities has been proposed, but is yet to become law. The reforms are discussed below, after an examination of cross-border gift deductibility.

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institution simply because its primary activity is intrinsically not charitable); Norbury, M. and Ritzinger, V. 2009. "All things charitable: High Court examines the way for-Word." *Taxation in Australia* 43: 502 (analysing the decision and concluding that it will provide commercial enterprises which are conducted as charities with certainty in the conduct of their activities); Richards, R. 2009. "A green light for charities." *IntheBlack*, 79: 66 (stating that the decision gives the green light to charities that want to become more commercially adventurous); Russell, C. 2009. "A word to the wise." *Keeping Good Companies* 61: 179 (asserting that the implications of the case are that charitable entities can engage in commercial activities for charitable purposes and retain their tax exempt status); Sadiq, K. and Richardson, C. 2010. "Tax concessions for charities: Competitive neutrality, the tax base and 'public goods' choice." *Australian Tax Forum*, 25: 297 (noting that the case illustrates how a charitable organisation with income from a commercial activity may still have access to the tax concessions because the entity is endorsed as an income tax exempt organisation). See also Dal Pont, G. E. 2010. *Law of charity*. Sydney: LexisNexis Butterworths pp. 578–582, which also emphasises the profit-making aspects of the decision.

[103] Stewart, M. 2014. "The boundaries of charities and tax." In, *Not-for-profit law: Theoretical and comparative perspectives* edited by M. Harding, A. O'Connell and M. Stewart, Cambridge: Cambridge University Press. In the section on the globalisation of charity, there is reference to the majority's finding on the "in Australia" issue, at pp. 397–398. Stewart also provides a summary of *Word Investments* in: Stewart, M. 2012. *Tax deductibility of cross-border giving: Australia gives no quarter* , Melbourne Legal Studies Research Paper No. 605, Melbourne: University of Melbourne, pp. 13–14.

Gift deductibility

Gift deductibility first appeared in Australian legislation after federation in two Victorian statutes, the *Income Tax Act 1907* (Vic) and the *Administration and Probate Duties Act 1907* (Vic), which provided for deductions for gifts to certain institutions situated within Victoria.[104] The restriction was a last minute amendment to the Bill by the Premier and was not discussed in the debate.[105] To this day philanthropic trusts established under this regime are prohibited from making grants to organisations outside the borders of Victoria.

The financial requirements of Australia's participation in World War I necessitated the enactment of the first Commonwealth legislation introducing personal income tax,[106] the *Income Tax Assessment Act 1915* (ITAA 1915).[107] The ITAA 1915 contained the first federal gift deductibility provision in section 18(h), which provides tax deductibility for gifts over £20 to charitable institutions *in Australia*:[108]

> 18. In calculating the taxable income of a taxpayer the total income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it there shall be deducted—(h) gifts exceeding Twenty pounds each **to public charitable**

[104] See *Income Tax Act 1907* (Vic) s 3 and *Administration and Probate Duties Act 1907* (Vic) s 3(2). Section 3 of the *Income Tax Act* states: "In estimating the income for any year of any taxpayer liable to tax there shall be deducted from the gross amount of such taxpayer's income any gift of any sum over Twenty pounds paid by him during such year to or for any free public library or any free public museum or any public institution for the promotion of science and art…or any public university or any public hospital or public benevolent asylum or public dispensary or any woman's refuge or ladies' benevolent society or miners' benevolent fund whether any such library or other institution is or is not in existence at the time of such gift. Provided that such public library or museum or other public institution is *situate within Victoria*" [emphasis added]. Section 3(2) of the *Administration and Probate Duties Act* added "public charitable bequests" and "public charitable settlements" to the list of institutions in s. 3 of the *Income Tax Act* exempted from administration and probate duties with the proviso that "such public library or museum or other public institution is *situate within Victoria*" [emphasis added]. For an interesting discussion of the parliamentary debates that led to this legislation, see Chia, J., and O'Connell, A. 2011. *Charitable treatment? A short history of the taxation of charities in Australia*. Research Paper, Melbourne: Melbourne Law School, pp. 9–11.
[105] Parliament of Victoria. Legislative Assembly. 1907. *Parliamentary debates (Hansard)* (19 September) Administration and Probate Duties Bill p. 1277; I am indebted to John Emerson for bringing this point to my attention.
[106] The power to levy taxes is a power concurrent with the States, pursuant to the *Australian Constitution* s. 51(ii).
[107] See Woellner et al. 2012. *Australian taxation law*. 22nd ed. Sydney: CCH, p. 8 [1-060].
[108] The original Bill did not include a tax deduction for gifts to charities, but did include tax deductions in respect of contributions to the war. See Chia, J., and O'Connell, A. 2011. *Charitable treatment? A short history of the taxation of charities in Australia*, Research Paper, Melbourne: Melbourne Law School, p. 15.

> **institutions** ***in Australia and*** contributions exceeding Five pounds in the aggregate in respect of each object of contribution made during the continuance of the present war **to any public fund established in any part of the King's Dominions or in any country in alliance with Great Britain for any purpose connected with the present war**: Provided that payments shall not be allowable as deductions under this paragraph unless verified to the satisfaction of the Commissioner.[109]

Section 18(h) appears to be based on the earlier Victorian provisions requiring that the charitable institution be "situate within Victoria,"[110] indicating a geographic restriction based on the physical location of the institution. As well as providing a deduction for gifts to charitable institutions *in Australia*, section 18(h) of the ITAA 1915 also provides a deduction for contributions over £5 to public funds *overseas*, specifically connected to the British effort in World War I. It is interesting to note that, while the original draft of section 18(h) in the Income Tax Assessment Bill 1915 restricted tax deductibility for contributions to public funds connected to the war effort to "any public fund established *in Australia,*"[111] the Attorney General amended it to replace Australia with the King's Dominions and Great Britain's allies in the war.[112] The provision as conceived by the Attorney General did not include the domestic gift deduction for gifts over £20; it *only* provided a deduction for international contributions. The Senate amended the Bill and returned it to the House with both the domestic gift deduction and the international contributions, and both were included in the Act.[113] Clearly, from its inception, there have been differences of opinion as to the geographic parameters of gift deductibility in Australia.

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109 ITAA 1915 s 18(h) [emphasis added].

110 Chia, J., and O'Connell, A. 2011. *Charitable treatment? A short history of the taxation of charities in Australia'* Research Paper, Melbourne: Melbourne Law School, p. 15. Note that £20 threshold for tax deductibility of donations was the same as that set by the Victorian legislation' the ITAA 1915 was likely only the second Australian income tax legislation to include this provision.

111 Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, 1 September 1915, p. 2 [emphasis added].

112 Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, 1 September 1915, p. 2 (William Hughes, Attorney-General).

113 Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, Income Tax Amendment Bill Procedural Text, 9 September 1915, p. 1. For a full discussion of the political manoeuvring that resulted in the gift deduction provision being included in the ITAA 1915, see Chia, J., &O'Connell, A. 2011. *Charitable treatment? A short history of the taxation of charities in Australia*. Research Paper, Melbourne: Melbourne Law School, pp. 15-16.

The *Income Tax Assessment Act 1922* (ITAA 1922) altered the gift deduction provision, section 23(h), and reduced the gift threshold to £5.[114] Also, given that Word War I had ended, there was no longer a need to reference donations to public funds overseas for purposes connected with the war.[115] Instead, the ITAA 1922 specifically included contributions to the Department of Repatriation[116] and continued to restrict tax deductibility to gifts to public charitable institutions "in Australia."[117]

A second Royal Commission on Taxation was established in 1932 and in relation to deductible gifts was primarily concerned with the parameters of the concession, including whether it should be restricted to charitable institutions carrying on their functions within the jurisdiction of the taxing authority. In its final report in 1934, the Commission recommended "that a deduction be allowed for gifts of one pound and upwards made during the year of income to charitable institutions which *carry on their functions within the jurisdiction of the taxing authority*."[118] In this event, "the Commonwealth would allow deductions to a charitable institution *in Australia*, and each State would allow donations to similar institutions within the State."[119] This language is consistent with the legislative history that "in Australia" is referring to the location of a charitable institution.

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[114] This provision stated: 23. (1) In calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer from all sources *in Australia* shall be taken as a basis, and from it there shall be deducted—(h) (i) contributions made to the Department of Repatriation or to any public authority for the purpose of being handed over to the Department of Repatriation: Provided that the value of the contribution if in kind shall be verified to the satisfaction of the Commissioner; and (ii) gifts exceeding Five pounds each made, during the year in which the income was derived, to public charitable institutions *in Australia*, if the gifts are verified to the satisfaction of the Commissioner [emphasis added].

[115] See Explanatory Memorandum, Income Tax Bill 1922 (Cth) p. 26.

[116] Known after 1976 as the Department of Veterans' Affairs. The most recent iteration of this defence provision is contained in ITAA 1997 s. 30-50, item 5.1.2.

[117] It is worth pointing out that para. 1.22 of the Explanatory Memorandum to the "In Australia" Bill 2012 states: "The Explanatory Memorandum to the Bill that became the *Income Tax Assessment Act 1922* notes that **the amendment** was for the purpose of limiting deductions to those actually incurred in Australia which is interpreted as meaning 'decided upon in Australia by the controlling authority, although the actual expenditure might be made outside Australia' and also included expenditure actually made in Australia." However, this appears to have been taken out of context, as the *ITAA 1922* Explanatory Memorandum is actually referring to **the amendment** of a different subsection, Subsection 23(a) concerning deductions for "all losses and outgoings…including commission, discount, travelling expenses, interest and expenses actually incurred in gaining or producing the assessable income."

[118] Commonwealth of Australia. Royal Commission on Taxation, *Third Report* (1934) para. 618 [emphasis added].

[119] Ibid, para. 617 [emphasis added].

This issue was raised at the Conference of Commonwealth and State Commissioners of Taxation to discuss recommendations of the Royal Commission.[120] During the discussion, the question was raised whether the words "in the state" in the New South Wales (NSW) gift deductibility provision was intended to cover contributions to "funds *raised* in other countries," such as the case of an earthquake in Japan, or whether the fund must be a state fund.[121] The Commonwealth Commissioner for Taxation responded that the federal law only covered charitable institutions "in Australia."[122] This 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. This is again consistent with the existing view that it is the location of the institution receiving the funds which is important, not the final beneficiary of those funds.

The ITAA 1936 enacted section 78 which contained a list of the types of organisations (not necessarily charities) that would be entitled to tax deductible donations and specific deductible gift recipients, many of which remain on the list today.[123] The Explanatory Memorandum said little about the "in Australia" provisions.[124] Section 78 grew considera-

[120] A conference of Commonwealth and State commissioners was held to discuss the Commission's recommendations during which there was a discussion on whether deductions to a public fund should include contributions to funds raised in other countries. See Conference of Commonwealth and State Commissioners of Taxation to Discuss the Recommendations of the Royal Commission on Taxation held in Melbourne on 8th August 1935, *Proceedings and Decisions of Conference*.
[121] Conference of Commonwealth and State Commissioners of Taxation to Discuss the Recommendations of the Royal Commission on Taxation held in Melbourne on 8thAugust 1935, *Proceedings and Decisions of Conference*, p. 140 [emphasis added].
[122] Ibid, p. 141.
[123] The relevant provision reads: 78. (1) 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.
[124] The only mention of the phrase "in Australia" in the Explanatory Memorandum to the ITAA 1936 was to note its inclusion in subsection 78(1)(iii) for deductions for the relief of persons *in Australia* who are in necessitous circumstances "to make the intention of the law clear"; see Explanatory Memorandum, Bill to Consolidate and Amend the Income Tax Assessment Act 1922-1934 (Cth) p. 81.

bly over the years, reflecting both the growth of the charity sector and the perception of its importance.[125] In the ITAA 1997 the long lists of deductible purposes and organisations were categorised into subject areas placed into Division 30.[126] Unlike other comparable jurisdictions, not all charities or even a coherent sub-set of charities received deductible gift recipient status.

Under Division 30, the gift deductibility provisions are extensive and detailed. Australian residents can deduct from their taxable income the value of donations of $2 or more made to a fund or organisation that is endorsed by the ATO as a Deductible Gift Recipient (DGR) or listed by name in the ITAA 1997 as a DGR. To be eligible for DGR endorsement by the ATO, an organisation must satisfy a number of conditions,[127] one of the most critical being that the organisation must be *in Australia*.[128] The "in Australia" requirements for DGR status are interpreted strictly by the ATO. In its public ruling on Public Benevolent Institutions (a class of DGR) the ATO sets out the "in Australia" special conditions:

> 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 exam-

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[125] See Chia, J., and O'Connell, A. 2011. *Charitable treatment? A short history of the taxation of charities in Australia'* Research Paper, Melbourne: Melbourne Law School, pp. 23-24, noting that growth in the Australian arts and scientific communities were particularly significant during this period, as reflected in the legislation. In the arts, the Australian Elizabethan Theatre Trust, National Trust of Australia, the Sydney Opera House Appeal Fund, the Sidney Myer Music Bowl, and the Art Gallery Society of NSW were specifically listed in the legislation in the 1950s. In the sciences, research into disease received recognition in 1924, and in 1946 special provision was made for scientific research, broadly defined. In addition, organisations such as the Australian Academy of Science and the Australian and New Zealand Association for the Advancement of Science, as well as various medical colleges and scientific foundations were specifically listed in the 1950s and 1960s.
[126] Other than s 78A of the ITAA 1936. Division 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.
[127] See ITAA, Subdiv. 30-BA.
[128] The "in Australia" requirements for DGR endorsement are set out in s. 30-15 of the ITAA 1997 under 'Special Conditions', which include that "the fund, authority or institution must be in Australia".

> ple, 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.[129]

The practical consequences of the "in Australia" requirements are that donations by Australian taxpayers made *directly* 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,"[130] fall within the Hunger Projects facts[131] or the organisation obtained its DGR status pursuant to one of the exceptions to the in Australia requirement. There are five such exceptions dispersed throughout Division 30 of the ITAA 1997, which provide scope for DGRs that are established and administered in Australia to pursue their purposes and have their beneficiaries overseas.[132] The exceptions are:

- overseas aid funds;
- developed country disaster relief funds;
- scholarship funds;
- public funds on the Register of Environmental Organisations; and
- DGRs specifically listed by name in the ITAA 1997 under the category of International Affairs.[133]

[129] Australian Taxation Office. 2003. *Income Tax and Fringe Benefits Tax: Public Benevolent Institutions*, TR 2003/5, paras 129–131, p. 31. Note that the recent case *of Commissioner of Taxation v Hunger Project Australia* [2014] FCAFC 69, 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.
[130] Ibid, para. 130, p. 31 ("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.").
[131] *Commissioner of Taxation v Hunger Project Australia* [2014] FCAFC 69. See footnote 140 below, and accompanying text.
[132] Australian Taxation Office. 1995. *Income tax: Overseas aid gift deduction scheme*, TR 95/2, p. 1 para. 1.
[133] Overseas aid funds s. 30.85; developed country disaster relief funds s. 30.86; scholarships s. 30.37; environmental organisations s. 30.55; and DGRs listed in the tax law under International Affairs s. 30.80. The In Australia Bill 2012 proposed listing the exceptions to the "in Australia" requirements in one provision, s. 30-18(3) of the ITAA 1997. The In Australia Bill 2012, cl. 23, had proposed a new exception of "prescribed medical institutions" to appear under s. 30-18 of the *Income Tax (Transitional Provisions) Act 1997*.

Overseas Aid Funds

Organisations undertaking relief and/or development work outside Australia can apply to establish an overseas aid fund under the Overseas Aid Gift Deduction Scheme (OAGDS) administered by the Australian Agency for International Development (AusAID). If the application is successful, the organisation can then apply to the ATO to be endorsed as a DGR under the general category of developing country relief fund.[134] Overseas aid funds and developing country relief funds are provided for in Subdivision 30-B of the ITAA 1997 under the category of international affairs.[135] They were first introduced in the ITAA 1936 through the Income Tax Law Amendment Bill 1981 (Cth). The government has stated that this exception to the "in Australia" requirements is "in recognition that although some organisations are not operating in Australia, it is considered that they nonetheless further Australia's overseas aid objectives and therefore contribute to Australia's broad public benefit."[136] There are four requirements that must be met to be an overseas aid fund. It must be:

(1) a public fund;
(2) a charity registered with the ACNC or operated by such a charity;
(3) established by an organisation declared by the Minister for Foreign Affairs to be an "approved organisation"; and
(4) established and maintained solely for the relief of people in a country declared by the Minister for Foreign Affairs to be a developing country.[137]

The requirement to be an approved organisation is difficult to meet, in terms of both substance and process. The applicant entity must complete a submission to AusAID containing evidence that it satisfies seven eligibility criteria for approved organisations, that the organisation is:

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[134] See Australian Taxation Office. 1995. *Income tax: Overseas aid gift deduction scheme*, TR 95/2, pp. 2–3, paras 4–6.
[135] See ITAA 1997 s. 30.80(1), item 9.1.1, and s. 30.85.
[136] Explanatory Memorandum, In Australia Bill 2012, para. 1.133. See also Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, 23 August 2012, p. 9728 (Lindsay Bradbury, Assistant Treasurer).
[137] ITAA 1997 s. 30-85(2).

(a) a legal entity;

(b) voluntary, not-for-profit and non-government;

(c) a community-based organisation accountable to its membership;

(d) clearly identifiable as Australian;[138]

(e) engages in activities focused on development and/or relief[139] covering at least one and preferably two years;

(f) supports overseas activities on a partnership basis with indigenous organisations;[140] and

(g) and its overseas partners both are *effective* in conducting their activities.[141]

The Government has noted that these eligibility criteria are needed "because of the difficulties associated with monitoring activities undertaken outside of Australia."[142] The overseas aid fund requirement in (4) above (regarding relief of people in a country declared to be a developing country) has two parts. The first, as set forth in a tax ruling by the Commissioner, is that the fund "be governed by a constitution or set of rules from which it is clear that its *exclusive purpose* is to provide relief to persons in certified developing countries."[143] This appears to be a different requirement from AusAID's condition that "the organisation's mission statement or purpose and its project objectives should re-

[138] An organisation needs to show how recipient communities know that the assistance they are receiving comes from Australian sources, including how the organisation promotes its Australian identity to donors/supporters, partners and beneficiaries; and if the organisation belongs to an international network, how it distinguishes its work and funding from that of the international network. See AusAID. 2009. *Overseas Aid Gift Deduction Scheme: Guidelines for Obtaining Gift Deductibility*, pp. 7, 10.

[139] Ibid, pp. 10–11. AusAID makes clear in their guidelines that, for the purposes of tax deductibility, relief and development do *not* include welfare, evangelism, missionary or political activities. If the organisation engages in these activities they must be distinguished from relief and development activities and managed separately.

[140] Ibid, p. 12. This requires that the organisation be more than just a fundraising arm of its overseas partners. However, the opposite conclusion was reached in the Federal Court case of *The Hunger Project Australia v Commissioner of Taxation* [2013] FCA 693, in which the applicant operated a fund endorsed as a DGR under the OAGDS and the Court found that, despite being predominantly engaged in fundraising, the applicant's principal object of relieving hunger was achieved through its close relationships with its overseas partners.

[141] Emphasis added. What constitutes "effective" by AusAID is primarily the monitoring and evaluation of overseas activities and partners.

[142] See Explanatory Memorandum, In Australia Bill 2012, para 1.135.

[143] Australian Taxation Office. 1995. *Income tax: Overseas aid gift deduction scheme*, TR 95/2, para. 6(a).

flect a focus on *development and/or relief*."[144] The OAGDS Guidelines provide distinct definitions for development and relief. *Development* is defined as:

> a process where a community of people work together to break the cycle of poverty and dependence so that their fundamental needs are met and the quality of their lives is enhanced. Development activities seek to address the root causes of the need identified and in doing so, make a contribution to reducing that need in the long term.[145]

By contrast, *relief* refers to:

> the provision of basic support to people in emergency situations…direct assistance (such as distribution of clothing, food, seeds and tools, temporary housing) may be provided as part of a short term relief response.[146]

Given the very different emphasis of development and relief work, it is unclear how an organisation that becomes an approved organisation through its development work would then qualify under requirement (4) as being "established and maintained *solely* for the *relief* of people…"

The second part of requirement (4) is the Minister's determination that the recipient country is a certified developing country.[147] These appear on a list of developing countries,[148] based on the OECD Development Assistance Committee's (DAC) list of countries and territories eligible to receive Official Development Assistance (ODA).[149] If a country is removed from the list by the Minister, overseas aid organisations can no longer apply overseas aid funds to that country.

The process of becoming an overseas aid fund is lengthy and involves two distinct steps. The first is applying for approved organisation status through AusAID, a government agency. Once AusAID has determined that the applicant has met all seven criteria, it

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[144] AusAID. 2009. *Overseas aid gift deduction scheme: Guidelines for obtaining gift deductibilit*y, p. 9 [emphasis added].
[145] Ibid, p. 9.
[146] Ibid, p. 10.
[147] Ibid, pp. 2, 18.
[148] Department of Foreign Affairs and Trade. 2012. *List of developing countries as declared by the Minister for Foreign Affairs,* Accessed 8 October 2014. http://www.ausaid.gov.au/Publications/Pages/3845_1029_3475_999_2902.aspx.
[149] AusAID. 2009. *Overseas aid gift deduction scheme: Guidelines for obtaining gift deductibilit*y, pp. 2, 18.

recommends to the Minister for Foreign Affairs that the organisation be declared an approved organisation. The Minister then advises the Treasurer of the approval. Following approval, the second step begins. The ATO assesses the application for DGR endorsement, and if it determines that there is a public fund in place established exclusively for the relief of persons in certified developing countries, the ATO will seek approval for the fund from the Assistant Treasurer. Once approved, the Assistant Treasurer publishes a notice in the Commonwealth Government Gazette declaring the overseas aid fund approved.[150] In an efficiency audit of the process, the Auditor General determined that it can take 18 months or more to complete,[151] although AusAID estimates the timeframe as 9 to 12 months.[152] The Auditor General found that the timeliness is affected by requiring approvals through two Ministers, and that as a result of this protracted process, some lawyers are advising their clients not to pursue endorsement under this category.[153] This appears to be reflected in the numbers. As of 31 October 2012, there were 218 overseas aid funds, representing just 0.75 per cent of all active DGRs.[154]

Developed Country Relief Funds

Developed country relief funds are also provided for in Subdivision 30-B of the ITAA 1997 under the category of International Affairs,[155] but have different requirements from developing country relief funds. They were first introduced in the ITAA 1997 through the Tax Laws Amendment (2006 Measures No. 3) Bill 2006 (Cth), which gave effect to the government's announcement in the 2005–06 budget that it would "increase philanthropy

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[150] Ibid, p. 1.
[151] See Australian National Audit Office. 2011. *Administration of deductible gift recipients (non-profit sector)*. Audit Report No 52, p. 108.
[152] See AusAID. 2009. *Overseas aid gift deduction scheme: Guidelines for obtaining gift deductibilit*y, pp. 17-18. AusAID also notes that "there may be an interval of several months between [the Minister for Foreign Affairs and the Treasurer's] decisions". This may explain the difference between the Auditor General's estimate and AusAID's estimate.
[153] See Australian National Audit Office. 2011. *Administration of deductible gift recipients (non-profit sector)* (Audit Report No 52) p. 108.
[154] Australian Taxation Office. 2013. *Taxation statistics 2010-11: A summary of tax returns for the 2010–11 income year and other reported tax information for the 2011–12 financial year*. NAT 1001-04.2013, p. 100.
[155] See ITAA 1997 s. 30.80 (1), Item 9.1.2, and s. 30.86.

by establishing five new categories of organisations that can receive tax deductible gifts."[156] Disaster relief was one of these new DGR categories.[157] The fund must be:

(1) a public fund;
(2) set up and controlled by a registered Public Benevolent Institution (PBI); and
(3) established and maintained solely for providing money for relief for people who are in distress as a result of a disaster in a country outside Australia that has *not* been declared by the Minister of Foreign Affairs as a Developing Country.[158]

The disaster must be recognised by a Treasury Minister as a disaster. The Minister may declare the disaster if satisfied that it developed rapidly and resulted in the death, serious injury or other physical suffering of a large number of people, or in widespread damage to property or the natural environment.[159] The DGR entitlement is limited to two years from the date specified in a Treasury Minister's declaration as the date of the disaster.[160] The ATO maintains a list of disasters that have been recognised by the Treasury since this provision was enacted in 2006.[161] The list is reproduced at Appendix B. At the time of writing, there were ten disasters on this list.

If a disaster affects both developed and developing countries, donations to the developed countries are made through a developed country relief fund, while donations to the developing countries are made to a developing country relief fund under the OADGS.[162]

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[156] Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, 25 May 2006 (Peter Dutton, Minister for Revenue and Assistant Treasurer) p. 16.
[157] The other categories covered war memorials, animal welfare, charitable services and educational scholarships. See Revised Explanatory Memorandum, Tax Laws Amendment (2006 Measures No. 3) Bill 2006 (Cth), p. 77, para. 11.4.
[158] See ITAA 1997 s 30.80, item 9.1.2 [emphasis added]. See also *ATO factsheet: Developed country disaster relief funds*. Accessed 8 October 2014. http://www.ato.gov.au/Non-profit/Guides/In-detail/Fact-sheets/Gifts---fundraising/Developed-country-disaster-relief-funds/.
[159] See Revised Explanatory Memorandum, Tax Laws Amendment (2006 Measures No. 3) Bill 2006, para 11.20, p. 81.
[160] ITAA 1997, s. 30.86(4).
[161] See: http://www.ato.gov.au/Non-profit/Gifts-and-fundraising/In-detail/Deductible-gift-recipient/DGR-categories/List-of-disasters/?anchor=P161-5612#P161-5612.
[162] See Bradbury, D. 2012. Declaration of a Disaster for the Purposes of Tax Deductibility – Hurricane Sandy. Press Release, No. 136. (5 November). Accessed 9 October 2014. http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/136.htm&pageID=003&min=djba&Year=&DocType=.

For example, following Hurricane Sandy which affected the United States, as well as a number of developing countries in the Caribbean including Cuba, Haiti, Jamaica, the Bahamas and the Dominican Republic, the Assistant Treasurer declared that donations to developed country relief funds, for the disaster in the United States, were tax deductible for two years, beginning on 29 October 2012.[163] Donations to the affected developing countries in the Caribbean were made through funds under the OADGS, with no time limits attached. The Bahamas, which is not on the list of developing countries was not mentioned in the Assistant Treasurer's press release, which would indicate that donations from Australians to the Bahamas would not be covered by the developed country relief fund and therefore would not be tax deductible. This omission highlights the difficulties that can arise with the narrow categories of exceptions to the "in Australia" requirements.

Public Funds on the Register of Environmental Organisations

The Register of Environmental Organisations (REO) was established in 1992 to enable deductions for gifts made directly to an environmental organisation admitted to the REO, in an effort to broaden the number of environmental organisations with DGR status and to prevent environmental organisations listed in the tax law acting as mere conduits for donations intended for other environmental organisations.[164] The REO is provided for in item 6.1.1 of the table in subsection 30-55(1) of the ITAA 1997 and is administered by the Department of the Environment[165] in consultation with the ATO.[166] While the ITAA 1997 does not specify that these environmental organisations are exceptions to the "in Australia" requirements,[167] *the Commissioner has taken the position that environmental organisations registered un*der item 6.1.1 do not need to have their causes or beneficiaries located in Australia.[168] The only requirement is that "the actual public fund must be in

[163] Ibid.
[164] See Explanatory Memorandum, Taxation Laws Amendment Bill (No. 5) 1992, pp. 43-44. At the time, there were five environmental organisations with DGR status listed in the ITAA 1936. These organisations served as conduits through which other environmental organisations accessed tax deductible donations.
[165] Formerly known as the Department of Sustainability, Environment, Water, Population and Communities.
[166] See Commonwealth Government. 2008. *Register of Environmental Organisations: A Commonwealth Tax Deductibility Scheme for Environmental Organisations – Guidelines*, p. 3.
[167] The Explanatory Memorandum to the Bill introducing the provisions for the REO in the ITAA 1936 was also silent on this issue. See Explanatory Memorandum, Taxation Laws Amendment Bill (No. 5) 1992.
[168] See Australian Taxation Office. 1995. *Income Tax: Public Funds*, TR 95/27, para. 14(c).

Australia."[169] This position is reflected in the REO Guidelines, which state that to be eligible for entry in the Register, "organisations and their public funds have to be physically located in Australia."[170] For an organisation to be entered on the REO, it must be a public fund and satisfy six requirements in Subdivision 30-E of the ITAA 1997:

(1) it must be a body corporate, a cooperative society, a trust, or an unincorporated body established for a public purpose by the Commonwealth, a state or a territory;[171]
(2) its principal purpose must be protecting and enhancing the natural environment or a significant aspect of it, providing information or education, or carrying out research about the natural environment or a significant aspect of it;[172]
(3) it must maintain a public fund to receive gifts for its principal purpose and comply with any Ministerial rules to ensure that gifts made to the fund are used only for its principal purpose;[173]
(4) it must not give any of its property, profits or financial surplus to its members, beneficiaries, controllers or owners;[174]
(5) it must have a policy of not acting as a mere conduit for the donation of money or property;[175] and
(6) it must provide statistical information about donations and gifts to the Environment Secretary each financial year.[176]

In addition to these legislative requirements for inclusion on the REO, there is a lengthy two-step admission process, similar to that for overseas aid funds. The first step is

[169] Ibid, para. 14.
[170] See Commonwealth Government. 2008. *Register of environmental organisations: A Commonwealth tax deductibility scheme for environmental organisations – guidelines*, p. 7, para. 1.5.
[171] See ITAA 1997 s. 30.260.
[172] See ITAA 1997 s. 30.265(1).
[173] See ITAA 1997 s. 30.265 (2), (4).
[174] See ITAA 1997 s. 30-270(1).
[175] See ITAA 1997 s. 30-270(2).
[176] See ITAA 1997 s. 30-270(4). The REO Guidelines provide that environmental organisations must include the following information in their annual statistical returns: (a) information on the expenditure of public fund monies and the management of public fund assets; (b) audited financial statements for the financial year; (c) information relating to any changes to the details of the organisation; and (d) any other information requested on the Statistical Return Form. See Commonwealth Government. 2008. *Register of Environmental Organisations: A Commonwealth Tax Deductibility Scheme for Environmental Organisations – Guidelines*, p. 11, para. 2.8.

applying to the Department of the Environment, which carries out an initial assessment of all applications for entry onto the REO to ensure that the organisations meet the legislative requirements in the ITAA 1997 and the administrative requirements in the REO Guidelines. Once the Department has determined that the applicant has met all these requirements, it refers the application to the Environment Minister, to approve and sign the instrument for entry onto the REO. It is then passed to the Treasurer to approve the Environment Minister's recommendation. The second step is then to have the ATO assess the application for DGR endorsement.[177] As noted under the overseas aid funds, the Auditor General has determined that this process can take more than 18 months, which may serve to discourage applications.[178] As of 31 October 2012, there were 573 funds on the REO,[179] representing 1.97 per cent of all active DGRs.[180] There is an annual statistical return required by environmental organisations but it does not include any financial information apart from donations received and total of grants distributed.[181] The Department does conduct random audits of organisations, but the results are not made public.

Scholarship Funds

Scholarship funds are provided for in Subdivision 30-B of the ITAA 1997,[182] having been introduced through the Tax Laws Amendment (2006 Measures No. 3) Bill 2006, as one of five new categories of organisations that can receive tax deductible gifts.[183] Pursuant to section 30-37 of the ITAA 1997, a scholarship fund must be established and operated for the sole purpose of providing money for eligible scholarships, bursaries or prizes. The scholarship, bursary or prize may only be awarded to people who are Australian citizens or

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[177] See Commonwealth of Australia. 2008. *Register of environmental organisations: A Commonwealth tax deductibility scheme for environmental organisations – guidelines*, p. 4.
[178] See Australian National Audit Office. 2011. *Administration of deductible gift recipients (non-profit sector)*. Audit Report No 52, pp. 108-109.
[179] See http://www.environment.gov.au/about/tax/reo/ for a complete list of organisations on the register.
[180] Australian Taxation Office. 2013. *Taxation statistics 2010-11: A summary of tax returns for the 2010–11 income year and other reported tax information for the 2011–12 financial year*. NAT 1001-04.2013, p. 100.
[181] The Return for 2014 is available at http://www.environment.gov.au/system/files/pages/53ca6702-48ad-414a-bf24-60e253d5ad0d/files/statistical-return-2013.pdf. Accessed 9 October 2014.
[182] See ITAA 1997 ss. 30-25, 30-37, item 2.1.13.
[183] Commonwealth of Australia. *Parliamentary Debates*, House of Representatives, 25 May 2006 (Peter Dutton, Minister for Revenue and Assistant Treasurer) p. 16. The other categories covered war memorials, disaster relief, animal welfare and charitable services. See Revised Explanatory Memorandum, Tax Laws Amendment (2006 Measures No. 3) Bill 2006 (Cth) p. 77, para. 11.4.

permanent residents of Australia within the meaning of the *Australian Citizenship Act 2007* (Cth),[184] and must:

(1) be open to individuals or groups of individuals throughout a region of at least 200,000 people in Australia, or throughout an entire state or territory;[185] and
(2) promote the recipients' education in:
  (a) an approved Australian course; and/or
  (b) educational institutions overseas, by way of study of a component of an approved Australian course.[186]

Given that these can only be awarded to Australian citizens or permanent residents for pre-approved courses, and that the overseas component of the scholarship is by way of study of a component of an approved course in Australia, any overseas study would likely be considered an activity that is merely incidental or minor, and not rising to the level of an exception to the "in Australia" requirements. As at 31 October 2012, there were 460 scholarship funds, representing 1.58 per cent of all active DGRs.[187]

DGRs Listed by Name under the 'International Affairs' Category

As a general rule, DGRs listed by name in the ITAA 1997 remain subject to the strict "in Australia" requirements. However, those that are listed as DGRs under the category of international affairs in section 30-80(2) are exempt from the conditions requiring that their purposes and beneficiaries be in Australia.[188] The international affairs category was first introduced into the ITAA 1936 in 1993, along with 11 other categories, as part of the tax simplification project, which sought, *inter alia,* to make the gift deductibility

[184] ITAA 1997 s. 30-37(a).
[185] ITAA 1997 s. 30-37(b).
[186] ITAA 1997 s. 30-37(c). For study overseas, the approved Australian course must give credit for the overseas study. See Sharma, V. et al. 2013. *Not-For-profit best practice manual*. Sydney: Thomson Reuters, para. 5.1.839.
[187] Australian Taxation Office. 2013. *Taxation statistics 2010-11: A summary of tax returns for the 2010–11 income year and other reported tax information for the 2011–12 financial year*. NAT 1001-04.2013, p. 100.
[188] See Australian Taxation Office. 1995. *Income tax: Public funds*. TR 95/27, para. 14(b). There is a similar provision in s. 50-50 (c) and (d) of the ITAA 1997 for ITEEs which are exempt from income tax despite conducting most of their work overseas. An ITEE must be a "prescribed institution" which is either: (a) located outside Australia and exempt from income tax in the country in which it is resident; or (b) has a physical presence in Australia but incurs its expenditure and pursues its objectives principally outside Australia.

provisions more readable.[189] At that time only three organisations were specifically listed in this category: the Australian Institute of International Affairs; the Australian National Travel Association; and The Foundation for Development Cooperation Ltd. There is now an eclectic collection of 19 DGRs listed by name under international affairs in the ITAA 1997.[190] In addition to two of the original members, the Australian Institute of International Affairs and The Foundation for Development Cooperation Ltd, there is a diverse range of activities and countries represented.[191] Some of these organisations have time limits on their gift deductibility, and at the time of writing, the time limits on gift deductibility to seven organisations had expired.[192]

While these 19 DGRs represent less than 1 per cent of all active DGRs (at 31 October 2012), the privileges of being in this select group are noteworthy. These DGRs are not only exempt from the strict in Australia requirements, but also *within* the five exceptions they have the lowest level of restrictions. Their overseas activities are not limited to development or relief work and their beneficiaries are not confined to particular countries, so long as they "continue to operate for their principal purpose and comply with any rules or conditions made by the government *on listing* as a DGR."[193] The government at the time when these DGRs *were listed* approved their overseas purposes and beneficiaries. Since that time, these organisations have been able to attract tax deductible donations and contributions for their overseas activities with relatively little oversight.[194]

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[189] *Taxation Laws Amendment Act (No 2) 1993* (Cth) s. 8.

[190] The *Tax Laws Amendment (2013 Measures No. 2) Act 2013* (Cth) s. 79 also added The Australia Foundation in support of Human Rights Watch Limited to s. 30-80(2).

[191] These include: The Diamond Jubilee Trust Australia; The Australian-American Education Leadership Foundation Limited; Sydney Talmudical College Association Refugees Overseas Aid Fund; United Israel Appeal Refugee Relief Fund Limited; the Asia Society AustralAsia Centre; The Global Foundation; Australia for UNHCR; Lowy Institute for International Policy; The Rotary Leadership Victoria Australian Embassy for Timor-Leste Fund Limited; Xanana Vocational Education Trust; American Australian Association Limited; Wheelchairs for Kids Inc.; Diplomacy Training Program Limited; Sichuan Earthquake Surviving Children's Education Fund; Bali Peace Park Association Inc.; the Christchurch Earthquake Appeal Trust of New Zealand; and Rhodes Trust in Australia.

[192] See ITAA 1997 s 30-80(2), Special Conditions in table.

[193] Emphasis added. See Australian Taxation Office, 2012. *Gift pack: Guide for deductible gift recipients and donors*. NAT 3132.

[194] DGRs listed by name are subject to s. 353-20 of the *Taxation Administration Act 1953* (Cth), which enables the Commissioner to require a specifically listed DGR to provide information relevant to its status as a

While the other exceptions to the "in Australia" requirements have appropriate integrity requirements in place, supported by special administrative arrangements to ensure that the DGR tax concession is directed to the causes it was approved for, and is not at risk of being misdirected to inappropriate and unauthorised operations,[195] there appears to be nothing in place to ensure the ongoing integrity of the DGR regime in regard to those DGRs listed specifically under the international affairs category. There are no special administrative arrangements in place to make sure donations are spent appropriately. Given that the process for admission into this exclusive group is largely political, the end result is an exception to the "in Australia" requirements, that offers little transparency or accountability.

Gift deductibility in Australia is closely held, unlike other comparable jurisdictions, with only certain types of charities and some other organisations being awarded the status. This means that many charities have a separate fund that has gift deductibility with a separation between the organisation and the deductible fund that it operates. The policy origins focused on geographic restrictions for tax deductibility, based on the physical location of the organisation, not necessarily whether it was engaged in cross-border activities. A blanket prohibition is effectively in place for all but minor and incidental cross-border activities unless the organisation falls within an exemption. Special categories of DGR organisations are permitted to engage in substantial cross-border philanthropy. Some, but not all, of such organisations are subject to more scrutiny by specialist regulators in line departments such as Foreign Affairs, and Environment. This restrictive climate is said, anecdotally, to have led to organisations with the converted DGR cross-border status acting as conduits or "channels" for individuals and organisations to donate to overseas organisa-

DGR in order to determine if it continues to be eligible for DGR status. The Commissioner is to advise the Minister if the entity is or is not operating consistently with the obligations as a DGR, including: failing to use gifts or money received solely for its principal purpose; changing its principal purpose; or failing to comply with any rules or conditions relating to the entity being or becoming a DGR. Failure to comply is an offence under s 8C of the *Taxation Administration Act 1953* (Cth).

[195] See Explanatory Memorandum, Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (the In Australia Bill 2012), paras 1.135 and 1.140, which state that appropriate integrity requirements exist for the exceptions of overseas aid organisations and environmental organisations, respectively, and note that the integrity requirements in place for overseas aid organisations under the OADGS "are supported by special administrative arrangements because of the difficulties associated with monitoring activities undertaken outside of Australia".

tions, often for an administrative fee. There is no equivalent of the USA "friends of" conduit available in Australia, and no reliable evidence of how significant this activity is at present and how much of it represents a threat to the fisc. However, moves have been afoot for several years to reform both income tax exemption and donation deductibility in this regard.

"In Australia" – Proposed Reform History

In 2011, as a result of the *Word Investments* litigation and concerns about terrorism financing, the Government introduced the "In Australia" Bill, seeking to clarify the law by codifying the Commissioner of Taxation's strict definition of the in Australia requirements.[196] This was to apply to both income tax exemption and donation deductibility. The Explanatory Memorandum noted in relation to income tax exemption of charities that:

> Ignoring minor overseas activities, the intent of the original law was only to allow a charity to be able to pass funds to an overseas charity that was endorsed as a deductible gift recipient (operating a developing or developed country relief fund), or an entity specifically prescribed in the regulations. The High Court's decision on *Word Investment* highlighted that the law is not achieving those objectives.[197]

One hundred and nine submissions were received about the exposure draft, drawing attention to a number of drafting defects. In its submission, the Australian Council for International Development (ACFID), the umbrella body for Australian international development charities,[198] summed up its objections to the draft as:

> The problems have arisen through the complexity of the various legal structures to which the legislation relates and as a result of the multiple avenues that the Gov-

[196] Tax Laws Amendment (2011 Miscellaneous Measures) Bill (No. 1) 2011: Tax exempt body "in Australia" requirements. See Treasury. 2011. *"In Australia" Special Conditions for Tax Concession Entities*. Accessed 8 October 2014. http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/In-Australia-Special-Conditions-for-Tax-Concession-Entities.

[197] Exposure Draft Explanatory Memorandum, Restating the "in Australia" special conditions for tax concession entities, 2011, para 1.13. Accessed 8 October 2014. http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/In-Australia-Special-Conditions-for-Tax-Concession-Entities.

[198] Australian Council for International Development. 2011. *Submission to Treasury on "in Australia' requirements for tax exempt bodies*, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2011/In%20Australia%20Special%20Conditions%20for%20Tax%20Concession%20Entities/Submissions/PDF/107_-_ACFID.ashx.

> ernment provides to tax free and tax deductible status. The proposed legislation attempts to apply simple tests, the result of which would be to create intractable clashes amongst the various legal statuses of the aid funds and their parent entities. In addition, the problem with the proposed legislation is that it seems to have been drafted without an understanding of the most practical considerations as to how charitable agencies go about doing their work.[199]

Another exposure draft was open for further consultation in 2012,[200] and received 47 submissions. The new exposure draft addressed some of the concerns raised, but not all. In 2012, the *Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012* was introduced into Parliament, but lapsed when Parliament was dissolved in August 2013 for an election. After the 2013 federal election the incoming government reviewed all tax proposals and decided to proceed with this particular initiative, publishing a third exposure draft,[201] which was opened for public consultation in March 2014.[202] That Bill has yet to be introduced into Parliament.

The policy of a strict test has not altered, despite submissions that such tight controls on cross-border charity is not in Australia's best interests. Several submissions questioned the wisdom of such restrictive measures "in our contemporary global world" and that it "would impose some of the highest barriers to international participation and engagement by not-for-profits in the world."[203] Each exposure draft revision has merely added exemptions and exclusions to various organisational categories and some particular organisations will be made largely exempt by regulation.

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[199] Ibid, p. 2.
[200] Treasury. 2012. *Restating and standardising the special conditions for tax concession entities (including the "in Australia" conditions)*, 17 April. Accessed 8 October 2014. http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/In-Australia-Special-Conditions-for-Tax-Concession-Entities-Revised.
[201] Assistant Treasurer, Arthur Sinodinos. 2013. Integrity restored to Australia's taxation system. Media Release. (14 December), item 37; Treasury. 2014. *Restating and centralising the special conditions for tax concession entities*. Accessed 8 October 2014. http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Conditions-for-tax-concession-entities.
[202] Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014: in Australia special conditions (hereinafter referred to as Exposure Draft and Exposure Explanatory Memorandum). Accessed 8 October 2014. http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Conditions-for-tax-concession-entities.
[203] Pilchconnect. 2012. Submission to Senate Standing Committee on the Australian Charities and Not-for-profit Commission and Special Conditions for Tax Concessions Bills (30 August).

"In Australia" 2014 Proposed Reforms

Submissions on the last exposure draft closed on 7 April and the Bill was expected to be before Parliament in late 2014 or early 2015. Although a number of submissions argued that a policy of stifling cross-border charity with greater regulatory controls was not in Australia's best interests, this appears not to have swayed either of the two main political parties. As noted above, the draft Bill does not deviate from its underlying policy thrust, but on the basis of consultations, it does include more exceptions and relaxations for specific organisations and certain activities. The provisions deal with both income tax exemption and donation deductibility status, using the same concepts where possible.

Exemption from Income Tax

The draft Bill proposes to add special conditions to the income tax exemption: as well as other pre-existing conditions, the organisation must:

- Operate principally in Australia; and
- Pursue its purposes principally in Australia.[204]

These provisions do not apply to associations of employees or employers, public educational institutions, public hospitals, primary and secondary resources, or tourism associations. Further organisations can be exempt from the provisions by being prescribed in the *Income Tax Assessment Act Regulations 1997* or being endorsed as a DGR. To be considered for prescription, the organisation must be either an overseas NFP organisation exempt from foreign tax in their resident country, or be resident in Australia and operate and pursue their objectives principally outside Australia.[205] The Explanatory Memorandum indicates that this power is intended to be applied only in exceptional circumstances where the organisation will be providing a broad benefit to the Australian community, and considering the national interest, tax system integrity, the risk of the organisation being utilised for money laundering or terrorist financing and any other relevant considerations. This power is subject to Parliamentary scrutiny, by way of disallowance, not administrative

[204] Exposure Draft, cl. 50-50(2).
[205] Exposure Draft, cl. 50-51 (2).

or judicial review.[206] This further tightens the control by the executive arm of government on which organisations will be relieved from the cross-border constraints.

The ATO has long regarded the meaning of "principally" as being more than 50 per cent, but the new provisions seek to replace "expenditure" with "operates." The Explanatory Memorandum suggests this will allow a wider range of circumstances to be considered such as:

> where the entity incurs its expenditure; where it undertakes its activities; where the entity's property is located; where the entity is managed from; where the entity is resident or located; where its employees or volunteers are located; and who is directly and indirectly benefiting from its activities.[207]

None of the above indicators is determinative, but a weighing up of all indicators is proposed. Examples used in the Explanatory Memorandum show that although an organisation may be controlled and managed from outside Australia, if the amount of expenditure, operations and beneficiaries is located in Australia, it could still satisfy the special conditions.[208] None of these considerations are included in the actual words of the exposure Bill and a court may well be persuaded to a different interpretation of "operate", as it is not a legal term. The ordinary sense of the word in the context of the provision may suggest itself to a court called on to determine its meaning. The Australian Macquarie Dictionary gives various meanings of "operate", including "to work or run, as a machine does; to keep (a machine, apparatus, factory, industrial system, etc.) working or in operation; to act effectively, exert force or influence,"[209] which may not be as wide as that expressed in the draft Explanatory Memorandum.

Further, the funds that an organisation provides to non-exempt organisations are to be taken into account in determining whether the requirements have been met.[210] An ex-

[206] Exposure Explanatory Memorandum, para. 1.98.
[207] Exposure Explanatory Memorandum, para. 1.59.
[208] Exposure Explanatory Memorandum, example 1.5 p. 17.
[209] "Operate —*verb (i)*". In *The Macquarie Dictionary Online*. Accessed 9 September 2014. https://www-macquariedictionary-com-au.ezp01.library.qut.edu.au/.
[210] If an income tax exempt entity provides money to another income tax exempt entity, the receiving entity will itself have met the "in Australia" special conditions and be operating principally in Australia, or be ex-

empt donor organisation is expected to have a reasonable knowledge of the purpose or cause that it intends the donee organisation to carry out with the funds. However, the donor need only take all those steps that are reasonable to confirm or trace the use of such funds outside Australia.[211] The Explanatory Memorandum notes that: "if it later transpires that the funds were spent in such a manner that would result in the loss of status of the providing entity, the entity will be able to rely on the reasonable and genuine steps it has taken to demonstrate compliance with the special conditions."[212] This specifically redresses the issues of the *Word Investments case* and strikes directly at conduit arrangements – what is known as "auspicing" or "channelling" in Australia, where an organisation with a tax status undertakes to receipt the donation or pass the funds on, for an administrative fee for an otherwise unrelated transaction.

Deductible Gift Recipients (DGRs)

The core principle for income tax exempt entities is applied similarly to DGRs, but with a stricter threshold test.[213] DGRs generally must:

- be established in Australia;
- operate solely in Australia; and
- pursue their purposes solely in Australia.[214]

According to the Explanatory Memorandum, "solely in Australia" is to be interpreted as requiring DGRs to be established and operated only in Australia (including control, activities and assets) and to have their purposes and beneficiaries only in Australia. However, overseas activities that are merely incidental to a DGR's purposes in Australia will not be caught. Further, if overseas activities are minor in extent and importance when considered with reference to the operations and pursuit of the organisation's Australian activities, again, it will not be caught. The Explanatory Memorandum states that "the

pressly exempt. Therefore, an entity does not need to take account of the eventual use of these funds by the donee entity.

211 S. 50-50(4A).

212 Exposure Explanatory Memorandum, para. 1.80.

213 Ss. 30-15(2), 30-18, 31-10(2)(a).

214 S. 30-18(1).

overall quantum of an entity's overseas expenditure should also be considered by reference to current public expectations about what is considered minor."[215] This is likely to produce an interesting contest between the tax authorities and the sector about what are "current public expectations" and how these are to be interpreted. Just as in relation to tax exemption, functioning as a mere conduit DGR for another organisation that operates overseas will not be permitted, and if funds are passed to another organisation that is not a DGR, then tracing must occur.[216]

There are a number of carve outs from these tests which have grown with each exposure draft of the Bill. Organisations that are DGRs under the international affairs category or are specifically listed under the international affairs category are exempt from the "in Australia" special conditions for DGRs.[217] The Explanatory Memorandum gives the reason "that they nonetheless further Australia's overseas aid objectives and therefore contribute to the broad public benefit of the Australia[n] community".[218] The Explanatory Memorandum goes on to note that further regulatory measures are already in place for these organisations under the scrutiny of the OAGDS.[219] Organisations on the REO can seek the approval of the Environment Minister to be exempt from the "in Australia" special conditions. They will need to convince the Minister that they have to engage in cross-border activities "in order to effect change that will be of benefit to the Australian public."[220] The draft Bill also makes provision for exceptions of scholarship, bursary or prize funds,[221] some touring arts organisations[222] and a new category of medical research institutions that operate outside Australia.[223]

[215] Exposure Explanatory Memorandum, para. 1.110, s. 30-18(2).
[216] S. 30-18(4).
[217] S. 30-18(5)
[218] Exposure Explanatory Memorandum, Para. 1.113.
[219] Exposure Explanatory Memorandum, para. 1.115.
[220] Exposure Explanatory Memorandum, para. 1.116.
[221] S. 30-18(5).
[222] Ss 30-18(9), 30-19(2), (3), 30-305(1).
[223] S. 30-80(1).

Possible Outcomes of the Proposals

The proposed amendments will tighten the law on the books for Australian cross-border charity. The tests have been tightened for both income exemption and donation deductibility status. The tracing provisions will affect the use of channelling/conduits/auspice that is believed to occur at present and those organisations hosting such arrangements for an administrative fee should consider reassessing their practices. However, the law on the books is not the same as the actual regulation at street level. It must be remembered that, if Australia returns to the pre-ACNC regulatory environment, there will be no annual financial return filed with federal regulators, tax or otherwise. Policing cross-border charity without the information provided in an annual financial return is a challenge. It is not known what resources the ATO will have to do this. The government's budget in 2014 announced staff reductions would cut 4,700 from the ATO's workforce of 25,000 by 2017–18.[224] Before the ACNC was established, the ATO's NFP section had about 60 full-time equivalent staff, to administer tax for approximately 120,000 NFP tax entities. The ATO's NFP compliance and audit statistics are not disclosed in its corporate reports and it is difficult to assess how compliant the sector is. There are some indications that it may be less than optimal. An Australian National Audit Office (ANAO) report on the ATO's work with DGRs immediately prior to the establishment of the ACNC indicated a range of areas for improvement, noting that:

> The inadvertent non-compliance with legislative requirements by fundraising organisations is recognised by the ATO as being a high risk, particularly given that many of these organisations are managed by volunteer committees that experience regular turnover. The management of this risk is not commensurate with its assessed level of potential non-compliance.[225]

There is further cause for concern following a remarkable case that was decided in late 2013, which involved a tax exempt "charity" that consisted solely of members who were closely related by birth or marriage. It claimed to undertake action-based qualitative

[224] Senate Economics Legislation Committee, Answers to questions on notice, Budget Estimates 2014. Accessed 8 October 2014.
http://www.aph.gov.au/~/media/Committees/economics_ctte/estimates/bud_1415/Treasury/answers/BET2099-2106_Ludwig.pdf.
[225] Australian National Audit Office. 2011. *Administration of deductible gift recipients (non-profit sector)*. Audit Report No.52 2010–11, p. 21.

research, i.e. research undertaken in an interactive real time manner.[226] All the members were described both as "researchers" and "guinea pigs." However, none of them had any qualifications in psychology (or any social science). One of the projects undertaken was "Project Inebriation" which dealt with the experience of owning and using luxury motor vehicles, including a Hummer ($100,000), a Ferrari ($300,000) and a Rolls Royce ($695,000), all purchased by the organisation for use by its members. Another was "Project India" which funded a member's trip to India to attend a wedding. None of the "research" conducted was ever published in any journal, although there were apparently "internal reports." Although the organisation did not file any type of tax return with the ATO, it was routinely audited for its compliance with the Goods and Services Tax (GST). The court noted that the organisation was "subject to a Business Activity Statement … audit, finalised in February 2007, in which the auditor found it was properly endorsed as a health promotion charity."[227] The ATO did not offer an explanation of why the auditor's suspicions were not aroused. The Commissioner was successful in persuading the Tribunal that the organisation's charity endorsement should be revoked retrospectively.

Australian Fisc Measurement of the Cost of Cross-Border Charity

Inadequate knowledge about the size of cross-border charity's cost to the fisc significantly hampers any rational assessment of the proportionality of current and proposed policy responses. How much of giving flows out of Australia has been a mystery, as is how much of this outflow is classed as tax deductible gifts or funds from exempt NFP income. The *Follow the yellow brick road* report, released in 1991, recommended that this be remedied and that statistics should be kept in order to inform policy makers and as a basis for ATO audit activity.[228] This has not been implemented. As Australian NFPs do not file tax

[226] *The Study and Prevention of Psychological Diseases Foundation Incorporated and Commissioner of Taxation* [2013] AATA 919.
[227] *The Study and Prevention of Psychological Diseases Foundation Incorporated and Commissioner of Taxation* [2013] AATA 919 at para 91.
[228] See Commonwealth of Australia. House of Representatives Standing Committee on Finance and Public Administration. 1991. *Follow the yellow brick road: The final report on an efficiency audit of the Australian Taxation Office – international profit shifting*, pp. 51 [4.1] and 55–56.

returns there is no convenient and reliable data source.[229] The Australian Tax Expenditures statement does not provide estimates for tax expenditures of many mainstream NFP concessions let alone those for cross-border charity.[230] The cost of income tax exemption has been quantified in Australia's tax expenditure statement for only 13 of 22 categories with some relation to the nonprofit sector, and those measurements have been described as having low reliability.[231] For example, the best that can be done for religious, scientific, charitable or public educational institutions is an order of magnitude "guesstimate" of $1,000 million plus.[232] The order of magnitude classifications are described as a "broad guide only ... estimated without the benefit of detailed data. They are based on assumptions and judgment and as such they should be treated with caution."[233]

Some light was provided on outgoing funds by the Australian Bureau of Statistics *Non-Profit Institutions Satellite Account 2012–13*[234] which was based on a sub-population of nearly 57,000 "economically significant" NFPs (of the ABS's estimated 177,000) which have an active tax role.[235] It estimated that, of A$5.684 billion in grants and other payments made by NFPs to others, A$1.03 billion (18 per cent) went to non-resident organisations, (i.e. any organisation domiciled overseas).[236] Over 95 per cent was credited to the categories of social services and international development.

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[229] The recently established Australian Charities and Not-for-profits Commission (ACNC) was to collect this information, but has not yet completed collecting annual returns from charities.
[230] Australia. Treasury. 2014. *Tax expenditures statement 2013*. Accessed 8 October 2014. http://www.treasury.gov.au/PublicationsAndMedia/Publications/2014/TES-2013; see also McGregor-Lowndes, M., Turnour, M. D., and Turnour, E. 2011. "Not-for-profit income tax exemption: is there a hole in the bucket, dear Henry?" *Australian Tax Forum*, 26: 601–631.
[231] Productivity Commission. *Research report*, Appendix E, E.7.
[232] Australia. Treasury, *Tax Expenditures Statement 2009* (2010), item B23, 74.
[233] Ibid 29.
[234] Australian Bureau of Statistics. 2014. *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13* (Catalogue No 5256.0), http://www.abs.gov.au/AusStats/ABS@.nsf/MF/5256.0
[235] This includes all market NFPs (approx. 21,000) and significant non-market NFPs (approx. 36,000). Market NFPs are nonprofits which receive income from sales sufficient to cover the majority of their costs of production. Sales in this context include: income received from government on a volume basis; rent, leasing and hiring income; sponsorship income; and membership fees. Non-market NFPs are NFPs which rely principally on funds other than receipts from sales to cover their costs of production or other activities e.g. donations.
[236] Australian Bureau of Statistics. 2014. *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13* (Catalogue No 5256.0), data cube table10,

The recently established Australian Charities and Not-for-profits Commission (ACNC) was to collect this information as part of its duty to collect and publish annual returns from charities, however that work has not yet been completed. About half of the ACNC registered charities have reported, with 2,402 (6 per cent) of them operating in countries outside Australia. In total, these charities were active in more than 100 countries, with the highest proportion operating in India (5 per cent), the Philippines (4 per cent), New Zealand (4 per cent), Papua New Guinea (4 per cent), Indonesia (4 per cent) Cambodia (3 per cent) and the USA (3 per cent).[237]

Australia is a member of the Organisation for Economic Co-operation and Development's (OECD) Development Assistance Committee (DAC)[238] which estimates private Australian cross-border development at just over US$1.4 billion in private giving to developing countries.[239] However, I believe a more accurate figure is US$897 million because of data calculation errors.[240] Because Australians also give to overseas activities and beneficiaries for purposes other than relief or development, such as the environment[241] and medical research,[242] the total cross-border philanthropy numbers would have to be added to the revised DAC calculations.

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http://www.abs.gov.au/AusStats/ABS@.nsf/MF/5256.0. Foreign branches and foreign subsidiaries of Australian organisations are regarded as non-resident organisations.

[237] Gilchrist, D. J., and Knight, P. 2014. *Australian charities 2014*. Report for the Australian Charities and Not-for-profits Commission. Melbourne: ACNC, pp. 38-39.

[238] A forum to discuss issues surrounding aid, development and poverty reduction in developing countries.

[239] OECD Development Assistance Committee. 2013. *OECD development co-operation peer review: Australia 2013*. Geneva: OECD, p. 52.

[240] I am indebted to the research of Natalie Silver for this point. The data are collected from the Australian Council for International Development (ACFID), the peak Council for Australian aid and development organisations. In ACFID's survey for the financial year 2011-12, total revenues to the sector amounted to A$1.4 billion, comprising A$424 million in government grants (30% of total revenue); A$108 million in investment income and income from other sources (7%); and A$871 million in community support (63%) including donations (monetary and non-monetary), fundraising, legacies and bequests. It appears that the Australian Government may have reported the *total* revenue provided by ACFID not just the community income component.

[241] There are more than 500 funds on the Register for Environmental Organisations, some of which engage in overseas charitable activities.

[242] The Association of Australian Medical Research Institutes and Research Australia estimate that Australia's independent medical research institutes, many of which undertake a significant amount of overseas activities and expenditure, collectively receive over A$100 million annually in donations: Association of Australian Medical Research Institutes and Research Australia. 2012. Submission to Parliamentary Joint Committee on

It is unfortunate that the recommendation to pay attention to measuring cross-border charity was not implemented at the time of the first inquiry about the issue as it would be invaluable in assisting the development of fiscal policy in this area. The lack of will to measure these tax expenditures is not only present in Australia and can casts doubt on the seriousness of regulator's concerns about the drain on the revenue that such activity may cause.

Conclusion

Australia is considered to have one of the strictest regimes for cross-border gift deductibility.[243] The formal reason proffered for the introduction of cross-border taxation measures was to counter tax abuse; more recently this has been supplemented by arguments about prevention of terror financing. However, the legislative architecture adopted for the regulation of cross-border charity clearly reflects that governing charity tax concessions generally in Australia – that is, a flat prohibition, mitigated by restricted special exemptions, to which it is difficult to gain access. For example, only a select few charities qualify for donation deductibility status in Australia, unlike other OECD jurisdictions, where all charities do. Accordingly, only certain classes of heavily vetted organisations can carry on cross-border activities. Approving cross-border status involves significant resources on the part of both applicant and tax administrator, with many barriers in the process. In some cases, approval may be in the gift of a minister of the crown, whose decision is not amenable to judicial or administrative review. The recent reform proposals have highlighted the legitimate issues for charities faced with a flat prohibition of cross-border activities, such as touring art and cultural concerns, medical research, education, and sporting organisations. Dealing with these by itemised exemptions and administrative fixes merely increases the complexity of administration for both charity and administrator – all to address what appears to be only minor leakage from the fisc.

Corporations and Financial Services, Inquiry into the Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012, p. 7.

[243] Muehlmann, B. W. et al. 2013. "Cross-border charitable giving and its tax limitations," *Bulletin for International Taxation*, 67(11): 5.

Regulation in practice is much more than law on the books, and what actually happens on the ground can be very revealing. Australian nonprofit organisations have been largely left alone to self-assess their continued taxation status. Actual government policing of cross-border charity is largely a mystery. The ATO is active at the threshold to granting of tax concessions, but thereafter its regulation is neither transparent nor assessable. Since organisations granted approval of cross-border donation deductibility are not generally required to file a tax return or make any other financial statements available publicly, and with no knowledge of the ATO's audit activity, it is difficult to have any confidence in enforcement of the law on the books. The cost of specialised audits for the taxation authorities would be significant, particularly as there are no annual tax returns to guide selective audits.

Anecdotal evidence points to some opportunistic channelling of donations by organisations with cross-border donation deductibility status. This is clearly targeted by the government's proposed taxation reforms, but with the proposed reduction in ATO budget and staff[244] and the abolition of the ACNC, the signs are not encouraging for any increased oversight of the cross-border activities of Australian nonprofit organisations. While gross illegal behaviour may be detected by third party regulators such as AUSTRAC, via financial institution mandated reporting, little appears to have been detected to date.

As globalisation proceeds at an even faster pace, Australia will increasingly suffer the indirect costs of such a restrictive policy that may outweigh the direct tax expenditure costs. Measuring these costs, both direct and indirect, would be a first step to reform, and should be followed by a review of the efficacy of the overall structure of Australian nonprofit taxation concessions.

[244] The 2014–15 federal budget announced that ATO will reduce staffing by 4700 by 2017–18. See also Senate Economics Legislation Committee, Answers to questions on notice, Budget Estimates 2014. Accessed 8 October 2014.
http://www.aph.gov.au/~/media/Committees/economics_ctte/estimates/bud_1415/Treasury/answers/BET2099-2106_Ludwig.pdf.

Appendix A

List of developing countries as declared by the Minister for Foreign Affairs
Last accessed on 16 September 2014, available at
http://aid.dfat.gov.au/Publications/Pages/3845_1029_3475_999_2902.aspx

EUROPE

Albania
Armenia
Azerbaijan
Belarus
Bosnia & Herzegovina
Georgia
Kosovo
Macedonia (former Yugoslav Republic)
Moldova
Serbia & Montenegro
Turkey
Ukraine

AFRICA
NORTH OF SAHARA

Algeria
Egypt
Libya
Morocco
Tunisia

SOUTH OF SAHARA

Angola
Benin
Botswana
Burkina Faso
Burundi
Cameroon
Cape Verde
Central African Rep.
Chad
Comoros
Congo, Rep.
Congo, Dem. Rep.
Cote d'Ivoire
Djibouti
Equatorial Guinea
Eritrea
Ethiopia
Gabon
Gambia
Ghana
Guinea
Guinea-Bissau
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritania
Mauritius
Mozambique
Namibia
Niger
Nigeria
Rwanda
St. Helena
Sao Tome & Principe
Senegal
Seychelles
Sierra Leone
Somalia
South Africa
South Sudan
Sudan
Swaziland
Tanzania
Togo
Uganda
Zambia
Zimbabwe

AMERICA
NORTH & CENTRAL

Anguilla
Antigua & Barbuda
Belize
Costa Rica
Cuba
Dominica
Dominican Rep.
El Salvador
Grenada
Guatemala
Haiti
Honduras
Jamaica
Mexico
Montserrat
Nicaragua
Panama
St. Kitts & Nevis
St. Lucia
St. Vincent & Grenadines

SOUTH AMERICA

Argentina
Bolivia
Brazil
Chile
Colombia
Ecuador
Guyana
Paraguay
Peru
Suriname
Uruguay
Venezuela

ASIA

Afghanistan
Bangladesh
Bhutan
Burma
Cambodia
China, (excl. Hong Kong)
East Timor
India
Indonesia
Kazakhstan
Korea, Dem. Rep.
Kyrgyz Rep.
Laos
Malaysia
Maldives
Mongolia
Nepal
Pakistan
Philippines
Sri Lanka
Tajikistan
Thailand
Turkmenistan
Uzbekistan
Vietnam

MIDDLE EAST

Iran
Iraq
Jordan
Lebanon
Syria
West Bank and Gaza Strip
Yemen

PACIFIC

Cook Islands
Micronesia, Federated States
Fiji
Kiribati
Marshall Islands
Nauru
Niue
Palau Islands
Papua New Guinea
Samoa
Solomon Is.
Tokelau
Tonga
Tuvalu
Vanuatu
Wallis & Futuna

Appendix B

Developed Country Disaster Relief Funds

Accessed 16 September, 2014 at https://www.ato.gov.au/Non-profit/Gifts-and-fundraising/In-detail/Deductible-gift-recipient/DGR-categories/List-of-disasters/#Developedcountrydisasterrelieffund

Name of disaster	Date	Declaration
Hurricane Sandy, USA	29 October 2012	Declaration of a disaster for the purposes of tax deductibility - Hurricane SandyExternal Link
North-eastern Italy earthquakes	20 May 2012	Declaration of a disaster for the purposes of tax deductibility - Italian earthquakesExternal Link
Joplin, Missouri tornado, USA	22 May 2011	Declaration of a disaster for the purposes of tax deductibility - multiple tornadoes in southern USAExternal Link
Southern USA tornadoes	28 April 2011	Declaration of a disaster for the purposes of tax deductibility - multiple tornadoes in southern USAExternal Link
Japan earthquake and tsunami	11 March 2011	Declaration of a disaster for the purpose of tax deductibility - Japan earthquake and tsunamiExternal Link
Christchurch earthquake	22 February 2011	Declaration of a disaster for tax purposes - Christchurch earthquakeExternal Link
Christchurch earthquake	4 September 2010	Declaration to boost disaster relief effort for the Christchurch earthquakeExternal Link
Typhoon Morakot, Taiwan	21 August 2009	Recognition of a disaster - Typhoon Morakot, TaiwanExternal Link
2009 Italian earthquake	6 April 2009	Declaration of the 2009 Italian earthquake as a disasterExternal Link
Greek fires	24 August 2007	

Appendix C

Other Significant Taxes

Goods and Services Tax (GST)

A broad based transaction tax known as the Goods and Services Tax (GST), at the rate of 10 per cent, came into effect on 1 July 2000 in Australia.[245] It replaced a national wholesale sales tax. The essential features are that:

- it is a tax on most goods, services or anything else supplied;
- it is collected by entities carrying on an enterprise;
- it is designed to be paid ultimately by the consumer rather than by an entity collecting the tax (this is achieved via a credit system);
- it is a multi-stage tax collected at each stage of the supply chain;
- it is effectively applied to the value added at each stage of the supply chain; and
- it has a credit mechanism that eliminates cascading (tax on tax).

There are limited concessions for certain types of NFPs such as religious bodies and DGRs engaging in certain transactions. GST is payable on taxable supplies and taxable importations. Subdivision 9-A of *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) defines a taxable supply and sets out the criteria that determine when a supply is a taxable supply. An entity only makes a taxable supply if all of the following criteria are satisfied:

- it makes a supply for consideration;
- it makes the supply in the course or furtherance of an enterprise that the entity is carrying on;
- the supply is connected with Australia; and
- the entity is registered or required to be registered.

[245] *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

Transactions taking effect outside the jurisdiction

The GST has few implications for NFPs conducting their businesses across borders apart from some minor compliance costs. As GST is primarily a tax on consumption in Australia, it is not intended to apply to things that are not consumed in Australia, such as exported goods. This means that no GST applies to exports, but that the exporter is entitled to input tax credits. Because the transactions are not within Australia, GST will not usually apply to NFPs making grants, or exporting goods or services across borders. Grants which are considered as gifts for those outside Australia will not attract GST for two reasons. First, from basic principles most gifts do not attract GST as no consideration is involved. In Australia, for tax purposes, a gift is something that is transferred voluntarily for no material advantage, which is stricter than the position in the USA.[246] Legislation puts this beyond doubt as it expressly states that "making a gift to a *non-profit* body" (in Australia) cannot be treated as consideration in any circumstances.[247] However, if the grantor gets some "material advantage" in connection with the grant then it will not be considered a gift for taxation purposes. For example, it will not be a gift if the grantor has the right to exploit the results of the grantee's work commercially, or if the grantor is provided with advice or information in return for the payment, e.g. where a NFP funds research in return for the right to use the results of that research in developing its own policy. However, this would not apply where the information is required merely to substantiate how the funds were spent or the grantee has to repay the assistance if it fails to comply with the grantor's requirements.[248] Second, GST will not apply if the grant is made to a body outside Australia. This applies even if the grantee supplies a material advantage in return for the grant when it is performed outside Australia.[249]

Importation of goods and services

Where goods are imported into Australia, the GST is payable by the importer, not

[246] *Federal Commissioner of Taxation* v *McPhail* (1968) 17 CLR 111; Australian Taxation Office. 2005. *Income tax: tax deductible gifts – what is a gift*, Taxation Ruling TR 2005/13.
[247] GST Act, s. 9-17 [emphasis added].
[248] Australian Taxation Office. 2012. *Goods and Services Tax: Financial assistance payments*, GST Ruling GSTR 2012/2; Australian Taxation Office. 2005. *Income tax: tax deductible gifts – what is a gift*, Taxation Ruling TR 2005/13.
[249] GST Act, s. 9-25(5).

by the overseas supplier.[250] This applies whether or not the importer is registered in Australia for GST, and whether or not it was carrying on an enterprise. However, if the importer is registered, it may be able to claim an input tax credit for the GST paid.

Fringe Benefits Tax

Fringe benefits tax (FBT) is payable by all employers, including the Commonwealth, state and territory governments. A fringe benefit is any non-cash remuneration (e.g. use of a car, provision of accommodation, or a loan of money at a non-commercial interest rate) which is provided in addition to, or in place of, the salary or wages of an employee. There are substantial FBT exemptions in place for NFP organisations that conduct activities outside Australia through employees and to a lesser extent for non-resident NFP organisations operating in Australia with employees.

Certain NFP employers are totally or partially exempt from FBT, including:

- international organisations exempted from income tax and other taxes;[251]
- religious institutions for benefits provided to religious practitioners, live-in domestic workers, certain employees caring for elderly or disadvantaged persons, or where the benefit is food and drink for non-live-in domestic employees;
- public benevolent institutions for benefits provided to an employee in respect of that employee's employment with the institution;
- public and NFP hospitals; and
- employers of certain live-in residential care workers.

[250] GST Act, s. 13-15.

[251] Refer to the *International Organisations (Privileges and Immunities) Act 1963*. In addition, the exemption applies to organisations established under agreements to which Australia is a party and which oblige Australia to grant the organisation a general tax exemption (s. 55). Examples of exempt international organisations would include: the UN; the Food and Agriculture Organization of the UN; Intergovernmental Committee for European Migration; Interim Commission for the International Trade Organization; International Bank for Reconstruction and Development; the IMF; International Civil Aviation Organization; the ILO; International Telecommunication Union; South Pacific Commission; UNESCO; Universal Postal Union; the WHO; World Meteorological Organization; the IAEA; Inter-Governmental Maritime Consultative Organization; International Development Association; the South-East Asia Treaty Organization; and Customs Co-operation Council.

The exemption from FBT for public benevolent institutions is a significant tax saving on wage costs for those employers.[252]

An Australian resident employer is liable to pay FBT on benefits provided to non-resident employees if PAYG withholding is required from the employee's salary or wages. PAYG withholding is not required if the income is exempt from Australian tax, for employees working overseas in relation to a development aid project in foreign service or employees from a foreign country coming to Australia.[253] This exemption had general application to most Australian resident employees, but from 1 July 2009 was confined to employees' foreign service that is directly attributable to:

(a) the delivery of Australia's overseas aid program by the individual's employer;
(b) the activities of the individual's employer in operating a developing country relief fund or a public disaster relief fund;
(c) the activities of the individual's employer if the employer is a prescribed institution that is exempt from Australian income tax;
(d) the individual's deployment outside Australia by an Australian government (or government authority) as a member of a disciplined force; or
(e) an activity of a kind specified in the regulations.[254]

Where an employee's foreign service is not within these requirements, the overseas income is not exempt from income tax and the person is therefore an "employee" for the purposes of the *Fringe Benefits Tax Assessment Act 1986* (FBTA Act). Further, where a non-resident employee is working in Australia or an Australian resident is working overseas, consideration must be given to whether the *International Taxation Agreements Act 1953* (Tax Agreements Act) modifies the operation of the Australian FBT regime to reduce double taxation of benefits. The Tax Agreements Act has effect notwithstanding the provisions contained in the ITAA 1997, the ITAA 1936 (other than Pt IVA) or in an Act impos-

[252] In 2013–14 the forgone revenue was estimated at $1,340 million in respect of PBIs: Australian Treasury. 2014. *Tax Expenditures Statement 2013*, p. 115.
[253] ITAA 1936, ss. 23AF and 23AG.
[254] ITAA 1936, s. 23AG(1AA).

ing Australian tax.[255] The meaning of "Australian tax" in section 3(1) of the Tax Agreements Act includes FBT imposed by the FBTA Act with effect from the enactment of *Act No 22 of 1995*, and therefore the Tax Agreements Act can modify the operation of the FBTA Act. Whether a particular double taxation agreement (DTA) will modify the FBTA Act is dependent upon how "Australian tax" is defined in the various Schedules of the Tax Agreements Act. Only the United Kingdom agreement, New Zealand agreement and (to a limited extent) the Indonesian agreement include specific provisions to avoid double taxation of fringe benefits. All other DTAs do not make any reference to Australian FBT.

Further, PAYG withholding is not required if the income of the non-resident employee is exempt, because it does not have an Australian source. For example, Article 15(2) of the USA Convention provides that remuneration derived by a US resident in respect of services performed in Australia is only taxable in the US if:

(a) the employee's stay in Australia does not exceed 183 days in a year;
(b) the remuneration is paid by an employer that is a not a resident of Australia; and
(c) the remuneration is not deductible in determining the profits of a permanent establishment which the employer has in Australia.

Where an employee is within these requirements, the overseas income is exempt from Australian income tax and the person is not an "employee" for the purposes of Australian FBT.

[255] Tax Agreements Act s. 4(2).

Appendix D

Terrorism and Money Laundering

Laundering of money to evade taxation solely or joined with illegal activities often involves cross-border activity and has always been of interest to the fisc. Australia was a foundation member of the Financial Action Task Force (FATF) on money laundering, an intergovernmental organisation, established in 1989 by the Group of 7 (G7) Summit held in Paris. The emphasis of the FATF is on promoting the adoption and implementation of anti-money laundering measures.[256] The Australian Transaction Reports and Analysis Centre (AUSTRAC), an Australian government agency, was established in 1989 under the *Financial Transaction Reports Act 1988* specifically to deal with such issues. Compared to agencies in other jurisdictions, AUSTRAC was fairly effective, being well-resourced with a limited number of large financial institutions to monitor (four major banks, compared to thousands in the US) and having good coordination with other key agencies responsible for tax and corporate securities. Much money laundering involved cross-border transactions, but the regulation did not overtly touch NFP organisations. This was because the few banks and other financial agents were required to report transactions over A$10,000 to AUSTRAC.

Unlike many countries, Australia has relatively few barriers to cross-border charity that flows into Australia in relation to funds. Part 4 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) requires reports about cross-border movements of physical currency (carrying, mailing or shipping) exceeding A$10,000 and cross-border movements (personal carriage) of bearer negotiable instruments of any value if requested by an authorised person.

After 11 September 2001, attention turned to terror financing, and AUSTRAC was subsequently given extended powers and reach under the *Anti-Money Laundering and*

[256] Reporting entities are required to meet the customer identification, due diligence, and record-keeping requirements, and most importantly they can report suspicious and prescribed transactions to relevant authorities. The FATF has no enforcement power; it can only expel those countries that do not comply with its membership requirements as determined through the mutual evaluation process.

Counter-Terrorism Financing Act 2006 (AML/CTF Act). In common with many other countries' criminal statutes with respect to terrorism, its financial support and advocacy were enacted. A number of NFP organisations were listed and prohibited to associate as part of the measures. Financial contributions through formal charitable donations was then listed by AUSTRAC as one of the three principal methods by which terrorism funds are raised in Australia.[257] After 2001, FATF released international recommendations on combating money laundering and the financing of terrorism.[258] The latest version of the recommendations includes Special Recommendation VIII (SR VIII) which advised countries to review their laws and regulations relating to NFP organisations in order to protect the sector from misuse:

- by terrorist organisations posing as legitimate entities;
- through the exploitation of legitimate entities as conduits for terrorism financing; and
- by concealing or masking the clandestine diversion to terrorist organisations of funds intended for legitimate purposes.[259]

A mutual evaluation of Australia's terrorism financing regime conducted in 2005 by FATF found that, with respect to NFPs, Australia was assessed as "partially compliant." FATF's summary of factors underlying the assessment were:

> Australia has reviewed its [NFP] laws and sector; however, the reviews did not result in the implementation of any specific measures.
>
> It is not clear that Australia has adequately implemented measures across the [NFP] sector to ensure that terrorist organisations cannot pose as legitimate non-profit organisations, or that funds or other assets collected or transferred by non-profit or-

[257] Australian Transaction Reports and Analysis Centre. 2010. *AUSTRAC typologies and case studies report 2010*, http://www.austrac.gov.au/files/typ_rpt.pdf, p. 8.
[258] Financial Action Task Force. 2003. *The Forty Recommendations* (Paris: OECD/FATF), http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202003.pdf
[259] Financial Action Task Force. 2004. *FATF IX Special Recommendations* (Paris: OECD/FATF), http://www.fatf-gafi.org/dataoecd/8/17/34849466.pdf.

ganisations are not diverted to support the activities of terrorists and terrorist organisations.[260]

Despite this finding, it reported that there have been "no substantiated links between terrorist groups and non-profit organisations in Australia" and the ATO has vetted charities more strictly, but not other NFPs regulated by states and territories.[261]

The AML/CTF Act was enacted following the 2005 mutual evaluation. The designated services of some NFP organisations now fall under that Act. The majority of NFPs do not provide services prescribed as a "designated service" under the AML/CTF Act as they are not financial institutions, the gambling sector, bullion dealers, remittance dealers or other professionals or businesses that provide particular designated services. However, AUSTRAC's interpretation of what constitutes a business, that is, "a venture or concern in trade or commerce, whether or not conducted on a regular, repetitive or continuous basis," in section 5, will include many NFP organisations.[262] Organisations that provide such designated services are required to undertake AML/CTF risk assessments, implement due diligence procedures and report detection of certain transactions to AUSTRAC (e.g. suspicious transactions, transactions over specified thresholds and international funds transfer instructions). Protection against abuse is also triangulated by the fact that financial transaction activity involving a NFP organisation would, in the normal course, be identified by the providers of other designated services it uses to deposit and transfer funds. The Commonwealth Attorney General also introduced guidelines and other educative initiatives to assist NFPs to undertake risk assessments and minimise exposure to money laundering or terrorism financing related exploitation.[263]

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[260] Financial Action Task Force. 2005. *Summary of Third mutual evaluation report on anti-money laundering and the combating of financing of terrorism: Australia* (Paris: OECD/FATF), http://www.fatf-afi.org/dataoecd/60/33/35528955.pdf, p. 18.
[261] Financial Action Task Force. 2005. *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism – Australia* (Paris: FATF/OECD), p. 125.
[262] Australian Transaction Reports and Analysis Centre. 2008. *What constitutes a reporting entity*. (Public Legal Interpretation Series, No. 4 of 2008). http://www.austrac.gov.au/files/pli_4_reporting_entity.pdf.
[263] Australia. Department of the Attorney-General. 2009. *Safeguarding your organisation against terrorism financing: A guidance for non-profit organisations*. (Canberra) http://www.ag.gov.au/www/agd/rwpattach.nsf/VAP/(3A6790B96C927794AF1031D9395C5C20)~AG+Safeguard+Terrorism+Flyer+in+Word.pdf/$file/AG+Safeguard+Terrorism+Flyer+in+Word.pdf.

AUSTRAC's declaration that charity is one of the three principal methods by which terrorism funds are raised in Australia has resulted in few public cases involving charities and appears not to have hampered legitimate cross-border transactions by NFP organisations. Only two cases involving NFPs have been reported by AUSTRAC, although there have been various press reports from time to time about terror financing through charity.[264] In 2009, two people pleaded guilty to offences under the *Charter of the United Nations Act 1945* (Cth) for making assets available to the Liberation Tigers of Tamil Eelam (LTTE), an entity proscribed for the purposes of that Act.[265] It was the prosecution's case that the defendants, as members of the Tamil Coordinating Committee, had played a role in the collection and transfer of $1,030,259 in donations to the LTTE between 13 December 2002 and 12 October 2004. The case resulted in convictions.

Between 1990 and 1997, a person and members of his immediate family operated a money laundering scheme through which at least A$48 million was transferred from Australia to Israel using a sham charity.[266] The scheme centred on the use of an internal bank management account that was opened in the name of United Charity, to give the appearance the deposited money was being used for genuine charitable purposes.[267] The money that was being laundered was the cash proceeds from Australian business activity that had not been disclosed to the ATO and the businessmen claimed a tax deduction on the sham charitable donation to bolster the appearance the account was being used to hold and transfer funds for charitable purposes. The transactions escaped AUSTRAC scrutiny as there was some degree of cooperation from within the bank. The laundering was detected with the appointment of a new bank manager.[268]

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[264] Bricknell, S., McCusker, R., Chadwick, H., and Rees, D. 2011. *Money laundering and terrorism financing risks to Australian nonprofit organisations*. AIC Reports Research and Public Policy Series 114, p. 19.
[265] *R v Vinayagamoorthy & Ors* [2010] VSC 148.
[266] *Director of Public Prosecutions (Cth) v Goldberg* [2001] VCSA 107; (2001) 184 ALR 387.
[267] Commonwealth Director of Public Prosecutions. 2001. *Annual report 2000–01*. (Canberra). http://www.cdpp.gov.au/Publications/AnnualReports/CDPPAnnualReport-2000-2001.pdf.
[268] Transcript of proceedings, *Director of Public Prosecutions (Cth) v Goldberg*, Supreme Court of Victoria, Court of Appeal, Vincent JA, 27 July 2001, p. 20.

In 2010, Sidel summarised the effect of such provisions:

> In Australia, there has been muted opposition in the face of little to no implementation of anti-terrorism law against the voluntary sector, though the listing and proscription of Australia-registered organisations under Australian law, or prosecutions of terrorism case ties to charitable organisations, might change that picture.[269]

In 2012, the ACNC was established, addressing one of the recommendations for "specific measures", from the 2005 mutual evaluation. The ACNC was given the ATO's responsibility for vetting charities in relation to money laundering and terror financing. To this was added scrutiny of governance issues within registered charities (which was not part of the ATO's regulatory toolbox).[270] The ACNC has engaged in monitoring and screening,[271] as well as community education in relation to charities sending funds overseas.[272]

The ACNC Act also allows for the implementation of external conduct standards for charities.[273] However, regulations still have not been made in relation to these provisions, so the ACNC cannot take any action under them. The intended object of the standards was to give the public confidence that funds sent outside Australia by registered charities are reaching intended beneficiaries and being used for legitimate purposes, and that funds and activities are not contributing to terrorist or other criminal activities. The proposed "in Australia" legislation, discussed above, was in part a further response to Australia's obligations under the FATF arrangements.

Australia participated in another mutual evaluation in September 2014, the report of which is due for release in February 2015.[274] With the abolition of the ACNC pending, and the return to the pre-ACNC situation, the next mutual evaluation report on these de-

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269 Sidel, M. 2010. *Regulation of the Voluntary Sector: Freedom and Security in an Era of Uncertainty*, (Routledge) p. 130.
270 *Australian Charities and Not-for-profits Commission Regulation 2013*.
271 ACNC. 2014. *Commissioner's Column* 27 August, http://www.acnc.gov.au/ACNC/Comms/Com_Col/CC_20140812.aspx
272 ACNC. 2014. Safe giving this Ramadan, *Media Release* 26 June, http://www.acnc.gov.au/ACNC/Comms/Med_R/MR_81.aspx
273 *Australian Charities and Not-for-profits Commission Act 2012*, Div. 50.
274 Australia. Department of the Attorney General. 2014. *Australia's engagement with the Financial Action Task Force,* http://www.ag.gov.au/CrimeAndCorruption/AntiLaunderingCounterTerrorismFinancing/Pages/FATF.aspx.

velopments will be instructive. In the meantime, AUSTRAC released a report in August 2014 "to strengthen the nation's defences against terrorism financing by improving industry and public awareness of the risks."[275] This was within days of the Australian Government raising the risk alert for terrorism and announcing that military forces would be deployed to the Middle East. The assessment indicates that there is a high potential for cross-border charity to be used for terror financing, but the actual incidence is quite low. It noted that:

> The risks associated with the misuse of charities and NPOs are high as these organisations offer the capacity for groups to raise relatively large amounts of money over time. However, this risk should be considered in the context of the relatively low incidence of terrorism financing in Australia, and the low value of funds suspected to have been raised in Australia to date. While charities and NPOs are one of the more significant Australian terrorism financing channels, they have not featured in a large number of Australian terrorism financing cases. Rather than representing a sector-wide risk, terrorism financing in Australia has been limited to a handful of charities and NPOs.[276]

[275] Australian Transaction Reports and Analysis Centre. 2014. *Terrorism Financing in Australia*, p. 2, available at http://www.austrac.gov.au/terrorism-financing-in-australia-2014.html.
[276] Ibid.