

Legal definition of 'Charity' still developing

In the immortal words of Tennessee Williams' character, Blanche DuBois in "A Streetcar Named Desire", charities and their beneficiaries (as well as Southern belles) depend upon the kindness of strangers.

And that theme rings even truer in this modern era, with the trend of governments to review many charity revenue exemptions available to charities.

This means that the work of charities becomes considerably harder and that the plight of those they assist becomes considerably worse, with fundraisers now having to focus their attention more than ever on the kindness of strangers.

That's why it is crucial that charity administrators know exactly what governments do offer to ensure they understand the revenue exemptions they still enjoy, the limitations attached to those exemptions and the necessity to comply with often petty and seemingly irrelevant constraints.

It is no easy task and an intellectual minefield that has caused dilemma for some time. In fact, the whole concept and technical legal definition of "charity" has created a quandary and level of uncertainty for many centuries.

There is also little comfort in knowing that in the year 2006, the law and practice of charity is still based upon the remaining remnants of a statute of Queen Elizabeth I passed in 1601.

While there was an attempt by the Federal Government to consider establishing a statutory definition of the expression "charity" in 2003, it did not proceed because of concern expressed by those in the charity sector. All that resulted was the passing of legislation extending the common law meaning of the term.

The most authoritative statement of the law on what constituted a charity was in the preamble to the Statute of Charitable Uses passed during the reign of Queen Elizabeth I in 1601.

However, it contained many antique concepts. Those concepts remain flexible and have been considered by the courts in Australia and the United Kingdom over the past 405 years. As a consequence of these decisions and subsequent Australian legislation, the following are considered to be charitable purposes:

- relief of poverty;
- relief of the needs arising from old age;
- relief of sickness and distress;
- advancement of religion;
- advancement of education;
- provision of childcare services on a not for profit basis;
- some self-help groups;
- contemplative religious orders;
- many other charitable purposes which are very much dependent upon their own circumstances (eg public works and utilities, disaster relief, culture, scientific and scholarly research, etc).

What is clear is that the word "charity" has a technical legal meaning which is different from its everyday meaning. It is important to be mindful that the technical definition of "charity" is particularly relevant in considering exemptions from income tax, capital gains tax, GST and other duties and taxes.

As a result of "A New Tax System" which came into effect on 1 July 2000, charities are no longer automatically exempt from income tax and other relevant taxes. Exemption is dependent upon the Commissioner of Taxation endorsing those bodies as being income tax exempt charities and that is why the opinion of the Commissioner of Taxation is an important consideration.

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Legal definition of 'Charity' still developing (cont.)

After much discussion on draft rulings, the Australian Taxation Office has issued two rulings which can be accessed through the Australian Taxation Office website at www.ato.gov.au (being TR2005/21 and TR2005/22).

These rulings are important and the principles in the rulings will be applied by the Commissioner of Taxation in considering whether or not the particular fund or institution is endorsed as a charity.

It is important to note that there is an important tax distinction between charitable funds and charitable institutions. The Australian Taxation Office takes the view that charitable funds will no longer be taken to be rebatable employers for the purposes of the fringe benefits tax legislation.

The kindness of strangers is as relevant today, as ever.

Have you considered establishing an ancillary fund?

One of the best kept secrets in the charities field is the advantages of ancillary funds, which are not widely known or utilised. They can provide benefits to some organisations wanting to provide money, property or benefits to Deductible Gift Recipients (DGRs).

Ancillary funds are like conduits or temporary repositories for channelling gifts to other DGRs and this can best be exemplified by an ancillary fund set up by a parish or school to collect money from donors and then channel them through to various other DGRs. e.g. a school building fund, a library or some DGR with a connection to such a parish or school.

They are set up by a will or trust deed and they allow an individual (but not a deceased estate) to claim deductions for donations made to these sorts of funds.

Corporates think about ancillary funds in a different way. Companies can set up an ancillary fund and ask their clients and employees to donate to it. Then the money from that fund could be distributed to a variety of DGR charities, with the donors being able to claim a tax deduction for their donation to the ancillary fund.

So the message we are trying to give to charities and not-for-profits is to partner with a corporate and get a corporate to set up a fund such as this with them as a potential beneficiary. It's a win-win scenario.

ATO moves to tighten recording of gifts to Deductible Gift Recipients

A potentially alarming idea is being considered by the ATO, where deductible gift recipients (DGRs) will be forced to provide the tax file numbers (TFN) of their donors.

The ATO recently invited people to submit comments on how this would work, how it would affect charities to have to collect this sensitive information and the impact on their costs of administration.

The implications of this would affect many charitable institutions and not-for-profit organisations. The purpose of this idea is that it would enable the ATO to complete (or "prepopulate") the "gift" section of each individual donor's income tax return, meaning the individual would not have to do this.

If this were to proceed, it may lead to the situation in a few years' time where a donor will not be entitled to claim a deduction if the donor has not provided their TFN.

This would cause problems with people collecting donations door-to-door and may force the industry to widely re-consider its options and collection practices. We made a submission to the ATO objecting to the proposal. Fortunately at this point the ATO has indicated that it is unlikely to proceed. However, DGRs should be alert to the possibility of this being revived as the ATO is examining prepopulation of income items in tax returns.

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Check your Endorsed Tax Exemption Status

A number of charities have discovered that according to the Australian Business Register (ABR) their current tax endorsements differ to what they were previously endorsed as, prior to 1 July 2005.

Of particular importance is that some charitable organisations who were previously exempt from paying FBT (on benefits grossed up to \$30,000) have found that they are now Rebatable Employers, so FBT would be payable, and FBT returns would have to be lodged.

As you are aware, from 1 July 2005 all charities have to be specifically endorsed to access charity concessions for Fringe Benefits Tax and GST.

The ATO wrote to all charities in November 2004 advising them of their endorsed status as a charity, and their entitlements for FBT and GST concessions. The charities were requested to advise the ATO if the status as shown, differed from their expectations, and often additional information had to be provided before the ATO would change the endorsement.

If the ATO did not hear from a charity, they took it that the status notified in November 2004 was correct, and they then endorsed it on that basis. The status was then recorded on the ABR which also commenced on 1 July 2005.

Many charities did not discover that their status had changed, particularly those from a Public Benevolent Institution to a Charitable Institution. With this, rather than being FBT exempt, they became Rebatable Employees, with FBT to be paid.

It is important therefore, that charities check their current endorsements, by accessing the ABR at www.abr.business.gov.au and see what form of charity they are classified as, what FBT status they hold, and whether they have been provided with GST concessions for a charity. If the endorsement is incorrect, they should seek professional advice, particularly on how to approach the ATO, to have any incorrect endorsement rectified.

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Do your annual financial reports need to comply with the new Australian accounting standards?

While charities in Australia are structured in many legal forms, there is now only one set of Accounting Standards applicable to their financial reporting obligations. These are as set out in Australian Equivalents to International Financial Reporting Standards (IFRS) issued by the Australian Accounting Standards Board. These new standards apply to reporting periods beginning on or after 1 January 2005. Thus, for many charities, the first reporting period where directors and others will be required to ensure their annual financial reports are in compliance with IFRS will be for the 31 December 2005 or 30 June 2006 year end. This new framework continues to allow for different levels of IFRS adoption in terms of whether or not the particular charity is a reporting entity.

While IFRS, as developed in Australia, apply to both for profit and not-for-profit entities, there are aspects of these standards that are specific to not for profit entities only. This sector-neutral accounting standard approach has not been followed in all comparable countries. For instance, in the United Kingdom, there are separately developed accounting and reporting requirements for charities which allow for their unique aspects.

With charities often now providing services traditionally provided by the public sector, and utilising public funds in the process, we have seen a growing regulatory trend that requires charities to prepare their annual financial reports as if they were a reporting entity. David Boymal, AASB Chairman, was also quoted last year in CFO magazine as stating that "...there is a growing demand for more regulation in churches and charities". As the AASB is responsible for setting accounting standards for the public and private not-for-profit sectors, we are likely to see an increasing expectation for charities to comply with more aspects of IFRS.

With this new framework in place those responsible will need to reconsider the form and content of the annual financial report of their charity, and adopt applicable IFRS if the report is to retain its credibility.

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It's not just a good time had by all!

Fundraising dinners and auctions are being put under the microscope. Prior to 1 July, 2004, a deduction was denied where a donor received a benefit in connection with a donation to a Deductible Gift Recipient (DGR), unless the benefit was insubstantial or immaterial like lapel badges.

However, from 1 July, 2004, a deduction has been allowed where a donor receives a benefit in connection with the contribution, provided that certain conditions are met and the benefit does not exceed a specified limit.

What this means for scenarios like fundraising dinners is that the donation must be greater than \$250, and the market value of the benefit, like the dinner, is to be the lesser of 10% of the donation or \$100 for a donor to obtain any tax deduction.

Obviously this would not apply to making donations through purchasing goods at an auction at such a dinner. Such purchases would not be considered to be "gifts" and would therefore not result in any tax deduction.

What are the duties and responsibilities of a director or committee member?

Have you been invited to join the board or committee of a charity or not-for-profit organisation? Before you get carried away with the excitement of your first board or committee appointment, you need to make yourself aware of your legal responsibilities if you take up the role.

Makinson & d'Apice is presenting an information seminar that will cover directors' duties and tax issues for charities and not-for-profit organisations on 16 May, 2006 at 4.45pm-6.30pm. If you would like to attend, call Beyhan Balci on 02 9233 9056.

New opportunities open for DGR categories

The Federal Government's announcement in May 2005 that there would be five new Deductible Gift Recipient (DGR) categories from July 1 this year will open up new opportunities for some organisations which are currently not recognised as DGRs.

These five new categories are:

- Funds that are established for the reconstruction and critical repair of eligible war memorials. This means approved funds may be endorsed as DGRs for a maximum period of two years.
- Public funds whose principal purposes are to relieve or prevent distress caused by declared natural or man-made disasters or assist in disaster reconstruction within Australia and developed countries.
- Charitable funds and organisations whose principal purposes are the provision of services which provide direct care to maltreated animals.
- Charitable funds that undertake a combination of activities that fall under existing DGR categories.
- Charitable funds that are established and maintained solely for the purpose of providing scholarships, bursaries or prizes to promote all levels of education where entry to persons is at a national, regional or state level.

This last new category, in particular, will provide many corporates and educational establishments with an opportunity to establish bursary funds or scholarships, where they have found it difficult trying to fit it within the tight DGR framework which currently exists.

This document has been written by Vera Visevic, Partner at Sydney law firm Makinson & d'Apice. It is intended as an information reference only and specific legal advice should be sought about individual circumstances.

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