

When is a gift not a gift?

How to determine if a donation to a DGR is tax deductible



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When is a gift no longer a gift?

“When issuing receipts to donors, DGRs must be careful to ensure that the gift they are receiving is actually a ‘gift’.”

For donors, an appealing aspect of giving is the benefit of tax deductibility. The ability for an organisation endorsed as a deductible gift recipient (DGR) to be able to class a ‘gift’ as a ‘deductible gift’, is therefore extremely valuable. DGRs must, however, before representing to donors that certain gifts will be tax deductible and before issuing tax invoices to donors, take heed of the law surrounding what actually constitutes a gift for the purposes of tax deductibility.

Although DGRs are not required by tax law to issue receipts for deductible gifts, many DGRs do and, as a result, DGRs must assume some degree of responsibility in ensuring that a received gift is in fact deductible, before issuing a donor with a receipt. Making such a determination can be difficult in certain situations, particularly when the gift comes with certain obligations or conditions attached to it. Such conditions and obligations placed on gifts by donors raise questions as to whether the gift can be deemed to be a gift, and if so, whether the recipient DGR can comply with the requirements and stipulations of the donor in the treatment of the gift.

Where to start in determining whether a gift is deductible?

DGRs should be aware that for a donor to claim a deduction for a gift, the following requirements must be met:

- 1 The gift must be made to a DGR.
- 2 The gift must really be a ‘gift’.
- 3 The gift must be of money or property that is covered by one of the gift types.
- 4 Any gift conditions must be satisfied.
- 5 The entity receiving the gift must be in Australia.
- 6 The gift must be made during the donor’s lifetime (ie the gift must not be testamentary).¹



Requirements 2, 3 and 4 will be explored in greater detail in this article.

2 The gift must really be a ‘gift’

Division 30 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) and section 78A of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) are the relevant pieces of legislation in relation to deductible gifts or contributions.

The ITAA 1997 does not define the expression ‘gift’ and therefore, for the purposes of Division 30, the word ‘gift’ takes its normal meaning. The courts have interpreted the concept of a gift over the years and have described it as having the following characteristics:

- There is a transfer of the beneficial interest in money or property.
- The transfer is made voluntarily (without any contractual obligation to transfer the gift).
- The transfer arises by way of benefaction.

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- No material benefit or advantage is received by the donor.

The Australian Taxation Office (ATO) released Taxation Ruling 2005/13, which discusses the above four points in detail. The main issues to consider when considering those four points are as follows:

(a) There is a transfer of beneficial interest in money or property

To be a gift, there has to be a transfer of money or property. Gifts of services are therefore not deductible. Volunteers are the obvious example of a class of people who provide DGRs with gifts of services. Those services are not, nor are any further costs incurred by a volunteer whilst providing those services, tax deductible.

For there to be a transfer, the property of the donor which is being gifted to the DGR must become the property of the DGR. Pursuant to subsection 78A(3) of the ITAA 1936, a gift deduction will not arise where the receiving DGR does not:

“receive immediate custody and control of the property, does not have the unconditional right to retain custody and control of the property in perpetuity to the exclusion of the donor or an associate of the donor or does not obtain an immediate, indefeasible and unencumbered legal and equitable title to the property.”

Subsection 78A(3) of the ITAA 1936 does not, however, apply to specified cultural or heritage gifts within the table in section 30-15 of the ITAA 1997.

(b) The transfer is made voluntarily without any contractual obligation to transfer the gift

For a transfer of property to be a gift, it must be the “*act and will of the donor, and there [must be] nothing to interfere with or control the exercise of that will.*”² Should a transfer be made by a donor under a sense of moral obligation, however, it will still be deemed to have been made voluntarily.

Even where it is clear that a donor has had a choice whether or not to make a transfer to a DGR, that transfer will not be deemed to be a gift if the gift has had the effect of discharging or decreasing a contractual obligation owed by the giver to the DGR (or an associate of the DGR).

Example: voluntary

Bob wishes to buy a piece of machinery from a DGR for \$75,000.00. Tom wishes to buy the same piece of machinery. Tom offers the DGR \$60,000.00 for the piece of machinery and also offers to make a donation of \$20,000.00 to the DGR. The DGR accepts Tom's offer. Tom's donation of \$20,000.00 to the DGR would not be deemed to be voluntary and would therefore not be deemed to be a gift.

A common example of where donations to DGRs fall short due to such donations not being deemed to be voluntary in nature, occurs in relation to payments by parents into a school building fund, where it is deemed that those payments are not being made voluntarily. The case of *Federal Commissioner of Taxation v McPhail*³ illustrates this. In this case parents were invited to make donations to the school's building



fund and if the parents decided to make such a donation, they would be eligible for lower school fees for their children. The High Court held that the donation made by the parents to the building fund was not tax deductible. Justice Owen made the following comments in reaching this decision:

“But it is, I think, clear that to constitute a “gift”, it must appear that the property transferred was transferred voluntarily and not as the result of a contractual obligation to transfer it and that no advantage of a material character was received by the transferor by way of return. In my opinion, neither of these conditions was fulfilled in the present case..... In the events that happened it was a payment made pursuant to a contract between the taxpayer and the School Council.”

(c) The transfer arises by way of benefaction

To be deemed a gift, a transfer by a donor to a DGR must be intended to confer a benefit on that DGR.

Subsection 78A(2)(b) of the ITAA 1936 states that a gift will not be deductible where:

“any fund, authority, institution ... to which the gift was made, makes, becomes liable to make... a payment, or transfers, becomes liable to transfer.... any property,

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Legislation — Federal

Below is an overview of recent activities of the Federal Government and regulatory authorities which impact on the not-for-profit sector.

GST tips

The Australian Taxation Office has issued a new Information Sheet entitled "GST tips for non-profit organisations" which can be found at <http://www.ato.gov.au/nonprofit/content.asp?doc=/content/00161180.htm>.

The purpose of this 10 page document is to assist organisations in the non-profit sector with understanding the nature of the GST concessions which apply to those organisations, and so the document is well worth reading.

Concessions

The Australian Taxation Office has been busy in that it has also issued an email entitled "Concessions for charitable fundraising events" which states that endorsed charitable institutions, endorsed trustees of charitable funds, gift deductible entities and government schools can now

choose to have all the supplies that they make in connection with a fundraising event treated as input taxed for GST purposes. An organisation that makes this choice must keep a record of its decision for each type of fundraising event. A consequence of making this choice to treat it as input taxed is that the organisation is not required to charge GST on the fundraising event, but similarly cannot claim input tax credits for any purchases or acquisitions made in relation to the fundraising event.

The concession allows organisations to use any surplus funds generated for relieving distress caused by, for example, the recent Queensland floods and Victorian bushfires. The way the surplus funds are used does not affect the GST treatment of the supplies that generated those funds.

If an organisation does not elect to have its supplies in connection with its fundraising event treated as input taxed and still holds the event, the supplies made in connection with that event will be subject to GST. ■

Vera Visevic is a partner of Makinson & d'Apice.

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Fundraising at a time of crisis — opportunity or risks?

A recent survey (*Global Fundraising Confidence Survey Report*) of some of the world's leading fundraising experts found that the majority are confident that non profits can avert possible negative fallout from the financial crisis by being proactive.

The key findings and recommendations of the survey suggests fundraising action versus apathy.

The resounding sentiment that emerged from the study was that non profit organisations must take proactive measures to fight the potential effects of the financial crisis on their fundraising income.

Respondents also cited the following as some of the key action points:

- Invest more in donor care and relationships and look at ways of improving donor experience with the charity. Stay close to donors and reiterate to donors they are needed and appreciated.
- Stay far-sighted and stick to strategy. Do not cut down investment at the expense of long term growth.
- Focus on planning, training and development. Now is the time to get the house in order - spend time planning, training, and developing campaigns, focus on getting internal processes and controls, so that when the crisis subsides you can go in with full readiness.



Opportunity for funding

There is also the lure of private sector funders as a great source of funding. With the recent move towards corporate social responsibility, increasingly not for profit organisations are being sought as partners by corporate Australia in these endeavours. These

partnerships give companies a low-cost and highly effective point of entry to social and community fields where they can make a real street-level contribution. Notwithstanding this, corporate commitments are going to be tested by the current financial crises.

In the public sector, government agencies are extending contractual arrangements with not for profits in almost all corners of the public service, with 'partnerships' being the current flavour. This enhances service delivery, given the knowledge and experience that the not for profits have accumulated, not to mention the compassion and sensitivity which characterises their mission and operations.

“Non profit organisations need to be proactive to protect fundraising income”

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Fundraising at a time of crisis — opportunity or risks?

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“Ensure continuous linkage between governance, risk and compliance with strategic direction”

Stay true to your cause

If not careful, not for profit organisations may be exploited and lose their distinctiveness and raison d'être. It is too easy for a not for profit organisation to sell its soul, tarnish its credibility, and become so dependent on government contracts/private sector funding that it comes to resemble a public bureaucracy, tailoring bids and behaviour to suit the wishes and language of the bureaucrats.

So, leaders of not for profits are engaged in a balancing act of the highest magnitude. The lobbying capacity of a not for profit organisation might be jeopardised if it becomes too dependent on the government hands that feed it, or too closely identified with a company's agenda.

From a not for profit board's oversight perspective, the need is to balance oversight, insight and foresight to maximise a board's effectiveness. Build leadership capabilities within the organisation. Ensure continuous linkage between governance, risk and compliance with strategic direction. Boards can also add value by using their strategic and technical skills and guide with rich insight and foresight. Make a contribution by understanding big picture trends, how to position the organisation for sustainability, achieve its strategic goals and what competitive threats are emerging. In the competitive world of philanthropy, the first to market and innovation is also key.

Key risks

Government funding comes with strings attached and may lead to an unhealthy dependence. This is especially true as the diversity of not for profits funds stand to shrink as philanthropic support decreases.

With the economic crisis there are increasing risks that bequests will be withdrawn resulting in liquidity issues, threatening social enterprises as philanthropic dollars diminish.

Working with corporates to identify innovative approaches to leverage talents to fill the gaps was one example of how partnerships can be used to shift a not for profit's focus away from purely financial contributions. However, with this comes risk associated with third/counter party risks.

Examples abound, where potential liabilities of directors could range from a conviction for corporate manslaughter arising from a car accident (not ensuring proper functioning of vehicle/fit for purpose) to negligent waste disposal.

But what are the risks not for profit organisations are exposed to?

Consider some of the key risks and decide how governing boards, CEOs, councillors, committee members would negotiate this minefield.

Committee members, directors, trustees or councillors all have very onerous responsibilities and if something goes wrong, they need to be ready to defend themselves, and be able to show that they have diligently discharged their responsibilities will help enormously.

Having delegated power to the CEO, what else can those charged with governance/board oversight do?

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to any person or incurs, becomes liable to incur, or may reasonably be expected to incur or to become liable to incur, any other detriment, disadvantage, liability or obligation.”

Justice Deane in *Leary v the Commissioner of Taxation of the Commonwealth of Australia*⁴ stated that:

“...benefaction focuses upon the effect of the transaction upon the recipient...[and involves] the concept that the relevant transfer is by way of well doing in that the recipient will be advantaged, in a material sense and without any countervailing material detriment arising from the circumstances of the transfer, to the extent of the property transferred to him.”

Where a detriment, disadvantage or obligation has been placed on a DGR as a result of a transfer from a donor but that donor was not aware at the time of the transfer of that disadvantage or detriment, the element of benefaction will not necessarily be deemed to be missing.

It is likely that the concept of placing obligations upon a transfer to a DGR will be of interest to many DGRs, as in practice it is not uncommon for ‘gifts’ to be

transferred to DGRs with some sort of obligation attached to it. Whether that obligation is an obligation to spend money in a certain way or an obligation to recognise or credit the donor for the gift, the question must be asked whether such obligations will preclude a conferral of benefaction upon the DGR.

In this regard, the proportion which the detriment, disadvantage, obligation, liability or limitation bears to the value of the property transferred may be looked to, that is, detriments that are immaterial in comparison with the value of the transfer will generally not preclude a finding that the transfer arises from benefaction.

Example: detriment

Sally transfers a house to a DGR which on a recent inspection was found to be in a good condition. Subsequently it is found that the house contains dangerous materials and a demolition order is made by the local council. The transfer is a gift as Sally was unaware of the detriment being passed to the DGR.

DGRs must also be careful where donors are making gifts or payments to the DGR on the condition that the gift or payment be transferred to a non-DGR. If such a condition is placed on the gift, the DGR will be seen to be merely an agent and no benefaction will have been conferred on the DGR itself. Where, however, a donor makes a payment to a DGR and expresses a preference that the money be passed on to an affiliate organisation but the DGR is not obligated to do so and retains discretion in this regard, the gift may be deemed to be tax deductible

even where the DGR does comply with the donor’s wishes.⁵

Example: donor request

Michelle donates \$200 to a DGR which is authorised to make payments to non-DGR’s, with a request that the money be given to a specific non-DGR. As the DGR does not have discretion whether or not to apply the amount in accordance with Michelle’s wishes, the \$200 is not a deductible gift, as no benefaction has been conferred on the DGR.

(d) No material benefit or advantage is received by the donor

Subsection 78A(2)(c) of the ITAA 1936 states that a gift will not be deductible where:

“the donor or an associate of the donor has obtained, will obtain or may reasonably be expected to obtain any benefit, advantage, right or privilege other than the benefit of any deduction”

The courts have interpreted this concept by stating that a transfer will not be deemed to be a gift where the donor receives a material benefit from the making of the transfer.

The case of *McPhail*⁶ can again be looked to in this regard, where it was held that the fee concession afforded to the parents of the school was a material benefit.

A benefit may be deemed to be material even where the value of the benefit to the giver is less than the value of the property transferred. Issues of proportionality between the ‘gift’ and the benefit to the giver will again need to be assessed.

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Public recognition accorded to donors will generally not be deemed to be materially benefiting the donor. However, should an obligation to recognise confer an obligation which results in substantial expenditure being outlaid by the DGR, the element of benefaction will likely be missing.

Example: public recognition

A wealthy businessman makes a gift of \$5 million to a public hospital (a DGR) for the purpose of building a new wing. The businessman stipulates that the new wing must be named after him. A plaque acknowledging the businessman is also placed in the foyer of the hospital. The naming would not be deemed to be a material benefit and paragraph 78A(2)(c) will not apply. Any benefit derived from the businessman and any obligation he imposed on the hospital is insignificant in relation to the value of the gift.

“A gift must meet the four criteria, discussed in the ATO’s Taxation Ruling 2005/13”

3 The gift must be of money or property that is covered by one of the gift types

The table on the next page provides a summary of the gift types.

4 Any gift conditions must be satisfied

For some DGRs, the law adds extra conditions affecting the types of deductible gifts they can receive. For example, the gift may only be tax deductible:

- between certain dates; or
- for a specific use.

Example: purpose

Gifts to a DGR that is an approved research institute will be tax deductible only if they are made for the purposes of scientific research in the field of natural or applied science.

A gift for use by the institute for some other purpose is not a deductible gift as it has not been made with a specific purpose required by the gift condition.

Many categories of DGR have no gift conditions. However, some categories of DGR have extra conditions placed on them by law affecting the types of deductible gifts they can receive (see examples on page 8).

Conclusion

In light of the above, DGRs must be careful to ensure that when issuing a donor with a receipt, the gift that they are receiving is actually a ‘gift’. The ATO is unable to advise what (if any) consequences would result for DGRs which issue receipts for ‘gifts’ which are not, in fact, gifts. Should a donor be required to eventually pay back tax to the ATO for a gift originally deemed deductible, but subsequently found not to be deductible, the result may be a very unhappy donor, which in turn will mean a very unhappy DGR as the donor may no longer wish to support that DGR. ■

Breanne Stratford is a solicitor at Makinson & d’Apice.

- 1 Unless they are made under the Cultural Bequests Program under subdivision 30-D of the ITAA 1997.
- 2 *Cyprus Mines Corporation v Federal Commissioner of Taxation* 78 ATC
- 3 (1968) 117 CLR 111
- 4 [1980] FCA 112
- 5 *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR
- 6 *Federal Commissioner of Taxation v McPhail* (1968) 117 CLR 111
- 7 The Cultural Bequests Program is currently suspended, however holders of certificates issued by the Minister for Arts while the program was operating can claim a deduction to the value on the certificate.

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Gift type	Description
■ \$2 or more	Gifts of money to the value of \$2 or more
■ Property > \$5,000	Gifts of property valued by the Tax Office at more than \$5,000
■ Property < 12 months	Gifts of property purchased by the donor during the 12 months before the gift was made
■ Shares ≤ \$5,000	Gifts of listed shares valued at \$5,000 or less and acquired at least 12 months before the gift was made
■ Trading stock	Gifts of the trading stock of a business disposed of outside the ordinary course of the donor's business
■ Cultural gifts	Gifts of culturally significant property made under the Cultural Gifts Program
■ Cultural bequests	Gifts made under the Cultural Bequests Program ⁷
■ Heritage gifts	Gifts of places included in the National Heritage List, the Commonwealth Heritage List or the Register of the National Estate

Example: conditions

Australian Disaster Relief Fund

To be tax deductible a gift must be made within two years beginning on:

- the date of the disaster as specified in the declaration (by the relevant State or Territory Minister); or
- otherwise on the date of the declaration.

Overseas Aid Fund

To be tax deductible the Treasurer's declaration must be in force at the time a gift is made.

Approved Research Institute

To be a deductible gift, the gift must be for the purposes of scientific research in the field of natural or applied science.



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Summary of key risks

- Core operating risk
- Financial risks
- Management risk
- Counterparty risk
- Loss of income
- Unauthorised expenditure
- Fraud
- Waste of resources
- Political risk (funding cuts)
- Loss of reputation
- Loss of donor support
- Poor services
- Tendering
- Management risks versus volunteer risks
- Lack of strategic planning
- Poor management information systems
- Human resource management
- Financial management
- Marketing debacles

Fundraising at a time of crisis — opportunity or risks?

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“The use of internal audit and robust risk management is of paramount importance”

Establish a risk management framework, monitor and control

A systematic approach to risk management would help boards clearly distil and develop a clear high level helicopter view of risks and potential impact.

It is important to realise that the auditor is not legally or professionally responsible for preventing irregularities. The prime responsibility rests with members of the governing board – through the implementation and continual operation of adequate internal controls

Risk identification and assessment

Establish a formal risk identification and assessment, risk-ranking and control process.

Ensure that a robust risk management process exists. Risks profiling should not be static. Frequently assess risks and associated threats.

Control activities and control environment.

The control environment is the foundation on which to build a sound control framework. Other control mechanisms should encompass clear guidelines on policy, and procedure manuals will include: **A statement of ethical standards** - guidance for dealing with members,

beneficiaries, government suppliers, donors and employees.

Monitoring

Consider if the board composition has a good balance of experience and skills. Board members should be in a position to decide if management reports provided suffice for their governance and decision making. Define a set of key risk indicators, along with key performance indicators for monitoring.

Look at shared service resources if there is no critical mass.

Clearly, every not for profit organisation needs an active board, one whose members set the right tone at the top. Consequently ensure that there is a culture of risk awareness, understanding of key risks and consequence. Empower management and volunteers by establishing limits and parameters in terms of risk taking, so as not to stifle innovation.

Effective monitoring demands good communication. Communicate, communicate and communicate! It cannot be overemphasized the value of open channels of communication. There should also be open cross functional discussions to avoid management blindness and operating in silos.

Summary

Especially during a time of economic challenges, the need for more innovative

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Legislation — States & Territories

Victoria

Stamp duty

The Victorian Government has announced that it will introduce measures to ensure that proposed stamp duty changes will not apply to retirement villages. The Victorian Government will amend the *Duties Amendment Bill 2008*, which is currently before the Victorian Parliament, and which is aimed at closing a loophole that allows the use of complex long term lease arrangements to escape duty liability in Victoria. The Parliament has said that it has consulted with stakeholders and was acting to prevent any possibility of unintended consequences of the Bill applying to retirement villages.

The Victorian Government has said that the Victorian State Revenue Office will release a draft ruling to clarify the intent of the new lease provisions.

Incorporated associations

Changes to the Victorian *Associations Incorporation Act 1981* are on the horizon. A Bill is currently before the Victorian Parliament

which, if passed, which is likely to occur, will extensively amend the current *Associations Incorporation Act 1981*. We will keep you advised of any changes to that legislation.

Queensland

Trusts

Legislation has been passed to amend the *Trusts Act 1973 (Qld)*. This will enable prescribed private funds and ancillary funds which are based in Queensland to distribute to deductible gift recipients, regardless of whether or not the DGR is charitable at law. This is provided, however, that the prescribed private fund or ancillary fund applies to the Australian Taxation Office to become an income tax exempt fund.

This amendment to Queensland's *Trusts Act* is similar to changes which have already been made to the *Charitable Trusts Act 1993* in New South Wales and the *Charities Act 1978* in Victoria, which enable income tax exempt funds to make donations to a wider range of DGRs.



New South Wales

Family Provision Act 1982

The *Family Provision Act 1982*, which up until recently legislated for claims made by disgruntled relatives against an estate, was repealed on 28 February 2009. The *Succession Act 2006* now governs family provision claims.

Incorporated associations

As is the case with the *Associations Incorporation Act* of Victoria, the *Associations Incorporation Act 1984* of New South Wales is also being significantly amended. A Bill is currently before the New South Wales Parliament and, if passed, will result in a significant overhaul of the current legislation applying to incorporated associations in New South Wales. We will provide you a full report on those proposed changes in our next issue. ■

Claire Russell is a solicitor at Makinson & d'Apice.

Fundraising at a time of crisis — opportunity or risks?

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financing, and strong leadership skills is key to managing the complexity in the organisational dynamics and business uncertainty which comes with greater risks and especially with more innovative funding and partnerships versus traditional fundraising. The use of internal audit and robust risk management to help drive value and

ensure the organisation stays true to its cause is also of paramount importance.

During a time of global financial crisis, not for profit organisations should remain focused on portfolio quality even in the face of decreasing profit margins and greater competition for funding.

Consider enhancing the risk management processes to mitigate losses arising from increased risk exposure associated with more competition, broader product breadth and a more complex funding structure and partnerships. ■

Shirley Liew is a director of Moore Stephens Sydney Pty Ltd.

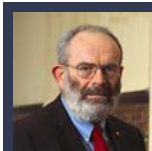
Balancing Act

Issue 12

Legal and tax affairs for the non-profit industry

March 2009

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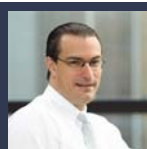
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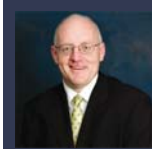


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Back issues

All issues of *Balancing Act* are available online at www.makdap.com.au. Articles in the last two issues include:

Issue 11, December 2008

- A new era for charities and non-profits
- Tax Office not appealing the decision in *Victorian Women Lawyers' Association*
- Senate report released
- Does your organisation undertake trading activities?
- Improving the integrity of PPFs
- Charities reminded to conduct annual self-reviews
- ATO compliance program 2008-09

Issue 10, September 2008

- Are you minding your own business?
- Is your organisation at risk of fraud?
- Is it better to give than to receive if you are a charitable institution?
- An annual checklist for not-for-profits

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