

# Balancing Act

Issue 19

Legal and tax affairs for the non-profit industry

May 2011



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## Makinson & d'Apice Research Study Report

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## Makinson & d'Apice Research Study Report

In early 2011, Makinson & d'Apice commissioned independent researchers and management consultants to conduct an Australia wide study of the legal landscape facing charities and other NFPs in Australia today.

There were approximately 250 responses from NFPs across Australia. We issued a Bulletin in April 2011 with some snapshot findings from the research study.

This can be accessed from our website at: <http://www.makdap.com.au/docs/Snapshot%20findings%20-%20final1.pdf>

We have undertaken a further consideration of the study and want to offer observations on three areas identified in that study:

### Legal Knowledge at Board Level

The survey indicates a real lack of understanding regarding NFP legal issues and compliance obligations at Board level. Our respondents were largely senior managers within the sector and many reflected on the lack of knowledge their Board Members possessed about their legal and fiduciary rights and obligations.

It was clear from the survey that there was increasing knowledge and expertise of these issues at senior management level



particularly over the last five years. However, there is scope for further education at Board Level.

***“A lack of foresight and ability to adequately risk manage potentially adverse situations at a high level means ... more than just avoidable legal costs ... like serious reputational damage”***

Notable comments:

- *“Better informed, more legally aware executives who can better deal with issues and disputes would make a difference.”*
- *“Setting up a course that people who were on Board of Management and Committees were made aware of their responsibilities as a Board Member. They should have to do a test before they can legally become a Board Member.”*
- *“We currently have a conflict of interest issue with one of our Committee Members but the Committee is struggling to understand and manage properly. Despite this the Committee are unwilling to access advice or training....”*
- *“Lack of awareness or knowledge of compliance issues. Attracting new Board Members due to the penalties imposed for non-compliance.”*
- *“...we are a small organisation – only one full-time worker – so we don't have time to think these issues through we just have to deal with the outcomes.”*

A lack of foresight and ability to adequately risk manage potentially adverse situations at a high level means when a real problem

*(Continued on page 2)*

***“indicates a real lack of understanding regarding NFP legal issues and compliance obligations at Board level.”***

## Makinson & d'Apice Research Study Report



***“The survey highlighted that NFPs considered they had weaknesses in management of legal issues.”***

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occurs there is often a big sting that is more than just avoidable legal costs. There is also broader impacts, like serious reputational damage.

### **NFPs Biggest Risk and Greatest Fear — Lack of Funding**

Many in our research sample were concerned that in the wake of the GFC and recent natural disasters, direct fundraising of the public would be difficult with givers suffering “*compassion fatigue*”.

Notable Comments:

- “*...resourcing to meet ongoing commitments v potential donor fatigue with recent demands for support following natural disasters.*”
- “*Shifting attitudes within the public regarding charity impact of one-off events on sustainable and repeatable fundraising eg Tsunami, Christchurch, Floods in Queensland.*”

However, the majority of our sample noted that most of their direct income was from government sources and were operating sometimes national charities with budgets of less than \$3 million per

annum, many on as little as \$500,000.00.

At least half of the NFPs surveyed feared their ability to cope and maintain services with a reduced amount of funding.

### **Inappropriate Advice**

The survey highlighted that NFPs considered they had weaknesses in management of legal issues. One-third of respondents rated their management of property legal issues as either weak or very weak. 30% of respondents rated their organisation’s relationships with external lawyers as weak or very weak. Whilst only 25% of respondents characterised their relationship with external lawyers as strong.

In addition, a quarter of respondents rated their organisation’s ability to take advantage of tax concessions as weak or very weak. This is a considerable concern for the sector as maximum advantage should be taken from tax concessions to then maximise funds available for the charitable purposes of the NFP.

Notable Comments:

- “*At times the external lawyer does not understand the business fully or the regulatory framework for NFP therefore advice may be based on a corporate view and not accounting for NFP issues.*”
- “*(Not)...understanding the complexity and uniqueness of our regulatory framework and Church structures.*”
- “*The response time of lawyers if they are working pro-bono their lack of knowledge of specific not-for-profit issues.*”
- “*As they do the work pro-bono – ability to have them turn work around in our timeframe.*”

The overwhelming majority of respondents (90%) agreed that the “*right*” legal advice from highly skilled lawyers in the NFP sector would have “*some positive*” or a “*great positive*” impact on their organisations.

*Bill d'Apice is a partner of Makinson & d'Apice*

## A New Regulator—A New Tax—A New Definition

The Gillard government announced a range of Budget measures on 10 May 2011 which will have a serious impact on the Charities and Not-For-Profits sector.

These measures include:

- The establishment of a National Regulator to be known as the Australian Charities and Not-For-Profits Commission which will be responsible for regulation of the sector.
- The establishment of a statutory definition of "Charity".
- The imposition of income tax on some income of NFPs from commercial activities where the proceeds are not applied towards the NFP's altruistic purpose.

Further information can be obtained from our Bulletin which is accessible at <http://www.makdap.com.au/docs/Makinson%20%20d'Apice%20Bulletin%20May%202011.pdf>:

When further details are available, these will be included in future editions of *Balancing Act* or special bulletins issued by our firm. ■

*Bill d'Apice is a partner of Makinson & d'Apice.*





*“these provisions may prove to be handy in circumstances where Board members leave organisations and decide to air any residual debated issues at their time of resignation.”*

## Protecting the reputation of Not-For-Profit organisations

In our recent survey of Not-For-Profit organisations, it became apparent that some organisations were extremely concerned with the reputation of their organisation being affected by matters that go on within the Boardroom. We thought that we would take the opportunity to remind Not-For-Profit organisations that although defamation laws across Australia consistently provide that corporations should not have recourse to defamation law for injury to reputation, (unless it is a corporation with fewer than 10 persons and not related to another corporation), there is an exception available to Not-For-Profit organisations which are companies limited by guarantee.

Section 9(1) of the *Defamation Act 2005* (NSW) states that a corporation has no cause of action for defamation in relation to the publication of defamatory matter about the corporation unless it was an excluded corporation at the time of publication. A corporation is an “excluded corporation” if, among other things, the objects for which it is formed do not include obtaining financial gain for its members or corporators (section 9(2)). Companies limited by guarantee should therefore take note.

The Sporting Shooters Association of Australia (Vic) (**SSAAV**) was a group of sporting shooters who had banded together informally to oppose laws which would have placed restrictions upon gun ownership. The organisation was a company limited by guarantee. Gun Control Australia (**GCA**) was a body incorporated under the *Associations Incorporation Act* in Victoria and its president, John Crook, often wrote pamphlets and spoke in public on the gun control issue. GCA produced a modest newsletter called “Update on Gun Control”. In issue number 3 of January 1990, Mr Crook, the editor of the newsletter, wrote that:

*“Perhaps worst of all was a statement made by Ted Drane, President of the Sporting Shooters Association. About a year ago Drane made a statement on radio and to The Australian that shooters were law abiding people, but qualified it by noting that shooters don’t have to conform with laws that they find disagreeable to the shooting fraternity.”*

*(Continued on page 5)*

## Protecting the reputation of Not-For-Profit organisations

(Continued from page 4)

In issue number 4 of May 1990, Mr Crook wrote:

*“Running against the will of the people is the gun lobby, led by the extremist Sporting Shooters Association, and backed to the hilt by gun traders, under the cunning guise of a gun safety organisation. These pro-violence groups claim of the NCV’s report: ‘much of this document is a clearly biased, unsupported nonsense, unworthy of the paper on which it is printed, let alone government or community support’. That section of the Australian community which supports violence can only gain by this attitude of the Shooting Sports Council of Victoria.”*

Naturally, the SSAAV complained about these publications.

Justice Shelton first considered the issue of whether SSAAV was a non-profit organisation capable of suing. The case was heard before the introduction of uniform defamation laws adopted across Australia in 2005. Accordingly, Justice Shelton looked to previous case law, namely *The Church of Scientology of California Incorporation v Reader’s Digest* [1980] 1NSWLR 344 wherein it was decided that companies who are non-trading corporations who maintain a right to acquire property which may be the source of income or revenue have a reputation capable of being protected. SSAAV was the proprietor of properties in Victoria, with its headquarters on land owned at Springvale on which it conducted club rooms and had a dining room from which it obtained revenue and it raised revenue from fees paid by 15,000 members, of approximately \$675,000.00 a year. Consequently, Justice Shelton was

comfortable stating that SSAAV was capable of suing for defamation.

In the SSAAV case, it was argued that the first publication was not about the SSAAV but about Ted Drane, but Justice Shelton dismissed this view. SSAAV stated that the first publication raised the following defamatory imputations:

- that SSAAV advocated that its members could break the law;
- that SSAAV advocated that shooters do not have to conform with laws they find disagreeable; and
- that SSAAV was irresponsible in advocating its views.

In respect of the second publication, SSAAV said that the following defamatory imputations were raised:

- that the SSAAV was an extremist organisation;
- that SSAAV conducted a deceitful campaign to promote shooting; and
- that SSAAV was a pro-violence group.

Justice Shelton found that the imputations alleged to be made of the first publication were in fact made and were defamatory. However, the GCA was able to rely upon a defence of qualified privilege as they were matters that were published in the course of discussing government and political matters and as such, on the basis of the case of *Theophanous*, they were protected by qualified privilege.

In relation to the second publication, Justice Shelton stated that the imputations were indeed made and they were indeed defamatory.

Justice Shelton specified that the defence of qualified privilege made in

respect of the second imputations could be defeated if SSAAV could establish malice on the part of Gun Control Australia and Mr Crook. However, because Mr Crook had an honest belief in the truth of the first words and the second words, and Justice Shelton was not convinced that Mr Crook was actuated by a dominant motive of personal spite or ill will or some other improper motive in publishing the first words or the second words, he found that the argument of malice was not made out. Justice Shelton decided that Mr Crook’s attitude to gun control had been quite consistent from the mid-1980s to date as demonstrated in his various writings, which suggested no dominant improper motive on his part. He placed little weight on the fact that Mr Crook failed to apologise.

GCA therefore succeed in their defence of qualified privilege in respect of the first publication and the second publication and the defence was not defeated by malice.

Companies limited by guarantee should be aware that this case was determined before the introduction of uniform defamation laws, but that it nevertheless is an example of a non-profit organisation that was found to be capable of suing in defamation, notwithstanding the decision against that Not-For-Profit organisation.

*Kylie Maxwell is a Senior Associate at Makinson & d’Apice.*

***“that SSAAV  
advocated that its  
members could  
break the law”***



## Supreme Court of NSW appoints new Trustee for Testamentary Charitable Trust

(Continued from page 6)

**“The wording of a testator’s wishes may not be the final word on charitable bequests ... especially when unincorporated charitable organisations become incorporated or merge with others.”**

- Challenge transferred the land on which Crowle stood to Crowle in 1993. The part of the land on which Challenge’s head office (known as ‘Lacey House’) stood was leased back to Challenge for a period of 99 years. In 1997, Challenge commenced action against Crowle concerning the transfer of that land. Those proceedings were dismissed.
- In 2008 Crowle merged its operations with the former Hornsby Branch of Challenge, which was called Achieve Foundation Limited. The merger entity is now named Achieve Australia Ltd (**Achieve**).
- Challenge continues to exist but on a much smaller scale since the devolution to its branches. It no longer has paid staff and is primarily involved in providing buses and holiday homes for use by disabled persons. Except for the lease of Lacey House and the land litigation, Challenge has had no contact with Crowle since 1993.

In her will, the testatrix expressed that while her daughter remained in the care of an institution other than a hospital, 40% of the trust income from time to time was to be given to that institution as a donation “to use



as it sees fit in carrying out its charitable activities.” The remainder of the trust income was to be used for the benefit of her

daughter. Any amount not used for that purpose was to be added to the capital. The testatrix expressed that the trust was to end on the death of her daughter, who died in 2008. The final distribution amount was in the order of \$1.4 million. Relevantly, the will made provision for the final distribution as follows:

1. One part was to be given to Challenge “if it still exists when the trust ends”. The gift was expressed to be made on trust for the charitable activities of Crowle “while ever it is still in existence”. Otherwise Challenge could use it as it saw fit in carrying on its other charitable activities; and
2. One part was to be given to the last institution, other than a hospital, which cared for the daughter of the testatrix “if it still exists when the trust ends”. The testatrix defined “institution” as “a home like the Crowle Home”. If the institution was Crowle, the gift was to be made to Challenge on the same terms as detailed in 1 above. If the daughter of the testatrix was in another institution before her death, the gift was to be made to that other institution on trust to use as it sees fit in carrying on its charitable activities.

Justice Ball took the view that as Challenge still exists, the gift described at 1 above was to it as trustee of the charitable trust created by the will. His Honour further held that as Crowle still exists and continues to provide residential care and associated services for the intellectually disabled, the gift must be used for Crowle’s purposes.

As Crowle was the last institution to care for the daughter of the testatrix before her death, His Honour held that the gift detailed at 2 above was to be interpreted to mean that a second gift to Challenge operated on the same terms as the first gift to Challenge.

His Honour then considered the important question of whether Challenge should be removed as a trustee of the trust established by the will. One power to replace a trustee may be found in section 70 of *The Trustee*

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## Supreme Court of NSW appoints new Trustee for Testamentary Charitable Trust

*(Continued from page 7)*

*Act 1925* (NSW). Section 70 applies when it is expedient to appoint a new trustee and it is inexpedient, difficult or impracticable to do so without the assistance of the Court. In the case of a trust for a charity, section 70(4) allows the Court to make an order for the appointment of a new trustee “on such evidence of the trust as the Court deems sufficient”. His Honour found section 70 to apply in this case and held that Challenge should be removed as a trustee and replaced by Achieve, the current owner and operator of Crowle.

A significant reason for this decision was the need for efficient administration of the trust. Keeping Challenge as the trustee would inevitably result in administrative

the trustee, such burdens and their associated delays may be avoided, thereby allowing more resources for the provision of welfare to Crowle residents.

His Honour was also concerned about the substantial risk of conflict if Challenge remained as trustee. The existing discord between Challenge and Crowle could lead to



“serious disagreements that may result in further litigation and a consequent diminution of the trust assets”.

Furthermore, in the event that Crowle ceased to exist, His Honour recognised the likelihood that the gifts would revert to Challenge. Interestingly, His Honour declared that the conflict in the case was “not between the management of the two organisations but between Challenge Foundation’s duties as trustee and its own interests”. By removing Challenge as trustee and appointing Achieve in its place, the risk of Challenge refusing to expend trust money for the benefit of the Crowle Home because it hoped that the money would become available to it in the future has been successfully averted.

Accordingly, the gifts in the will went to Crowle, and Achieve was appointed as the new trustee of the charitable trust created by the will.

This notable case shows us that the wording of a will when it comes to charitable bequests is not always the

final word, especially when unincorporated charitable organisations become incorporated or merge with others.

*Joanne Irvine is a lawyer at Makinson & d'Apice*

**“His Honour ... held that Challenge should be removed as a trustee and replaced by Achieve, the current owner and operator of the Crowle Home”**

burdens, including the requirement for Achieve to apply to Challenge for access to trust funds as well as the fact that Challenge would have very little knowledge of the needs of Crowle. By appointing Achieve as

**“The conflict ... was between Challenge Foundation’s duties as trustee and its own interests.”**

## Full Federal Court confirms that a community bank can be tax exempt

A recent Full Federal Court decision has confirmed that a community bank was exempt from paying income tax as a community service organization. The decision is important as it confirms that a properly structured venture between a not-for-profit organization and for profit business can be exempt from tax. Such an organisation would also be able to access fringe benefits tax concessions allowing it to offer attractive salary packages to staff.

### Background to the decision

Recently, a decision handed down by Perram J in *Wentworth District Capital Ltd v Commissioner of Taxation* [2010] FCA 862 was appealed by the ATO to the Full Federal Court (refer to previous article: <http://moorestephensresources.com.au/articles/399/1/Company-supporting-community-bank-is-now-tax-exempt-decision-now-subject-to-ATO-challenge-/Page1.html>).

The ATO contended that the trial judge had erred when he held that the facilitation by Wentworth District Capital Limited (WDCL) of face-to-face banking for reward in a small country came within the definition of a 'community service' under section 50-10 of the *Income Tax Assessment Act 1997*. The Full Federal Court dismissed the appeal by the Commissioner of Taxation and ruled in favour of WDCL.

WDCL was setup in order to provide the residents of Wentworth with banking services in their own town. To do this it entered into a franchise agreement with Bendigo Bank Limited to operate a franchise on WDCL's premises operated by its staff. In 2006 WDCL amended its constitution to include the provision and promotion of face-to-face

banking services for the Wentworth community one of its main objects. The Commissioner sought to assess WDCL's profits for the 2006 and 2007 income years.

### The Decision of the Full Federal Court

Emmett, Gilmour & Gordon JJ agreed with the trial judge, and emphasised the following points:

1. WDCL's main or dominant purpose was to facilitate the provision of face-to-face banking services in Wentworth by making it commercially viable for Bendigo Bank to operate in Wentworth.
2. This main purpose was a community service purpose, thus WDCL was covered by the exemption in section 50-10 of the ITAA97 for the 2006 and 2007 income years.

The ability of WDCL to rely on this exemption lay in the fact that its purpose was not to actually provide face-to-face banking services, but rather to facilitate the provision of these services. Their Honours found this facilitation brought a benefit to Wentworth that was "both real and tangible."

It is important to note that in all the judgements Their Honours stressed that the provision of banking services was not a community service purpose of itself. They drew the distinction between providing these services and facilitating the provision of these services to a town that had no bank and benefited greatly from WDCL's activities.

### What does this mean for taxpayers?

The decision confirms that business ventures between not for profit community organisations and for

profit business can be exempt for income tax. However, crucial to their exemption status will be an ability to show that there is some sort of actual benefit to a particular community from their activities, similar to those provided to the Wentworth community by WDCL. Consequently it is important that such venture be structured correctly.

If an organisation does qualify as an income tax exempt community purpose organisation it will also be able to access the fringe benefits tax (FBT) rebate. This rebate equates to 48% of the gross FBT payable by the organisation, and this significantly reduces its FBT liability. Qualifying organisations are able to offer very attractive salary packages to staff in a manner that is tax effective for both parties. Finally it is important to note that the ATO can still appeal this decision to the High Court.

For further discussion on the issues raised by this Full Federal Court decision please contact one of the authors or your Moore Stephens Relationship Partner.

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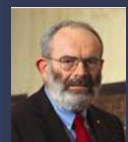
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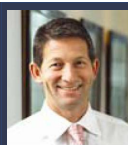
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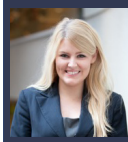
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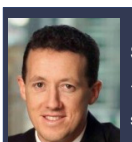
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## Back issues

All issues of *Balancing Act* are available online at [www.makdap.com.au](http://www.makdap.com.au). Articles in the last two issues include:

### Issue 18, January 2011

- Political lobbying—the Aid/Watch case
- DGR Endorsement for Declared Flood Zones
- Regulation of Public Ancillary Fund
- Streamlining Financial Reporting for NFPs
- Formation of a NFP Sector Reform Council
- Queensland Incorporated Associations
- Apple Under Fire

### Issue 17, October 2010

- Regular review for Not-For-Profits
- Review Checklist
- Partial rate exemptions
- Community Savers Funding
- Senate Committee Report on Public Benefits test
- Company supporting community bank is tax exempt

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