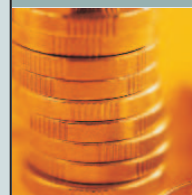


# Not-for-profit — don't pay someone else's tax

By **Vera Visevic**, Partner, Makinson & d'Apice Lawyers



It is a common misconception that reining in costs is irrelevant for not-for-profit organisations. In fact, because they do not have the profits of conventional companies, they are under even more pressure to minimise their costs.

There are currently numerous tax exemptions, concessions, rate exemptions, stamp duty exemptions and other special forms of treatment (concessions) which are available to the not-for-profit sector. Unfortunately, and to their financial detriment, many not-for-profit organisations and charities (which we shall collectively refer to in this article as 'charities') are not aware of the various concessions available to them and are thereby unnecessarily paying taxes, rates and duties which they do not legally need to pay.

The management of each charity, regardless of which state or territory the charity is based in, must be familiar with all of the concessions which are available to them to ensure that they are availing themselves of all such concessions for the benefit of that charity. It is further extremely beneficial for management to be alert to changes in any such concessions so that:

- the charity is at all times operating within the parameters of that concession and
- the charity avails itself of any newly created concessions which are being offered to them by the State or Federal Government.

This article lists the basic concessions which are currently available to charities both at a federal level and a state/territory level.

## State versus federal

It is important to note that although some activities may be considered to be 'charitable' under state legislation, this does not necessarily mean that the activity will be considered charitable under federal legislation or for that matter under the legislation of other states. This adds to the general confusion surrounding

- *Charities often pay more tax than required*
- *Federal, state and council concessions are available*
- *Treatment can vary depending on whether a charity is a fund or an institution*

charities law and creates difficulties for charities which operate on a national scale. It may be possible for a charity to satisfy a particular state that it is a charity for the purposes of obtaining a concession under a state law, and yet it may not be possible for that same charity to satisfy the Commonwealth for the purpose of obtaining a tax concession charity (TCC) endorsement.

## Tax exemptions

Since 1 July 2000, charities must be endorsed by the Commissioner of Taxation to obtain income tax exemption. A charity which is endorsed as such by the ATO is referred to as a TCC. The endorsement system was further extended on 1 July 2005 to benefits or exemptions in respect of GST, FBT and for endorsement as a deductible gift recipient (DGR).

If an organisation is endorsed as a charity, that organisation will be entitled to the following exemptions:

- income tax and CGT
- franking credits
- certain GST concessions and
- FBT exemption or rebate.

Some charities are also entitled to receive certain State Government concessions (for example pay-roll tax, stamp duty, debits tax, land tax, car parking levy, council rates and water rates).

**Income tax and CGT**

As an introduction, if an organisation is exempt from income tax, then it is also automatically exempt from CGT. They go hand in hand.

The relevant section is s 50-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). To be eligible for these exemptions, not only does an organisation need to be a charity, but it also needs to satisfy one of the following criteria:

- (a) the organisation has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia or
- (b) the organisation is a DGR under s 30-15 of the ITAA 1997 or
- (c) the organisation is a prescribed institution (meaning prescribed by the *Income Tax Assessment Regulations 1997*) located outside Australia and it is exempt in its country of residence (in essence, the Tax Commissioner needs to be satisfied that the organisation is not likely to participate in tax avoidance arrangements and that the exemption will not result in tax revenue being shifted from Australia to another country) or
- (d) the organisation is a prescribed institution which is physically present in Australia but the organisation incurs expenditure and pursues objectives principally outside Australia.

**Franking credits**

The concept of ‘franking’ comes from the imputation system under the ITAA 1997. Tax paid by the company is allocated to shareholders by way of imputation credits which are attached to the dividends that they receive. These dividends are called ‘franked dividends’. Australian taxpayers are entitled to a tax offset equal to the franking credit.

As exempt entities do not pay income tax, there is no opportunity to offset a franking credit against assessable income.

The ITAA 1997 provides that certain exempt institutions (including endorsed charities and DGRs) will be eligible for a refund of the franking credits attached to franked distributions that they

receive. This refund can be claimed by eligible bodies annually by application to the ATO.

**GST concessions**

Charities are not exempt from GST as such, but the GST Act contains a large number of concessions for charitable institutions and trustees of charitable funds including the following.

- Charities can choose to account for GST on a cash basis (rather than an accruals basis) notwithstanding that annual turnover may exceed the threshold (currently \$2 million) relevant to other registered entities
- A supply by a charity is GST free if the consideration is for less than 50 per cent of the market value including GST. For

accommodation, the consideration need only be less than 75 per cent of market value. Where those tests are not satisfied, the supply can still be GST-free if the amount charged by the entity for the supply is less than 75 per cent of the amount that the charity was liable to pay for acquiring the relevant item. Non-commercial newsletters, magazines and journals sold by charities will normally be GST-free even though it may be difficult to establish a market value. Detailed guidelines for establishing market value including a series of benchmark values have been prepared by the ATO and are accessible from

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the ATO website

- A charity operating a retirement village is not liable to GST on supplies of accommodation, accommodation-related services or meals
- Raffles and bingo-style fundraising activities conducted by charities in accordance with relevant state or territory law are GST-free
- The supply of donated second-hand goods by a charity is GST-free provided that the charity has not dealt with the goods in such a way that they no longer have their original character
- Gifts or donations to a charity are GST-free
- General fundraising activities are subject to GST. However, charitable institutions can elect to have fundraising events treated as input-taxed if it suits the institution
- The ATO will allow simplified accounting methods to charities which are making supplies that are taxable and other supplies

that are GST-free. A typical example of this would be a tuckshop which has high volume, low value item business. Charitable retailers in those circumstances will be able to calculate the percentage of their turnover that relates to taxable sales and calculate GST on that basis.

To be eligible for these GST concessions, a charity must be endorsed. This endorsement is separate to any other endorsement that a charity may require for exemption from income tax or for FBT concessions.

### Public benevolent institutions

A public benevolent institution (PBI) is a particular type of charity, but has its own distinctive definition. The term 'PBI' is not defined in tax law or other legislation and must be understood in accordance with the case law. Essentially, the ATO has defined in its Taxation Ruling TR 2003/5 *Income Tax and Fringe Benefits Tax: Public Benevolent Institutions* that a PBI is a:

non-profit institution organised for the direct relief of such poverty, sickness, suffering, distress, misfortune, disability, destitution or helplessness as arouses compassion in the community.

It is clear that a charity is not automatically a PBI, but a PBI is always a charity.

### Tax exemptions

If an organisation is endorsed by the ATO as a PBI, that organisation will be entitled to the following exemptions:

- income tax and CGT
- franking credits
- certain GST concessions
- FBT exemption
- DGR status and
- some State Government concessions (for example pay-roll tax, stamp duty, debits tax, land tax, car parking levy, council rates and water rates).

### DGRs

The income tax law determines which organisations can receive income tax deductible gifts. They are called DGRs. DGRs are either:

- endorsed by the ATO or
- listed by name in the tax law.

The majority of DGRs are endorsed by the ATO. To be endorsed as a DGR, an organisation must fall within a general DGR category as specified in the Act and meet the other conditions which relate to that category. There are more than 30 general DGR categories. Some examples are:

- public hospitals
- health promotion charities
- public universities
- school building funds

- PBIs
- necessitous circumstances funds
- overseas aid funds
- public libraries, museums and art galleries and
- ancillary funds.

Division 30 of the ITAA 1997 states that PBIs are entitled to be endorsed as DGRs.

Any charities endorsed as DGRs have the very significant benefit of being able to offer donors tax deductions for all donations made to that charity.

### Charitable institution or charitable fund?

The tax law distinguishes between charitable institutions and charitable funds. Whether a charity has the character of an institution or a fund is a question of fact.

### Tax distinctions

Why does it matter whether an organisation is an institution or a fund? A charitable institution is entitled to the following benefits which are not available to a charitable fund:

- gift deductibility is available for health promotion charities which are charitable institutions
- gift deductibility is available in relation to harm prevention charities which are charitable institutions
- FBT exemption
- FBT rebate.

A charitable fund is currently entitled to no FBT concessions.

A charitable institution is entitled to an FBT rebate of 48% of the FBT payable subject to a \$30,000 cap on the grossed-up taxable value of the benefits.

A charity which is a PBI, and a health promotion charity, is entitled to an FBT exemption where the grossed up taxable value of fringe benefits to each employee is \$30,000 or less.

A public hospital, a non-profit hospital and a public ambulance service are entitled to an FBT exemption subject to a \$17,000 cap on the grossed up taxable value of the benefits.

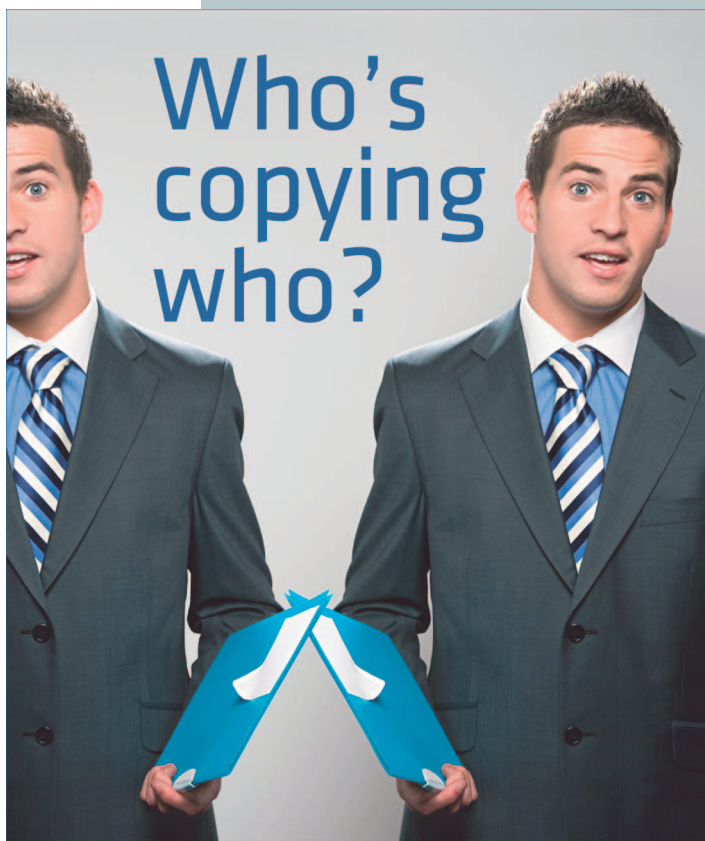
Until recently the ATO has taken the approach that charitable funds have been rebatable employers for FBT purposes. This approach has not applied since 1 July 2005 and charitable funds are no longer entitled to the FBT rebate. Therefore charitable funds are not entitled to any FBT concessions.

### Definitions

The ATO has adopted the following definitions.

#### (a) Charitable institution

An 'institution' is defined as an establishment, organisation or association, instituted for the



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promotion of some object, especially one of public or general utility. It may be constituted in different ways including as a corporation, unincorporated association or trust. However, it involves more than mere incorporation, or trustees merely administering trust property in accordance with a trust deed. (It does not include a structure controlled and operated by family members and friends.)

**(b) Charitable fund**

A 'fund' is a pool of money or property that is set aside and managed by a trustee or trustees for the purpose of making distributions to other persons or entities, or for making the property available for its purposes, or both.

To attempt to simplify this distinction — if the entity mainly manages trust property and/or holds trust property to make distributions to other entities or people, it will be a fund. Conversely, if it mainly carries on activities that are charitable, it will most likely be treated as an institution and not a fund.

**State concessions**

There are numerous state or territory concessions available to each charity. Each state and territory has its own list of concessions and conditions which need to be satisfied in order for a charity to be entitled to benefit from that concession.

A list of some concessions is as follows:

- council rates
- water rates
- land tax
- pay-roll tax
- stamp duty on leases, purchases and mortgages of property
- stamp duty on insurance premiums
- motor vehicle registration fees and
- stamp duty on the transfer of motor vehicles.

Each charity should regularly check on:

- which concessions it is receiving
- that it is still complying with the requirements attached to that concession and
- what new concessions have been created.

The failure by the management of a charity to avail itself of all such concessions would be considered to be improvident and wasteful, and further, such failure may constitute 'waste of trust assets' as that concept is used in trust law.

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