THE TAX INSTITUTE

10 August 2018

Mr Dean Karlovic
Australian Taxation Office
GPO Box 9977
MELBOURNE VIC 3001

By email: dean.karlovic@ato.gov.au

Dear Mr Karlovic,

Draft Taxation Ruling TR 2018/D1- Income Tax: the 'in Australia' requirement for certain deductible gift recipients and income tax exempt entities

The Tax Institute welcomes the opportunity to make a submission to the Australian taxation Office (**ATO**) in relation to *Draft Taxation Ruling TR 2018/D1- Income Tax: the 'in Australia' requirement for certain deductible gift recipients and income tax exempt entities* (**Draft Ruling**).

Summary

Our submission below addresses some concerns we have with each of the following conditions:

- DGR in Australia condition;
- Division 50 in Australia condition; and
- Refund of Franking Credits condition.

Discussion

1. DGR in Australia condition

a) General comments

i) Ordinary meaning - there are several instances in which the Draft Ruling notes that a particular term is not defined in the legislation and therefore bears its ordinary meaning. A dictionary definition is then provided followed by the Commissioner's view as to what the term means. However, it is not always clear how the ordinary meaning has been used in arriving at the Commissioner's view on the meaning. For instance, paragraph 8 notes a dictionary definition of the phrase 'be in' as meaning "to exist; have reality;

live; take place; occur; remain as before… to be found or located in". It is then followed by a view, presumably held by the Commissioner that a fund, authority or institution will 'be in Australia' if it is established or legally recognised in Australia and operates in Australia at that time. Separate explanations are then provided in subsequent paragraphs as to the meanings, in differing contexts, of "established" and "operated". However, neither of these terms are cited in the ordinary dictionary definition of 'be in' which is the actual term in the legislation requiring interpretation. Further, the meanings in the different contexts themselves introduce other terms or concepts, such as being "established and legally owned or held", "managed" and "established and recognised". This suggests that the Draft Ruling has sought to replace one (legislative) term with a number of other (non-legislative) terms. The lack of consistency is likely to give rise to additional confusion.

One alternative approach might be to recognise that a fund, authority or institution is "in Australia" where it would otherwise be considered to have a permanent establishment in Australia.

ii) Location of a 'fund' (paragraph 8) – we query how the location of the fund is defined, and whether the focus is meant to be on where the fund is legally recognised or where the fund has legal personality. We note that there is an apparent inconsistency in the legislative requirement that the 'fund' (ie, a pool, stock or store of assets, in the definition provided in paragraph 5) 'be in Australia', but the Draft Ruling takes the position that the location of the physical assets comprising the fund does not matter. If the fund is the assets and the fund is required to be in Australia, it is difficult to understand how the location of those assets does not matter. There is also substantive content contained in Footnote 15 which we think should be included in the body of the Draft Ruling rather than the footnote.

iii) Unincorporated association (paragraph 13) – it is unclear from this paragraph how an unincorporated association will be treated for the purposes of the 'DGR in Australia condition' as it does not have its own "legal recognition" as that term appears to be used in the Draft Ruling. This may be another reason why the requirement for legal recognition is not appropriate in the relevant context.

b) Overseas funds

Paragraph 14 of the Draft Ruling refers to an institution being 'operated in Australia' if it is managed on a day-to-day basis by a local 'committee of management or similar structure'. It is unclear as to what level of presence, control or kind of organisational structure is required to exist in Australia to satisfy this requirement, particularly as regards entities established overseas. For instance, does it mean that a single manager located in Australia will not be sufficient? Do the members of the "committee of management" need to be members of the board or committee of management of the

main entity? Further, it is unclear what is intended by the note to paragraph 14 as well as footnote 26. It would be useful if the ATO could clarify what is meant here and perhaps only include the additional explanation either in the note or the footnote.

c) Examples 5 and 6

We consider that Examples 5 and 6 are quite important examples in the Draft Ruling. However, in relation to Example 5, paragraph 34 states that the CEO and General Manager are located in the UK and they undertake the day-to-day management of the Australian operations by consulting with the UK-based directors. This does not seem like a sensible fact pattern or practical outcome. For this example to make more sense and to logically reach the conclusion that the entity is not operated in Australia, we query whether the example is instead meant to refer to the UK-based directors as comprising the majority of the directors of the company, rather than the Australian directors. It is still submitted that it is unusual for a CEO and General Manager to only consult with certain directors (even a majority) to the exclusion of others. However, we would query whether, in reality, there could be an organisation in this case without at least a local manager of some nature and, if so, this would raise the question indicated above as to what is required to satisfy the requirement that an institution be "managed" in Australia.

2. Division 50 in Australia condition

a) Disregarded Amounts

Per paragraph 57 of the Draft Ruling, 'disregarded amounts' include distributions made by the entity out of gifts or government grants for the purposes of testing whether the entity incurs expenditure and pursues its objects in Australia. While reference is made to section 50-75 of the *Income Tax Assessment Act* 1997 (Cth) (**1997 Act**), only subsection (1) seems to have been dealt with within the Draft Ruling. We suggest that some explanation be given to disregarded amounts contained in section 50-75(2) (in relation to operating a fund) also be included in the Draft Ruling.

We also consider that a further example that considers whether the circumstances below would satisfy the 'Division 50 in Australia condition' would be a useful addition to the Draft Ruling:

i) the entity has a physical presence in Australia and all decision making (both operational and strategic) is carried out in Australia;
ii) the entity is a charity registered with the ACNC, but is not a DGR;
iii) all fundraising for the entity is conducted in Australia;
iv) all of the entity's income (apart from a small amount of interest) comes from donations (i.e. disregarded amounts);
v) the objects of the entity are all overseas and the entity achieves its objects by engaging subcontractors in the overseas country (this expenditure, and these objects, are funded entirely by disregarded amounts);

vi) the only activities of the entity in Australia are fundraising activities and activities to make Australians aware of the overseas issue which the entity has been established to address.

3. Refund of Franking Credits condition – disregarded amounts

It is unclear what is meant by paragraph 94. If the Commissioner's view is that amounts that are considered 'disregarded amounts' for paragraphs 57 to 60 should in fact be included when determining whether the 'refund of franking credits condition' is satisfied or not, it should be expressed this way. The way paragraph 94 is currently expressed is confusing.

4. Expenditure, objects and activities - Examples 8, 9 and 10

Examples 8, 9 and 10 seem to introduce a 'nexus' concept about the location where expenditure is incurred for the purpose of Division 50 of the 1997 Act, though the incurring of expenditure is a 'timing' concept, not a 'location' concept. The ATO seems to place importance on the location of where funds are deployed or received or where services provided are consumed. However, in our view, the relevant test should be where the decisions are made.

In Example 8 in particular, the Australian entity needs to trace expenditure through a third party sub-contractor to the place where the services are consumed, not just the location where the funds from the sub-contracting entity are received. It is difficult to see the practical application of the 'nexus' concept in what is a very broad interpretation of where expenditure has been incurred.

Paragraph 54 is so broad that it does not provide any useful guidance in practice and the examples included in the Draft Ruling only serve to confuse the issue.

This issue also crosses over with determining the place where the objects are pursued. In our view, the test for determining whether the objects are pursued principally in Australia should be whether all strategic decisions are made in Australia (by a local board and management team). This position should not be altered simply because of there being a separate concept of 'activities' or where those activities take place. Where the objects are pursued and where the activities take place are two separate issues that require separate analysis and should not be conflated.

5. Other matters

a) Disregarded amounts – tracing of gifts and government grants – compliance approach

There appears to be some inconsistency between paragraph 102 which is concerned with the tracing gifts and grants where there is evidence they have been distributed overseas and footnote 48 which is about gifts or grants only for use within Australia (or gifts of land in Australia). It would be useful if the ATO could clarify whether it is gifts or

grants for which there is evidence the gift/grant has only been distributed in Australia that it will not apply compliance resources or whether it is to gifts/grants where there is evidence the gift/grant has been distributed overseas that it will not apply compliance resources.

b) ACNC Form

The questions relating to applying for DGR status on the Australian Charities and Not-For-Profits Commission (**ACNC**) application form should be updated to be consistent with the ATO's revised views in relation to the 'DGR in Australia condition' as contained in the Draft Ruling.

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours faithfully,

Tracey Rens
President