

Not-for-profit bodies

Good Causes and Tax Reform

BY DAVID MARIS

You and your family belong to clubs, or help out with a school or charity. Is your not-for-profit ready for the impact of tax reform?

There are many different types of community groups, I refer to them here as "not-for-profits" (NFPs). Where I am referring to a body with a particular tax characteristic, like a gift-deductible, I make that clear. The big issues for most NFPs are:

- ABNs.
- Endorsement.
- GST.

Those three issues are linked. The way they are linked has caused confusion in the community. The legislation is difficult. It takes time to explain. I have spent a deal of time assisting NFPs on a pro bono basis. I decided that there must be other busy tax professionals who could use a guide.

Particular types of NFPs will have their own peculiar issues, especially under the GST regime. I readily acknowledge that I have not been able to cover specific types of entities, such as schools and related parents' groups. Variations between States, and between private institutions, mean that each situation needs individual attention.

CAN MY NFP GET AN ABN?

Most NFPs are entitled to an ABN. The threshold is low. Many NFPs should get an ABN. Operating without an ABN

can be difficult. Some NFPs must get an ABN. If the NFP needs endorsement for income tax purposes, or must register for GST, it must get an ABN as part of the process.

To be entitled to an ABN, the body must:

- be an entity that is carrying on an enterprise in Australia; or
- be a company under the Corporations Law, including a company limited by guarantee. This is obvious and does not require discussion; or
- be an entity that makes supplies connected with Australia in the course or furtherance of an enterprise. I will not talk about this category.

For most NFPs, the two issues are therefore whether they are entities and whether they conduct an enterprise. These requirements are set out in the *A New Tax System (Australian Business Number) Act 1999* (Cth) (ABN Act).

What is an "Entity"?

Apart from normal business structures, like a company, partnership and trust, the definition also includes:

- a body corporate, like an incorporated association.
- a corporation sole - some religious

entities were formed this way.

- an unincorporated association or body of persons. This covers most voluntary associations that are not incorporated.

A voluntary association is an "entity" under that last heading: ruling MT 2000/1. The ruling gives an example of a non-profit athletics club. It holds athletic meetings. It has a membership, a committee, rules, and an understanding between the members. Members can join or leave. The membership will change over time.

Enterprise

I assume that you have decided that your NFP is an entity. The additional "enterprise" test only applies if it is not a Corporations Law company. The definition of "enterprise" in the ABN Act is as follows:

...an activity, or a series of activities, done:

- (a) in the form of a "business"; or
- (b) in the form of an adventure or concern in the nature of trade; or
- (c) ...
- (d) by the trustee of a fund that is covered by, or by an authority or institution that is covered by, Division 30-B of the *Income Tax Assessment Act 1997* and to which deductible gifts can be made; or
- (e) by a charitable institution or by a trustee of a charitable fund; or

(f) by a religious institution; or

(g) ...

For many tax-exempts and gift-deductibles, paragraphs (d), (e) & (f) mean some hard issues are avoided. They are deemed to carry on an enterprise. For the most part, they will be "entities". They will be operating in Australia. They are deemed by paragraph (d), (e) or (f) to be an "enterprise", and can get an ABN.

Other NFPs have to think about paragraphs (a) & (b) of the "enterprise" definition. Note that the definition goes on to talk about the situation where activities of a body are limited to making supplies to members of the body. The classic case is a mutual organisation, such as a sports club.

Mutuality does not prevent activities being in the form of either "a business" or "an adventure or concern in the nature of trade". Does the local chess club carry on an activity in the form of either a business or an adventure or concern in the nature of trade?

Often, the only supply a chess club makes is of the facility for members to meet in quiet surrounds once a week to push wood. But the technical question is: how "commercial" in character need the activities be, for the club to fall within paragraphs (a) or (b) of the definition of "enterprise"?

The concept of a "business" is familiar in Australian tax law. Whether an activity is a "business" is a question of fact. MT 2000/1 gives a number of factors to consider, including whether there is a significant commercial activity. MT 2000/1 also says that the word "trade":

is commonly used to denote operations of a commercial character by which the trader provides to customers, for reward, some kind of goods or services.

Whether or not there is a trade or an adventure in the nature of trade is a question of fact and degree. It should have the characteristics of a business deal.

These thresholds are not very high. MT 2000/1 goes on to say that the words "in the form of" mean that

there need not be a profit-making intent. There are no bright lines in the ruling, but there is a useful example of a non-profit football club.

This club fields football teams, has member-related activities, and runs a bar staffed by volunteer members. The bar means the club is conducting an enterprise. However, MT 2000/1 also says that, if there were no bar, possibly merely fielding a football team and conducting other member-related activities would be an enterprise.

Conclusions About Eligibility for ABN

Many NFPs operating in Australia will be eligible for an ABN virtually as of right. The remainder need only show that they are entities carrying on an enterprise in Australia. The thresholds for those tests are low. Remember also that these tests have the same wording in the GST Act.

DOES MY NFP NEED AN ABN?

In a surprising range of cases, it is virtually impossible to avoid the need

for an ABN. NFPs requiring endorsement or GST registration, must apply for an ABN. Those dealing with government or business will feel pressured to get an ABN.

Dealings with Government

I understand that a recent seminar for voluntary organizations currently in receipt of State funding was told that they would be frowned on if they did not obtain ABNs. It appears that many organizations will need an ABN for this purpose, if no other.

GST Registration

An NFP can get an ABN without registering for GST. The next question is whether the NFP will choose to register for GST. If registered for GST, the NFP will get an ABN. Some NFPs do not have a choice about registering for GST, because of their turnover.

Minimum requirements for GST registration are that the body is an entity and that it conducts an enterprise. These concepts are discussed above. The definitions in the ABN

David Marks

Act are identical to the GST definitions. I discuss the turnover threshold below.

No-ABN Withholding Tax

No-ABN withholding tax is part of the Pay As You Go system. One withholding event is for a payment for a supply if the payee does not quote its ABN. The rule applies to a payment for a supply the other entity has made (or proposes to make) to the payer.

The supply must be in the course or furtherance of an enterprise carried on in Australia by the other entity (payee). The chief way in which the withholding rule will not apply is where the payee has given the payer a correct quote of the payee's ABN.

Grants from Government

Where an NFP obtains a grant from government, it seems that the government will require quote of an ABN before payment. It seems that most national or umbrella organizations will require an ABN on that basis alone. It is not clear to me whether this is because of the GST, or is a separate administrative requirement.

It may be a de facto consequence of GST. Where government makes a grant to a NFP, the grant may be considered to be consideration for the supply by the NFP to government of an undertaking to apply that money in a particular way. (This is discussed in more detail below, in relation to GST.)

Assuming the positive requirements of no-ABN withholding are met, government would withhold 48.5 per cent of the amount payable to the NFP unless:

- The NFP quotes its ABN; or
- The NFP gives a statement that the grant would be wholly exempt income in the hands of the recipient. A practical difficulty is that a sponsor may simply not want to think about this issue of tax exemption.

Other Potential Supplies

Take this example. A local chess club obtains sponsorship of an exhibition match. The local radio station will pay \$500 to cover expenses already incurred. The club is an entity. It carries

on an enterprise in Australia. The sponsorship deal involves a supply by the club to the radio station – they get signage rights.

An average club might not have bothered to get an ABN. It is income tax exempt and under the GST registration threshold. The club could give the sponsor the ATO's pro forma "Statement by a supplier" stating why no-ABN withholding tax does not apply. But the sponsor is already doing the club a favour.

The onus is on the sponsor to make the correct call on no-ABN withholding. It may reasonably insist on the quote of an ABN to protect itself. Why should a sponsor potentially be inconvenienced, when a club could easily obtain an ABN?

ENDORSEMENT

For many gift-deductible and tax-exempts, 1 July 2000 is a watershed. Specific classes of bodies must be endorsed by the Commissioner to retain their gift-deductible or tax-exempt status. This has caused a great deal of misunderstanding in the community.

I want to dispel that confusion. Not all tax-exempts must obtain an ABN. Only some need endorsement to retain tax-exempt status and they must get an ABN to be endorsed. If a tax-exempt gets an ABN, this does not of itself confer gift-deductible status. Only gift-deductible entities have that status. (Many gift-deductibles need endorsement.)

Tax-exempts

Only the following bodies will no longer be tax-exempt unless endorsed: a charitable institution, a public charitable fund established by will before 1 July 1997, derivative trusts such as a will, and a fund established in Australia for public charitable purposes by will or trust deed which is not otherwise covered.

Endorsement is covered by Subdivision 50-B *Income Tax Assessment Act 1997* (ITAA97) and ruling TR 2000/11. One requirement is an ABN. Endorsement allows the Commissioner to check that entities comply with special conditions govern-

ing tax-exempt status. Endorsement imposes an obligation to advise the Commissioner if the entity loses tax-exempt status. The Commissioner can revoke endorsement.

Gift-deductibles

Endorsement of gift-deductibles is required by s 30-17 ITAA97. The requirements are difficult to summarise for the purposes of this general paper. As a guide, most existing gift tax-deductibles will need to obtain endorsement unless it is a political party, the Australiana Fund, Artbank, certain National Trust bodies, or an entity named in Div 30-B.

The power to endorse is in Subdiv 30-BA ITAA97. Usually the fund must have an ABN to qualify for endorsement. Again, there are now formal mechanisms requiring a fund to advise the Commissioner of loss of entitlement to endorsement, and the Commissioner can revoke an endorsement. See also ruling TR 2000/12.

Changes to Operations

It is now a criminal offence not to tell the Commissioner when a body has lost entitlement to endorsement. Committee members and trustees should make this topic a standing item for review on their agendas.

GST

The impact of GST on NFPs varies considerably. It depends on their activities and nature. For example, the NFP may undertake educational or childcare services, which are concessionaly treated. The entity may be able to qualify as a religious institution that makes GST-free services as an integral part of the practice of its religion.

Obviously there are particular provisions and concessions that will have a unique impact on each class of NFP. I will concentrate instead on those factors that are likely to have broader application.

Threshold for Registration

I dealt with the basic requirements for GST registration above. The registration turnover threshold for a non-profit

body is \$100,000. There is no definition of "non-profit body" in *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act). Ruling GSTR 2000/11 provides some guidance about the meaning of "non-profit body".

The Commissioner considers that a "non-profit body" is a body not carried on for the purpose of profit or gain to its individual members. The Commissioner accepts a body as being a non-profit body where, by operation of law (for example, a statute governing its activities) or by its constituent documents, the body cannot distribute its profits or assets amongst its members while it is functional or on its winding up.

This is not the place for a general discussion about working out the registration threshold. However, there are two points that particularly interest NFPs. First, you exclude from calculation supplies that are input taxed. Also, note that the term "value" has a special meaning here.

For a taxable supply, the value is 10/11 of the price of the supply. However, when the supply is GST-free, the value is deemed to be the price.

Gifts to Non-profit Bodies

I may be getting ahead of myself here, but this appears to be a convenient point at which to consider an exclusion from the GST definition of "consideration". Without consideration, there is no taxable or input taxed supply. The exclusion relates to "making a gift to a non-profit body".

Ruling GSTR 2000/11 says there are three essential elements for a "gift". First it must be voluntary. It must not be the result of a prior contractual obligation. Secondly, the donor should not receive an advantage of a material character by way of return in making the grant or gift.

The third requirement is that the gift must flow from benefaction and a detached, disinterested generosity. Curiously, the ruling states that a grant made as a function of government, which does not have the characteristics of benefaction and detached, disinterested generosity, is not a "gift".

Receipt of Grants

GST's wide definition of "supply" means that a grant to a NFP often constitutes consideration for a supply by the NFP to the grantor. The definition of "supply" includes entry into an obligation to do something. This is very broad indeed. The definition of "consideration" also causes difficulty.

"Consideration" includes a payment, act or forbearance, "in connection with a supply of anything" or "in response to or for the inducement of a supply of anything". Therefore, where a tied grant is made, the grant is consideration for a supply of the NFP's promise to use the funds in a particular way.

Ruling GSTR 2000/11 deals with grants, and is required reading if you are assisting a body with government or private sector sponsorship. I have noted these things:

- Not every grant results in a supply.
- A supply to the world at large is not a "supply" for the purposes of the GST legislation. However, an undertaking to supply services to others will be treated as a supply (of that promise).

- Mere expression of an intention by the grantee will not be enough to constitute a supply. The obligation must be binding.
- The payment itself will usually not be a supply, unless made in kind. If in kind, both the grant, and any service or obligation conferred by the grantee, can be supplies. Both grantor and grantee have GST responsibilities.
- The grant must somehow be connected with the supply of something by the grantee, for the grant to constitute consideration for a supply.

Advantages of Registration for GST

Should a NFP, which is under the registration turnover threshold, register for GST nonetheless? If it does so, it will be entitled to input tax credits in relation to its creditable acquisitions. A grantor will be entitled to an input tax credit for tied grants.

However, the NFP's membership fees and tied grants will be subject to GST. It becomes responsible for filing GST returns. Voluntary GST registration is usually not advantageous. Many bodies

David Marks

In this category do not set out to make a surplus. They spend any surplus generated to further their objectives.

Therefore, voluntary GST registration is a marginal proposition. The body is a non-profit, pass-through vehicle. It is a proxy for private consumption by its members. If unregistered (effectively input taxed), the body brings forward the point of effective final consumption. The added economic value of collective action is preferably left untaxed by not voluntarily registering.

I know one NFP that imposes a substantial annual membership fee as a way of raising funds. The funds are used to support the good causes espoused by that group. That group also receives considerable sponsorship in support of those causes. It may have to register for GST on the basis of its annual turnover.

Perhaps that group should reduce its annual membership fee, and trust its members to make gifts to this non-profit body instead. Gifts to a non-profit body are not consideration for a supply, but membership fees are.

Non-commercial Activities

Some supplies are GST-free. The supplier must be a government school, charitable institution, a trustee of a charitable fund, or a gift-deductible entity. The consideration for the supply must be less than 50 per cent of the GST-inclusive market value of the supply. (The percentage is 75 per cent if it is a supply of accommodation.)

Alternatively, if that body supplies the thing for less than 75 per cent of what it paid, the supply may also qualify as GST-free. Finally, such a body can supply second-hand goods GST-free if the goods are not transformed, and the goods were supplied to the body as a gift or under a previous application of this rule.

Gambling

This GST concession only helps an organization mentioned under the previous heading. If the gambling is legal, its supply will be GST-free if it is a ticket in a raffle, or related to participation

in bingo. There is provision for extension of the types of gambling by regulation.

Fund-raising Events

These provisions assist the types of bodies referred to under the previous two headings. Provided that the body elects to treat all supplies related to the event as input taxed, and keeps its records in a particular way, a supply made in connection with a fund-raising event will be input taxed.

Being input taxed is less generous than being GST-free. However, it means the supplies do not count for the registration threshold. Also, the fund-raising event is effectively treated as final consumption. This allows the NFP to keep its profit over and above the GST-inclusive costs of inputs for the event.

There are limits on the types of events that will be assisted. It must be conducted for the purpose of fund-raising. It must not form a part of a series or regular run of like or similar events. The types of events are very prescriptive:

- fête, ball, gala show, dinner, performance, or similar event;
- an event comprising sales of goods if each sale is for less than \$20 (or other amount set by regulation) and selling goods is not part of the body's business;
- something which the Commissioner decides is a fund-raising event. You can make an application, and you can have an adverse decision reviewed.

Non-profit Sub-entities

Certain organizations would have been responsible for GST compliance in relation to activities of their far-flung branches. A local group might have thought that it was well under the registration threshold, and effectively input taxed. There was an issue about whether that threshold had to be determined by looking at the national turnover.

Division 63 GST Act applies to a registered entity. A number of community organizations, including the types of organizations that could take advantage of the concessions referred to above, can make a choice. The choice

will mean that a branch of the entity is treated as a separate entity.

The branch must keep independent books, and be separately identified. The head entity's records must show that the sub-entity is treated as a separate entity for GST purposes. The branch then has the option to register itself. The Commissioner can set an independent registration turnover threshold.

Division 49 has the opposite effect. It allows religious entities to group. Transactions internal to the group do not count for GST purposes. The entities must be endorsed as income tax exempt, and be part of the same religious organization.

Paper Warfare

The non-profit sector might be concerned about the paperwork and compliance that comes with tax reform. Bodies that generally fell outside the sales tax system (in the sense that they were neither manufacturers nor wholesalers) now:

- Face the prospect of withholding from grants.
- Must monitor turnover to ensure they apply for GST registration when necessary.
- Keep detailed books in relation to concessions.
- Apply for and monitor endorsement, if needed to keep up tax-exempt or gift-deductible status. □

David W. Marks BCom (Hons) LLB (Hons) (UQ), LL.M (QUT), FTIA

David is a barrister at the Queensland Bar. He practises tax and revenue law. Prior to his call to the Bar, David was a Senior Associate with Allen Allen & Hemsley, again practising in tax and revenue. David is an active member of the Institute's Brisbane tax discussion groups, and of other tax committees. Like many tax practitioners, his practice and his community links have led him to consider the issues in this article.