



Taxpayer Alert

TA 2016/5

Purported tax-exempt non-profit 'foundations' used to evade or avoid taxation obligations

Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more about Alerts. See [Alerts](#) issued to date.

Description

We are currently reviewing arrangements where taxpayers are purporting to stream their untaxed employment, contractor or business income through an unincorporated 'foundation' that they treat as not being subject to income tax. The foundations and the persons who control them also frequently do not comply with their other tax obligations, such as those relating to superannuation and GST.

In a typical arrangement:

1. An advisor or promoter assists individuals (participants) with setting up a 'private' 'foundation' which is then claimed to be exempt from all taxes. The advisor or promoter tells participants that, by operating their business or income producing activities through such a foundation, participants are able to 'opt out of,' or disregard the tax system. A small portion of the income that is streamed through the foundation may be paid to humanitarian or social causes, such as through charities, and these payments are sometimes presented as a justification for the foundation's purported tax-free status.
2. The structure of a foundation, whatever called or however described, has all or most of the following features:
 - a. Articles of Association (Articles) or a similar document, often supplied by the advisor or promoter, typically describe the structure as a 'non-profit private foundation'. The Articles typically state that participants, who are sometimes described as 'principal participants', are responsible for carrying on the activities of their foundations. The Articles often describe other individuals, who assist the participants in conducting the day-to-day affairs of the foundation, as 'volunteers'.
 - b. Bank accounts are opened in the name of the foundation with the participants as signatories. The advisor or promoter may sometimes facilitate the opening of the bank accounts.
 - c. The foundation is not registered for a Tax File Number or an Australian Business Number.

- d. The foundation is not registered as a charity with the Australian Charities and Not-for-profits Commission, nor does it have 'deductible gift recipient' status or otherwise meet the requirements for tax exemption under tax legislation.
 - e. The foundation may notify the ATO that it is excused from withholding tax obligations on the basis that any payment from the foundation is exempt income. Participants often do not lodge income tax returns for themselves with some notifying the ATO that lodgement is not required, or that they have nil income to report. Some participants lodge income tax returns, but omit from their assessable income, business or personal receipts that have been streamed through the foundation.
3. Participants may:
- a. purport to carry on one or more businesses through, or in the name of, the foundation
 - b. carry on a business separately from the foundation, perhaps using a company or trust, while arranging for business income to be received directly into the foundation's bank accounts
 - c. arrange for an employer to pay salary and wages, from which tax has not been withheld, directly into the foundation's bank accounts or to an intermediary which then remits the payments to the foundation's bank accounts, and/or
 - d. arrange for remuneration generated through the provision of personal services to be paid directly into the foundation's bank accounts or to an intermediary which then remits the payments to the foundation's bank accounts.
4. Amounts that are received by the foundation, or which are paid by the foundation to participants or volunteers, are not reported for tax purposes.
5. While participants may contribute some of the money received by their foundation to humanitarian or social causes, they primarily use such monies for personal consumption and investment, and the participants remain in control of the way in which the monies are used by their foundation.

What are our concerns?

These types of foundation structures are artificial and contrived, and the purpose of their design is simply to evade or avoid tax. We are concerned that participants and volunteers who are using these arrangements are not properly reporting their assessable income by representing that their income has not been derived by them and that it belongs instead to an entity that is not taxable.

It is likely that the proliferation of such arrangements will undermine public confidence in the good work done by those in the community who legitimately use charities and not-for-profit entities in order to improve the wellbeing of others.

Based on our review of these arrangements to date:

- The proper amount of tax is not being paid by those involved in the use of the foundation.
- They may constitute shams, as there is no intention by the parties to establish a genuine non-profit foundation, and their purpose is to give the Commissioner and others the impression that it is a genuine tax-exempt entity. The associated arrangements that purport to stream employment or business income to, or through, the foundation may also be shams.

- Amounts received by the foundation under this arrangement may comprise ordinary income that has been derived by the participants and which is assessable to the participants under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). Amounts of money received by the foundation may also comprise statutory income (eg net capital gains) which is assessable to the participants under section 6-10 of the ITAA 1997.
- The purported diversion of income to the foundation may be income derived by the participants under subsection 6-5(4) of the ITAA 1997 as amounts applied or dealt with on behalf of, or as directed by, the participants.
- Where a foundation has more than one participant and is being used to carry on a business, or is being used to receive income from an investment that is held in the foundation's name, there may be a partnership, at least for the purposes of the income tax law. If so, Division 5 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) may apply.
- In some circumstances, it may be that a trust relationship arises between the persons involved in a foundation, either as a participant or volunteer, and Division 6 of Part III of the ITAA 1936 may apply.
- Where an intermediary receives monies that it then remits to a foundation, the personal services income regime in Part 2-42 of the ITAA 1997 may apply.
- The general anti-avoidance rules in Part IVA of the ITAA 1936 may apply to cancel tax benefits obtained by the participants.
- There may be breaches of, or failure to comply with, other taxation laws such as PAYG withholding and superannuation obligations and payment of GST.
- There may also be possible serious offences committed by the promoters or participants under either the taxation law or the Criminal Code.

What are we doing?

We are currently reviewing these arrangements and engaging with a number of entities who we believe are already involved. Compliance action may also be undertaken in respect of other taxpayers who we identify as having entered into this type of arrangement.

What should you do?

If you have entered into, or are contemplating entering into, an arrangement of this type we encourage you to:

- a) phone or email us at the contact details provided below
- b) ask us for our view through a [private ruling](#)
- c) seek independent professional advice, or
- d) make a [voluntary disclosure](#) to reduce penalties that may apply.

Penalties may apply to participants and promoters of this type of arrangement, including serious penalties under Division 290 of Schedule 1 to the *Taxation Administration Act 1953* for promoters. Registered tax agents involved in the promotion of this type of arrangement may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*.

Do you have information?

To provide information about this or another arrangement or a promoter of this or another arrangement:

- phone us on **1800 177 006** (after the initial messages, wait for the 'Taxpayer Alert' option then press **1**), or
- complete the [ATO Tip-Off Form](#)

References

Subject References:

business income
exempt income
foundations
income alienation
non-profit entities
tax exempt
personal services income

Date issued:	29 April 2016
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