TR 2015/1EC - Compendium

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Ruling Compendium – TR 2015/1

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2014/D5 *Income tax: special conditions for various entities whose ordinary and statutory income is exempt*.

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	**Governing rules condition**	
	What are the 'governing rules' of the entity?	
1.1	(a) The draft ruling does not assist organisations in drafting or amending their governing rules in order to comply with the governing rules condition and income and assets condition. (b) The draft ruling does not set out whether written rules should go into more detail, or whether unwritten rules should be reduced to writing.	Comment 1.1(a) and (b) The ruling sets out principles which are intended to apply to any governing rules. The Ruling will not prescribe the level of detail in an entity's rules. No change.
1.2	Paragraph 9 of the draft ruling states that the governing rules of an entity are 'a coherent set of enforceable rules'. (a) What is meant by 'coherent' is not clear. Remove reference to 'coherent'. (b) What is meant by 'enforceable' is not clear. This is problematic for unincorporated associations, as these organisations do not have enforceable rules. The draft ruling appears to be premised on the assumption that the constitutions of unincorporated associations are enforceable contracts, rather than unenforceable compacts. As a matter of law, that is, this is a doubtful premise. It is a well-established legal principle that the courts will only intervene in the internal governance of unincorporated associations where there are	Paragraph 9 of the final ruling has been reworded to remove references to 'coherent' and 'enforceable'. 'Enforceability' is not appropriate for unincorporated associations.

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	property rights, trust law infringements or other exceptional arrangements.[1] The draft ruling therefore needs some clarification so far as it applies to unincorporated associations. References to 'enforceable' should be removed.	
1.3	A further distinction should be made between rules that bind the entity, and rules that bind others (for example, rules that bind officers of the entity to do certain things.) For example, governing rules are the rules that authorise the policy, actions and affairs of the entity **or those who govern it**. That is, insert 'or those who govern it' in the definition of governing rules. This change should be carried through to all of the relevant references in the draft ruling.	Paragraph 9 of the final ruling has been reworded to include in the interpretation of governing rules 'the rules that direct what: • the entity is required and permitted to do, and • those who control the entity are required and permitted to do in respect of the entity.' This change has been carried throughout the final ruling.
1.4	The way that the draft ruling deals with the circumstance where an entity's governing rules are not captured in a separate written document, could be clarified. To ensure it is clear that the draft ruling does in fact address these circumstances, we recommend that a clear statement to this effect be included in the binding part of the ruling, perhaps after paragraph 11. It would also be useful to separately address this issue in Appendix 2.	Paragraph 11 of the final ruling has been amended to include unwritten rules. Paragraph 12 has been added to the final ruling to include circumstances where governing rules come from a centralised source with no separate written document containing rules for each particular entity.
1.5	Regarding paragraph 94 of the draft ruling, an entity's governing rules do not include contracts entered into with government or voluntary codes of conduct. It is difficult to envisage a situation where provisions contained in a government funding contract could constitute a governing rule. A breach of a contractual term should be addressed through contract law. That is, delete the references to: 'contracts entered into with government'	Paragraph 14 of the final ruling explains that agreements entered into that give rise to obligations to third parties generally do not constitute an additional source of governing rules. Paragraph 109 in the explanation section of the final ruling has been reworded to delete references to 'contracts entered into with government' and 'voluntary' codes of conduct.

[1] For the general principle, see *Cameron v. Hogan* (1934) 51 CLR 358. For exceptions, see cases such as *McKinnon v. Grogan* [1974] 1 NSWLR 295; *Mitchell v. Royal NSW Canine Council Ltd* [2001] NSWCA 162.

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	and 'which may be voluntary'.	
1.6	Paragraph 97 of the draft ruling refers to the instance where the governing rules come from a centralised source such that there is no separate written document containing the governing rules that specifically relate to the particular entity. This is commonplace for religious institutions where there are a common set of governing rules that apply to each separate entity (that, for example, relates to each church in the organisation) though there are not a separate set of documents for each separate entity. We note, however, that these comments are not included in the binding part of the ruling.	Paragraph 12 has been added to the final ruling to include circumstances where some or all of the governing rules come from a centralised source with no separate written document containing rules for each particular entity.
1.7	DGR compliance obligations should be part of governing rules. Delete the words 'or for government concessions such as fundraising exemptions or deductible gift status' as examples of rules which do not form part of an entity's governing rules.	Deductible gift recipient (DGR) provisions are not part of the governing rules of the entity. These rules are a broad regime that is not targeted to a particular entity or type of entity. No change.
	What are the 'substantive' requirements in the entity's governing rules?	
1.8	In paragraph 12 of the draft ruling, there should be only one substantive requirement, which relates to the purpose and status for which the entity has received its income tax exemption. All other rules including wind-up provisions should be regarded as procedural. Only a breach of an entity's rules relating to such a purpose should result in the loss of income tax exemption.	This interpretation would limit the scope of substantive requirements to rules relating to an entity's purpose, and those relating to its not-for-profit status (which also relates to the entity's purpose). Under this view, there would be a complete overlap between the governing rules condition and the income and assets condition, and such an interpretation is therefore not preferred, on the basis that Parliament would have intended that the income and assets condition and the governing rules condition each have separate 'work' to do. No change.
1.9	The phrase 'substantive requirements' does not have a technical legal meaning. For a word or words to have a technical legal meaning, you would have to be able to point to some legislation or a case(s) that set out what that	Paragraph 18 of the final ruling has been reworded to state that 'substantive' requirements are rules that define the rights and duties of the entity. This is consistent with both the ordinary and technical legal meaning of 'substantive'. The case law on the

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	technical legal meaning is. This is not the case here.	legal meaning of 'substantive' has been included in the explanation section of the final ruling.
1.10	In paragraph 12 of the draft ruling, a distinction is drawn between the substantive requirements in an entity's governing rules and the procedural rules. However, neither concept is properly defined in the ruling and therefore it is not clear where the distinction is drawn. We request that the Commissioner provide further detail as to what he regards as 'substantive requirements' and what he regards as 'procedural requirements' in an entity's governing rules. The draft ruling should also provide further assistance for trustees in determining which provisions in a trust deed are substantive requirements.	Paragraphs 18 to 20 of the final ruling have been reworded to provide greater clarity between those rules that are substantive requirements and those that are not. An additional 8 examples have been included at paragraphs 124 and 125 in Appendix 1 of the final ruling to provide further guidance and clarity.
1.11	Rights and duties of an entity may also be determined by the general law, for example, corporations law or trust law. It is unclear whether such general law, or which parts of it, would be considered part of the 'substantive requirements' of an entity's rules?	Paragraphs 12, 111, 113, 127 and 128 of the final ruling have been added to provide an example of governing rules of an entity found outside its constituent documents. Entities must apply the general principle of 'substantive' to their individual circumstances.
1.12	(a) Regarding paragraph 91 of the draft ruling, how would the ATO determine which religious laws were 'substantive', and which ones not? The draft ruling does not assist religious organisations in determining whether a breach of their many religious laws, regulations, by-laws, etcetera, would result in a breach of the new special conditions. In particular, which are 'substantive requirements' for the purposes of the governing rules condition? (b) Further, it is unclear from the draft ruling whether the potential application of a religious dispensation in relation to a religious law would affect whether or not it was a 'substantive' requirement.	Entities must apply the general principle of 'substantive' to their individual circumstances. Paragraphs 18 to 20 of the final ruling have been reworded to provide greater clarity between those rules that are substantive requirements and those that are not. An additional 8 examples have been included at paragraphs 124 and 125 in Appendix 1 of the final ruling to provide further guidance and clarity.
	At what time must the entity comply with all of the substantive requirements in its governing rules?	
1.13	Regarding the questions that must be considered to determine whether an entity satisfies the governing rules condition (in paragraph 8 of the	Adding the term 'substantively' to the interpretation of the provision is reading words into the law that change the intent of

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	draft ruling), the third question should be: • Has the entity **substantively** complied with all of the substantive requirements in its governing rules? This is because there are degrees of non-compliance and while the rule may be substantive, the non-compliance may be trivial.	Parliament. No change.
1.14	Paragraph 14 of the draft ruling states that the governing rules condition is applied on a continuous basis throughout the income year or, in other words, it applies *at all times* during the year. (a) It is entirely impractical for affected entities to continuously monitor compliance at all times throughout the income year. It in turn creates difficulties in the areas of governance of such entities (for example, office bearers, auditors, etcetera). (b) This issue also needs to be also viewed in the context of the sheer diversity of the not-for-profit sector. That is, one size does not fit all, and the approach taken in the draft ruling may place an excessive and unreasonable compliance burden on large scale entities. (c) The ATO should take a proportionate approach that takes into account the size and complexity of the entity. Taking a proportionate approach would allow the ATO to consider a variety of factors including whether the controllers of the entity personally acted in compliance and had adequate systems in place to ensure compliance and identify and take action against non-compliance (or failed to do so). Additional detailed practical guidance could be included in the draft ruling, to ensure entities are made aware of what the ATO will require as evidence of satisfying the governing rules condition at all times during the income year.	The governing rules condition and income and assets condition apply at all times during an income year. Entities covered by the endorsement provisions in the *Taxation Administration Act 1953* (TAA 1953) already have an ongoing obligation to monitor their entitlement to income tax exemption (see section 426-45 in Schedule 1 to the TAA 1953). The new special conditions extend the requirement for ongoing monitoring to a broader range of entities; we do not accept that this requirement is 'entirely impractical'. Concerns about proportionality and fairness have been addressed by the inclusion of Appendix 3 explaining the Commissioner's administrative practice.
2	**Income and assets condition**	
	What is the 'purpose for which the entity is established'	
2.1	The two questions in paragraph 16 of the draft ruling do not address the true meaning of 'purpose', which necessarily involves reading into the words that are stated an understanding that they would include purposes	Paragraphs 26 to 28 have been added to the final ruling to clarify that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established.

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	incidental and ancillary and directed to the stated purpose.	
2.2	The clarity of the ruling would be improved if all references to 'purpose' be amended to read 'purpose or purposes'.	The draft ruling makes it clear in paragraph 25 that 'purpose' includes the plural. No change.
2.3	Paragraph 20 should read: The purpose for which a fund is established is ascertained by considering the constituent documents of the fund (primarily **in the case of a fund established as a trust** the instrument of trust or the will) and any relevant legislation.	Paragraph 24 of the final ruling has been updated to clarify the manner in which the purpose of an entity is ascertained.
2.4	The draft ruling should take into consideration the High Court's dicta in *Taxation of the Commonwealth of Australia v. Word Investments Limited* (2008) 236 CLR 204 where it was provided that there be an overriding or 'paramount' purpose. Specifically the Court in *Word* noted a requirement to find a 'true, main, dominant or paramount purpose' and powers subserving the main purpose (as decided in *HA Stevenson & Son Ltd (in liq) v. Gillanders, Arbuthnot & CO* [1931] HCA 4) 'applies precisely to entities like Word which have a memorandum of association with an objects clause.'.	Paragraphs 147 to 150 of the final ruling explain the distinction between the purposes of registered charities and other exempt entities.
2.5	(a) Paragraph 127 of the draft ruling states that 'regard must be given to the current circumstances of the entity'. It would be helpful if an example was used to explain this. (b) While we accept that the law requires exempt income status is to be determined in each year, the term 'apply' should be considered in a broader context of possible accumulations, and the ATO's views on accumulations are not determined until the end of the year. Accordingly, the language of TR 97/22 ('a significant proportion of surplus funds') sets the context better.	Paragraph 135 of the final ruling clarifies that ascertaining the purpose for which the entity is established involves a consideration of all of the features of the entity. The Commissioner's view on accumulation is consistent with the position in TR 2011/4. The accumulation of income is a broader concept than 'surplus funds'. However, the final ruling considers both 'net' income and 'gross' income to provide greater clarity.
2.6	Paragraph 133 of the draft ruling, in effect, suggests that the clear words of the legislation are to be set aside. The legislation does not distinguish between purposes on the one hand and ancillary and incidental purposes on the other.	The courts have made it clear that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established. Refer to paragraphs 151 to 156 of the final ruling. No change.

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	The draft ruling necessarily has to make this distinction (which is consistent with the general law) to avoid the unworkable consequence that a strict application of the wording of the legislation would demand.	
2.7	It would be helpful for the draft ruling to state that, for sporting clubs, TR 97/22 is not displaced in determining 'main purpose', and that TD 93/190 should be read in conjunction with the draft ruling.	Paragraphs 149 and 150 of the final ruling make it clear that entities, other than registered charities, must have a main or dominant purpose. The Commissioner's view is consistent with TR 97/22. This ruling explains special conditions that apply far more broadly than just the type of entities covered by those other rulings. No change.
2.8	It would be helpful for the draft ruling to state that payments to members (or on behalf of members) in pursuit of the entity's objects, satisfies the new special conditions.	Whether a payment to a member of an organisation will be an 'application of income and assets solely for the purpose for which the entity is established' will depend on all the facts and circumstances. Example 7 in the final ruling provides an example of where a payment on behalf of members, purportedly in pursuit of the entity's objects of promoting the study of madrigal, would not satisfy the new special condition.
	Incidental and ancillary purposes	
2.9	What (if anything) is the effect of including incidental or ancillary purposes as expressly stated purposes in constituent documents? The view of the draft ruling seems to be that if the entity's purposes that are stated in its constituent documents include purposes that are incidental or ancillary to its charitable purpose, the entity will not lose its income tax exemption if it applies its income and assets condition towards one of these incidental or ancillary purposes. If, on the other hand, the entity's constituent documents do not make reference to ancillary or incidental purposes, the income and assets condition will be breached if the entity carries out incidental or ancillary purposes. The entity would therefore arguably lose exempt status.	This was not an intended interpretation. Paragraphs 26 to 28 have been added to the final ruling to clarify that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established.

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	The inability of an entity to pursue ancillary or incidental purposes will have a negative impact on the entity and the community. Further clarification is requested.	
2.10	The draft ruling is unclear as to whether the pursuit of incidental or ancillary purposes can ever lead to loss of income tax exempt status and, if so, why or why not. In particular, paragraphs 132 to 136 of the draft ruling includes ancillary and incidental purposes to charitable organisations as coming under the 'purposes' head. However, the prior and legally binding section of the draft ruling contains no mention of incidental or ancillary purposes. The Commissioner's position should be made clearer, particularly in the binding section of the draft ruling.	Paragraphs 26 to 28 have been added to the binding section of the final ruling to clarify that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established.
	Has the entity applied its income and assets solely for the purpose for which the entity is established?	
	Accumulation	
2.11	Many entities will not have detailed plans covering accumulations of income. The draft ruling should further clarify if the ATO has concerns about accumulation. The discussion in paragraph 143 is insufficient in this regard.	Paragraphs 31 and 32 of the final ruling have been reworded to clarify the factors that influence whether accumulation is consistent with an entity's purpose. Changes have been made to include reference to accumulation in Example 8 and an additional Example 11 has been added to the final ruling.
2.12	The ATO should also consider providing some safe harbours in relation to: 1. the number of years that an entity can accumulate income; 2. the % of income that can be accumulated; and 3. the purposes for which income can be accumulated without attracting adverse ATO attention. However, depending on their circumstances, entities should still be permitted to accumulate outside the safe harbours. This should be expressly acknowledged in the draft ruling.	The ruling does not change the Commissioner's view on accumulation. As accumulation must occur for some specific and objectively justifiable good reason, based on the individual entity's circumstances, prescriptive 'safe harbours' are not appropriate. No change.
2.13	In providing its views on accumulation, relevant case law, including	Paragraphs 165 to 170 of the final ruling provide the relevant

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	Bargwanna and *TACT v. FCT* (2008) 71 ATR 827, should be referred to in the draft ruling. It may be useful for the Commissioner to also refer to the guidance issued by the Charities Commission of England and Wales at: https://www.gov.uk/government/publications/charities-and-reserves-cc19/charities-and-reserves.	case law in regard to accumulation and 'applied for purposes'.
2.14	We note that the concepts of 'income' and 'profits' become conflated in parts of the draft ruling (see for example paragraphs 24, 25 and 143) suggesting that an entity accumulating 'most of its profits' would need to show this was consistent with its purpose. This does not have regard to the fact that profits should merely be what's left over after the entity has applied its income to its purposes and may, for instance, only represent a small percentage of its overall income.	Paragraph 31 of the final ruling has been amended to clarify that income includes both the entity's 'gross' income and 'net' income.
2.15	(a) To assist in creating certainty for entities concerned about accumulating funds and falling foul of the income and assets condition, it would be beneficial for the draft ruling to include an example of where accumulation would be considered inappropriate. Further clarity on levels of acceptable accumulation allowable under the income and assets condition would be welcome. (b) Entities would benefit from 'bright-line' tests regarding threshold limits surrounding the 'income and assets condition'. Currently the draft ruling notes an entity will fail the test where it accumulates 'most' of its profits over a number of years and where the accumulation is not consistent with its purposes. (c) There is currently no guidance surrounding the Commissioner's interpretation of the terms 'profit' or 'most'. More examples on this would be helpful, dealing with different reasons for accumulation, long-term accumulation plans, and entities that seek to accumulate all of their income over a period of time. Guidance on whether the Commissioner would seek to interpret the ability to accumulate income differently for charitable funds and other types of charitable entities would also be welcome.	The ruling does not change the Commissioner's view on accumulation. Paragraph 31 of the final ruling has been reworded. An additional example has been included in the final ruling where an entity's accumulation does not satisfy the income and assets condition (see Example 11). Example 8 has been amended to provide a further example of where accumulation would be appropriate.

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	Meaning of 'solely'	
2.16	Regarding references to 'incidental' in paragraph 146 of the draft ruling. When taken in context of the draft ruling only, the word 'incidental' appears to connote minor or insignificant activities. Further, the use of the word 'incidental' in such a context is not in keeping with ATO existing Tax Ruling TR 2005/21 and Tax Ruling TR 2011/4 on charitable entities. These Rulings state that an incidental activity for a 'charitable institution' need not be minor in quantum and what is critical is if those activities are 'in aid of' the charity's purpose. This is supported by the High Court in the *Word Investments* case, which accepted that a charitable institution could undertake substantial trading activities if charitable activities were the 'immediate natural and probable consequence' of its activities. The draft ruling should take further steps to clarify its intended use of the term 'incidental' and especially, clarify that 'incidental', at least in relation to charitable institutions, need not mean 'minor'.	References to 'incidental' have been removed from the interpretation of the 'solely' test. Paragraphs 26 to 28 have been added to the final ruling to clarify that incidental or ancillary purposes are merely aspects of an entity's purpose for which it is established. Incidental or ancillary does not mean minor in quantitative terms.
2.17	The use of the term 'one-off' in paragraph 27 of the draft ruling is unclear. Does it mean a modest payment that is out of the ordinary? Or could it encompass as well a modest payment made on a number of occasions? A better description that 'one-off' might be 'occasional, unrelated applications'. Further clarity is also needed as to whether the term 'one-off' is intended to apply across the life of an entity, or whether 'one-off' is assessed on an annual basis.	Paragraph 35 of the final ruling has been reworded to state that the 'solely' test will still be satisfied where: • the misapplication or misapplications are immaterial in amount, and • there is a one-off misapplication or occasional, unrelated misapplications of part of the income or assets of an entity for a purpose other than the purpose for which the entity is established during an income year.
2.18	The income and assets will still be satisfied despite a one-off application of part of the income or assets of an entity, other than for the purpose for which the entity is established, that is insignificant in amount **or minor in extent and importance**. That is, insert 'or minor in extent and importance'.	Paragraph 34 of the final ruling has been simplified to state that certain misapplications of an entity's income and assets of an insignificant nature will not result in a breach of the condition. Relevant considerations include whether the amount of the misapplication is immaterial and whether the misapplication is an isolated incident.

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3	**Breaches of the new special conditions – where no breach or misapplication is taken to have occurred**	
3.1	The distinction between a remediation *post factum* and a rectification *ab initio* as set out in paragraphs 152 to 154 of the draft ruling is valid but for practical purposes not relevant. The fact that a breach has occurred and has been remedied ought not to disqualify the entity from its tax exemption status where there has been no loss and the ongoing charitable purposes are being satisfied. It should only be in a case where the charitable purpose is no longer being fulfilled that loss of tax exemption should apply.	As the special conditions apply at all times during the income year, a breach of the conditions that is remedied at a later date still results in an entity being in breach of the condition for some period during the income year. Appendix 3 to the final ruling sets out the circumstances in which the Commissioner may consider whether or not to allocate resources to take compliance action in respect of an entity which has become taxable for a period of time due to a breach of the governing rules condition or the income and assets condition. No change.
4	**References to the Revised Explanatory Memorandum to the Tax Laws Amendment (2013 Measures No. 2) Bill 2013**	
4.1	The Explanatory Memorandum (EM) to the *Tax Laws Amendment (2013 Measures No. 2) Act 2013* at 11.59 states that the amendments are, *inter alia*, to maintain the operation of minor tax integrity requirements by addressing 'inappropriate conduct', which 'does not always manifest in the pursuit of an alternate purpose by nonetheless should result in an entity no longer being entitled to endorsement'. Some explanation of the 'inappropriate conduct' which is being referred to is needed in the draft ruling, as it is not immediately apparent from the legislation or the EM what the offending conduct is. None of the examples in the draft ruling state that they are illustrations of 'inappropriate conduct'.	The phrase 'inappropriate conduct' does not appear in the law, however the context of the provisions provides that an entity that is not following its own rules, or is applying any of its income and assets other than for the purposes for which it is established will be engaged in 'inappropriate conduct' even if that conduct does not manifest in the pursuit of an alternative purpose. The examples given in the ruling explain how the law can apply to particular factual circumstances.
4.2	The EM also states at 11.64 that the 'law confirms the Court's interpretation in *Commissioner of Taxation v. Bargwanna* [2012] HCA 11, relating to whether a charitable trust is applied for the purposes for which it is established.' How this is so is not immediately apparent from the legislation or the EM. The draft ruling should make at least some reference to the case. This is	Paragraphs 161, 162, 163 and 166 have been added to the final ruling to provide the High Court's view in *Bargwanna* in regard to a fund being 'applied for the purposes for which it was established'.

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	particularly concerning because one of the more important points made by the High Court in that case was that in revenue matters the benign construction usually applied to charitable trusts did not apply. The draft ruling would be improved by an explanation of how the case law is 'confirmed' by the introduction of the new special conditions.	
5	**Administrative Treatment**	
	Commissioner's practical administration where corrective action is taken by the entity	
5.1	The draft ruling does not state that the Commissioner has power to exempt or excuse breaches. On one construction, the legislation appears to operate in a guillotine fashion so that if there is a breach then exempt status is lost. There is nothing in the draft ruling that clarified this so to provide assurance that the income tax exempt status of the trust is not lost by inadvertent breach of substantive requirements. If in fact inadvertent breach of substantive requirements will lead to loss of income tax exempt status, this should be spelt out clearly in the draft ruling.	The Commissioner does not have the power to exempt or excuse breaches. Paragraph 38 of the final ruling makes it clear that a breach of either or both special conditions will result in a loss of income tax exemption.
5.2	The content of Appendices 2 and 3 of the draft ruling should be made binding.	The Explanation section provides additional information to help taxpayer's understand the Commissioner's view. It does not form part of the binding ruling. The Administrative treatment does not represent the Commissioner's view about the way in which a taxation provision applies therefore is not part of a binding public ruling.
5.3	The Commissioner's approach in Appendix 3 indicates that the very concept of the governing rules condition is flawed.	This is a matter of policy.
5.4	The information contained in Appendix 3 is useful as it indicates the likelihood of the Commissioner to take compliance action against an entity that has breached the special conditions. However, as it does not form part of the binding part of the draft ruling, this offers little comfort to these entities if they do breach the special conditions (inadvertently or otherwise). It would be useful to know what specific compliance action the	The Administrative treatment does not represent the Commissioner's view about the way in which a taxation provision applies therefore is not part of a binding public ruling. Paragraph 38 of the final ruling makes it clear that a breach of either or both special conditions will result in a loss of income tax exemption. Concerns about fairness have been addressed by the inclusion

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	Commissioner would take in the appropriate circumstances. Does this involve taking away an entity's endorsement for income tax exemption? If so, this should be made clear in the draft ruling and further guidance should be provided on both how and when the Commissioner is likely to revoke endorsement. The Commissioner seems to be indicating that he has other powers beyond revocation of endorsement (for example, per paragraph 161, the Commissioner states he could 'require the entity to take additional steps to correct the breach or misapplication'). The Entity C recommend that a clear statement regarding how the Commissioner may administer the revocation power be included in the binding part of the draft ruling with additional guidance contained in Appendix 3 amended as suggested by the Entity C.	of Appendix 3 explaining the Commissioner's administrative practice. Paragraph 191 of the final ruling has been amended to change the word 'require' to 'advise'. This reflects the potential for a dialogue between the entity and the Commissioner about what 'corrective action' is appropriate in a particular case. It takes into account the Commissioner's compliance approach and the appropriate application of resources as set out in Appendix 3. The revocation of endorsement only applies to registered charities. This ruling applies to all 'entities' as defined in paragraph 5 of the final ruling. The Commissioner's power to revoke endorsement is contained in section 426-55 of the *Taxation Administration Act 1953.*
	Potential overlap with ACNC governance standards for registered charities	
5.5	Paragraph 168 of the current draft ruling notes the ACNC governance standards have the potential to significantly overlap with the income and assets condition. Amendments to the draft ruling are required in order to further clarify when this will be the case, for example under the current regime, whether submitting an Annual Information Statement to the ACNC will be sufficient to satisfy the Commissioner of compliance without the need for an additional determination.	Subdivision 45-B of the *Australian Charities and Not-for-profits Commission Regulation 2013* sets out the governance standards that registered charities must meet on an ongoing basis. This is independent of any reporting obligation that registered charities may have under the *ACNC Act 2012.* No change.
5.6	It is noted that the governance standards of the ACNC regime do not apply to basic religious charities.	Comment noted. No change.
6	**Examples**	
6.1	An attempt to draw the distinction between the two concepts (substantive v. procedural) is made by way of inclusion of Examples 1, 3, 4, 5 and 6. In Example 1, the Commissioner regards the requirement to record all financial transactions and to prepare annual financial statements as a substantive requirement. In our view, we would regard this as a	Paragraphs 18 to 20 of the final ruling provide greater clarity between those rules that are substantive requirements and those that are not. The substantive requirements in an entity's governing rules are those that define the rights and duties of the entity. The

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	procedural requirement. In Example 3, the Commissioner regards the requirement for approval of expenditure in QWE's governing rules as a procedural requirement; however, on another interpretation, it is possible this could also be characterised as a substantive requirement as there could be a real reason why a particular organisation sets this spending limit rather than it being an arbitrary limit (for example to ensure monies are not spent inappropriately). The examples included in the draft ruling do not assist to clarify which requirements are 'substantive' and which are 'procedural'.	remainder of an entity's governing rules are procedural requirements, which are the rules prescribing the method or manner in which the rights and duties of the entity are carried into effect, and where applicable, enforced. Administrative processes are typically procedural requirements. These clearer interpretations have been carried through the final ruling, including the Examples.
6.2	The examples generally do not assist in understanding the impact of the governing rules condition and income and assets condition to complex entity structures and situations.	This ruling explains special conditions that apply broadly across multiple types of entity. Broad principles have been explained and examples provided across all types of exempt entities in the sector. Where organisations have raised issues with us we have reflected those scenarios in the examples where possible. Each entity needs to apply the general principles to their individual circumstances.
6.3	The current examples contained in the draft ruling which illustrate the 'governing rules condition' do not refer to instances where governing documents would be recognised beyond an entity's constituent documents. It would be useful and beneficial to include at least one example where 'governing rules' would be taken to include sources beyond an organisation's constitution. If it is not possible to include an additional example highlighting the use of sources beyond an organisation's constitution, removing the sentence 'there may also be other sources (such as relevant legislation) that comprise or supplements an entity's governing rules' from paragraph 10 would also be appropriate.	Paragraph 128 of the final ruling has been added to provide an example of 'substantive' requirements in 'other' rules (that is, governing rules of an entity found outside its constituent documents).
6.4	Examples in the draft ruling imply that the ATO has a view that an entity cannot raise funds from commercial activities that are unrelated to the purpose for which it is established. This argument was rejected by the	The examples in the draft ruling do not imply unrelated commercial activities are impermissible. The examples provide realistic factual scenarios that entities are familiar with to help

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	High Court in *Word Investments*. Examples in the draft ruling raise questions about how an entity produces its income. This is not relevant to special conditions dealt with in the draft ruling, and references should be removed.	better understand the application of the special conditions.
6.5	Further examples would be helpful to provide guidance as to the application of the governing rules condition to clubs.	The ruling provides the Commissioner's interpretation of the new special conditions that apply to approximately 600,000 entities in the not-for-profit sector. Where organisations have raised issues with us we have reflected those scenarios in the examples where possible. Broad principles have been explained and examples provided across all types of exempt entities in the sector.
6.6	Example 2 may cause some uncertainty if the club's constitution states that the club must adhere to all liquor licensing laws and regulations, as is common. This should not be a breach of the club's governing rules condition. Liquor or gaming licensing breach is irrelevant when it comes to assessing the club's income tax exempt status. The example should therefore be reworked to specifically exclude a club's operational activities from breaching the governing rules condition, even in the event that it is also a breach of the club's constitution.	If an entity's constitution states that the club must adhere to all liquor licensing laws and regulations, this is a 'substantive' requirement in its governing rules because it defines a duty of the club. It is not a 'procedural' requirement.
6.7	To assist in creating certainty for entities concerned about accumulating funds and breaching the income and assets condition, the draft ruling should include an example of where accumulation would be considered inappropriate.	Example 11 of the final ruling has been added to include an example where accumulation of income breaches the income and assets condition.
6.8	In paragraph 33 delete the words 'the primary'.	Example 1 has been replaced in the final ruling.
6.9	In paragraph 35 delete the sentence 'Beachside does not own or rent its own premises and does not provide social facilities for its own members.'	The sentence 'Beachside does not own or rent its own premises and does not provide social facilities for its own members' has been removed from the final ruling.
6.10	In paragraph 37 delete the words 'enforceable' and 'coherent'. Follows on from comment regarding paragraph 9.	The final ruling has been drafted to remove references to 'coherent' and 'enforceable'.
6.11	Please advise whether the same view in Example 3 would apply where	The view of the authoring team is that the same view would

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	an organisation's constitution requires the prior approval of members to a certain transaction. For example, prior member approval for the sale of real estate.	apply where the entity's constitution requires prior approval of members. The same reasoning as given in the example would apply.
6.12	Example 6 highlights the concern with the policy itself. Had the constitution not been amended prior to the entity providing assistance to a homeless child or man then the entity would be in breach of a substantive governing rule. If that is the case then the example should make that explicit. The example should be amended to demonstrate a breach.	The Example in Appendix 3 provides the scenario suggested in the comment whereby the constitution is not amended prior to the change in purpose.
6.13	In paragraph 58 delete the words 'to Italy and France in that year'.	Example 7 in the final ruling has been reworded to remove references to 'Italy and France'.
6.14	In Example 7, is this not a matter for FBT compliance rather than application of income and assets?	This ruling is not about compliance with FBT provisions. Implications for other taxes are not considered. No change.
6.15	In paragraph 64 it is suggested that before the phrase 'and arranges for volunteers to operate the shop', insert the words 'employs a part-time manager and driver for collection of goods'. Where chains of opportunity shops operate effectively under a charity's auspices, some paid employees typically work alongside volunteers to ensure roster management and safe handling, storage and transport of goods. There should be no suggestion, either explicitly or by omission, that some paid employment in the operation of an opportunity shop should in any way render a charity ineligible for tax concessions.	Example 8 in the final ruling has been reworded to add a reference to 'paid employees'.
6.16	Example 8 in the draft ruling deals with the issue of when commercial activities may or may not breach the special conditions. The example concerns how a tax exempt entity may raise profits. It does not deal with the type of commercial activities addressed in *FCT v. Word Investments Limited (Word Investments)* [2008] HCA 55. The test under the legislation that is considered in the draft ruling is how an entity **applies** its income - how an entity produces its income was dealt with in *Word Investments* and should be irrelevant in any ruling on the application of the special conditions. In our view, Example 8 should be	Example 8 in the draft ruling does not imply unrelated commercial activities are impermissible. The example provides a realistic scenario that entities are familiar with to help better understand the application of the income and assets condition to various items of expenditure.

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	removed from the draft ruling.	
6.17	In Example 9, the reference to 'majority of profits' should not be elevated to an absolute test. To avoid the phrase being elevated to a test, or appearing to define what an acceptable accumulation is, we suggest that it be replaced with 'a significant proportion of its surplus funds' as in paragraph 54 of TR 97/22. In this way the ATO can make its point without introducing a new, contentious phrase. Further, the 'majority of profits' notion does not necessarily take into account expense items.	The Commissioner's view on accumulation is consistent with the position in TR 2011/4. The accumulation of income is a broader concept than 'surplus funds'. However, the final ruling considers both income and profit to provide greater clarity.
6.18	In Example 9, the reference to the 'majority of members' is possibly misleading as paragraph 57 of TR 97/22 refers to 'a high level of participation by members'. This is a practical issue for sporting clubs that are 'controlled' by sporting members but have large numbers of social members.	Example 9 in the final ruling has been reworded to state that there is a 'high level of participation' of members in the entity's sporting activities.
6.19	Example 11 is potentially a sensitive example. Probably best to refer to another type of exempt entity.	The entity in Example 12 of the final ruling has been changed from an employee association to an incorporated entity.
6.20	An example could be provided of an organisation incurring modest and appropriate expenditure to provide a Christmas function for its staff and or supporters. Such expenditure is commonly accepted, and is expected of employers. Similarly an example that covers Award nights the organisation may hold for its staff or the people it cares for would be a welcome clarification. Such events require an appropriate level of entertainment to make the occasion a suitable recognition event.	The final ruling explains when an entity has applied its income and assets solely for the purpose for which the entity is established. In the case of functions held by the entity, whether or not the entity satisfies the income and assets condition (and the governing rules condition) will depend on the particular circumstances. As a result, it is considered that a further example would be of limited value.
6.21	It is commonplace for entities to have an annual gala event that may be held at a prestigious location. The organisation will incur significant expense in delivering these events – with the full expectation of generating a fundraising surplus through ticket sales and income from auctions of donated goods and services. A guiding example around such events would be helpful to the sector.	Example 8 of the final ruling provides an example of a situation where profits from commercial activities used to further an entity's purpose do not result in a breach of the income and assets condition. It is therefore considered that an additional example is not required.

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6.22	Directors who sit on the Board of not-for-profit (and income tax exempt) organisations generally do so in an honorary capacity and do not receive any payment in the way of directors' fees. It is essential for the sector to be able to access the skills and talents of such directors. It is not uncommon for NFP organisations to provide an occasional dinner event for the directors of the organisation – generally prior to a significant governance event such as a strategy day or a Board effectiveness assessment day. A guiding example around such events would be helpful to the sector.	See response to issue 6.20. It is considered that , whether or not the entity satisfies the income and assets condition (and the governing rules condition) in this situation will depend on the particular circumstances of the entity. As a result, an additional example would be of limited value.
7	**Other**	
7.1	(a) The draft ruling attempts to introduce a 'one size fits all' approach to charitable and non-charitable exempt entities. (b) It would be beneficial for the ATO to confirm within the ruling that the Commissioner's specific interpretation of such entities in TR 2011/4 and TR 97/22 respectively would continue to apply.	Comment 7.1(a): The ruling provides the Commissioner's interpretation of the new special conditions that apply to approximately 600,000 entities in the not-for-profit sector. Broad principles have been explained and examples provided across all types of exempt entities in the sector. Comment 7.1(b): The ruling does not concern the meaning of 'charity' (cf TR 2011/4) or 'being established for the encouragement of a game or sport' (cf TR 97/22). This ruling explains special conditions that apply far more broadly than just the two types of entities covered by those other rulings. Where appropriate other rulings are cross referenced. For example, see paragraphs 169 and 170 of the final ruling regarding accumulation.