TR 2005/D7 - Income tax: companies controlled by exempt entities

This document has been finalised by TR 2005/22.

Draft Taxation Ruling

Income tax: companies controlled by exempt entities

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office.*

What this Ruling is about

Class of person/arrangement

1. This Ruling concerns the income tax exemption, under Division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997), of companies – whether incorporated or unincorporated – which are not carried on for the profit or gain of their individual members, and which are controlled by an entity or entities that are exempt from income tax under that Division.

2. It does not deal with aspects of exemption that are unrelated to the connection or relationship between the company and the exempt entity that controls it.[1] Also, it does not deal with companies that are not non-profit,[2] or with trusts,[3] or with situations where income is in fact derived by the exempt entity itself and not by the company.

Legislative background

3. In Division 50 of the ITAA 1997, section 50-1 provides that:

> The total *ordinary income and *statutory income of the entities covered by the following tables is exempt from income tax. In some cases, the exemption is subject to special conditions.[4]

[1] Examples of such matters not covered are the endorsement provisions for charities.
[2] The refund of excess imputation credits provisions – in Part 3-6 of the ITAA 1997 – may apply in relation to taxable for-profit companies, to provide a no-tax result between the company and its tax exempt owner.
[3] For non-charitable trusts, the income tax exemption of their presently entitled beneficiaries may provide a no-tax result for the trust and its tax exempt beneficiaries.
[4] The asterisks before 'ordinary income' and 'statutory income', and in other places in the ITAA 1997, signify a defined term in the legislation.

4. The tables in Division 50[5] set out a range of types of entity, from 'charitable institution'[6] to 'trade union',[7] and from 'municipal corporation'[8] to 'a society, association or club established for the encouragement of: (a) animal racing'.[9] Many of the items also have special conditions attaching to them. For example, the non-profit requirement is specified as a special condition for many items,[10] and endorsement is a special condition for items applying to charities.[11]

5. For the various types of entity and special conditions, the requirements are, of course, different. For example, the tests for item 1.2 – 'religious institution' – are not the same as those for item 5.2 – 'a public authority constituted under an *Australian law'.

6. A range of rulings are available on different aspects of exemption, including Taxation Determination TD 93/190 on community service organisations, Taxation Ruling TR 97/22 on exempt sporting clubs, Draft Taxation Ruling TR 2005/D6 on charities, and Taxation Ruling TR 2000/11 on endorsement of income tax exempt charities.

7. As well as the question of whether a particular company is covered by an item in Division 50, there is also the question of which amounts the exemption will apply to. Section 50-1 applies the exemption to 'total *ordinary income and *statutory income of the entities covered by the following tables'. Accordingly, it is only the ordinary and statutory income of the entity, to which the exemption applies. This ensures that an exempt entity cannot arbitrarily claim an exemption in respect of amounts that are not in fact its ordinary or statutory income. However, it can also mean that where a company is acting only as the agent of an exempt entity (a situation which is expected to be unlikely or rare), the income generated may be the income of the exempt entity and not of the company. Such matters will turn on their own facts and are not canvassed in this Ruling.

Summary

8. In brief, this Ruling explains that, in working out whether a particular company is exempt from income tax, in circumstances where that company has a relationship or a connection with another entity that is itself exempt, it is that company that must meet the requirements for exemption. It explains that it is not sufficient for an entity which controls the company to meet those requirements.

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[5] In this Ruling all legislative references are to the ITAA 1997, unless otherwise noted.
[6] Item 1.1 in section 50-5.
[7] item 3.2 in section 50-15.
[8] Item 5.1(a) in section 50-25.
[9] Item 9.1(a) in section 50-45.
[10] For example, for item 9.1 in section 50-45 covering sports clubs, music societies, and so on.
[11] For example, for item 1.1 covering charitable institutions.

9. It explains that all the relevant circumstances of a company are to be taken into account in determining whether it satisfies the particular legislative requirements for exemption. These circumstances may, of course, include the company's relationship or connection with an entity that happens to be exempt from income tax.

10. The significance of such relationship or connection will depend on the circumstances and on the legislative requirements. The Ruling explains that it would not be the *exemption* of the related entity that could be relevant, but the factual relationship or connection itself.

Definitions

11. In this Ruling, for convenience of presentation, the following terms bear these meanings:

- '**exempt entity**' means an entity that is exempt from income tax under section 50-1 of the ITAA 1997; and
- '**non-profit company**' means a company – whether incorporated or unincorporated – which is not carried on for the profit or gain of its individual members. For its use in this Ruling, the term does not bear the meaning defined in subsection 3(1) of the *Income Tax Rates Act 1986*.

Date of effect

12. When the final Ruling is issued, it is proposed to apply to arrangements begun to be carried out from its date of issue. However, the final Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the final Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

13. For the ordinary income and statutory income of a non-profit company to be exempt from income tax under Division 50 of the ITAA 1997, the company itself must be covered by the tables in that Division.

14. To be covered, the company must itself meet the description and requirements of an item in those tables. If the company, in its own right, does not fall within the description and meet the requirements of any item, it will not be covered by the tables, and so its ordinary and statutory income will not be exempt from income tax under the Division.

15. It is not possible to merely attribute the characteristics and purposes of an exempt entity to a different company, or to simply 'look through' the company to the exempt entity.

16. Deciding whether an entity is covered by a category of exempt entity in the tables in Division 50 involves matters of fact and degree. In this regard the degree and type of integration of a company with an organisation that happens to be an exempt entity can be relevant. Nonetheless, it is the purposes and character of the company itself – as shown by all relevant features including its constituent documents and activities – that will be determinative.

17. Accordingly, the following features, on their own, will not be sufficient to show a company is covered by the tables in Division 50:

- control of the company by an exempt entity or entities;
- common membership of the board of both the company and the exempt entity;
- use of the company's surplus funds for exempt entities or their purposes;
- the commitments of members of the company being related to those of an exempt entity or entities;
- common motives inspiring the company and associated exempt entities;
- the providing of free services to associated exempt entities; and
- the holding of property by the company on trust for exempt entities.

Explanation

The entity

18. For ordinary income and statutory income to be exempt from income tax under Division 50, they must be the ordinary income and statutory income *of an entity*: section 50-1. Accordingly, the threshold to exemption is identifying an entity.

19. Once an entity is identified, the issue becomes whether it is covered by the tables in Division 50. If the entity is not covered by those tables, its ordinary income and statutory income will not be exempt from income tax under Division 50.

20. In the non-profit sector, to which Division 50 largely applies, various structures are found. For example, a sporting group might include several unincorporated associations and several corporations. By way of further example, a religious group might include an unincorporated association and some corporations (where each may include several quasi-independent divisions or branches), and several trusts. An educational group might have a main corporation and several related corporations and trusts. Within such groups the various structures will commonly be thought of collectively – all are 'the club', or 'the church', or 'the college'.

21. For Division 50, on the other hand, the key concept of 'entity' – on which exemption is premised – has a defined meaning given by section 960-100 of the ITAA 1997. Briefly, entity is defined to mean any of:

(a) an individual;

(b) a body corporate;

(c) a body politic;

(d) a partnership;

(e) any other unincorporated association or body of persons;

(f) a trust;

(g) a superannuation fund.

(The meanings of these terms are explained in Miscellaneous Taxation Ruling MT 2000/1.)

22. Accordingly, when Division 50 is applied, it does not apply to the group collectively described as 'the club', or 'the church', or 'the college'.[12] It is only the particular entities – as defined in section 960-100 – to which Division 50 can apply. So, for example, for a sporting group that included an unincorporated association and two corporations, each would need to be covered by an item in Division 50 if its income was to be exempt. This would be the case irrespective of whether the people of the sporting group thought of themselves collectively as 'the club'. So, it could happen that two of the entities were exempt but another, which did not satisfy any item in Division 50, was not.

Focus on the entity

23. Given it is the entity itself that must be covered by an item in the tables in Division 50, it is *its* character or purpose, rather than the character or purpose of a related exempt entity, that will be determinative. Several cases illustrate this point.

[12] As discussed in paragraph 20.

24. In *Commissioner for ACT Revenue Collections v. Council of the Dominican Sisters of Australia*[13] the Council sought exemption from pay-roll tax as a religious institution. It was a company limited by guarantee, established by a religious order to conduct a teachers training college. The Council's membership was identical to the religious Order's governing body, called the Generalate Council.

25. Before the Administrative Appeals Tribunal[14] the issue was treated as 'whether the Corporate Council is entitled to claim and bear the shield of religion carried on by the Generalate Council'.[15] The Tribunal found that it could and accordingly the Council was exempt as a religious institution. The grounds were that the purpose of the Order was the advancement of religion through education, and 'the Corporate Council is the legal face of the Generalate Council. It is the legal entity which acts on behalf of the Generalate Council and was created to hold legal title to property on its behalf'.

26. On appeal the Full Federal Court did not accept this approach:

> To say, as the Deputy President said, that the [Council] merely represented the legal means by which the Order gave effect to its underlying principles and that the [Council] became clothed with the fundamental character of the Order was not to answer the critical question, which was whether the promotion or advancement of religion was the primary and dominant object of the [Council]. That question could only have been answered after an examination of the objects and activities of the [Council] to determine whether its primary and dominant object was the promotion of religion or, as the applicant submitted, the advancement of education. We do not think the Deputy President undertook such an examination.[16]

27. This approach also means it is not possible to merely attribute the characteristics and purposes of an exempt entity to a different company. In *Glebe Administration Board v. Commissioner of Pay-roll Tax (NSW)*[17] the relationship between the Board and a religious institution was described in this way:

> … a religious institution, the Church of England Diocese of Sydney, had been given power by statute to confer by its own ordinance management powers of a commercial kind upon the Board as a corporate body. Thus the religious institution was enabled to, and did, create an entity controlled by, but distinct from, the religious institution, namely a non-religious Board whose duty was to raise money in a commercial way, for the purposes of the religious institution.[18]

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[13] 91 ATC 4602; (1991) 22 ATR 213 (*Dominican Sisters*).
[14] 91 ATC 2010; (1991) 22 ATR 3021.
[15] At 91 ATC 2014; 22 ATR 3025.
[16] At 91 ATC 4602 at 4607; 22 ATR 213 at 218. The matter was returned to the Administrative Appeals Tribunal where it was subsequently dismissed for non-appearance by the Council.
[17] (1987) 10 NSWLR 352; 87 ATC 4825; 19 ATR 297 (*Glebe Administration Board*).
[18] At (1987) 10 NSWLR 352 at 365-366; 87 ATC 4825 at 4835; 19 ATR 297 at 309 per Priestley JA, with whom McHugh JA agreed.

28. The character of the Church of England Diocese of Sydney was not attributed to the Board it had established and controlled. Rather, the Board was held to not be a religious institution. This was because, on a consideration of the Board itself, it did not have this character. The character of the body that formed and controlled it was not determinative.

29. To focus on the character of the relevant entity itself, means that a 'look through' approach is not appropriate. This is illustrated by *Theosophical Foundation Pty Ltd v. Commissioner of Land Tax (NSW)*.[19]

30. At issue in the case was, inter alia, whether the Foundation was a religious society. All shares in the Foundation were held by two companies limited by guarantee, one holding assets for an unincorporated national society promoting theosophical doctrines, and the other a lodge having the same theosophical objects. The Foundation's activities were substantially to manage the commercial letting of a building. It also operated a bookshop and library in the building and published a magazine and pamphlets.

31. At first instance[20] Wallace J 'looked through' the associated bodies to find that the Foundation was a religious society. His Honour relied on the facts that the directors and members of the Foundation and of the societies that were its members were all either members of or directly associated with the same theosophical society, and the organisations had common major aims or objectives.[21]

32. On appeal this approach was rejected.[22] When the Foundation was characterised in its own right, without 'looking through', it was not accepted as a religious society:

> It is a member of what may be loosely described as a group of affiliated bodies, corporate and unincorporated, of which one, at least, is, by admission, a religious society. The respondent company was called into existence as a member of that group for the purpose of acquiring and managing a particular piece of property, for the benefit of other members of the group or of the cause which it is their common purpose to advance, this cause being, as a matter of inference from the admission which has been made, a religious cause. But that circumstance does not make the respondent a 'religious society'.[23]

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[19] (1966) 67 SR (NSW) 70 (*Theosophical Foundation*).
[20] *Theosophical Foundation Pty Ltd v. Commissioner of Land Tax (NSW)* (1965) 82 WN (Pt. 1) (NSW) 545.
[21] At (1965) 82 WN (Pt. 1) (NSW) 553.
[22] By Herron CJ (1966) 67 SR (NSW) 70 at 78, and by Sugerman JA, with whom McLelland JA agreed, at 83-84.
[23] At (1966) 67 SR (NSW) 70 at 84, per Sugerman JA, with whom McLelland JA agreed.

33. Another example is provided by *Cremation Society of Australia Ltd v. Commissioner of Land Tax (NSW)* (1973) 2 NSWLR 704; 4 ATR 194. At issue was whether a corporation was non-profit. Its shares were owned solely by a non-profit company, and it only paid dividends to that company. In finding that the corporation was not non-profit the court said:

> The fact that the appellant is a company with a share capital which makes profits and distributes those profits as dividend to its shareholder must, I regret to say, be regarded as predominant and the restrictions on the dividends in the hands of the shareholder must be disregarded as irrelevant.[24]

That is, the non-profit character of the ultimate recipient of the profits did not change the character of the corporation itself.

Particular features

34. In deciding whether a non-profit company is covered by the tables in Division 50, its various features need to be taken into account and objectively weighed. These features can include the facts of the matters set out in paragraph 17.

35. While the consideration can include these facts, and while they may point towards the company being covered by an item in Division 50, they cannot to be considered in isolation from the other features and circumstances of the company. On their own they will not be determinative.

Control

36. The approach of the courts in *Dominican Sisters*, *Glebe Administration Board*, and *Theosophical Foundation* illustrate that control by another entity does not determine character or purpose. Control of a company by an exempt entity or entities will not, on its own, cause the company to be covered by the tables in Division 50.

37. For example in *Glebe Administration Board* – where the Board was not accepted as a religious institution – its members were the Archbishop and persons chosen by the Standing Committee of the Synod of the Diocese of Sydney. Also, practical control remained with the Standing Committee, and the Board 'was subject in many ways to direction by the Standing Committee, as for example in getting approval of proposed sales of property'.[25]

[24] (1973) 2 NSWLR 704 at 707; 4 ATR 194 at 196.
[25] At (1987) 10 NSWLR 352 at 364; 87 ATC 4825 at 4834; 19 ATR 297 at 307.

Common membership

38. Common membership of the board of both a company and an exempt entity will not, on its own, cause the company to be covered by the tables in Division 50. For example, in the *Dominican Sisters* case, the Council's membership being identical to the religious Order's governing body did not suffice to show that the Council was a religious institution.

Use of surplus funds

39. Use of a company's surplus funds for exempt entities or their purposes will not, on its own, cause it to be covered by the tables in Division 50.

40. For example in *Cronulla Sutherland Leagues Club Ltd v. Federal Commissioner of Taxation*[26] the Leagues Club was not accepted as an exempt sporting club. This was despite the fact that without the funds it provided, the associated football club could not have continued to play in the New South Wales Rugby League competitions.

> The policy of the appellant is to conduct its affairs so as to maximise the surplus that is available to enable it to support the football club. On occasions the level of commitment to the football club has necessitated the appellant in economies in general maintenance. Substantial amounts were contributed by the appellant to the football club which represented a substantial percentage of the appellant's after-tax profit.[27]

41. Another example is provided by *Glebe Administration Board* where some of the net proceeds of the Board's revenue earning activities were used by the Church for public charitable purposes, and all were available to be so used if the Standing Committee of the Diocesan Synod chose. Again, the Board was nonetheless not accepted as a religious institution.

Common commitments

42. The commitments of members of the company being related to those of an exempt entity or entities will not, on its own, cause it to be covered by the tables in Division 50.

43. For example, in *The Church of the New Faith v. Commissioner of Pay-roll Tax (Vic.)* Mason ACJ and Brennan J commented that:

> It does not follow that the common religion of a group stamps a religious character on an institution founded, maintained or staffed by members of that group or that the purpose or activity of such an institution is religious.[28]

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[26] 90 ATC 4215; (1990) 21 ATR 300 (*Cronulla Sutherland Leagues Club*).
[27] At 90 ATC 4215 at 4226; 21 ATR 300 at 312-313 per Lockhart J.
[28] (1983) 154 CLR 120 at 128-129.

44. This does not apply only to religious commitments. In *Cronulla Sutherland Leagues Club* – where the Leagues Club supported the associated rugby league football club – it was controlled by people connected with rugby league. As Lockhart J said:

> The control of the appellant has remained in the hands of persons interested in promoting the football club and all directors of the appellant have since the formation of the present football club in 1963 been members of that club. Also, the directors of the appellant become directors of the football club.[29]

Notwithstanding this the dominant purpose of the Leagues Club was characterised by Lockhart J and Beaumont J as promoting 'the provision of the facilities of a licensed club for it members and visitors'[30] and not the encouragement of sport.

Common motives

45. Common motives inspiring the company and associated exempt entities will not, on its own, cause it to be covered by the tables in Division 50.

46. There is some judicial support for considering the subjective motives or intentions of promoters in determining an organisation's purpose in some situations: *A & S Ruffy Pty Ltd v. Federal Commissioner of Taxation* (1958) 98 CLR 637 at 651 per Dixon CJ, Williams and Webb JJ; *Brookton Co-operative Society Ltd v. Federal Commissioner of Taxation* (1981) 147 CLR 441 at 453 per Mason J, with whom Wilson J agreed; *Cronulla Sutherland Leagues Club* per Beaumont J at 90 ATC 4243; 21 ATR 331;[31] *Terranora Lakes Country Club Ltd v. FC of T* 93 ATC 4078 at 4087; (1993) 25 ATR 294 at 305.

47. Nonetheless, even where such an approach was consistent with the particular legislative requirements, those subjective motives or intentions would only be features to consider along with all the other relevant features. For example, in the context of exempt sporting clubs:

> ... although the intentions of the promoters of the taxpayer may be relevant in determining the purpose for which the taxpayer was incorporated, it is necessary to look at the taxpayer's actual activities, since the purpose of its incorporation can be ascertained from what it did.[32]

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[29] At 90 ATC 4215 at 4225; (1990) 21 ATR 300 at 312.
[30] At 90 ATC 4215 at 4244; (1990) 21 ATR 300 at 332 per Beaumont J.
[31] See also comments of Lockhart J at 90 ATC 4215 at 4227; (1990) 21 ATR 300 at 314.
[32] *Cronulla Sutherland Leagues Club* at 90 ATC 4215 at 4243; (1990) 21 ATR 300 at 331 per Beaumont J.

48. Also, in both *Glebe Administration Board* and *Theosophical Foundation*, even though their commercial activities were performed for the ultimate benefit of associated religious entities, the Board and Foundation were not themselves religious bodies. While it can be accepted that their particular business enterprises were not conducted for their own sake, in characterising the character or purpose of the bodies themselves, the motives and subjective intentions would be only one of the matters to be considered. Their operations would also be relevant, and could well be the more important.

49. The approach of the Full Federal Court in *Council of the Dominican Sisters* – which looked to the character or purpose of the entity itself, rather than that of an associated body – is to be followed rather than the approach of the Board of Review in *Case B122* (1952) 2 TBRD 613; 2 CTBR (NS) *Case 82* (and of JF McCaffrey in *Case C57* (1952) 3 TBRD 297; 3 CTBR (NS) *Case 68*).[33]

Free services

50. The providing of free services to associated exempt entities will not, on its own, cause a non-profit company to be covered by the tables in Division 50.

51. For example, in *Glebe Administration Board*, where the Board was not accepted as a religious institution, its operations included the provision of management services to parishes and other church connected bodies. The services were without charge, unless the owner was to receive a commercial benefit.[34]

52. In *Cronulla Sutherland Leagues Club*, where the Leagues Club was not accepted as an exempt sporting club:

> The appellant [the Leagues Club] has assisted the Football Club with facilities such as the Caltex Field and other fields together with their associated facilities and the appellant allows the Football Club to use the Caltex Field for a nominal fee and to reap the benefits of sponsorship and advertising rights. The appellant bears all the costs of maintaining the fields and all capital expenditure. It also makes available to the Football Club without charge fully equipped offices and meeting facilities in the club house.[35]

[33] These decisions are discussed in TR 2005/D6.
[34] At (1987) 10 NSWLR 352 at 363; 87 ATC 4825 at 4833; 19 ATR 297 at 307.
[35] At 90 ATC 4225-4226; 21 ATR 300 at 312 per Lockhart J.

Holding property on trust

53. The holding of property by a company on trust for an exempt entity or entities will not, on its own, cause it to be covered by the tables in Division 50. As was commented on the circumstances of *Theosophical Foundation*: 'Even a corporation which holds land on trust for a religious society does not, by force of that circumstance, itself become a 'religious society'.[36]

54. The trust itself would be deemed to be an entity by section 960-100 (see MT 2000/1). Exemption for the entity being the trust would turn on whether it was covered by the tables in Division 50, in the same way as for other entities: section 50-1.

55. If a company that was trustee of a trust sought exemption under Division 50, the company itself would need to be covered by the tables in that Division. In its own capacity, and in its capacity as trustee of a trust, it would be two different entities: section 960-100.

Integration

56. There will be many companies controlled by exempt entities which, when looked at in their own right, will be covered by the tables in Division 50. In determining whether they are so covered, all relevant features are taken into account.

57. While the particular features, as set out in paragraph 17, do not suffice on their own for a company to be income tax exempt, their facts can be relevant. That is, they can be relevant but are not determinative.

58. Determining what is the character or purpose of a company can involve matters of fact and degree. The factual matters referred to in paragraph 17 could, in light of the other circumstances of a company, point towards it being exempt from income tax.

59. They would not do so in terms of the fact that the related entity or entities were exempt; Division 50 does not include any such relationship test. Rather, they could be relevant as showing that – from a commonality of purpose, or a degree of integration in the pursuit of purposes – the company had the purpose or character required by the item in Division 50. That is, the factual connections between the company and the exempt entity or entities could be facts pointing towards the company's character or purpose. The focus of such a consideration is always the company itself, as illustrated by the *Dominican Sisters* case.[37]

[36] At (1966) 67 SR (NSW) 70 at 84 per Sugerman JA.
[37] See discussion from paragraph 24.

60. Of course, whether a company was exempt from income tax would depend on the requirements of the particular item in Division 50. The various features set out in paragraph 17 could be more or less relevant depending on those requirements. For example, for an entity to be covered by item 5.2 in section 50-25, it would need to be 'a public authority constituted under an *Australian law'. If it was not itself a public authority and was not constituted under an Australian law, the fact that it was set up and controlled by such an authority, or provided free services to the authority, or used its surplus to support the authority, would be immaterial. The fact that it was not a 'public authority constituted under an Australian law' would be determinative. On the other hand, for a non-profit company to be covered by item 2.1 in section 50-10, its main purpose would need to be 'community service purposes (except political or lobbying services)'. In deciding whether it was established for such purposes, the types and degree of integration with other entities could be factually persuasive.[38]

Scenarios

61. While each company's position will turn on its own particular facts, in the comments that follow, the application of particular items is illustrated where exempt entities have established separate non-profit companies:

- to provide services to the exempt entities;
- to provide benefits to parties connected with the exempt entities; and
- to carry on commercial enterprises to generate profits.

62. The comments do not purport to set up another or different test in addition to those of the particular items in Division 50. Rather, they seek to illustrate how the principles of particular items could apply to the scenarios. References are made to the particular items and to Tax Office rulings on those items.

Infrastructure services

63. An exempt entity might set up and control a non-profit company solely to provide services to it in the carrying out of its purposes. Depending on the type and degree of integration in the pursuing of purposes, this may be a pointer towards the company's purpose or character.

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[38] It should also be noted that the requirements for different items in the tables in Division 50 vary as regards purpose. For example, for a sports club under item 9.1(c) in section 50-45, it could have an unrelated non-sporting purpose, provided it was secondary (see TR 97/22 paragraph 42). For a charitable institution under item 1.1 in section 50-5, on the other hand, all of its purposes must be charitable, or at least incidental or ancillary to such purposes (see TR 2005/D6). Accordingly, a charitable institution could not have an unrelated secondary purpose, but a sports club could.

Example

64. *A non-profit corporation is set up and controlled by a religious group to insure each of its twenty charitable entities against loss due to fire, etc to their assets. The twenty charitable entities in the group carry out educational, religious and medical purposes, owning schools, clinics, offices, churches and halls. The corporation's sole function is to provide insurance to the charitable entities in respect of such assets, in a cost-neutral way.*

65. *The corporation is a charitable institution in terms of item 1.1 in section 50-5. It does not merely possess characteristics as outlined at paragraph 17. Also, while it does not perform educational, religious and medical services, and while the providing of insurance cover in itself is not a charitable purpose, the corporation's circumstances indicate it is solely carrying out charitable purposes and it has no other purpose. Its purposes, in their own right, are wholly charitable. There is no private benefit provided.*

Example

66. *A non-profit company is set up and controlled by an exempt sports club in a metropolitan area. It operates solely to bring spectators, from more distant parts of the metropolis, to games played by the club's teams at the home ground. Using funding from the club, it arranges transport and pick-up points, coordinates seating, advertises games, and so on.*

67. *The company's purpose is the 'encouragement of a game or sport', as required by item 9.1(c) in section 50-45. Therefore, provided it meets the other requirements of section 50-45, it will qualify for income tax exemption. In terms of TR 97/22, the company is encouraging the sport 'through marketing' and by 'encouraging club members to be spectators at and to support the game or sport',[39] and does not have any other purposes.*

68. The mere providing of services to an exempt entity would not, however, demonstrate exemption (see also the discussion from paragraph 50).

Example

69. *A college and its seven related entities, which are all charities, set up and control a non-profit corporation to provide business support services, such as labour hire, office services and publicity. The corporation actively seeks clients in the business and non-profit sectors, and provides its services to them at commercial rates and on a commercial basis. It also provides at-cost services to the eight charities.*

[39] Paragraphs 11 and 51 of TR 97/22.

70. *The corporation is not a charitable institution in terms of item 1.1 in section 50-5. While it provides at-cost services to the charities and is controlled by them, its purposes are not limited to charitable purposes only.*

71. The fact that a company only operates in a way that is integrated with the operations of its exempt parent does not necessarily mean it will qualify for exemption under Division 50. In each situation the particular requirements of the items in the tables in Division 50 must be satisfied.

Example

72. *A non-profit hospital, which is not a charitable institution,[40] is exempt from income tax in terms of item 6.2 in section 50-30 of the ITAA 1997. It sets up and controls a company to provide laundry and food services to the hospital. The company's sole function is to provide those services to the hospital.*

73. *The company is not exempt from income tax in terms of item 6.2 in section 50-30. The item requires that the entity be a 'hospital'. Even though the company's purposes are solely for the sake of the operation of the hospital, and are fully integrated with it, it is not itself a hospital. Accordingly, it cannot qualify under that item.*

Benefits

74. In some situations the benefits provided by a non-profit company (that has been set up and controlled by an exempt entity) might be intended to flow not only to the exempt entity but also to other parties. Where this is the case such benefits can also be a relevant matter in determining its character or purpose.

75. Two cases illustrate the effect of providing personal benefits on whether an organisation is a charity. In *Presbyterian Church of New Zealand Beneficiary Fund v. Commissioner of Inland Revenue* [1994] 3 NZLR 363 a superannuation scheme for retired ministers of the Presbyterian Church was accepted as a charity. While recognising the financial benefits to be provided to particular persons – the ministers – the court viewed them as incidental to the advancement of religion. The importance of the ministry to the Church and the lifelong commitment were particular features influencing the decision.[41]

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[40] While many non-profit hospitals will be charities, others will not. An example is provided by *Waterson and others v. Hendon Borough Council* [1959] 2 All ER 760 where the hospital was operated by a friendly society for the benefit of its members.

[41] Note, though, that for Australian income tax purposes, the taxable income of superannuation funds will be taxed under Part IX of the *Income Tax Assessment Act 1936*. If the fund is to be accepted as a complying fund it must also meet the requirements of the *Superannuation Industry (Supervision) Act 1993*.

76. The contrast is provided by *Hester v. Commissioner of Inland Revenue* (2004) 21 NZTC 18,421 in which the Church of Jesus Christ of Latter-day Saints Deseret Benefit Plan was not accepted as a charity. It covered employees of two of the Church's entities, employed in administration and education. The court distinguished the circumstances from those in the *Presbyterian Church of New Zealand Beneficiary Fund* case. It covered employees generally, whose roles were more transportable to other employment, and whose employment activities were not 'essential' to the operation of the Church. The court said *Presbyterian Church of New Zealand Beneficiary Fund* was an exceptional case, and that it did not authorise the proposition that any church-controlled superannuation scheme for its employees would be a charity.

77. For sporting clubs, the decision in *Cronulla Sutherland Leagues Club* illustrates the effect of purposes that go beyond the encouragement of a game or sport. On the facts in that case, while there were strong indicators of a sporting purpose,[42] the main purpose was the provision of social amenities and licensed club facilities. Those circumstances can be contrasted with the example at paragraph 66.

Commercial enterprises

78. The fact that a non-profit company carries on a business or commercial enterprise is unlikely, on its own, to determine whether it is covered by the tables in Division 50. Such a fact would be one of the matters to be taken into account in light of the particular item in the tables.

[42] Such as the use of its surplus funds to support the associated football club and the provision of free facilities to the football club.

79. As mentioned, determining what is the purpose or character of a company can involve matters of fact and degree.[43] In light of the other circumstances of a company, the appropriate conclusion may be that the business-like activities are merely incidental to other acceptable purposes,[44] or are no more than the conducting of acceptable purposes in a business-like way,[45] or amount to a secondary purpose which does not affect exemption.[46]

80. However, there can also be situations where the appropriate conclusion is that the purpose of a company is to carry on a business or commercial enterprise to generate profits. In these situations it is unlikely that the company would qualify for exemption under any of the items in the tables in Division 50. The fact that such a company is set up and controlled by an exempt entity would not cause it to be exempt.[47]

Example

81. *XYZ is a charitable institution focusing on a particular childhood disease. It is endorsed by the Tax Office as exempt from income tax. XYZ establishes a corporation limited by guarantee, ABC Ltd, to carry on a trucking and haulage business. ABC Ltd's object is to carry on the business. Its members are the board of XYZ. Its surpluses are to be used to further XYZ and its activities. ABC Ltd conducts the business to the public in a commercial way, but carries free for XYZ on the rare occasions it needs trucking or haulage services. It applies for endorsement.*

82. *ABC Ltd is not entitled to endorsement as an income tax exempt charity. Its purposes are not those of a charitable institution. The fact that it is set up and controlled by an exempt charity does not mean it, too, is a charitable institution or exempt. Nor do the facts that it uses its surpluses to further XYZ's charitable purposes, and that it occasionally provides free services to XYZ.*

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[43] At first instance in *Cronulla Sutherland Leagues Club Ltd v. Federal Commissioner of Taxation* 89 ATC 4936 at 4952; (1989) 20 ATR 1404 at 1417 per Hill J.

[44] The training farm for delinquent boys in *Salvation Army (Victoria) Property Trust v. Fern Tree Gully Corporation* (1951-52) 85 CLR 159 is an example.

[45] See for example *Incorporated Council of Law Reporting for England and Wales v. A-G* [1971] 3 All ER 1029 (preparation and sale of law reports); *Incorporated Council of Law Reporting (Qld) v. Federal Commissioner of Taxation* (1971) 125 CLR 659; *McGarvie Smith Institute v. Campbelltown Municipal Council* (1965) 11 LGRA 321 (manufacture and sale of animal vaccines); *Scottish Burial Reform and Cremation Society Ltd v. Glasgow City Corporation* [1967] 3 All ER 215 (cremation services for fees).

[46] For some items an unrelated purpose can be acceptable, if it is secondary. For example, for exemption as a sports club under item 9.1(c) in section 50-45, a non-sporting purpose can be consistent with exemption, as long as it is no more than secondary: TR 97/22 paragraph 42. In contrast, for a charitable institution under item 1.1, all its purposes must be charitable or incidental or ancillary to its charitable purposes; that is, it must be exclusively charitable.

[47] Where an exempt entity uses a for-profit company to generate profits from commercial enterprises, the refund of excess imputation credit provisions – in Part 3-6 of the ITAA 1997 – may apply to provide a no-tax result between the company and its tax exempt owner.

Example

83. A non-profit company is set up and controlled by four exempt sports clubs. Its object is to promote the four sports. Its sole function is to operate a hotel with bars, bistro and gaming machines. Its surplus is distributed in support of sporting purposes proposed by the clubs.

84. *The company's main purpose is not the 'encouragement of a game or sport', as required by item 9.1(c) in section 50-45. It does have features that are highly persuasive of sport, viz it 'uses a significant proportion of its surplus funds in encouraging the game or sport' and its 'constituent documents emphasise that the club's main purpose is to encourage a game or sport and the club operates in accordance with those documents'.*[48] *However, when weighed with the sole function of operating the hotel, its main purpose is not the required encouragement of a game or sport.*[49]

85. Such conclusions are predicated, of course, on the purpose of the company in fact being the carrying on of a business or commercial enterprise to generate profits. It is not to be assumed that just because a company is conducting a business that its purpose is the carrying on of the business. All the relevant circumstances need to be taken into account and weighed in relation to the company as a whole, and in light of the legislative requirements.

86. However, where the purpose of the company is otherwise the carrying on of a business or commercial enterprise to generate profits, the matters listed at paragraph 17 would not cause a different conclusion. This is clearly indicated by the cases.[50] The having of such a purpose can co-exist with control by an exempt entity, or the use of surplus to further purposes connected with exempt entities, or objects in the constituent document that refer only to purposes consistent with exemption.[51]

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[48] See paragraph 15 of TR 97/22.

[49] See also paragraph 55 of TR 97/22, citing the comments of Hill J in *St Marys Rugby League Club Ltd v. FC of T* 97 ATC 4528 at 4534; (1997) 36 ATR 281 at 288 on any future plans to build a motel.

[50] See *Glebe Administration Board*, *Theosophical Foundation*, and the comments in *Re Smith, Deceased: Executor Trustee and Agency Co. of South Australia Ltd v. Australasian Conference Association Ltd* [1954] SASR 151 at 159. The case of *Calder Construction Co. Ltd v. Commissioner of Inland Revenue (NZ)* (1963) 13 ATD 214 – where the company carried on businesses – applied legislation unlike anything in Division 50, and is not relevant to it.

[51] For example, 'there may be cases in which it appears that what are called ancillary powers constitute in truth the main objects for which the company was formed and in which, on looking at the reality of the situation, the whole matter cannot be regarded as concluded merely because, in the memorandum of association, certain objects and powers are stated to be subordinate to other objects': *Christian Enterprises Ltd v. Commissioner of Land Tax (NSW)* (1968) 88 WN (Pt. 2) (NSW) 112 at 123 per Walsh JA, with whom Asprey JA agreed. The factual conclusion in that case – a company engaging in property development was accepted as a religious society – is sometimes cited against the approach taken in this Ruling. Irrespective of what might be said of the weighing of factors in that case, the court accepted that religious objects in a constituent document would not on their own demonstrate a company's character, as the passage quoted indicates.

87. The holding of passive investments to generate returns is unlikely to amount to a purpose in its own right. Where this is the major activity of a non-profit company, its objects and distributions are likely to be the main indicators of its purpose.

Example

88. *A non-profit company is set up and controlled by a community service organisation that is exempt from income tax in terms of item 2.1 in section 50-10 of the ITAA 1997. The company has the same objects as the exempt entity. Its sole function is to hold passive investments to generate a return, and to make distributions from the surplus for community service purposes.*[52]

89. *The company's main purposes are community service purposes, as required by item 2.1. Its holding of passive investments to generate a return does not indicate any different purpose. It falls within the description of community service organisations set out in TD 93/190.*

Your comments

90. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date.

Due date:	**24 June 2005**
Contact officer:	**Bernie Mackinnon**
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Telephone:	**(07) 4753 7659**
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Detailed contents list

91. Below is a detailed contents list for this draft Taxation Ruling:

[52] Which are not political or lobbying purposes, as set out in item 2.1.

Commissioner of Taxation
11 May 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

MT 2000/1; TD 93/190; TR 2005/D6; TR 92/20; TR 97/22; TR 2000/11

Subject references:

- charities
- community service organisations
- cultural organisations
- exempt entities
- income tax exempt charities
- religious organisations
- sporting organisations
- tax exempt body

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 Pt IX
- ITAA 1997 Div 50
- ITAA 1997 50-1
- ITAA 1997 50-5
- ITAA 1997 50-10
- ITAA 1997 50-15
- ITAA 1997 50-25
- ITAA 1997 50-30
- ITAA 1997 50-45
- ITAA 1997 Pt 3-6
- ITAA 1997 960-100
- Income Tax Rates Act 3(1)
- Superannuation Industry (Supervision) Act 1993

Case references:

- Case B122 (1952) 2 TBRD 613; 2 CTBR (NS) Case 82
- Case C57 (1952) 3 TBRD 297; 3 CTBR (NS) Case 68
- A & S Ruffy Pty Ltd v. Federal Commissioner of Taxation (1958) 98 CLR 637
- Brookton Co-operative Society Ltd v. Federal Commissioner of Taxation (1981) 147 CLR 441
- Calder Construction Co. Ltd v. Commissioner of Inland Revenue (NZ) (1963) 13 ATD 214
- Christian Enterprises Ltd v. Commissioner of Land Tax (NSW) (1968) 88 WN (Pt. 2) (NSW) 112
- The Church of the New Faith v. Commissioner of Pay-roll Tax (Vic.) (1982-1983) 154 CLR 120
- Commissioner for ACT Revenue Collections v. Council of the Dominican Sisters of Australia 91 ATC 4602; (1991) 22 ATR 213
- Re Council of the Dominican Sisters of Australia and Commissioner for ACT Revenue Collections 91 ATC 2010; (1991) 22 ATR 3021
- Cremation Society of Australia Ltd v. Commissioner of Land Tax (NSW) (1973) 2 NSWLR 704; 4 ATR 194
- Cronulla Sutherland Leagues Club Ltd v. Federal Commissioner of Taxation 89 ATC 4936; (1989) 20 ATR 1404
- Cronulla Sutherland Leagues Club Ltd v. Federal Commissioner of Taxation 90 ATC 4215; (1990) 21 ATR 300
- Glebe Administration Board v. Commissioner of Pay-roll Tax NSW (1987) 10 NSWLR 352; 87 ATC 4825; 19 ATR 297
- Hester v. Commissioner of Inland Revenue (2004) 21 NZTC 18,421
- Incorporated Council of Law Reporting for England and Wales v. A-G [1971] 3 All ER 1029
- Incorporated Council of Law Reporting (Qld) v. Federal Commissioner of Taxation (1971) 125 CLR 659
- McGarvie Smith Institute v. Campbelltown Municipal Council (1965) 11 LGRA 321
- Presbyterian Church of New Zealand Beneficiary Fund v. Commissioner of Inland Revenue [1994] 3 NZLR 363
- Salvation Army (Victoria) Property Trust v. Fern Tree Gully Corporation (1951-52) 85 CLR 159
- Scottish Burial Reform and Cremation Society Ltd v. Glasgow City Corporation [1967] 3 All ER 215
- Re Smith, Deceased; Executor Trustee and Agency Co. of South Australia Ltd v. Australasian Conference Association Ltd [1954] SASR 151
- St Marys Rugby League Club Ltd v. FC of T 97 ATC 4528; (1997) 36 ATR 281

- Terranora Lakes Country Club Ltd v. FC of T 93 ATC 4078; (1993) 25 ATR 294
- Theosophical Foundation Pty Ltd v. Commissioner of Land Tax (NSW) (1965) 82 WN (Pt. 1) (NSW) 545
- Theosophical Foundation Pty Ltd v. Commissioner of Land Tax (NSW) (1966) 67 SR (NSW) 70
- Waterson and others v. Hendon Borough Council [1959] 2 All ER 760

ATO references

NO: 2004/2514
ISSN: 1039-0731
ATOlaw topic: Income Tax ~~ Exempt income ~~ business and professional income - Australian sourced
Income Tax ~~ Exempt entities ~~ charity, education, science and religion