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

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Draft Taxation Ruling

Income tax: the 'in Australia' requirement for certain deductible gift recipients and income tax exempt entities

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Summary – what this draft Ruling is about

1. This draft Ruling provides the Commissioner's view on the following conditions in the *Income Tax Assessment Act 1997* (ITAA 1997)[1] dealing with deductible gift recipients (DGRs) and exempt entities:

- the condition that certain[2] DGRs be 'in Australia' before a gift or contribution to them is tax deductible (in this draft Ruling we call this the DGR in Australia condition).[3]
- the condition that certain entities have a 'physical presence in Australia' before their income is exempt from tax (in this draft Ruling we call this the Division 50 in Australia condition).[4]

[1] All legislative references in this draft Ruling are to the ITAA 1997, unless otherwise indicated.
[2] For those funds, authorities or institutions covered by an item in a table in Subdivision 30-B.
[3] Refer to the definition of DGR in Australia condition at paragraph 3 of this draft Ruling and the DGR in Australia condition from paragraph 4 of this draft Ruling.
[4] Refer to the definition of Division 50 in Australia condition at paragraph 3 of this draft Ruling and the Division 50 in Australia condition from paragraph 42 of this draft Ruling.

- the condition that a registered charity or DGR have a 'physical presence in Australia' before they qualify for a refund of franking credits (in this draft Ruling we call this the Refund of franking credits condition).[5]

2. This draft Ruling does not consider the meaning of the words 'in Australia' in other parts of Australian taxation law.[6]

Definitions

3. The following terms are used in this draft Ruling:

- **ACNC** means the Australian Charities and Not-for-Profits Commission.
- **DGR in Australia condition** refers to the special condition that a fund, authority or institution be 'in Australia' to be entitled to DGR endorsement (see paragraph (a) of column 4 in item 1 of the table in section 30-15).
- **Division 50 in Australia condition** refers to the special condition that certain entities have a physical presence in Australia and, to that extent, incur their expenditure and pursue their objectives principally 'in Australia', in order to be tax exempt (see paragraphs 50-50(1)(a), 50-55(1)(a) and 50-70(1)(a)).
- **Refund of franking credits condition** refers to the test which determines eligibility for a franking refund for a registered charity or DGR (see section 207-117).

Ruling

DGR in Australia condition

4. The DGR in Australia condition[7] requires a fund, authority or institution to 'be in Australia'.[8] To 'be in' is to exist; have reality; live; take place; occur; remain as before... to be found or located in.[9] Applying the ordinary meaning of the phrase 'be in Australia' in the context of the DGR conditions, a fund, authority or institution will be in Australia at a particular time if:

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[5] Refer to the definition of Refund of franking credits condition at paragraph 3 and the Refund of franking credits condition from paragraph 92 of this draft Ruling.
[6] Including other provisions in Divisions 30 and 50. For example, paragraph 50-65(1)(a) provides a special condition for item 1.6 that the fund 'is located in, and which incurs its expenditure principally in, Australia'.
[7] Special condition (a) in item 1 of the table in section 30-15.
[8] Australia includes the Australian territorial and offshore boundaries. Refer to the definition of 'Australia' in sections 960-500 and 960-505, which includes States and

- it is established or legally recognised in Australia[10], and
- it operates in Australia at that time.

Fund

5. The word 'fund' is not defined in the ITAA 1997 and takes its ordinary meaning. A fund is a pool, stock or store of assets.[11] The dictionary meanings of fund include 'stock of money or pecuniary resources'[12] and 'a stock of money, esp. one set apart for a purpose'.[13] Courts have interpreted a fund to mean 'money (or investments) set aside and invested, the surplus income being capitalized'.[14]

6. A trust fund is usually established by will or instrument of trust and can be legally recognised in Australia for the DGR in Australia condition by obtaining an Australian Business Number (ABN) for the trust or registering as a charity.

7. A fund which is not a separate trust is usually operated as part of an entity. Such a fund will not qualify for an ABN or registration as a charity in its own right. It will be the legal recognition of the entity (for example, an incorporated association or company limited by guarantee) operating the fund which will give the fund legal recognition (see Examples 1 to 3 of this draft Ruling).

8. It does not matter where the physical assets or money of the fund are located (see Example 2 and 3 of this draft Ruling), rather a fund is in Australia if all or a substantial part of its store of assets or money is:

- established and legally owned or held by a trustee or other entity in Australia, and

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internal Territories, their internal waters and any islands, and certain offshore areas and installations.

[9] Retrieved 2 July 2018 from http://www.macquariedictionary.com.au.

[10] Being either established or legally recognised is sufficient. Legal recognition means being given status by the Australian legal system. It could include, for example, registration under the *Australian Charities and Not-for-Profits Commission Act 2012* (ACNC Act), *Corporations Act 2001*, *A New Tax System (Australian Business Number) Act 1999* (ABN Act) or as an incorporated association under an Act of Parliament of a State or Territory. An unincorporated association could have a registered business name, an ABN, and many are registered charities.

[11] See Taxation Ruling TR 2011/4 *Income tax and fringe benefits tax: charities* at paragraph 224.

[12] Retrieved 2 July 2018 from http://www.macquariedictionary.com.au.

[13] *Australian Oxford Dictionary* ,1999, Oxford University Press, Melbourne Australia.

[14] *Australian Provident Funds Pty Ltd v. FC of T* (1966) 14 ATD 333 at 351.

- managed[15] by a trustee or other entity located in Australia[16] (see Examples 1 and 2 of this draft Ruling).

Authority

9. 'Authority' is not defined in the ITAA 1997 and takes its ordinary meaning. The dictionary meaning of 'authority' includes '1. the right to determine, adjudicate, or otherwise settle issues or disputes; the right to control, command, or determine... 2. a person or body with such rights.'[17] Case law demonstrates that the question whether a particular entity is an 'authority' will be a question of fact and degree dependent on the circumstances, and points out that:

- incorporation by legislation is not necessary[18]
- the body must be an agency or instrument of government set up to exercise control or execute a function in the public interest and it must be an instrument of government existing to achieve a government purpose[19]
- the body must perform a traditional or inalienable function of government and have governmental authority for doing so[20], and
- the conferral, or not, of statutory, administrative or coercive powers on the body is not determinative.[21]

10. For the DGR in Australia condition, 'authority' generally refers to 'public authority' in Subdivision 30-B.[22]

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[15] For a fund to be managed in Australia, it would be expected that the operational decision-making function for the assets is exercised here. It is not necessary that high level strategic decision making happen in Australia. That is, the test is less than what is required by central management and control test for corporate residency in subsection 6(1) of the *Income Tax Assessment Act 1936*.

[16] Some public funds have additional requirements imposed by Subdivision 30-B that require its purposes and beneficiaries to also be in Australia. See items 2.1.8, 2.1.9, 2.1.9A, 2.1.13, 4.1.3, 4.1.5, 5.1.3, 8.1.1, and 8.1.2 in Subdivision 30-B.

[17] Retrieved 2 July 2018 from http://www.macquariedictionary.com.au.

[18] *Renmark Hotel v. FCT* (1949) 79 CLR 10 and *Silverton Tramway Co Ltd (*1953) 10 ATD 295; (1953) 88 CLR 559.

[19] *Committee of Direction of Fruit Marketing v. Australian Postal Commission* (1980) 144 CLR 577.

[20] *Renmark Hotel Inc v. FCT* (1949) 79 CLR 10; *General Steel Industries Inc v. Commissioner of Railways (NSW)* (1964) 112 CLR 125 and *Re Anti-Cancer Council of Victoria; ex parte the State Public Services Federation* (1992) 175 CLR 442.

[21] *Renmark Hotel Inc v. FCT* (1949) 79 CLR 10; *Western Australian Turf Club v. FCT* (1978) 139 CLR 288; 78 ATC 4133; 8 ATR 489.

[22] For the DGR in Australia condition, 'authority' generally refers to 'public authority' in Subdivision 30-B. The meaning of public authority extends to bodies other than government bodies, provided the status and authority have been conferred by statute in Australia and are exercised for public purposes: *Incorporated Council of Law Reporting of the State of Queensland v. FCT* (1924) 34 CLR 580; *Renmark Hotel Inc v. FCT* (1949) 79 CLR 10; *FCT v. Bank of Western Australia Ltd; FCT v. State Bank of NSW Ltd* 96 ATC 4009 per Hill J.

11. An authority is established in Australia if it is established and recognised by the Commonwealth or a State government. It is operated in Australia if it is exercising control, power or command for the public advantage in Australia, or executing a function in the public interest in Australia (see Example 4 of this draft Ruling).

Institution

12. An institution[23] is an establishment, organisation or association, instituted for the promotion of an object, especially one of public or general utility. It connotes a body called into existence to translate a defined purpose into a living and active principle.[24] An institution may be formed in different ways including as a corporation limited by guarantee, unincorporated association or a trust. Trustees whose only function is the management of a trust fund consistent with the terms of a trust deed do not operate an institution.[25] Some further quality or function that gives the trust, when regarded as a whole, the character of an establishment, organisation or association instituted for the promotion of an object is required.

13. For the DGR in Australia condition, an institution could be established in Australia by being registered under the *Corporations Act 2001*, established by instrument of trust, established as an incorporated association under State or Territory legislation, established as an Australian government agency, or operated as an unincorporated association. An institution could be legally recognised by registration under the ACNC Act as a registered charity, or under the ABN Act, or recognised as a corporation by the Australian Securities and Investments Commission (noting that incorporation on its own is not sufficient).

14. An institution is operated in Australia if it is managed on a day-to-day basis by a local committee of management or similar structure located in Australia (see Examples 5 and 6 of this draft Ruling).[26]

Note: The DGR in Australia condition does not require institutions, including public benevolent institutions, to have purposes or beneficiaries located in Australia (see Example 6 of this draft Ruling).

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[23] For the DGR in Australia condition, the most common institution is a 'public benevolent institution'.
[24] *Stratton v. Simpson* (1970) 125 CLR 13 at 157-8 per Gibbs J and TR 2011/4.
[25] Stephen J in *Commissioner of Land Tax for the State of New South Wales v. Joyce and Ors* (1974) 132 CLR 22 at 32; (1974) 5 ATR 32 at 39-40 and *Sargeants Charitable Foundation v. Chief Commissioner of State Revenue* 2005 ATC 4632; [2005] NSWSC 659 at paragraph 25.
[26] For example, the operation, management and control of branch operations may be exercised in Australia, notwithstanding that this branch is answerable to an entity in another country.

Examples

Example 1 – fund 'in Australia'

15. *The Cambodian Education Society (the CES) is a not-for-profit organisation in Australia, registered as a charity by the ACNC. The CES was established by an instrument of trust settled in Australia – a public fund solely for providing money for the construction of a building to be used by the CES as a school for orphaned children in Cambodia.*

16. *The CES public fund seeks endorsement as a DGR under item 2.1.10 of the table in section 30-25.*

17. *The trustee of the CES public fund opens a bank account in Australia and receives donations from the Australian public. The monies received are held by a trustee that operates in Australia.*

18. *The CES public fund meets the DGR in Australia condition. It is established and legally recognised in Australia[27], and it is operated in Australia as its monies are held by a trustee that makes operational decisions concerning the fund in Australia.*

Example 2 – fund not 'in Australia'

19. *The Kitsune Foundation, a global not-for-profit organisation founded in Japan, has set up an Australian entity called the Megitsune Foundation. The Megitsune Foundation, a company limited by guarantee, is a registered charity that has a principal purpose of protecting the arctic fox from habitat loss, exploitation and hunting.*

20. *The Megitsune Foundation operates a public fund to raise money from the Australian public to help fund global research projects to address the declining arctic fox population. The public fund is on the Register of Environmental Organisations kept under Subdivision 30-E and is seeking endorsement as a DGR under item 6.1.1 of the table in section 30-55.*

21. *The funds raised from the Australian public are controlled by an executive committee. The executive committee is made up of three members from the Megitsune Foundation who are all responsible to the Australian community and two members from the Kitsune Foundation in Japan. The executive committee meets regularly in Japan, and all operational decisions concerning the fund are made in that place.*

22. *The Megitsune Foundation public fund is legally recognised in Australia because it is legally owned by an Australian company and the public fund is on the Register of Environmental Organisations.*

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[27] It is sufficient for a fund, authority or institution to be either established or legally recognised in Australia, or both. In this example, the CES public fund is established by trust deed in Australia and is legally recognised in Australia under the ACNC Act and ABN Act.

23. *However, the Megitsune Foundation public fund is not operated in Australia because managerial and operational decisions concerning the fund are not made in Australia. That function is performed solely by the executive committee and its members at times when they are located in Japan. The Megitsune Foundation public fund does not satisfy the DGR in Australia condition.*

Example 3 – fund 'in Australia'

24. *The East Gippsland Special Kids Trust (the EGSKT) is a public fund established by trust deed to provide assistance and relief to children residing in the East Gippsland Shire in necessitous circumstances because of physical and intellectual disabilities.*

25. *The EGSKT is registered as a charity by the ACNC and is seeking endorsement as a DGR under item 4.1.3 of the table in section 30-45.*

26. *The EGSKT meets the DGR in Australia condition because it is established and legally recognised in Australia*[28]*, and it is operated in Australia where its funds are held and managed by the trustees.*

Note: *The EGSKT also satisfies the additional geographical requirements imposed by item 4.1.3 that its purposes and beneficiaries are in Australia.*

Example 4 – authority 'in Australia'

27. *A State government established by statute the Southern Abalone Authority (SAA) to manage the abalone fishery in parts of the State. The SAA engages in research and development and investment on mitigating abalone-related diseases.*

28. *The SAA leases premises in a regional centre. The SAA funds its activities from research donations, grants, commercial abalone licences and policing fines.*

29. *The SAA is an Australian government agency and is seeking endorsement as a DGR under item 1.1.4 of the table in section 30-20.*

30. *The SAA is established by government in Australia and is operated in Australia because it executes a function in the public interest in Australia. The SAA satisfies the DGR in Australia condition.*

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[28] The EGSKT is established in Australia by trust deed and is legally recognised in Australia under the ACNC Act and ABN Act.

Example 5 – institution not 'in Australia'

31. *The Neuromuscular Disease Foundation Australia (NDFA) is a company limited by guarantee registered as a health promotion charity by the ACNC. The NDFA is seeking endorsement as a DGR under item 1.1.6 of the table in section 30-20.*

32. *The NDFA has a charitable purpose of promoting the prevention of neuromuscular disease by raising public awareness of the disease and its causes. The NDFA has sibling organisations in the UK, USA and Canada. The NDFA works closely with the UK entity which acts on behalf of the other organisations.*

33. *The majority of the directors of the NDFA are Australian residents. The other directors reside in the UK. Full board meetings are held twice a year by telephone.*

34. *The CEO and General Manager are located in the UK. The day-to-day management of the Australian operations of the NDFA is undertaken by the CEO and General Manager who consult with the UK-based directors in the conduct of those operations.*

35. *Although the NDFA is established and legally recognised in Australia*[29]*, it fails the DGR in Australia condition because it is not operated in Australia. The day-to-day management of its operations is undertaken in the UK.*

Example 6 – institution 'in Australia'

36. *The Tuberculosis Foundation Australia Ltd (TBFA) is a company limited by guarantee. It is part of a global network of organisations operating in various countries under the name of the Tuberculosis Foundation. The Tuberculosis Foundation was founded in the USA and its global headquarters is in New York.*

37. *The principal aim of the TBFA (which is the shared aim of the global network) is to raise funds to relieve the distress, suffering, destitution and helplessness of tuberculosis by providing financial assistance to families in need. The TBFA relies on public donations, the work of its directors and volunteers who organise events to raise funds.*

38. *The TBFA works closely with the global head entity in New York, which acts on behalf of all the other worldwide foundations to distribute funds in the most effective way to benefit families in need. The distribution of funds occurs in partnership with local organisations.*

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[29] The NDFA is established in Australia as a company limited by guarantee and is legally recognised in Australia under the *Corporations Act 2001*, ACNC Act and ABN Act.

39. *The TBFA has an office in Sydney and a board of directors in Australia responsible for the day-to-day management of its operations. The TBFA is registered as a public benevolent institution (PBI) by the ACNC and is seeking endorsement as a DGR under item 4.1.1 of the table in section 30-45.*

40. *The TBFA meets the DGR in Australia condition because it is established and legally recognised in Australia*[30]*, and it is operated in Australia. The TBFA is operated in Australia because the day-to-day management of its operations is in Australia.*

Note: *It is not a requirement for DGR endorsement of the TBFA (a PBI) that it has its purposes and beneficiaries in Australia.*

Division 50 in Australia condition

41. An entity satisfies the Division 50 in Australia condition where it has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia.

42. Apart from the exceptions in paragraph 43 of this draft Ruling, the following entities must satisfy the Division 50 in Australia condition:

- registered charities
- scientific institutions
- public educational institutions
- public hospitals and hospitals carried on by a society or association
- societies, associations or clubs established for the encouragement of science
- societies, associations or clubs established for community service purposes
- societies, associations or clubs established for the encouragement of animal racing, art, a game or sport, literature or music, and
- societies, associations or clubs established for musical purposes.[31]

43. An entity does not need to meet the Division 50 in Australia condition to be tax exempt where the entity is:

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[30] The TBFA is established in Australia as a company limited by guarantee and is legally recognised in Australia under the *Corporations Act 2001*, ACNC Act and ABN Act.

[31] See section 50-5 items 1.1, 1.3, 1.4 and 1.7, section 50-10 item 2.1, section 50-30 item 6.1 and section 50-45 items 9.1 and 9.2.

- a registered charity, scientific institution, public educational institution or hospital, which is an institution that meets the qualifying conditions to be a DGR including the DGR in Australia condition
- a society, association or club, if it meets the qualifying conditions to be a DGR
- a prescribed institution, society, association or club located outside Australia and exempt from income tax in the country in which it is resident, and
- a registered charity that is a prescribed institution that has a physical presence in Australia but which incurs its expenditure and pursues its objectives principally outside Australia.[32]

First requirement – physical presence in Australia

44. 'Physical presence' is not defined in the ITAA 1997. According to the online edition of the Macquarie Dictionary, physical means 'of or relating to material nature'[33] and presence 'the state or fact of being present, as with others or in a place.'[34]

45. In the context of the Division 50 in Australia condition, an entity has a physical presence in a place where it conducts its range of physical operations.[35] The entity can be conducting these operations either as a separate legal personality or through a division, subdivision or branch. Mere ownership of property in Australia, or the conduct of some operations by agents for the entity, would not indicate that an entity has a physical presence in Australia.[36]

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[32] These entities have met the special conditions in Division 50 by satisfying an alternative test. See paragraphs 50-50(1)(b) to (d), 50-55(1)(b) and (c), 50-70(1)(b) and (c).
[33] Retrieved 2 March 2018 from http://www.macquariedictionary.com.au.
[34] Ibid.
[35] In practical terms, those physical operations will extend to those by which the entity derives income and other funds. The broader statutory context described in the Explanatory Memorandum to the Bill in which the Division 50 'in Australia' measure was introduced, is that the measure is designed to prevent arrangements which could use organisations to shift untaxed funds overseas. See Explanatory Memorandum to the *Taxation Laws Amendment Bill (No 7) 1997* at paragraph 5.24.
[36] See Explanatory Memorandum to the *Taxation Laws Amendment Bill (No 7) 1997* at paragraph 5.28.

Second requirement – incurs expenditure and pursues objectives principally in Australia

46. To meet the Division 50 in Australia condition an entity that has a physical presence in Australia must also, to that extent, incur its expenditure and pursue its objectives principally in Australia. The words 'to that extent' require an examination of the degree to which the entity's expenditures and objectives are sourced or result from the conduct of Australian operations. Accordingly, all of the entity's operations and objectives must be identified and compared.

47. Where an entity has a physical presence in Australia only, it must incur its expenditure, and pursue its objectives, principally in Australia (see Example 7 of this draft Ruling).

48. Where an entity has a physical presence in Australia and also overseas, only the expenditures incurred and objectives pursued that are attributable to that entity's physical presence in Australia are examined. For example, if an entity's physical presence in Australia is through the operation of a division, the second requirement applies only to that Australian division's expenditure incurred and objectives pursued (see Examples 8 and 9 of this draft Ruling).

Principally

49. The word 'principally' is not defined in the ITAA 1997 and takes its ordinary meaning of mainly or chiefly. Each case will depend upon its facts. It is not possible to specify a particular percentage, however, more than 50% would generally be considered to meet the 'principally' requirement (see Example 7 – Scenario (c) and Examples 8 and 9 of this draft Ruling).

Incurs its expenditure and pursues its objectives

50. To maintain Division 50 income tax exemption during income years following the time when it first qualifies, an entity must continue to satisfy the Division 50 in Australia conditions, including the condition that it is an entity that incurs its expenditure and pursues its objectives principally in Australia.

51. This test does not require that an entity actually incur its expenditure principally in Australia for a particular income year. Rather, the test is concerned with whether, at a particular time, the entity can be described as being the kind of entity which incurs expenditure in that way (see Example 10 of this draft Ruling). The question to be determined in this context is whether, as a matter of ordinary language, it would be reasonable to describe the entity as being the type of entity that incurs its expenditure principally in Australia.

52. This is a question of characterisation, which has regard to past and current activities of the entity, as well as its objective intentions for the future. In this context, evidence of the current activities of an entity such as their annual expenditure will be given considerable weight. Evidence of intended expenditure, or prior activities, will also be relevant, to the extent that they have a bearing on the characterisation referred to in paragraph 50 of this draft Ruling (see Example 10 of this draft Ruling).[37]

53. The phrase 'incurs its expenditure' is not defined in the ITAA 1997 and takes its ordinary meaning. Expenditure is incurred when the entity pays out or disburses money or is liable to pay out or disburse money.[38] It may include payments, or accounts payable, for rent, utilities, salary and wages, and goods or services. Expenditure includes the distribution of gifts and grants that an entity has received.

54. The place where an entity 'incurs its expenditure' will depend on the whole of the circumstances, which may include:

- where the decision to make the expenditure is made
- where the expenditure is made
- where the recipient of the expenditure is located, and
- if the expenditure relates to goods or services, where those goods or services are consumed[39] (see Example 7 – Scenario (a) of this draft Ruling).

Note: In determining whether an entity incurs its expenditure principally in Australia for these purposes, the Commissioner adopts the compliance approach set out in Appendix 1 of this draft Ruling.[40]

55. The phrase 'pursues its objectives' is not defined in the ITAA 1997 and carries its ordinary meaning. Objectives are pursued where an entity does things in an attempt to realise them. An entity can pursue its objectives by making a payment to another entity,[41] unless it knows or ought to know that the recipient will apply the funds for a purpose other than the entity's objectives.[42]

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[37] Evidence of prior expenditure will not be considered, for example, where the objectives of the entity have since changed.

[38] Refer also to paragraph 6 of Taxation Ruling TR 97/7 *Income tax: section 8-1 – meaning of 'incurred' – timing of deductions* for additional guidance on the meaning of incurred.

[39] As an example, the majority of the High Court in *Federal Commissioner of Taxation of the Commonwealth of Australia v. Word Investments Limited* (2008) 236 CLR 204 (*Word Investments*) considered that the test was satisfied for the disbursement of funds to another entity present in Australia which in turn distributed funds to charitable causes overseas as 'the decisions to pay were made in Australia, the payments were made in Australia, the payments were made to Australian organisations, and the objects of *Word Investments* included giving financial assistance to those organisations'.

[40] See paragraphs 93 to 104 of this draft Ruling.

[41] In *Word Investments*, at paragraph 73, the majority of the High Court noted that the purpose of Word Investments could be fulfilled by, among other things, making payments to other institutions which had charitable purposes and concluded that

56. An entity pursues objectives in Australia if things done by the entity attempt to realise those objectives in Australia. The things can be done overseas if they are just the means for that attempt (see Example 7 – Scenario (b) and Examples 8 and 9 of this draft Ruling).

Disregarded amounts – certain distributions may be made overseas

57. For the purposes of testing whether an entity incurs expenditure and pursues objectives principally in Australia, disregard any distributions that the entity makes out of gifts or government grants that it has received (either directly or from a gift-deductible fund, authority or institution it operates).[43] (In the remainder of this draft Ruling we call these **disregarded amounts**). This means that where an entity pays disregarded amounts overseas, this will not affect whether it satisfies the Division 50 in Australia condition.

58. When working out what are disregarded amounts, 'gifts' are taken to include receipts from fundraising by raffles, dinners, auctions, jumble sales and the like, but do not include receipts from commercial activities or contracts for services.[44] They do not need to be tax deductible.

Note: The meaning of 'gift' in this context is different to the meaning of 'gift' for deduction purposes.[45]

59. 'Government grants' include payments made by government to entities for specific purposes, whether or not the entity is placed under an obligation to ensure that the grant is applied for those purposes, but do not include payments made by government for services provided under contract.

60. When and where a gift or government grant is distributed is a question of fact.

Note: The Commissioner accepts a compliance approach that relieves the strict requirement for tracing when and where gifts and government grants are distributed (see Appendix 1 of this draft Ruling).

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because the making of payments to other charitable institutions occurred in Australia, Word Investments pursued its objectives in Australia.

[42] See *Inland Revenue Commissioners v. Helen Slater Charitable Trust Ltd* [1982] Ch 49 at 60.

[43] See subsections 50-75(1) and (2).

[44] Explanatory Memorandum to the Taxation Laws Amendment Bill (No 3) 1998 at [3.15-3.18].

[45] Refer to Taxation Ruling TR 2005/13 *Income tax: tax deductible gifts – what is a gift* for further guidance.

Periodic operation of the provisions in Division 50

61. An entity must continue to test the Division 50 in Australia condition in each income year for which tax exemption is sought.[46]

Examples

Example 7 – Distributions to other organisations or funds

62. *The Faithism Foundation is a company limited by guarantee that is a registered charity under item 1.1 of the table in section 50-5.*

63. *The Faithism Foundation's charitable purpose is to advance the Faithism religion. Its objects are to inform the public about the beliefs of the Church of Faithism and to make funds available to organisations which run websites and conduct public seminars regarding Faithism.*

64. *The Faithism Foundation receives income from commercial activities and investments. It receives no disregarded amounts.*

65. *Evangelical organisations contact the Faithism Foundation and request funding. The Faithism Foundation evaluates each request and decides whether to make a distribution and, if so, in what amount and on what conditions.*

66. *The Faithism Foundation is governed by a board of directors (Board). The activities of the Faithism Foundation are carried out by a mix of volunteers and paid employees.*

67. *The Faithism Foundation has its headquarters in Melbourne. It employs a project officer who vets incoming requests from charitable organisations. The project officer makes a recommendation to the Board to decide whether to make a distribution. The guidelines provided to the project officer for vetting applications place no limit or preference on favouring contributions that are made to organisations that are in Australia.*

68. *In the 20X1 income year, the Faithism Foundation incurs all its operating costs (for example, utilities, telephone, stationery, rent and salary and wages) of $30,000 in Australia.*

Scenario (a)

69. *In the 20X1 income year, the Faithism Foundation makes a single distribution of $10,000 to the ABC Fund. The ABC Fund is an Australian organisation headquartered in Sydney that promotes the Faithism religion in Australia.*

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[46] For our compliance approach as to how we will administer the Division 50 in Australia condition see Appendix 1 of this draft Ruling.

70. *The Faithism Foundation has a physical presence only in Australia. It satisfies the Division 50 in Australia condition because it has incurred its expenditure and pursued its objectives principally in Australia.*

71. *The distribution to the ABC Fund is expenditure incurred in Australia because the decision to make the payment is made in Australia, and the payment is made in Australia to an organisation in Australia. The Faithism Foundation is pursuing its objectives in Australia because its objects include giving financial assistance to organisations that promote the Faithism religion.*

Scenario (b)

72. *In the 20X1 income year, the Faithism Foundation makes a single distribution of $50,000 to the DEF Fund. The DEF Fund has its headquarters in Melbourne but its activities consist primarily of paying the expenses of Faithism missionaries in overseas countries.*

73. *The Faithism Foundation has a physical presence only in Australia. It satisfies the Division 50 in Australia condition because it incurs its expenditure and pursues its objectives principally in Australia.*

74. *The distribution to the DEF Fund is expenditure incurred in Australia because in the circumstances, the decision to make the payment is made in Australia, and the payment is made in Australia to an organisation in Australia. The Faithism Foundation is pursuing its objectives in Australia because its objects include giving financial assistance to organisations that promote the Faithism religion. Although the DEF Fund ultimately expends the funds overseas, the Faithism Foundation meets the Division 50 in Australia condition.*

Scenario (c)

75. *In the 20X1 income year, the Faithism Foundation makes the following distributions:*

- *$10,000 to the ABC Fund. The ABC Fund is headquartered in Sydney and promotes the Faithism religion in Australia.*
- *$50,000 to the DEF Fund. The DEF Fund is headquartered in Melbourne and promotes the Faithism religion overseas.*
- *$110,000 to the XYZ Society. The XYZ Society is headquartered in New York and promotes the Faithism religion in the USA.*

76. *The Faithism Foundation has a physical presence only in Australia. However, it fails the 'in Australia' requirement in paragraph 50-50(1)(a) because it has not incurred its expenditure and pursued its objectives principally in Australia.*

77. *The Faithism Foundation does not incur its expenditure principally in Australia. The evidence of actual operations shows that the Faithism Foundation's total expenditure incurred in the 20X1 income year is $200,000 (including operating costs of $30,000). Of this total amount, $110,000 is distributed to the XYZ Society which is not in Australia and $90,000 is incurred in Australia. There is no evidence about the circumstances of the expenditures in the 20X1 year or the planned future activities of the Faithism Foundation that would disturb the inference, drawn from the current activities of the Foundation, that it does not incur its expenditure principally in Australia.*

78. *The distribution to the XYZ Society is not expenditure incurred in Australia because in the circumstances, although the decision to make the payment is made in Australia and the payment is made in Australia, the payment is made to an organisation that is not in Australia.*

79. *The Faithism Foundation does not pursue its objectives principally in Australia. Although its objects include giving financial assistance to organisations that promote the Faithism religion, more than 50% of its distributions provide financial assistance to overseas organisations.*

Example 8 – principally in Australia

80. *The Melbourne-based Australian Accounting School (AAS) is a company limited by guarantee that is a public educational institution under item 1.4 of the table in section 50-5.*

81. *The main objective of the AAS is to provide accounting-based training to the public. Due to increased demand to provide training to overseas-based students, the AAS establishes a separate entity in China – the China Accounting School (CAS) – from which overseas-based students will be trained.*

82. *The CAS has administration staff only. The AAS provides the educational function by sending sub-contractors from Australia to China to provide training. The AAS pays the fees and travel expenses for the teachers providing training in China. The CAS does not reimburse the AAS for this expenditure. In the 20X1 income year, this represents 10% of the total expenditure of the AAS. The AAS receives no disregarded amounts.*

83. *The AAS has a physical presence only in Australia. The AAS must incur its expenditure and pursue its objectives principally in Australia to meet the Division 50 in Australia requirement.*

84. *In the 20X1 income year, the AAS incurs the expenditure of fees and travel-related expenses sending sub-contractors to China to conduct training. This expenditure is sourced from the Australian operations of the AAS so is counted in the reckoning of whether AAS incurs its expenditure principally in Australia in the income year. This expenditure is not incurred in Australia because in the circumstances, although the decision to make the payment is made in Australia and the payment is made in Australia to Australian sub-contractors, the service to which the expenditure relates is consumed overseas. However, as this represents only 10% of the total expenditure incurred in the 20X1 income year, the AAS incurs its expenditure principally in Australia.*

85. *The AAS is pursuing its objectives in China as well as Australia. To measure its pursuit of objectives, the AAS may use expenditure as a suitable proxy. In this case, overseas activities represent 10% of the total pursuit of objectives in the 20X1 income year. Thus, the AAS is pursuing its objectives principally in Australia.*

86. *In the 20X1 income year, the AAS satisfies the Division 50 in Australia condition.*

Example 9 – not principally in Australia

87. *Following on from Example 8 of this draft Ruling, the AAS's Chinese operations expand in response to public demand over the next few years so that in the 20X5 income year the expenditure incurred in China accounts for 75% of the total expenditure of the AAS.*

88. *As only 25% of the AAS's expenditure is incurred in Australia, and there is no evidence to suggest that the AAS is pursuing objectives other than those demonstrated by its current activities, it no longer incurs its expenditure and pursues its objectives principally in Australia. The AAS does not satisfy the Division 50 in Australia condition during the 20X5 income year, and is not entitled to income tax exemption.*

Example 10 – principally in Australia

89. *Prior to its destruction in an accident in 20X3, the observatory operated by the Hilltop Astronomy Association (HAA) had been a nationally popular venue used to teach groups of Australian schoolchildren about the universe.*

90. *The HAA's committee of management formulate a plan to rebuild and extend the facilities. Funds of $3 million will be accumulated in the two years prior to the commencement of reconstruction activities in 20X6. During this period, the expenditure of the HAA in Australia is limited to the initial costs of building design, office administration and the maintenance of an interactive educational website. The amount of Australian expenditure is marginally less than the ongoing contribution that the HAA makes to school training programs in three South Pacific Island nations. The total of expenditure in each of the years is approximately $400,000.*

91. *In the 20X4 and 20X5 income years, less than 50% of the actual expenditure of the HAA is incurred in Australia. However, it is necessary to consider whether HAA remains the type of association which can be characterised as incurring its expenditure principally in Australia. In this regard, it is relevant to consider the history of the association and the current planning for the reconstruction of the observatory. Based on the whole of the facts, the HAA has not at any time ceased to be an entity that incurs its expenditure and pursues its objectives principally in Australia. The HAA at all times satisfies the Division 50 in Australia condition.*

Refund of franking credits condition

92. The Refund of franking credits condition requires that, to be entitled to the refund of franking credits for a franked distribution that it receives during an income year, a registered charity or DGR must at all times during that income year:

- have a physical presence in Australia, and
- to that extent, incur its expenditure and pursues its objectives principally in Australia.[47]

93. For these purposes, the Commissioner considers that the terms 'physically present', and 'incurs its expenditure and pursues its objectives principally in Australia' have the same meaning as they have in the Division 50 in Australia condition (as described at paragraphs 44 to 56 of this draft Ruling).

94. Disregarded amounts (as explained in paragraphs 57 to 60 and the compliance approaches in Appendix 1 of this draft Ruling) do not apply to the Refund of franking credits condition.

[47] See section 207-117.

Date of effect

95. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, the 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 Ruling (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public rulings*).

Commissioner of Taxation
4 July 2018

Appendix 1 – Compliance approaches

This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this Appendix in good faith and consistently with the ruling section, the Commissioner will administer the law in accordance with this approach.

Actual expenditure and the Division 50 in Australia 'incurs its expenditure' test

96. The Division 50 in Australia condition is a continuous test which considers the state of an entity at a particular time, but having regard to its overall operations, including past, current and intended actions.

97. The Commissioner recognises that there is little compliance risk in an income tax year where actual expenditure is incurred principally in Australia. So, for the requirement that an entity incurs its expenditure principally in Australia, the Commissioner will not apply further resources to take compliance action for an income year where evidence shows that more than 50% of actual expenditure (less disregarded amounts) is incurred in Australia.

Example A1 – application of the administrative treatment for actual expenditure

98. *The expenditure of the Olie Foundation in the years 20X1 to 20X3 is shown in the table below.*

Year	*Australian expenditure*	*Indonesian expenditure*	*Australian percentage*
20X1	*$400*	*$300*	*57%*
20X2	*$200*	*$300*	*40%*
20X3	*$450*	*$300*	*60%*

99. *The Olie Foundation has actually incurred more than 50% of its expenditure in Australia in the 20X1 and 20X3 income years and the Commissioner will not apply further resources to take compliance action in those years.*

100. *The Olie Foundation did not incur more than 50% of its expenditure in Australia in the 20X2 income year, so it cannot rely on the compliance approach in that year. It will need to rely on evidence of intention and the circumstances in which the failure has arisen to demonstrate that it is at all times in the 20X2 income year an entity that incurs its expenditure principally in Australia (see Example 10 of this draft Ruling).*

Disregarded amounts – tracing of gifts and government grants

101. An entity's distribution of the proceeds of a gift or government grant it has received is disregarded (a disregarded amount) for the application of the Division 50 in Australia condition. The Commissioner recognises that money is fungible, and it can be difficult to trace where gifts or grants have been expended in the absence of conditions that are attached to them.

102. The Commissioner will not apply further resources to take compliance action where the evidence shows that an entity treats the proceeds of a gift or government grant as having been distributed overseas, and that treatment is not inconsistent with the factual circumstances and conditions in which that gift or grant has been made.[48]

Example A2 – application of the administrative treatment for tracing of gifts and government grants

103. *The Vandalay Association is a performing arts company established for the promotion of art that meets the description of exempt entity in item 9.1 of the table in section 50-45.*

104. *The Vandalay Association's receipts (income) in the 20X1 income year are $150,000. This is sourced from income from investments of $25,000, income from performance fees of $50,000 and gifts received of $75,000. There are no conditions placed on any gifts limiting their use in Australia.*

105. *In the 20X1 income year, the Vandalay Association incurred expenditure of $87,000 overseas for a tour to Asia. Of the remaining receipts, $10,000 is held in reserve and the other $53,000 is spent on organising performances in Australia.*

106. *The Vandalay Association treats the gift as expended wholly on the tour to Asia, and concludes that relevant expenditure is incurred in the 20X1 year to the extent of $12,000 overseas ($87,000 less $75,000) and $53,000 in Australia.*

107. *The Commissioner will not apply resources to take compliance action to test the correctness of this treatment.*

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[48] For example, gifts or grants made only for use in Australia, or gifts or land in Australia.

Appendix 2 – Your comments

108. You are invited to comment on this draft Ruling, including the proposed date of effect. Please forward your comments to the contact officer by the due date or join the conversation on this Ruling on the Public Advice and Guidance Community on Let's Talk.

109. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**10 August 2018**
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Appendix 3 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 97/7; TR 2005/13; TR 2011/4

Previous Rulings/Determinations:

TR 2000/11

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- ITAA 1997 50-50(1)(c)
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