



Government of Western Australia
Department of Finance
Office of State Revenue



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Hon Robyn McSweeney MLC
Chair
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Dear Ms McSweeney

INQUIRY INTO THE TAXATION LEGISLATION AMENDMENT BILL 2014

Thank you for the opportunity to provide a submission to the Committee for its inquiry into the Taxation Legislation Amendment Bill 2014.

Please find attached a submission in response to the invitations received by Ms Anne Nolan, Director General, Department of Finance, and Ms Nicki Suchenia, Acting Commissioner of State Revenue.

Yours sincerely

Rod Richardson
ACTING COMMISSIONER OF STATE REVENUE

14 October 2014



DEPARTMENT OF FINANCE

SUBMISSION TO THE STANDING COMMITTEE ON LEGISLATION INQUIRY INTO THE TAXATION LEGISLATION AMENDMENT BILL 2014

Introduction

In making this submission, I note that the Inquiry focuses specifically on unintended consequences, if any, that may apply to 'legitimate' fourth-limb charities.

The use of this terminology in framing the Inquiry highlights the very difficult distinction that the Taxation Legislation Amendment Bill 2014 (the Bill) seeks to draw out in order to allow State taxation exemptions to continue to apply to 'legitimate' charitable organisations and remove the exemptions from a narrower sub-set of charitable organisations that the common law nevertheless regards as 'legitimate'.

In this context, neither the existing taxation legislation nor the amendments define the meaning of a charity. The common law is relied upon to make such determinations. Consequently, for the amendments to apply, an organisation must meet the threshold common law tests that determine whether it can be considered a charity in the first instance. Once it is a charity at common law, there is no other mechanism, outside the operation of the amendments in this Bill, for a distinction to be made regarding whether the organisation is a 'legitimate' charity or otherwise.

In framing this response, I have addressed the issues based on my understanding that the purpose of the Inquiry is to ascertain whether the amendments will operate to exclude a broader range of charities from exemptions than contemplated by the Government, thereby placing a reliance on the discretion of the Minister for Finance to 'reinstate' their exempt status.

Background to Charities Law

The existing exemptions for charitable organisations in the taxation Acts rely on common law principles to determine whether a particular organisation is a charity or not. The Bill therefore also relies on that underlying common law and the main points are described below to give context to this submission.

Much of the current common law regarding charities is based on a United Kingdom case commonly known as *Pemsel's case*.¹

¹ *Income Tax Special Purposes Commissioners v Pemsel* [1891] AC 531

Pemsel's case classified the categories of charitable purposes into four principal divisions, namely:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; or
- other purposes considered beneficial to the community.

Subsequent court decisions clarified the extent of the fourth division (commonly referred to as the 'fourth limb'), in that it related only to organisations that carried out certain functions recognised as being charitably beneficial to the community, yet were not covered in the first three limbs.

The existing law, in the case of the Pay-roll Tax Assessment Act, also relies on the common law meaning of 'public benevolent institution'. Based on the common law, a public benevolent institution is a sub-category of a charity that falls within the first division of Pemsel's charitable purposes as an organisation that provides direct relief from poverty, sickness, disability, destitution, helplessness or other distress.

The law of charity continues to evolve, and it is now well recognised that it has extended to classes of organisations that were not traditionally considered to be charities.

The Exemptions

The *Duties Act 2008*, *Land Tax Assessment Act 2002* and *Pay-roll Tax Assessment Act 2002* each contain exemptions for charitable organisations.

Section 96 of the Duties Act provides that duty is not chargeable on a dutiable transaction (e.g. a purchase of real property) that is entered into for charitable or similar public purposes. It is not necessary that the person liable to pay the duty is a charitable body, merely that the transaction is entered into for charitable purposes.

Section 37 of the Land Tax Assessment Act provides an exemption for land owned by a public charitable or benevolent institution that is used solely for the purposes for which the institution was established.

Section 40(2)(n) of the Pay-roll Tax Assessment Act provide that wages paid by a charitable body for doing work of the kind ordinarily performed in connection with a charitable purpose for which the body is established are exempt from payroll tax.

Section 40(2)(c) of the Pay-roll Tax Assessment Act also provides a separate exemption for public benevolent institutions, which is unaffected by the amendments in the Bill.

Chamber of Commerce and Industry Western Australia Case

Following a State Administrative Tribunal (SAT) case² that found that the Chamber of Commerce and Industry of Western Australia (Inc) (CCI) to be a common law charity and therefore exempt from payroll tax, the Government determined that the taxation laws should be amended to narrow the availability of exemptions for certain charitable organisations.

The case revolved around whether the CCI's activities were primarily for the promotion of industry and commerce in Western Australia generally (which earlier case law supported as fitting the fourth-limb of charitable purposes), or if they were primarily for serving the private interests of members.

The SAT concluded that the CCI's dominant purpose was the promotion of business generally in Western Australia. Accordingly, the CCI became eligible for the payroll tax exemption for charities, involving a refund of the payroll tax that it had paid over a number of preceding years. It also became eligible for land tax and transfer duty exemptions.

On 15 May 2013, the then Treasurer advised the Parliament of the Government's intention to legislate '*to exclude certain business, professional and industry organisations from accessing state tax exemptions for charities*'. The announcement arose out of concern that the CCI decision would result in a costly precedent in which other similar organisations would be considered charities and qualify for exemptions.

Legislative Scheme

The design of the legislative scheme to narrow the charitable organisation exemptions in the taxation Acts was developed in consultation with the Department of Treasury.³

The area of charities law is complex and it was difficult to precisely define the characteristics of organisations that should be excluded from the various exemptions without creating avoidance opportunities. It was also recognised that the law was continuing to evolve, including through expected further and ongoing legal challenges by organisations not traditionally considered to be charities. As such, the legislative design needed to have a degree of flexibility that would allow quick adjustments should future decisions result in the requirement to further narrow the exemptions.

² *Chamber of Commerce and Industry of Western Australia (Inc) and Commissioner of State Revenue* [2012] WASAT 146

³ Matters of taxation policy are the responsibility of the Treasurer and Department of Treasury. The Office of State Revenue provides advice on administration issues, and is also responsible for instructing Parliamentary Counsel's Office during the development of amending Bills that seek to implement taxation policy changes.

Several policy options were considered to meet the desired taxation exemption policy outcome, including the specific exclusion of organisations from the exemption by name or, as operated for the payroll tax exemption for the period between 1984 to 1997, requiring all charitable exemptions to be approved by the Minister.⁴ Excluding organisations by name was considered inappropriate and would result in revenue leakage⁵ pending determination of the status of each organisation. Approval by the Minister would affect all charities, adding significant and unnecessary 'red tape' to the exemption process.

The most practical and equitable solution was to exclude a sub-set of fourth-limb charities that have a similar characteristic (i.e. promoting trade, industry or commerce) to the basis upon which the SAT determined the CCI to be a charity. By focussing on this sub-set, charities that fall within the first three divisions of charitable purposes would not be affected by the amendments.

Using the same approach, it was also considered appropriate that professional associations be excluded from the exemptions on the basis that such organisations are generally heavily focussed on providing services to members.

While not currently recognised as charities, the Government also decided that political parties and trade unions be expressly excluded from the exemptions in the event of any future expansion of the common law definition of charity to these classes of organisations.

The terms 'promote trade, industry or commerce' and 'professional association' are defined terms to provide further focus on the class of organisations to be excluded from the exemptions. The individual terms 'promote', 'trade', 'industry' and 'commerce' are not defined and take their ordinary meaning.⁶

The amendments operate to exclude a fourth-limb charity and a charity that is a professional association, having as a purpose (rather than a dominant purpose) the promotion of trade, industry or commerce or the promotion of a profession respectively.

⁴ For the period 1984 to 1997, the Minister had the absolute discretion to prescribe an exemption to a worthy charitable organisation. The function was transferred to the Commissioner in 1997 as the process of requiring ministerial approval on every occasion was considered cumbersome (see the Explanatory Memorandum to the Revenue Laws Amendment (Assessment) Bill 1997).

⁵ Following the CCI decision, \$56.7 million has been refunded to eight similar organisations. This includes for retrospective periods.

⁶ See Black's Law Dictionary: 'Promote' means to contribute to growth, enlargement, or prosperity of; to forward, to further; to encourage; to advance; 'Trade' means the act or business of buying and selling for money; traffic; barter; 'Industry' means any department or branch of art, occupation, or business conducted as a means of livelihood or for profit; especially, one which employs much labour and capital and is a distinct branch of trade; 'Commerce' means the exchange of goods, productions, or property of any kind; selling, and exchanging of articles.

This was a deliberate design feature of the legislative scheme to ensure there was no scope for dispute about the threshold test that would exclude an organisation from the exemption. For example, if a dominant purpose test had been used, it would have been possible to argue that an organisation had dual purposes of equal importance. The test, as drafted, minimises opportunities that would otherwise be available to structure an organisation's objectives and operations to fall within the boundaries of the exemption.

However, to be excluded from the exemption, the promotion of trade, industry or commerce, or the promotion of a profession, must be a clearly identifiable objective or purpose of the organisation.

While the amendments are only intended to affect a sub-set of fourth-limb charities and charities that are professional associations, it was recognised that exclusion by reference to a class of organisation having as a purpose the promotion of trade, industry or commerce or the promotion of a profession, may result in some 'legitimate' charities being inappropriately excluded from the exemption.

In light of this, it was considered appropriate that the Government have a more refined mechanism available to mitigate the effect of its broader taxation exemption policy, allowing it to take into account the specific circumstances of particular organisations at an individual level.

For this reason, a discretion is provided for the Minister to reinstate the exempt status of an excluded charity, other than in relation to a political party or a trade union. Such decisions require the concurrence of the Treasurer and the application of a public interest test. Furthermore, a decision to reinstate an exemption must be published in the *Government Gazette*.

Based on the intended operation and administration of the amendments, it is not expected that many charities will be excluded from the exemptions.

Representations

Following passage of the Bill in the Legislative Assembly, representations were made by the Western Australian Council of Social Service (WACOSS) to the Minister and other Parliamentary members.

It is understood that while WACOSS supports the objective of the amendments, concerns were expressed that the amendments may unintentionally result in 'legitimate' charities, such as indigenous and disability organisations and those promoting social enterprises, being excluded from the exemption and leaving them open to the discretion of the minister of the day to reinstate their exempt status.

Together with representatives from the Department of Premier and Cabinet, Ms Suchenia met with WACOSS representatives to better understand their concerns about the amendments.

While specific named organisations could not be discussed due to taxpayer confidentiality restrictions, it became apparent that WACOSS had concerns that the amendments could affect organisations that were most likely to be public benevolent institutions, even though the policy intent was that public benevolent institutions would not be affected by the amendments. Nonetheless, through the endorsement of the Minister, an assurance was given that the Bill was being reviewed and, if necessary and to the extent possible, a Committee amendment would be moved to add further clarity to the intended operation of the amendments.

WACOSS also indicated a point of concern that the use of the term 'promotion of trade, industry or commerce' would unintentionally exclude from the exemption 'legitimate' charities who deliver important services to the Western Australia community.

WACOSS was of the belief that the term 'promote trade, industry or commerce' related to the conduct of business activities or the development of business opportunities.

The conduct of business activities and development of business opportunities are considered to be 'supporting' activities and the draft legislation clearly distinguishes these activities from the promotion of trade, industry or commerce. Nonetheless, subject to the passage of the legislation, an assurance was given that a revenue ruling⁷ will be published by the Commissioner to clarify this interpretative point, providing relevant examples to illustrate the differences.

Committee Amendments

In response to the concerns raised by WACOSS and others, the Bill was reviewed to determine whether further clarity could be provided around the class of charities to be excluded from the amendments.

A Committee amendment has been drafted and approved by the Minister to expressly exclude from the operation of the amendments a public benevolent institution and a body, the main objective of which is a public benevolent purpose and that would be a public benevolent institution if all secondary or minor purposes of the body were purposes incidental to its main purpose.⁸

This Committee amendment was listed on Supplementary Notice Paper No. 86 Issue No. 1 on Tuesday 23 September 2014.

The Committee amendment will add further clarity to the intended operation of the amendments.

⁷ A revenue ruling is a statement providing an analysis of the Commissioner's interpretation of certain provisions of the legislation administered by the Office of State Revenue or details of its administrative procedures and practices associated with specific aspects of revenue administration that are not related to the assessment of tax.

⁸ An organisation may lose its status as a public benevolent institution if it carries out a secondary and independent activity, such as promoting agriculture, to its dominant and benevolent purpose.

Does the Bill Impose Unintended Consequences on Legitimate Fourth-Limb Charities?

As noted earlier in this submission, the answer to this question is complicated by the requirement to determine whether an organisation is a 'legitimate' charity.

While common law principles determine whether an organisation is a charity or not, it is the role of the State Government to determine how its taxation policy is then applied to charitable organisations. Under the taxation laws as they currently stand, the taxation policy provides all charitable organisations with an exemption.

This Bill seeks to implement the Government's alternative taxation policy by excluding a sub-set of charitable organisations from receiving taxation exemptions. However, due to the complexity of charities law, it has proven difficult to comprehensively describe the characteristics of the excluded class in a manner that ensures that the Government's narrower taxation policy objective will be accurately reflected in all cases.

In recognition of this, the Bill includes a mechanism to allow the responsible Minister to reinstate the taxation exemption of a charitable organisation at an individual level, where the exclusion by reference to a class may have resulted in a charity being excluded from the exemption.

The ability of a Government minister to determine an organisation's charitable exemption status is not new in the context of State taxation laws.

The payroll tax charitable exemption that applied from 1984 to 1997 required the Minister to approve all payroll tax applications (not just those relating to fourth limb charities) for charitable exemptions. No express right of appeal to these decisions existed in the legislation. The reasons for the removal of this exemption are set out in the Explanatory Memorandum to the Revenue Laws Amendment (Assessment) Bill 1997.

To implement this decision, the amendments have been designed to apply to a narrow sub-set of fourth-limb charities that have as a purpose the promotion of trade, industry and commerce, or charities that are professional associations.

Based on the policy intent and application of the amendments, it is only expected that a small number of charities will be excluded from the exemptions and not of the class to which WACOSS refers.

However, based on the design features of the amendments, as discussed above, it is possible that a 'legitimate' charity may unintentionally be excluded from the exemptions. This possibility is mitigated through a discretion to allow the Minister to reinstate the exempt status of an excluded charity based on the circumstances of each case.

The ministerial discretion is an open and transparent process that operates in a similar manner that applied for payroll tax exemptions for the period 1984 to 1987. In making a decision, a public interest test is required to be applied and the minister of the day must seek the concurrence of the Treasurer of the day. A decision reinstating an exemption must also be published the *Government Gazette*.

The proposed Committee amendment and publications to support the amendments will provide further clarity on the narrow reach of the amendments.

OFFICE OF STATE REVENUE

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