



## TECHNICAL UPDATE

### NEW TAX RULING: SPECIAL CONDITIONS WHICH MUST BE SATISFIED BY ENTITIES CLAIMING TAX EXEMPT STATUS

**THE ATO HAS ISSUED A NEW TAXATION RULING, TR 2015/1, IN WHICH IT HAS ADDRESSED TWO OF THE SPECIAL CONDITIONS WHICH MUST BE SATISFIED BY CERTAIN ENTITIES CLAIMING TAX EXEMPT STATUS UNDER DIVISION 50 OF THE *INCOME TAX ASSESSMENT ACT 1997* (ITAA 1997).**

The two special conditions addressed are that:

- The entity must comply with all the substantive requirements in its governing rules (governing rules condition), and
- The entity must apply its income and assets **solely** for the purpose for which the entity is established (income and assets condition).

The ruling concludes that a breach of either of the conditions will cause an entity's ordinary and statutory income to not be exempt from income tax.

#### **Governing rules condition**

The ruling observes that there are three questions that must be considered to determine whether an entity satisfies the governing rules condition, being

- What are the 'governing rules' of the entity?
- What are the 'substantive' requirements in the entity's governing rules?
- At what time must the entity comply with all of the substantive requirements in its governing rules?

#### **What are the 'governing rules' of the entity?**

The ruling observes that the 'governing rules' of an entity are those rules that authorise the policy, actions and affairs of the entity, and thus direct:

- What the entity is required and permitted to do
- What those, who control the entity, are required and permitted to do in respect of the entity.

#### **SECTOR**

Tax

#### **CONTACT**

##### **MARCUS LEONARD**

National Leader, Tax  
Tel: +61 2 9240 9771  
marcus.leonard@bdo.com.au

##### **LISA PRITCHARD**

Partner, Adelaide  
Tel: +61 8 7421 1418  
lisa.pritchard@bdo.com.au

##### **MARK MOLESWORTH**

Partner, Brisbane  
Tel: +61 7 3237 5999  
mark.molesworth@bdo.com.au

##### **ERIC OLUFSON**

Partner, Cairns  
Tel: +61 7 4046 0000  
eric.olufson@bdo.com.au

##### **MAL SCIACCA**

Partner, Darwin  
Tel: +61 8 8981 7066  
mal.sciacca@bdo.com.au

##### **BRETT SKIRVING**

Partner, Hobart  
Tel: +61 3 6234 2499  
brett.skirving@bdo.com.au

##### **DAVID BLAKE**

Partner, Melbourne  
Tel: +61 3 9603 1709  
david.blake@bdo.com.au

##### **RUSSELL GARVEY**

Partner, Perth  
Tel: +61 8 6382 4865  
russell.garvey@bdo.com.au

The ruling further observes, amongst other things, that:

- An entity may have governing rules from more than one source
- The written documents under which the entity was formed will usually be the main source of its governing rules
- A centralised source may provide some or all of the governing rules for a group of entities or a particular type of entity
- Not all rules that apply to an entity will form part of the entity's governing rules
- An entity must identify all of its governing rules in order to then consider what the 'substantive' requirements are in those rules.

#### **What are the 'substantive' requirements in the entity's governing rules?**

The ruling observes that the substantive (as opposed to the procedural) rules are those that define the rights and duties of the entity and include rules such as those that:

- Give effect to the object or purpose of the entity
- Relate to the non-profit status of the entity
- Set out the powers and duties of directors and officers of the entity
- Require financial statements to be prepared and retained
- Set out criteria for admission as a member of an entity
- Require an entity to maintain a register of members
- Relate to the winding-up of the entity.

#### **At what time must the entity comply with all of its substantive requirements in its governing rules?**

The ruling expresses the view that the governing rules condition is applied on a continuous basis throughout the whole of an income year.

#### **Income and assets condition**

The ruling suggests that in determining whether an entity has applied its income and assets solely for the purpose for which the entity is established, there are two questions that must be considered:

- What is the purpose for which the entity is established?
- Has the entity applied its income and assets solely for the purpose for which it is established?

#### **What is the purpose for which the entity is established?**

The ruling expresses the opinion that:

- The purpose for which the entity is established is determined by a consideration of all of the features of the entity
- The main factors to be considered are the objects in the entity's constituent documents and the activities of the entity after its formation
- An entity can have more than one purpose
- The purpose can include an incidental or ancillary purpose
- An entity can change its purpose during an income year.

## Has the entity applied its income and assets solely for the purpose for which it was established?

The ruling expresses the opinions that:

- Income and assets must be applied **solely** for the purpose, not substantially or 'on the whole'
- Some accumulation of the income of the entity is permissible, provided such accumulation is consistent with the purpose for which the entity is established
- While a strict standard of compliance is required under the 'solely' test, misapplications of an entity's income or assets of an insignificant nature will not breach the condition
- The income and assets condition is applied continuously throughout an income year.

### Application of Ruling

The ruling applies both before and after the release date.

#### BDO comment

The release of the ruling is a timely reminder to entities that claim income tax exempt status under Division 50 of the ITAA 1997 that compliance procedures should be put into place to ensure that:

- There is strict compliance with the governing rules of the entity
- The income and assets of the entity are applied solely for the purpose for which it was established.

The entity needs to consider all activities that are currently undertaken by the entity and be able to clearly demonstrate how each activity is a core activity within the purpose of the activity or the activity is undertaken to assist the entity in delivering its purpose.

An example of the latter category is fundraising – this will usually be outside the core purpose but will allow the entity to generate income to pursue its sole purpose.

Where the entity is considering new activities or a change of existing activities is proposed, consideration should be directed towards the issues of:

- Whether a change to the constituent documents of the entity should be considered
- Whether or not the change would involve the application of the income or assets of the entity otherwise than solely for the purpose for which the entity was established.

#### MORE INFORMATION

1300 138 991

[www.bdo.com.au](http://www.bdo.com.au)

NEW SOUTH WALES  
NORTHERN TERRITORY  
QUEENSLAND  
SOUTH AUSTRALIA  
TASMANIA  
VICTORIA  
WESTERN AUSTRALIA

#### National expertise

*The BDO Tax team is one of the largest and most dynamic tax practices in Australia, with 30 partners and more than 150 specialists located in each major city across the country.*

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact the BDO member firms in Australia to discuss these matters in the context of your particular circumstances. BDO Australia Ltd and each BDO member firm in Australia, their partners and/or directors, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO refers to one or more of the independent member firms of BDO International Ltd, a UK company limited by guarantee. Each BDO member firm in Australia is a separate legal entity and has no liability for another entity's acts and omissions. Liability limited by a scheme approved under Professional Standards Legislation other than for the acts or omissions of financial services licensees.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2015 BDO Australia Ltd. All rights reserved.