

## **ATEM COUNCIL FLYING MINUTE No 1/2006**

**TO:** ATEM COUNCIL MEMBERS

**FROM:** VP Richard Easter

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### **ATEM's Tax Status and the Constitution**

#### **BACKGROUND**

The Australian Tax Office is reviewing the tax status of organisations similar to ATEM. At present ATEM does not pay tax on its income but unless appropriate steps are taken, this will change. The ATEM Foundation Australia has Tax Free status as a Charitable Trust and meets the criteria. We have had written confirmation of this from the ATO. ATEM has had no such advice in respect of ATEM Inc in Australia and we need to establish a similar status by self assessment, confirmed by our tax agent, Moore Stephens. Without it ATEM is likely to have to pay tax on all income received from non-members and sponsorship. Notwithstanding the enormous accounting and reporting burden this would imply, we would lose a significant part of our operating income.

There is currently an amnesty provided by the ATO to allow all organisations that are currently treating themselves as income tax exempt to review their status in light of recently announced ATO Taxation Rulings on the criteria that all tax exempt organisations must satisfy.

As an important first step FMAC sought advice from our tax agents Moore Stephens. A copy of their advice is attached below.

To confirm ATEM's tax free status, we have to ensure that the criteria to be classified as a Charitable Organisation under the Education not-for-profit provision are satisfied.

ATEM will be able to self assess as a public education not-for-profit organisation which will be income tax exempt provided the objectives in the Constitution reflect that ATEM is established as such and that its principal purpose is providing education to administrators and managers across the sector – both members and non-members.

This is of course how ATEM has been operating and will continue to operate, but we must amend the Constitution accordingly.

#### **ADVICE FROM MOORE STEPHENS**

1. The attached advice has been received from ATEM's Tax Agent, Moore Stephens. The ATEM constitution needs some minor amendments in order for ATEM Inc to self assess as a public education not-for-profit organisation which will be income tax exempt.

2. The ATEM Constitution (section 8.1) requires 21 days notice of notice of a Special General Meeting to change the Constitution. Therefore a Notice of a Special General Meeting, to follow on after the ATEM AGM, must go out to both Australian and New Zealand members **before Sunday 6 August**.

3. The following changes to the Constitution are needed.

### **3.1 CLAUSE III**

#### **Current Statement of Objects**

The objects of the Association are to:

- (a) represent the professional interests of tertiary education administrators and managers;
- (b) maintain and improve the level of professional competence and practice in the field of tertiary education administration and management;
- (c) aid the professional development of members;
- (d) recognise in appropriate ways outstanding contributions to tertiary education administrative and management practice;

#### **Proposed Statement of Objects (new phrases are highlighted)**

The objects of the Association are to:

- (a) Develop and improve the level of professional competence and practice in the field of tertiary education administration and management by providing courses, conferences, interactive web sites and publications to members, non-members or those with an interest in the tertiary or higher education sectors;
- (b) Provide professional development guidance and further the professional interests of tertiary education administrators and managers;
- (c) Recognise in appropriate ways outstanding contributions to tertiary education administrative and management practice;
- (d) To encourage, develop and implement educational programs and services for any persons in Australia and New Zealand either by way of ATEM providing the services or via making a donation to an educational institution which has similar educational outcomes.

### **3. CLAUSE 12**

#### **12 CURRENT DISSOLUTION OF ASSOCIATION**

The Association may be wound up voluntarily in the manner prescribed by s88 of the Act which requires a special resolution of the Association in general meeting. Members of the Association shall not be liable to contribute towards payment of its debts and liabilities.

#### **12 PROPOSED DISSOLUTION OF ASSOCIATION**

The Association may be wound up voluntarily in the manner prescribed by s88 of the Act which requires a special resolution of the Association in general meeting.

Members of the Association shall not be liable to contribute towards payment of its debts and liabilities. All remaining assets of the Association will be distributed to the ATEM Foundation, as a deductible gift recipient.

**Property to Suitable Educational Body**

If at the time of dissolution the ATEM Foundation is not classified as charity by the Australian Tax Office the remaining property must be given to one or more institution(s) which is mentioned in the tables in section 30-25 of the Income Tax Assessment Act 1997 (Cth).

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## ATTACHMENT

### **Association for Tertiary Education Management Inc (ATEM) Advice from Moore Stephens**

#### **1. Is ATEM income tax exempt?**

To be income tax exempt an organisation must have either;

- Been endorsed by the Tax Office as a charity or a non-charitable fund that distributes money, property or benefits solely to deductible gift recipients that are income tax exempt; or
- Self assess whether they are exempt from income tax

#### **2. Charities**

A charity is an institution or fund established and operated for charitable purposes. A charitable purpose includes the advancement of education. The constitution of ATEM outlines that it offers support with regards to professional development, networking and conferences for managers and administrators working in tertiary education. Therefore, it could be argued that ATEM is a charitable institution which advances education.

Due to the fact that charities generally don't have members, most clubs, societies and associations are not charities if:

- It's not carried on primarily for charitable purposes
- It's purpose is not for the public benefit or relief of poverty
- It's primarily for sporting, recreational or social purposes, or
- It's primarily for political, lobbying or promotional purposes

As ATEM has members that receive benefits, ATEM runs into the risk that the member benefits provided may preclude it from being a charitable entity. This is if it is seen to be ATEM's primary purpose.

The Objects of ATEM would need to be clarified to

1. clearly identify that the primary purpose is educating the sector
2. work with sector that includes Govt, Associations, Universities etc to develop relevant educational and leadership material

3. identify the sector as widely as possible
4. ensure that benefits are to public as well as members
5. that any assets on wind up are to go to charitable bodies
6. that it is a not for profit entity.

### 3. Self Assessment

Certain types of clubs, societies and associations can be exempt from income tax, which included the following:

- Community service organisations
- Cultural organisations
- Educational organisations
- Employment organisations
- Friendly societies
- Health organisations
- Religious organisations
- Resource development organisations
- Scientific organisations
- Sporting organisations

### 4. Educational organisations

To be exempt from income tax and self assess ATEM; will need to satisfy *all* of the following conditions:

- It must be a public educational institution
- It must be a charity
- It must meet at least one of three tests

#### ***Public education institution***

The ATO defines a public educational institution as, ‘an institution that is available or open to the public or a section of the public and whose dominant purpose is providing education’. Any other purpose of the organisation must be incidental or ancillary to providing public education. Education in this context does not extend to merely providing information or lobbying.

Public educational institutions include:

- universities or colleges managed by public bodies
- grammar schools
- primary and secondary schools run by churches or religious bodies, and
- non-profit business colleges.

Non-public educational institutions include:

- colleges run for the profit of the private owners
- associations operated for their members’ professional benefit, and
- promotional and lobbying bodies.

#### ***Charity***

If ATEM is deemed an educational organisation, it might also be a charity. If a public education institution is also a charity, it must meet the special requirements for charities to be income tax exempt.

***Three tests***

For an educational organisation that is not a charity to be exempt from income tax, it must pass **one** of the following tests:

1. physical presence in Australia test
2. deductible gift recipient test, or
3. prescribed by law test.

***Charity Conclusion***

ATEM's current Constitution leaves some doubt as to whether it will satisfy the ATO's definition of a public education institution. This is due to the fact that the activities carried on by ATEM include a focus on the advancement of education, namely provide support with regards to professional development, networking and conferences for managers and administrators working in tertiary education. It may be better to define who may attend the educational activities more clearly being, anybody with an interest in the higher education sector whether they be a member of ATEM or not.

If ATEM wishes to self assess under the category of educational institution it will need to provide services to the public as well as its members. This could be argued with the existence of its conferences and professional development courses being provided to non-members as well as members. It may also need to ensure it provides education and not just support managers, its members and administration staff within the tertiary education sector.

ATEM will also be required to amend clause 12 of its constitution to indicate that all remaining funds will be distributed not to the members but a deductible gift recipient otherwise there is a risk that they could be argued that members get the benefit under the wind up provisions.

**5. If ATEM is deemed not be income tax exempt:**

- It may have the benefit of special rates of tax
- The effect of mutual dealings may be excluded from its income

**Mutuality Principle**

In the event that ATEM is not considered a charity the mutuality principle should apply whereby income from members is tax exempt. Below are the concepts that help define the mutuality principle.

***Concept 1 - Legal structure of the non profit entity***

- No formality or prescribed form as to the legal structure of a non-profit entity.

***Concept 2 – A common fund for a common purpose***

- Based on an association of persons who have joined together, not for trade or profit, but to achieve, a common purpose, interest or benefit in which all the members participate or are entitled to do so.

- All members must contribute into the common fund.
- Ownership and control of the fund must remain, at all time, with the members as the contributors and participants in the use of the common fund.

***Concept 3 – Identity of contributors and participants***

- Members contributing to the fund must be identical to the members using the fund

***Concept 4 – Classes of membership***

- Members who own and control the common fund must have the same entitlements, privileges and obligations over the running of the entity, and the voting rights allocated under their membership must give them control over the spending of the fund.
- Can have different classes of membership
- Must be some correlation between the contributions paid and the entitlements to benefits

***Concept 5 – Disposal of membership interest***

- Membership interests are effectively prohibited from sale, disposal or transfer to external third parties.
- When members cease membership, there are no entitlements to a refund of contributions already paid, although outstanding fees remain a liability.

***Concept 6 – Collective benefits***

- Members cannot be capable of receiving financial benefits from the entity

***Concept 7 – Ancillary activities and benefits***

- Majority of activities undertaken by the entity must reflect the common purpose for which the entity was established

***Concept 8 – Refund of contributions***

- Surplus in excess of members contributions, arising from the use of the common fund, is not assessable income to the entity
- Contributions are deemed capital contributions
- Need a reasonable correlation between what members contribute and what they may be entitled to receive back from the fund
- Cannot refund more than what was contributed as it would be

***Concept 9 – Derivation and use of non-mutual income***

- Pay tax on non-mutual income
- Cannot distribute non-mutual income to members
- Must be retained within the entity and used solely towards the common purpose

***Concept 10 – Distributions to non-contributors***

- Distributions of any surplus funds are assessable income in the hands of the participants

***Concept 11 – Non-profit prohibition clause***

- Constitution should contain a clause prohibiting the distribution of profits or gains, if any, to members who control the entity during its lifetime.
- This provides the entity with its non-profit status
- Profits retained should be used entirely towards the financing or promotion of the common purpose
- If entity is capable of declaring a dividend payable to its members, it will be deemed to be carried on for the purpose of profits or gains to its members and mutuality will not apply
- Doesn't matter how they derived income, just how it is distributed

***Concept 12 – Dissolution prohibition clause***

- Constitution should contain a dissolution prohibition clause in the event of a winding up, as it may have accumulated a substantial amount of surplus over its lifetime
- Need distinction between a surplus resulting from mutual sources (membership fees) and non-mutual sources (profit derived and not spend towards common purpose)
- If constitution provides for distribution of mutual funds to its member on winding up, such distributions do not constitute a financial benefit to its member if it's a return on members own contributions
- If distribute above members original contribution, then lose non-profit status
- If you can distribute non-mutual funds on winding up, then lose non-profit status

**6. Mutuality Conclusion**

Although, the mutuality principle is not affected with the different sources of income that ATEM may derive, it is affected when it comes to the distribution of its funds. The current constitution of ATEM seems to provide different rights to different classes of members. For example:

- Students – are entitled to receive the full range of member benefits, but not eligible for grants, scholarships or voting rights
- Members - entitled to the full range, including grants, scholarships and voting rights
- Associates – not detailed in the constitution
- Fellow- not detailed in the constitution

Nevertheless it could be argued that there's a correlation between the contributions paid and the entitlements to the benefits as the membership fees on each class of members differs.

However, the constitution fails to outline whether or not members have the right to say how the money should be spent.

Although, ATEM would satisfy concept two and six, regarding the common fund, the fact all members must pay and members cannot be capable of receiving financial benefits, it will most likely fail concept three, as the contributing members will not necessary be the members receiving the benefits as ATEM also provides support to

non members. ATEM's constitution also fails to address the disposal of members' interest and refund of contributions.

## **7. Optimal Outcome**

If ATEM wishes to self assess and thus be granted tax exemption it will not be required to pay income tax nor lodge tax returns. However, ATEM will be required to carry out regular reviews to ensure that their tax exempt status has remained unchanged.

If ATEM fails to satisfy the self assessment provisions and wished to qualify for partial tax exemption under the principle of mutuality, it will need to consider the administrative cost of having to separate the mutual sources and non-mutual sources, which could pose an administrative nightmare, depending on the volume of members and non-members.

Therefore, it would be of greater benefit if ATEM passes the self assessment provisions of being a public educational institution as they will be provided with full tax exemption and will not be required to separate the sources of income.

## **8. What to do next**

In order for ATEM to take advantage of the full tax exemption under the self assessment provision the following will need to be satisfied:

- ATEM will need to ensure that its services are provided to the public, not just its members.
- ATEM will need to ensure that it is providing education and not just supporting managers, its members and administration staff within the tertiary education sector.
- ATEM will also be required to amend clause 12 of its constitution to indicate that all remaining funds will be distributed not to the members but a deductible gift recipient otherwise there is a risk that they could be argued that members get the benefit under the wind up provisions.