Accounting to Caesar for profits unrelated to the public good

It has been estimated that 'the value of tax concessions given by all Australian governments to [not-for-profit organisations (NFPs)] could be at least $4 billion in 2008–09 and that it could realistically be twice this amount when non-estimated expenditures are included'.[1] Australia, unlike other developed economies, does not tax the unrelated business income of charitable organisations.

The US introduced an unrelated business income tax (UBIT) in 1950[2] in response to unfair competition claims, with income tax exempt NFP organisations regularly generating income by carrying on business activities unrelated to their core purposes.[3] Under UBIT, tax exempt NFP organisations are taxed at the corporate tax rate on income not related to their core purposes.

An IRS special statistical report on UBIT in 2007 established that, in fact, little unrelated income of NFPs was actually taxed.[4] About 4 per cent of NFP charitable organisations reported unrelated business income — less than half of 1 per cent of their aggregate revenue of $US1,072.2 billion, resulting in an extra $US63.3 million in tax collected. The low amount of collections is attributed to a number of factors, including the width of exemptions, sophisticated tax planning, errors, and ignorance of the specific provisions.[5]

In the UK, a different structural approach has been taken with unrelated business income; it also results in little revenue being collected, but substantial administration and compliance costs. The Charity Commission for England and Wales will refuse to register charities with objects for trading, because trading is not a charitable object.[6] This stance has promoted the use of charity trading subsidiaries which are controlled by the charity, but which separate risk from the charity's assets. The profits from a trading subsidiary do not qualify for charity tax

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[1] Productivity Commission, *Contribution of the Not-for-Profit Sector: Research Report* (2010) xxxi, 78 ('Productivity Commission Research Report').

[2] John G Simon, Harvey Dale and Laura Chisolm, 'The Federal Tax Treatment of Charitable Organizations' in Walter W Powell and Richard Steinberg (eds), *The Nonprofit Sector: A Research Handbook* (Yale University Press, 2nd ed, 2006) 267.

[3] These included, the operation of a business called Mueller Macaroni, by New York University Law School. The IRS has brought litigation against exempt organisations on the basis that the 'tail wags the dog' – unrelated business having become so large quantitatively that the organisation can no longer be said to operate for exempt purposes; see *Better Business Bureau v United States* 326 US 279 (1945); and Evelyn Brody, 'Business Activities of Nonprofit Organizations: Legal Boundary Problems' in Joseph J Cordes and C Eugene Steuerle (eds), *Nonprofits and Business* (Urban Institute Press, 2009) 83, 93–4.

[4] Margaret Riley, 'Unrelated Business Income Tax Returns, 2003: Financial Highlights and A Special Analysis of Nonprofit Charitable Organizations' Revenue and Taxable Income' (2003) 26 *Statistics of Income Bulletin* 88.

[5] Evelyn Brody, 'Business Activities of Nonprofit Organizations: Legal Boundary Problems' in Joseph J Cordes and C Eugene Steuerle (eds), *Nonprofits and Business* (Urban Institute Press, 2009), 97; Richard Sansing, 'The Unrelated Business Income Tax, Cost Allocation and Productive Efficiency' (1998) 51 *National Tax Journal* 83.

[6] See Peter Luxton, *The Law of Charities* (Oxford University Press, 2001) 20.2 (citing refusal of Charity Commission of England and Wales to register entities with such objects as charities); Jean Warburton, Debra Morris and NF Riddle, *Tudor on Charities* (Sweet & Maxwell, 2003), 7.039.

exemption and are liable to corporation tax. However, payments (Gift Aid contributions) made by the trading subsidiary to the controlling charity reduce the level of profits which are taxable in the trading subsidiary. Tax exemption is available to the recipient charity in respect of the income which it receives from the trading subsidiary. Any dual use of assets or staff must be apportioned. The net result is that there are additional costs of establishment and maintenance of the separate legal structures, tax administration and compliance costs, but little additional income tax revenue.[7]

As part of the 2011 federal Budget process, the Australian government announced the introduction of what amounts to a UBIT on the income of NFP entities, commencing from 1 July 2011.[8] It broadly proposed that NFPs pay tax on any retained earnings not annually remitted and applied to the purposes of the tax concession entity, and that existing input tax concessions (such as Fringe Benefits Tax and Goods and Services Tax) would not be available for unrelated commercial activities. The government postponed the commencement date to 1 July 2012 to allow for more consultation.[9] It still proposes that new 'unrelated activities', commencing from 7.30 pm (AEST) on 10 May 2011, will be affected. Unrelated activities begun before that date will be covered by transitional arrangements amounting to a phase-out over an unspecified period.

The proposed Australian reform to the use of tax concessions by businesses operated by NFPs contains elements of both US and UK provisions, with notions of taxing only retained profits from unrelated business, with a suggested separation of activities in a taxable trading entity.[10]

This chapter identifies difficulties with the UBIT experienced on a practical level in the US and the UK, on which there is extensive evidence-based literature.[11] As Australia enters into a

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[7] There may be added revenue for property and indirect taxes as the trading subsidiary is usually not exempt from such taxes as a charity may be. Oonagh Breen, Holding the Line: Regulatory Challenges in Ireland and England when Business and Charity Collide" in McGregor Lowndes and O'Halloran (eds), Modernising Charity Law: Recent Developments and Future Directions (Edward Elgar Publishing, 2010)

[8] Treasury, *Budget measures 2011–12*, Budget paper no. 2, 10 May 2011, p 36.

[9] The Hon. David Bradbury, MP, and the Hon. Mark Butler, MP, "Extended start date for 2011–12 Budget measure to better target not-for-profit tax concessions", media release no. 009, 30 March 2012. Available at http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/009.htm&pageID=003&min=djba&Year=&DocType.

[10] Treasury, *Better Targeting of Not-for-Profit Tax Concessions* (Consultation Paper, 27 May 2011) http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2056.

[11] Evelyn Brody and Joseph Cordes, 'The Unrelated Business Income Tax: All Bark and No Bite?' (Seminar Series No 3, The Urban Institute Center on Nonprofits and Philanthropy, 2001); Evelyn Brody, 'Business Activities of Nonprofit Organizations: Legal Boundary Problems' in Joseph J Cordes and C Eugene Steuerle (eds), *Nonprofits and Business* (Urban Institute Press, 2009), 99; Margaret Riley, 'Unrelated Business Income Tax Returns, 2003: Financial Highlights and A Special Analysis of Nonprofit Charitable Organizations'

UBIT regime, it is timely to examine the likely impacts on management, accounting, financing and structuring of nonprofit enterprise.

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Revenue and Taxable Income' (2003) 26 *Statistics of Income Bulletin* 88. Richard Sansing, 'The Unrelated Business Income Tax, Cost Allocation and Productive Efficiency' (1998) 51 *National Tax Journal* 83.