

# Measuring Comparative Worthiness of Charities– An Australian Perspective\*

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## OVERVIEW

This paper examines how comparative worthiness of nonprofit organisations is decided in Australia. The field of taxation concessions is the main field where this game is played, but unlike many other jurisdictions, there are some different rules which create levels of worthiness. The level of Deductible Gift Recipient (DGR) which allows access to gift deductibility is an added gloss to the usual charity category and is akin to the situation in Singapore<sup>1</sup> and South Africa.<sup>2</sup>

The paper first briefly describes the current trends and context of the Australian nonprofit sector to help locate the ensuing discussion. The categorisation of the worthiness of nonprofit organisations for taxation concessions is then discussed. In Australia the worthiness for taxation exemption is different from gift deductibility and other concessions and each is examined in turn. As relevant in each section, the law (statute and common law) which outlines the formal definitions used to separate nonprofit organisations is discussed, but just as important is the application of those definitions by the judiciary and the administrators (Australian Taxation Office – ATO). Two recent High Court decisions have highlighted a number of issues in the application of the definitions of comparative worthiness which are closely analysed.

## THE AUSTRALIAN CONTEXT

While it is estimated that there are some 700,000 nonprofit organisations in Australia,<sup>3</sup> there are only about 51,865 strictly “charitable” entities in line with English or (U.S.) section 501(c)(3) definitions.<sup>4</sup> Approximately 540 000, are small, non-

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<sup>1</sup> Institutions of a Public Character (IPA)

<sup>2</sup> Public Benefit Organisation (PBO)

<sup>3</sup> Lyons, Mark (2001) *Third Sector. The Contribution of Nonprofit and Cooperative Enterprises in Australia*. Crows Nest: Allen and Unwin.

<sup>4</sup> Australian Taxation Office, *Taxation Statistics 2005-06* Chapter 10 ‘Charities and Deductible Gifts’ available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00117625.htm&mnu=41468&mfp=001>

employing organisations that rely on voluntary contributions and approximately 60 000 are 'economically significant' organisations (not necessarily charitable) which have an active tax role and employ staff.<sup>5</sup> Over the last decade in line with the general economic climate in Australia, the sector as a whole has been growing rapidly, together with volunteering and philanthropy.

The second national satellite accounts for the Australian not for profit sector has been released, and shows that in 2006-07, the sector generated \$41 billion gross value added (GVA) — equivalent to 3.9 per cent of GDP.<sup>6</sup> In inflation adjusted terms,<sup>7</sup> gross value added increased by \$26 billion since 1999-00. Including the estimated value of volunteer services, the estimated economic contribution of the sector was \$55.6 billion in 2006-07.

This is comparable to the measured contribution to the Australian national income of the wholesale trade sector (\$48 billion), transport and storage (\$48 billion) and the government, administration and defence sector (\$40 billion). It is larger than the gross value added of the communications sector (\$25 billion), but smaller than that of finance and insurance (\$77 billion).

Since 1999-2000, gross value added on a satellite account basis (that is, inclusive of the value of volunteer services) has roughly doubled. This represents an average annual increase of more than 13 per cent. In real terms, gross value added on a satellite account basis has increased at an average annual rate of 6 per cent.

The sector employs 890 000 paid staff (equivalent to 8.5 per cent of total Australian employment). Nearly 4.6 million volunteers, equivalent to 317 200 full time equivalent staff in 2006-07, were engaged in the sector. The sector employs a similar number of employees to the construction sector and, when volunteers are added, uses more labour than the manufacturing sector.

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<sup>5</sup> The majority of nonprofit organisations which are entitled to tax exemption are able to self assess and do not need to register in any way with the ATO.

<sup>6</sup> Australian Bureau of Statistics, (2009) *Australian National Accounts: Non-Profit Institutions Satellite Account, 2006-07*, Cat No. 5256.0

<sup>7</sup> Calculated using the GDP deflator.

The total amount donated and claimed as tax-deductible donations in 2006-07 was \$1.89 billion (compared to \$1.55 billion for the previous income year).<sup>8</sup> This constitutes an increase of \$329 million (or 21.1%) from the previous income year. The average tax-deductible donation made and claimed by Australian taxpayers to DGRs was \$440.01 (compared to \$370.83 in the previous income year). This average amount has nearly trebled in the last decade. Over the past five years tax deductible giving has increased by an average of nearly 16% per annum due in part to incentives to encourage philanthropy, such as Prescribed Private Funds (PPFs), and the strong economic conditions in Australia. Despite the donor participation rate falling slightly in 2007 (from 36.45% to 36.30%), the percentage of taxable income represented by deductible gifts continues to increase steadily (from 0.34% to 0.38 %).

## TAXATION CONCESSIONS FOR NONPROFIT ORGANISATIONS

Most nonprofit organisations are entitled to varying degrees of exemption or concessions from taxes, charges and fees. Nonprofit organisations may have exemption from paying any income tax, capital gains tax, or fringe benefits tax, in addition to their donors claiming an income tax deduction for gifts. They may also be exempt from state taxes such as land tax, payroll tax, stamp duty and various transaction tax imposts. Local councils give various concessions in respect of rates and charges. At all levels of government and quasi-government bodies and utilities, fees and charges are often waived or discounted for nonprofit organisations.

Where concessions are minor, often for convenience in respect of complying with some legislative impost meant for business entities, the phrase: "charity, community, benevolent, patriotic or sporting purpose or a similar purpose prescribed under a regulation" is used. This is the widest measure of worthiness.

A narrower measure used is that of 'charity'. There are 15 pieces of Commonwealth legislation and 163 pieces of State and Territory legislation, under which ascertaining entitlement to a benefit or some other legal outcome involves

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<sup>8</sup> McGregor-Lowndes, Myles and Newton, Cameron (2009) *An Examination of Tax Deductible Donations Made By Individual Australian Taxpayers in 2006–07*, Australian Centre for Philanthropy and Nonprofit Studies Working Paper No. CPNS 45.

determining the charitable purpose or status of an organisation.<sup>9</sup> There are some 52,000 charities registered with the ATO. Only half this number are worthy enough to qualify for Deductible Gift Recipient (DGR) Status and are not necessarily charities. Whereas in other jurisdiction charitable status is the main gateway to taxation and other concessions, in Australia gift deductibility and other generous FBT concessions are reserved to this category or even narrower categories (Public Benevolent Institutions). In the narrowest categories, individual organisations have been awarded the privileged status by their name being placed into the statute books.

What has been coming to the fore in recent inquiries is that these layered definitions of worthiness create a deal of confusion, and compliance and administrative costs, and defy rational explanation. For example the Senate Economics Committee Report stated that:

“The committee agrees that Australia's taxation system is confusing for Not-For-Profit Organisations and difficult for the general public to understand. Tax concessions for the Sector seem to represent historical accidents rather than any rational plan.”<sup>10</sup>

This system could be defended on the basis that only ‘worthy’ nonprofit organisations receive the most generous of scarce concessions, but most definitions are now based on concepts of worthiness that belong to another era, particularly that of Public Benevolent Institution. If the tiered definitional structure is to remain, the definitions need to reflect a more contemporary concept of ‘worthiness’.

First the paper turns to examining the worthiness concepts used in income tax exemption with a focus on the definition of charity. Two recent High Court cases are examined for the insights on assessing the worthiness of organisations on the boundary. Then the paper will turn to the other major category of concessions, Deductible Gift Recipients and in particular Public Benevolent Institutions and specifically named organisations.

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<sup>9</sup> Refer Submission 170 by the National Roundtable of Nonprofit Organisations, Senate Economics Committee Report, December 2008 available at [http://www.aph.gov.au/senate/committee/economics\\_ctte/charities\\_08/index.htm](http://www.aph.gov.au/senate/committee/economics_ctte/charities_08/index.htm)

<sup>10</sup> Australia, Senate Standing Committee on Economics, *Disclosure Regimes for Charities and Not-for-profit Organisations*, 4 December 2008, at 93.

**NFP organisations, charities and related entities<sup>a</sup>**

<i>Tax concessions</i>	<b>Entity type</b>					
	<i>NFP organisations</i>	<i>Community service organisations</i>	<i>Charity</i>	<i>Public Benevolent Institutions (PBI)</i>	<i>Religious Institutions</i>	<i>Deductible Gift Recipient (DGR)</i>
Income tax exemption		✓	✓	✓	✓	
Tax free threshold of \$416	✓					
Receives deductible gifts				✓		✓
Refund of imputation credits			✓	✓		✓
Fringe benefits tax exemption				✓		
Fringe benefits tax rebate		✓	✓		✓	
GST non-profit concessions	✓	✓				
GST charity/gift deductible entity concessions			✓	✓		✓
GST religious organisation concessions					✓	

<sup>a</sup> These entity types may also satisfy criteria for other entity types. For example, all the entity types listed above are not for profit and therefore are entitled to the concessions available to not for profit organisations. In addition, a charity may also be a DGR and therefore entitled to gift deductibility or a PBI could also be a charity and therefore entitled to the concessions available to charities.

Source: CDI 2001 (Appendix B).

## Income Tax Concessions

Specifically, exemption from taxation for nonprofit bodies can occur through:

- the common law doctrine of mutuality,<sup>11</sup> or
- statutory intervention (Division 50 of the *Income Tax Assessment Act 1997*).

A list of nonprofit entities exempt from income tax is set out in Division 50 of the *Income tax Assessment Act 1997*. The specific exemptions in the Act are not mutually exclusive and often an entity may fall within more than one category. An example is that a school may be both a “public education institution” and a “charitable institution”, as may a religious institution or a scientific institution. This adds to lay confusion generally.

The categories of income tax exemption from Division 50 *Income Tax Assessment Act 1997* are reproduced below:

### *Section 50-5 Charity, education, science and religion*

Item	Exempt entity
1.1	*Charitable institution
1.2	Religious institution
1.3	Scientific institution
1.4	Public educational institution
1.5	*Fund established for public charitable purposes by will before 1 July 1997
1.5A	*Trust covered by paragraph <u>50-80(1)(c)</u>
1.5B	*Fund established in Australia for public charitable purposes by will or instrument of trust (and not covered by item 1.5 or 1.5A)
1.6	Fund established to enable scientific research to be conducted by or in conjunction with a public university or public hospital
1.7	Society, association or club established for the encouragement of science

\*Any entity covered by item 1.1, 1.5, 1.5A and 1.5B is not exempt from income tax unless the entity is endorsed as exempt from income tax by the Australia Taxation Office.

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<sup>11</sup> The mutuality principle is a common law concept based on the proposition that a person’s income consists only of funds derived from external sources and that funds derived from internal sources are therefore not assessable for income tax purposes. *The Bohemians Club v FCT* [1918] 24 CLR 334.

*Section 50-10 Community service*

Item	Exempt entity
2.1	Society, association or club established for community service purposes (except political or lobbying purposes)

*Section 50-15 Employees and employers*

Item	Exempt entity	Special conditions
3.1	(a) employee association; or (b) employer association	the association: (a) is registered under an Australian Law relating to the settlement of industrial disputes; and (b) is located in Australia, and incurs its expenditure and pursues its objectives principally in Australia
3.2	Trade union	located in Australia and incurring its expenditure and pursuing its objectives principally in Australia

Note: Despite items 3.1 and 3.2, certain ordinary and statutory income of some associations of employees and some registered trade unions may be subject to income tax under Division 8A of Part III of the *Income Tax Assessment Act 1936*.

*Section 50-20 Finance*

Item	Exempt entity
4.1	a friendly society (except a friendly society dispensary)

*Section 50-25 Government*

Item	Exempt entity
5.1	(a) a municipal corporation; or (b) a local governing body
5.2	a public authority constituted under an Australian Law

Note: The ordinary and statutory income of a State or Territory body is exempt: see Division 1AB of Part III of the *Income Tax Assessment Act 1936*.

*Section 50-30 Health*

Item	Exempt entity
6.1	Public hospital

6.2	Hospital carried on by a society or association (not carried on for the profit or gain of its individual members)
6.3	the following organisations registered for the purposes of the <i>National Health Act 1953</i> : (a) a medical benefits organisation; (b) a health benefits organisation; a hospital benefits organisation (not carried on for the profit or gain of its individual members)

*Section 50-35 Mining*

Item	Exempt entity
7.1	the Phosphate Mining Company of Christmas Island Limited (incorporated in the Australian Capital Territory)
7.2	The British Phosphate Commissioners Banaba Contingency Fund (established on 1 June 1981)

*Section 50-40 Primary and secondary resources, and tourism*

Item	Exempt entity
8.1	A society or association established for the purpose of promoting the development of: (a) aviation; or (b) tourism (not carried on for the profit or gain of its individual members)
8.2	A society or association established for the purpose of promoting the development of any of the following Australian resources: (a) agricultural resources; (b) horticultural resources; (c) industrial resources; (d) manufacturing resources; (e) pastoral resources; (f) viticultural resources; (g) aquacultural resources; (h) fishing resources (not carried on for the profit or gain of its individual members)

*Section 50-45 Sports, culture, film and recreation*

Item	Exempt entity
9.1	a society, association or club established for the encouragement of: (a) animal racing; or (b) art; or (c) a game or sport; or (d) literature; or (e) music
9.2	a society, association or club established for musical purposes
9.3	the Australian Film Finance Corporation Pty Limited (incorporated under the <i>Companies Act 1981</i> on 12 July 1988)

The law generally exempts from tax all income generated by these organisations provided that:

1. the organisation's main purpose or object is exempt and its actual activity is directed to these purposes;
2. the organisation is nonprofit (ie. it does not distribute, and is constitutionally prohibited from distributing, its surplus to anyone or any purpose, other than its stated exempt objectives); and
3. the organisation has an appropriate dissolution clause which transfers any surplus to a similar tax exempt organisation, not its members or controllers.

The main category is “charitable institution or fund”. It is here that the ATO and the courts are called upon to make the majority of ‘worthiness’ decisions. Charity law in Australian state and federal jurisdictions closely follows the English definition of charity based on the Preamble to the Elizabethan *Statute of Charitable Uses* of 1601.<sup>12</sup> English case authority is consistently used as the basis for Australian law in both federal and state courts. This reliance on the common law is demonstrated in a taxation ruling by the Australian Taxation Office (ATO) on the meaning of ‘charity’ for the purposes of the *Income Tax Assessment Act 1997*: in the course of a 70 page explanation, the

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<sup>12</sup> 43 Eliz. 1, Cap.4.

ruling cites 145 English cases and only 113 Australian, with 28 decisions from other jurisdictions.<sup>13</sup>

A trust expressed to be for both charitable and non-charitable purposes is invalid under the general law.<sup>14</sup> However, the fact that a charitable institution has non-charitable purposes incidental or ancillary to its charitable purposes does not invalidate gifts to the institution.<sup>15</sup> This principle of trust law is also applied to determining the charity status of incorporated bodies and for taxation purposes. An institution is accepted as charitable if its dominant purpose is charitable.<sup>16</sup> Any non-charitable purposes of the institution must be no more than incidental or ancillary to this dominant purpose. Finding an institution's sole or dominant purpose involves an objective weighing of all its features. They include its constitutive or governing documents, its activities, policies and plans, administration, finances, history and control, and any legislation governing its operation.<sup>17</sup>

To guide this vetting process the ATO has published a series of draft rulings and one set out the Tax Commissioner's view of what was a 'charitable institution or fund' for the purposes of income tax exemption.<sup>18</sup> Two High Court cases have followed the publication of this ruling which has taken a different view in some instances about the application of the law and how one determines worthiness.

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<sup>13</sup> Australian Taxation Office, *Income tax and fringe benefits tax: charities*, TR 2005/21 & 22, dated 21 December 2005.

<sup>14</sup> Meagher, R. P. and W. M. C. Gummow. *Jacob's Law of Trusts in Australia*, 6th edition, Butterworths, Sydney, 1997, p. 237. Some State legislation operates to save, as charitable, trusts which would otherwise be invalid because of mixed charitable and non-charitable purposes: *Charitable Trusts Act 1993* (NSW) s 23(1); *Property Law Act 1958* (Vic) s 131(2); *Trusts Act 1973* (Qld) s 104; *Trustee Act 1936* (SA) s 69A(1); *Trustees Act 1962* (WA) s 102(1); and *Variation of Trusts Act 1994* (Tas) s 4(3). There is a question whether such legislation, dealing as it does with trusts, would apply to entities constituted as companies limited by guarantee or as associations. While the matter is not clear, the better view would seem to be that the legislation would apply.

<sup>15</sup> *Congregational Union of New South Wales v Thistlethwayte* (1952) 87 CLR 375; *Stratton v Simpson* (1970) 125 CLR 138.

<sup>16</sup> *Congregational Union of NSW v Thistlethwayte* (1952) 87 CLR 375 at 442 per Dixon CJ, McTiernan, Williams and Fullagar JJ.

<sup>17</sup> Australian Taxation Office 1999, *Draft Taxation Ruling — Income tax and fringe benefits tax: charities*, TR 1999/D21, paras 103 and 111-112.

<sup>18</sup> Australian Taxation Office, *Income tax and fringe benefits tax: charities*, TR 2005/21.

## Central Bayside

Central Bayside Division of General Practice Ltd (Central Bayside)<sup>19</sup> sought exemption from payroll tax in Victoria on the basis that the wages were paid “by a charitable body ... to a person during a period in respect of which the body satisfies the Commissioner that the person is engaged exclusively in the work of the body of a charitable nature”.

Central Bayside was a company limited by guarantee whose members were general medical practitioners in the Central Bayside area of Melbourne. The directors were appointed by the members without government interference or power to dismiss them. Central Bayside was part of a nationwide scheme designed by the Commonwealth government to promote healthcare at a local level through the Divisions of General Practice Program. It was agreed or assumed by all judges that its constitutional objects were charitable, falling within the head of “purposes beneficial to the community”. About 93% of Central Bayside’s income was from government grants with about 43% being an “outcomes based funding” grant from the Commonwealth. The funding was contractual in nature, rather than a statutory appropriation. Central Bayside’s other income was derived from advertising, sponsorship and interest.

The Commissioner of State Revenue (revenue authority) decided that Central Bayside was not a ‘charitable body’ because:

1. its main purpose was to protect and advance the interests of its members, and
2. it was merely a governmental conduit executing government policy.

At the primary appeal hearing, the Commissioner conceded on the first issue that Central Bayside’s main purpose was not “to protect and advance the interests of its members”. Both the primary appeal, full court appeal judges and High Court remarked that they were not sure why this concession was made. The outcome may have been different if this issue had been argued fully.

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<sup>19</sup> *Central Bayside Division of General Practice Ltd v Commissioner of State Revenue* [2006] HCA 43

All five judges of the High Court arrived at the conclusion that Central Bayside was a ‘charitable body’. However, there were three separate judgments with varying reasons for the decision. The Commissioner:

“contended that it was precluded because it acted so much under the control or influence of government that it could be seen to be acting in furtherance of government objectives rather than, or as well as, in the independent performance of its own objects.”<sup>20</sup>

Gleeson CJ, Heydon and Crennan JJ all agreed that Bayside was not under the control of the government and used the following to decide the worthiness:

1. An examination of the funding agreements found that although they were in large measure in a standard form, the central obligations depend on the “Programs of Activity” as described in the organisation’s extended Strategic Plan and approved Business Plans. As the plans were devised by each division to suit its own purposes, resources, problems and personnel, each organisation in fact proposed the items for Commonwealth funding.
2. The evidence did not reveal that there was in fact any incapacity to negotiate. There was no legal compulsion on the organisation to seek funding from the Commonwealth. That the organisation had to report or follow its strategic plan did not necessarily mean it was under the dictation of the government. The court found that it was common for the donors of funds for charitable purposes to attach conditions to the gift or to stipulate mechanisms pursuant to which the funds are to be expended. These conditions or stipulations do not affect the charitable character of gifts.

The Court considered that Central Bayside could decide whether to accept or reject the government funding, as Central Bayside had an independently formed board which made its own decisions. Just because a charity had the same goals as government, did not mean without more, that it is not independent of government. It may have been different if the Central Bayside board members were appointed, dismissed or controlled by government. In a separate judgment, Justice Callinan agreed in principle with this line of reasoning.

Justice Kirby while reaching the same result, reached it after an interesting review of the place of the definition of charity in modern Australian society. He noted that, “For judges, no longer subject to the authority of Imperial or English courts, to

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<sup>20</sup> [2006] HCA 43 at para 23.

maintain obedience to conceptions of “charity” and “charitable bodies”, expressed in such different times, seems, on the face of things, an irrational surrender to the pull of history over contemporary understandings of language used in a modern Australian statute.”<sup>21</sup> However, in the end Justice Kirby did not seek to overturn the current judicial definition of charity.

Justice Kirby stated the traditional approach:

“In deciding whether an organisation, claiming to be a “charitable body” fits that description, the starting point for analysis is to identify the organisation's (ie the “body's”) purposes. Obviously, the constitution of the body will be important for this purpose. However, it cannot be conclusive. The constitution will often have been drafted by lawyers with an eye to the revenue implications of the document. That is why it is material to have regard also to the activities of the organisation, as an assurance that the nominated "purposes" are genuine and express the real, as distinct from purely nominal, objectives for which the body is established.”<sup>22</sup>

Justice Kirby went on to note that it was not a task that was without difficulty and quoted the Supreme Court of Canada:

“The difficulty is that the character of an activity is at best ambiguous; for example, writing a letter to solicit donations for a dance school might well be considered charitable, but the very same activity might lose its charitable character if the donations were to go to a group disseminating hate literature. In other words, it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature ... Unfortunately, this distinction has often been blurred by judicial opinions which have used the terms ‘purposes’ and ‘activities’ almost interchangeably. Such inadvertent confusion inevitably trickles down to the taxpayer organization, which is left to wonder how best to represent its intentions to [the revenue] in order to qualify for [exemption]”.<sup>23</sup>

There is an element of truth in the observations about lawyers and their drafting with an eye to the taxation definitions, however one has to afford lawyers who are skilled in such matters which is often out of the reach of smaller organisations.

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<sup>21</sup> [2006] HCA 43 at para 96.

<sup>22</sup> [2006] HCA 43 at para 120

<sup>23</sup> [2006] HCA 43 at para 121, citing *Vancouver Society of Immigrant and Visible Minority Women v MNR* [1999] 1 SCR 10 at 108 [152]-[153]. See also *Attorney-General v Brown* (1816) 1 Swans 265 [36 ER 384]; *Attorney-General v Eastlake* (1853) 11 Hare 205 [68 ER 1249].

## Word Investments Case

The *Word Investments case*<sup>24</sup> has proceeded from a tribunal, through a single judge of the Federal Court, the Full Court of the Federal Court, and has recently been heard in the High Court of Australia. The issue was about the assessment of a nonprofit organisation for charity status and the approach taken by the various judicial officers is instructive.

Word Investments Ltd (Word) was established in 1975 by Wycliffe Bible Translators (Wycliffe) to provide financial and fund-raising support to Wycliffe. Wycliffe is an evangelical missionary organisation that seeks to spread the Christian religion through literacy and translation work, predominantly in the developing world. Wycliffe was an income tax exempt charity and claimed that Word Investments was exempt as a charity as well.

Word Investments initially raised funds through housing development and then passed any surplus on to Wycliffe. These activities ceased in the early 1980s, but in the late 1980s Word took over the fundraising activities then carried on by Wycliffe, activities which consisted of investing money borrowed at non-commercial rates from supporters. At this time, Word also offered financial planning for a fee. Word continued to pass funds to Wycliffe until in 1996 it resolved to establish Bethel Funerals, a funeral business. Bethel Funerals traded with the public and surplus funds were given to Wycliffe.

The tribunal, the single judge in the Federal Court and the Full Court of the Federal Court found by an examination of its constitution that Word was charitable. It is notable that the Federal Court adopted the orthodox view that where it is not possible to determine an organisation's objects from its constitution, it is merely necessary to resort to an examination of activities, noting:

“Where it is unclear from the listed objects of an organisation what its main purpose is, or where the evidence shows that the listed objects do not reflect the actual purpose of the organisation, it is appropriate to

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<sup>24</sup> Re VT 2003/66 *v The Commissioner of Taxation* AAT, 2005 No VT 2003/66; *Commissioner of Taxation v Word Investments Ltd* [2006] FCA 1414 (2006 *Word case*); *Commissioner of Taxation v Word Investments Ltd* [2007] FCAFC 171 (2007 *Word case*); *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd* [2008] HCA 55 (High Court of Australia, 3 December 2008).

look to the activities of the organisation together with expressed objects.”<sup>25</sup>

In the High Court, Gummow, Hayne, Heydon and Crennan JJ found that Word was entitled to be regarded as a 'charitable institution' under the Income Tax legislation. Kirby J found for the Commissioner of Taxation and decided that Word was not entitled to be regarded as a charitable institution.

The majority found that Word's company constitutional objectives, although containing 'powers' was still charitable, being that of advancing religious charitable purposes. Both the intention at the time Word was formed, and its activities since, indicated that it was charitable. The Court noted that this test had to be applied and assessed for each income tax year.

However, it was the dissenting judge, Kirby J, who gave the most detail about how the court should go about deciding the 'worthiness' of a charity. He stated:

“To determine whether a propounded "institution" or its purposes are “charitable”, it is necessary in every case for the decision-maker to engage in an act of characterisation. This is not a simple task. First, there is uncertainty as to which factors may be considered when classifying the purpose of a propounded institution. Secondly, the characterisation may, in the particular case, involve a finely balanced determination of the facts, upon which informed decision-makers might disagree. Thirdly, institutions typically have many purposes pursued through a range of activities. Some such purposes and activities may be charitable, whereas others may not. Some may be major whereas others may be minor or incidental.

Without statutory guidance, characterisation of an institution typically requires the decision-maker to consider a mass of cases and search for the most analogous decisions. In today's society, this must be done in circumstances where the activities of charities, their purposes, objectives and mode of operation are changing. Such changes result partly from new and different social conditions. They partly flow from the attempt of putative “charitable institutions” to carry out new, larger and different objects but within legislation that was substantially enacted in earlier times, traceable to much earlier times, and addressed to charitable activities somewhat different from those now often undertaken by not-for-profit bodies.<sup>26</sup>

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<sup>25</sup> 2006 *Word case* at para 28.

<sup>26</sup> [2008] HCA 55 at paras 163-4.

With respect, there are real dangers in assigning too much importance to the constituting document. This is especially so now that the doctrine of *ultra vires* in relation to companies has been discarded as an important element in Australian corporations law.<sup>27</sup>

The constituting document can obviously be drafted widely or ambiguously. Its language may generate uncertainty as to the true purposes of the institution propounded as charitable. It may contain multiple purposes but not indicate whether they are all of equal importance or whether some purposes are subsidiary to others. The document may not identify the outer limits of the purposes which the institution may pursue. For these reasons, in my opinion, the real *discrimen* for the characterisation of an entity propounded as a “charitable institution” is what that entity actually does and what purposes it actually pursues. I take this to be the reason why, in *Incorporated Council of Law Reporting (Q) v Federal Commissioner of Taxation*<sup>28</sup>, Barwick CJ said:

“If its purposes are charitable, it will be such an institution for the nature of the institution inheres in the purposes it is created to *and does* pursue.”

Courts, including this Court, should take the constituting purposes into close account, however they should not be blinded by them. Courts should view the stated purposes in the context of determining what the propounded entity actually does to fulfil the stated purposes. In his reasons in *Attorney-General v Ross*, Scott J (a judge with much experience in this field) explained why this was the correct approach:<sup>29</sup>

“The question whether under its constitution the union is or is not charitable must, in my view, be answered by reference to the content of its constitution, construed and assessed in the context of the factual background to its formation. This background may serve to elucidate the purpose for which the union was formed...

I must not be taken to be expressing the opinion that the activities of an organisation subsequent to its formation can never be relevant to the question whether the organisation was formed for charitable purposes only. *The skill of Chancery draftsmen is well able to produce a constitution of charitable flavour intended to allow the pursuit of aims of a non-charitable or dubiously charitable flavour. In a case where the real purpose for which an organisation was formed is in doubt, it may be legitimate to take into account the nature of the activities which the organisation has since its formation carried on. ... The activities of an organisation after its formation may serve to indicate that the power to carry on non-charitable activities was in truth not incidental or supplementary at all but*

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<sup>27</sup> [2008] HCA 55 at para 173.

<sup>28</sup> (1971) 125 CLR 659 at 666 (emphasis added).

<sup>29</sup> [1986] 1 WLR 252 at 263; [1985] 3 All ER 334 at 343 (emphasis added).

was the main purpose for which the organisation was formed. In such a case the organisation could not be regarded as charitable.”

Australia, unlike the UK, Canada and USA, has until very recently had no regulatory gatekeeper to assess whether the constitutional documents of a nonprofit organisation are in fact a charitable purpose upon formation. In Australia, organisations self assessed their status and the drafting of object clauses was never subjected to independent scrutiny as occurs in other jurisdictions. This lack of discipline has led to the difficult task of an external assessment not only of the constitutional documents, but the actual activities of organisations. This is further hampered by small organisations that did not seek legal assistance when drafting their constitutional documents which over the years have developed into large organisations with quite different activities.

### **Gift Deductibility Status**

The other significant area of ‘worthiness’ measurement in Australia is the award of gift deductibility status. This is particularly so for the status of Public Benevolent Institution which is the gateway to generous Fringe Benefit Tax exemptions. As noted above, charity status alone does not give gift deductibility status which is reserved for a smaller population of organisations. Sub-Division 30B of the *Income Tax Assessment Act* 1997 lists thirteen general categories of deductible gift recipients under the Act. These include:

- health;
- education;
- research;
- welfare and rights;
- defence;
- environment;
- industry, trade and design;
- the family;
- international affairs;
- sports and recreation;
- philanthropic trusts;
- cultural organisations; and
- other recipients.

Under each general category the tax statute lists specific organisations or specific classes of organisations that are to be donation deductible and there are also named classes of organisations such as public benevolent institutions, higher educational institutions, public authorities for research, and ancillary funds. Two of the categories are chosen to illustrate how worthiness is measured in this area of the law: Public Benevolent Institutions and specifically named organisations.

### **Public Benevolent Institutions (PBIs)**

The taxation legislation does no more than state that a Public Benevolent Institution is entitled to the concession. The High Court considered the definition of PBI in the case of *Perpetual Trustee Co Ltd v FC of T*.<sup>30</sup> The court held that the Royal Naval House which provided low cost accommodation and recreation for petty officers and lower ratings when ashore in Sydney was a not public benevolent institution. The following language was used to describe the characteristics of a PBI:

‘In the context in which the expression is found, and in ordinary English usage, a “public benevolent institution” means, in my opinion, an institution organized for the relief of poverty, sickness, destitution, or helplessness.’<sup>31</sup>

‘... I am unable to place upon the expression “public benevolent institution” in the exemption a meaning wide enough to include organizations which do not promote the relief of poverty, suffering, distress or misfortune.’<sup>32</sup>

‘Such bodies vary greatly in scope and character. But they have one thing in common: they give relief freely to those who are in need of it and who are unable to care for themselves. Those who receive aid or comfort in this way are the poor, the sick, the aged, and the young. Their disability or distress arouses pity, and the institutions are designed to give them protection.’<sup>33</sup>

The ATO has issued a public ruling which is the view of the Commissioner about the law and its application.<sup>34</sup> The ATO’s definition of a PBI is a “nonprofit

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<sup>30</sup> (1931) 45 CLR 224.

<sup>31</sup> per Starke J at 45 CLR 232

<sup>32</sup> per Dixon J at 45 CLR 233-234

<sup>33</sup> per Evatt J at 45 CLR 235-236

<sup>34</sup> Australian Taxation Office, *Income tax and fringe benefits tax: public benevolent institutions*, Taxation Ruling 2003/5.

institution organised for the direct relief of poverty, sickness, suffering, distress, misfortune, disability or helplessness.”<sup>35</sup>

The characteristics of a PBI are:

1. that it has as its object the relief of poverty, sickness, suffering, distress, misfortune, destitution or helplessness;
2. that it is carried on without the purpose of private gain for particular persons;
3. that it is established for the benefit of a section or class of the public;
4. that the relief is available without discrimination to every member of that section of the public that the organisation aims to benefit;
5. that the aid is given directly to those in need; and
6. that any non-benevolent activities are minor and ancillary to the association’s basic operation.

It is important to remember there is a distinction between charitable bodies and public benevolent institutions. A charitable body will not be a public benevolent institution unless it satisfies the above criteria.

The ruling warns that:

- It is not sufficient that an organisation is ‘benevolent’ in merely dictionary terms, that its actions are socially worthwhile, that it is charitable in legal terms or that it is fully funded by government.
- The ATO does not have discretion to accept an organisation as a public benevolent institution when in reality it is not.
- When the ATO notifies organisations that they are not public benevolent institutions they sometimes change their constituent documents and re-apply. If their plans and operations are still not predominantly for public benevolence, their status will not change as far as the ATO is concerned.

The formal approach of the ATO as to its assessment is:

“Whether a particular organisation is a public benevolent institution is a matter of fact and degree. It is an objective question in which all relevant factors must

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<sup>35</sup> Ibid, para 7.

be considered. In particular, both the organisation's constitution and its activities will be relevant. Features to consider include:

- the objects, powers and membership criteria set out in the organisation's constituent documents;
- legislation affecting its rules, powers, etc;
- the policies and procedures which guide its operations;
- the activities and operations that it actually performs, including:
  - the uses and sources of funds and property;
  - the activities of the executive body;
  - the duties and tasks of employees and volunteers.”<sup>36</sup>

The assessment of PBIs by the ATO is very problematic. Recent inquiries have been marked by savage criticism by the sector and in particular small organisations who have had their PBI applications rejected. One of the key problems with assessment is that it is informed by written documents which are often written in loose language which does not translate well into ‘old charity model’ language of the definition of PBI. Instead of the key words of ‘direct relief of poverty, sickness, suffering, distress, misfortune, disability or helplessness’, being commonplace, grassroots organisations tend to use the discourse of modern community development concepts of prevention, inclusion, ‘teaching people to fish rather than giving them a fish’, building ‘self confidence’, advocacy on behalf of others or attacking the systemic causes of poverty. These do not assist in building a picture of activities that satisfies the criteria.

As noted above the issue of constitutional documents not being drawn with a clear distinction between objects and powers also causes difficulties here.

The courts have not added too much to the approach of the Commissioner. Justice Tadgell in an appeal case noted that:

“The judge had the task of characterizing the respondent's institutional activity on one side of the line or the other as essentially and predominantly benevolent or not. The characterization involved an assessment, partly qualitative and

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<sup>36</sup> Ibid, para 23

partly quantitative, of what the appellant stood for and what it did. A value judgment was to be made on the whole of the available evidence.”<sup>37</sup>

The method of determining worthiness by the ATO on the material supplied by the organisation such as annual reports, flyers, brochures and constitutions may be written in loose lay language which is not of the same discourse genre of notions of ‘old charity’ or ‘benevolence’. Apart from actually visiting the organisation and questioning the staff, volunteers, clients and board to observe what actually happens, it is suggested that it is hard to compete with the court’s ability to have evidence presented to it which is tested in open court. In most cases, resourcing will not allow ATO officers to make such site visits. It is becoming more apparent that those organisation with access to skills of drafting not only their constitutions, but their application to the ATO and flyers, brochures, web site and annual report face a far better chance of obtaining the concessional status.

### **Specific named Organisations**

Specific organisations have found their way into the statute by Parliament being persuaded that the organisation is deserving of the status of being a deductible gift recipient. There are about one hundred and thirty such organisations. The listing of specific organisations as being deductible is occasionally the product of overt political forces and ‘worthiness’ is a direct result of political forces. Two examples illustrative of the policy process are the listing of Nursing Mothers and the political research organisations of major political parties. Championed by the Australian Democrats (a minor party of the Australian Senate), the initial attempt to amend legislation to include Nursing Mothers failed. During the debate, Senator Walsh the Minister for Finance conceded that “there is an element of semi or quasi-arbitrariness in the selection” of such organisations<sup>38</sup> whilst Senator Stone, former Head of the Treasury admitted that, “It has been one of the most contentious, time-consuming and difficult areas of tax law for many years.”<sup>39</sup> Nursing Mothers initiated a grassroots political campaign to alter the decision. After six months of association members lobbying their

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<sup>37</sup> Commissioner of Taxation v *Cairnmillar Institute* at 92 ATC 4312-4313.

<sup>38</sup> Australia, Senate Hansard, 1989, at p. 3766.

<sup>39</sup> Australia, Senate Hansard, 1989, at pp. 3769-70.

members of Parliament, 10,000 letters and personal representations by wives of members of Parliament who were members of the organisation, the Senate agreed to Nursing Mothers being listed.

Another example is the listing of the Evatt and the Menzies Foundations that are commonly referred to as the ‘think-tanks’ of the major political parties. They would not qualify for donation deductibility status under any other category in the taxation legislation. On the first of April, 1998, Hansard records the following in relation to a question without notice asked by Mr. Crean of the Prime Minister, Mr. Howard:

**“Mr. Howard:** ... The honourable member comes to a decision that was taken on 1 October 1996 by the government to grant \$100,000 to the Menzies Foundation and also grant \$100,000 to the Evatt Foundation.

**Mr. McLachlan:** The Evatt Foundation!

**Mr. Howard:** Hang on, it gets better. We also granted tax deductible status to the Menzies Research Centre. Let me say a couple of things about that and then I will come to the issue of declaration which has been asked by the Member for Hotham. The first thing I would report to you is that, on the day cabinet met, I happened to ring the Leader of the Opposition. I rang the Leader of the Opposition and I said, ‘Kim, we have it in mind to give \$100,000 to the Menzies centre. In the interests of political balance, we will give \$100,000 to the Evatt Foundation and grant tax deductibility to the Menzies Research Centre because Evatt has already got it.’ I might add in parenthesis that I was the Treasurer who, in 1981, granted tax deductibility to the Evatt Foundation.”<sup>40</sup>

Clearly the worthiness of these specifically listed organisation depends on the robust decision making of elected representatives. Again, a sense of unfairness is harboured by small voluntary organisations without access to political champions.

## CONCLUSION

Australia’s tiered system of differing definitions of worthiness to access different taxation concessions for nonprofit organisations might have once pleased Treasury officials as being targeted prudent fiscal measures. However, as definitions have failed to keep pace with progress of social welfare principles and modern policy imperatives the complex web of definitions only serves to confuse and frustrate those who do not know the rules of the game.

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<sup>40</sup> Australia, House of Representatives Hansard, 1998, p. 2118.

The resource constrained administrator is placed in a difficult position when assessing worthiness. As Australia has no modern regulator to ensure that nonprofit organisations actually pursue their stated constitutional purposes, the ATO cannot place any great store in an organisation adhering to its constitutional purposes. Further, many of the constitutional purposes are muddled due to poor drafting and lack of revision over the years. When arcane definitions and social welfare conceptions which form the substratum of the concessional definitions are added, it makes it difficult to be consistent and fair to all applicants.

As the courts are able to receive and test evidence to discover the essence of the organisation which is often beyond the resources of the ATO, it is understandable that the courts come to a different assessment of the worthiness of many who have to financial ability to challenge ATO determinations.