

# Submission to the Commonwealth Treasury

## A Definition of Charity

### Consultation Paper October 2011

School of Law- University of Western Sydney

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#### Introduction

This submission addresses the release of the Commonwealth Treasury's consultation paper on *A Definition of Charity* (October 2011). The University of Western Sydney (UWS) has a taxation law academic group within the School of Law. Members of this group wish to provide an informed contribution on this discussion paper.

If any of the responses require further explanation please contact Lecturer of Taxation and Financial Planning, Elen Seymour at the UWS School of Law at [e.seymour@uws.edu.au](mailto:e.seymour@uws.edu.au)

#### Staff Involved in Producing Submission:

The University of Western Sydney, School of Law, has a variety of staff from many different areas of the law. In respect of this submission, the substantive legal submissions have been prepared by Elen Seymour.

**SEYMOUR;** Elen is a Lecturer in Taxation Law and Financial Planning at the University of Western Sydney. Elen coordinates and teaches Revenue Law and Taxation Law to undergraduates. In addition Elen teaches Tax Planning and Capital Gains Tax to postgraduates. She is currently undertaking a PhD in taxation law on charitable purpose at the University of Sydney Law School.

## General Observations:

The consultation paper, *A Definition of Charity*, is seeking input from the community as to the issues surrounding the proposal to introduce a legislative definition of charitable purpose. In particular to leverage off work already done on the Charities Bill 2003. It is noted that such an adoption of a legislative definition is broadly consistent with Recommendation 7.1 of the Productivity Commission's Report that the Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendations of the Charities Definition Inquiry.

Broadly this submission supports the implementation of a definition and the proposed amendments, which take into account the changes in Australian common law interpretation since the Charities Bill was introduced. It is particularly worth noting the references to international experience and practice are to be commended.

This submission is concerned with the questions raised by Consultation Questions 1-12.

## Consultation Question – 1 Dominant Purpose

*Are there any issues with amending the 2003 definition to replace the 'dominant purpose' requirement with the requirement that a charity have an exclusively charitable purpose?*

It is noted that the driver for the introduction of a legislative definition of charitable purpose is stakeholder consensus as to the need. This expressed desire has been highlighted in numerous reports – such as those conducted by the Commonwealth for example in the 2010 Productivity Commission Research Report, *Contribution of the Not-for-profit Sector* including the submissions by the stakeholders. The origin of this consensus is the pursuit of clarity to reduce compliance costs for the charitable sector. It is also anticipated it will assist in increasing public confidence in the sector, another driver for the introduction.<sup>1</sup>

By adopting the common law test of exclusive charitable purpose and incorporating it into legislation it is suggested, cautiously, that the above outcomes could be achieved. The caution relates to the need to frame the legislative definition so as to prevent simply moving the focus of confusion from the common law to the intentions of parliament.

It is noted that the exclusive charitable purpose draws on the common law: 'a charitable institution cannot have an independent non-charitable purpose (regardless of how minor that independent non-charitable purpose may be)'.<sup>2</sup> As Allsop J stated in the Full Federal Court in *Word Investments* the question as to the true character or

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<sup>1</sup> NFP newsletter 1 edition

<sup>2</sup> *Stratton v. Simpson* (1970) 125 CLR 138.

nature of the entity is to be assessed having regard to its objects, purposes and activities'.<sup>3</sup>

It is proposed that the any charitable purpose test be framed explicitly as a two-stage test. The first part is to consider the purpose of the institution and evaluate whether the institution has the requisite exclusive charitable purpose. It is considered that the purpose test be expressly described as applying to the constituent documents of the entity<sup>4</sup>. Examination of constituent documents to determine purpose by way of the stated and implied objects contained in those documents will then be a requirement.

It should be made clear that the constituent documents should not be limited to formal documentation such as required under incorporation or trust deeds. An evaluation of purpose should be able to take into account any documents that go towards indicating the objects of the entity. Care should be taken that 'integrated holistic inquiry directed to whether an body of facts and circumstances satisfies [the] legal category or conception'<sup>5</sup> approach is facilitated for the relevant decision maker. This would be best achieved by not creating an exhaustive checklist of documents that are to be considered. The burden of proof should be on the institution claiming a charitable purpose to demonstrate that their constituent documents have the requisite purpose.

This second part of the test should be formulated and applied to determine whether the activities of the entity are consistent with the furtherance of the stated purpose. In application this will, of necessity, be a question of fact. Activities that are not themselves charitable will cause the enquiry to centre on whether the activities are carried on in furtherance of the institution's charitable purpose. That is non-charitable activities will not defeat exclusive charitable purpose so long as the activities are directed at furthering the charitable purpose<sup>6</sup> and have the requisite absence of private gain. As this approach has explicitly been adopted by the ATO in TR2011/4<sup>7</sup> it suggests that application of a two-stage approach to determining purpose will not be administratively burdensome.

Care should be taken to ensure that any changes do not undermine the current position where the activities test is an annual one. That is, 'it would not be enough that the purpose or main purpose of an institution were charitable if in fact it ceased to carry out that purpose'.<sup>8</sup> Provisions in the legislation exempting tax on annual income, have "a periodic operation"; the statute directs the inquiry to a particular time, namely, the year of income so that consideration must be given not only to the purpose for which the [institution] was established but also the purpose for which it is

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<sup>3</sup> Allsop J, *Federal Commissioner of Taxation v Word Investments Ltd* (2007) 164 FCR 194, 197

<sup>4</sup> *Federal Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55,

<sup>5</sup> Allsop J, *Federal Commissioner of Taxation v Word Investments Ltd* (2007) 164 FCR 194, 198.

<sup>6</sup> Per Gummow, Hayne, Heydon and Crennan JJ, *Federal Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55, para 40.

<sup>7</sup> *Taxation Ruling TR 2001/5 Income tax and fringe benefits tax: charities* see paras 30-38

<sup>8</sup> Per Gummow, Hayne, Heydon and Crennan JJ, *Federal Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55, para 34.

currently conducted.<sup>9</sup>

Please note that it is considered that the above will apply to Consultation Questions 10 and 11.

### **Consultation Question 2 Peak Body**

*Does the decision by the New South Wales Administrative Tribunal provide sufficient clarification on the circumstances when a peak body can be a charity or is further clarification required?*

The decision provides sufficient clarification on a peak body's potential charitable status when taken together with the definition of a charity, particularly considering the characteristics that exclude charity such as political activities.

### **Consultation Question 3 Meaning of "public"**

*3. Are any changes required to the Charities Bill 2003 to clarify the meaning of 'public' or 'sufficient section of the general community'?*

It is proposed that the Board of Taxation's recommendation that 'sufficient section' be defined as one, which is not 'numerically negligible', compared with the size of that part of the community to whom the purpose would be relevant. It is to be preferred that this expansion be part of the Explanatory Materials rather than specifically included in the legislation.

The activities test should be used to exclude activities from being for the public benefit it is set up to advance the interests of its members in their capacity as members, unless these benefits are incidental or ancillary to the purpose of benefiting the community.

### **Consultation Question 4 Meaning of "public"**

*4. Are changes to the Charities Bill 2003 necessary to ensure beneficiaries with family ties (such as native title holders) can receive benefits from charities?*

Giving the relevant regulatory body the discretion on application by the applicant to grant exemption from the public benefit test could accommodate the needs of beneficiaries with family ties. However in contrast to the New Zealand model, the entity would be automatically excluded from being charitable for income tax purposes, because blood ties connect its members. However, the entity can apply for exemption and if it is otherwise charitable and can otherwise still meet the public

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<sup>9</sup> Per Gummow, Hayne, Heydon and Crennan JJ, *Federal Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55, para 34.

benefit test, exemption status could be granted. Relevant factors to be considered such as the nature of the entity, the activities it undertakes, the potential beneficiary class, the relationship between the beneficiaries and the number of beneficiaries, would be considered.

#### **Consultation Question 5 & 6 Meaning of “public benefit”**

*5. Could the term ‘for the public benefit’ be further clarified, for example, by including additional principles outlined in ruling TR 2011/D2 or as contained in the Scottish, Ireland and Northern Ireland definitions or in the guidance material of the Charities Commission of England and Wales?*

*6. Would the approach taken by England and Wales of relying on the common law and providing guidance on the meaning of public benefit, be preferable on the grounds it provides greater flexibility?*

The two questions are considered together.

It is proposed that further clarification not be included in the legislation. The approach of leaving it to common law to provide guidance to provide greater flexibility is preferable. For as has been observed ‘while the essential characteristics of charitable purposes do not change, what will satisfy those purposes changes with society.’<sup>10</sup> Although this will not increase the level of certainty available for those in the sector it does allow what is charitable to be determined by contemporary values.<sup>11</sup>

A higher degree of certainty could be obtained by providing the sector with guidance by legislating for an equivalent to Taxation Rulings. This could operate to explain the position currently held on public benefit by the Commissioner and also to bind the Charity Commissioner to determining public benefit in accordance with the Ruling/s.

#### **Consultation Question 7, 8 & 9**

The three questions were not considered for this submission.

#### **Consultation Question 12 Political Activities**

*12 Are there any issues with the suggested changes to the Charities Bill 2003 as outlined above to allow charities to engage in political activities?*

It is considered that the Charities Bill 2003 should be altered to remove from disqualifying activities political activities of the type where the entity is attempting to change the law or government policy. However the definition should provide that a charity could only engage in paragraph (c) type political activities where it has the

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<sup>10</sup> Per Lord Simonds *National Anti-Vivisection Society v Inland Revenue Commissioners* [1948] AC 31, 69.

<sup>11</sup> Justice Downs *Aid/Watch Incorporated v Commissioner of Taxation* [2008] AATA 652 at para 17.

requisite charitable purpose within the existing heads of charity. Thus the activities test would centre the enquiry on whether those activities are in the furtherance of that charitable purpose. The *Aid/Watch* decision should be maintained but further supported by the ACNC making available material to assist charities in determining what are acceptable political activities. It is suggested that a Ruling type system be implemented and created on this issue to increase certainty without the requirement for legislative prescription.

### **Conclusion:**

The proposal to amend the Charities Bill to realign the proposed definition of charitable purpose with the public and sector demands is one that is broadly supported by this submission. Of particular concern is the need to balance certainty and transparency with simplicity and flexibility. It is considered that while amendments to the Charities Bill are required it is an overall better outcome that the amendments are implemented with the introduction of the ACNC. An acceptable compromise can be obtained by allowing the ACNC to create supporting and explanatory material. If the material is given legislative equivalency to binding Rulings that the ATO currently operates under then that in turn gives greater certainty without adding undue complexity to legislation.

Finally the government is to be commended for attempting to implement changes in this area of law that for too long has been left languishing in the “too hard” basket.

**Elen Seymour**

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**9 December 2011**