



THE TAX INSTITUTE

14 May 2012

Manager
Philanthropy and Exemptions Unit
The Treasury
Langton Crescent
PARKES ACT 2600
Attn: Ms Robyn Vincent

By email: nfpreform@treasury.gov.au

Dear Ms Vincent,

Consultation Paper: A Definition of Charity

The Tax Institute is pleased to have the opportunity to make a submission to the Treasury in relation to the consultation paper entitled "A Definition of Charity" (**Consultation Paper**). We thank you for agreeing to consider our submission on the Consultation Paper outside of the original consultation period.

We note that The Tax Institute makes the following submission on behalf of our members in the tax profession, as Australia's leading professional association in tax. In the interests of full disclosure, we note that while The Tax Institute is also registered as a charitable institution under Item 1.1 of section 50-5 of the *Income Tax Assessment Act 1997* (Cth), we do not make this submission in that capacity.

Summary

The statutory definition of "charity" must be properly formulated, given that it will determine whether a particular entity is a charity, and therefore eligible for certain tax concessions¹, and not just a "not-for-profit" (**NFP**) entity.

Our submission below addresses some specific issues that are raised in the Consultation paper which pertain to the definition of "charity". For ease of reference, we have referred to the specific consultation questions to which our discussion relates.

Our submission refers to two main issues, namely:

- a) Presumption of public benefit; and
- b) Type of entity.

¹ Income Tax Concession, GST charity concession and FBT rebate

In short, the presumption of public benefit should be retained on the basis that it will assist to alleviate the compliance burden for both the entity which has a charitable purpose to which the presumption applies and the regulator.

Similarly, the definition of charity should be clarified to confirm that entities whose sole purpose is charitable and otherwise meet the definition of “charity” should still be “charities” even though they receive government funding or are subject to government control. Also, a joint venture arrangement that charities typically enter should not be excluded from being regarded as an “entity” that is charitable.

Consultation Issues

1. Presumption of Public Benefit

Consultation questions:

Q7: What are the issues with requiring an existing charity or an entity seeking approval as a charity to demonstrate they are for the public benefit?

Q8: What role should the ACNC have in providing assistance to charities in demonstrating this test, and also in ensuring charities demonstrate their continued meeting of this test?

Q9: What are the issues for entities established for the advancement of religion or education if the presumption of benefit is overturned?

At common law, the presumption of “public benefit” applies to the first three heads of “charitable purposes”² being the relief of poverty, the advancement of education and the advancement of religion. That is, entities that fall within one of the first three categories are presumed to be providing a public benefit, unless there is evidence to suggest otherwise. Entities falling within the fourth category, that have other purposes beneficial to the community that do not fall squarely within the first three categories, need to positively demonstrate they are for the public benefit. Moreover, at common law, a purpose that is for the relief of poverty satisfies the public benefit test even if it benefits individuals who do not constitute a section of the public (for example, a donor’s poor relations).

The *Charities Bill 2003* (Cth) (**Bill**) would overturn the presumption of public benefit in relation to the first three heads of charitable purposes, and would require all entities seeking recognition as a charity to pass the “public benefit test” contained in draft section 7 of the Bill. Removing the presumption shifts the compliance burden of proving there is “public benefit” to the entity and away from the regulator, currently the ATO and anticipated from 1 October 2012 to be the new Australian Charities and Not-for-Profits Commission (**ACNC**).

The Tax Institute does not believe such a shift is beneficial to the industry as a whole, which in effect would overturn 400 years of common law in this area and thereby creating uncertainty for both newly formed charities that will fall under the first three heads of charitable purpose as defined in *Pemsel’s case* and those already in existence that may have relied on the presumption to maintain that they operate for the public benefit. Such a shift may result in unnecessary uncertainty.

² As identified in *Commissioners for Special Purposes of Income Tax v Pemsel* [1891 – 1894] All ER Rep 28 (**Pemsel’s case**)

Removal of the presumption may also give rise to increased work on the regulator's part to satisfy itself that every entity applying for recognition as a charity properly satisfies the "public benefit" test, rather than also being able to rely on the presumption that the entity is for the public benefit. Existing charities already carry the burden of being required to continue to review themselves and ensure they continue to operate for the public benefit and must notify the relevant authority where this is no longer the case.

Using the list of charitable purposes as currently expressed in draft section 10 of the Bill³, Treasury could consider expanding the charitable purposes to which the presumption would apply and only require rebuttal that there is no public benefit if the regulator has information suggesting this is the case. Accordingly, and consistent with the current common law position, only entities falling into the last "catch-all category" would be required to satisfy the "public benefit" test. This would ease the compliance burden on the regulator, existing charities and newly formed charities in proving they are for the public benefit.

Arguably, there would still be scope for the regulator to rebut the presumption, particularly in cases of concern noted by the 2010 Senate Inquiry in relation to certain religious (cult-like) groups, that may be required to demonstrate they are for the public benefit, rather than rely on the presumption. Whether it is appropriate that such discretion be incorporated into the definition of "charity" itself or the governing law of the regulator is a question for Treasury.

2. Type of entity

Consultation questions:

Q14: Is any further clarification required in the definition on the types of legal entity which can be used to operate a charity?

Q15: In the light of the Central Bayside decision, is the existing definition of 'government body' in the Charities Bill 2003 adequate?

a) Definition of "government body"

"Government body" is defined in draft section 3 of the Bill to include, among other things, a body controlled by the Commonwealth, a State or a Territory. This definition is sufficiently broad to exclude many entities that traditionally have been regarded as charitable, including art galleries, museums, hospitals and educational institutions. Many of these bodies are established under statute and are subject to the ultimate control of a minister, even though their day to day control is vested in a board of directors or trustees, and ministerial control is not in practice exercised.

Hospitals, art galleries, museums and the like are generally entitled to specific tax concessions, which they would not lose, even if they are not regarded as charitable. However, if they are non-charitable under the new definition, a great many gifts and

³ This list has been referred to in this submission for the purpose of the discussion in relation to retaining the presumption of public benefit. This should not be interpreted as being support from The Tax Institute for the purposes listed as being the only purposes that should be regarded as "charitable purposes".

trusts intended to benefit these institutions would be invalid or ineffective, for the following reasons:

- (a) Many donors, particularly those leaving testamentary gifts, establish perpetual trusts for the benefit of charitable objects, including hospitals, museums and art galleries. If the objects of these trusts are non-charitable, the trust fails: see *Income Tax Special Purposes Commrs v Pemsel* [1891] AC 531 at 581 per Lord Macnaghten.
- (b) Alternatively, because gifts for non-charitable purposes are invalid, a donor/testator may confer power on their trustees/executors to distribute solely among charitable objects. The trustees or executors would therefore have no power to distribute to those institutions whose charitable status is doubtful under the proposed definition.

In many cases, a broad interpretation of the “government control” limb of the definition of government body would have the unfortunate effect of invalidating gifts that were good charitable gifts at the time they were made and would deprive the affected institutions of important sources of funds.

The uncertainty that the proposed definition would create is illustrated by the approach that the Commissioner of Taxation has adopted towards institutions subject to government control, and the response by State Governments. According to the Commissioner in Taxation Ruling TR 2011/4, government departments and government controlled organisations are unlikely to be charitable institutions because they are simply performing a government responsibility. In response to the Commissioner’s interpretation, State Governments legislated to ensure that trustees would have power to continue to benefit organisations that, but for their connection to government, would be charitable (see for example, s 7K of the *Charities Act 1978* (Vic)). However, the Commissioner takes the view that this legislation is not binding on the Commonwealth. Trusts that distribute to these organisations are therefore regarded by the Commissioner as non-charitable (see TR 2011/4 at paragraphs [119]-[120]). This issue is touched on in paragraph 144 of the Consultation Paper, and merits close attention in the final formulation of the definition.

The Tax Institute recommends that the new definition should ensure that institutions traditionally regarded as charitable retain their charitable status. This could be achieved by:

- removing the exclusion for government bodies;
- alternatively, creating an exception to the exclusion to ensure that bodies treated as charitable under s 7K of the *Charities Act 1978* (Vic) and equivalent legislation in the other States and Territories continue to be charitable; or
- creating exceptions by reference to a list to ensure that institutions traditionally regarded as charitable retain their charitable status. The list should include, at a minimum, hospitals, art galleries, museums and universities. The Tax Institute also recommends that local government bodies be included.

In addition to the reasons given above, there are three further reasons for adopting one of these alternatives.

First, it would avoid the invalidation of gifts on the basis of minor deficiencies in wording. Under the proposed definition, a gift to the National Gallery of Victoria (**NGV**) to purchase paintings for public display would be valid (see *In re Cain (Deceased): The National Trustees Executors & Agency Co of Australasia Ltd v Jeffrey* [1950] VLR 382), while a gift outright to the NGV might be invalid; a gift to the Royal Melbourne Hospital to care for patients stricken with cancer would be valid, while a gift to the same hospital outright might be invalid.

Secondly, it would allow valid charitable gifts to be made equally to privately owned and operated hospitals and art galleries, and to public hospitals, museums and art galleries.

Thirdly, it is extremely doubtful whether the proposed exception for government bodies reflects the position at common law. A number of cases establish that gifts in support of the government or the people of a locality or a nation may be charitable. For example, in *Nightingale v Goulbourn* (1847) 5 Hare 484, a gift to “the Queen’s Chancellor of the Exchequer for the time being and to be by him appropriated to the benefit and advantage of my beloved country, Great Britain” was held to be a good charitable gift. Similarly, in *In re Smith; Public Trustee v. Smith* [1932] 1 Ch. 153, the Court of Appeal held that a bequest of the testator’s residuary estate “unto my country England to and for – own use and benefit absolutely” (the will was made on a printed form) was a valid gift for charitable purposes. Finally, gifts for the relief of taxes,⁴ to reduce the National Debt,⁵ and in reduction or aid of rates⁶ have all been held to be charitable.

Government funded, statutory corporations have also been held to be charitable. In *The Trustees of the British Museum v White* (1826) 2 Sim & St 594, Leach V-C held that a gift to the trustees of the British Museum to be employed for the benefit of that institution was a charitable gift, notwithstanding that the Trustees of the British Museum were established by statute as a corporation and partly funded from public money. It is therefore long established case law that publicly funded museums and art galleries are charitable, case law that has been applied in Australia, and relied upon by countless numbers of donors (see for example *Re Inman* [1965] VR 238 and *Re Cain (deceased); the National Trustees Executors & Agency Co of Australasia Ltd v Jeffery* [1950] VLR 382, in both of which the Supreme Court of Victoria held that gifts to the NGV are good charitable gifts).

In TR 2011/4, the Commissioner of Taxation relies on the decisions in *In re Cain (Deceased): The National Trustees Executors & Agency Co of Australasia Ltd v Jeffrey* [1950] VLR 382 and three Full Federal Court decisions that dealt with the definition of “public benevolent institutions” for the view that government departments and government controlled organisations are unlikely to be charitable institutions because they are simply performing a government responsibility.

The Tax Institute acknowledges that a gift to a government department would not ordinarily be charitable (see *In re Cain*), but whether the three public benevolent institution cases provide support for the exclusion of government controlled entities is extremely doubtful, in light of the decision in *Central Bayside Division of General Practice Ltd v Commissioner of State Revenue (Vic)* (1996) 228 CLR 168; 2006 ATC

⁴ *Attorney-General v Bushby* (1857) 24 Beav. 299.

⁵ *Thellusson v Woodford* (1799) 4 Ves. 227; affirmed (1805) 11 Ves. 112 (H.L.); *Income Tax Commissioners v Pemsel* [1891] AC 531, at 544.

⁶ *Doe d. Preece v Howells* (1831) 2 B. & Ad. 744; *Attorney-General v Blizard* (1855) 21 Beav. 233.

4610. In *Central Bayside*, Gleeson CJ, Heydon and Crennan JJ accepted the taxpayer's submission that it was a charitable body even though the government was the source of the funds it used to carry out its purpose. Its consent to conditions the government imposed on the employment of those funds did not establish that the appellant was not independently carrying out its purpose. In a joint judgment, their Honours said:

To carry out the object of the appellant may be said to assist the achievement of government policy, but it does not follow that the appellant's object has changed from improving patient care and health to achieving government policy. The appellant's object continues; all that has happened is that it has seen entry into a beneficial agreement with the government as a means of achieving that object.⁷

Having concluded in favour of the taxpayer, Gleeson CJ, Heydon and Crennan JJ dealt with the three Full Federal Court cases concerning public benevolent institutions: *Metropolitan Fire Brigades Board v FCT* (1990) 27 FCR 279; *Mines Rescue Board of New South Wales v FCT* (2000) 101 FCR 91, and *Ambulance Service of New South Wales v FCT* (2003) 130 FCR 477. Their Honours distinguished these decisions because:

The analogy between the institutions in those cases and the appellant breaks down, because in those cases the relevant institutions were created by statute, were subject to extensive ministerial control and were "virtually part of a Department of State" or "represented the Crown", or were "governmental" bodies. The appellant was not created by, and is not subject to, any statute generating those characteristics.⁸

The taxpayer also argued that a body with charitable objects is a charitable body even if it is subject to substantial or complete government control. Gleeson CJ, Heydon and Crennan JJ noted that one of the cases the appellant relied on, *Re Sutherland deceased; Queensland Trustees Ltd v Attorney-General* [1954] St R Qd 99 at 101, did support that proposition. In that case, the trustee company asked the Court to determine a series of questions, one of which was whether "hospitals which are wholly maintained at the public expense and are subject to the entire control of government officers" are charitable. The Full Court of the Supreme Court of Queensland answered the question "yes", but Gleeson CJ, Heydon and Crennan JJ noted that this authority was of very limited weight, because no party contended for a different answer. They therefore chose not to decide whether this submission was correct, or to determine the related issue of whether a body, to be charitable, must independently carry out its charitable purpose.⁹

Kirby and Callinan JJ delivered separate judgments in favour of the taxpayer. Callinan J expressed doubt about whether "everything that was said and held" in the three public benevolent institution cases was correct.¹⁰

Accordingly, whether a body, otherwise charitable, can be characterised as charitable even if it is subject to substantial or complete government control is an open question after *Central Bayside*. Moreover, bodies that do not owe their origins to statute, that are

⁷ (2006) 228 CLR 168, at [41].

⁸ *Central Bayside General Practice Association Ltd v Commissioner of State Revenue (Vic)* (1996) 228 CLR 168 per Gleeson CJ, Heydon and Crennan JJ at [47].

⁹ *Ibid* at [48].

¹⁰ *Ibid* at [180].

governed by trustees or directors independent of government on a day to day basis or that receive substantial funding from the private sector are likely to be considered charitable notwithstanding their connection to government.

Given the importance of charities providing services and other benefits to the community at large, often relieving the Government¹¹ of the burden of providing these services, it is vital that the new definition provides certainty both to potential donors and to government connected entities about whether they will be recognised as charities and afforded the tax concessions that are otherwise provided to charities. The current proposed definition fails to do this.

b) Definition of 'partnership'

The term "entity" is defined by reference to the definition contained in section 960-100 of the *Income Tax Assessment Act 1997* (Cth) which includes, among other things, a partnership. The core definition of "charity", "charitable institution" or any other kind of "charitable body", however, currently excludes a "partnership".

Often charities do work in arrangements with other partners that do not necessarily meet either the common law definition or the more expansive tax law definition of "partnership". Often the arrangement amounts to a joint venture type of arrangement.

We note the Board of Taxation recommended, in its review of the Bill, that the term "partnership" be clarified either by way of a note in the Bill or in the explanatory material that accompanies the Bill so it is clear that a joint venture arrangement would be included as a type of entity that could amount to a charity, charitable institution or other kind of charitable body. The Tax Institute would support clarification of the term partnership to exclude a joint venture as ordinarily contemplated by charities in undertaking their charitable work as this would clarify that this type of entity could still gain recognition as a charity and therefore access the relevant tax concessions otherwise available to charities.

If you would like to discuss this matter, please contact me or The Tax Institute's Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, reading 'Ken Schurgott'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Ken Schurgott
President

¹¹ Federal, State or local depending on the nature of the service provided