

CHAPTER 4: THE NEED FOR CLEARER AND MORE CONSISTENT DEFINITIONS

In recognition of the public benefits provided by charities, they are afforded a range of favourable legal and administrative treatments. The law treats trusts for charitable purposes more favourably than private trusts.¹ Charities receive support from all levels of government, including taxation relief. They are also entitled to collect donations from the public and donations to some charities are tax deductible to the donor.² The title of charity can also bring with it a degree of public credibility. Satisfying the requirements of the 'definition' of charity can therefore affect the way an entity operates and the level of public and government support it receives.

These implications of the definition of a charity have a wider reach than the effects on individual entities. Charities, and the larger not-for-profit sector of which they are a part, are a significant contributor to the economy and society and are increasingly involved in the provision of publicly funded goods and services. (The nature and significance of the charitable and related sector is examined in Chapter 6.) The efficiency and effectiveness of charities and related entities can therefore have an impact on the wider economy.

The Committee has identified a number of issues relating to the current approach to determining charitable status, and its application, that impede the sector from operating optimally.

A 'one-size-fits all' approach to charity

As noted in Chapter 2, the 'definition' of a charity derives from the law of trusts. The common law has developed principles to determine whether a trust has charitable purposes. While the number of philanthropic trusts is growing, it is still true to say that most modern Australian charities are not constituted as trusts; more usually they are constituted as companies limited by guarantee or as associations, many of which are unincorporated. Nevertheless, their

1 Meagher, RP and Gummow, WMC 1997, *Jacobs' Law of Trusts in Australia*, 6th edition, Butterworths, Sydney, pp 237-238.

2 Deductible gift recipient status is available to a range of entities, including public benevolent institutions (PBIs). All PBIs meet the requirements of charity but only some charities are PBIs.

charitable status is determined on the basis of tests developed to identify charitable trusts.

One of the principles underlying a charitable trust is that the trustee cannot apply it for a non-charitable purpose. Lord Browne-Wilkinson recently restated this principle when he said:

In order to demonstrate that trusts are, in law, charitable, it must be shown that those trusts are exclusively charitable. If it is shown that, consistently with the provisions of the trust deed, property can be applied for purposes other than charitable purposes the trust will fail.³

As a result, charitable trusts must have exclusively charitable purposes; any other purposes must be incidental or ancillary to the charitable purposes. This same principle is applied to entities that are not trusts. For example, in order to be eligible for taxation concessions as a charity, an incorporated or unincorporated body is also required to have exclusively (or in the words of the Australian Taxation Office 'essential or dominant'⁴) charitable purposes.

Commonwealth taxation provisions have sought to overcome the limitations of the 'one-size-fits-all' approach by introducing additional categories of favourably treated entities. As will be discussed below, this has led to considerable confusion in the sector and in the wider community about what is 'a charity'.

Some State revenue provisions narrow or widen the common law meaning of charity to achieve their policy outcomes. As a result, charities are faced with an array of different requirements between and within different jurisdictions, all claiming to base their provisions on the common law meaning of charity.

In their delivery of services through non-government agencies governments are generally not concerned with whether or not an entity is a 'charity'. However, the charitable status of an entity may have implications for the administration of government programs. For example, the Department of Family and Community Services submitted to the Inquiry that it has been required to reduce its grants to non-charitable child care centres to reflect savings from the abolition of the wholesale sales tax, while such adjustments are not required to be made to the grants to charitable entities operating child care centres.

³ *Attorney-General of the Cayman Islands and others v Wahr-Hansen* [2000] 3 All ER 642 at 646.

⁴ Australian Taxation Office (ATO) 1999, *Draft Taxation Ruling, Income tax and fringe benefits tax: charities*, TR 1999/D21, para 50.

Interaction with the taxation provisions

In the Commonwealth taxation provisions, charitable, religious and community service organisations appear in the exemption provisions of the *Income Tax Assessment Act 1997* (ITAA97). Public benevolent institutions (PBIs) are found in the gift provisions of the ITAA97 as well as in the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). The taxation concessions available to charitable and related entities are set out in Appendix B.

An income tax exemption is provided to a range of entities, of which charities is only one. Division 50 of the ITAA97 (the exemption provisions) is organised in tables, each with a heading describing the type of organisation contained in it. (The tables are reproduced in Appendix C.) Section 50-5 is 'Charity, education, science and religion'. The other headings are: community service; employees and employers; finance (friendly societies); government (municipal corporation, local governing body and public authority); health; mining; primary and secondary resources and tourism; and sports, culture, film and recreation.

Some entities fit into more than one of the categories listed in section 50-5. An entity may fall within the common law meaning of charity as well as satisfying the requirements to fit into 'education', 'science' or 'religion'. (The interaction between charity and the categories of education, science and religion is discussed in Chapter 30.) A charity could also fall into the meaning of community service organisation, 'health' or 'sports, culture, film and recreation'. (The relationship between charity and community service organisations is discussed in Chapter 31.)

The existence in the taxation provisions of a number of categories that entities may fit into can be a cause of confusion. The boundaries between these categories and charities in the legal sense have become blurred. Sometimes, entities themselves can be uncertain about whether they are entitled to income tax exemption because they are a charity or because they fall into one of the other categories.

In some other common law countries, such as England, all charities are eligible for the same taxation concessions. However, in Australia distinctions are made between charities. In particular, not all charities are eligible to receive tax deductible gifts; that is, not all are deductible gift recipients (DGRs). A range of entities is eligible for DGR status either through falling under a general category or through being listed by name in the ITAA97. The general categories and specific listings in the ITAA97 are organised into tables (reproduced in Appendix C). The tables show the following headings: health; education; research; welfare and rights (which includes PBIs); defence; the

environment; industry; trade and design; the family; international affairs; sports and recreation; philanthropic trusts; cultural organisations; and other specifically named organisations.

It is clear from submissions to the Inquiry that much of the confusion in the sector is related to what tax or other concessions attach to what type of entities and what the boundaries are between different types of entities. This is not surprising given the wide range of categories of entities that can access the concessions. For example, a common misunderstanding is that all charities are PBIs and vice versa. All PBIs will meet the common law definition of charity but not all charities are PBIs. Another common misconception is that an organisation must be a PBI to be a DGR whereas PBIs are only one category of DGR. There are charities that are not PBIs but access the DGR provisions through one of the other categories or through specific listing. For example, charities operating in the cultural and environmental spheres can access DGR status through being entered on the registers of cultural and environmental organisations. PBIs are also distinguished from other DGRs by being eligible for a capped exemption from fringe benefits tax.

Since 1 July 2000, charities and deductible gift recipients have had to seek endorsement in order to retain or obtain Commonwealth income tax concessions. Endorsement is not required of other types of entities that receive an income tax exemption. In anticipation of the endorsement process, the ATO published guidance on the meaning and scope of charities and related organisations. The publications *ClubPack*, *CharityPack* and *GiftPack* have gone some way to clarifying issues for entities in the sector.⁵ The 'packs' are necessarily general and cannot provide all the information necessary for all entities to determine their status unambiguously. The ATO has also released draft rulings on its interpretation of charity and PBI, but these may be too technical for those with little background knowledge.⁶

The submissions also point to confusion arising from different approaches taken by Commonwealth and State governments. As will be discussed in Chapter 8, while State taxation provisions rely on the common law meaning of charity, some provisions include or exclude particular types of entities. According to Aged and Community Services SA & NT:

There appear subtle differences in the use of terms by State and Federal Governments and others, when describing the sector to which the

⁵ ATO 2000, *CharityPack*, *GiftPack* and *ClubPack*.

⁶ TR 1999/D21 and ATO 2000, *Draft Taxation Ruling, Income tax and fringe benefits tax: public benevolent institutions*, TR2000/D14.

inquiry refers. It may be useful, independent of any change to eligibility, to ensure that the usage of terms is simplified and standardised.

Reliance on the common law

An issue that emerged strongly in the course of the Inquiry was the high degree of confusion among charities about how the current approach to determining charitable status applies to them. As discussed above, part of this confusion stems from the labyrinth of taxation provisions.

Confusion also stems from the reliance on the common law. Individual charities generally do not have, and cannot be expected to have, a working knowledge of 400 years of case law, or to be able to interpret how more recent court decisions involving other entities may affect their own status. As a result, applications for charitable status are sometimes made with little understanding of the principles that are to be applied, and therefore with unreliably formed expectations of whether charitable status is likely to be achieved. Even large, well-established charities that have a good working knowledge of the law relating to charitable purposes can be unsure about how particular activities they engage in are likely to affect their charitable status.

The 'flexibility' of charity law is regarded as one of its most positive features. It is undeniable that the law has allowed many purposes to be charitable that were not so considered, or which did not exist, at the time of the Statute of Elizabeth. However, the clarification of the definition of charity through the common law relies on litigation. Modern charities have demonstrated a disinclination to litigate to achieve charitable status because of perceptions of the high costs involved and the uncertainty of the outcome. Many cases that are brought to the courts stop with the decision of the primary judge. In recent times few have reached the intermediate appellate level. The High Court has not been asked to decide a case on charitable purposes since 1974 and has not heard a case on PBI since 1942.

A further drawback of the common law is that judges have no control over what cases come before them. They decide the issues in the disputes that are brought before them and then only at the level in the court hierarchy at which the parties decide to stop. The ability of the common law to respond to changes in the priorities and expectations of charities is limited as a result.

In February 1999, the Supreme Court of Canada delivered judgment in its first charity appeal in more than 25 years. In referring to possible legislative reform,

the majority agreed that ‘the law in this area is in need of reform but there are limits to the degree of change that the common law can accommodate’.⁷

Like all other modern social and economic entities, charities need to be able to respond to changes in their operating environment. That may mean responding to changes in the needs of the community, finding innovative ways to meet peoples’ needs, reacting at times to rapid and significant shifts in the extent to which their services are directly funded by governments, or finding innovative ways to fund their operations. While the community expects that charities will be able to respond quickly to such changes, their responsiveness can be hampered by having to wait for the law to ‘catch up’.

⁷ *Vancouver Society of Immigrant and Visible Minority Women v. Minister of National Revenue* [1999] 1 SCR 10 at 15;(1999) 99 DTC 5034 at 5051.