

CHAPTER 11: NOT-FOR-PROFIT ENTITIES

The 'not-for-profit' characteristic of a charity is not in dispute; however, there is some evidence that the meaning of the term requires clarification.

The Committee recommends the use of the term 'not-for-profit' instead of 'non-profit'.

We also recommend that the structure of a charity should not affect its status and therefore propose to use the term 'entity' to include all structures appropriate for carrying out charitable purposes.

Not-for-profit

Current approach

One of the tangible features of the requirement that charities be for the public benefit is the requirement that a charity be not-for-profit. This essentially means that any profits or surpluses a charity makes must be used to further its charitable purposes. Such profits or surpluses must not be distributed to owners, members or any other individual or group of individuals.

The courts have addressed the scope and meaning of the not-for-profit characteristic of charities and from these authorities we can draw the following principles:

- that the not-for-profit requirement applies both during the operation of a charity and upon its dissolution or winding-up (this is generally provided for in appropriate clauses of the constituent documents of a charity);¹
- that the absence of private profit is a necessary attribute of charity;² and
- that private profit refers to the distribution of the profit and/or capital of an entity to private individuals or non-charitable entities but does not include

1 Dal Pont, G. 2000, *Charity Law in Australia and New Zealand*, Oxford University Press, Melbourne, p 23 Dal Pont cites *Re Delius (deceased)* [1957] 1 Ch 299 at 308; and *Incorporated Council of Law Reporting (Queensland) v Federal Commissioner of Taxation* (1971) 125 CLR 659 at 670 and 672.

2 Dal Pont, pp 22-23. Dal Pont cites *Commissioner of Inland Revenue v Medical Council of New Zealand* [1997] 2 NZLR 297 at 318 per Thomas J.

the payment of wages or allowances to employees, reimbursement of expenses, or payments for services.³

In most State and some Commonwealth Acts affecting charities, the not-for-profit requirement is explicit.⁴ In other Acts the requirement is implied as is the case for charitable institutions and trusts in the *Income Tax Assessment Act 1997* (ITAA97).

The common law meaning of not-for-profit has been adopted administratively by the Australian Taxation Office (ATO):

An organisation is not charitable if it is carried on for the purposes of profit or gain to particular persons including its owners or members... We regard an organisation as being non-profit where, by its constituent documents or by operation of law (for example, a statute governing an organisation), it is prevented from distributing its profits or assets for the benefit of particular persons while it is operating and on winding up.⁵

Views on the current approach

Submissions strongly supported the retention of the not-for-profit requirement imposed on charities. For example, the Geelong Ethnic Communities Council argued that the not-for-profit principle should be one of the key defining characteristics of charity and the Pony Riding for the Disabled Association noted that charity is 'understood by everyone' to be not-for-profit.

Although there is clear agreement that charities must be not-for-profit, there is also support for the concept to be defined with more certainty as part of the definition of charities. According to the Vacluse Progress Association there is a need for a clear definition in relation to not-for-profit. The NSW Department of Public Works and Services noted that the Committee should, as part of defining charity, define and establish the not-for-profit nature of charities.

Submissions have noted some confusion in the community regarding the meaning of not-for-profit. The main cause of confusion regarding the

3 Dal Pont, p 22. Dal Pont cites *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Limited* [1963] NZLR 450 at 456.

4 For example, s3(1) of the *Payroll Tax Act 1987* (ACT) defines a 'charitable organisation' as 'an association, society, institution or body carried on for a religious, educational or charitable purpose, other than one carried on for the purpose of securing pecuniary benefit to its members'.

5 Australian Taxation Office 1997, *Taxation Ruling, Income Tax: exempt sporting clubs*, TR 97/22, states that, where the law or the constituent document does not prohibit distributions, it is a question of fact in each case as to whether an organisation can still be not-for-profit.

not-for-profit requirement is whether it is compatible with charitable status for a charity to carry on commercial activities or make investments in order to maximise the income available for it to carry on its charitable purpose.

The term non-profit itself is misunderstood by people who believe that companies so classified should generate no surpluses and accumulate no reserves and...any redefinition should seek to remedy this misunderstanding.

(Group Training Australia)

However, the common law itself seems very clear that the generation of profit does not affect not-for-profit status. According to Dal Pont:

...simply because an association, pursuant to a power conferred in its constituting documents, trades in the form of a commercial business, this does not *of itself* negative its otherwise charitable status provided that no object other than charity is or ever can become entitled to participate in the income yield or in any ultimate distribution of capital. (Author's emphasis.)⁶

Committee's conclusions

The Committee considers that the current definition of not-for-profit, as determined by the common law and as administered by the ATO, is appropriate.

As noted earlier, there is some confusion about whether the carrying on of commercial activities by a charity will affect a charity's not-for-profit status. While this is clearly not the case in the current law, the Committee sees a need to provide some clarity to the sector and the wider community. In particular, it needs to be stressed that not-for-profit does not mean that a profit or surplus cannot be generated. We consider that replacing the term 'non-profit' with the term 'not-for-profit' will go some way towards this. Not-for-profit more closely describes the entity's aim as not being the generation and distribution of profit.

6 Dal Pont, p 22.

Recommendation 1

That the term 'not-for-profit' be adopted in place of the term 'non-profit' for the purposes of defining a charity.

Entities

Current approach

The common law does not prescribe a structure for charities. The ITAA97 describes charities as institutions and trusts whereas some State Acts refer to charitable organisations, associations, societies or bodies. As noted by Dal Pont:

Although historically charities were structured almost exclusively by way of a trust...the trust is simply one of several vehicles through which charities are structured in modern times...charity does not have to take any particular legal form; it may be a trust or an undertaking; it may be incorporated or unincorporated...⁷

In earlier years most charities were established as trusts created by will or settlements. Some were created by statute and some by Royal Charter but these too were usually trusts. In more recent times, trusts have tended to be replaced by companies limited by guarantee or by associations, usually incorporated but not necessarily.

Views on the current approach

The issue of whether the structure of an organisation should be considered in determining its status was taken up in very few submissions. However, some submissions did suggest the adoption of terms other than those currently used. For example, the Ross House Association suggests the term 'body' and the St Vincent de Paul Society uses the term 'entity'.

Mission Australia argued that all charities should be required to be incorporated as companies limited by guarantee as a way of ensuring that the assets of a charity are used for the intended purpose. It recommended that:

...all charities be incorporated as companies limited by guarantee in order to provide high standards of accountability, ownership and purpose as well as transparency in their use of funds and distribution of

⁷ Dal Pont, p 345.

assets...uniform laws should be adopted in order to preserve the integrity of charities.

It was suggested by Mission Australia that the whole of the law relating to charities could then be enacted as part of the Corporations Law, thus avoiding the need to provide for it, or any aspect of it, in statutes dealing with the revenue.

Committee's conclusions

As noted, the common law imposes no specific restrictions on the structure that a charity may take. However, we consider that the use of one term to describe a charity would help achieve a definition of charity that is both clear and flexible. The term 'entity' is a concept that we believe is able to be adapted for use in the definition of charity. As an example, section 37 of the *A New Tax System (Australian Business Number) Act 1999* defines 'entity' as:

- an individual (a natural person);
- a body corporate;
- a corporation sole;
- a body politic;
- a partnership;
- any other unincorporated association or body of persons;
- a trust; or
- a superannuation fund.

This definition also appears in the dictionary at section 960-100 of the ITAA97. Definitions used in other provisions include different types of entities. For example, section 128A(1) of the *Income Tax Assessment Act 1936* includes 'the Commonwealth, a State or an authority of the Commonwealth or of a State'.⁸

For the purposes of charity, the Committee considers that some of the types of bodies in current definitions of entity would need to be excluded. They are individuals, political parties, partnerships, superannuation funds and the Commonwealth, a State or an authority of the Commonwealth or of a State.

An individual is not considered to be an appropriate entity for the purposes of defining a charity. Unacceptable problems of accountability could arise if an individual were to be allowed to adopt the status of charity. For example, it would be an impossible task to determine that an individual had a dominant charitable purpose. The exclusion of both political parties and government bodies from charitable status is discussed in Chapters 26 and 28 respectively. A superannuation fund is clearly an entity formed for the benefit of its members, not the public and would therefore be excluded from being a charitable entity.

We think the suggestion that charities should be required to be incorporated as companies limited by guarantee has some merit. However, we do not adopt it because we think it is impractical. There would be great difficulty in requiring charities, especially those established as trusts, to assume a new guise. In some cases it may be impossible.

Although there are different ways in which charitable entities may be established, it seems unlikely that those having the responsibility for their administration would not be held subject to equitable obligations to administer charitable entities, however created, as trusts or by analogy with trusts. Otherwise, statutes such as the *Charitable Trusts Act 1993* (NSW) would have no operation or effect in relation to charities not expressly created as trusts. Furthermore, there may be questions concerning the application of the Attorney-General's historical role and responsibility in relation to charities, for example, where a charitable entity is being administered dishonestly or incompetently or where a dominant charitable purpose fails and a scheme has to be evolved to reconstitute it. Strangely our researches have not found any reference to these questions in any of the relevant texts whether published here or in the United Kingdom.

The issues raised by the term 'institution' are addressed later in the Report in Chapters 29 and 30.

8 This provision is part of Division 11A — Dividends, Interest and Royalties paid to Non-Residents and to certain other Persons.

Recommendation 2

That the term 'entity' be adopted to describe charities, and that the definition of 'entity' include:

- *a body corporate;*
- *a corporation sole;*
- *any association or body of persons whether incorporated or not; and*
- *a trust;*

and exclude:

- *an individual;*
- *a political party;*
- *a partnership;*
- *a superannuation fund; and*
- *the Commonwealth, a State, a Territory or a body controlled by the Commonwealth or a State or Territory.*

