Revenue Law Journal

Volume 20 | Issue 1 Article 3

5-1-2011

Tax Exempt - It's Not About Tax But Charity

John Tretola

Follow this and additional works at: http://epublications.bond.edu.au/rlj

Recommended Citation

Tretola, John (2010) "Tax Exempt - It's Not About Tax But Charity," *Revenue Law Journal*: Vol. 20: Iss. 1, Article 3.
Available at: http://epublications.bond.edu.au/rlj/vol20/iss1/3

This Journal Article is brought to you by the Faculty of Law at ePublications@bond. It has been accepted for inclusion in Revenue Law Journal by an authorized administrator of ePublications@bond. For more information, please contact Bond University's Repository Coordinator.

Tax Exempt - It's Not About Tax But Charity

Abstract
There are over 700,000 non-profit organisations in Australia; and over 48,000 income tax exempt charities. This article analyses recent cases and considers how the courts are interpreting the status of charitable and not-for-profit bodies for income tax purposes.

Keywords
non-profits, not-for-profit, charitable bodies, taxation of non-profits, tax exempt charities

This journal article is available in Revenue Law Journal: http://epublications.bond.edu.au/rlj/vol20/iss1/3

TAX EXEMPT - IT'S NOT ABOUT TAX BUT CHARITY

JOHN TRETOLA*

There are over 700,000 non-profit organisations in Australia; and over 48,000 income tax exempt charities. This article analyses recent cases and considers how the courts are interpreting the status of charitable and not-for-profit bodies for income tax purposes.

INTRODUCTION

The recent decision of *Wentworth District Capital Ltd v Commissioner of Taxation*[1] (*Wentworth District* case) explored the issue of when an association established for community purposes is eligible for income tax exempt status. Perram J in the Federal Court held that a not-for-profit corporation established to facilitate the provision of face-to-face banking services in a rural town was exempt from income tax on the basis that it was established for 'community service purposes'. On 28th March 2011 the Full Federal Court unanimously upheld the decision of Perram J and in so doing also unanimously agreed with the reasoning of his Honour in coming to that decision.[2]

This article investigates what 'community service purposes' actually means and explores the way in which this term has been interpreted in Australia. It also looks at the recent treatment of the term 'charitable purposes' by the Australian courts.

With now over 700,000 non-profit organisations in Australia and just over 48,000 income tax exempt charities in Australia,[3] this article will also review other recent cases such as *FCT v Word Investments;*[4] *Victorian Women Lawyers Association Inc v FCT;*[5] *Central Bayside General Practice Association Ltd v Commissioner of State Revenue*[6] and

---

* Lecturer, Adelaide University, Business School.

1 [2010] FCA 862 (13 August 2010).

2 *Commissioner of Taxation v Wentworth District Capital Limited* [2011] FCAFC 42 (28 March 2011).

3 Professor Myles McGregor-Lowndes, (2008) 'Contemporary Issues in Australia's Non-profit Sector', paper presented in *Not for Profit Tax Issues* (Tax Institute of Australia) Brisbane, 17 November 2008, 9.

4 (2008) 226 CLR 204.

5 [2008] FCA 983.

6 (2006) 228 CLR 168.

FCT v Aid/Watch Inc[7] and consider what trend, if any, is emerging in these recent cases as to how the courts are interpreting the status of charitable and not-for-profit bodies for income tax purposes.

RELEVANT LAW[8]

Section 4-1 provides that income tax is payable by each individual or company based on their taxable income and under s 4-15 taxable income is defined as assessable income less allowable deductions. However, not all assessable income is liable to taxation, as s 6-20 provides that an amount of ordinary or statutory income is exempt income if it is made exempt from income tax by a provision of this Act or another Commonwealth law. Section 50-1 provides that the ordinary or statutory income of the entities covered by one of the tables in a series of tables following that section and shown in ss 50-5 to 50-45, is exempt from income tax.

Specifically, Division 50 provides that an entity will be exempt from income tax if it:

(i) Is a charitable institution (s 50-5);

(ii) Has the requisite connection with Australia or is otherwise a deductible gift recipient or other prescribed institution (s 50-50); and

(iii) Is endorsed by the Commissioner as exempt (s 50-52).

There are also exemptions available on other grounds, such as being a scientific, religious or public educational institution.

Of particular reference in the *Wentworth District* case was the table shown at item 2.1 in s 50-10 which provides that the income of a society, association or club established for community service purposes (except political or lobbying purposes) is exempt.

For any entity to be eligible for tax exempt status the entity must first either show that it is 'charitable' or second, if it is not 'charitable', show that it has been established for community service purposes.

WHAT IS MEANT BY THE TERM 'CHARITABLE'?

The term 'charitable' is not defined in the legislation and so reference must be made to the general or common law for its legal meaning. The religious implications of the

---

7 [2009] FCAFC 128 and [2010] HCA 42.

8 All references to legislation in this article are to the *Income Tax Assessment Act 1997* unless otherwise stated.

word 'charity'[9] came to mean more of a social obligation. Francis Bacon in 1625 made the admonishment, 'defer not charities till death; for, certainly, if a man weigh it rightly, he that doth so, is rather liberal of another man's, than of his own'. Courts have long held that the technical legal meaning of 'charitable' is based on the 'spirit and intendment' of the preamble to the *Statute of Charitable Uses 1601* (43 Eliz 1, c4) ('the Statute of Elizabeth').

The Statute of Elizabeth does not define 'charitable', but instead contains a list of purposes that are deemed to be charitable. For example: 'the relief of the aged, impotent and poor people; the maintenance of the sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities, the repair of bridges, ports and havens, causeways, churches, sea-banks and highways and, amongst other things, the help of orphans and the aid or ease of any poor inhabitants'. This was not intended to be an exhaustive list.

In *Pemsel's case*[10] Lord Macnaghten classified the categories of charitable purposes under four heads:

1. Trusts for the relief of poverty;
2. Trusts for the advancement of education;
3. Trusts for the advancement of religion; and
4. Trusts for other purposes beneficial to the community not falling under any of the preceding heads.

In July 2004 the *Extension of Charitable Purpose Act* 2004 (Cth) was passed and this Act retained the common law meaning of 'charitable', but ss 4 and 4A extended the term 'charities' to include not-for-profit entities providing childcare facilities to the public, entities providing self help and entities of contemplative religious orders.

CHARITABLE INSTITUTION

For an entity to be a charitable institution it must also be 'an institution'. A charitable institution can use a variety of structures including an incorporated association, a company limited by guarantee or established through a trust or will, but it cannot be an entity controlled or managed by family members and friends.[11]

---

9 See *Corinthians XIII*: 'though I bestow all my goods to the poor ... and have not charity, it profiteth me nothing'; and charity is also regarded as one of the 5 main pillars of Islam (zadaqah).

10 [1891] AC 531.

11 Taxation Ruling TR 2005/21 [24].

Furthermore, a 'charitable institution' requires more than the mere incorporation of trustees administering a trust, as the activities of the organisation must also be assessed. It must be an institution that exists for the public benefit or the relief of poverty and have purposes that are charitable in the legal sense. A 'charitable fund', on the other hand, has a more passive role and will generally comprise a pool of money or property set aside and managed by a trustee or trustees for the purpose of making distributions to other institutions who themselves undertake the charitable activity.[12]

The distinction between a 'charitable institution' and a 'charitable fund' is important. Although both can be exempt from income tax, the requisite connection of a charitable fund with Australia must be stronger as it must solely pursue its purposes in Australia. Further, certain tax related concessions, such as fringe benefit tax rebates, GST concessions and a refund of franking credits, are only available to 'charitable institutions' and not funds.

Division 50 of the Act requires that a 'charitable institution' must have a physical presence in Australia and to pursue its objectives principally in Australia or be eligible to be a deductible gift recipient or be a prescribed organisation or be located outside of Australia and be exempt in the other country of residence or have a physical presence in Australia but pursue its objectives outside of Australia.[13] The status of being income tax exempt is not a self assessing provision and application must be made to the Commissioner who then assesses the application and, if successful, endorses the institution or fund as income tax exempt.

In Australia, the concept of 'public benevolent institution' first emerged in the High Court case of *The Perpetual Trustee Co Ltd v Federal Commissioner of Taxation*[14] and this concept requires evidence that the organisation is involved in the direct relief of poverty, sickness, destitution or helplessness. The difference in income tax effect of a 'public benevolent institution' (PBI) as against other 'charitable institutions' is that a PBI is also eligible for the status of a deductible gift recipient.

COMMISSIONER'S VIEWS

The Commissioner has set out his views on what constitutes a 'charity' in *Taxation Ruling* TR 2005/21.[15]

> A charitable institution is an institution established and maintained for purposes that are charitable in the technical legal sense. For a fund to be established for

---

12 Ibid [25].

13 Section 50-55 of the Act.

14 (1931) 45 CLR 224.

15 Taxation Ruling TR 2005/22 is also relevant.

> 'public charitable purposes' its purposes must also be charitable in the technical legal sense.[16]
>
> For a purpose to fall within the technical legal meaning of 'charitable' it must be:
>
> - Beneficial to the community, or deemed to be for the public benefit by legislation applying for that purpose;
> - Within the spirit and intendment of the Statute of Elizabeth, or deemed to be charitable by legislation applying for that purpose.[17]
>
> The benefit of a charitable purpose need not be for the whole community; it is sufficient that it is for an appreciable section of the public.[18]
>
> An institution is deemed by legislation[19] to be for the public benefit to the extent that it is an open and non-discriminatory self-help group.[20]

The Ruling sets out purposes which are not charitable, and listed amongst these are: a purpose to provide private benefits; a purpose that is sporting, recreational or social; a purpose which is political or involves lobbying; and a purpose which is commercial or governmental. The views contained in the Ruling are of course only the Commissioner's views and do not have any force of law. The Commissioner has, however, actively sought to bring some certainty into this area of the law by way of litigation.[21] That explains why there have been quite a number of recent cases exploring the boundaries of the definition of 'charity' and 'charitable purpose' and also 'community service purposes'.

Central Bayside General Practice Association Ltd v Commissioner of State Revenue[22]

Central Bayside was a not-for-profit company limited by guarantee. It was one of a number of general practice associations which had received federal government funding in the delivery of regional health services. 93% of Central Bayside's income was from this grant funding.

Central Bayside had made an application for payroll tax exemption under the Victorian *Payroll Tax Act 1971* (Vic) on the basis that it was a charitable institution,

---

16 Taxation Ruling TR 2005/21 [7].

17 TR 2005/21 [8].

18 TR 2005/21 [9].

19 Section 5 of the *Extension of Charitable Purpose Act 2004.*

20 TR 2005/21 [11].

21 In the 2008/09 Compliance Program the Commissioner expressly stated his desire to test the boundaries of the definition of 'charity' through a number of test litigation cases.

22 (2006) 228 CLR 168.

but that application was refused by the Commissioner of State Revenue on the basis that the true nature of the entity was that of government.

On appeal, the High Court unanimously found that Central Bayside was a charitable institution as its purposes were to improve patient care and so alleviate sickness and suffering. Although it did have a substantial reliance on government funding, its governance was independent of any government and it could choose to not apply and receive funding and instead obtain other income sources. In reaching its decision, the High Court reaffirmed the application of the technical meaning to the word 'charity' unless a contrary intention is evident.[23]

Kirby J, whilst agreeing with the conclusion reached by other members of the High Court, took a very different course with his reasoning. In particular, he criticised the continuing use of the categories established by the Statute of Elizabeth and the reasoning and analogy from the preamble to that statute on the basis that categories and social circumstances as they existed in England in 1601 are unlikely to be of relevance to circumstances in Australia in the 21st century and beyond.[24]

VICTORIAN WOMEN LAWYERS' ASSOCIATION INC

This was a single judge (French J) decision of the Federal Court handed down in June 2008[25] which considered the status of the Victorian Women Lawyers Association (VWLA), who had sought endorsement as a 'charitable institution' on the basis that the Association was established for community service purposes. The objects of the VWLA were to promote the interests of women in the legal profession and the advancement of women generally.[26] The VWLA had sought a private ruling to show that they were an income tax exempt entity for various income years. The ATO had refused to grant a favourable private ruling but instead agreed to take this case to court under its test case program.

The ATO took the view that the VWLA was not sufficiently involved in charitable purposes for it to be endorsed as a 'charitable institution' principally because the activities of the VWLA were designed to benefit individual members rather than provide any public benefit. The ATO also considered that one of the stated objects of the VWLA was to work towards the reform of the law and the ATO took the view that this gave the activities of the VWLA a political purpose and political purposes

---

23 Ibid 178-179 (Gleeson CJ, Heydon and Crennan JJ), 205-8 (Kirby J), 216-17 (Callinan J).

24 Ibid 200-5 (Kirby J).

25 *Victorian Women Lawyers Association Inc v Commissioner of Taxation* [2008] FCA 983.

26 Ibid [10].

cannot be charitable purposes.[27] The court, however, decided the issue by assessing holistically the objectives and activities of the VWLA. The primary focus of the objectives must have regard to the constitution of the VWLA but these are to be interpreted in light of the history of the formation of the VWLA and the activities undertaken since its formation.

The nature of the characterisation inquiry, whereby the question as to the true nature or character of the entity is to be assessed by reference to its objects, has been discussed and approved in other cases such as in *Royal Australasian College of Surgeons v Federal Commissioner of Taxation*[28] and by Allsop J in *Word Investments*.[29] On the basis of this assessment the court determined that the principal purpose of the VWLA was 'to overcome a well-known social deficit'[30] namely the substantial underrepresentation of women in the legal profession, and on that basis the VWLA was providing a benefit to the public and so therefore was a 'charitable institution'.

In respect to the Commissioner's contention that VWLA in working towards law reform indicated a purpose of political reform, the Court disagreed as there was no evidence that VWLA favoured any political party and in any event 'working towards the reform of the law' was not contrary to any public policy or to any existing laws and was not political in nature. Furthermore, despite any social and networking activities providing a benefit to individual members they were still in aid of the principal purpose which was to provide a public benefit for the elimination of discrimination and consequent disadvantage on the ground of gender in the legal profession in Victoria and society generally.

French J held that VWLA was a community service organisation as one that provides 'some practical help, benefit or advantage'[31] and a charitable institution as it provided services that were beneficial to the community. His Honour also observed that the term 'community service purposes' was intended to pick up a broader range of entities than those covered by the concept of 'charitable institution'.[32] Some may doubt this outcome. Apart from this comment in this case, no other cases have taken up this broader interpretation of the term 'community service purposes'.

---

27 Lord Parker in *Bowman v Secular Society Ltd* [1917] AC 406, 442: 'a trust for the attainment of political purposes has always been invalid because the court has no means of judging whether or not a proposed change in the law will or will not be for the public benefit'.

28 (1943) 68 CLR 436.

29 164 FCR 194.

30 *Victorian Women Lawyers Association Inc v Commissioner of Taxation* [2008] FCA 983 [148].

31 Ibid [163].

32 Ibid.

THE *WORD INVESTMENTS* CASE[33]

Word Investments ('Word') was a company established as the fundraising arm of the organisation, Wycliffe Bible Translators Australia ('Wycliffe'). Word was involved in a number of business dealings and investments with the aim that any profit generated (after expenses had been deducted) would be directed exclusively to Wycliffe.

Word at no time engaged in charitable activities itself. Its purpose was simply to raise funds for Wycliffe, but its activities have changed over time beginning first with raising funds from housing development and then to generating interest on monies deposited, and then through conducting a commercial funeral business. The primary object of the *Memorandum of Association of Word* was the advancement of religion. The other objects in this memorandum included provisions to achieve the primary object by enabling Word to carry out any business or activity which may be capable of being carried on in connection with its objects.[34]

Word had applied for endorsement as an income tax exempt charitable institution pursuant to s 50-5 of the Act. This was refused and Word objected. The Commissioner disallowed the objection, Word appealed to the Administrative Appeals Tribunal (AAT). The AAT held that Word was not a charitable institution as, amongst other things, Word operated a funeral business.

After appeals and cross-appeals to the Federal and Full Federal Courts, Word was successful in its appeal to the Full Federal Court, which ruled that Word was a charitable institution. The Commissioner then appealed to the High Court, arguing that Word was not a charitable institution, as its main purpose was not religious and that it was mainly engaged in investment and trading activities.

The High Court 4:1 (Kirby J dissenting) affirmed the decision of the Full Federal Court and held that Word was a charitable institution. The High Court had to decide whether or not the purposes of Word went beyond the scope of 'charitable purposes' and so whether or not Word was a 'charity' in its own right, whether or not Word could influence the application of funds donated to the charities, and whether or not Word did have a physical presence in Australia. The High Court determined that that, even though Word's objects were not intrinsically charitable, they were charitable in character because they were carried out in furtherance of a charitable purpose.[35] It was of critical importance that Word's revenues (less administrative expenses) were applied to charities, that its sole purpose for being was to do so, and

---

33 *Federal Commissioner of Taxation v Word Investments Limited* (2008) 236 CLR 204.

34 Ibid 218.

35 Ibid 221.

that the business side of its activities was merely designed to effectuate this purpose.[36]

The High Court also determined that Word was a charitable institution, even though it was not directly engaged in any charitable activities beyond directing its profits to a charitable institution, with the majority holding that the term 'institution' should be interpreted widely. Word was also not authorised (in its Memorandum of Association) to make any distributions for non-charitable purposes and so did not have any control over the manner in which its funds were spent. Word was also found to have a physical presence in Australia, as it advanced its money exclusively to Wycliffe in Australia even though the ultimate beneficiaries were not in Australia, as the Act did not distinguish between the indirect and direct effects of where the money was expended.

The High Court concluded that Word was a charitable institution, as it was established and maintained for the advancement of religion and that it did have a physical presence in Australia. Kirby J (dissenting) took the view that Word was not a charitable institution, as it engaged in commercial purposes and that these were an unrelated activity separate and independent from any activities that were charitable in nature.[37]

AID /WATCH - FULL FEDERAL COURT DECISION[38]

Aid/Watch had sought income tax exemption on the basis that it was a charitable institution established for the relief of poverty. The stated purposes of Aid/Watch are to promote environmentally sound and efficient aid programs. Its activities include research, monitoring and campaigning on the impact of Australian and multinational aid programs. Aid/Watch is not involved in providing any aid itself. Instead, Aid/Watch aims to influence government policy on aid.

The AAT had earlier held on appeal that Aid/Watch was primarily established for the relief of poverty and that the means to achieve this included the research aimed at influencing government policy.[39] The Full Federal Court on appeal reversed this decision. It held that, while the general objects of Aid/Watch - which were to promote the efficient and effective use of aid which in turn assisted the relief of poverty - were charitable, the specific goal of Aid/Watch to influence government policy was political in nature.

---

36 Ibid.

37 Ibid 270.

38 *Commissioner of Taxation v Aid/ Watch Incorporated* [2009] FCAFC 128.

39 [2008] ATC 10-037.

The Full Federal Court acknowledged that the threshold test for 'political purpose' was not easy to articulate. But it quoted with approval the comments made by Santow J in *Public Trustee v Attorney General (NSW)*[40] that, 'pressure for political change can range from direct lobbying of the government for legislative change, to attempts to educate and persuade the public and change public opinion on a particular issue'.

The Federal Court said:

> Aid/Watch's attempt to persuade the government (however indirectly) to its point of view necessarily involves criticism of, and an attempt to bring about change in, governmental activity and, in some cases, government policy. There can be little doubt that this is a political activity and that behind this activity is a political purpose.[41]

As a result, the Court held that the 'natural and probable consequence' of Aid/Watch activities was in effect to influence public and government opinion and that this was a political purpose. Such a purpose was inconsistent with the organisation being run for charitable purposes. Aid/Watch appealed to the High Court.

AID /WATCH - HIGH COURT DECISION[42]

On 1 December 2010 the High Court upheld 5 : 2 the appeal by Aid/Watch, holding that it was a charitable institution - and so eligible for tax exempt status. The majority (French CJ; Gummow, Hayne, Crennan and Bell JJ) made it clear that an institution may be charitable where it has a real or imputed intention of contributing to the public welfare[43] even where it may be involved in changing the law, but not if this were by illegal means.[44]

In looking at the activities of Aid/Watch the majority concluded that its activities did contribute to the public welfare and that this was a purpose beneficial to the community.[45] The majority stated[46] that, 'the generation by lawful means of public debate ... concerning the efficiency of foreign aid directed to the relief of poverty, itself is a purpose beneficial to the community within the fourth head in *Pemsel*.'[47]

---

40 (1997) 42 NSWLR 600, 617.
41 [2009] FCAFC 128 [37].
42 *Aid/ Watch Incorporated v Commissioner of Taxation* [2010] HCA 42.
43 Ibid [43].
44 Ibid [38].
45 Ibid [46]-[47].
46 Ibid [47].
47 [1891] AC 531.

THE *WENTWORTH DISTRICT CAPITAL* CASE - FEDERAL COURT DECISION[48]

After the Westpac bank closed the last remaining bank branch in Wentworth in September 1996, the Wentworth community formed a company limited by guarantee, Wentworth District Capital Ltd ('WDCL'). It then entered into an arrangement with Bendigo Bank Ltd ('Bendigo Bank'), under which the Bank provided banking services in Wentworth through premises, staff and equipment provided by WDCL.

Whilst there remained the local post office outlet and a limited banking facility available at the local pharmacy, these were not full service and involved some delays to customers. Importantly, local customers were very unlikely to transact substantial loan business through these limited facilities. The community bank opened in March 1999 and the banking business set up by WDCL quickly became successful. By September 1999, WDCL broke even for the first time.

The annual report for the year ended 30 June 2009 showed an annual turnover of $100 million and a profit before income tax of about $200,000. The success of WDCL led to the issue of what to do with the surplus of funds generated. After repaying the original monies pledged as deposits, with interest, a grants scheme was introduced in 2002 under which community groups could apply for and receive grants from WDCL.

Since 2002, WDCL has paid out over $1 million in grants to various community groups such as local football clubs, schools, bowling clubs and the Rotary Club. There was no requirement on recipients to bank with the branch. The facts showed that, despite the drought, the Wentworth branch improved the economic circumstances of the town.[49] In addition, the plight of the older residents of the town also improved as they much preferred the facilitation of face-to-face banking.[50]

In its corporate constitution at clause 1.2, WDCL had two principal objects. These objects were to take over the funds and other assets and liabilities of the steering committee and to conclude a Management Agreement with Bendigo Bank Limited and/or its subsidiaries to enable the company to manage a franchised office of Bendigo Bank Limited. The legal structure under which the branch operated in Wentworth involved Bendigo Bank granting an exclusive licence to Bendigo Franchising Pty Ltd to conduct the Wentworth franchising operation, under which Bendigo Franchising Pty Ltd granted franchises to third parties to conduct retail shopfronts for the Bendigo Bank.

---

48 [2010] FCA 862.

49 Ibid [16].

50 Ibid [17].

Perram J admitted that the expression 'established for community service purposes' was inherently vague and that 'the expression "community service" has such a wide and sweeping range of meanings that it is difficult to be sure what is connoted at all'.[51] As this expression 'community service' was ambiguous, his Honour then referred to the rule of statutory interpretation contained in s 15AB of the *Acts Interpretation Act 1901* (Cth). It allows reference to extrinsic materials in cases where the meanings of words in legislation is not clear. As a result his Honour referred to the *Explanatory Memorandum* to the *Taxation Laws Amendment Act (No 2) 1990,* which introduced s 23(g)(v) into the *Income Tax Assessment Act 1936*[52] and provided for an exemption from income taxation for community services organisations.

The *Explanatory Memorandum* gave examples of the types of institutions intended to be covered by the exemption in s 23(g)(v) as organisations that would not be eligible for income tax exemption under other existing provisions of the *Income Tax Assessment* Act 1936, such as section 23(e). While they are not 'charitable institutions', they nevertheless undertake a range of activities for the benefit or welfare of the community such as the various service clubs - Apex; Rotary; Lions; Zonta and Quota and the like.[53]

The *Explanatory Memorandum* stated:

> That the words 'for community service purposes' are not defined but are to be given a wide interpretation. The words are not limited to those purposes beneficial to the community which are also charitable but also extend to a range of altruistic purposes.[54]
>
> The words would also extend to promoting, providing or carrying on activities, facilities or projects for the benefit or welfare of the community, or of any members of the community, who have particular need of those activities, facilities or projects by reason of their youth, age, infirmity or disablement, poverty or social or economic circumstances.[55]

To determine the purpose for which an entity is established, regard should be had to the entity's present conduct and activities. Purposes directed to the benefit or welfare of members of the community who are in particular need must arise by reason of the youth, age, infirmity or disablement, poverty or social or economic circumstances of those members of the community.[56] His Honour noted that these causes of need must

---

51 Ibid [31].

52 A provision rewritten with exactly the same wording as s 50-10 of the *Income Tax Assessment Act 1997.*

53 [2010] FCA 862 [38].

54 Ibid [39].

55 Ibid.

56 Ibid.

be interpreted broadly. For example, social or economic circumstances can include such varied matters as gender, living in a remote location or language difficulties.[57]

Perram J was in no doubt that the Treasurer,[58] in his *Explanatory Memorandum,* clearly intended community service organisations such as Rotary Clubs to be eligible for the exemption under the former provision s 23(g)(v),[59] which is now replaced by s 50-10.[60] His Honour was also in no doubt that the term 'community service purposes' was intended to have a wide meaning and that the concept of services was intended to be extended to 'activities, facilities or projects' which were promoted or provided by the organisation and which could deal with a need arising from the social or economic circumstances of living in a remote area.[61]

The concept of 'community service' is to be interpreted in the sense of providing some identifiable practicable help, benefit or advantage. This was the approach adopted by French J in *Victorian Women Lawyers' Association Inc v Federal Commissioner of Taxation*[62] and Jessup J in *Navy Health Ltd v Federal Commissioner of Taxation.*[63] His Honour then went on to consider what community service *purposes* might actually be. He noted that it would cover a wide range of aims and could include, for example, purposes such as funding, promoting or organising community services and as long as the proposed purpose has some *reasonable connexion* to the delivery of the community service it should be within the class of contemplated services.

His Honour distinguished the comments made by Jessup J in *Navy Health,* as he did not think Jessup J intended to mean that the community service benefit had to be necessarily provided directly by the community service organisation.[64] If that were so then the exemption would be removed from 'all entities whose purposes were other than the direct supply of community services'[65] and this would mean that entities that pursued only fund raising activities would be denied the exemption. It is also necessary to determine whether or not the entity was 'established' for community service purposes and this requires a consideration of the actual activities provided by the entity in the year in question and also a review of the entity's constitution.

Finally, the entity must have the dominant or main purpose of providing a community service and that this will be a practical issue to determine. This does

---

57 Ibid.
58 Mr Paul Keating MP.
59 *Income Tax Assessment Act* 1936 (Cth).
60 *Income Tax Assessment Act* 1997 (Cth).
61 [2010] FCA 862 [40].
62 [2008] FCA 983 [162]-[163].
63 [2007] FCA 931 [33].
64 [2010] FCA 862 [49].
65 Ibid [48].

allow the existence of other purposes but as long as these are all incidental or ancillary and reasonably connected to the main purpose of providing a community service then the exemption can still apply.

In applying these principles, it was clear that WDCL was established for the main purpose of remedying the defect in the lack of face-to-face banking services in the town of Wentworth. WDCL sought to address this problem by entering into a franchise arrangement with Bendigo Bank. Although WDCL was bound, under the franchise agreement, to further the interests of the franchisor, this was not the principal purpose of the establishment of WDCL. It was never a purpose of WDCL to provide banking services and it never did so. Bendigo Bank, through one of its subsidiaries, was the only entity which ever provided these banking services.[66]

WDCLs' purpose was merely to facilitate the provision of banking services in the town by making it commercially viable for a bank to return to Wentworth.[67] This was consistent with the original purpose for its establishment and the formal objects in its constitution which included the promotion of community banking services. Even though WDCL may have had other purposes, such as the distribution of surplus funds back to the community, through the community grants programme, these purposes were ancillary and still reasonably connected to the main purpose of providing a community service to address the lack of banking facilities in a remote location.

The management of a franchise branch of the Bendigo Bank was argued by the Commissioner as being one of the main purposes of WDCL. But Perram J took the view that the management of the branch was a means rather than an end in itself, the main end or purpose being to address the defect of a lack of banking facilities in the remote country town. This was achieved by the means of the franchise agreement.[68]

His Honour concluded that there was a real and tangible benefit to the Wentworth District community by the activities of WDCL and held that WDCL was entitled to the income tax exemption provided for in s 50-10.[69]

THE *WENTWORTH DISTRICT CAPITAL* CASE - FULL FEDERAL COURT DECISION[70]

The Full Bench (Emmett, Gilmour and Gordon JJ) of the Federal Court handed down on 28 March 2011 its unanimous decision supporting the reasoning of Perram J. The Full Bench agreed that WDCL was established for the purposes of providing a

---

66 Ibid [57].
67 Ibid [58].
68 Ibid [61].
69 *Income Tax Assessment Act 1997*.
70 *Commissioner of Taxation v Wentworth District Capital Limited* [2011] FCAFC 42.

community service as its main or dominant purpose in being set up was to facilitate the provision of face-to-face banking services in the town of Wentworth.[71]

In rejecting the Commissioner's appeal, the Full Bench of the Federal Court rejected the Commissioner's argument that WDCL had the main or dominant purpose of conducting and managing a franchise branch of the Bendigo Bank as the only entity that conducted the business of banking was Bendigo Bank or its wholly owned subsidiary.[72]

The Full Bench held that from the outset WDCL was established to facilitate face-to-face banking by making it commercially viable for Bendigo Bank to operate in Wentworth. This purpose was a community service purpose as without the facilitation of a banking service provided by Bendigo Bank the streets of Wentworth were emptied of cars and people and the town had no life or atmosphere,[73] and so their Honours were in no doubt that the facilitation of face-to-face banking services provided a substantial benefit to the community of Wentworth that was both real and tangible.[74]

LIMITATIONS ON ACTIVITIES

The Commissioner has taken a view in his Ruling[75] that a charitable institution could conduct commercial activities, but only incidental or ancillary to its charitable activities.

Kenny J in *Federal Commissioner of Taxation v Triton Foundation*[76] regarded it as settled law that whether or not an entity is a charitable institution depends upon the central or essential object of the entity determined by reference to its constitution and activities and that an entity will not lose its charitable status just because some of its objects or activities are non-charitable. The *Wentworth District Capital* case[77] also supports this view in that, although some of the purposes of WDCL, such as the management of a banking franchise and the distribution of surplus funds back to the community, through the community grants programme, were non-charitable (although it was not argued that WDCL was a charitable institution), these purposes were incidental and still reasonably connected to the main purpose of providing a community service, which was to address the lack of banking facilities in a remote location.

---

71 Ibid [42]-[43].
72 Ibid [35]-[37].
73 Ibid [16].
74 Ibid [43].
75 TR 2005/21 [128]-[129].
76 (2005) 147 FCR 362.
77 [2010] FCA 862.

The *Word Investments* decision, whilst appearing to expand the concept of activities that may be seen as charitable, does not mean charitable entities can perform whatever activities they wish. There are still limits as to what activities a charitable entity can be involved in so as to ensure their proceeds are not assessable. However, if an entity has a non-charitable purpose or object which is more than incidental or ancillary to its main charitable object, then case law has been consistent in ruling such entities as non-charitable. *Cronulla Sutherland Leagues Club*[78] is a case where the commercial operations became a purpose in themselves rather than a means to a charitable end. This resulted in that entity not being granted charitable tax exempt status.

This was the same outcome reached in the recent case of *Navy Health Ltd v Federal Commissioner of Taxation*[79] where the provision of benefits to other than serving armed forces personnel or their dependants was a non-charitable object. As this was carried out in a commercial way, Navy Health was not established for community service purposes.

HENRY REVIEW RECOMMENDATIONS

The *Henry Review* of 2010 provided some recommendations into the future of tax concessions for not-for-profit organisations. Because of the contributions that the not-for-profit sector makes to community wellbeing, it is appropriate that the sector continue to receive some level of government support. Most of this government support comes from the various tax concessions such as the income tax exemption and deductible gift recipient status.

The *Henry Review* identified that the current system of concessions is complex and does not fully reflect community values about the merit and social worth of the activities it subsidises. Whilst most of the concessions do not appear to violate the principles of competitive neutrality where not-for-profits entities operate in commercial markets, this is not so in the case of the fringe benefit tax concessions. The *Henry Review* therefore recommended that the fringe benefit tax concessions be reconfigured to alleviate this competitive neutrality concern. It was also recommended that the mutuality principle be better targeted in the case of not-for-profit clubs which operate large trading activities. However, it does not appear that the government is going to implement these proposals.

Earlier, on 12 May 2009, the Assistant Treasurer did announce that the government would amend the 'in Australia' requirements in Division 50 to ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to

---

78 *Cronulla Sutherland Leagues Club v FCT* (1990) 23 FCR 82.
79 [2007] FCA 931.

overseas charities or other overseas entities. This measure was directed specifically to the outcome in the *Word Investments* decision to prevent charities and other tax exempt entities directing funds to overseas projects outside of the current restrictions.

WHERE TO NOW?

Of recent High Court judges, Kirby J has been the most active in reviewing what definition of charity and charitable purposes should be adopted by Australian courts.

In *Word Investments* his Honour remarked:[80]

> The law on charitable institutions is difficult, very artificial, noted for its illogicalities and full of anomalies. In it many fine distinctions have been made. Knowledgeable judges have admitted that: all those who practice in this branch of the law know how infinite is the variety of decided cases, how extreme sometimes the refinements, and how apparent on occasions the contradictions which those cases demonstrate.

In *Central Bayside* Kirby J stated:[81]

> There is no reference in *Pemsel* or in the preamble to many considerations that might be apt to embody the meaning of a charitable body in contemporary Australian society. For example, there is no mention of the defence of fundamental human rights and human dignity; the maintenance of the benefits of science and technology; the protection of refugees and other vulnerable persons; the need for specific assistance for indigenous peoples; the protection of the welfare of animals; the advancement of culture, arts and heritage; the defence of the environment and so forth. To impose rigid categories derived from an English statute of the early seventeenth century (re-endorsed in 1891...) seems arguably incompatible with this Court's duty to adopt a purposive interpretation of legislation enacted by an Australian legislature.

His Honour further noted that a 2000 federal inquiry concluded that although the preamble to the statute of Elizabeth had been 'valuable', it had 'now outlived its usefulness'.[82] This 2001 report also noted that the removal of the *Pemsel* test was recommended by English reports in 1952 and 1976.[83]

---

80 236 CLR 204, 240.

81 228 CLR 168, 200.

82 Committee for the Inquiry into the Definition of Charities and Related Organisations, *Report of the Inquiry into the Definition of Charities and Related Organisations* (2001).

83 Committee on the Law and Practice Relating to Charitable Trusts, *Nathan Report* (London, December 1952); National Council of Social Service, *Charity Law and Voluntary Organisations – the Goodman Report* (London, 1976).

His Honour further noted that in Canada the defects of the *Pemsel* test were noted by a majority of the Canadian Supreme Court.[84] A paper, cited in the Canadian Supreme Court,[85] made it clear that the 'time had come ... to redefine radically the legal parameters of what is charitable by simply breaking with Lord Macnaghten's four heads and articulating a restatement of the law as it is practice today rather than tortuously trying to fit everything into the categories set out in Pemsel'.[86]

His Honour then referred to the current New Zealand position as reflected in the recent adoption of the *Charities Act* 2005 (NZ) and noted that although the enactment does preserve the traditional four heads of charity,[87] it also adds a new category, specific to New Zealand circumstances, that of special Maori charities.[88]

Finally, Kirby J referred to the current position in India and noted that India had also recognised the *Pemsel* doctrine but also added to it with recognition of local cultural concepts.[89] Notwithstanding this strong reservation, Kirby J ultimately applied the categories of *Pemsel* to the *City Bayside* case as he did consider that the *Pemsel* approach does afford sufficient flexibility to keep pace with modern community interests.

The High Court back in 1998 expressed sentiments in harmony with the more recent statements of Kirby J where, in its unanimous decision in *Bathurst City Council v PWC Properties Pty Ltd,*[90] it noted that the understanding of judges in the community in which they live of what a particular activity involves may be accepted as a proper understanding of the nature of that activity, and that the spirit and intendment of the Preamble to the statute of Elizabeth should be given no narrow or archaic construction.[91]

A UNITED STATES PERSPECTIVE

The United States' tax law allows an exemption from income tax for a variety of non-profit philanthropic or mutually beneficial organisations.[92] However, the United States' tax law includes a notable distinction to the laws of other common law

---

84 See *Vancouver Society of Immigrant and Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10, 106.
85 Ibid 51.
86 Blake Bromley, 'Contemporary Philanthropy - is the Legal Concept of "Charity" Any Longer Adequate?' in DWM Waters (ed), *Equity, Fiduciaries and Trusts* (1993) 59, 98.
87 Section 5(1) *Charities Act* 2005 (NZ).
88 Section 5(3) *Charities Act* 2005 (NZ).
89 *CIT v FICC* (1981) AIR SC 1408 at 1414-5 per Venkataramiah J.
90 (1998) 195 CLR 566.
91 Ibid 582.
92 See IRC § 501 (2006).

countries in this respect, in that it also contains a rule that subjects to income tax, the income of these organisations that is not related to their exempt purpose.[93]

This is referred to as the unrelated business taxable income rule and means that income that is derived from an activity that constitutes a trade or business that is regularly carried on and is not substantially related to organisation's tax exempt status will be subject to income tax. The rate of tax that applies is the corporate tax rate but the first $1,000 of unrelated business income is exempt.

If this approach was to be adopted in Australia then it would result in the profits derived by the funeral business in *Word Investments* being subject to income tax. However, anecdotal evidence from the United States suggests that the compliance costs associated with implementing such a measure would far outweigh the benefits to the revenue and that in any event, the tax concessions granted to charities do not distort economic behaviour. Further research and empirical study in this area is suggested.

CONCLUSION

The terms 'charitable purpose' and 'community service purposes' are imprecise terms. The recent surge in cases coming before the courts on the meanings of these terms, due largely to the taxpayer funded test case program, has gone a long way to clarifying the meaning of these terms.

The tests and analysis applied by Perram J in *Wentworth District Capital* and the broad interpretation adopted goes a long way in the direction of clarifying what community service purposes actually means. His Honour made it clear that the concept of 'community service' is to be interpreted broadly and in the sense of providing some identifiable practicable help, benefit or advantage. His Honour also made it clear that an entity must have the dominant or main purpose of providing a community service and that is a question of fact. This does allow the existence of other purposes but as long as these are all incidental or ancillary and reasonably connected to the main purpose of providing a community service then the exemption can still apply.

The *Word* decision, whilst prima facie appearing to expand the concept of activities that may be seen as charitable, does not mean entities established for charitable purposes can perform whatever activities they wish. There are still limits as to what activities a charitable entity can be involved in so as to ensure their proceeds are not assessable.

However, as long as the commercial activities are only incidental or ancillary to the main charitable purpose then the activities of the entity are likely to remain exempt

[93] IRC § 511(a) (2006); Reg 1.511.1-1.511.3.

from income tax. If Australia were to adopt an approach like that in the United States to tax unrelated business income then a different outcome would have been reached in cases like the *Word Investments case.* There is some justification in taking this approach, as it would remove the competitive advantages such tax exempt organisations will invariably receive under the existing approach, but the anecdotal evidence suggests that the compliance costs associated with implementing such a change would far outweigh any benefits to the revenue.

Should the existing reliance on the *Pemsel* tests to determine charitable purpose continue? Kirby J provided valuable discussion on this issue in the *Central Bayside* case and valid arguments can be made both in removing this reliance on legislation passed back in 1601 in England as arguably the *Pemsel* categories are out of touch with modern Australia, and in keeping the existing tests as arguably they do provide much scope for flexibility and can be adapted to meet the changing circumstances of modern society. His Honour resolved the issue in the *Central Bayside case* by retaining the existing tests as he accepted and applied the view of Lord Wilberforce made back in 1968 that 'the law of charity is a moving subject which has evolved to accommodate new social needs as old ones become obsolete or satisfied.'[94]

The outcomes in the recent cases in this area, such as *Word Investments, Victorian Women Lawyers*, *Aid/Watch* and *Wentworth District Capital,* provide compelling evidence that there is still considerable scope for flexibility in adapting the *Pemsel* categories to modern Australia and the courts, in recent times, have been very successful in doing so.

[94] *Scottish Burial Reform and Cremation Society v Glasgow Corporation* [1968] AC 138, 154.