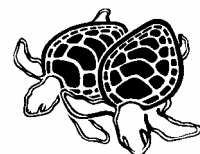


National Roundtable of Nonprofit Organisations

Submission to the Australian Taxation Office (ATO) on Draft Taxation Rulings TR 2005/D6 and TR 2005/D7

22 July 2005



Environment Centre NT



This submission is made by the National Roundtable of Nonprofit Organisations and is endorsed by the following organisations:



The **Australian Conservation Foundation (ACF)** is committed to inspiring people to achieve a healthy environment for all Australians. For 40 years we have been a strong voice for the environment, promoting solutions through research, consultation, education and partnerships. We work with the community, business and government to protect, restore and sustain our environment. www.acfonline.org.au



The **Australian Council for International Development (ACFID)** is an independent national association of Australian Non Government Organisations (NGOs) working in the field of international aid and development. www.acfid.asn.au



Clean Up Australia is a not for profit community based environmental organisation founded by Ian Kiernan AO. Clean Up Australia is dedicated to developing sustainable solutions and addressing the critical issues that face us in the areas of waste, inefficient water use, degrading waterways and climate change

Clean Up Australia is most recognised for its annual Clean Up Australia Day campaign, but over the past 15 years the Clean Up Australia concept has grown to include a global outreach program, Clean Up the World, the Clean Water, Towards Zero Waste and Climate Change campaigns. Clean Up Australia is committed to implementing positive action to address critical environmental issues both locally and globally by co-ordinating practical action, educating the community, advocating community concerns and by facilitating partnerships with governments, industries and community groups.



Climate Action Network Australia (CANA) is an alliance of 30 groups concerned about global warming. They come from the health, community development and environmental movements, as well as the research community. CANA, in turn, belongs to the global Climate Action Network (CAN) which has representative groups in more than 70 nations from every continent of the globe.

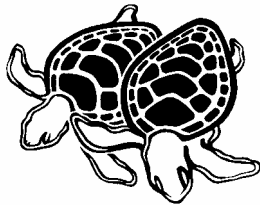
Established in 1998, CANA has been working to increase the understanding of climate change, and to encourage governments, businesses and individuals to undertake actions to reduce greenhouse gas emissions, and their climate change impacts. www.cana.net.au



The **Community Housing Federation of Australia (CHFA)** is the national peak organisation representing the views of community housing providers in Australia. Our purpose is to ensure community housing develops as a viable housing option providing quality housing services to tenants. We achieve our purpose through research, public policy development and promotion of housing issues to governments and other key stakeholders. CHFA maintains links with and between housing providers across Australia, providing a voice for their interests at the national level. www.chfa.com.au



The **Conservation Council of SA (CCSA)** is the peak environment group in South Australia providing leadership, support and advocacy, and innovation to the environment movement and broader South Australian communities for an enduring healthy environment in SA. Formed in 1971, CCSA is a non-profit and strictly non-political organisation governed by 55 of the state's conservation groups. www.ccsa.asn.au



Environment Centre NT

The **Environment Centre NT (ECNT)** was established in 1983. It is the Northern Territory's peak non-government environment group. ECNT's goals are to increase understanding and valuing of our unique environment; improve its protection; and ensure the NT economy is as ecologically sustainable as possible. ECNT works at a local, national and international level to raise awareness about the NT environment and threats to it. ECNT aims to work closely with Indigenous communities and Traditional Owners on environmental issues. www.ecnt.org



Environment Victoria is the state's peak environment group. We champion action on river health, climate change and waste matters, and represent over 100 local conservation groups across Victoria. EV also carries out a large number of environmental education and behaviour change programs. www.envict.org.au



Friends of the Earth (FoE) Australia is a national environmental NGO working on issues of environmental justice and ecological sustainability. It is the national member of FoE International, which is currently active in 73 countries. www.foe.org.au



Fundraising Institute Australia Ltd (FIA), established in 1968, is the national peak body for Australian fundraisers engaging directly with over three thousand fundraisers representing a total of two thousand organisations in the not-for-profit sector across a wide spectrum of societal needs in community service, health and medical research, education and related services, religion, arts and cultural development, overseas aid, indigenous affairs and sport and recreation. Our representation has grown broader than the traditional 'charities' and reflects the contemporary face of charity and fundraising in Australia. www.fia.org.au



Greenpeace exists because this fragile earth deserves a voice. It needs solutions. It needs change. It needs action. Greenpeace is an independent organisation campaigning to ensure a just, peaceful, sustainable environment for future generations. Our mission and core values are based on independence, non-violence and bearing witness.

Behind the scenes, we campaign on many levels. We use non-violent, direct actions to expose global environmental problems and force solutions. Our victories are a testament to the effectiveness of Greenpeace's methods.

Greenpeace Australia was founded in 1977 and joined forces with Greenpeace Pacific in 1998. Together we have more than 113,000 supporters who are the backbone of Greenpeace Australia Pacific. www.greenpeace.org.au



The **Mineral Policy Institute (MPI)** is an Australian based, not-for-profit non-government organisation working to protect and enhance the natural environment through research, capacity building, and advocacy to prevent environmentally and socially destructive mining, minerals and energy practices and projects.

MPI works closely with communities and their organisations to promote and protect the rights of those faced with the environmental, cultural and economic impacts of mining, minerals and energy projects. We work to ensure that the mining, minerals and energy industries comply with the principles of ecologically sustainable development, social justice and human rights. We also promote equitable and efficient mineral and energy use and reduced resource consumption. www.mpi.org.au



The **National Association for the Visual Arts (NAVA)** is the peak body representing and advancing the professional interests of the Australian visual arts and craft sector. Since its establishment in 1983, NAVA has been a powerful force in bringing about policy and legislative change to encourage the growth and development of the visual arts and craft sector and to increase professionalism within the industry. It also provides direct service to members through offering expert advice, representation, resources and a range of other services. www.visualarts.net.au



As the State's peak environment organisation, the **Nature Conservation Council of NSW (NCC)** works closely with member groups, local communities, government and business to protect, sustain and conserve the NSW environment. NCC serves as the umbrella organisation for more than 120 environmental member groups to co-ordinate and develop NSW-based community education projects, scientific research, conferences, conservation publications and awareness campaigns. NCC also advises key decision-makers at a local, state and national level. www.nccnsw.org.au



Total Environment Centre was established in 1972. It was formed to assist community groups to protect the environment; undertake research and community education; and advocate broad policy improvements to prevent environmental degradation and restoration - across city and bush. It is a non-profit association incorporated under the NSW Association Act and registered under the NSW Charitable Fundraising Act. www.tec.org.au



Volunteering Australia is the national peak body working to advance volunteering in the Australian community. Its role is to represent the diverse views and needs of the volunteer movement while promoting the activity of volunteering as one of enduring social, cultural and economic value. www.volunteeringaustralia.org



World Vision Australia is a non-governmental organisation (NGO) and is part of a World Vision Partnership of Christian NGOs working in over 96 countries on development, relief and advocacy projects. www.worldvision.org.au

Submission to the Australian Taxation Office on Draft Taxation Rulings TR 2005/D6 and TR 2005/D7

22 July 2005

**This submission is made by the National Roundtable of Nonprofit Organisations and
is endorsed by the 17 organisations listed on the preceding three pages.**

Introduction

We support the intention of Draft Taxation Ruling TR 2005/D6 (“the draft”) to provide additional clarity on the ATO’s approach to the meaning of “charitable institution” and “fund established for public charitable purposes”. As a long line of distinguished jurists has observed, the common law development of the concept of “charity” has left something to be desired, and any effort to fill in some of the gaps, reconcile some of the apparent contradictions and better support the charitable sector is to be welcomed.

In many areas, the draft represents a fair summary of the state of the law on charities and provides some improved guidance to charities. While recognising that the draft is limited to providing guidance within existing legislation and case law, we hope that this is nevertheless a step along a path to rationalisation and improvement of tax legislation applicable to charities generally, along the lines recommended by the Charities Inquiry.

We particularly commend the draft’s explicit recognition of the legitimacy of a broad range of engagement with governments by charities in furtherance of charitable purposes. These activities, including promoting or opposing changes to the law, presenting views on issues during elections, participating in government processes, and analysing policies of political parties, are increasingly recognised as a vital part of charities’ work in addressing not just the symptoms of distress, injustice and environmental degradation in our society but also their underlying causes and ultimate solutions.

This submission sets out our views on sixteen key areas of concern, with corresponding recommendations for improvement of the draft. One major concern is the shift away from the requirement that a charity must have a “dominant charitable purpose”, as stated in TR1999/D21, in favour of the view that a charity’s purpose must be exclusively charitable. The difficulties with this new approach are discussed in section 1.

Another substantial issue is the draft’s approach to determining the purpose of an organisation, which entails an assessment of the organisation’s activities in all cases. In our view, the cases illustrate that recourse to activities will be necessary only in relatively narrow circumstances. Section 2 addresses this and related points.

Section 3 considers a range of drafting and conceptual issues relating to particular purposes discussed in the draft. Section 4 deals with the denial of FBT benefits to charitable funds. Section 5 deals with the scope of applicability of the draft. Section 6 considers the proposed rules for assessing the status of entities controlled by exempt entities.

Summary of recommendations

1. The draft should provide that a charity must have a “dominant” charitable purpose, rather than exclusively charitable purposes, and should clarify that incidental non-charitable purposes are permissible if they support a dominant charitable purpose.
2. The draft should clarify that reference to the stated purposes and objects of an organisation will usually be sufficient to determine that the organisation is for charitable purposes. Recourse to an examination of activities and operations will be necessary only to the extent necessary to resolve any ambiguity in the stated purposes and objects, or if there are substantial grounds for believing that the stated charitable purposes are misleading or have been abandoned.
3. The last two sentences of paragraph 124 should be deleted.
4. The draft should clarify that instances of activities inconsistent with charitable purposes do not necessarily mean an organisation is not charitable. In many cases, inconsistent activities may justify remedial action to ensure that the charity pursues only its stated purposes, rather than denial or revocation of charitable status.
5. The draft should clarify that breaches of applicable laws by a charity or its employees or officers, though incurring the normal penalties for such breaches, justify denial or revocation of charitable status only if the breaches are so widespread and serious that they demonstrate abandonment of charitable purposes.
6. In light of the ambiguity of the phrase “contrary to public policy”, the first sentence of paragraph 99 should be deleted.
7. At the end of paragraph 99, the following passage should be inserted: “However, otherwise charitable purposes will not be invalidated because they conflict with fundamentally unjust laws. For example, the furtherance of girls’ education in a particular country would be a charitable purpose, even if education of girls in that country is illegal (as it was under the repressive Taliban regime in Afghanistan). Reference to international human rights standards is appropriate in considering whether any particular purpose is not charitable because it is illegal. Furthermore, non-violent protest activities in furtherance of charitable purposes that result in non-serious breaches of laws will not typically result in revocation or denial of charitable status.”
8. The phrase “or cause” should be deleted from paragraph 100. The phrase “or its line” should be deleted from paragraph 103.
9. The draft should recognise that purposes to promote changes to law or policy may be charitable, if a reasonably clear public benefit exists. Examples include cases where the clear trend of the law is in a particular direction or where an international treaty has been signed but not yet implemented through domestic legislation. Furthermore, purposes to promote law reform generally may be charitable.
10. Paragraph 109 should be rewritten as follows: “A purpose of affecting or seeking changes to particular government policies or decisions of governmental authorities can be charitable, if related to an otherwise charitable purpose. Charities may have

a purpose of ensuring that governmental decisions are made in accordance with applicable laws and international standards or of improving decision-making by the provision of relevant information.”

11. The phrase “incidental or ancillary” should be replaced throughout the draft by a more precise formulation, such as “reasonably expected to further”.
12. The heading “environment” in paragraph 207 should read, in full: “preservation of native wild life both flora and fauna, prevention of the destruction of species, the improvement and protection of a river, addressing the imbalance within the environment.”
13. The following heading should be added in paragraph 207: “peace and human rights: work for the elimination of war, promotion of human rights”.
14. In the absence of any clear legislative intent to deny FBT benefits to charitable “funds”, as that term is used in the ITAA 1997, the ATO should retain its current approach of making FBT benefits available to both charitable funds and charitable institutions.
15. The draft should apply to the interpretation of charitable institution and fund in the GST legislation as well as income tax and fringe benefits tax legislation.
16. Commercial entities that are bound to direct their surpluses exclusively to exempt entities should themselves be deemed to be exempt entities.

1. Distinction between “purposes” and “objects”

In general, courts considering charitable purposes have used the terms “purposes”, “objects”, “ends” and similar terms interchangeably. A distinction is drawn between these “purposes”, on the one hand, and “activities” of an organisation on the other. The distinction is a well-recognised one between an end and the means used to achieve that end.

Courts have also consistently observed that the “dominant” or “main” purpose of a charity must be charitable, and that other purposes must be in support of, or “ancillary to” the charitable purpose. Thus, with respect to “political” purposes, Dal Pont accurately summarised the state of the law as follows:

If a purpose can be characterised as political, it will only have a vitiating effect if it is the or a *main* purpose of the gift or institution – a political purpose ancillary or subsidiary to a charitable object has no such vitiating effect.¹

This approach was followed in TR 1999/D21, which stated for example that a charitable institution’s “sole or dominant purpose must be charitable” and that “an institution’s purposes which, when viewed in isolation, would not be charitable, must be incidental or ancillary to the charitable purpose.”

¹ G E Dal Pont, *Charity Law in Australia and New Zealand*, Oxford University Press, Melbourne, page 207 (emphasis in original).

The current draft changes this approach by providing that a charity's purposes must be "exclusively charitable", not just predominantly charitable.

The ATO has indicated that no change in approach is intended by the shift in wording, and that the change is merely a clarification to make the draft more user friendly. However, without disputing this intention, substituting the phrase "exclusively charitable purpose" for "dominant charitable purpose" does entail a substantive change in meaning.

In effect, the draft establishes a new, three-tiered distinction between "purpose", "objects" and "activities". That is, the plain words of the draft mean that a charity must have "exclusively" charitable purposes, but may have "objects" as well as "activities" that are, viewed in isolation, non-charitable, provided that they are ancillary or incidental to the charitable purpose.

Under this framework, the difference between an "object" (which in some circumstances may be non-charitable), and a "purpose" (which may not) is of crucial importance, yet the draft offers no clear principled distinction between these terms. The draft defines "object" as "the reasons for which [the charity] is to exist and operate", as stated in its constituent documents. The term "purpose" is nowhere clearly defined, but is in standard usage synonymous with both "reason" and "object". Paragraphs 147-149 refer to the purpose for which an organisation "exists and operates", which is the same formulation used in defining the "objects" of an organisation.

One possible view of the difference is that the "objects" represent the stated reasons for an organisation's existence, while the "purposes" represent the "real" reasons for its existence. These will be identical in most cases, but could diverge where the stated reasons are a sham or do not completely reflect the nature of the activities widely undertaken by the organisation.

However, if this is the distinction between "objects" and "purposes", why are "incidental non-charitable objects" acceptable (as set out in paragraph 157), provided they further a charitable purpose, but "purposes" themselves must be exclusively charitable? In other words, if it is acceptable for a charity to write down in its constitution a set of reasons for its existence that include "incidental non-charitable" reasons, why is it impermissible for the charity to abide by those reasons for existence in reality?

Aside from the practical difficulties, the draft doesn't give weight to the consistent judicial use of terms such as "dominant purpose" and "main purpose" on the basis that such terminology "is not ... used to imply that a charity can have secondary non-charitable purposes." This view is not supported by the cases, which accept non-charitable purposes that further or support a charitable purpose.²

² See in particular *Congregational Union of New South Wales v Thistlethwayte* (1952) 87 CLR 375 at 442, and discussion in G E Dal Pont, "Determining the 'Purpose'", unpublished paper presented at Queensland University Technology seminar on TR2005/D6 & D7, 11 July 2005.

In defence of the changes, the ATO has suggested that some charities were confused by the wording in TR1999/D21 and, in particular, read that draft to mean that *any* non-charitable subsidiary purposes were acceptable, not just those that were ancillary or incidental to a charitable purpose.

This concern appears to underlie the example given in paragraph 149 of an association set up for two wholly separate purposes – caring for injured animals and stamp collecting, with the animals being the main focus. Under the accepted approach of Australian courts, this institution would not be a charity, not because its “purposes” were not exclusively charitable, but because the non-charitable purpose of stamp collecting had nothing to do with its dominant charitable purpose.

Any confusion in TR1999/D21 on this issue could easily be fixed with a much less drastic tweaking of the ruling. For example, the first two sentences of paragraph 103 in TR1999/D21 could be rewritten as follows:

For an institution to be a charitable institution, its sole or dominant purpose(s) must be charitable, and any other purposes must be in furtherance of its sole or dominant purpose(s).

In our view, the framework set out in the draft would result in greater confusion and disputation, particularly around whether particular stated or unstated goals of an organisation rise to the level of a separate “purpose” or are just “objects” or “activities”. This is particular so in light of the fact that the stated purposes and objects of all existing charities have already been drafted with the conventional judicial requirement of a “dominant charitable purpose” in mind.

On this issue, the formulation in TR1999/D21 was preferable and more accurately reflected the state of the law. It also drew a more simple and sensible distinction between means (activities) and ends (purposes, objects, goals, etc.). With minor re-phrasing to correct any genuine confusion, the wording of TR1999/D21 should be retained.

Recommendation: The draft should provide that a charity must have a “dominant” charitable purpose, rather than exclusively charitable purposes, and should clarify that incidental non-charitable purposes are permissible if they support a dominant charitable purpose.

2. Approach to assessing the “purpose” of an institution

2.1 Circumstances in which “activities” are relevant to ascertaining “purpose”

The draft’s approach to ascertaining the “purpose” of an organisation is not consistent with judicial precedent and could lead to a disproportionate expenditure of scarce ATO and charitable resources for little benefit.

The draft contemplates that ascertaining the “purpose” of an institution or fund entails an examination of both the constituent documents of the organisation and its activities. While

accepting that the constituent documents are “the starting point” and “have the most weight”, the draft envisions that some examination of an organisation’s activities will always be required.

Investigation of the activities of charities will be wholly appropriate and called for in some instances. However, conducting a full-fledged examination of activities in every case is not consistent with judicial instructions on the proper approach to assessing purpose. In *Re Inman*, faced with having to determine whether a trust in favour of the Royal Victorian Institute for the Blind was valid, the Court took the following view:

For the immediate purpose it is sufficient to inquire whether the Royal Victorian Institute for the Blind is a charitable institution *when judged by its objects*.³

The Court took the same approach of looking no further than the stated objects in assessing the other organisations in that case. A similar method was adopted by the Court in *Public Trustee v Attorney-General*:

I consider the correct approach is to look at the 1967 constitution which provides a coherent statement of the Federal Council for the Advancement of Aborigines and Torres Strait Islanders’ objects, and to use extrinsic evidence of activities only if there be ambiguity and only to the extent necessary to resolve it.⁴

In that case, the Court expressly declined to consider extrinsic evidence of the organisation’s activities in making its findings, because there was no ambiguity in the stated objects of the organisation.

And again, in *Attorney General (NSW) v The NSW Henry George Foundation Ltd*:

Another aspect of the problem which needs to be considered when working out what is a dominant purpose is to know whether one merely looks at the foundation document of the trust or what the trust is doing in practice. The usual approach is to say that so long as the stated purposes are clearly defined, one looks no further; see Sheppard Report at pp 101-103. *There is no need to delve further into this matter in the present case as an examination of the foundation document is sufficient*.⁵

The Australian approach is thus to limit the inquiry to the stated objects of an organisation, unless there is some ambiguity in those objects or evidence to suggest that the activities “demonstrate an effective abandonment of indubitably charitable objects.”⁶

The Courts’ reluctance to look beyond the organisational documents except in a narrow set of circumstances is sensible, in light of the administrative burden that a close examination of

³ *Re Inman (deceased)* [1965] VR 238 at 241 (emphasis added).

⁴ *Public Trustee v Attorney-General of New South Wales and ors* (1997) 42 NSWLR 600 at 610.

⁵ *Attorney-General (NSW) v The NSW Henry George Foundation Ltd* [2002] NSWSC 1128.

⁶ *Public Trustee*, *supra* note 4, at 621. There is no suggestion in that case, however, that a positive inquiry into whether the activities demonstrate abandonment of charitable purpose is necessary in every case, and in fact the Court limited itself solely to consideration of the charity’s stated purposes.

activities would place on charities themselves and public authorities administering relevant laws. While examining the stated objects of an organisation is a straightforward exercise, reviewing the activities of a charity is a much more complex and time-consuming task, with attendant administrative burdens.

Without wanting to belabour the point, these burdens cannot be underestimated. Modern charities are complex organisations, often with diverse and changing activities in response to changing demands and circumstances. Even apparently simple requests for “a list of activities” over a certain period of time or “an estimate of the number of hours” spent on such activities can result in scores of hours of staff time compiling a response. Given the potentially serious consequences of any investigation, external legal advice is likely to be sought as well. Charities are not required to keep detailed, systematic, centralised records of activities or hours, and it would frequently not be an efficient use of donor resources to do so in the same way that many commercial entities do. Furthermore, without any clear guidance or standards on how charities should track their activities, an investigation into activities occurs effectively in a policy vacuum. Thus, charities will be inclined to over-respond to requests for information, particularly if they are phrased in general terms. Investigations into activities should be carefully targeted towards specific issues with specific charities where there is a genuine, objectively verifiable basis for concern.

The draft cites a single 50-year-old precedent from another jurisdiction to support the proposition that an examination of charitable purpose should *always* go beyond the stated purposes. In our view, this foreign precedent can not be preferred over the weight of consistent and unambiguous Australian legal authority. Even if there were not clear legal precedent on this issue, a policy of examining the activities of organisations in all cases should not be adopted without some rigorous assessment of the costs and benefits of such resource-intensive examinations.

Recommendation: The draft should clarify that reference to the stated purposes and objects of an organisation will usually be sufficient to determine that the organisation is for charitable purposes. Recourse to an examination of activities and operations will be necessary only to the extent necessary to resolve any ambiguity in the stated purposes and objects, or if there are substantial grounds for believing that the stated charitable purposes are misleading or have been abandoned.

2.2 Factors in assessing whether an activity is for a charitable purpose

The list of factors set out in paragraph 124 to be used in assessing whether a particular activity is for the sake of a charitable end or a political end does not provide clear and accurate guidance.

The list includes the following factors:

- The activity not undermining charitable ends
- The activity reasonably furthering charitable ends
- The activity being “proportionate” in terms of resources applied
- The “reasonableness” of the activities

- Reliance on evidence rather than emotional appeal
- Avoidance of falsehoods and distortions
- Expression of activities in “responsible” ways

The list is similar to the 1999 version of the guidance issued by the U.K. Charity Commission, *CC9 – Political Activities and Campaigning by Charities*, as quoted in the final report of the Charities Inquiry.⁷ However, the 1999 version of CC9 was later substantially redrafted, in explicit recognition by the U.K. Charity Commission that it was unduly prescriptive and should focus “greater emphasis on the campaigning activities that charities can undertake, as opposed to the restrictions.”⁸

For example, while the original guidance stated that “it would be unacceptable (except where the nature of the medium makes it impracticable to set out the basis of the charity's position) for a charity to seek to persuade government or the public on the basis of material which was **merely** emotive”,⁹ the current version of CC9 omits this passage entirely, and does not tie the assessment of purpose to a charity’s use of “emotive” content at all.

The U.K. had good reasons to move away from a list of factors indicating political purpose such as this. To begin with, the law requires only that a charity have charitable purposes; it does not require that a charity always be reasonable, always apply its resources in the best way, never appeal to emotion, and never make errors.

Furthermore, the factors are vague, highly subjective and could not be applied consistently and even-handedly. They give little actual guidance to charities on what activities are acceptable and what should be avoided. This is particularly true for the requirement that activities should be expressed in “responsible” ways. Is a peaceful protest against a company’s record of polluting a local river “responsible”? The answer will depend largely on who is asked and what personal values and perspective they hold. The lack of clarity and wide divergence of views on these sorts of questions could well lead to an increase in requests for private rulings; the ATO may wish to consider whether answering requests for advice on whether particular activities are “responsible” is an appropriate use of its resources.

The factors bear little or no correlation to whether something is actually in furtherance of political or charitable purposes. Overtly partisan political materials can be factual, accurate and a proportionate use of resources, just as materials with no political connection whatsoever can be emotive, erroneous and a poor use of resources.

⁷ Commonwealth of Australia, *Report of the Inquiry into the Definition of Charities and Related Organisations*, June 2001, page 215, available at www.cdi.gov.au.

⁸ Charity Commission for England and Wales, *CC9 – Political Activities and Campaigning by Charities*, September 2004, paragraph 6, available at <http://www.charity-commission.gov.uk/publications/cc9.asp#17>

⁹ Charity Commission for England and Wales, *CC9 – Political Activities and Campaigning by Charities* (September 1999 version), available at <http://web.archive.org/web/20001205062000/www.charity-commission.gov.uk/cc9.htm>. Note as well that the report of the Charities Inquiry (*supra* note 7 at page 215), in quoting this passage, omitted without indication the section in brackets, which is a crucial qualifier to the statement.

The suggestion that “merely emotive” appeals tend to indicate political rather than charitable purposes is, in our view, unjustifiable. Many of the issues that charities deal with on a daily basis are inherently emotional, and often the most effective way to inspire people to act for the common good is to combine effective appeals to both mind and heart. Witness the recent calls for aid for areas affected by the Asian tsunami, many of which appealed directly and primarily to individuals’ basic sense of humanity and desire to help out those in need, with little or no “supporting evidence”. The utilisation of such emotional appeals is both legitimate and widespread.

Finally, underlying many of the factors on the list is the implication that the *quality* and *effectiveness* of a charity’s activities are relevant in ascertaining its purpose, rather than simply focusing on whether the activities further its charitable purposes. There is no legal support for this approach. Ultimately the supporters of a charity are the best placed to determine the quality and effectiveness of a charity’s activities and will support those charities that they regard as effective in addressing the charity’s purpose.

The determination of whether an activity furthers a charitable or a political purpose will depend upon the particular circumstances of each case. The enumeration of a set of factors such as this is unnecessary and risks dissuading charities from undertaking a wide range of perfectly legitimate charitable activities.

Recommendation: The last two sentences of paragraph 124 should be deleted.

2.3 “Inconsistent activities” and charitable purpose

The draft’s position that, where an institution’s activities are inconsistent with its charitable purpose, it will not be a charitable institution, could be expanded on with fuller discussion of the topic.

The examples given are clear cut instances of abandonment or complete disregard of charitable purposes. In our view, the draft would be enhanced by providing clarification on how inconsistencies of lesser gravity should be addressed.

There is a real distinction, which the draft should articulate, between an organisation with no genuine charitable purpose, and an organisation with indisputably charitable purposes that happens to act inconsistently with them in a particular instance or instances.

Thus, there may well be cases where the inconsistency between activities and purposes is so pervasive that it casts doubt upon the stated charitable purposes – for example if a charity is set up as a mere sham for other activities. However, far more common will be one-off or non-serious departures from what are without question charitable purposes resulting from honest mistakes, errors in judgment, lapses in governance, and so forth.

The proper approach to take in most circumstances will be to ensure that the charity’s activities conform to its stated purposes, not to revoke its charitable status. In the case of fraudulent or *ultra vires* activities by an employee or officer of a charity, for example, the

proper remedy might include a warning, commitments by the charity to improve internal controls, or legal action against the relevant individual, but not revocation of charitable status.

The approach of the U.K. Charity Commission on inconsistent activities is sensible:

13. An institution may be identified as having **activities** which are not charitable, although its **objects** are charitable. If this is the case, we will offer advice on ways in which the organisation can continue to carry out its objects by operating in a purely charitable way. This could involve limiting or changing certain current activities or hiving them off to non-charitable subsidiaries.

14. In cases where the conduct of the trustees amounts to "misconduct" or "mismanagement" we will not normally remove an institution from the Register. Instead, we will use our remedial powers to ensure that the charity pursues its charitable objects. ... The exception will be in the very limited number of cases where the institution is demonstrated to be a sham....¹⁰

Recommendation: The draft should clarify that instances of activities inconsistent with charitable purposes do not necessarily mean an organisation is not charitable. In many cases, inconsistent activities may justify remedial action to ensure that the charity pursues only its stated purposes, rather than denial or revocation of charitable status.

2.4 “Illegal activities” and charitable purpose

Paragraph 99 states that “if a purpose is either unlawful or a lawful purpose is to be carried out by unlawful means it is also not charitable.”

It will be rare if ever that an organisation with stated unlawful purposes, or specific directives to employ unlawful means, claims entitlement to charitable status. As with “inconsistent activities”, situations where a charity (or one of its employees or officers) happens to breach applicable laws are more likely.

While we do not suggest that charities are entitled to engage in illegal conduct with impunity, the draft could be misinterpreted to suggest that any breach of a law by a charity or its officers or employees has the consequence of loss of charitable status. Revocation of charitable status is of course a drastic step, with serious consequences for non-culpable donors as well the charity itself and its beneficiaries.

A loss of charitable status because of illegal acts would also result in charities being treated more harshly than private companies for the same sorts of conduct. A company does not lose its entitlement to tax benefits (such as the diesel fuel rebate, or the 150% deduction for

¹⁰ Charity Commission for England and Wales, *RR6 – Maintenance of an Accurate Register of Charities*, available at <http://www.charity-commission.gov.uk/publications/RR6.asp#8>.

certain resource exploration expenses) if it breaches the law; a charity should not be treated more severely.

The normal remedy for an illegal act will be applicable criminal penalties. Revocation of charitable status would be warranted only in the rarest of circumstances where the breaches are so severe and widespread that they represent an abandonment of charitable purposes.

Recommendation: The draft should clarify that breaches of applicable laws by a charity or its employees or officers, though incurring the normal penalties for such breaches, justify denial or revocation of charitable status only if the breaches are so widespread and serious that they demonstrate abandonment of charitable purposes.

3. Consideration of particular purposes

3.1 Purposes “against public policy”

The statement in paragraph 99 that “a purpose contrary to public policy is not charitable”, without some further explanation of what is meant by “contrary to public policy”, could be interpreted in an unduly restrictive manner and should be deleted.

The term “public policy” has a potentially wide ambit. The entire body of existing law, for example, may be said to be “public policy”. If that is the case, any object to seek changes to legislation or policy, even if in furtherance of charitable purposes, could be interpreted as “contrary to public policy.” Yet the draft ruling recognises the legitimacy of these activities in paragraphs 122-124.

We do not think that a broad interpretation is warranted or intended in the draft ruling. Nor would the cases cited in footnote 88 support such a view. The example given in *Perpetual Trustee Co (Ltd) v Robins* is of a fund for education of the soldiers of a foreign hostile power, which would presumably be illegal in any case. *Re MacDuff* gives the example of the proverbial school for thieves, again plainly an illegal purpose. *Re Pieper* does not even mention the phrase “public policy”, but merely suggests that a trust should not be construed so as to require the application of trust assets in a location overseas where it would be illegal under Australian law to apply those assets.

The examples given in these cases outline a very narrow set of circumstances in which “public policy” concerns could negate a charitable purpose. In fact, all of the examples are comfortably accommodated in the rule that an illegal purpose is generally not a charitable one. There do not seem to be any cases where the supposed rule against purposes “contrary to public policy” has actually been applied or has even merited more than a passing reference without discussion.

Recommendation: In light of the ambiguity of the phrase “contrary to public policy”, the first sentence of paragraph 99 should be deleted.

3.2 Illegal purposes and unjust laws

As a general proposition, an illegal purpose will not be a charitable one. However, there is hidden complexity behind even this superficially uncontroversial statement. These complexities often arise where the purposes and activities of charities, particularly those involved in overseas aid and development work, come into conflict with unjust laws.

For example, after the Taliban regime took power in Afghanistan, they categorically outlawed the education of women, and banned women from working outside the home. Some charities continued to provide textbooks and funding for underground schools for girls, run by Afghani women. In our view, education of Afghani women was still a charitable purpose, even though illegal under the laws of the Taliban. It would be perverse for Australian law to grant legitimacy to such unjust laws by incorporating them into our domestic law of charities.

While there do not appear to be any judicial precedents on this point, it is instructive that the U.K. Charity Commission has no categorical rule against breaching laws in furtherance of charitable purposes. Instead, it urges charities to consider the situation carefully, take legal advice, and “balance the benefits of carrying out that activity against the dangers and disadvantages, including the potential human, financial and reputational cost, of doing so.”¹¹

Another area where the draft could provide clearer guidance is the relationship between non-violent protests and charitable status. The tradition of peaceful protest activities against unjust practices is an honourable and respected one, and includes the ideals and activities of many of the most widely revered figures in recent history, such as Mahatma Ghandi, Martin Luther King, Bishop Desmond Tutu and many others. These individuals pursued non-violent protest even when those activities were “illegal” under the laws of Colonial India, the Southern U.S., or Apartheid South Africa, but it would sully the law to suggest that their activities were not for the public benefit.

Of course, protestors must bear the consequences of any legal breaches in which they engage, but it does not follow that their activities must carry the additional penalty of being deemed uncharitable.

Recommendation: At the end of paragraph 99, the following passage should be inserted: “However, otherwise charitable purposes will not be invalidated because they conflict with fundamentally unjust laws. For example, the furtherance of girls’ education in a particular country would be a charitable purpose, even if education of girls in that country is illegal (as it was under the repressive Taliban regime in Afghanistan). Reference to international human rights standards is appropriate in considering whether any particular purpose is not charitable because it is illegal. Furthermore, non-violent protest activities in furtherance of charitable purposes that result in non-serious breaches of laws will not typically result in revocation or denial of charitable status.”

¹¹ Charity Commission for England and Wales, *Charities Working Internationally*, available at <http://www.charity-commission.gov.uk/supportingcharities/cwi.asp>, para. 86.

3.3 Purposes related to political “causes” and “party lines”

Para 100 of the draft suggests that the purpose of advocating a political party “*or cause*” is not charitable. Para 103 similarly states that the purpose of supporting a party “*or its line*” is not charitable.

The draft provides little further explanation of what is meant by the phrases “political cause” or “political party line”. There is a risk that the unqualified use of these terms, outside the specific context of the few cases in which they have been used, could have the unintended consequence of preventing legitimate charitable objects.

For example, suppose that a conservation group develops a plan to restore a river to health, and a political party subsequently adopts the plan as part of its agenda. Would the conservation group’s continued advocacy of its plan constitute “supporting a party line”? We do not believe that the intent of the draft is to prohibit such purposes, yet the sweeping statement that a charity may not have a purpose of supporting a “party line” could easily take on precisely that meaning for individuals unacquainted with the legal precedents.

Such an interpretation would be far broader than the narrow context in which that phrase was used in *Re Hopkinson (deceased); Lloyd’s Bank Ltd v Baker*, the case cited in support of the proposition. In that case, the Court found that the object of the trust was to “advance the cause of the Labour Party by improving its methods of propaganda and by increasing its electoral efficiency.” Although the trust supported what in some sense was a policy document or “line” of the Labour Party, it was a policy that was explicitly directed towards improving the organisational and political success of the party.

There is a meaningful distinction between supporting the “line” of a party *because it is the line of that party*, and supporting a policy because it furthers a charitable purpose, even if it also happens to coincide with the agenda of a particular party.

In our view, the proposition that an institution is not charitable if its “dominant purpose is advocating for a political party or candidate” is clear and best reflects the state of the law. Expanding this to encompass advocacy of “party lines” and “causes” as general prohibitions does not provide accurate guidance for charities and ATO staff and should be avoided in the absence of a much more detailed and nuanced discussion of these topics.

Recommendation: the phrase “or cause” should be deleted from paragraph 100. The phrase “or its line” should be deleted from paragraph 103.

3.4 Purposes related to changing law or government policy

The statement in paragraph 105 that “an institution or fund whose purpose is to change the law or government policy is not charitable” is too categorical and does not reflect recent judicial developments.

The traditional approach to this question, as articulated in *Bowman*, is that courts will not endorse the charitable nature of purposes to change law or policy, because they have no way of judging whether such changes would be for the public benefit. However, recent Australian cases have found this reasoning less than persuasive, at least in some circumstances.

For example, in *Public Trustee*, the Court considered a situation where the trend of the law was plainly towards introduction of laws prohibiting discrimination against indigenous persons, but this had not yet occurred in all Australian jurisdictions. The Court found little difficulty making judgments about the public benefit of anti-discrimination legislation in that context, observing that:

a trust may survive in Australia as charitable where the object is to introduce new law consistent with the way the law is tending. There is then no longer contrariety in an *established* policy of the law.¹²

The Court in *Attorney General for NSW v the NSW Henry George Foundation* was even more critical of the traditional reservations about courts judging the public benefit of legislation:

Santow J also says, and I think, with respect, that both what I may call mainstream as well as progressive authority is tending in this direction, that it is not necessarily so that judges cannot determine whether a political purpose is for the public benefit. What is for the public benefit may change from time to time. However, to take an obvious example, if Australia has ratified an international treaty but it has not yet become part of domestic law, urging that the country go further may very well be able to be judged by a court as being for the public benefit.¹³

The Court goes on to say that

There is a feeling of what I might call “judicial cop out” in the policy that the court cannot judge the public benefit of proposals to amend the law. Indeed, in many instances, the fact that diverse arguments are presented to the public on issues of importance may itself be important to the community.¹⁴

The approach taken by Australian courts recently has been to recognise that a purpose to change the law need not be inconsistent with charitable purposes where a public benefit can reasonably be identified.

In our view, the draft should reflect these developments and advance a less categorical view of the relationship between charitable purpose and efforts to change law or policy. Furthermore, purposes to promote law reform generally may be charitable, as it is widely

¹² *Supra* note 4 at 607-08.

¹³ *Supra* note 5 at [48].

¹⁴ *Ibid* at [65].

recognised that the law does and should constantly evolve in response to changing societal circumstances.

Recommendation: the draft should recognise that purposes to promote changes to law or policy may be charitable, if a reasonably clear public benefit exists. Examples include cases where the clear trend of the law is in a particular direction or where an international treaty has been signed but not yet implemented through domestic legislation. Furthermore, purposes to promote law reform generally may be charitable.

3.5 Seeking changes to particular decisions of governmental authorities

The statement in paragraph 109 to the effect that charities may not have a purpose of seeking changes to particular decisions of governmental authorities is too broad.

In expressing reluctance to extend charitable purposes to attempts to change law or policy, courts have frequently pointed to a supposed inability to determine whether a particular change will be “for the public benefit”. Whatever force this argument may have with respect to changes to legislation, it does not apply to all other governmental decision-making. For example, it can hardly be maintained that a court can not judge whether a governmental decision made in open violation of applicable laws is in the public interest.

In fact, courts have recognised that a purpose of ensuring compliance with laws can be charitable. For example, in *Re Herrick* the Court upheld a charitable trust with the purpose of promoting prosecutions for cruelty to animals.¹⁵

Consider also the purpose of providing legal aid to those in poverty – which paragraph 186 of the draft accepts as charitable. Frequently such legal aid will entail challenging the decisions of public authorities in individual cases on such matters as entitlement to income and housing assistance. Legal aid for persons in those circumstances improves the administration of justice, as well as assisting those in poverty. The purpose is charitable, even if a fundamental, even dominant aspect of it entails challenging governmental decisions that are or may be factually, legally or procedurally defective.

The citation of *McGovern and others v Attorney-General and another* in support of the proposition that challenging government decisions is not a charitable purpose illustrates the danger of adopting the precedents of other jurisdictions without due regard to subsequent legal developments.

In *McGovern*, a U.K. Court found that the Amnesty International Trust was not a charitable institution on the basis that its purpose of attempting to secure the release of prisoners of conscience was “substantially political”. Australian commentators have criticised this case and Australian courts have repeatedly rejected it as a persuasive authority.¹⁶ The

¹⁵ *Re Herrick* (1918) 52 ILT 213.

¹⁶ See, e.g., *Public Trustee*, *supra* note 4 at 606-608; *Re Blyth* [1997] QSC 30; *Attorney-General (NSW) v The NSW Henry George Foundation Ltd*, *supra* note 6 at [47].

Parliament of Australia overtly rejected the case by specifically listing Amnesty International as a DGR in 1982, only one year after *McGovern* was decided.

More importantly, U.K. law itself has moved on from *McGovern*. Following the judgment, U.K. commentators pointed out the bitter irony of a law that permitted charities to oppose cruelty to animals but prohibited them from pressuring governments not to torture human beings. These arguments have progressively prevailed: the Amnesty International Trust was registered as a charity in the U.K. in 1986 and has remained on the register ever since. It continues to have a purpose of reversing governmental decisions that violate human rights. The U.K. Charity Commission now accepts that:

A human rights charity may bring pressure to bear in individual cases (including through the mobilisation of public opinion) to encourage a government to respect its own human rights legislation. A charity may provide support for attempts to obtain redress through the courts of the country concerned.... Even if the legal code of the country in which the abuse takes place does not expressly provide redress, it may still be possible to attempt to obtain compensation or a public inquiry or an acknowledgement of responsibility. A human rights charity may also support the investigation and prosecution before international tribunals of individuals and organisations accused of human rights abuse.¹⁷

Thus, the current position in the U.K. is that charities may have a purpose of influencing particular decisions, at least where those decisions are contrary to domestic or international human rights law. *McGovern*, never accepted in Australia and now superseded in the U.K., is a not a good example.

Recommendation: Paragraph 109 should be rewritten as follows: “A purpose of affecting or seeking changes to particular government policies or decisions of governmental authorities can be charitable, if related to an otherwise charitable purpose. Charities may have a purpose of ensuring that governmental decisions are made in accordance with applicable laws and international standards or of improving decision-making by the provision of relevant information.”

3.6 “Incidental or ancillary” objects and activities

The phrase “incidental or ancillary” has been the source of much confusion when used to discuss the relationship between charitable purpose and activities or objects that, seen by themselves, are arguably non-charitable. With all respect to the Courts that have employed the term in the past, it should be replaced with a more precise formulation.

Paragraph 150 states, correctly in our view, that activities that, seen in isolation, are non-charitable, are acceptable if they are “for the sake of, or in aid of, or in furtherance of ... charitable purposes”. Any of these three phrases better describe the circumstances in which

¹⁷ Charity Commission for England and Wales, *RR12 - The Promotion of Human Rights*, January 2005, at [18], available at <http://www.charity-commission.gov.uk/publications/rr12.asp#9>.

“non-charitable” activities may be pursued by a charity, though even more precise would be “reasonably expected to further charitable purposes”.

The difficulty with the terms “incidental” and “ancillary” is that they can bear multiple interpretations. The primary definition of “incidental” in the Oxford Shorter Dictionary is “occurring or liable to occur in fortuitous or subordinate conjunction with something else”. Used in this way, the term implies nothing more than the fact of a connection between two things. It is in this sense that the term appears to be used in the draft, as evidenced by the explanations in paragraphs 101, 150 and elsewhere.

However, “incidental” can also be defined as “of a minor, casual, or subordinate nature”. This definition includes some judgment of the *scale* of a thing in relation to another, rather than the simple fact of a connection between the two. Thus, “incidental expenses” may be understood as describing not only that the expenses were incurred in connection with a task, but also that they were relatively minor in amount.

If the word “incidental” is preceded by a phrase such as “merely” or “no more than”, it suggests that “incidental” is being used in the latter, quantitative sense. Thus, a rule that “non-charitable” activities must be “no more than incidental” could imply a quantitative restriction on what proportion of an organisation’s time or resources may be spent on such activities. Such an interpretation would be inconsistent with the rule as correctly stated in paragraphs 101, 150 and elsewhere.

Recommendation: The phrase “incidental or ancillary” should be replaced throughout the draft by a more precise formulation, such as “reasonably expected to further”.

3.7 Other charitable purposes

The summary of purposes that have been recognised as charitable set out in paragraph 207 is helpful and welcomed. In our view, there is no need to limit the list to instances that have been specifically recognised in cases, particularly in those areas where statutory or administrative developments have obviated the need for further development of the common law (as with human rights in the U.K.). Even if there are no cases on point, the draft should offer guidance to charities on whether particular purposes – notably promotion of human rights – that are widely viewed as analogous to recognised categories of charities will in fact qualify for charitable status.

Under the “environment” heading, the recent case of *Perpetual Trustees Ltd v State of Tasmania* refers to the “prevention of the destruction of species” and addressing “imbalance within the environment” as charitable in nature.¹⁸ We recommend that these purposes be added.

The statement under the “environment” heading that “the purpose, however, must not be to lobby or be political in nature” is somewhat confusing, as it could mistakenly give the impression of a further specific restriction on environmental purposes, in addition to the

¹⁸ *Perpetual Trustees Ltd v State of Tasmania* [2000] TASSC 68 at [15].

general principles discussed in detail in paragraphs 99-124. We do not believe this is the intent of the draft, but there is no need to restate the general principle here in abbreviated form. For clarity's sake, it should be deleted.

We also note that the case of *Re Blyth* explicitly recognises “work for the elimination of war” as a charitable purpose, and recommend this as a further addition to the list of charitable purposes.¹⁹ We also suggest the addition of “human rights” as a recognised charitable purpose, given its acceptance in the U.K.²⁰

Recommendation: The heading “environment” in paragraph 207 should read, in full: “preservation of native wild life both flora and fauna, prevention of the destruction of species, the improvement and protection of a river, addressing the imbalance within the environment.”

The following heading should be added in paragraph 207: “peace and human rights: work for the elimination of war, promotion of human rights”.

4. Denial of FBT benefits for charitable funds

In our view, there is no principled reason for denying FBT benefits for charitable funds, and the ATO should maintain its current policy.

The primary distinction between charitable “funds” and charitable “institutions” relates to the criteria that have to be met to access the income tax exemption under section 50-5 of the ITAA 1997. It is worth noting that these distinctions between the two categories of charities did not exist prior to 1997, when they were introduced in the ITAA 1997 and incorporated into the ITAA 1936 through Schedule 5 of the Taxation Laws Amendment Act (No. 4) 1997.

There is no indication that, in drawing these distinctions in 1997, Parliament intended to affect the then-existing interpretation of “charitable institution” in the FBT Act.

Thus, while the distinction between a “fund” or “institution” obviously cannot be ignored in the Income Tax Assessment Act, there is no reason to assume that it is intended to apply also to accepted classes of charities in pre-existing tax legislation. There would be no reason to do so, in our view.

The use of “charitable institution” in the FBT Act allows an interpretation encompassing both “funds” and “institutions”, in the technical sense in which those terms are used in the ITAA 1997. Indeed, this appears to have been the ATO’s approach since section 65J of the FBT Act was adopted in 1992. No principled reason has been advanced for the change in approach.

¹⁹ *Re Blyth* [1997] QSC 30.

²⁰ See *supra* note 17.

Recommendation: In the absence of any clear legislative intent to deny FBT benefits to charitable “funds”, as that term is used in the ITAA 1997, the ATO should retain its current approach of making FBT benefits available to both charitable funds and charitable institutions.

5. Applicability to GST legislation

The draft is expressed as applying to the meaning of charitable institution and charitable fund under the FBTA, the ITAA 1997 and the ITAA 1936. We note that *A New Tax System (Goods and Services Tax) Act 1999* also extends certain tax concessions to charitable institutions and funds, for example under Subdivision 38-G of that Act. We suggest that the draft should apply to this legislation as well.

Recommendation: The draft should apply to the interpretation of charitable institution and fund in the GST legislation as well as income tax and fringe benefits tax legislation.

6. Approach in assessing subsidiaries of exempt entities

TR 2005/D7 does not give clear guidance on the circumstances in which fundraising subsidiaries of exempt entities will themselves be considered exempt.

A very common situation is where an exempt entity establishes a wholly-owned subsidiary that carries on a profit-generating activity, with the profits being directed solely to the exempt parent entity for its use in pursuing its charitable purposes. Often, though perhaps not always, the organisational documents of the subsidiary limit distribution of profits solely to the charitable parent entity.

Unfortunately, a close reading of paragraphs 78-89 of TR 2005/D7 sheds no light on whether the subsidiary in these circumstances is in fact tax exempt, or according to what principles this determination will be made.

The ruling states at paragraph 80 that “there can be circumstances where the appropriate conclusion is that the purpose of a company is to carry on a business or commercial enterprise to generate profits. ... The fact that such a company is set up and controlled by an exempt entity would not cause it to be exempt.” An example is then given of a charity that sets up a trucking and haulage business, the surpluses of which are “to be used to further” the charity and its activities.

The draft concludes that the trucking company is not exempt, because its “purposes are not those of a charitable institution.” The draft gives no real indication of how it arrived at this conclusion, or how it ascertained the “purpose” of this company. One might think that the “purpose” of such a company is solely to raise funds for a charity, which would seem to be a charitable purpose. If the draft did not consider this to be the “purpose” of the company, why not?

The second example is of a non-profit company that operates a hotel, with its surplus distributed “in support of sporting purposes proposed by the clubs.” This too is not considered to be an exempt entity, but again there is no real explanation of how the draft reaches this conclusion. In paragraph 84, the “purpose” is said to be “not the encouragement of a game or sport”, but the draft doesn’t say what the purpose of the company is or how it reached that conclusion. The only fact cited against the entity that its sole activity was operating a hotel, and this consideration clearly trumped the facts that the constitution emphasised that its purpose was to encourage sport, and a “significant proportion” of surplus was used to that end. The example demonstrates a fundamental confusion between the “activities” and the “purposes” of an entity, in that the purpose appears to have been derived solely from the activities undertaken, without any regard to why they were undertaken and the use to which the profits from those activities are put.

That example would support the conclusion that any entity with a sole *activity* of carrying on a business will be deemed to have a *purpose* of carrying on that business, and will thus not be exempt. Yet instead the draft states, at paragraph 85, that both examples are “predicated, of course, on the purpose of the company in fact being the carrying on of a business or commercial enterprise to generate profits.” The draft thus begs the fundamental question of what the “purpose” of the entity is and how it is to be ascertained.

Paragraph 85 maintains that “it is not to be assumed that just because a company is conducting a business that its purpose is the carrying on of the business,” yet the examples in the preceding paragraphs virtually compel just that assumption. Paragraph 86 gives further examples of facts and circumstances that do not indicate that an entity is exempt.

Finally in paragraphs 88-89 the reader is given the only example of an entity carrying on a commercial activity that is considered exempt. The example is of a passive investment company, but the reader is given no idea of what qualities of a passive investment company differentiate it in principle from the purportedly non-exempt trucking company and hotel operator. The draft does not explain why the passive investment company’s purpose is “community service”, while the trucking company’s purpose is not. Both companies, after all, supported their respective parent charities by distributing surplus profits. The draft cites no cases in support of this distinction, and gives no explanation of the principles behind it.

In our view, an entity that is bound by its organisational documents to distribute all surpluses to a charity, and that acts in accordance with those provisions, should itself be deemed exempt.

The importance of the organisational documents in this regard is highlighted by *Cremation Society of Australia Ltd v Commissioner of Land Tax (NSW)*,²¹ a case cited in TR 2005/D7 in support of its general argument. In that case, the key fact as given by the Court in denying tax exempt status was the absence of any provision in the memorandum and articles of association of the company excluding private gain and requiring distribution of

²¹ *Cremation Society of Australia Ltd v Commissioner of Land Tax (NSW)* (1973) 2 NSWLR 704.

surplus to exempt entities. Plainly the outcome of the case would have been different had the organisational documents contained such provisions.

In light of this case, at least where the organisational documents explicitly limit distribution of profits solely to exempt entities, fundraising subsidiaries should be considered exempt entities.

The practical difficulties of a contrary approach can be briefly summarised. For one, the ruling is unlikely to result in any appreciable increase in tax revenues or improvement in the administration of tax laws. The major effect is likely to be that many charities will cease using separate subsidiaries for active fundraising activities, preferring to carry out those activities under the mantle of the parent organisation itself, where they are likely to be deemed ancillary or incidental to the overall charitable purpose. If this occurs, charities would in effect be denied the risk management and administrative benefits of parent-subsidiary structures that are available and widely used in the corporate sector.

Alternatively, some charities may choose to avail themselves of the refund for excess imputation credit provisions in Part 3-6 of the ITAA 1997. The frank acknowledgement of this as an option in footnote 47 of TR 2005/D7 demonstrates a clear understanding by the ATO that the government can not expect any increase in revenues as a result of denying exempt status to subsidiaries of exempt entities.

It is fair to ask why subsidiaries in these instances should not simply be granted exempt status in the first place, thus sparing both the ATO and charities of the patently unnecessary burden of utilising the imputation credit refund provisions.

Recommendation: Commercial entities that are bound to direct their surpluses exclusively to exempt entities should themselves be deemed to be exempt entities.

Contact

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