

**SENATE INQUIRY INTO TAX LAWS AMENDMENT
(PUBLIC BENEFIT) BILL 2010**

SUBMISSION BY THE TREASURY

SUMMARY

This submission provides the Committee with contextual information that may assist its examination of the Tax Laws Amendment (Public Benefit) Bill 2010, advice on how the proposed tax law provisions would be administered, and what the effects of the Bill may be.

The Bill would require all charitable or religious institutions to meet a public benefit test before accessing an income tax exemption. The Bill would apply to all taxpayers endorsed or self-assessed as income tax exempt under the charitable or religious institutions categories in Division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Background

Charitable purposes are categorised under four heads: the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community. The existing common law relating to charities includes a public benefit requirement. However, there is a presumption in the common law that charities operating under the first three heads are providing a public benefit. In certain circumstances, the presumption may not apply, and a charity is required to demonstrate its public benefit. There is no test of public benefit, either in the common law or elsewhere, in relation to self-assessing religious organisations. The number of self-assessing religious institutions is expected to be relatively small.

In 2003, the then Government released an exposure draft of a Charities Bill following the 2001 *Report of the Inquiry into the Definition of Charities and Related Organisations*. The exposure draft sought to codify the definition of charitable purposes at the Commonwealth level, and included a public benefit test. The charities Bill did not proceed. Most recently, the Australia's Future Tax System Review and the Productivity Commission's report *Contribution of the Not-for-profit Sector* both recommended that similar legislation be enacted.

The primary interaction between the Commonwealth and charitable and religious entities is through the taxation system. There is no clear head of power that would allow the Commonwealth to legislate generally with respect to charities. Accordingly, reform across the spectrum of charities law and regulation would require cooperation between the Commonwealth and all State and Territory governments.

The Bill

The proposed public benefit test will effectively remove the common law presumption for charitable institutions, and require those institutions and religious institutions to demonstrate in some way that they are providing a public benefit.

The Bill is drafted along the lines of the public benefit test enacted in the Charities Act (Northern Ireland) 2008. The Northern Ireland Charities Act is part of a trend in the United Kingdom and Ireland to codify the common law as it applies to charities, including the requirement to demonstrate a public benefit. Other jurisdictions have adopted different mechanisms to achieve similar outcomes to those of the Bill.

Implications of the Bill

The Bill will have broad application to all charities and religious organisations. Charitable organisations currently operating for the relief of poverty, the advancement of education, and the advancement of religion may be concerned that they would have to positively prove

they are operating for the public benefit. Overseas experience demonstrates that the introduction of a public benefit test, thus removing the presumption of public benefit, has not caused significant issues for the charitable sector more broadly. These jurisdictions have issued guidance to the sector about what is a public benefit. The most common effect of removing the presumption about public benefit under the first three heads of charity overseas has been that charities have had to state publicly the public benefit they provide, whereas previously they did not.

There have, however, been implications for fee-charging charities in the United Kingdom, such as private schools, hospitals and aged care facilities, which have had to demonstrate that they provide sufficient benefit and material access to people who cannot afford the fees.

As with any alteration to the tax laws, public consultation is favoured to ensure that desired outcomes are achieved, and that unintended consequences are avoided. In other jurisdictions that have enacted similar statutory public benefit tests (and broader changes), the process of developing, consulting on, and issuing guidelines has taken many years.

The Bill will codify only one aspect of the definition of charitable purposes. It will not define charitable purposes more generally, and will only apply to charities and religious organisations seeking an income tax exemption. The public benefit test introduced by the Bill will not apply to charities seeking access to other tax concessions (at either the Commonwealth or State level).

The proposed public benefit test would also not apply to other organisations eligible for an income tax exemption under Division 50 of the ITAA 1997, such as charitable funds, scientific institutions, public educational institutions, community service societies, and sporting organisations.

Administration

The presumption of a public benefit in the common law has arisen because of the difficulties faced by the courts in deciding whether or not particular activities are providing a public benefit. The most problematic head of charity in this regard appears to be the advancement of religion, as it involves judgements about the worth of religious observance itself, and may also involve consideration of the merits of one religion relative to another. There is a risk that the Commissioner of Taxation would face the same difficulties historically faced by the courts in administering the provisions of the Bill.

Codifying a public benefit test will assist by clearly articulating principles that, while they are substantially already in effect, are contained in legal rules arising from a long series of court judgements. However, a statutory test would still require substantial legislative guidance to assist the Commissioner, and the practical operation of the test would be substantially determined by the substance of any regulations issued by the minister. There is a risk that the Commissioner may still have to make presumptions that certain activities are providing a public benefit in certain circumstances.

Treasury is not in a position to comment on the tax or other affairs of any individual organisation or taxpayer.

CHARITY AND TAX LAW

Items 1.1 and 1.2 in the table in section 50-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) allow 'charitable'¹ institutions to be endorsed as income tax exempt entities, and 'religious' institutions to self-assess as tax exempt entities. The tax laws, however, do not define the meaning of either of these terms.

COMMON LAW DEFINITION OF CHARITY

The current legal definitions of *charity* and *charitable purpose* still rely on the preamble to the Charitable Uses Act 1601 (UK) more commonly referred to as the Statute of Elizabeth. The preamble to the Statute listed numerous charitable purposes. In the 1891 case *Income Tax Special Purpose Commissioners v. Pemsel*², Lord Macnaghten categorised charity under four heads:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- other purposes beneficial to the community not falling under any of the preceding heads.

For an organisation to be charitable at common law, amongst other things, its purpose generally must fall under one of the four heads of charity and must be within the 'intendment' of the *Statute of Elizabeth*.³

Not only must charities have charitable purposes, they must also:

- not act unlawfully;⁴
- not be predominantly engaged in political advocacy;⁵
- not provide private benefits (for example, to their own trustees);⁶ and
- be operating in the 'public benefit'.⁷

¹ Reference to 'charity' and 'charitable' refer to the meaning of these words established by the law of equity.

² [1891] AC 531.

³ The Commonwealth has enacted several statutory extensions to charitable purpose in the *Extension of Charitable Purpose Act 2004*. Queensland, Western Australia, South Australia and Tasmania have extended the definition of charity to include 'recreational charities'.

⁴ *Auckland Medical Aid Trust v Commissioner of Inland Revenue*, [1979] 1 NZLR 382, 395.

⁵ E.g. *Re Hopkinson (deceased); Lloyds Bank Ltd v Baker and others*, [1949] 1 All ER 346, 350.

⁶ *Re Smith's Will Trusts; Barclays Bank v Mercantile Bank and others*, [1962] 2 All ER 563, 567.

⁷ *National Anti-Vivisection Society v Inland Revenue Cmr*, [1947] 2 All ER 217; *Nelan v Downes* (1917) 23 CLR 546, 563 (religion); *Re Mair (dec'd)* [1964] VR 529; *Re Hilditch (dec'd)* (1986) 39 SASR 469 (poverty).

The courts have presumed that charities established for the relief of poverty and the advancement of education or religion (i.e. under the first three heads) are providing a 'public benefit'. For the fourth head of charity, the onus is on the purported charity to prove that it is acting in the public benefit.

While a presumption exists under the first three heads of charity, the Commissioner of Taxation can and does revoke endorsement of organisations where there is factual evidence available that the organisation does not provide a public benefit.⁸ Moreover, endorsed entities are required to self-assess annually that they are still entitled to their endorsement. In effect, this means that, if an organisation ceases to provide a public benefit under the existing common law requirements, it must advise the Commissioner accordingly.

Following the 2001 Charities Definition Inquiry, closed contemplative religious orders and open and non-discriminatory self-help groups were deemed to be providing a 'public benefit' under the *Extension of Charitable Purpose Act 2004*. This Act also deemed not-for-profit child care organisations to be charitable. In 2008, participation in the establishment phase of the National Rental Affordability Scheme was temporarily deemed to be a charitable purpose for Commonwealth law.⁹ It is not clear whether the Bill is intended to require deemed charities to meet the public benefit test.

The number of entities endorsed by the Commissioner of Taxation as tax concession charities at June 2010 is 55,658. The number of charities without Commonwealth tax concessions but charitable according to state law is unknown.

Organisations endorsed by the Commissioner of Taxation under item 1.1 are eligible for an exempt from income tax as a result of the endorsement. The *Tax Expenditures Statement 2009* indicates that the cost to revenue of the income tax exemption for all institutions exempted under section 50-5 of the ITAA 1997 is unquantifiable but that the magnitude of the cost to revenue is in excess of \$1 billion per annum.¹⁰ This amount does not include other tax concessions that charitable organisations may be entitled to under Commonwealth or state tax laws, such as Goods and Services Tax (GST), Fringe Benefits Tax (FBT), land or payroll tax concessions. Access to these other concessions is achieved through other provisions in the tax laws. Given the stated intent of the Bill is to affect concessional tax status generally, further provisions in relation to other types of taxation would be needed to achieve the objectives of the Bill.

RELIGIOUS INSTITUTIONS

While the meaning of 'religion' is not defined in the tax laws, the courts have given some broad direction on what is or is not a religion in Australian law.¹¹ The Commissioner of Taxation administers the tax laws as it applies to religious organisations consistent with the law, including the guidance provided by the courts from time to time.

Under the tax laws, religious organisations are entitled to self-assess as religious institutions, thereby gaining an exemption from income tax (item 1.2 of section 50-5 of the ITAA 1997). Self-assessment, however, is subject to review at any time by the Commissioner and, when

⁸ E.g. *Church of Jesus Christ of Latter-Day Saints v Henning*, [1963] 2 All ER 733.

⁹ These extensions and modifications do not apply at the state or territory level.

¹⁰ Australian Treasury, *Tax Expenditures Statement 2009*, 74.

¹¹ *Church of the New Faith v Commissioner of Pay-Roll Tax (Vic)* ("Scientology case"), (1983) 154 CLR 120.

questioned, the entity has the burden of proof. There is no common law public benefit test in relation to working out whether or not an entity is a religion.

As religious organisations self-assess their eligibility for an income tax exemption and are exempt from lodging income tax returns, the number of these entities is unknown.

Many religious organisations may also be eligible for endorsement as charitable institutions under item 1.1, and thus eligible for a range of other tax concessions (for example, GST and FBT concessions) generally not available to entities self-assessed as 'religious institutions'.

Following the enactment of the *Extension of Charitable Purpose Act 2004*, those religious organisations that could not, under the common law, demonstrate a public benefit were deemed to provide a public benefit by legislation. It now appears the religious institutions category may be an inoperative category, or is currently only accessed by a limited number of organisations that are not able to be endorsed as charitable institutions. The impact of any alteration to the religious institutions category on individual entities would need to be identified through a period of public consultation.

INTERNATIONAL COMPARISONS¹²

There have been a series of reforms to charity law in the UK and Ireland since 2005. England and Wales, Ireland, Northern Ireland and Scotland have all codified charity law, including establishing legislated public benefit tests.¹³ Other jurisdictions also have legislative provisions that require a demonstrable public benefit in one form or another. In most cases, the public benefit tests remove the presumption that any charitable purpose provides a public benefit.

All countries with legislated public benefit tests have also established commissions to administer charities generally. The various commissions are required to provide guidance to charities about what is or is not in the public benefit. Such guidance appears to be similar in status to interpretative advice provided by the Australian Taxation Office (ATO) in Australia about whether or not an organisation or activity will be charitable.

Canada

In Canada like Australia, the laws relating to charities are primarily the responsibility of sub-national governments, while income tax laws are the responsibility of the national government. The national government's control over charities appears to be mostly achieved through provisions relating to taxation, and the common law as it applies to charities has not been altered by statute at the national level.

Consistent with the common law, where the purposes of an organisation fall within the first three heads of charity, a presumption of public benefit exists. The common law has established similar presumptions for some charitable activities that fall within the fourth

¹² Extracts of various provisions are provided in **Attachment B**.

¹³ Entitlement to charitable status in Northern Ireland and Scotland is entirely separate from charity status under the UK revenue laws. In working out whether or not an organisation is entitled to tax concessions, the UK applies the definition and tests that apply in England and Wales throughout the UK. However, the legislated public benefits test in Northern Ireland and Scotland more closely mirror the test proposed in the Bill.

category. Those exceptions aside, under the fourth head, the public benefit must be proved according to the common law.

England and Wales

The United Kingdom enacted the Charities Act 2006 (UK). The Act codified what was previously the common law in England and Wales as it applies to charities, and it includes a public benefit test.

The provisions that exist in England and Wales are similar to those in the proposed Bill. The Act removes the common law presumption of a public benefit under all heads of charity, and requires the Charity Commission of England and Wales to issue guidance on what is or is not a public benefit. This guidance is considered to be a restatement of existing common law principles. Unlike the proposed Bill, it does not require a weighing of the benefits against any detriment or harm.

Ireland

The Irish Charities Act 2009 codified the definition of charitable purpose. Of note, the definition of charity excludes certain types of organisations and activities from being charitable. Section 10 provides that:

- (10) For the purposes of this section [charitable purpose], a gift is not a gift for the advancement of religion if it is made to or for the benefit of an organisation or cult—
 - (a) the principal object of which is the making of profit, or
 - (b) that employs oppressive psychological manipulation—
 - (i) of its followers, or
 - (ii) for the purpose of gaining new followers.

The Irish legislation also includes a public benefit test. The Act provides that '[i]t shall be presumed, unless the contrary is proved, that a gift for the advancement of religion is of public benefit.'¹⁴ For the other three heads of charity a public benefit must be positively shown.

New Zealand

The Charities Act 2005 (NZ) codified various aspects of the common law as it relates to charities. The Act refers to a public benefit test, but the substance of the test remains based on the common law. Therefore, the test preserves the common law presumption that where a purpose falls within one of the first three heads of charity (relief of poverty, advancement of education or advancement of religion), it is presumed to be a purpose that provides a benefit to the public.

Northern Ireland

The Charities Act (Northern Ireland) 2008 codified the common law as it relates to charities in Northern Ireland. As part of the codification, the Act enacted a public benefit requirement.

¹⁴ *Charities Act 2009 (Ire)*, s 3.

The test removes any common law presumption about whether or not a charity is providing public benefit. Moreover, the test requires that any benefit be balanced against any harm, and 'whether any condition on obtaining that benefit (including any charge or fee) is unduly restrictive.' Guidelines are required to be issued by the Charity Commission for Northern Ireland on the operation of the public benefit requirement. Consultation commenced on 3 September 2009, but final guidelines have not yet been issued.

Charities in Northern Ireland will still need to meet the definition of charity (including the public benefit test) as it applies in England and Wales to access UK tax concessions.

Scotland

The Scottish Charities and Trustee Investment (Scotland) Act 2005 has a very similar public benefit test as Northern Ireland. It removes any common law presumption about whether or not a charity is providing public benefit and requires that any benefit be balanced against any harm, and consideration 'whether any condition on obtaining that benefit (including any charge or fee) is unduly restrictive.' The Office of the Scottish Charities Regulator has issued guidance material on how to be endorsed as a Scottish charity, including how to meet the public benefit test.

Charities in Scotland will still need to meet the definition of charity (including the public benefit test) as it applies in England and Wales to access UK tax concessions.

South Africa

In 1999, the Katz report¹⁵ in South Africa recommended that the previous scheme of tax concessions be replaced with a scheme of 'exempt public-benefit organisations'. The aim was to replace what was considered the subjectivity of the former charitable system with one which was objective and had clearly defined eligibility criteria. A 'public-benefit' purpose or activity was clearly legislated and provision was made for a minister to declare, by notice, new public benefits as social needs and priorities changed over time.

United States

The Internal Revenue Code (the Code) provides federal tax exempt status for many types of organisations, including those organisations described in section 501(c)(3), which are commonly referred to under the generic heading of 'charitable organisations'. Under the Code, these organisations must be organised and operated exclusively for tax exempt purposes. One of the requirements to obtain an income tax exemption is that an organisation must provide a public benefit, not a private benefit.

To meet the public benefit requirement some organisations are required to meet further tests. For example, in relation to religious organisations, the US Internal Revenue Service maintains two basic guidelines: (1) that the particular religious beliefs of the organisation are truly and sincerely held; and (2) that the practices and rituals associated with the organisation's religious belief or creed are not illegal or contrary to clearly defined public policy.¹⁶

The courts in the US have determined that organisations are required to satisfy the burden of proof regarding their tax exempt status. For example, the court in *Church of Spiritual*

¹⁵ Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa, *Fiscal Issues Affecting Non-Profit Organisations*, 1999.

¹⁶ Department of the Treasury Internal Revenue Service Publication 557, *Tax-Exempt Status for Your Organization*, Rev. June 2008.

Technology v United States, 26 Cl. Ct. 713 (1992) held that churches and other religious organisations are subject to the same burden of proof requirements as other organisations.

In the US, a charitable organisation or trust must be set up for the benefit of an indefinite class of individuals, not for specific persons. This principle is embedded in the law of trusts and is referred to as the requirement of a charitable class.¹⁷

ADMINISTRATION AND GUIDANCE IN THE UK

The amount of publicly available information and guidance materials provided by the various charities commissions in Ireland, the UK, and other jurisdictions is large and readily available. Because tax concessions in Northern Ireland and Scotland turn on meeting the definition of charity as it applies in England and Wales, we have only looked (in general terms) at how the UK Charity Commission assesses public benefit.

The UK Charity Commission provides guidance on the existing common law as it applies to public benefit, and does not create a new legal definition of public benefit. The guidance sets out a framework of factors to consider when assessing public benefit based on the principles of public benefit contained in existing case law. They are of similar legal standing to the interpretative material provided by the Australian Commissioner of Taxation.

The UK Charity Commission does not make rulings about classes of charitable organisations, but rather about individual organisations on a case-by-case basis and on their merits. The Commission states that it considers three things when assessing whether or not an organisation is providing a public benefit. These are:

- aims – what the organisation’s aims are, whether those aims are charitable and whether the aims are fully and accurately reflected in the organisation’s stated objects;
- benefit – there must be an identifiable benefit or benefits; and
- public – benefit must be to the public or a section of the public.

The Commission can consider relevant factual background information, such as asking for evidence of an organisation’s activities or proposed activities, in order to decide whether or not its aims are charitable and for the public benefit. An assessment of an organisation’s aims includes an assessment of the organisation’s actual activities, not merely the organisation’s purported objectives.

Avenues of administrative and judicial review similar to those that apply in relation to Australian tax law are also available.

PURPOSE OF THE BILL

The purpose of the Bill is to require charitable and religious organisations seeking access to an exemption from income tax to prove that they are providing a public benefit. Senator Xenophon states in the second reading speech for the Bill that:

¹⁷ Ineke A. Koele, *International Taxation of Philanthropy*, 2007, 22.

Offering tax exemptions says, on the part of the Government and on behalf of tax-payers, 'we acknowledge the work you do, and support you in your aims.' ...when the Government is effectively making donations on our behalf through tax exemptions, we just have to take the organisation's word that they're working in the public good.

While the Bill is substantially the same as certain provisions in the Charities Act (Northern Ireland) 2008, it differs fundamentally in that the Northern Ireland Act is a stand-alone piece of legislation that seeks to 'cover the field' in relation to charity law, while the Bill inserts one provision of that Act into a tax law of general application.

The Bill establishes a 'public benefit' test, and requires that the minister, by regulation, must formulate a public benefit test, and that all organisations must meet the public benefit test prior to either being endorsed as charitable or self-assessing as religious institutions under items 1.1 or 1.2 in the table in section 50-50 of the ITAA 1997. The timeframe for issuing regulations is before 1 July 2010.

The Bill, in essence, seeks to codify the existing common law test of public benefit, and remove any presumption for organisations seeking endorsement under the first three heads of charity. It also requires organisations self-assessed as religious institutions to meet the same test. Depending on how the test were constructed, it might also affect organisations seeking endorsement under the fourth head of charity.

THE PROPOSED PUBLIC BENEFIT TEST

As the Commissioner would have to draw upon or distinguish existing common law concepts to administer the proposed public benefit test, it is useful to contrast the provisions of the Bill against the existing common law.

Paragraph 50-5(2) of the Bill states:

- (2) The public benefit test must include the following key principles:
 - (a) there must be an identifiable benefit arising from the aims and activities of an entity;
 - (b) the benefit must be balanced against any detriment or harm;
 - (c) the benefit must be to the public or a significant section of the public, and not merely to individuals with a material connection to the entity.

Paragraph 50-5(2)(a)

In Australia, the current approach to assessing whether or not there is a public benefit is included in Taxation Ruling TR2005/21. The ruling states that, in the Commissioner's view, motivation or indirect consequences are currently insufficient to show a public benefit according to current common law; public benefit considerations may also include the group at which the benefits of the entity are aimed and the objects and activities of the entity.

The common law already envisages situations where purported charities' purposes fail to exhibit public benefit aspects,¹⁸ where public benefit is negligible,¹⁹ and where public

¹⁸ E.g. *Cocks v. Manners* (1871) 12 Eq. 574; *Gilmour and Coats and Ors* [1969] 1 All ER 848.

¹⁹ *Re Pinion (deceased)* [1965] 1 All ER 890.

detriment outweighs any public benefit.²⁰ An issue of concern with the Bill's wording is that the satisfaction of an 'identifiable benefit' test may be outside existing precedent and difficult for applicants to 'prove', especially where benefits are intangible.

Paragraph 50-5(2)(b)

Currently, weighing of public benefit against public detriment or harm is not required. However, the ATO advises that these considerations are, at times, taken into account by the Commissioner. The leading case is *National Anti-Vivisection Society v Inland Revenue Commissioners* [1947] 2 All ER 217 which concluded that a purpose of banning animal vivisection was not charitable because the moral uplift benefit to humanity was outweighed by improvements to medical treatments resulting from animal experimentation.

The Bill would require an explicit balancing of public benefit against detriment or harm in all cases. The Commissioner, hitherto, has not been required to make such judgements, and the ATO advises that the Commissioner would have difficulty making judgements without clear direction in legislation from the Parliament or in other guidance material. The UK Charity Commission's paper relating to similar provisions notes that 'where the benefits are overwhelming, the existence of some inconsequential detriment would not affect public benefit' but that '[w]here the detriments are so significant, such as physical harm, they are more likely not to result in an overall benefit to the public.'²¹ Such an approach, if adopted by the Australian Commissioner of Taxation, may make the proposed test more readily able to be administered.

Further, it is unlikely that an entity would have objects or purposes that were unambiguously detrimental or harmful. However, problems may arise in deciding whether a clearly detrimental, possibly criminal, act done by an individual that is a member of, or otherwise associated with, an entity should be taken to be an act of the entity or organisation. Ultimately, the Commissioner may have to decide whether or not an organisation condoned or sanctioned the acts of that individual, either directly or tacitly, and whether or not any act of an individual should, therefore, cause the entity to fail the public benefit test.

Paragraph 50-5(2)(c)

Whether there is a 'material connection' between an individual and an entity is not part of the common law as it relates to determining whether there is a public or private benefit. This is currently a separate common law requirement.

The ATO advises that its officers frequently deal with the public versus private group aspect of the public benefit requirement based on the common law. The usual issues that arise are blood, member, or employee relationships. Whether existing precedent would assist would depend upon whether or not 'material connection' has the same meaning – or a similar meaning – to 'private benefit' according to the common law.

THE ADMINISTRATIVE IMPACT

The measure is likely to have some administrative impact both on government, through the ATO, as well as on the charity sector, and the efficacy of the provisions of the Bill would be

²⁰ *National Anti-Vivisection Society v Inland Revenue Cmrs*, [1947] 2 All ER 217.

²¹ Charities Commission of the United Kingdom, *Analysis of the Law Underpinning Charities and Public Benefit*, 2008, [2.31].

largely determined by the resources that were applied by the ATO to the administration of the relevant provisions.

The ATO advises that it already applies the common law public benefit test to applications for endorsement. As the Bill would remove any presumption about public benefit, it appears that the ATO would need to assess the details of individual organisations and confirm that they do indeed pass the public benefit test as prescribed. If the Bill also requires already endorsed entities to meet the public benefit test, this would be resource-intensive for the ATO. Initially, there may be an increased number of appeals and litigation as the law is tested by applicants.

It is also likely that organisations would be required to provide more information relating to their activities. We note that the Government has also adopted a policy of working towards reducing red tape and streamlining reporting for not-for-profits as part of the National Compact with the third sector.²²

CAPACITY OF THE COMMISSIONER TO ADMINISTER THE LAW

The Commissioner does not currently have a capacity to make ‘policy decisions’ about what should or should not be considered to provide a public benefit. He can only interpret and apply the statute and common law and apply it to the circumstances of individual taxpayers. Accordingly, the proposal to confer on the Commissioner a responsibility to determine whether or not a particular organisation provides a public benefit would be different to the types of discretions that the Commissioner currently exercises.

Moreover, any legislative test in the tax laws would be administered by the Commissioner of Taxation and would, therefore, be subject to the usual administrative and judicial review mechanisms that apply to the tax laws. An example of how difficult this may be in relation to religious organisations was provided by the courts when first establishing the common law presumption that religious organisations provide a public benefit.

[A court can] never can know that [religious teachings] are objectively true, unless it first determines that the religion in question is a true religion. This it cannot do. It not only has no means of doing so, but it is contrary to the principle that all religions are now equal in the law. It follows that there must be one of two results: either – (1) the law must cease to admit that any divine worship can have spiritual efficacy to produce a public benefit; or (2) it must admit the sufficiency of spiritual efficacy, but ascertain it according to the doctrines of the religion whose act of worship it is.

The first alternative is an impossible one. The law, by rendering all religions equal in its sight, did not intend to deny that which is the basis of, at least, all Christian religions, that acts of divine worship have a spiritual efficacy. To do so would, virtually, be to refuse to recognize the essence of all religion. The other result must, therefore, necessarily ensue. It must ascertain the spiritual efficacy according to the doctrines of the religion in question; and if, according to those doctrines, that divine service does result in public benefit, either temporal or spiritual, the act must, in law, be deemed charitable.²³

²² Available at: <http://www.nationalcompact.gov.au/>.

²³ *Attorney-General v Delaney* (1875) 10 IR (CL) 104, 264, quoted by Barton CJ in *Nelan v Downes* [1917] 23 CLR 546.

If required to administer the proposed test, the Commissioner is likely to face difficulties similar to those identified by the court in *Delaney*. Administrative or judicial reviews of the Commissioner's decisions in relation to individual organisations are likely to have some precedential value for other similar organisations. Particularly in the case of the religious organisations, the Commissioner may be required to factually differentiate between various religions and religious teachings in order to determine whether or not a religion was providing a sufficient public benefit. Ultimately, the Commissioner may have to make similar presumptions to those which have been adopted by the courts under the common law public benefit test. If this were the case, the efficacy of the Bill is likely to be reduced.

ORGANISATIONS AND ACTIVITIES AFFECTED

Experience in the UK has indicated that the various public benefit tests have had an impact upon a diverse range of organisations. In the UK, all organisations operating under the first three heads of charity have had to meet the public benefit test. This has had implications for many 'fee charging' charities. In the UK, these have included independent schools as well as charitable hospitals, aged care facilities, recreational facilities and art galleries and museums.

The UK has issued extensive guidance to the sector on the public benefit test, on the implications for certain classes of charities, as well as on the types of changes that may be required to meet the test. For example, in order to meet the public benefit requirement, independent schools in the UK have been required to demonstrate that they offer free or subsidised access to people who cannot afford access to a service or facility, offer financial assistance such as scholarships and bursaries, or provide other significant public benefits such as community use of school facilities.²⁴

LEGAL STATUS OF ANY GUIDELINES

As already noted, the Bill is heavily based on developments in Ireland and the UK, and in those jurisdictions various statutory authorities are required to issue guidelines on the application of the various public benefits tests.

The UK Charity Commission advises as follows:²⁵

D2. What is the legal standing of the Charity Commission's public benefit guidance?

The Charity Commission's public benefit guidance is guidance on what the law says on public benefit. It does not create new public benefit law. Nor does it create a new legal definition of public benefit.

Our guidance sets out a framework of factors to consider when assessing public benefit based on the principles of public benefit contained in existing case law.

We have expressed the principles of public benefit as legal requirements, as we believe they are required by existing case law. But we recognise that this guidance is, of necessity, a

²⁴ Available at: http://www.charity-commission.gov.uk/Charity_requirements_guidance/Charity_essentials/Public_benefit/

²⁵ Available at: http://www.charity-commission.gov.uk/Charity_requirements_guidance/Charity_essentials/Public_benefit/

summary of the underlying law, rather than a detailed statement of the law with all the fine distinctions that can apply in diverse, individual cases.

The law proposed by the Bill appears to be different. The Bill requires that the minister must formulate and promulgate by regulation a public benefit test. Accordingly, as delegated legislation, the public benefit test would have force of law in its own right. Were there a difference between the existing common law and the public benefit test, the Commissioner would be required to follow the elements of the test not the common law. This may dilute the usefulness of any existing common law in administering the test.

While subject to disallowance by either House, the substantive provisions of the law affecting the rights or responsibilities of taxpayers would be determined outside the Parliamentary process by the executive branch of government. This is not consistent with the broad principles that underlie tax system design in Australia.

CONSULTATION ON A PUBLIC BENEFIT TEST

Should the Bill be passed by the Parliament, the timeframe set out in the Bill for the issuing of guidelines by the minister – 1 July 2010 – is unrealistic. In other jurisdictions that have enacted similar statutory public benefit tests, the process of developing, consulting on, and issuing guidelines has taken many years.

There are nearly 60,000 endorsed charitable entities in Australia. These entities range from organisations with significant financial and intellectual resources to very small organisations operating at ‘grass-root’ levels with minimal infrastructure and support networks. In addition the geographic spread of these organisations may pose additional difficulties in consulting effectively.

Accordingly, were the Bill to be adopted, consideration would need to be given to extending the timeframe for developing and issuing guidelines on the public benefit test.

The Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) advises us that it contracts with a variety of charitable and church-based service providers, which provide a range of important services to the community, particularly to the most disadvantaged. Concerns in the sector arising from the Bill include: increased uncertainty for such charitable providers; a risk of greater litigation arising from the removal of common law presumptions about public benefit; and a loss of service provision to vulnerable sectors of the community. FaHCSIA supports wider consultation on the implications of the Bill for the broader charitable sector, reflecting the Government’s and sector’s commitment in the National Compact to consult about such significant policy changes.

ATTACHMENT A: RECOMMENDATIONS OF RELEVANT REVIEWS

A public benefit test for charities has been addressed in various inquiries and reports. Most pertinent are the Australia's Future Tax System Review, the Productivity Commission's Not-for-profit Review, and the 2001 Charities Definition Inquiry.

Australia's Future Tax System Review

The recent Australia's Future Tax System Review recommended that a national charities commission be established with broad regulatory responsibilities, and that the commission be tasked with 'modernising and codifying the definition of charity.'²⁶

On 2 May 2010, the Government announced:²⁷

Today we have announced that the first wave of our agenda is to reform resource, company and small business taxes and superannuation. We are also attracted to developing changes in a number of other areas considered by the review, especially making tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system. This would represent a full second term agenda.

Other recommendations in the review are not government policy. We have called for a mature tax debate and expect the other recommendations to be subject of much debate in the coming years.

Productivity Commission's report into the Contribution of the Not-for-profit Sector

In its 2010 Report into the Contribution of the Not-for-profit Sector, the Productivity Commission recommended as follows:

Recommendation 7.1:

The Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendations of the 2001 Inquiry into the Definition of Charities and Related Organisations.

The Government has not yet responded to the Report.

Definition of Charities and Related Organisations

In 2001, the Definition of Charities and Related Organisations²⁸ undertook a broad review of the definition of charity and related issues in Australia. That inquiry made the following recommendations about the issue of public benefit:

...

Strengthened public benefit test

The Committee recommends that the principles developed through the common law to determine whether a purpose is for the public benefit should remain. That is, the purpose must be aimed at achieving a universal or common good, it must have practical utility and it

²⁶ See recommendation 41, Australian Treasury, *Australia's Future Tax System Review: Report to the Treasurer, Detailed analysis*, Vol 1, 211.

²⁷ Treasurer's Media Release No. 28 of 2010, available at: www.treasurer.gov.au.

²⁸ Available at: <http://www.cdi.gov.au/>.

must be for the benefit of the general community or a sufficient section of it. However, we are of the view that the public benefit 'test' should be strengthened by emphasising that a charity's dominant purpose must also be altruistic.

The strengthened public benefit test was applied to a number of issues that came before the Committee. For example, we recommend that self-help groups that have open and non-discriminatory membership be regarded as having met the public benefit test. Government bodies are not altruistic and so should continue to be excluded from charity. Mutual groups and certain other groups whose members are linked by family or employment ties are also not altruistic and should be excluded from charity.

Recommendation 6 (Chapter 13)

That the public benefit test, as currently applied under the common law, continue to be applied; that is, to be of public benefit a purpose must:

- be aimed at achieving a universal or common good;
- have practical utility; and
- be directed to the benefit of the general community or a 'sufficient section of the community'.

Recommendation 7 (Chapter 13)

That the public benefit test be strengthened by requiring that the dominant purpose of a charitable entity must be altruistic.

Recommendation 20 (Chapter 29)

That there be a definitional framework to distinguish altruistic entities from other not-for-profit entities.

...

In response to the recommendations of the 2001 Charities Definition Inquiry, the then Government sought to codify the definition of charitable purposes, including an explicit public benefit test, as detailed in **Attachment C**. The Government did not proceed with the Charities Bill.

ATTACHMENT B: LEGISLATED 'PUBLIC BENEFIT' TESTS

England and Wales

The public benefit test that applies in England and Wales is located in sections 3 and 4 of the Charities Act 2006 (UK). As noted in the body of the submission, in order to access tax concessions for charitable organisations, charities in Northern Ireland and Scotland must meet this test, not the test contained in their respective charities legislation.

...

3 The "public benefit" test

(1) This section applies in connection with the requirement in section 2(1)(b) that a purpose falling within section 2(2) must be for the public benefit if it is to be a charitable purpose.

(2) In determining whether that requirement is satisfied in relation to any such purpose, it is not to be presumed that a purpose of a particular description is for the public benefit.

(3) In this Part any reference to the public benefit is a reference to the public benefit as that term is understood for the purposes of the law relating to charities in England and Wales.

(4) Subsection (3) applies subject to subsection (2).

4 Guidance as to operation of public benefit requirement

(1) The Charity Commission for England and Wales (see section 6 of this Act) must issue guidance in pursuance of its public benefit objective.

(2) That objective is to promote awareness and understanding of the operation of the requirement mentioned in section 3(1) (see section 1B(3) and (4) of the Charities Act 1993 (c. 0), as inserted by section 7 of this Act).

(3) The Commission may from time to time revise any guidance issued under this section.

(4) The Commission must carry out such public and other consultation as it considers appropriate –

(a) before issuing any guidance under this section, or

(b) (unless it considers that it is unnecessary to do so) before revising any such guidance.

(5) The Commission must publish any guidance issued or revised under this section in such manner as it considers appropriate.

(6) The charity trustees of a charity must have regard to any such guidance when exercising any powers or duties to which the guidance is relevant.

...

Northern Ireland

The following provisions are included in the Charities Act (Northern Ireland) 2008:

...

The "public benefit" test

3.–(1) This section applies in connection with the requirement in section 2(1)(b) that a purpose falling within section 2(2) must be for the public benefit if it is to be a charitable purpose.

(2) In determining whether that requirement is satisfied in relation to any such purpose, it is not to be presumed that a purpose of a particular description is for the public benefit.

(3) In determining whether an institution provides or intends to provide public benefit, regard must be had to–

(a) how any–

(i) benefit gained or likely to be gained by members of the institution or any other persons (other than as members of the public), and

(ii) detriment incurred or likely to be incurred by the public, in consequence of the institution exercising its functions compares with the benefit gained or likely to be gained by the public in that consequence, and

(b) where benefit is, or is likely to be, provided to a section of the public only, whether any condition on obtaining that benefit (including any charge or fee) is unduly restrictive.

Guidance as to operation of public benefit requirement

4.–(1) The Commission must issue guidance in pursuance of its public benefit objective.

(2) That objective is to promote awareness and understanding of the operation of the requirement mentioned in section 3(1) (see section 7(3) and (4)).

(3) The Commission may revise any guidance issued under this section.

(4) The Commission must carry out such public and other consultation as it considers appropriate–

(a) before issuing any guidance under this section, or

- (b) (unless it considers that it is unnecessary to do so) before revising any such guidance.
- (5) The Commission must publish any guidance issued or revised under this section in such manner as it considers appropriate.
- (6) The charity trustees of a charity must have regard to any such guidance when exercising any powers or duties to which the guidance is relevant.

...

Ireland

The following provisions are contained in the Charities Act 2009:

...

- (2) A purpose shall not be a charitable purpose unless it is of public benefit.
- (3) Subject to subsection (4), a gift shall not be of public benefit unless—
 - (a) it is intended to benefit the public or a section of the public, and
 - (b) in a case where it confers a benefit on a person other than in his or her capacity as a member of the public or a section of the public, any such benefit is reasonable in all of the circumstances, and is ancillary to, and necessary, for the furtherance of the public benefit.
- (4) It shall be presumed, unless the contrary is proved, that a gift for the advancement of religion is of public benefit.
- (5) The Authority shall not make a determination that a gift for the advancement of religion is not of public benefit without the consent of the Attorney General.
- (6) A charitable gift for the purpose of the advancement of religion shall have effect, and the terms upon which it is given shall be construed, in accordance with the laws, canons, ordinances and tenets of the religion concerned.
- (7) In determining whether a gift is of public benefit or not, account shall be taken of—
 - (a) any limitation imposed by the donor of the gift on the class of persons who may benefit from the gift and whether or not such limitation is justified and reasonable, having regard to the nature of the purpose of the gift, and
 - (b) the amount of any charge payable for any service provided in furtherance of the purpose for which the gift is given and whether it is likely to limit the number of persons or classes of person who will benefit from the gift.
- (8) A limitation referred to in subsection (7) shall not be justified and reasonable if all of the intended beneficiaries of the gift or a significant number of them have a personal connection with the donor of the gift.
- (9) There shall be no appeal to the Tribunal from a determination of the Authority to which subsection (5) applies.
- (10) For the purposes of this section, a gift is not a gift for the advancement of religion if it is made to or for the benefit of an organisation or cult—

- (a) the principal object of which is the making of profit, or
- (b) that employs oppressive psychological manipulation—
 - (i) of its followers, or
 - (ii) for the purpose of gaining new followers.

...

Scotland

The following provisions are contained in the Charities and Trustee Investment (Scotland) Act 2005:

8 Public benefit

(1) No particular purpose is, for the purposes of establishing whether the charity test has been met, to be presumed to be for the public benefit.

(2) In determining whether a body provides or intends to provide public benefit, regard must be had to-

(a) how any-

(i) benefit gained or likely to be gained by members of the body or any other persons (other than as members of the public), and

(ii) disbenefit incurred or likely to be incurred by the public, in consequence of the body exercising its functions compares with the benefit gained or likely to be gained by the public in that consequence, and

(b) where benefit is, or is likely to be, provided to a section of the public only, whether any condition on obtaining that benefit (including any charge or fee) is unduly restrictive.

9 Guidance on charity test

OSCR must, after consulting representatives of the charitable sector and such other persons as it thinks fit, issue guidance on how it determines whether a body meets the charity test.

ATTACHMENT C: 2003 ATTEMPT TO LEGISLATE DEFINITION OF CHARITABLE PURPOSE

The draft Charities Bill 2003²⁹ included a requirement that to be a charity, the entity must also meet a public benefit test. However, the Government did not proceed with the draft Bill. Then Treasurer Costello said:

The Government has tonight announced that the common law meaning of a charity will continue to apply, but the definition will be extended to include certain child care and self-help groups, and closed or contemplative religious orders.

...The Government has taken advice from the Board of Taxation that the draft legislation does not achieve the level of clarity and certainty that was intended to be brought to the charitable sector.

Therefore, rather than introducing a legislative definition of a ‘charity’, the common law meaning will continue to apply...³⁰

Extract from Charities Bill 2003

4 Core definition

(1) A reference in any Act to a charity, to a charitable institution or to any other kind of charitable body, is a reference to an entity that:

(a) is a not-for-profit entity; and

(b) has a dominant purpose that:

(i) is charitable; and

(ii) unless subsection (2) applies—is for the public benefit; and

(c) does not engage in activities that do not further, or are not in aid of, its dominant purpose; and

(d) does not have a disqualifying purpose; and

(e) does not engage in, and has not engaged in, conduct (or an omission to engage in conduct) that constitutes a serious offence; and

(f) is not an individual, a partnership, a political party, a superannuation fund or a government body.

(2) The entity’s dominant purpose need not be for the public benefit if the entity is:

²⁹ Available at: <http://www.taxboard.gov.au/>.

³⁰ Treasurer’s Media Release No. 31 of 2004, available at: <http://treasurer.gov.au/>.

- (a) an open and non-discriminatory self-help group; or
- (b) a closed or contemplative religious order that regularly undertakes prayerful intervention at the request of members of the public.

...

7 Public benefit

- (1) A purpose that an entity has is for the *public benefit* if and only if:
 - (a) it is aimed at achieving a universal or common good; and
 - (b) it has practical utility; and
 - (c) it is directed to the benefit of the general community or to a sufficient section of the general community.
- (2) A purpose is not directed to the benefit of a sufficient section of the general community if the people to whose benefit it is directed are numerically negligible.
- (3) Subsection (2) does not limit the other circumstances in which a purpose is not for the benefit of the general community or to a sufficient section of the general community.

...

Extract from the explanatory memorandum

...

What is the public benefit

1.33 With some exceptions [*Part 2, subsection 4(2)*], the dominant purpose of an entity must be for the public benefit if that entity is to fulfil the definition of a charity.

1.34 An entity has a purpose for the public benefit if it:

- is aimed at achieving a universal or common good;
- has practical utility; and
- is directed to the benefit of the general community or to a sufficient section of the general community. [*Part 2, subsection 7(1)*]

1.35 A purpose is aimed at achieving a universal or common good where it is beneficial. A purpose that is harmful cannot, therefore, be aimed at achieving a universal or common good.

1.36 A benefit must have a practical utility. Benefits are not restricted to material benefits, but include social, mental and spiritual benefits.

1.37 A purpose directed to the benefit of the general community or to a sufficient section of the general community will not have a numerically negligible group as its potential beneficiaries. [*Part 2, subsection 7(2)*]

1.38 Any private benefits to the members of the charitable entity must be incidental to carrying out the charitable purpose. This does not preclude the provision of private benefits to members, but restricts this provision to the point where it is incidental to the overall purpose of the entity.

1.39 Further to this, the public benefit does not exist where there is a relationship between the donor and the beneficiaries (including either a family or an employment relationship).

Example 1.2

A company establishes a program whereby the employees are given regular health checks and health care advice. The company established the program for the benevolent purpose of improving the health and wellbeing of employees.

While the program has a dominant charitable purpose of the advancement of health, it would not meet the public benefit test, as there is a relationship between the donor (the company) and the beneficiaries (the employees).

...

2004 REPORT BY THE BOARD OF TAXATION ON THE DRAFT BILL

The Board of Taxation commented on the public benefit test, but did not make any recommendations on the issue below.

...

Chapter 6, Public benefit and other definitional issues³¹

...

6.2 Presumption of public benefit: A number of submissions were concerned that the draft Bill requires entities to meet the public benefit test in section 7. This is seen as a departure from the common law which holds that bodies with a charitable purpose under the three traditional heads of charity (the relief of poverty, the advancement of education, and the advancement of religion) are presumed to be established for the public benefit.

Subsection 7(1), however, omits the presumption by providing that:

(1) A purpose that an entity has is for the ***public benefit*** if and only if:

- (a) it is aimed at achieving a universal or common good; and
- (b) it has practical utility; and
- (c) it is directed to the benefit of the general community or to a sufficient section of the general community.

6.3 Several religious organisations were particularly concerned about this new requirement. 'Any loss of the common law presumption of public benefit will also raise a real possibility of

³¹ Board of Taxation, *Consultation on the Definition of a Charity*, 2004, available at: <http://www.taxboard.gov.au/>.

an increased number of disputes between religious and other charitable organisations and government authorities as to whether the requisite public benefit exists for charitable status.’ (Anglican Church Diocese of Sydney)

6.4 There is a perception that administrative costs could be considerably increased if it became necessary for religious bodies to demonstrate public benefit for each of their constituent entities, as required by the definition. The Anglican Church Diocese of Sydney suggested instead that the ‘common law public benefit presumption be included as part of clause 7 of the proposed definition of charity in respect of all religious and other charitable purposes except where the purpose is a “purpose that is beneficial to the community” (paragraph (10)(1)(g)).’

...