The tax position of charities in Australia – why does it have to be so complicated?

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One of the difficulties with the tax concessions that are available to charities and similar bodies in Australia is that the provisions are extremely complex. A number of other jurisdictions including the United Kingdom, Canada and New Zealand grant concessions to bodies that are "charities" or that are engaged in "charitable purposes". Some of these jurisdictions rely on the common law meaning of the term "charitable" while others have adopted a statutory definition that encompasses the common law meaning. By contrast, the Australian provisions relating to eligibility for concessions contain numerous categories, many of the categories do not use the term charity and there are also a number of overlapping conditions. This article suggests that the Australian tax concessions for charities should be simplified.

Charitable organisations enjoy a number of tax concessions under the Australian tax system. This is seen as a way of the government providing support for charities and, despite some criticism, is generally supported as an appropriate use of public funds. Most other developed countries also provide support for charities through their tax systems. One of the difficulties with the tax concessions for charities in Australia is that the provisions are extremely complex. This complexity makes it more difficult, and therefore more costly, for charities to assess whether they are entitled to the concessions. In 2000, the government established an inquiry into definitional issues in relation to charities.[1] The purpose of the inquiry was to consider whether there should be a statutory definition of charity.[2] Although tax issues were raised, the inquiry did not directly address the issue of entitlement to tax concessions. The purpose of this article is to highlight the complexity and to examine easier ways to provide the concessions based on the experience of other jurisdictions such as the United Kingdom, Canada and New Zealand.

The first part of the article considers what constitutes a charity for the purposes of the tax legislation. The second part of the article considers the problem of complexity vis-à-vis the goal of simplicity in relation to tax and discusses why the issue of simplicity differs from the prospect of introducing a statutory definition of "charity". The third part of the article considers three important tax concessions available to charitable entities, how they came to be in their present form and compares other jurisdictions' ways of dealing with the same concession. The final part of the article considers some options for reform.

WHAT IS A CHARITY FOR TAX PURPOSES?

Since there is no statutory definition of the term "charity" or "charitable purposes" in the tax legislation (or elsewhere), the terms take their meaning from the common law which was initially concerned with the law of charitable trusts. In the United Kingdom, the *Charitable Uses Act of 1601* (known as the Statute of Elizabeth)[3] was introduced to address abuses in charitable trusts. The Preamble sets out various charitable purposes:

> The relief of the aged, impotent and poor people; the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities; the repair of bridges, ports, havens, causeways, churches, sea-banks and highways; the education and preferment of orphans; the

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[1] The Inquiry into the Definition of Charities and Related Organisations (Charities Definition Inquiry or CDI) was established in September 2000 and the Report (hereafter the CDI Report) was submitted to the government in June 2001.

[2] CDI Report, n 1, Terms of Reference, pp v-vi.

[3] The Act was eventually repealed in 1888.

> relief, stock or maintenance of houses of correction; the marriages of poor maids, the supportation, aid and help of young tradesmen, handicraftsmen and persons decayed; the relief or redemption of prisoners or captives; and the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers and other taxes.

The Preamble has been relied on in many cases as the basis for a determination of whether an entity is charitable despite the fact that it has not been regarded as exhaustive. In *Incorporated Council of Law Reporting (Queensland) v FCT*, Barwick CJ noted its general guidance as follows:

> Out of certain instances given in the preamble to the Act of 1601 a broad concept emerges of the kind of object of public utility which will satisfy the quality of charity.[4]

In 1891, Lord Macnaghton in *Income Tax Special Purposes Commissioners v Pemsel*[5] classified the categories of charitable purposes under four heads:

> Charity in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community not falling under any of the preceding heads.

This classification of charitable purposes has remained the cornerstone of identifying whether an entity is a charity, ie an entity established for charitable purposes. The final catch-all category has allowed courts to respond to more modern community views as to what categories of entity should be recognised as charities.[6]

Case law also suggests that some purposes are not charitable, eg political purposes.[7] It has also been held that government bodies or bodies performing government functions are different in nature to charities and should not be treated as charities.[8]

In addition to the charitable purposes requirement, case law also indicates that the entity must be not-for-profit and that its purposes be for the public benefit. The not-for-profit requirement means that any profit or surplus of the entity must be used to further its charitable purpose and must not be distributed to members or other individuals associated with the entity.[9] The public benefit requirement has been held to mean that the benefit must flow to the public generally or to a sufficient section of it.[10] This can mean that entities that would otherwise be seen to have charitable purposes may not be

[4] *Incorporated Council of Law Reporting (Queensland) v FCT* (1971) 125 CLR 659; 2 ATR 515. The significance of the preamble was confirmed by the High Court in *Royal National Agricultural and Industrial Association v Chester* (1974) 48 ALJR 304.

[5] *Income Tax Special Purposes Commissioners v Pemsel* [1891] All ER Rep 28 at 55.

[6] The Australian Tax Office (ATO) has released *Income tax and fringe benefits tax: Charities*, TR No 21 (2005) which sets out the Commissioner's views on the meaning of the term "charity" and identifies examples of courts relying on this final category to find that entities are charities (at [218]).

[7] For example, in *National Anti-Vivisection Society v IRC* [1948] AC 31, a society whose main purpose was to lobby to introduce legislation to prohibit experiments on animals was not charitable and in *McGovern v A-G* [1982] 3 All ER 493 at 506 an organisation that sought change to government policy in relation to securing the release of prisoners of conscience was also held not to be charitable. In Australia, these principles have also been applied – see *Royal North Shore Hospital of Sydney v A-G for NSW* (1938) 60 CLR 396. However, in *Public Trustee v A-G for NSW* (1997) 42 NSWLR 600, the court was able to sever those purposes that were deemed political (dealing with support for the abolition of legislation involving racial discrimination) and find that a valid gift had been made based on the other charitable purposes of the organisation.

[8] A recent example is the High Court decision in *Central Bayside Division of General Practice Ltd v Commissioner of State Revenue* (2006) 228 CLR 168; 63 ATR 220; 2006 ATC 4610.

[9] In *Incorporated Council of Law Reporting (Queensland) v FCT* (1971) 125 CLR 659; 2 ATR 515 it was noted that this requirement is not inconsistent with the entity making a profit, provided it is not distributed to members. The ATO has stated in its Ruling dealing with public benevolent institutions that it would regard an organisation as being not-for-profit where "by its constituent documents or by operation of law (eg a statute governing an organisation), it is prevented from distributing its profits or assets among members while it is operating or on its winding up": ATO, *Income tax and fringe benefits tax: Public benevolent institutions*, TR No 5 (2003). See also *FCT v Word Investments Ltd* [2007] FCAFC 171 where the Full Federal Court held that the carrying on of a commercial business and the making of profits would not prevent an entity from being a charity provided the profits were used for a charitable purpose.

[10] In *Re Compton* [1945] 1 Ch 123, a gift for the education of descendants of named persons introduced into their qualification a purely personal element and such gift was, therefore, to be regarded as a family trust and not as one for the benefit of a section of the community. In *Oppenheim v Tobacco Securities Trust Co Ltd* [1951] AC 297, a gift providing assistance for the education

charities because, for instance, they benefit too narrow a section of the community (self-help groups or membership based groups) or provide no benefit at all (eg contemplative religious orders).[11]

THE PROBLEM OF COMPLEXITY

This article argues that the tax legislation as it applies to charitable entities is too complex. In 1985, a Treasury White Paper[12] identified the three criteria for assessing a tax system as "equity", "efficiency" and "simplicity". Those criteria have been used since that time to evaluate the effectiveness of the tax system as a whole and to judge individual proposals for reform. In relation to simplicity, the paper stated:

> A good tax system should be as simple as possible. A complex tax system makes it difficult for people to understand the law and apply it to their circumstances. The present law has become so complex that it is difficult to convey its meaning simply and adequately on tax return forms and in other printed matter. Complexity imposes high compliance costs on the community and high administrative costs on the tax authorities. Complex tax laws also result in socially unproductive and costly tax litigation. These considerations suggest that, where possible, tax reform measures capable of ready comprehension and application should be preferred over more complex alternatives.[13]

The White Paper also noted that the three criteria sometimes conflict. For example, "measures to make the system more equitable might require complex legislative provisions and may also cause economic distortions".[14] This article suggests that in the case of concessions for charitable entities there is no good argument for complexity, that the complexity has arisen as a result of a piece-meal approach and that it is relatively straightforward to remove the complexity.

The Review of Business Taxation in 1999 identified one of the major objectives guiding development of the tax system as "promoting simplification and certainty".[15] The Inspector-General of Taxation has also identified simplicity as one of the "fundamental principles" of tax policy.[16]

The Charities Definition Inquiry (CDI) in 2000 was not limited to considering the tax position of charities, or even with considering the definition of charities for tax purposes, but rather with the definition of charity and related organisations for all Commonwealth purposes. The Committee was asked to:

> provide options for enhancing the clarity and consistency of the existing definitions in Commonwealth law and administrative practice with respect to charities, religious and community service not-for-profit organisations. These should lead to legislative and administrative frameworks at the Commonwealth level that are appropriate for, and adapted to, the social and economic environment of Australia.[17]

However, the CDI Report does note that the existence in the tax provisions of a number of categories that entities may fit into under the tax legislation can be a cause of confusion. It noted (p 34):

> It is clear from submissions to the Inquiry that much of the confusion in the sector is related to what tax or other concessions attach to what type of entities and what the boundaries are between different types of entities. This is not surprising given the wide range of categories of entities that can access the concessions.

It also noted (p 33):

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of children of employees or former employees failed. It was held that the common employment of the potential beneficiaries would not be sufficient to constitute them a section of the public so as to afford the necessary public character to render it charitable. There seems to be little case law in Australia. Some of the general principles are discussed in ATO, n 6, TR No 21 of 2005.

[11] Some of these matters have been addressed by specific statutory provisions and are discussed below.

[12] Treasury, *Reform of the Australian Tax System*, Draft White Paper (1985).

[13] Treasury, n 12 at [1.8].

[14] Treasury, n 12 at [1.10].

[15] Review of Business Taxation Final Report, *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) p 104.

[16] Inspector-General of Taxation, *Issues Paper No 2 – Policy Framework for Review Selection* (2003).

[17] CDI Report, n 1, Terms of Reference, p v at [4].

Sometimes, entities themselves can be uncertain about whether they are entitled to income tax exemption because they are a charity or because they fall into one of the other categories.

By contrast, the CDI Report found that in other common law countries, such as England, all charities are eligible for the same taxation concessions.

The CDI was clearly concerned with the confusion that stemmed from the "labyrinth of taxation provisions" (p 35). However, its inquiry was really focused on whether it was still appropriate to rely on common law concepts or whether it was more appropriate to set out a statutory definition that could then form the basis for tax and other legislation dealing with charities. It would be left open to government to determine whether particular provisions, such as different tax concessions, should be available to all or some subset of charities (p 39). The CDI Report dated June 2001 did recommend that a statutory definition be enacted. In August 2002, the government responded positively to the recommendation[18] and in July 2003 released draft legislation containing a statutory definition and asked an ongoing advisory body, the Board of Taxation, to undertake consultation on that draft legislation.[19] The Board's report was delivered to the government in December 2003 and in May 2004 it was announced that the government had taken advice from the Board "that the draft legislation does not achieve the level of clarity and certainty that was intended to be brought to the charitable sector" and that, therefore, the common law meaning would continue but that the government would introduce "a statutory extension to the common law meaning of a charity to include non-profit child care available to the public, self-help groups with open and non-discriminatory membership, and closed or contemplative religious orders that offer prayerful intervention to the public".[20] That legislation, the *Extension of Charitable Purposes Act 2004* (Cth), came into force on 1 July 2004. The impact of that legislation on the tax position of charitable entities is considered below.

One of the problems with the existing tax concessions is that the term "charitable" is not necessarily the basis for determining access to tax concessions, so that even being able to determine whether an entity is charitable does not answer the more immediate question of whether the entity is entitled to a particular tax concession. In the case of each concession, it is necessary to consider the eligibility criteria because, even if an entity qualifies as a charity at common law, this does not ensure it has access to a particular concession. The CDI did note that government may wish to restrict some concessions to different types of charities but thought it would be possible to identify a subset, which they called "benevolent charities", to which the government may choose to offer some exclusive concessions.[21] This suggestion was not taken up in the Exposure Draft legislation considered by the Board of Taxation or in the legislation that was subsequently enacted.

CURRENT TAX CONCESSIONS FOR CHARITABLE ENTITIES

Although there are many tax concessions for charitable entities at both the federal and State level,[22] this article considers three of the main concessions available at the federal level. They are as follows:

- exemption from income tax;
- gift deductibility; and
- fringe benefits tax (FBT) concessions.

In each case it is necessary to consider the background to the concession, eligibility for the concession and how the provision came to be in its present form. It is also necessary to consider how other jurisdictions deal with the type of concession being considered.

[18] Treasury, Press Release No 49 (29 August 2002).

[19] Treasury, Press Release No 59 (22 July 2003).

[20] Treasury, Press Release No 31 (11 May 2004).

[21] CDI Report, n 1, p 258.

[22] At the State level, there are concessions relating to land tax (eg *Land Tax Act 2005* (Vic), s 74), payroll tax (eg *Payroll Tax Act 1971* (Vic), s 10(bb)) and stamp duty (eg *Duties Act 2000* (Vic), s 45). At the Commonwealth level, there are concessions relating to GST (*A New Tax System (Goods and Services Tax) Act 1999* (Cth), Subdiv 38-250) and franking credits (*Income Tax Assessment Act 1997* (Cth) (ITAA 1997), s 207-115).

Income tax exemption

Background

Charitable organisations have been exempt from paying income tax since the introduction of income taxes by the States in 1884[23] through to the first Commonwealth income tax legislation in 1915,[24] and continuously to the existing legislation.[25] The concession was based on the English legislative position which had contained an exemption from income tax for charitable organisations dating back to the first *Income Tax Act* in 1799.[26]

The concession has attracted some criticism. Professor McGregor-Lowndes has noted that in 1863, Gladstone, as Chancellor of the Exchequer, questioned the exemption of charities from income tax on the basis of lack of accountability and because some charitable hospitals were catering only to the wealthy.[27] A similar sentiment was echoed in a submission to the CDI in relation to tax concessions for private schools.[28] There has also been concern expressed from time to time that commercial operations run by charitable organisations have an unfair advantage when competing with for-profit organisations as a result of the income tax exemption and other tax concessions.[29] The recent Full Federal Court decision in *FCT v Word Investments Ltd*[30] confirms that where profit from commercial activities is used for charitable purposes, this will not affect an entity's charitable status.

A further difficulty with the concession is that it is difficult to quantify what level of support is being provided to charities through this concession, ie it is impossible to estimate the amount of revenue foregone by government (referred to as "tax expenditures"). The government's annual tax expenditure statements, which attempt to measure the cost of benefits and concessions delivered to taxpayers through use of the taxation system, list the cost of the income tax exemption for religious, scientific, charitable or public educational institutions as "NA" – not available.[31] In any event, Professor McGregor-Lowndes notes that tax expenditure analysis is not really appropriate for charities for a number of reasons.[32] First, he notes the lack of data on revenue foregone. Secondly, he suggests that charities and other non-profits may be outside the taxation base, ie if charities were never part of the taxation system, then the loss to the revenue is nil. Thirdly, he notes that charities and other non-profits may not be the appropriate objects of taxation which primarily applies to individuals and to companies and some other entities in their capacity as agents for individuals. Fourthly, he notes that the imposition of income tax on charities and other non-profits would not result in much additional revenue as the tax applies to taxable income and that such entities could simply use up any surplus in a particular year. Despite these criticisms, there does appear to be a general acceptance that the provision of the income tax exemption is an appropriate way for government to assist charitable activities.[33]

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[23] South Australia was the first State to impose income tax under the *Taxation Act 1884* (SA).

[24] *Income Tax Assessment Act 1915* (Cth). In the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936), the relevant provisions were ss 23(e) and 23(j).

[25] ITAA 1997, Div 50.

[26] *Income Tax Act* 39 GEO III c 13, s 5.

[27] Discussed in McGregor-Lowndes M, *Public/Private Accountability and the Tax Exempt Status of Charitable Organisations*, Seminar Paper for Social Policy and Research Centre (University of New South Wales, 20 February 2003).

[28] McGregor-Lowndes, n 27, p 2.

[29] CDI Report, n 1, pp 229-230.

[30] *FCT v Word Investments Ltd* [2007] FCFCA 171.

[31] Treasury, *Tax Expenditure Statement 2006*, Item B4.

[32] See McGregor-Lowndes, n 27, pp 18-20.

[33] *Taxation Review Committee*, Full Report (1975) referred to in McGregor-Lowndes, n 27, p 18.

The current concession

The concession is currently contained in Div 50 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) which is headed "Exempt Entities". The Division contains nine categories of entity but only three are really relevant to organisations that would describe themselves as charitable. Those categories are:

- charity, education, science and religion (s 50-5, Items 1.1-1.7);
- community service (s 50-10, Item 2.1); and
- health (s 50-30, Items 6.1-6.3).

The term "charitable institution" appears in Item 1.1 and the term "charitable purpose" appears in Items 1.5 and 1.5B. As already noted, in the absence of a statutory definition, the term "charity" takes its meaning from the common law. Following the CDI Report, the government introduced legislation to extend the meaning of the term "charity" to include:

- organisations providing child care to the public on a non-profit basis;
- self-help bodies with open and non-discriminatory membership; and
- closed or contemplative religious orders that offer prayerful intervention for the public.[34]

Under s 50-5 there is a distinction drawn between institutions and funds. The distinction is significant because of the different requirements that need to be satisfied for the exemption. In *Stratton v Simpson*,[35] Gibbs J noted that, in its ordinary sense, "institution" means "an establishment, organisation, or association, instituted for the promotion of some object, especially one of public utility". This has been held to mean something different from a fund which involves the management of property or money.[36] Such arrangements are also sometimes described as philanthropic trusts or foundations. Other types of entities referred to are "a society, association or club" established for the encouragement of science or for community services purposes, certain hospitals and certain registered organisations that provide medical and related benefits.[37]

In addition to the reference to different types of entities, different categories of entity are required to satisfy different conditions. For example, a requirement to be endorsed by the Commissioner of Taxation applies to charitable institutions and to trusts and funds established for charitable purposes;[38] a condition of physical presence in Australia applies to charitable and religious institutions;[39] separate conditions relating to applying the fund for the purpose for which it was established apply to charitable funds;[40] and certain entities are subject to an express requirement that they are not carried on for the purpose of profit or gain of individual members.[41]

Since 2000, there has been a requirement that certain income tax exempt entities be endorsed by the Commissioner of Taxation.[42] According to the Explanatory Memorandum to the legislation,[43] the purpose of the measure is to protect the integrity of the taxation system in respect of deductible gift recipients and income tax exempt charities. However, the original reason for the measure was that the government was proposing to tax trusts like companies, ie impose tax at the entity level and then allow beneficiaries to claim franking credits for tax already paid.[44] One concern expressed at this proposal was that donations to charitable entities from trusts would be made out of after-tax income.

[34] *Extension of Charitable Purposes Act 2004* (Cth), ss 4-5.

[35] *Stratton v Simpson* (1970) 125 CLR 138.

[36] *Douglas v FCT* (1997) 77 FCR 112; 36 ATR 532.

[37] See ITAA 1997, s 50-10, Item 2.1; s 50-30, Items 6.1-6.3.

[38] ITAA 1997, s 50-52.

[39] ITAA 1997, s 50-50.

[40] ITAA 1997, s 50-57. See the decision in *FCT v Word Investments Ltd* [2007] FCAFC 171.

[41] ITAA 1997, s 50-30, Items 6.2-6.3; s 50-40, Items 8.1-8.3; s 50-45, Item 9.2.

[42] ITAA 1997, Subdiv 50-B.

[43] *A New Tax System (Tax Administration) Act 1999* (Cth), Explanatory Memorandum at [6.7].

[44] Treasury, *Not a New Tax: A New Tax System* (1998) p 114.

The proposal was that the government would maintain a register of charities and that only a registered charity would be able to claim the refund of tax paid by the trust. That is, the proposal for registration (later changed to endorsement) was to preserve the position of deductible gift recipients when the taxation of entities proposal was implemented. That proposal was abandoned but the endorsement process was introduced in any event. The endorsement process was also made to apply to charitable entities claiming income tax exemption and later expanded to entities applying for FBT exemption.[45]

The endorsement process does not alter any of the eligibility requirements for income tax exemption. The Explanatory Memorandum to the legislation described the operation of the rules as follows:

> Although this measure introduces a requirement to approach the Commissioner for the relevant endorsement, there is no change to the current requirements for concessional status.[46]

Entities are required to apply for endorsement once and there is no annual review. However, an entity may lose endorsement if the Commissioner determines that it no longer meets the requirements. This would appear to be a difficult matter to determine given that there is no formal review process. Unlike other jurisdictions, the endorsement process is not linked to any form of supervision of the activities of charities.

One of the issues concerning endorsement is that it only applies to some charitable entities. For example, in relation to income tax exemption, the only entities that are required to be endorsed are "charitable institutions", "funds established for public charitable purposes" or funds that contribute to such funds. This suggests that an entity that is, say, a religious institution does not need to be endorsed. However, the Commissioner's view is that if the religious institution is also a charitable institution it must be endorsed. Rather surprisingly, it states:

> if an entity is both a charitable institution and a religious institution (item 1.2 in section 50-5), it must be endorsed as an income tax exempt charity. The fact that it is a religious institution does not confer exemption from income tax. It is immaterial whether it meets the conditions for exemption as a religious institution.[47]

Based on the common law meaning of charity and assuming that almost all religious entities would be concerned with the advancement of religion, the enumeration of religious entity as a separate category of exempt entity appears to be unnecessary. One argument for including a separate category for religion is that contemplative orders may not meet the public benefit criteria.[48] The same could be said for public educational institutions (concerned with the advancement of education) and perhaps community service organisations (concerned with other purposes beneficial to the community). By contrast, hospitals that are eligible for tax exemption do not need to be endorsed.

Under s 50-5 of ITAA 1997, charitable institutions must satisfy one of two conditions set out in s 50-50(a) or (b). Under s 50-50(a), a charitable institution must meet two requirements: first, it must have a physical presence in Australia; and, second, to the extent it has a physical presence in Australia, it must incur its expenditure and pursue its objectives principally in Australia. Alternatively, under s 50-50(b), the entity must meet the description and requirements in Item 1 of the Table in s 30-15. The item refers to funds, authorities and institutions covered by Subdiv 30-B, which are named there or for which there is an endorsed deductible gift recipient. To satisfy s 50-50(b), it is not sufficient that the charitable institution operates a gift deductible fund or institution. The charitable institution must be a deductible gift recipient in its own right.

There are also a number of special conditions that apply to a charitable fund, the main one being it must be applied for the purposes for which it was established (ss 50-57, 50-60). Surprisingly, there

[45] *Taxation Laws Amendment Act (2004 Measures No 1) Act 2004* (Cth), applicable from 1 July 2005.

[46] *Taxation Laws Amendment Act (2004 Measures No 1) Act 2004* (Cth), Explanatory Memorandum at [6.3].

[47] ATO, *Income tax: Endorsement of income tax exempt charities*, TR No 11 (2000) at [10].

[48] See, though, the *Extension of Charitable Purposes Act 2004* (Cth).

is no equivalent requirement for institutions as to the use of funds.[49] Charitable funds are subject to further conditions that depend on the date on which they were established.[50]

Certain entities that are eligible for tax exemption are subject to an express requirement that they not be for profit or for the gain of individual members. This is set out in s 50-30 with respect to "hospitals carried on by a society or association" and "medical, health or hospital benefits organisations" and in s 50-70 with respect to "a society, association or club established for the encouragement of science", "a society, association or club established for community service purposes (except political or lobbying purposes)" and some other entities that are not really within the scope of charity. A key requirement of the definition of charity at common law is that it be not-for-profit. For example, it has been noted that "the absence of private profit is a necessary attribute of charity", and "that private profit refers to the distribution of profits and/or capital of an entity to private individuals or non-charitable entities but does not include the payment of wages or allowances to employees, reimbursement of expenses, or payments for services".[51] If, instead, income tax exemption was simply provided for "charitable organisations", it would not be necessary to impose this additional requirement.

The complex nature of the income tax exemption raises the question of whether there is a simpler way of achieving the same result. It is instructive to consider the way in which the income tax exemption is dealt with in some other jurisdictions.

Position in other jurisdictions

The position in the United Kingdom under the *Income and Corporations Taxes Act 1988* (UK) is that various types of income of a charity are exempt from income tax. This includes rent and profits from land, interest, annuities and certain dividends. Such income is exempt if it is applied for charitable purposes only (s 505(a)-(d)). There is a more limited exemption for income from business or trading. In this case, the income is only exempt if the profits are applied solely for the purposes of the charity, and either the trade is exercised in the course of actually carrying out the primary purpose of the charity, or the work in connection with the trade is mainly carried out by beneficiaries of the charity (s 505(e)). There is also an exemption for small profits.[52] Capital gains made by a charity are not subject to tax if the gain is applied for charitable purposes.[53] The income tax and capital gains tax relief may be denied or restricted if expenditure by the charity during the period is incurred otherwise than for exclusively charitable purposes. Such expenditure is referred to as non-qualifying expenditure. This restriction generally only applies to charities where the relevant income and gains exceed £10,000 (s 505(3)).

The income tax and capital gains tax exemptions apply to a "charity". The term "charity" is defined in the *Income and Corporations Taxes Act* as "any body of persons or trust established for charitable purposes only". The Inland Revenue accepts that entities that are registered with the Charities Commission need only notify Inland Revenue of their status.[54] Charities in the United Kingdom that are not required to be registered[55] can apply to Inland Revenue to be eligible for the tax exemptions. Currently, the definition of charity and charitable purposes is determined under common

[49] By contrast an entity which is an endorsed deductible gift recipient must use any gifts for the principal purpose of the fund, authority or institution: ITAA 1997, s 30-125(5).

[50] See ITAA 1997, s 50-5, Items 1.5, 1.5B; ss 50-52, 50-57 and 50-60.

[51] Dal Pont G, *Charity Law in Australia and New Zealand* (Oxford University Press, 2000) pp 22-23, referred to in the CDI Report, n 1, pp 91-92.

[52] *Finance Act 2000* (UK), s 46(4). The annual limit is £5,000, or if the turnover is greater than £5,000, 25% of the charity's gross income, but no more than £50,000.

[53] *Taxation of Chargeable Gains Act 1992* (UK), s 256(1).

[54] See website for HM Revenue and Customs Charities, http://www.hmrc.gov.uk/charities/index.htm viewed January 2008.

[55] This includes some English and Welsh entities and also Northern Irish and Scottish entities.

law and the Charities Commission (which has general regulatory authority over charities in England and Wales) issues guidance as to what an entity must do to maintain its charitable status.[56]

The new *Charities Act 2006* (UK) received Royal Assent on 8 November 2006. One of the main purposes of the Act is to define a charity as a body or trust which is for a charitable purpose and for the public benefit and then to include a description of the main purposes which are charitable. The list also includes any other purpose which is charitable at law, which allows the courts to respond to changing circumstances. The decision to introduce a statutory "definition" arose out of a review conducted by a strategy unit within the Prime Minister's office.[57] The Act appears to have widespread support. One interesting aspect of the new Act is that (under s 3) all charities will have to meet an express public benefit test. The essential point, however, is that the term that is used for eligibility to the tax relief is "charity". Although there has been some discussion as to whether this "one size fits all" approach is the most desirable,[58] it is clear that the approach is much more straightforward than the one that currently applies in Australia.

In Canada, under the federal *Income Tax Act 1985* (Can), the taxable income of a "registered charity" is exempt (s 149). An exemption is also provided for certain other entities such as a low-cost housing corporation, a non-profit corporation for scientific research and experimental development, and a non-profit community organisation. A registered charity can be a charitable organisation, private foundation or public foundation (s 248). A charitable organisation is defined (at s 149.1(1)) to mean "an organization, whether or not incorporated, all the resources of which are devoted to charitable activities carried on by the organization itself, and no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof".

The Canadian Revenue Authority (CRA) has responsibility for registration of charities and exercises a regulatory role under s 248. It can revoke registration, inter alia, if the entity ceases to comply with the requirements of the Act for its registration or fails to file an information return as and when required under the Act or a regulation (s 168). In determining whether an entity is a charity, the CRA relies on the English common law and issues guidance on how it interprets that term. As to charitable purposes, the CRA adopts the four heads set out in *Pemsel's* case.[59] It also notes that the term "charity" requires a public benefit, ie "it must be established for the benefit of the public or a sufficient segment of the public".[60] The CRA notes that the public benefit requirement means that the organisation may not otherwise benefit private individuals except under certain limited conditions and, subject to some exceptions, the organisation cannot exist for the benefit of its members. It is also noted that the following other factors would be likely to prevent an organisation from being registered:

- the organisation is established for the purpose of making a profit;
- the organisation is set up for illegal purposes or for purposes that are contrary to public policy; or
- the organisation is set up for political purposes or is involved in political activities beyond the limits allowed at law.

The Canadian approach, basically, is to use the one term to identify eligibility for income tax exemption and to rely on the common law definition to determine the scope of the eligibility.

In New Zealand, under the *Income Tax Act 2004* (NZ), both business income and non-business income are exempt from tax for eligible charitable organisations, but different rules must be satisfied for the exemption to be available for each type of income. In relation to business income, the

[56] See website for the Charities Commission, http://www.charity-commission.gov.uk viewed January 2008.

[57] Prime Minister's Strategy Unit, *Private Action, Public Benefit – A Review of Charities and the Wider Not-For-Profit Sector* (2002).

[58] Warburton J, "Charity – One Definition for All Tax Purposes in the New Millennium" [2000] *British Tax Review* 144.

[59] *Income Tax Special Purposes Commissioners v Pemsel* [1981] All ER Rep 28. See Canada Revenue Agency (CRA), *Registering a Charity for Income Tax Purposes*, T4063 (2001), http://www.cra-arc.gc.ca/formspubs/menu-e.html viewed January 2008.

[60] CRA, *Guidelines for Registering a Charity: Meeting the Public Benefit Test*, CPS-024 (2006).

exemption is only available if the income is used for charitable purposes within New Zealand (s CW 35). Furthermore, business income will not be exempt if anyone connected with the charitable organisation receives or is able to receive any benefits or income from the organisation and is in a position to determine or materially influence the nature or the amount of the benefit they receive. In relation to non-business income (ie income from interest, dividends or rent), the organisation must simply use the income for charitable purposes (s CW 34).

In order to qualify for exemption as a charity, the organisation must carry on charitable activities, be established for charitable purposes (if a trust), or be established exclusively for charitable purposes (if a society or institution). The legislation defines "charitable purposes" by reference to the common law meaning of the term (s OB 1). From 1 January 2007, there is an additional requirement that all charities requiring tax-exempt status need to be registered. This requirement was introduced by the *Charities Act 2005* (NZ).[61] That Act still essentially relies on the common law definition of charity and requires the entity's purpose to fall within at least one of the categories of:

- advancement of education;
- advancement of religion;
- the relief of poverty; and
- benefit to the community.

In addition, in carrying out this purpose the charitable entity must, with the exception of the relief of poverty, benefit an appreciably significant section of the community (the public benefit test). The *Charities Act* also indicates that a charitable entity will not be disqualified from registering if it also has a secondary or supplementary non-charitable function (such as advocacy) as part of its charitable purpose.[62]

This survey of other jurisdictions shows that it is possible to simplify the law with respect to providing income tax exemption for charitable entities. This does not seem to be dependent on whether the jurisdiction incorporates a statutory definition of charity, relies on the common law meaning of charity or modifies the application of that definition by restricting tax relief to only some charitable organisations or some categories of income.

Gift deductibility

Background

The first Commonwealth income tax legislation in 1915 contained a provision that allowed taxpayers a deduction against assessable income for gifts to "public charitable institutions".[63] In *Chesterman v FCT*,[64] a case dealing the term "charitable" in the *Estate Duty Assessment Act 1914* (Cth), it was considered whether, in the context of providing relief from the application of estate duty, it was appropriate to give the term its popular meaning (ie the relief from poverty) or to adopt a wider legal meaning as set out in *Pemsel's* case.[65] The Privy Council overturned the High Court to adopt the wider legal meaning. The government response to this case was to rethink the operation of some of the tax concessions to charities and to seek ways to limit the application of some of those provisions. In relation to gift deductibility, the term "public charitable institution" was initially retained but a definition of that term was added when the *Income Tax Assessment Act* was consolidated in 1927. The definition was as follows (s 23):

> Public charitable institution means a public hospital, a public benevolent institution and includes a public fund established and maintained for the purpose of providing money for such institutions or for the relief of persons in necessitous circumstances.

The effect of the definition was that deductibility was only available for gifts to a more limited group

[61] Registration is voluntary but necessary for income tax exempt status.

[62] *Charities Act 2005* (NZ), s 5(3).

[63] *Income Tax Assessment Act 1915* (Cth), s 18(h). The equivalent provision in the ITAA 1936 was s 78.

[64] *Chesterman v FCT* (1925) 37 CLR 317.

[65] *Income Tax Special Purposes Commissioners v Pemsel* [1891] All ER Rep 28 at 54.

of charitable institutions. In the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936), the term "public charitable institution" (and the definition) was removed and the entities listed in the definition became the framework for the eligible entities now listed in Div 30 of the ITAA 1997.

The *Estate Duties Assessment Act* was also amended as a result of *Chesterman's* case to remove the reference to charitable and replace it with "a public hospital, a public benevolent institution in Australia or a fund established and maintained for the purpose of providing money for such institutions or for the relief of persons in necessitous circumstances".[66] The term "public benevolent institution" was not defined in either Act. It was considered for the first time in *Perpetual Trustee Co Ltd v FCT*,[67] where the High Court held that the term was limited to organisations that are established for the relief of poverty, sickness, destitution or helplessness. In that case, an organisation that provided inexpensive accommodation to "lower ranks of the Navy" was held not to be a public benevolent institution. That case has been relied on in subsequent cases dealing with the term and the Australian Tax Office (ATO) has accepted that the case represents the current position as to what constitutes a public benevolent institution.[68]

Despite general acceptance that it may be appropriate to have some sort of subset of charities that are eligible for certain tax reliefs, as opposed to allowing all charities equal access, there has been some discussion of the continuing relevance of the term "public benevolent institution" itself. The CDI Report concluded that the interpretation of the term was outdated and unnecessarily restrictive.[69] It noted that governments have limited resources and "seek to discriminate between competing claims when deciding whether, and to what extent, to provide support",[70] and recommended that it was appropriate to identify a subset of charities that could attract more favourable treatment. They suggested that the subset be called "benevolent charities", ie "a charity whose dominant purpose is to benefit, directly or indirectly, those whose disadvantage prevent them from meeting their needs".[71] That recommendation was acknowledged by the government when it published the CDI Report in August 2001 but was not included in the proposals when the government announced its formal response in 2002.[72] As already noted, the key matter in that response was the announcement of draft legislation to consider a statutory definition of the term "charity" which was abandoned following an inquiry by the Board of Taxation.

By providing a deduction for gifts to various entities, the government is effectively subsidising the gift by a donor to its chosen recipient. Eligible recipients are seen as benefiting because donors know that the after-tax cost of giving will be less than the actual cost. The deduction is unusual in the sense that it is the only deduction that is not linked to the earning of assessable income. Professor Krever comments on the indirect nature of this concession with part of the benefit flowing to someone other than the taxpayer.[73] He notes that if a taxpayer on the top rate of tax (currently 46.5%) makes a $100 gift to a charity, the deductibility means that the taxpayer effectively only pays $53.50. In other words, the taxpayer contributes $53.50 and the government contributes $46.50 to the charity. The cost to the government of providing this concession is much easier to quantify than the tax exemption concession. The government's Tax Expenditure Statement for 2006 estimates that the cost of providing a deduction for gifts to approved entities amounts to $710 million for 2007-2008.[74]

[66] *Estate Duties Assessment Act 1914* (Cth), s 8(5), as amended in 1928.

[67] *Perpetual Trustee Co Ltd v FCT* (1931) 45 CLR 224.

[68] ATO, n 9, TR No 5 of 2003.

[69] CDI Report, n 1, pp 253-255.

[70] CDI Report, n 1, p 255.

[71] CDI Report, n 1, p 258, Rec 21.

[72] Treasury, Press Release No 49 (29 August 2002).

[73] Krever R. "Charities and Philanthropic Organisations – Reforming the Tax Subsidy and Regulatory Regimes" in Krever R and Kewley G (eds), *Australian Tax Research Foundation and Comparative Public Policy Unit* (Monash University, 1991) p 6.

[74] Treasury, n 31, Item A64.

The current concession

The concession is currently contained in Div 30 of the ITAA 1997 headed "Gifts or Contributions". Subdivision 30-A contains a table of gifts or contributions that can be deducted and sets out eligible recipients, as well as the type of gift, the amount that can be deducted and any special conditions that apply. For example, the gift may be either money or property; and the amount of the deduction is the amount of the gift (if the gift is money) and the value of any gifts of property (s 30-15(2)). From the point of view of the donee (the taxpayer claiming the deduction), it is necessary to show that the amount given is a gift,[75] that the gift is made inter vivos,[76] and that the gift is greater than $2[77] (or in some cases $250).[78] The maximum amount of the gift eligible for deduction is effectively the amount of the taxpayer's income in a year because the rules that allow for carry-forward of losses exclude gift deductions (s 26-55).

Importantly, the deduction is only available for gifts to eligible gift recipients (referred to as "deductible gift recipients"). The Table in Subdiv 30-A lists eight types of deductible gift recipient but perhaps the most important is Item 1: "A fund, authority or institution covered by an item in any of the Tables in Subdiv 30-B". The difference between a fund and an institution was discussed above. Before considering the Tables in Subdiv 30-B, it should be noted that a gift to an entity listed in Item 1 will only be deductible if two further conditions are met. Those conditions require the eligible entity to be based in and operating in Australia and in some cases, but not all, to be endorsed by the ATO.

To be eligible for gift deductibility, the fund, authority or institution must be "in Australia".[79] This is not part of the definition of a deductible gift recipient but, rather, a separate condition that must be satisfied. For example, an entity may be eligible for FBT relief even though it does not satisfy this requirement, but would not be eligible for deductible gift recipient status. The CDI Report noted that several submissions argued that the requirement was too restrictive but concluded that it was open to government to limit the availability of taxation benefits to charities based in and operating in Australia.[80] The ATO appears to take a fairly relaxed attitude to the requirement noting that "where a public benevolent institution conducts an activity outside Australia that is merely incidental to providing relief in Australia, or is insignificant, it will not disqualify the institution from endorsement".[81] It also suggests that where a public benevolent institution provides public benevolence outside Australia, it might establish a public fund to provide for those services.[82]

As already noted, the requirement to be endorsed was originally proposed as a way of allowing eligible entities to claim refunds of tax made by trusts that were to become subject to the entities' taxation regime. Section 30-17 of the ITAA 1997 now provides that a gift or contribution made to the following types of recipient is deductible only if the recipient is endorsed as a deductible gift recipient under the rules in Subdiv 30-BA (or where the entity is specifically named or is a prescribed private fund):

(a) a recipient covered by Item 1 of the Table in s 30-15, ie a fund, authority or institution covered by a general item in any of the Tables in Subdiv 30-B. However, a fund, authority or institution mentioned *by name* in an item of a Table in Subdiv 30-B is not subject to the deductible gift recipient endorsement requirements;

[75] See, eg *FCT v McPhail* (1968) 117 CLR 111. The Commissioner of Taxation has set out his views as to what constitutes a "gift" in ATO, *Income tax: Tax deductible gifts – what is a gift*, TR No 13 (2005).

[76] ITAA 1997, s 30-15(2). Capital gains or losses from testamentary gifts may be disregarded: s 118-60.

[77] ITAA 1997, s 30-15(2), Table Items 1-6. Krever, n 73, p xxi, notes that the first minimum was £20.

[78] ITAA 1997, s 30-15(2), Table Items 7 and 8, relating to fundraising events.

[79] ITAA 1997, s 30-15(2), Table – Special Condition (a).

[80] CDI Report, n 1, p 257.

[81] ATO, n 9, TR No 5 of 2003 at [130].

[82] Income tax gift deductibility may be available for the public fund under the Overseas Aid Gift Deduction Scheme provided for by Item 9.1.1 of s 30-80 of the ITAA 1997. The scheme is administered by AusAid under the Department of Foreign Affairs.

(b) a recipient covered by Item 2 of the Table in s 30-15, ie an ancillary fund for the funding of Subdiv 30-B entities. However, a prescribed private fund under Item 2 is not subject to the deductible gift recipient endorsement requirements; and

(c) a recipient covered by Item 4 of the Table in s 30-15, ie a public library, museum or gallery falling under the Cultural Gifts program.

The Explanatory Memorandum accompanying the legislation introducing the endorsement requirement speaks of the purpose of the requirement as being "to protect the integrity of the taxation system in respect of deductible gift recipients and income tax exempt charities".[83] The decision to exclude named funds or institutions and prescribed private funds[84] appears to be because such entities go through some sort of approval process, but if part of the reason for introducing endorsement was to have a single place where donors could check on the status of a gift recipient, separate checking processes appear to defeat the purpose. Another reason why it is confusing to have endorsement for some but not all recipients is that endorsed entities are subject to express requirements relating to maintenance of gift funds under s 30-125(4)-(7). The Explanatory Memorandum states that these express requirements were previously implicit[85] but it may be that entities not needing endorsement could now argue that those requirements do not apply. The issue concerning named recipients has raised some concern. In 2002, in response to the CDI Report, the government announced a change that would allow future additions to the list of organisations specifically named as deductible gift recipients to be prescribed by regulation rather than requiring a legislative amendment.[86] Although this was not an express recommendation, the Treasurer noted that this would "allow continued scrutiny by Parliament but ... make the process less administratively costly and more timely".[87] The proposal was ultimately removed from the Bill because of opposition in the Senate.

The Tables in Subdiv 30-B currently contain 14 further categories. The existing categories are as follows:

Health: s 30-20	The family: ss 30-70 and 30-75
Education: ss 30-25 to 30-35	International affairs: ss 30-80 and 30-85
Research: s 30-40	Sports and recreation: s 30-90
Welfare and rights: s 30-45	Philanthropic trusts: s 30-95
Defence: s 30-45	Cultural organisations: s 30-100
Environment: s 30-50	Fire and emergency services: s 30-102
Industry, trade and design: ss 30-55 and 30-60	Other recipients: s 30-105

The government announced in the 2005 Budget that five new categories are to be introduced. The proposed new categories extend deductible gift recipient support to funds and organisations established to cover war memorials, disaster relief, animal welfare, charitable services and educational scholarships.[88]

[83] *A New Tax System (Tax Administration) Act 1999* (Cth), Explanatory Memorandum at [6.7].

[84] *Income Tax Assessment Regulations 1997* (Cth), Reg 995-1 lists 339 prescribed private funds as at 2 December 2005.

[85] *A New Tax System (Tax Administration) Act 1999* (Cth), Explanatory Memorandum at [6.7].

[86] *Taxation Laws Amendment Bill (No 7) 2003* (Cth).

[87] Treasury, Press Release 49 (29 August 2002).

[88] Treasury, Press Release 49 (10 May 2005). Legislation to implement the proposal has not yet been introduced.

The most common category that is relied on by charitable entities is the "welfare and rights" category. Under that category there is a further division of "general recipients" and "specific recipients", ie those approved by Parliament and named in the Tables in Subdiv 30-B. The general Welfare and Rights category contains the following:

4.1.1 A public benevolent institution

...

4.1.3 A fund established and maintained for the relief of persons in Australia who are in necessitous circumstances

4.1.4 A public fund on the register of harm prevention charities

The reason why the term "public benevolent institution" came to be included in the legislation has already been considered, namely to identify a subset of charities that would be eligible for additional tax concessions. The term has been considered by a number of cases in such a way that it now quite a restricted term. In Taxation Ruling No 5 of 2003, the ATO stated that a public benevolent institution is:

> a non-profit institution organised for the direct relief of such poverty, sickness, suffering, distress, misfortune, disability, destitution, or helplessness as arouses compassion in the community. It is not sufficient that an organisation is "benevolent" in merely dictionary terms, that its actions are socially worthwhile, that it is charitable in legal terms or that it is fully funded by government.[89]

The CDI Report noted that a significant restriction is that services provided must be direct and would not include an organisation that simply promotes or is concerned with social welfare in the community generally.[90] Other restrictions are that a public benevolent institution cannot be purely governmental or a statutory body,[91] and cannot be for the relief of suffering in animals[92] (although see some named entities). The fact that an organisation may charge a fee for the provision of its services does not prevent it from being a public benevolent institution.[93]

The second category of a necessitous circumstances fund was most likely intended to be a fund established for the same purposes as a public benevolent institution. Again, the courts have interpreted it narrowly. For example, in *Ballarat Trustees Executors and Agency Co Ltd v FCT*,[94] Kitto J said that "necessitous circumstances" refers to an "inability to afford what may fairly be regarded as necessities for persons living in Australia", distinguishing such necessities from things that are merely desirable advantages. In that case, persons who were unable to afford the fees charged by a private hospital, but who enjoyed a modestly comfortable existence, were considered not to be in necessitous circumstances. According to the ATO, a person is in necessitous circumstances where his or her financial circumstances are insufficient to obtain all that is necessary for a modest standard of living in the Australian community. A strong indicator of this would be where a person's level of income is such that he or she is eligible to receive income tested government benefits.[95]

Since 2003, a deduction is also available (under s 30-287) for gifts made to a public fund that, when the gift is made, is on the register of harm prevention charities maintained by the Secretary of the Department of Family and Community Services. Under the rules in Subdiv 30-EA, the principal activity of the institution must be the promotion of the prevention or the control of "behaviour that is harmful or abusive to human beings" (s 30-289(1)). Section 995-1 defines such behaviour as:

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[89] ATO, n 9, TR No 5 of 2003 at [7]-[8].

[90] CDI Report, n 1, p 246.

[91] *Metropolitan Fire Brigades Board v FCT* (1991) 27 FCR 279; 21 ATR 1137; 91 ATC 4052; *Mines Rescue Board of New South Wales v FCT* (2000) 101 FCR 91 at [26]; 45 ATR 85; 2000 ATC 4580; *Ambulance Services of NSW v DCT* (2003) 130 FCR 477; 53 ATR 391; 2003 ATC 4674.

[92] *FCT v Royal Society of Prevention of Cruelty to Animals (Qld)* [1993] 1 Qd R 571; 23 ATR 582; 92 ATC 4441.

[93] In *Commissioner of Pay-roll Tax Vic v Cairnmillar Institute* [1992] 2 VR 706; 23 ATR 314; 92 ATC 4307, the Institute charged a fee for treating psychological and psychiatric disorders, but waived the fee for patients who could not afford it. The Institute was held to be a public benevolent institution.

[94] *Ballarat Trustees Executors and Agency Co Ltd v FCT* (1950) 80 CLR 350 at 355.

[95] ATO, *Income tax: Necessitous circumstances funds*, TR No 9 (2000) at [9].

"emotional, sexual or physical abuse; suicide; self-harm; substance abuse; and harmful gambling". Item 4.1.4 was included to assist these charities in attracting public support for their activities.[96] It is also arguable that these institutions would not be public benevolent institutions or necessitous circumstances funds.

In addition to the welfare and rights category, other categories could also be relevant to entities that are commonly regarded as charitable. For example, the "health" category includes public and non-profit hospitals, health research institutions, charitable institutions whose principal activity is to promote the prevention or control of disease in human beings[97] and public ambulance services.[98] The "education" category includes public universities,[99] other tertiary institutions, various funds including a fund maintained solely for providing money for the acquisition, construction or maintenance of a building of a school or college, including one carried on by a non-profit society or association.

It is highly likely that most of these funds or institutions could have been covered by the use of a more general term such as "charitable institution", even if the government then wanted to identify a subset of such institutions or funds that would be eligible for gift deductibility status.

Position in other jurisdictions

Tax relief for gifts to charities in the United Kingdom takes a different form to that in Australia. In the United Kingdom, a taxpayer makes a gift to the charity and the charity then claims an amount from the Inland Revenue based on the basic rate of tax, currently 22%. This is described as the "Gift Aid Scheme".[100] If an individual taxpayer makes a contribution to a charity of say, £780, they will be entitled to a deduction for the contribution grossed-up to reflect the basic rate of tax, ie to £1,000. Provided certain requirements are met, such as the completion of a Gift Aid declaration by the donor, the charity is entitled to recover £220 from Inland Revenue. If the taxpayer is a "higher rate" taxpayer (currently 40%), the taxpayer can recover £180, although this entitlement can also be passed on to the charity. Eligibility for the relief has been simplified in recent years. For example, there is no minimum or maximum amount of contribution. There are, however, statutory limits on the benefits that can be provided by the charity to donors.[101] In addition to Gift Aid, it is also possible to contribute to charity through the Payroll Giving Scheme, which allows an employee to make contributions from pre-tax income.[102] Tax relief is available in relation to gifts of land and certain eligible investments as well as cash.[103] The nature of the relief in the United Kingdom is therefore more complicated than that which applies in Australia.

However, importantly, the eligibility criteria for recipients of gifts giving rise to these concessions is extremely straightforward compared with the Australian position. The relevant provisions deal with gifts to a "charity" and that term is currently defined in the same way as that which applies for income tax exemption. The changes contained in the *Charities Act*, which include a statutory definition of the

[96] Treasury, Press Release No 49 (29 August 2002).

[97] In the Treasury, Press Release No 55 (22 June 2000) it was stated that the government wanted to ensure that such institutions would be able to access the tax treatment available to public benevolent institutions. It was felt that, over time, their activities had changed such that they may no longer be public benevolent institutions.

[98] Included as a result of the decision in *Ambulance Services of New South Wales v DCT* (2003) 130 FCR 477; 53 ATR 391; 2003 ATC 4674 which held that ambulance services were not public benevolent institutions: see Explanatory Memorandum to *Taxation Laws Amendment (2004 Measures No 2) Act* (Cth) at [8.3].

[99] The notion of a public university is now thought to be that of an institution that is open to the public rather than one that is publicly funded. It is therefore most likely that "private" universities would qualify under this category. See, however, *Australian Hospital Care (LaTrobe) Pty Ltd v FCT* (2000) 105 FCR 20 at [53]; 45 ATR 593; 2000 ATC 4723.

[100] *Finance Act 1990* (UK), s 25 as amended by the *Finance Act 2000* (UK), s 39.

[101] *Finance Act 1990* (UK), s 25(5A) as amended by the *Finance Act 2000* (UK), s 39.

[102] *Income and Corporations Taxes Act 1988* (UK), s 202 as amended by the *Finance Act 2000* (UK), s 38.

[103] *Income and Corporations Taxes Act 1988* (UK), ss 587B-587C.

term "charity" and an explicit public benefit test, are also relevant to the gift concessions as are the changes to the registration requirement.[104] The Act also proposes a licensing requirement for charities wishing to conduct public collections.

Tax relief for gifts to charities at the federal level in Canada depends on whether the donor is an individual or a corporation. It may also depend on the type of gift made to the charity. In relation to individuals, the *Income Tax Act 1985* (Can) provides a tax credit (s 188.1) rather than a deduction.[105] The credit was introduced in 1988 and replaced a general deduction for charitable contributions. At the federal level, the credit is computed at the lowest marginal rate of tax for the first $CAN200 of total gifts claimed in the taxation year and the highest marginal rate for amounts exceeding $CAN200 (s 118.1(3)). The credits are non-refundable and non-transferable but the amount may be carried forward and claimed within a five-year period. The gift may be cash or property (including capital property, listed personal property or trading stock). In the case of property the taxpayer is able to claim a credit in respect of the "fair market value" of the property (s 118.1).

The Canadian *Income Tax Act* lists eight categories of eligible recipients, the most important being "a registered charity". A registered charity is defined at s 248(1) as follows:

> a charitable organisation, private or public foundation ... that is resident in Canada and was either created or established in Canada ... that has applied to the Minister in the prescribed form for registration, and is at that time registered.

A "charitable organisation" means (s 149.1(1)):

> a (a) an organisation, whether or not incorporated:
>
> b (b) all of the resources of which are devoted to charitable activities carried on by the organisation itself;
>
> c (c) no part of the income of which is payable to, or is otherwise available for the personal benefit of any proprietor, member, shareholder, trustee or settler thereof, and
>
> more than 50% of the directors, trustees, officers or like officials of which deal with each other [at arm's length].

A "charitable foundation" means (s 149.1(1)):

> a corporation or trust that is constituted and operated exclusively for charitable purposes, no part of the income of which is payable to, or otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settler thereof, and that is not a charitable organisation.

The distinction between a charitable organisation and a foundation is that charitable organisations engage in charitable activities themselves, while charitable foundations operate for charitable purposes by disbursing funds to charitable organisations and other qualified donees.[106]

Canada generally relies on the common law meaning of charity referring to the four categories of charity in *Pemsel's* case as well as requiring that the purpose must be "for the benefit of the community or of an appreciably important class of the community".[107]

Tax relief for gifts to charities in New Zealand under its *Income Tax Act 2004* (NZ) also depends on whether the donor is an individual or a company. An individual taxpayer is entitled to a rebate of income tax equivalent to the amount of the gift, provided it is not a testamentary gift and it is $NZ5 or more (s KC 5). Gifts of property do not attract tax relief. The amount of the rebate is one third of all gifts to these organisations (s KC 5(2)). Companies and Maori associations are entitled to a deduction for gifts to eligible organisations (ss DB32 and DV 11). Until recently, there were caps on the amount of the rebate available to individuals and the deduction for companies and Maori associations.

[104] See Charities Commission, n 56.

[105] Companies are entitled to claim a deduction, see *Income Tax Act 1985* (Can), s 110.1.

[106] Duff D, "Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform" (2004) *Osgoode Hall Law Journal* 47 at 74.

[107] Duff, n 106 at 75.

Following the release of a Discussion Paper in October 2006 aimed at encouraging giving to charities,[108] the government introduced legislation to remove the caps.[109]

The eligibility criteria for recipients of these gifts are set out in the Act, the main category being (s KC 5(1)(aa)):

> a society, institution, association, organisation, or trust which is not carried on for the private pecuniary profit of any individual and the funds of which are, in the opinion of the Commissioner, applied wholly or principally to any charitable, benevolent, philanthropic, or cultural purposes within New Zealand.

There are also a number of related categories and a number of listed entities. The organisations identified are referred to as "donee organisations" (as distinct from charitable organisations which qualify for income tax exemption).

In relation to the main category of donee organisations, the form of the entity is quite broad. It can be a society, institution, association, organisation, trust or fund. The funds of the entity must be applied wholly or principally to "charitable, benevolent, philanthropic or cultural purposes within New Zealand". Apart from the reference to cultural purposes, the reference to "benevolent and philanthropic purposes" suggests that the designation of an organisation as a donee organisation goes beyond the notion of an entity that is charitable in the strict legal sense. That is, a charitable entity will be tax exempt and may also be a donee organisation but an entity may be a donee organisation and not necessarily be a charity. The term "charitable" is not defined in the legislation and so relies on the common law.

According to the Inland Revenue, "benevolent and philanthropic purposes basically mean doing good for other people ... It includes organisations whose proceeds or funds are used to benefit all or a large part of the public".[110] Another explicit requirement is that the organisation must not be carried on for the private benefit of any member or an associate of any member.

The New Zealand *Charities Act 2005* establishes a Charities Commission which came into being on 1 July 2005. The Commission is to provide a registration and monitoring system for charitable organisations. The registration process was planned to commence in July 2006 but was deferred until February 2007. It has already been noted that registration with the Commission is voluntary and will not alter a charity's legal status. However, a charitable organisation is required to register to maintain income tax exemption (and the exemption from gift duty for donors). Amendments to the *Income Tax Act 2004* (and the *Estate and Gift Duties Act 1968* (NZ)) ensure that the benefits are limited to organisations registered as charitable entities. However, the function of determining eligibility to be a donee organisation under the *Income Tax Act* remains with the Inland Revenue. Therefore there have been no legislative changes to the provisions that allow individuals to claim rebates and companies to claim deductions in relation to their charitable donations. However, an integrated process is being developed so that an entity that is registered with the Commission will be eligible for donee status. Organisations seeking donee status that are not charities will need to deal with Inland Revenue.[111]

Fringe benefits tax

Background

The *Fringe Benefits Tax Assessment Act 1986* (Cth) as originally drafted did not contain any reference to charitable organisations. There was, however, an exemption for benefits provided to employees of religious entities. During debate in the Senate, it was argued that a similar concession should be

[108] New Zealand Government, *Tax Incentives for Giving to Charities and Other Non-Profit Organisations*, Discussion Paper (2006), http://www.taxpolicy.ird.govt.nz/publications/files/taxcharitiesdd.pdf viewed January 2008.

[109] The *Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Act 2007* (NZ) was passed on 12 December 2006 and will take effect in the 2008/2009 income year.

[110] New Zealand Inland Revenue, *Charitable organisations: A tax guide for charities, donee organisations and other groups*, IR 255 (2002) p 32.

[111] "New Zealand Inland Revenue" (2005) 17(7) *Tax Information Bulletin*.

available for a broader range of charitable organisations.[112] The legislation as finally enacted did contain an exemption for employees of public benevolent institutions and some other bodies, such as public hospitals. The concession has also been expanded to include some other entities such as health promotion charities[113] and ambulance services.[114]

In 2000, it was felt that the concession may have been abused, especially by public hospitals that were providing consulting medical practitioners with significant fringe benefits often as the only form of remuneration for services. This led to the introduction of a cap on the amount of benefits that can be provided under this exemption. The amount of benefits that can be provided was said to be the equivalent of providing an average six-cylinder car.[115]

The current concession

Section 57A of the *Fringe Benefits Tax Assessment Act 1986* (Cth) provides that a benefit provided by an employer is an exempt benefit if the employer is a public benevolent institution.[116] The term "public benevolent institution" has been discussed in relation to gift deductibility. The exemption also applies to benefits provided to employees of certain hospitals, ambulance services and health promotion charities (s 57A(1)). In relation to hospitals, the concession is available if the employer is a government body with employees whose duties are performed in a public hospital that is a public benevolent institution, a non-government public hospital or a private, not-for-profit hospital (s 57A(2)); or the employer is a non-government public hospital (s 57A(3)(a); or the employer is a private not-for-profit hospital (s 57A(4)). Each of these types of entities is subject to a lower cap as to the amount of benefits that can be provided compared with other entities referred to in s 57A. The ATO has released a Practice Statement that provides some guidance as to when an entity will be a "hospital" and therefore subject to the lower cap. It provides that if the provision of acute care (either medical, psychiatric, surgical or obstetric) is the predominant objective, the organisation will apply the lower cap.[117]

In relation to ambulance services, the concession applies if the employer is a public hospital and the employer provides public ambulance services and the employee is predominantly involved in connection with those services (s 57A(3)(b)). This provision was included in the legislation following the decision in the *Ambulance Services of New South Wales v DCT*,[118] which held that a public ambulance service was not a public benevolent institution. Where the concession applies, the lower cap applicable to hospitals applies to the provision of fringe benefits. The concession for health promotion charities was incorporated because of concern that, over time, such organisations would not qualify as public benevolent institutions. The term "health promotion charity" is defined in s 136(1) to mean a charitable institution whose principal activity is to promote the prevention or the control of disease in human beings. The term "disease" is also defined as including any physical or mental ailment, disorder, defect or morbid condition whether of sudden onset or gradual development and whether of genetic or other origin. The ATO has provided some guidance as to how it will interpret the

[112] See House of Representatives, *Hansard*, 30 May 1986. The changes were suggested by Senator Flo Bjelke-Petersen.

[113] The exemption for health promotion charities was included in 2001. In announcing the legislative change, the Treasurer said that although these entities may have been public benevolent institutions in the past, over time their activities had changed and they may no longer qualify as public benevolent institutions: Treasury, Press Release 55 (22 June 2000).

[114] The exemption for ambulance services was included in 2004 following the decision in *Ambulance Services of New South Wales v DCT* (2003) 130 FCR 477; 53 ATR 391; 2003 ATC 4674 which held that such services were not public benevolent institutions.

[115] Treasury, n 44, p 49.

[116] The definition of "fringe benefit" provides that a fringe benefit does not include an exempt benefit (para (g)).

[117] ATO, *Practice Statement Law Administration*, No 9 (2001). As to the meaning of "acute care", the Statement refers to the *National Health Data Dictionary*, Version 9, p 337.

[118] *Ambulance Services of NSW v DCT* (2003) 130 FCR 477; 53 ATR 391; 2003 ATC 4674..

concession. In particular, it notes that an institution's activities can be either prevention or control and that the institution can have other activities provided that prevention or control of disease is the main activity.[119]

In addition there is a separate exemption for an employee of a religious institution which requires the employee to be a religious practitioner and that the benefit not be provided in respect of duties of the employee other than "pastoral duties; or any other duties that are directly related to the practice, study teaching or propagation of religious beliefs" (s 57). There is also an exemption for an employee of a government body, religious institution or non-profit company that provides live-in residential care (s 58).

Since 1 April 2005, certain entities entitled to concessions will not be eligible unless they are endorsed by the Commissioner under ss 123C-123E. The entities that are required to be endorsed are public benevolent institutions and health promotion charities. The requirement for endorsement also applies to charitable institutions (other than public benevolent institutions or health promotion charities) that are eligible for the rebate in s 65J.[120]

The exemption for public benevolent institutions and other entities has been capped so that benefits provided in excess of the cap will attract FBT. The process for calculating the FBT liability in these cases is extremely complex and is based on the employer's "aggregate non-exempt amount" (s 5B(1D)-(1L)). Broadly, an employer's aggregate non-exempt amount is the sum of the grossed-up[121] value of benefits provided to each employee that exceeds the relevant thresholds, ie $17,000 for employees engaged in duties connected with qualifying public and non-profit hospitals or public ambulances services, or $30,000 for employees of public benevolent institutions that are not public hospitals.

Tax-exempt employers are liable to pay FBT in the same way as other employers. However, since 1994, the payment of FBT is a deduction that does not benefit such employers, since they cannot use tax deductions. To compensate for this fact, a rebate is provided to certain tax-exempt employers. An employer is entitled to the rebate if it is covered by the description in the legislation. The list includes a charitable institution that is endorsed under s 123E(1).[122] Other eligible entities that could be charities include a religious institution, a non-profit scientific institution, a scientific or public educational institution, a non-profit school and a non-profit entity established for community service purposes (not being political or lobbying purposes).[123] In order to claim the rebate, the employer must not be a public benevolent institution or a health promotion charity. The reason given for this is that public benevolent institutions and health promotion charities will generally qualify for an exemption under s 57A subject to the cap referred to above. The reference to such bodies in s 65J is to ensure that they cannot claim the rebate in relation to benefits above the cap.[124] However, such a limitation seems unnecessary, given that the way in which the rebate is calculated means that no rebate is available in respect of benefits that exceed the thresholds. The rebate is calculated as follows:

.48 x [gross tax – aggregate non-rebateable amount] x rebateable days in year

[119] ATO, *Income tax and fringe benefits tax: Health promotion charities*, TR No 8 (2004) at [7].

[120] The rebate provision is discussed below.

[121] Since 1994, an employer's fringe benefits tax (FBT) liability is calculated based on the grossed-up value of the benefit. The effect of the gross-up is to regard the employee as receiving both the value of the benefit and the FBT paid by the employer, allow the employer a tax deduction for both (as would be the case if they paid salary) and tax the total at the top marginal rate. The reason for the gross-up is to reduce distortions caused by the difference between the individual and company tax rates. Since 2000 there have been two gross-up formulas – one for benefits for which the employer is entitled to GST input tax credits on the acquisition price, and the other for benefits for which there is no entitlement to GST input tax credits. The gross-up rules are contained in *Fringe Benefits Tax Assessment Act 1986* (Cth), s 5B(1B) and (1C).

[122] *Fringe Benefits Tax Assessment Act 1986* (Cth), s 65J(1)(baa).

[123] *Fringe Benefits Tax Assessment Act 1986* (Cth), s 65J(1)(a)-(ba), (j).

[124] See *A New Tax System (Fringe Benefits) Act 2000* (Cth), Explanatory Memorandum at [1.52].

For example, if a rebateable employer provided $100 of Type 2 fringe benefits, the fringe benefits taxable amount would be $187 and the FBT liability would be $87 and the employer can claim a rebate of 48% of this amount, ie $41.76. The effect is that eligible employers can claim a rebate of 48%[125] of the FBT that would be payable but, as already noted, no rebate is available for benefits provided above the threshold.

Position in other jurisdictions

Apart from New Zealand, no other jurisdiction imposes a separate tax on the provision of benefits to employees.

The position in New Zealand is that fringe benefits provided by charitable organisations are exempt under *Income Tax Act 2004* (NZ), s CX 21. This is subject to two exceptions. First, FBT applies when the employee is employed in a business whose activity is outside its benevolent, charitable, cultural or philanthropic purposes (s CX 21(1)). Fringe benefits tax also applies when the charitable organisation provides charge facilities such as credit cards to an employee enabling them to acquire goods and services unrelated to the employer's business and the employer is liable to pay for those goods and services and the value of such benefits exceeds 5% of the employee's salary or wages in the tax year (s CX 21(2)). If FBT is payable on benefits provided, the rate of tax (rather than the value of the benefit) is grossed-up so that the rate of tax payable on fringe benefits is either 49% or 64%, reflecting the highest two bands of personal tax in New Zealand (33% and 39% respectively) (s ND 1). There is no equivalent of the rebate for non-profit entities that do not qualify to meet the exemptions currently available for charitable organisations.[126]

The New Zealand government undertook a review of the taxation of fringe benefits in 2003.[127] One of the issues considered was whether the exemption for charities should be retained.[128] It had been argued that the exemption advantaged employees of charities because they pay less tax than other employees on the same total remuneration.[129] It was noted that the main form of benefit offered by charities is motor vehicles. One option considered was to limit the concession in relation to motor vehicles. Ultimately, it was concluded that significant changes to the concessions were not warranted. This was due in part to a view that many charities are not large enough to have employees and provide significant benefits or that if they did there was no clear information as to how the concessions were being used. One change that was recommended was the limit on the provision of credit cards referred to above.[130] That measure was introduced and applies from 1 April 2006.

As is the case with the other concessions, the position in New Zealand in relation to the FBT concession is much more straightforward than the Australian position with entitlement being extended to all charitable organisations.

PROPOSALS FOR REFORM

The comparison of the Australian tax treatment of concessions for charitable entities with other jurisdictions indicates that our approach is much more complex. Some of that complexity may be

[125] The rebate percentage does not exactly correlate with the FBT rate. The 48% rebate was introduced in 1992 when the FBT rate was 48.5%. The FBT rate has recently been reduced to 46.5% by *Taxation Laws Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006* (Cth), but no change has been made to the rebate percentage.

[126] However, all employers may take advantage of the more generous de minimis exemptions which allow the provision of benefits where the aggregate taxable value of benefits (other than those specifically excluded eg cars) does not exceed certain thresholds. The thresholds are $NZ800 per annum or $NZ15,000 over the last four quarters: *Income Tax Act 2004* (NZ), s ND 1Q. In Australia there is an exemption for minor benefits: see s 58P of the *Fringe Benefits Tax Assessment Act 1986* (Cth). The threshold has been $A100 for a considerable period of time but has just been changed to $A300: see *Taxation Laws Amendment (2006 Measures No 5) Act 2006* (Cth).

[127] New Zealand Inland Revenue Department, *Streamlining the Taxation of Fringe Benefits*, Discussion Document (2003), http://www.taxpolicy.ird.govt.nz/publications/files/html/fbt03/c10.html viewed January 2008.

[128] New Zealand Inland Revenue Department, n 127, Ch 10.

[129] See also New Zealand Government, *Tax and Charities*, Discussion Document (2001), http://www.taxpolicy.ird.govt.nz/publications/files/html/ddcharities/index.html viewed January 2008.

[130] New Zealand Government, n 129 at [10.12]-[10.13].

justified on the basis that it reflects a particular policy decision to limit the relief available in a particular way. However, it is also possible that the same policy objectives could be achieved more simply. To achieve this goal, it is not necessary for a statutory definition to be introduced even though some other jurisdictions believe that to be desirable.

In relation to income tax exemption, it is clearly open to government to decide which entities will be exempt. Division 50 provides income tax exemption to various entities other than those that could be described as charitable. It should, however, be possible to simplify the Division insofar as it does provide an exemption to charitable entities. One possibility would be to replace the three categories identified in ss 50-5 (charity, education, science and religion), 50-10 (community service) and 50-30 (health) with one category, namely a charitable institution or fund. It would also be possible to include other entities that may not be regarded as charities at common law. This could be done expressly in Div 50 or by virtue of the *Extension of Charitable Purposes Act*. It would, of course, be possible to include conditions relating to income tax exemption such as presence in Australia, rules as to how funds are to be applied and endorsement. It should not be necessary to refer to the not-for-profit requirement, since this is implicit in the use of the term "charity". In relation to endorsement, it may be appropriate for the government to require registration and to supplement this with some form of regulatory regime. It may be appropriate to reconsider the recommendation from the CDI report that there be a dedicated administrative body that would be responsible for ensuring accountability of charities to the public.[131]

A final point in relation to income tax exemption is that it is open to the government to decide whether it will retain the exemption for income from all sources or whether, like the United Kingdom and New Zealand, it has a more limited exemption for trading income.

In relation to gift deductibility, it is also clearly a matter for government as to which entities are entitled to deductible gift recipient status in order to facilitate charitable giving. One possibility would be to do away with the Tables in Subdiv 30-B and replace them with a reference to a particular type of charitable entity. At present, it is likely to want to identify a subset of charities that are eligible for that status. This subset could be referred as "benevolent charities" as suggested by the CDI, since there has certainly been criticism of the term "public benevolent institution" as being outdated. A new approach would enable government to identify clearly which charitable entities would get the benefit of the concession and overcome the use of outdated terminology. If it was determined that any existing categories of entities were not covered by the general term, further categories could be added. The government may also choose to name particular entities or it could replace the endorsement requirement with a registration requirement (as described above for income tax exemption) and require that registration to specify whether the entity was or was not a deductible gift recipient.

In relation to FBT exemption, it is likely that the exemption would be available to entities that are eligible for deductible gift recipient status. In relation to the rebate, this could be available to charities or other tax-exempt entities, other than those that are eligible for the exemption. The cap that currently applies to public benevolent institutions could also apply to entities that are eligible for exemption other than hospitals and the lower cap that currently applies to hospitals could remain.

The main advantage of the suggested approach is that, even without a statutory definition of the term charity, that term does have an accepted common law meaning and could and should form the basis for the range of tax concessions currently on offer. The simplification would reduce compliance costs and create a more straightforward approach to tax concessions for charities in Australia.

[131] CDI Report, n 1, Ch 32.