

Statutory Definition of a Charity



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Statutory Definition of a Charity

By Bill d'Apice

**“Any new definition will result in there being winners and losers”
-Bill d'Apice**

The Assistant Treasurer has released a Consultation Paper, seeking comments on the proposal for a statutory definition of charity.

The Government announced in the 2011/12 Budget that it was committed to the introduction of a statutory definition of charity which will apply to all Commonwealth laws from 1 July 2013 and will be based on the 2001 *Report of the Inquiry into the Definition of Charities and Related Organisations* and the definition in the *Charities Bill 2003*. It also vowed to take into account the findings of recent judicial decisions, such as the *Aid/Watch* case and the *Word Investments* case.

The current definition of “charity” is based on the Statute of Charitable Uses enacted in the English Parliament in 1601 and its interpretation over the ensuing 400 odd years by English and Australian courts.

Lord Macnaghten in *Pemsel's* case stated what have since commonly been accepted as the four categories of charity:

1. the relief of poverty;
2. the advancement of education;
3. the advancement of religion; and
4. other purposes beneficial to the community not falling into any of the preceding categories.

The fourth of these categories is understandably the one most difficult to interpret as it is a dynamic concept referable to matters existing at the time that the status of an organisation is being considered.

There have been a number of cases both in England and Australia over these many years which have further refined the definition of charity. In fact, it has been refined to a point that the Australian Taxation Office issued a 90 page ruling on

the subject one month ago (TR2011/4). (See later article by Moore Stephens).

Whilst the Government is contending that there is a need for a statutory definition as the current definition is unclear and confusing, it is our view that the considerable body of law that has built up around the definition of “charity” offers sufficient clarity and any new definition will result in there being winners and losers but, more particularly, in greater uncertainty as the expressions and concepts in any new legislation will be tested in the courts, without doubt.

However, the Government is committed to the introduction of a statutory definition.

We urge all charities to carefully review the Consultation Paper which can be found at <http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=2161> and lodge a submission. Submissions are due on 9 December 2011 and should be sent to nfpreform@treasury.gov.au.

Having reviewed the Consultation Paper, we offer the following observations:

- We are concerned that many more organisations seeking charitable status may now be required to demonstrate public benefit. This has been an issue of significant controversy and litigation in the United Kingdom where there is such a requirement. Under the current law in Australia, there is a presumption that an organisation established for the promotion of education or religion or for the relief of poverty is for the public benefit. Under the current law, the onus is on the Australian Taxation Office (or the ACNC after 1 July 2012) to rebut that presumption. This rebuttable presumption is, in our opinion, important and should be maintained.

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- The proposal that the purpose of a charity must be exclusively charitable could be dangerous and it is hard to see how such a provision would sit comfortably with the proposed Unrelated Business Income Tax proposal. Activities which are incidental or ancillary or for the purposes of promoting the dominant charitable purposes of a charity should be acceptable.
- The entitlement of peak bodies which support other charitable organisations to be endorsed themselves as charitable organisations needs to be protected. Where their purposes and activities support charitable purposes then they should be entitled to endorsement as a charity, even though they may not deal directly with members of the public.
- The position of companies controlled by exempt entities including those which provide infrastructure support to charities need to be protected and their entitlement to endorsement as charities continued. The principles in Taxation Ruling TR2005/22 should be incorporated into the definition.
- The concept of “public benefit” should be defined, unlike in the UK situation, and it should be defined broadly. Otherwise, compliance

costs in demonstrating that charities provide a public benefit may be significant.

- Suggestions that an organisation that has been approved as a charity will be at risk of losing its status if it has caused significant harm or detriment or engaged in illegal activities could have unforeseen consequences. In many charitable organisations there are unfortunately people who have been involved in illegal activities (of course, unauthorised by the charity). Such unauthorised activities should not put at risk the endorsement of the charity.
- Engagement in limited political activities should not disentitle a charity to endorsement. Consistent with the *Aid/Watch* decision, generation of public debate concerning matters arising under one of the heads of charity should be acceptable and should not disentitle an organisation to be endorsed as a charity.

We urge you to review the Consultation Paper and lodge a submission, however brief, and lodge them with the Philanthropy and Exemptions Unit of the Treasury at nfpreform@treasury.gov.au on or before 9 December 2011.

Should you require any assistance in relation to such a submission, please do not hesitate to contact us.

The Consultation Paper can be found at:

<http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=2161>

The ATO's view on charities following recent court decisions

By Stephen O'Flynn and Abi Chellapen, Moore Stephens

The Australian Taxation Office released Taxation Ruling TR 2011/4 on 12 October 2011 which sets out the Commissioner's view on:

- features that distinguish a charitable institution from a charitable fund;
- circumstances under which an institution or fund will be considered charitable;
- determining whether the purpose of an institution or fund is charitable; and
- recent court decisions in numerous cases such as Word Investments, Aid/Watch, Central Bayside and Victorian Women Lawyers.

The ruling was previously issued as Draft Tax Ruling TR 2011/D2 and replaces TR 2005/21 which has now been withdrawn. The ATO have sought to provide certainty for taxpayers on the above issues and it is expected that the ruling will not adversely affect charities.

We have summarised below the key differences between TR 2005/21 and TR 2011/4:

- For a purpose to satisfy the technical legal meaning of "charitable", it must fall within one of the four heads of charity; the relief of poverty, the advancement of education, the advancement of religion and other purposes beneficial to the community. Furthermore, it must be for the public benefit. TR 2011/4 provides that where the charity falls within one of the first three heads, there will be a rebuttable presumption that the charity is for the public benefit. However, for "other purposes beneficial to the community" the public benefit must be affirmatively established;
- TR 2011/4 states that the objects or objectives in the constituent documents of an institution and its activities which give effect to those objects will be the main factors used in determining whether the entity has a charitable purpose. Furthermore, it is essential that the entity is not only established for charitable purposes, but it is maintained (ie its ongoing activities) for that purpose;
- Following the High Court's decision in Word Investments, the ATO confirms the following:
 - An institution can be charitable even if its activities are not intrinsically charitable as long as the activities are carried on in furtherance of the institution's charitable purpose;
 - A "charitable institution that endeavours to make a profit from its activities can still be charitable if its profit making goal is only in aid of its charitable purpose";
 - If an entity's sole purpose is charitable and it carries on a business or commercial enterprise to give effect to that charitable purpose, the entity may still have a charitable purpose. It is not necessary for the activities themselves to be intrinsically charitable;



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The ATO's view on charities following recent court decisions

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- The fact that an entity can distribute surpluses to owners or members will not deter an entity from being charitable as long as the distribution of funds to its owners or members is in furtherance of its charitable purposes;
- A structure with a small and exclusive membership that is controlled by family members and friends and undertakes limited activities is not an institution. It may however still be a charitable fund;
- Following from the High Court's decision in Aid/Watch, political purpose can be considered charitable if it generates public debate with a view to influence legislation, government activities or government policy in respect of one or more of the four categories of charity;
- Following the decision in Central Bayside, where the sole purpose of an institution is charitable, neither the fact that its services have the effect of helping to achieve government policy objectives nor the fact that it relies heavily on government funding will detract it from being characterised as charitable;
- An entity that accumulates funds can still be charitable as long as the accumulated funds are being accumulated in order to increase the funds available to effect the entity's charitable purpose.

To download a copy of the Ruling, please visit: <http://www.ato.gov.au/entry.aspx?menuid=43612>

In our view the ruling is a positive outcome as it consolidates the various courts decisions and expands the ATO's initial view on charitable purpose. The additional examples included in TR 2011/4 are also welcomed as additional assistance to taxpayers in determining whether their entities are charitable. However, it is essential to review the Ruling and determine if your entity's particular circumstances satisfy the definition of charitable as determined by the Commissioner in this Ruling.

Unfortunately, whilst a number of these concepts have to some extent now been solidified through TR 2011/4, we will also have to watch closely the proposed changes to the statutory definition of charity and other Not-For-Profit changes.

For the latest on these issues please refer to the NFP online newsletter released by the Assistant Treasurer.

It is essential to review the Ruling and determine if your entity's particular circumstances satisfy the definition of charitable

- Stephen O'Flynn & Abi Chellapen



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Public Ancillary Funds

By Bill d'Apice

As indicated in previous editions of this magazine and other publications and bulletins from our firm, the Government is proceeding with amendments to the taxation laws and the drafting of Regulations and Guidelines concerning the operation of Public Ancillary Funds. The Government has previously indicated that changes will take effect from 1 January 2012.

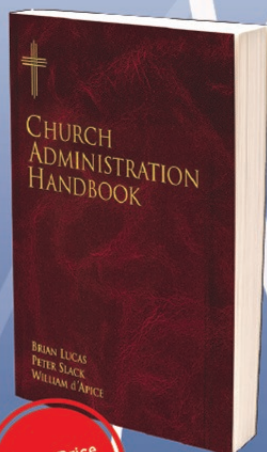
The enabling legislation (*Tax Laws Amendment (2011 Measures No. 7) Bill 2011*) is currently before Parliament.

At the time of issue of this newsletter, the legislation is before the Senate for consideration. We will provide an update when the legislation, regulation and guidelines have been passed and issued.



CHURCH ADMINISTRATION HANDBOOK

By Brian Lucas, Peter Slack and William d'Apice



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— L A W Y E R S —

Let's Co-Operate to discuss Co-Operatives

By Bill d'Apice & Kylie Maxwell

On 7 November 2011 NSW Fair Trading released its discussion paper (which can be accessed at http://www.dft.nsw.gov.au/pdfs/Cooperatives_and_associations/cooperatives/Discussion_paper_financial_reporting_obligations_small_cooperatives.pdf) on financial reporting obligations for small co-operatives. The discussion paper proposes the introduction of a legislative scheme which will be in the form of a code called the Co-Operatives National Law, initially to be passed by the NSW Parliament, but then to be either adopted or passed as consistent legislation by other jurisdictions around Australia. This development follows on from public consultation which occurred towards the end of 2009 on a range of aspects of the proposed legislative schemes.

The questions posed by the discussion paper largely focus on public accountability measures, the advantages of reviewing instead of auditing and reporting to members of co-operatives. In particular, Not-For-Profit organisations are invited to provide their comments in relation to the following issues:

- the costs and benefits of public accountability through financial reporting;
- whether a co-operative's ability to fundraise in certain ways should be determinative of public accountability measures;
- whether the impact of the failure of a co-operative on stakeholders should be used as the threshold for determining public accountability financial reporting for co-operatives;
- whether deductible gift recipient endorsement should be the deciding factor to determine whether different public accountability requirements are required of certain of co-operatives or whether the receipt of government grants is also a significant factor;

- should co-operatives have their accounts reviewed instead of audited and should this depend on the size of the co-operative;
- costs and benefits of the reduction in the number of co-operatives being required to lodge audited financial reports;
- should the Australian Accounting Standards continue to be the basis for the recognition, measurement and classification of transactions for co-operatives;
- what information should be provided to members to enable them to assess the financial health of the co-operative or to decide to allocate resources or to commit to a co-operative;
- the utility of using the National Standard Chart of Accounts as a model for classification of expenditure and balance sheet items for co-operatives;
- costs and benefits of utilising the best practice reporting model for Not-For-Profits produced by the Institute of Chartered Accountants.

As usual, we will submit our views on these topics to NSW Fair Trading, but Not-For-Profit organisations should consider whether they wish us to assist them or with their submission.



Submissions are due to be received by NSW Fair Trading by 7 December 2011.

“The questions posed by the discussion paper largely focus on accountability measures, the advantages of reviewing instead of auditing and reporting to members of co-operatives”

- Kylie Maxwell

Not a Health Promotion Charity, but still a Charitable Institution

By Bill d'Apice & Kylie Maxwell

A recent case determined by the Administrative Appeals Tribunal of Australia has charities asking why they place so much importance on the wording of the objects of the organisation in their constituent documents to the exclusion of other factors.

Bicycle Victoria Inc (BVI) v Commissioner of Taxation was determined by the AAT in June this year. In this case, BVI sought an endorsement as an income tax exempt charity under section 50-110 of the *Income Tax Assessment Act 1997 (ITAA97)* on the basis that it is a charitable institution as described in Item 1.1 of the table in section 50-5 of ITAA97. It also sought endorsement as a health promotion charity under section 123D of the *Fringe Benefits Tax Assessment Act 1986 (FBTA Act)* and as a charitable institution under section 176-1 of the *A New Tax System (Goods and Services Tax) Act 1999 (GST Act)*.

The AAT found that BVI was a charitable institution and was entitled to be endorsed as an income tax exempt charity on the basis that it was a charitable institution under item 1.1 of the table in section 50-5 of ITAA97 and that it was a charitable institution under section 176-1 of the GST Act but that it was not entitled to be endorsed as a health promotion charity

under section 123D of the FBTA Act.

In announcing that BVI was a charitable institution under both Acts, the AAT found that while the primary purpose for which BVI (under its former name) was established in 1976, was to encourage people to use the bicycle as a means of transport and as a means of getting together for fun, sport and recreation, the reason for encouraging people to use bicycles was not articulated in the earlier literature of the entity. Later literature referred to the social side of cycling. Even later editions (seemingly from about 2005) focused on health, culminating in changes being made to its Constitution in 2009 which were consistent with its later emphasis on health. However, the AAT described the promotion of fitness as being an *ad hoc* purpose early on, later becoming more defined as an overall strategy. Ultimately, the AAT found that:

“The fact that cycling may be a sport in some instances and a leisure activity in another does not characterise Bicycle Victoria’s purpose of being for sporting purposes or for recreational purposes as such. It is for the purpose of promoting cycling in all its forms and for the overall purpose of promoting

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“It is for the purpose of promoting cycling in all its forms and for the overall purpose of promoting fitness. That is a purpose that is charitable”

- Kylie Maxwell

Not a Health Promotion Charity, but still a Charitable Institution

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fitness. That is a purpose that has been recognised as charitable. Therefore I am satisfied that Bicycle Victoria is a charitable institution."

On the other hand, section 123D of the FBTA Act, requires that a health promotion charity have, as its principal activity, the promotion of the prevention or control of diseases in human beings. On this ground, the AAT stated that while the prevention and control of disease is a *consequence* of the principal activity of BVI (which is for the promotion of cycling and physical fitness), the promotion of prevention and control of disease in human beings is not its principal activity. This decision was made despite the fact that the "prevention of control and disease" was listed as an object of the company in its constituent documentation.

The consequence of this case is that it reemphasises the importance of identifying the principal activity of a Not-For-Profit organisation. It is also important to determine whether the promotion, prevention or control of diseases in human beings is the principal activity of the Not-For-Profit organisation or just a consequence of its principal activity.

The decision clearly emphasises that it is not enough to include in the drafted objects in an organisation's Constitution or rules, the goal of "the prevention and control of disease", as BVI had done so in vain. Not-For-Profit organisations are reminded that it is not only their objects in their constituent documents but their activities that determine their status with the ATO and that they should examine the principal purpose of their organisation based on all the evidence before approaching the Tax Office for endorsement.



“The decision clearly emphasises that it is not enough to include in the drafted objects in an organisation’s Constitution or rules, the goal of the “prevention and control of disease”, as BVI had done so in vain”

- Kylie Maxwell

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Finance for the Not-For-Profit Sector

“The Inquiry is also concerned about what measures can be taken to improve access to the capital for NFPs”
-Belinda Huang

By Bill d'Apice & Belinda Huang

There has been growing momentum in the last year from the Federal and State Government in considering ways to assist in the provision of finance for the Not-For-Profit Sector. Of note, a Senate Inquiry has been launched to explore the issues and viability of finance for the Not-For-Profit Sector, a Social Enterprise Development and Investment Fund (SEDIF) has been established and the NSW Government has launched a pilot tender in the State Budget for “Social Benefits Bonds”. The aims of these initiatives appear to be geared towards financially assisting charities and Not-For-Profit organisations (NFPs) beyond the traditional methods of distributing resources by means of grants and philanthropic funding.

Senate Inquiry

On 9 February 2011, the Senate referred the issue of finance for the Not-For-Profit sector to the Senate Economics Committee for inquiry and report. An issues paper was released (which can be accessed at http://www.aph.gov.au/senate/committee/economics_ctte/capital_market_2011/issues_paper/index.pdf) and the Inquiry invited submissions from the public on the issues raised in the paper.

The paper noted that many NFPs (also referred to as “social enterprises” in the paper) are often significantly undercapitalised and struggle to access mainstream sources of capital, in particular, of the non-grant or non-gift kind. The Inquiry, from a governmental perspective, is interested in investigating the viability of linking NFPs with financial intermediaries known as “community finance institutions” that could assist NFPs in building financial and social sustainability.

The paper identifies a number of existing issues relating to financing the Not-For-Profit sector. The paper notes that NFPs have different capital needs at different



stages of their life cycle (from start up capital to sustainability and consolidation capital), which highlights the need for funding diversity. The Inquiry is also concerned about what measures can be taken to improve access to capital for NFPs.

The full report (which can be accessed at http://aph.gov.au/senate/committee/economics_ctte/capital_market_2011/report/report.pdf) on the Inquiry was released on 25 November 2011. Should you have any questions in connection with it, please do not hesitate to contact us.

Social Enterprise Development and Investment Fund

In July 2010, the Federal Government announced that it will provide \$20 million investment for the establishment of at least two SEDIFs. The purpose of a SEDIF is to provide financial products to “social enterprises” (defined as generally being business models that combine market trading with a social or environmental purpose, which can be for profit or not for profit). In contrast to traditional philanthropic funding and grants, the funds provided to social enterprises will be in the form of financial products, which means there will be an expectation of debt or equity capital to be repaid by the borrower.

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Finance for the Not-For-Profit Sector

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On 9 August 2011 the Government selected Foresters Community Finance and Social Enterprise Finance Australia to be fund managers for the SEDIFs.

Fund managers will be responsible for using the funds to provide flexible and tailored financial products to social enterprises and NFPs. It is expected that fund managers will work with social enterprises to diversify finance options, develop investment capacity and demonstrate social impact.

Social Impact Bonds

In our previous Balancing Act article (<http://www.makdap.com.au/docs/Balancing%20Act%20-%20Issue%2020,%20August%202011.pdf>), we touched upon the growing interest in “social impact bonds” in the United Kingdoms. These bonds are new financial instruments used to fund activity from NFPs that focus on addressing important social issues. The approach would involve investors buying government-issued bonds and the money is used to fund preventative social schemes run by particular NFPs. The bond will be repaid to investors with a return contingent on the scheme’s success.

The abovementioned Senate Inquiry paper considers these bonds in detail. Meanwhile, the NSW Government announced on 5 September 2011 that it will launch a pilot tender in the State Budget for social impact bonds. We expect to see further development in respect of these bonds in the near future.

“Fund managers will be responsible for using the funds to provide flexible and tailored financial products to social enterprises and NFPs” - Belinda Huang

Preparation for Charities and NFPs

Given the growing interest from both the Federal and State Government in considering and trialling new forms of financial products to assist NFPs and social enterprises, charities and NFPs interested in participating in the upcoming financial initiatives should consider ensuring that their organisation is in an optimal legal and commercial position to participate. It is anticipated that the financial products to be made available will be made at an “arm’s length”, legal and commercial basis and NFPs will most probably be appraised on their organisational capacity and capabilities. It may be prudent for interested NFPs to, in preparation, review their legal and financial status and in particular consider the following issues:

1. Is the structure of the organisation a company limited by guarantee, an incorporated association or does it take some other kind of legal form?
2. Does the organisation’s constitution (if there is one) satisfy applicable legal requirements?
3. Are there mechanisms in place to promote good governance structures and procedures, such as in terms of managing financial risk?
4. Are the financial and accounting records up to date and clear enough to give a positive representation of the financial and social outcomes achieved or achievable by the organisation?

While the Government is finalising their approaches, charities and NFPs can take advantage of this time to prepare and be ready for when the expected increase in financial opportunities for the Not-For-Profit sector are made available.



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- UK Trends - Social Impact Bonds
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- Preparing for a Harmonised System of Work Health and Safety Laws in Australia
- Procedural Fairness in Disciplinary Decisions

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- Makinson & d'Apice Research Study Report
- A New Regulator - A New Tax - A New Definition
- Protecting the reputation of Not-For-Profit organisations
- Supreme Court of NSW appoints new Trustee for Testamentary Charitable Trust
- Full Federal Court confirms that a community bank can be tax exempt

Please feel free to circulate this newsletter to others who may be interested. If you would like to receive future issues of *Balancing Act* via email, please register at http://www.makdap.com.au/resources_registration.cfm.

Disclaimer: This publication is a non-comprehensive general outline of the law as at 29 November 2011. You should not act upon or rely on any information contained in this newsletter without obtaining specific legal advice.

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