

# **TEN Webinar**

## **Charities straying outside the boundaries – the legal and regulatory challenges**

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## The Charitable Purposes

1. It is crucial to the functioning of a charity that its leaders have ever present an awareness how each proposed activity effects the entity's charitable purpose. 'Straying outside the boundary' of charitable purpose can have disastrous effects, the most prominent of which is the prospect of the loss of charitable endorsement, and the concomitant tax concessions, endorsements or funding. Ultimately, as I will set out, the responsibility to ensure the acquittal of charitable purposes falls to what the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (*ACNC Act 2012*) terms the 'responsible entities' of a charity, which include the directors, trustees, governing committee members or otherwise, depending on the structure adopted. This is an increasing area of concern, as many charities follow government funding or programmes into activities that may not demonstrably acquit their charitable purposes.
2. The first port of call in ascertaining whether your activities fall within the boundary line of your charitable purpose for the purposes of Commonwealth law is section 12(1) of the *Charities Act 2013*, which lists twelve charitable purposes as follows:
  - a. advancing health
  - b. advancing education
  - c. advancing social or public welfare
  - d. advancing religion
  - e. advancing culture

- f. promoting reconciliation, mutual respect and tolerance between groups of individuals that are in Australia
  - g. promoting or protecting human rights
  - h. advancing the security or safety of Australia or the Australian public
  - i. preventing or relieving the suffering of animals
  - j. advancing the natural environment
  - k. promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a state, a territory or another country (where that change furthers or opposes one or more of the purposes above), and
  - l. other similar purposes 'beneficial to the general public' (a general category).
3. Section 5(b)(i) of the *Charities Act 2013* (Cth) provides that a charity must have purposes that are exclusively charitable:
- charity means an entity:
- (a) that is a not for profit entity; and
  - (b) all of the purposes of which are:
    - (i) charitable purposes (see Part 3) that are for the public benefit (see Division 2 of this Part); or
    - (ii) purposes that are incidental or ancillary to, and in furtherance or in aid of, purposes of the entity covered by subparagraph (i); and
- Note 1: In determining the purposes of the entity, have regard to the entity's governing rules, its activities and any other relevant matter.
- Note 2: The requirement in subparagraph (b)(i) that a purpose be for the public benefit does not apply to certain entities (see section 10).
- (c) none of the purposes of which are disqualifying purposes (see Division 3); and
  - (d) that is not an individual, a political party or a government entity.
4. The obligation to work towards charitable purposes is also set out at Australian Charity and Not-for-profit Commission (ACNC) Governance Standard One, which provides:
- Standard 1: Purposes and not-for-profit nature
- Charities must be not-for-profit and work towards their charitable purpose. They must be able to demonstrate this and provide information about their purposes to the public.

### Identifying Non-Charitable Purposes

5. The courts have long considered question of whether a charity has 'strayed outside' its charitable purposes through the mechanism of the 'independent purpose' test. A charity that has an independent non-charitable purpose will not be charitable, even though all of its remaining purposes are charitable. In practice, this test operates in conjunction with the 'ancillary or incidental purposes' test. Any purposes that are incidental or ancillary to other charitable purposes will not disqualify an entity from

charitable status. At the Commonwealth level, this test is reflected in section (b)(ii) of the *Charities Act 2013* (set out above).

6. In *Inland Revenue Commissioners v City of Glasgow Police Athletic Association* [1953] AC 380 at 405 per Lord Cohen the House of Lords stated the test in the following terms:

(1) If the main purpose of the body of persons is charitable and the only elements in its constitution and operations which are non-charitable are merely incidental to that main purpose, that body of persons is a charity notwithstanding the presence of those elements. (2) If, however, a non-charitable object is itself one of the purposes of the body of persons and is not merely incidental to the charitable purpose, the body of persons is not a body of persons formed for charitable purposes.

7. In *Commissioner of Taxation v Word Investments*<sup>1</sup> (*Word Investments*) the High Court stated the test as follows (at paragraph 17): 'In examining the objects [of an institution], it is necessary to see whether its main or predominant or dominant objects, as distinct from its concomitant or incidental or ancillary objects, are charitable'.
8. The question of whether a non-incidental or non-ancillary purpose is present is not to be approached quantitatively. Whether a purpose is incidental or ancillary does not require that the purpose be minor in quantitative terms.<sup>2</sup> It is however difficult to reconcile this position with that stated in Australian Tax Office Ruling 2011/4, which provides that 'Benefits are incidental if they are a minor by-product of activities undertaken to carry out the institution's purpose'. Whether a purpose is a main purpose or is ancillary or incidental is one of degree, turning on the individual circumstances of each entity the subject of the enquiry, leading one commentator to conclude that the courts approach is 'hardly exact'<sup>3</sup> and 'as with all matters of degree, a principle capable of certain application has appeared elusive.'<sup>4</sup> Nevertheless some attempt at illustrating the nature of the test can be made through an analysis of the case law.
9. In *Navy Health Limited v. Federal Commissioner of Taxation*<sup>5</sup> (*Navy Health*) Jessup J held that a health fund established for armed services personnel and their dependants was not charitable because membership was also available to civilians. Justice Jessup held that the provision of benefits to persons who were civilians, though minor in number, was not an incidental or ancillary purpose (at paragraph 71):

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<sup>1</sup> (2008) 236 CLR 204.

<sup>2</sup> TR 2011/4 at 28.

<sup>3</sup> Gino Dal Pont, *Law of Charity* (LexisNexis Butterworths, 2nd edition, 2010) at 13.15.

<sup>4</sup> *Institution of Professional Engineers New Zealand Inc v Commissioner of Inland Revenue* [1992] 1 NZLR 570 at 577-83 per Tipping J.

<sup>5</sup> (2007) 163 FCR 1; [2007] FCA 931.

That such a group of persons, numerically minor though they were in the overall scheme of the applicant's operations, should be within the cohort of persons whom the applicant benefited does, in my view, demonstrate that the applicant had as an object the provision of health benefits to persons who fell outside the Downing principle. This object could not be described as ancillary or incidental in the sense explained above. The object was, I consider, a substantive and free-standing one on its own.

10. In *Navy Health* Justice Jessup stated the test as follows:

When the courts have described objects of an institution as ancillary, incidental or concomitant to a main object, they have not meant that the lesser object was merely a minor one in quantitative terms. Rather, they have required that object not be of substance in its own right, but *only to be something which tends to assist, or which naturally goes with, the achievement of the main object* (our emphasis added).<sup>6</sup>

11. In *Stratton v Simpson* Windeyer J posited the test as follows: 'that any other purposes are no more than 'incidental, subservient and ancillary, *only lawfully to be pursued as conducive to promoting*' the dominant purpose' (our emphasis added).<sup>7</sup> In *Victorian Women Lawyers' Association Inc v. Federal Commissioner of Taxation*<sup>8</sup> (*Victorian Women Lawyers*), French J stated at paragraph 149 that the '...activities of the association, including the social and networking functions, may have benefited members. They were, however, plainly directed to the larger object and in many cases to a larger audience, the legal profession in Victoria. They were in aid of the principal objective...'.

12. The Explanatory Memorandum to the *Charities Bill 2013* (Cth) sets out the following explanation on the meaning of ancillary or incidental:

1.24 To be a charity, an entity's purposes must all be charitable, other than incidental or ancillary purposes that further or aid the charitable purpose. [Paragraph 5(b)]

1.25 An entity cannot have an independent non-charitable purpose, however minor that purpose may be. A purpose is independent if it is an end in itself, or has substance in its own right, or is not intended to further or aid a charitable purpose.

1.26 However, an entity may have incidental or ancillary purposes that may be non-charitable when viewed in isolation but which *must further or aid the charitable purpose*. These purposes must not be ends in themselves, but *tend to assist, or naturally go with, the achievement of the charitable purpose*. They must be merely *for the sake of*,

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<sup>6</sup> (2007) 163 FCR 1; [2007] FCA 931.

<sup>7</sup> (1970) 125 CLR 138 at 148.

<sup>8</sup> (2008) 170 FCR 318; [2008] FCA 983.

*in aid of, in furtherance of, or concomitant to, the accomplishment of the entity's charitable purpose.* (our emphasis added)<sup>9</sup>

13. As stated in the above extract from the Explanatory Memorandum, where an independent non-charitable purpose exists, the entity will not be charitable. A purpose is independent rather than incidental or ancillary if it is an end in itself, or of substance in its own right or is not intended to further a charitable purpose.<sup>10</sup>
14. The NSW Land and Environment Court decision *Community Housing Limited v Clarence Valley Council*<sup>11</sup> provides an example of a housing charity that was held to hold a non-charitable independent purpose for the purposes of local government rates exemption. The decision reflects the traditional dual conditions of charitable purpose and charitable use that are characteristic of the granting of rating exemptions. In the decision the judge rejected rating exemption for Community Housing Limited's properties on the grounds that its Constitution, whilst containing some charitable purposes, also contained a non-charitable purpose, the provision of 'training, vocational and related education'. The Court held:

The provision of training, vocational and related education, and skills development to improve employment opportunities is in my opinion neither an independently charitable purpose nor merely incidental to some otherwise evident or identifiable main charitable purpose of the company. It is fundamentally general in its terms and incapable as a matter of language of being accommodated within any recognised description or category of charitable purpose. "Training" does not have any charitable content standing alone and does not acquire any from the context in which it appears. The same can be said of "vocational". The reference to "related education, and skills development" does not succeed in qualifying the clause as an independent charitable

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<sup>9</sup> These statements reflect the requirements posited in TR 2011/4:

182. For the purposes of this Ruling, 'incidental or ancillary' means for the sake of, or in aid of, or in furtherance of, an institution's charitable purpose. It does not mean minor in quantitative terms. As long as these other purposes are wholly incidental or ancillary to fulfilling or furthering the institution's charitable purpose so that they are, *in reality, only aspects of the charitable purpose*, they will not affect the charitable status of the institution.

183. Determining whether a purpose is incidental or ancillary involves questions of degree, judgment, proportion, impression and weight. It is not enough that the purpose might happen to further a charitable purpose: it must *be genuinely for the sake of, in aid of, or in furtherance of, the charitable purpose*.

184. As well as the term 'incidental or ancillary', other expressions used in the cases are 'subsidiary' and 'concomitant'. They all express the idea that the objects or purposes *are not ends in themselves but are only for the sake of, or in aid of, or in furtherance of, the accomplishment of the institution's charitable purpose.* (our emphasis added)

<sup>10</sup> TR 2011/4 at 29.

1.29 Where an entity has a non charitable independent purpose, or its activities or other features demonstrate that it has a non-charitable independent purpose, the entity will not be a charity.

<sup>11</sup> [2014] NSWLEC 193.

purpose for the advancement of education. Even if it were capable of meeting the description of a charitable purpose for the advancement of education, the exemption sought by the company would not be available to the extent that there is no evidence that any of its properties are used for any such purpose.

The decision demonstrates the need to give careful consideration to the drafting of objects clauses within governing documents, and to consider the consequence of any non-charitable objects. The decision is based in NSW state law and the common law of charity, but essentially concerns the same test as that applied under the federal *Charities Act 2013*.

15. A further recent example of a 'charity' that was found to have independent non-charitable purposes is provided by *Helena Partnerships Ltd v HM Revenue and Customs*.<sup>12</sup> In that decision the 'charity' had entered into an arrangement with the local Council to make available 75% of its stock to tenants referred by the Council, an arrangement that was tied to its funding allocation. The Court found that:

It is not suggested that this policy of itself restricted the allocation of even that three quarters of Helena's available housing stock, let alone the remaining quarter, to persons who would qualify as being in need for the purposes of, for example, the category of charitable purpose consisting of the relief of the poor, the elderly and the infirm. It was agreed between the parties that some of the Council's housing was let to persons who were (in that charitable sense) in need, but some of it was let to persons not in such need. It was also agreed that parts, but nothing like the whole, of the area of the Council, and adjacent areas of North West England, suffered from poor socio-economic conditions.

It was thus not open to argue that Helena Partnerships Ltd extended the charitable purpose of the relief of poverty. The England and Wales Court of Appeal (Civil Division) held that the purpose of making 'the provision of a housing stock available for occupation by tenants generally (rather than so as to relieve a charitable need) is not a charitable purpose'. The consequences for Helena Partnership Ltd were disastrous, with the body being liable for corporate taxation on the rents collected within the backdated period in which it was not charitable.

## Private Benefit and Charities Generally

16. Much of the consideration of the independent purpose test has developed in the common law concerning the conferral of private benefit. This law then clarifies not only the threshold for when the activity of conferring a private benefit will reach the level of

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<sup>12</sup> [2012] EWCA Civ 569 (England and Wales Court of Appeal (Civil Division)), Lloyd, Black, Lewison LJJ, 9 May 2012)

a purpose, but also when any set of non-charitable activities will give rise to a non-charitable purpose. As charities are required to operate for the public benefit, any charity that has an independent purpose of conferring private benefit on individuals will not be charitable. This is not to say that charities cannot confer private benefit *at all*. A charity in seeking the public benefit almost invariably benefits a private individual in some manner. At one level, all public benefit must reduce to the level of private benefit. Accordingly, the delivery of private benefit to individuals by charities in itself is not precluded. In *Joseph Rowntree Memorial Trust Housing Assoc Ltd v Attorney-General* Peter Gibson J held:

The schemes are for the benefit of a charitable class, that is to say the aged having certain needs requiring relief therefrom. The fact that, once the association and the trust have selected individuals to benefit from the housing, those individuals are identified private individuals does not ... make the purpose in providing the housing a non-charitable purpose when individual poor recipients of bounty are selected.<sup>13</sup>

17. Justice Ashley in *Common Equity Housing Ltd v Commissioner of State Revenue*<sup>14</sup> (*Common Equity*) addressed the issue of private benefit to individuals in the context of housing in the following terms:

There must be an element of bounty [that is gain to an individual] in order that a disposition be in relief of poverty. But it does not follow that the recipients of the disposition might not be obliged to make some monetary contribution to what is provided: see, eg *Re Cottam*; *Midland Bank Executor & Trustee Co Ltd v Huddersfield Corp* [1955] 1 WLR 1299; see also *Re Monk* [1927] 2 Ch 197, where a trust to loan moneys to poor people, the moneys to be repaid free of interest, was held charitable; and *Joseph Rowntree Memorial Trust Housing Assoc Ltd v Attorney-General* [1983] 1 Ch 159 at 174.

If, in the present case, any operating profits of the plaintiff were returnable as dividends to its shareholders (mainly the cooperatives) it might be said that the apparent bounty of rental at below market rent was at least less than seemed to be the situation. But the articles of association preclude such an outcome.<sup>15</sup>

18. Justice Ashley in *Common Equity* also refuted the claim that the mere financial gain to the tenant in poverty amounts to a private benefit that would preclude charitable endorsement:

Counsel for the defendant further submitted that the corporation is shown not to be associated for a charitable purpose because tenants:

- have scope for financial gain – in the form of below market rental ...

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<sup>13</sup> [1983] 1 Ch 159 at 176.

<sup>14</sup> (1996) 33 ATR 77.

<sup>15</sup> At page 92.



I reject those submissions... [this] effectively treats the plaintiff's bounty, expressed in the form of low rental charged on the lease and the sub-lease, as the tenant's financial gain. Upon such an approach the greater the bounty the less would be the evidence of charitable purpose. That could not be so. Moreover, any such assumed gain cannot deny the non-profit making nature of the plaintiff as constituted and as it operates.<sup>16</sup>

19. The foregoing establishes that the question is not whether there is private benefit, but instead, whether such is the purpose of the organisation. If any personal benefit obtained by a non-charitable beneficiary is incidental or ancillary to a charitable purpose, charitable status is not affected.<sup>17</sup> Justice Roxburgh's comments in *Re Delius (deceased)* are relevant: 'a charitable trust must not have inherent in it the potentiality of individual profit for a non-charitable beneficiary.'<sup>18</sup> The prohibition on distribution of profit to members or persons who are not eligible for charitable relief extends both to the operation of the entity and upon its winding up.

20. The existence of private benefits which are incidental or ancillary to a public benefit will not by itself affect the classification of a purpose as charitable. This requirement is also reflected in the ACNC's guidance on 'Remunerating charity Board Members', which provides (amongst other requirements):

A charity that pays its board members should be able to justify payments in the context of it pursuing its charitable purpose and explain how the payments will assist in achieving its purpose.<sup>19</sup>

21. In *Inland Revenue Commissioners v City of Glasgow Police Athletic Association* Norman J held that the relevant test is 'Whether the private benefits are 'the unsought consequence of the pursuit of the public purpose' [qualifying], or are instead 'an end in itself and without its attainment the public purpose would never come into view' [not qualifying].<sup>20</sup> If those benefits are 'an inevitable concomitant of a charitable purpose', they will not upset that purpose.'<sup>21</sup> This position is affirmed by the Australia Tax Office in TR 2011/4: 'The existence of private benefits that are merely incidental or ancillary to a public benefit will not by itself affect the classification of a purpose as charitable.'<sup>22</sup>

The Tax Ruling provides the following examples of this principle:

Because charities act for the benefit of the public, it is practically inevitable that people benefit from them. However, this personal benefit is merely incidental to the carrying

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<sup>16</sup> At 94.

<sup>17</sup> *McGovern v Attorney-General* [1982] 1 Ch 321 at 333 per Slade J.

<sup>18</sup> [1957] 1 CH 299 at 308.

<sup>19</sup> <https://www.acnc.gov.au/tools/guides/remunerating-charity-board-members>

<sup>20</sup> *Inland Revenue Commissioners v City of Glasgow Police Athletic Association* [1953] AC 380 at 396; *British Launderers' Research Association v Hendon Rating Authority* [1949] 1 KB 462 at 467-8 per Denning LJ.

<sup>21</sup> *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450 at 456 per Gresson P.

<sup>22</sup> at 55.

out of the charitable purpose. For example, while it is the individual students of a charitable school who are educated, those private benefits are merely the result or consequence of carrying out the educational purpose. Similarly, in *Victorian Women Lawyers* the fact that members themselves may have benefited from the activities of the Association did not adversely affect the charitable purpose because the activities of the Association were 'plainly directed to the larger object and in many cases to a larger audience'.<sup>23</sup>

22. The relevant question is whether the purposes are charitable and whether any non-charitable purpose to provide private profit, if it exists, is ancillary or incidental to the main purpose.

### Other Relevant Factors, Activities and Policy Documents

23. The question of whether a charity is pursuing its purposes, or has strayed outside the boundary is answered by holistic appraisal. At the Commonwealth level, Note 1 to section 5 of the *Charities Act 2013* provides that '[i]n determining the purposes of the entity, have regard to the entity's governing rules, its activities and any other relevant matter.' The stated objects of an entity are merely one reference point, and the activities of the entity the subject of the enquiry may also be relevant to determining its genuine purpose.
24. As held by Ashley J in *Common Equity* 'in determining whether the plaintiff is a corporation associated for charitable purposes I should first look to the dominants whereby it was constituted; but that I should also consider the nature of its operation up to the present time.'<sup>24</sup> An example may be taken from *Royal Australasian College of Surgeons v. Federal Commissioner of Taxation* (1943) 68 CLR 436; (1943) 7 ATD 289, where the High Court had regard to both the objects in the College's constituent document and its activities in finding that the College's dominant purpose was the advancing of science. The objects were stated to be partly for the promotion of surgical knowledge and practice and partly for the promotion of professional interests. An analysis of its activities disclosed the undertaking of conferences for surgeons to discuss and study surgical matters, a technical surgical library for members, publishing journals, financing research, examinations for admission to fellowship of the College, and administering research and scholarship funds. The High Court held that the objects that by themselves, could have been to promote the private professional interests of members, were properly to be considered incidental to the dominant purpose of advancing science as a result of the activities of the entity. However, whilst activities may be relevant, as Dal Pont notes, 'The purpose in which the furtherance of

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<sup>23</sup> TR 2011/4 at 146.

<sup>24</sup> At page 90.

which an activity is carried out, not the character of the activity, is what determines whether or not it has a charitable character.’<sup>25</sup>

25. The Explanatory Memorandum to the *Charities Bill 2013* (Cth) reflects this position:

1.27 In determining or substantiating an entity’s purpose, it is the substance and reality of the purpose that must be identified. To substantiate — that is, to confirm or corroborate or demonstrate — the entity’s charitable purposes, the activities of an entity may be considered. It is the role of its activities and the extent to which they further, or are in aid of, the entity’s purpose that is relevant, not the nature of the activities. In considering activities to substantiate the charitable purpose, it may be necessary to go beyond governing rules to operating rules and activities to substantiate its stated objects.

26. The Explanatory Memorandum points to the following other relevant factors:

1.28 Other relevant factors may include elements of the governing documents such as powers, rules, not for profit and winding up clauses, clauses governing who can benefit from the entity’s activities and in what ways, the entity’s policies and plans, administration, finances, origins, history and control, and any legislation governing the entity’s operation. [Note 1 in paragraph 5(b)]

### Summary

27. Summarising the above discussion, the question of whether an independent non-charitable purpose exists (including that of the purpose of bestowing non-incidental or non-ancillary private benefit) is not to be determined by reference to quantitative factors. The test has been described in various forms:

- a. ‘that any other purposes are no more than ‘incidental, subservient and ancillary, *only lawfully to be pursued as conducive to promoting*’ the dominant purpose.’ (our emphasis added)<sup>26</sup>
- b. ‘that object not be of substance in its own right, but *only to be something which tends to assist, or which naturally goes with, the achievement of the main object*’ (our emphasis added).<sup>27</sup>
- c. ‘They must not be ends in themselves, but tend to assist, or naturally go with, the achievement of the charitable purpose.’<sup>28</sup>

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<sup>25</sup> Gino Dal Pont, *Law of Charity* (LexisNexis Butterworths, 2nd edition, 2010) citing various at [13.14].

<sup>26</sup> (1970) 125 CLR 138 at 148.

<sup>27</sup> (2007) 163 FCR 1; [2007] FCA 931.

<sup>28</sup> *Charities Bill 2013* (Cth) Explanatory Memorandum.

- d. 'They must be merely for the sake of, in aid of, in furtherance of, or concomitant to, the accomplishment of the entity's charitable purpose.'<sup>29</sup>
- e. Whether the activities can be seen as 'plainly directed to the larger object and in many cases to a larger audience'.<sup>30</sup>
- f. The benefits are 'inevitable concomitant of a charitable purpose'<sup>31</sup>
- g. Whether the private benefits are 'the unsought consequence of the pursuit of the public purpose' [qualifying], or whether they are instead 'an end in itself and without its attainment the public purpose would never come into view' [not qualifying].<sup>32</sup>

### Taxation Ruling 2015/1

28. In 2013 the *Income Tax Assessment Act 1997* was amended to introduce special conditions that a not-for-profit entity must satisfy to maintain entitlement to income tax exemption:

- a. to comply with all the substantive requirements in its governing rules ('the governing rules condition'), and
- b. to apply its income and assets solely for the purpose for which the entity is established ('the income and assets condition').

29. It is the latter condition which is of interest in the current paper. Subsequently, the Australian Taxation Office released TR 2015/1, which sets out the Commissioner of Taxation's view on the special conditions. It provides that 'the income and asset condition will not be breached merely due to an entity having an incidental or ancillary purpose.' However it is the requirement that the assets be applied 'solely' that introduces some degree of novelty, when considered against the common law prescriptions on qualitative assessment. The Ruling provides that only 'immaterial' or 'occasional, unrelated misapplications' of charitable funds will not breach the provisions:

34. A strict standard of compliance is required under the 'solely' test. Nevertheless, the Commissioner accepts that misapplications of an entity's income and assets of an

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<sup>29</sup> *Charities Bill 2013* (Cth) Explanatory Memorandum; see also *Victorian Women Lawyers* (2008) 170 FCR 318; [2008] FCA 983, where French J stated at paragraph 149 that the '...activities of the association, including the social and networking functions, may have benefited members. They were, however, plainly directed to the larger object and in many cases to a larger audience, the legal profession in Victoria. They were in aid of the principal objective...'

<sup>30</sup> *Victorian Women Lawyers*.

<sup>31</sup> *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450 at 456 per Gresson P.

<sup>32</sup> *Inland Revenue Commissioners v City of Glasgow Police Athletic Association* [1953] AC 380 at 396; *British Launderers' Research Association v Hendon Rating Authority* [1949] 1 KB 462 at 467-8 per Denning LJ.

insignificant nature will not result in a breach of the condition. Relevant considerations include the amount of the misapplication and how often the misapplication occurs.

35. The income and assets condition will still be satisfied where:

- the misapplication or misapplications are immaterial in amount, and
- there is a one-off misapplication or occasional, unrelated misapplications of part of the income or assets of an entity for a purpose other than the purpose for which the entity is established.

It must be assumed that this is referring only to any misapplications that fall outside of any ancillary or incidental purposes.

## Advocacy by Charities

30. There has been a lot of recent interest in the Australian Charities and Not-for-profits Commission's ability to revoke a charity's tax exempt status for its political advocacy. As noted above, section 12(1) of the *Charities Act 2013* sets out the varying charitable purposes at law. Section 12(1)(l) appears at the end of this list of purposes and provides the circumstances when advocating for change in the law can be undertaken without affecting an entity's charitable status. It is as follows:

the purpose of promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a State, a Territory or another country, if:

- (i) in the case of promoting a change—the change is in furtherance or in aid of one or more of the purposes mentioned in paragraphs (a) to (k); or
- (ii) in the case of opposing a change—the change is in opposition to, or in hindrance of, one or more of the purposes mentioned in those paragraphs.

31. Section 11 demarcates a boundary which, if transgressed, will mean that advocacy is no longer undertaken in pursuit of a charitable purpose. Crossing that boundary will disqualify an entity from being charitable:

disqualifying purpose means:

...

- (b) the purpose of promoting or opposing a political party or a candidate for political office.

The disqualifying provision has no regard to whether the purpose is the main purpose or not. It need only be an independent purpose.

32. The combined effect is that a charity:

- a. cannot have a main purpose of changing the law in and of itself, any such purpose has to be for in furtherance or in aid of a charitable purpose; and
  - b. cannot have an independent purpose of promoting or opposing a political party or candidate for office.
33. Although there has been significant calls for reform of this test, I would like to argue the case against reform. The reason why the law is in place is to stop the politicisation, and thus the delegitimisation, of charities. To allow groups with mere political motive to take charitable form would undermine confidence in the independence of the sector as a whole. If one accepts this correlation between charity and pure motive, then a boundary line between charity and partisan politics must be maintained. However, the threat of the loss of tax exemption can have a distinctly sobering effect on free speech. As charities exist to promote public benefit, precisely where the line is drawn can then have significant impacts on civil society freedom.
34. Adopting an international perspective, a review of the law of Anglophone democracies reveals just how contentious this boundary line can be. During the height of World War One in *Bowman v Secular Society* Lord Parker handed down the seminal English dictum that a charitable “trust for the attainment of political objects has always been held invalid... because the court has no means of judging whether a proposed change in the law will or will not be for the public benefit”. More recently the English Charity Commission has declared a somewhat conciliatory position, recognising that, as “the independent nature of the charitable sector is of fundamental importance to society”, although “a charity cannot have a political purpose... political activity can be carried out by a charity to support the delivery of its charitable purposes”. Much then turns on the distinction between “purpose” and “activity”.
35. Although imbibing the English common law, the United States has taken a vastly differing position, choosing to disqualify mere activity. In the US charities must “not participate in, or intervene in... any political campaign on behalf of... any candidate”. Although the bureaucracy has declared it will look to the percentage of a charity’s turnover, in the lead judgement *Branch Ministries v Rossotti* a charity lost its tax exemption for placing two newspaper advertisements critiquing Bill Clinton’s policy.
36. Notwithstanding the bureaucracy’s position, US law thus imposes a strict activity test, which renders even individual acts of critique liable to disqualification. Not having the numbers in the Congress to amend the law, earlier this year Trump signed an executive order prohibiting Treasury from taking “adverse action” against charities.
37. The contagion of contention has also spread to Canada, where earlier this year the Ontario Supreme Court ruled that a tax agency imposed advocacy cap of 10 per cent

of resources unconstitutionally burdened free speech. In doing so, the court upheld the prohibition on partisan activities.

38. In Australia, clarity has been provided by the High Court. In the 2010 Aid/Watch decision the court wielded the constitutionally protected “freedom of political communication” to overturn Lord Parker’s dictum. As noted above, under the *Charities Act 2013*, in Australia charities can have a purpose of critiquing government policy, provided such is done in furtherance of their public benefitting charitable purpose. There is a boundary line: a charity cannot have a “purpose of promoting or opposing a political party or candidate”. Again the incidental or ancillary test is employed here. An independent purpose of advocating for law reform that is not in furtherance of a charitable purpose will disqualify an entity from registration. The same applies to an entity that has a main or independent purpose of promoting “purpose of promoting or opposing a political party or candidate”.

39. The Explanatory Memorandum to the *Charities Act 2013* provided the following clarification:

Disqualifying purpose

1.107 The disqualifying purpose is concerned with direct partisan political engagement that supports or opposes a candidate or party for office or other partisan political engagement to the extent and in a way that this can be construed as a purpose.

1.108 This does not prevent entities from distributing information, critiquing or comparing party policies in order to further the achievement of their charitable purpose.  
[Paragraph 11(b)]

1.109 Entities may engage with candidates or representatives of political parties to lobby, debate or seek explanation of policies relevant to their charitable purposes. They may also assess and critique their policies.

1.110 In determining whether an entity has a purpose to promote or oppose a candidate or political party, considerations could include whether the focus of the entity is on promoting or opposing a particular candidate or a political party in general, rather than on their policies that are relevant to the charitable purpose, the direct nature and extent of engagement and association with a candidate’s or a party’s campaigns or publications, or lack of balance in promoting or opposing the policies of another political party or candidate with similar policies relevant to the charitable purpose.

40. The Statement of Compatibility with Human Rights accompanying the *Charities Bill* provided:

3.14 Activities engaged in by a charity will not necessarily constitute a purpose of that charity, that is, a charity may engage in an activity without having the purpose of engaging in that activity. For example, a charity may produce ‘score cards’ setting out

how a particular party's policies aligns with the charity's aims and this is unlikely to constitute a purpose of that charity.

3.21 The Bill enables entities to generate and engage in public debate with fewer restrictions than the provisions relating to political purposes in comparable overseas jurisdictions such as the United Kingdom and New Zealand where such purpose may be only incidental or ancillary to another charitable purpose.

41. These documents confirm that the relevant test is the independent purpose versus incidental and ancillary purposes test. The ACNC has also released guidance on the boundaries of permissible advocacy.<sup>33</sup> Although the boundary must always be determined with regard to the whole circumstances of a charity's operation, one-off or incidental activities (like those in Branch Ministries) are unlikely to amount to a purpose. Importantly, the principles directing this boundary line are not novel – they are found in a longstanding and developed tradition in the common law of charities that guides the identification of independent non-charitable purposes.
42. In my view, setting the boundary at an organisational purpose of supporting or opposing a political party more adequately walks the line between inviting charities' contribution on policy and protecting their legitimacy as independent, non-partisan players in a democratic polity. Tax exemption sends the message to charities that your contribution to our common weal is sought, so much so that we are willing to subsidise it. Conversely by tying exemption to a strict "no political comment condition" the State risks the allegation that not only does it not want the comment of charities as to what comprises the common good, it will wield the threat of financial impost against any such offering.
43. The role of charities in pursuing their vision of the common good is fundamental to the great contest of ideas that characterises a flourishing democracy – this requires competing visions, and at times, challenges to the State, especially in the name of charitable good. In my view, while there may be a case for reform elsewhere, in many respects we lead the world on the question of advocacy by charities.

### External Conduct Standards

44. The final potential 'boundary straying' area I will consider is the proposed External Conduct Standards (ECS), Regulations anticipated by the *ACNC Act 2012* itself, which were released in draft form for consultation earlier this year. Relevantly, the ECS employ a purposive test in positing Standards that must be complied with by charities wholly or partially operating overseas (or Australian charities who work in collaboration

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<sup>33</sup> <https://www.acnc.gov.au/advocacy-charities>.



with entities wholly or partially working overseas) in order to retain their charitable status. One example relates to the use of resources (including funds) at Standard 1:

(3) The registered entity must:

(a) take reasonable steps to ensure that its activities outside Australia are carried out in a way that is consistent with its purpose and its character as a not-for-profit entity; and

(b) maintain reasonable internal control procedures to ensure that resources (including funds) are used in a way that is consistent with its purpose and character as a not-for-profit entity; and

(c) take reasonable steps to ensure that the resources (including funds) given to third parties outside Australia (or within Australia for use outside Australia) are applied:

(i) in accordance with the entity's purpose and character as a not-for-profit entity; and

(ii) with reasonable controls and risk management processes in place.

45. It is not clear that the variously deployed requirement that activities be 'consistent with its purpose and character as a not-for-profit entity' is the test that relates to the determination of charitable purpose (the independent versus incidental or ancillary purposes test outlined above). Indeed, by its application to all individual *activities* (including all operations and the application of funding and resources) it would appear that the ECS test is an entirely novel requirement that operates in addition to the test that applies to charities. Certainly the notion that activities should be consistent with the '*character*' of the entity (as distinct from its purpose) is entirely novel. Furthermore the notion of 'consistency' is distinct from the existing law of charities, which instead considers whether activities have been undertaken 'in furtherance of', or are 'advancing' charitable purposes.

46. The Explanatory Materials do not clarify the content of this novel test. Given the ECS have in view the activities and operations of charities, the Explanatory Material rather confusingly state:

The requirement that the registered entity must act consistently or in accordance with its character as a not-for-profit entity ensures that while operating overseas the entity acts in accordance with the purpose for which the entity was created and how it is run in Australia. This means acting consistently with the legal requirements of being a charity and not knowingly operating in a way that is inconsistent with those laws.

It appears that the two distinct notions of not-for-profit and charitable purpose are conflated here. It is acknowledged that, as currently drafted, the ECS only are proposed to apply to charities registered under the *ACNC Act 2012*, however this does not alter the fact that as currently drafted, the ECS pose a test that is distinct from the purposive test applied to charities at the levels of have outlined. The tension could

possibly be resolved by replacing the term 'not-for-profit' entity with 'charitable entity' in the ECS and by removing requirement of 'consistency' with 'character' as opposed to 'purpose'. Instead, the requirement imposed should be the long-standing and well-known requirement that the charity advance the relevant *charitable* purpose.

47. To fail to do so would mean that charities that conduct operations overseas would apparently be operating under two differing tests, the requirement that all purposes be in furtherance of charitable purposes, and the requirement that their activities be consistent with their 'purpose and character as a not-for-profit entity'. Regulation 50.4(2) within the ECS clarifies that:

a registered entity does not operate outside Australia only because it carries out activities outside Australia that are merely incidental to the operation and pursuit of a registered entity's purposes in Australia.

Although this refers to *activities* that are pursuant to *purposes* (distinct from the traditional incidental / ancillary purposes pursuant to charitable purposes test) it will (likely) have an akin substantive effect to the existing test under the *Charities Act 2013*. However Regulation 50.4(2) does not displace the fact that it is a separate test from the 'consistent with purpose and character as a not-for-profit' entity test imposed elsewhere under the ECS.

48. It is a further concern that the ECS introduce an apparent tracing requirement for distributed funds. They place unprecedented obligations on domestic donor charities that give to a second Australian charity that operates overseas, effectively enabling the donor charity to lose its own charitable endorsement for the failings of the recipient charity. In substance, the proposed legislation introduces the prospect that charities can lose their endorsement due to the operations of a third party which are beyond their control. This has the potential to be a major disincentive to giving, particularly amongst religious donor charities, and thus decrease the overall contribution by Australian charities to development relief. While it is entirely reasonable that international charities would comply with the obligations imposed under Regulations, it is not realistic to require domestic charities to be able to exercise control over these matters. Placing the obligations on charities that have no practical ability to ensure the compliance is not justified. This is inequitable, giving rise to the prospect that a charity can be penalised for the actions of a third party over whom it has no control. It is entirely foreseeable that the provisions will detrimentally impact the level of donations provided by domestic Australian charities to Australian charities that operate overseas. This is because domestic charities will not, acting prudently, wish to expose their own charitable status to the operations of a third party charity in this way.

49. There is also a concern that the Regulations would have the perverse incentive that domestic charities that are currently giving through existing charities that specialise in international operations may instead commence international giving or operations directly as a means to avoid the risk of loss of charitable status due to the operations of a third party charity. This would then expand the number of direct engagements by Australian charities in the developing world who may not command comparable levels of expertise, experience or controls. Such a perverse incentive would then have an impact on the quality of Australia's international development, and consequently its international reputation.

### What to do if Things go Awry?

50. Division 65 of the *ACNC Act 2012* provides that charities registered with the ACNC have an obligation to notify the ACNC where:
- a. There is non-compliance with the *ACNC Act 2012*, the Governance Standards or the External Conduct Standards
  - b. The non-compliance is 'significant'; and
  - c. The non-compliance means the entity is no longer entitled to be registered as a charity.
51. With reference to the second requirement, the Act provides that:
- in determining whether the contravention or non-compliance is significant, take account of the following matters:
- (a) the nature, significance and persistence of any contravention or non-compliance;
  - (b) the desirability of ensuring that contributions (see section 205-40) to the registered entity are applied consistently with the not-for-profit nature, and the purpose, of the registered entity.
52. The third requirement deploys the above discussion on independent non-charitable purposes. Charities must also comply with the External Conduct Standards and the Governance Standards in order to retain registration. Charities must notify within 28 days of first becoming aware of circumstances that create an obligation to notify (60 days for small registered charities in limited circumstances). In dealing with a breach, the ACNC will have regard to whether the non-compliance was intentional, and whether any responsible persons knew about or contributed to improper conduct. The ACNC's Regulatory Approach Statement discloses the ACNC's preferred approach is to commence with assisted compliance, then move to proactive compliance, followed by graduated sanctions and revocation as a last step.
53. Further, Deductible Gift Recipients (who may also be charities) have an additional and separate obligation to notify the Australian Tax Office if they no longer meet the requirements of their DGR status. That obligation is contained at section 426-45 of the

*Tax Administration Act 1953* (Cth) (TAA). Furthermore section 426-55 of the TAA provides the circumstances in which the Commissioner may revoke an endorsement. In that event, the entity has rights of review of the decision under section 426-60. If a DGR determines that it is obliged to notify the Commissioner of non-compliance it must comply with that obligation.