

CHARITABLE FUNDRAISING THROUGH COMMERCIAL ACTIVITIES: THE FINAL WORD OR A PYRRHIC VICTORY?

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In Commissioner of Taxation v Word Investments Ltd ('Word')¹ the Full Court of the Federal Court has recently challenged the notion that an entity cannot be a tax exempt charity if its primary activities consist of raising funds by commercial means to apply those funds to charitable objects.² The question for the charitable sector is whether winning this 'battle' over fundraising will provoke a response that results in the loss of the 'war.' The significance of the issue is likely to increase in light of the growing need for charities to obtain alternative funding sources to government grants and private donations. This article examines how Word sits with the authorities on charities conducting commercial fundraising activities. Ultimately, the inquiry addresses the potential consequences of increased commercial activity following Word and suggests there is a risk that Word may result in the introduction of legislative limits to such activities.

1. INTRODUCTION

Why do charities care about commercial fundraising? The question can be broken down further. Why do charities want to carry out commercial fundraising activities and what impact will such

* Lawyer, Blake Dawson. The author wishes to express his gratitude to Professor Stephen Barkoczy and to Len Hertzman for their comments on an earlier draft of this paper.

¹ (2007) 164 FCR 194.

² The Commissioner of Taxation has obtained special leave to appeal to the High Court: Australian Taxation Office, *Non-Profit News Service No. 0201 - Word Investments Ltd: Tax Office granted special leave* (2008) <<http://www.ato.gov.au/nonprofit/content.asp?doc=/Content/00143293.htm>> at 9 August 2008.

CHARITABLE FUNDRAISING

activities have on charities? And what do ‘commercial activities’ consist of? Part 2 seeks to answer these questions.

The case law and legislation before *Word* already permitted charities to conduct an extensive breadth of fundraising activities, including less obvious ones, such as gaming activities. Part 3 investigates these activities and concludes by reconciling *Word* with the earlier authorities, ultimately proposing a ‘but for’ test as a method of distinguishing between fundraising activities which are ancillary to an entity’s charitable purpose and those which are not. However, if *Word* does conform with, or is a minor extension of, the case law, what are the implications of potentially increased commercial fundraising by charities? Is there a risk that *Word* may result in the introduction of legislative limits to such activities? Part 4 considers the implications and the approaches to this issue across several jurisdictions.

The cases are replete with warnings that the particular legislative context determines the ambit of permissible activities for charities. This paper is limited to the income tax exemption under Div 50 of the *Income Tax Assessment Act 1997* (Cth) (‘ITAA97’) and, more particularly, whether certain charitable entities fall within the descriptions set out in the table in s 50-5.³

2. THE FUNDAMENTALS

This Part outlines two preliminary concepts. First, it outlines the reason why charities want to conduct such activities. Secondly, it outlines the circumstances in which the income tax exemption is available and thirdly it provides a definition of ‘commercial activities.’

³ Additional matters are not explored. For instance, this paper will not explore the breadth of the ‘in Australia’ requirement raised in *Word*, or the extent to which the purpose, activities and motives of related entities should be imputed to an entity.

2.1 Why do Charities Want to Carry Out Commercial Activities?

There are signs that charities are under increasing pressure to raise funds by alternative means other than the traditional reliance on donations or passive income. At the start of this decade the *Report of the Inquiry into the Definition of Charities and Related Organisations* noted that charities were experiencing a number of drivers to ‘engage in commercial activities’, including the expectations of both state and federal governments.⁴ At first instance in *Word*, Sundberg J emphasised the trend:⁵

With the decline of the welfare state, charitable organisations are expected to do more with the same resources. Reliance on donations alone will, in many cases, be insufficient. Hence many charitable organisations have established business ventures to generate the income necessary to support their activities.

These anecdotal comments are mirrored by ABS data⁶ and the report entitled *Giving Australia: Research on Philanthropy in Australia*, which identified that of almost 500 non-profits surveyed, 29% ‘operated a commercial venture or social enterprise’.⁷ Commentators in other jurisdictions have also noted an increasing

⁴ Inquiry into the Definition of Charities and Related Organisations, *Report of the Inquiry into the Definition of Charities and Related Organisations* (2001) 223-224. See especially Commonwealth Department of Health and Aged Care, submission extract at 223

⁵ *Word* (2006) 64 ATR 483, [60] (Sundberg J).

⁶ In the 1999-2000 income year, 58% of non-profit institution income was generated from the “sales of goods and services”: Australian Bureau of Statistics, *Non-Profit Institutions Satellite Account*, Cat No5256.0 (2002).

⁷ In 87% of the cases, the venture or enterprise was an add-on to the services conducted in carrying out ‘their primary purpose and mission’: Department of Family and Community Services, *Giving Australia: Research on Philanthropy in Australia* (2005) 43. Note that the report relates to non-profit entities, not specifically to charities.

CHARITABLE FUNDRAISING

engagement by charities in commercial activities,⁸ in part due to the greater sophistication and complexity of charities.⁹

2.2 The income tax exemption for charities

A number of state and federal tax concessions and exemptions are potentially available to charities,¹⁰ with the exemption from federal income tax under Div 50 of the ITAA97 one of the more significant. Sections 50-1 and 50-5 of the ITAA97 provide an exemption for the income of a number of ‘charitable’ entities as follows:¹¹

⁸ AC Maerov et al, ‘Back to Bake Sales: Defining the Scope of Related Businesses Conducted by Charitable Organizations and Foundations’ (2003) 51 *Canadian Tax Journal* 1602 in Canadian Tax Foundation, *TaxFind – Publications: Current Cases* (2007) 1, 1; ABC Drache ‘Charities, Non-profits and Business Activities’ (1997) 30 Canadian Tax Foundation 1 in Canadian Tax Foundation, *TaxFind – Publications* (2007) 1, 1; DL Sharpe, ‘Unfair Business Competition and the Tax on Income Destined for Charity: Forty-Six Years Later’ (1996) 3 *Florida Tax Review* 367, 451; JD Colombo, ‘Commercial Activity and Charitable Tax Exemption’ (2002) 44 *William and Mary Law Review* 487, 489-490; D Morris, ‘Fund-Raising for Maintained Schools: The Charity Law Implications’ (1995) November-December *Conveyancer and Property Lawyer* 453.

⁹ Colombo, above n 8, 489-490.

¹⁰ For instance, at the Commonwealth level, deductible gift recipient status, the fringe benefits tax exemption or rebate, imputation credit refund and GST concessions. At the state level, concessions exist in relation to taxes such as land tax, pay-roll tax and stamp duty. A number of the concessions are available only to more narrowly defined classes of entities, such as public benevolent institutions.

¹¹ This is subject to meeting certain additional conditions and obtaining endorsement from the Commissioner. Note that although the ITAA97 includes a trust within the definition of ‘entity’, a trust is manifestly not a juristic person, a distinction which may explain some of the difficulties with importing charity law notions developed in relation to trusts, into the construction of laws which relate to both persons and purposes.

50 1 Entities whose ordinary income and statutory income is exempt

The total *ordinary income and *statutory income of the entities covered by the following tables is exempt from income tax. In some cases, the exemption is subject to special conditions.

...

50-5 Charity, education, science and religion

Charity, education, science and religion		
Item	Exempt entity	Special conditions
1.1	charitable institutions	see sections 50-50 and 50-52
1.2	religious institution	see section 50-50
1.3	scientific institution	see section 50-55
1.4	public educational institution	see section 50-55
1.5	fund established for public charitable purposes by will before 1 July 1997	see sections 50-52 and 50-57
1.5A	trust covered by paragraph 50-80(1)(c)	see sections 50-52 and 50-60
1.5B	fund established in Australia for public charitable purposes by will or instrument of trust (and not covered by item 1.5 or 1.5A)	see sections 50-52 and 50-60
...		

Word concerned the application of item 1.1 of the table in s 50-5 of the ITAA97, that is, whether Word Investments Ltd ('Word') was a 'charitable institution'.¹² In broad terms, although the issue was not contested in *Word*, an 'institution' is:¹³

¹² The additional special conditions, being satisfaction of the 'in Australia' requirement set out in s 50-50 of the ITAA97 and the endorsement requirement set out

CHARITABLE FUNDRAISING

“an undertaking formed to promote some defined purpose...” or “the body (so to speak) called into existence to translate the purpose as conceived in the mind of the founders into a living and active principle”.

The term ‘charitable’, as it is used in the item 1.1 phrase ‘charitable institution’, continues,¹⁴ subject to minor modifications,¹⁵ to bear its general law meaning.¹⁶ There are, broadly, two positive limbs to the general law meaning of ‘charity’, both of which must be satisfied:

- The entity’s purposes must be charitable in the sense propounded in *Commissioners for Special Purposes of Income Tax v Pemsel* (‘*Pemsel’s Case*’)¹⁷ with reference to the preamble to the Statute of Charitable Uses 1601 (43 Eliz I c4). That is, the purpose must be the relief of poverty, the advancement of education, the advancement of religion, or other purposes beneficial to the community (by analogy with those set out in the Statute or accepted in the case law).

in s 50-52 of the ITAA97, are not explored in this article, although the ‘in Australia’ requirement was considered in *Word*.

¹³ *Stratton v Simpson* (1970) 125 CLR 138, 158 (Gibbs J, Barwick CJ and Menzies J agreeing) approving Lord Macnaghten at 511 in *Mayor of Manchester v McAdam* (*Surveyor of Taxes*) [1896] AC 500, 145-146 (Cf Windeyer J), 154 (Cf Walsh J).

¹⁴ Despite a recent inquiry into the definition of ‘charitable’ which recommended a legislative overhaul: Inquiry into the Definition of Charities and Related Organisations, above n 4.

¹⁵ There have been certain modifications to the two positive limbs to extend their reach under Div 50 of the ITAA97: *Extension of Charitable Purpose Act 2004* (Cth).

¹⁶ *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* (2006) 228 CLR 168 (‘*Central Bayside*’), footnote 28 (Gleeson CJ, Heydon and Crennan JJ). Although *Central Bayside* concerned a provision in the *Pay-roll Tax Act 1971* (Vic), their Honours’ comments related to the use of ‘charitable’ generally in legislation. See also at [169] (Callinan J), [76]-[119] (Kirby J) (Cf Kirby J’s detailed re-examination of the approach in *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531, which his Honour ultimately accepted).

¹⁷ *Pemsel’s Case* [1891] AC 53, 573 (Lord Herschell, Lord Watson agreeing), 583 (Lord Macnaghten, Lords Morris and Watson concurring).

- The entity (excluding those for the relief of poverty) must be for the public benefit. In essence, the entity must provide a benefit¹⁸ and must do so for a section of the public rather than a private group of individuals.¹⁹ Stated negatively, this means that the entity must not be for private profit.

In addition, some cases have accepted certain negative factors as precluding charitable status.²⁰ However, it will be relevant when ascertaining whether a charity meets the positive limbs of the test to assess whether the charity carries on ‘commercial activities’. If the entity’s purpose is to carry on a commercial enterprise as an end in itself, the first limb will not be fulfilled. Similarly, if the entity generates a surplus for distribution to a private group of individuals, the second limb will not be met.

2.3 Commercial activities

“When I use a word,” Humpty Dumpty said in rather a scornful tone, “it means just what I choose it to mean - neither more nor less.”²¹

¹⁸ *Re Pinion* [1965] Ch 85, 107 (Harman LJ), 107-108 (Davies LJ), 109-111 (Russell LJ); *Gilmour v Coats* [1949] AC 426, 446 (Lord Simonds).

¹⁹ *Verge v Somerville* [1924] AC 469, 499 (Lord Wrenbury); *Thompson v Federal Commissioner of Taxation* (1959) 102 CLR 315, 321-323 (Dixon CJ, Fullagar and Kitto JJ in agreement). See also *Strathalbyn Show Jumping Club Inc v Mayes* (2001) 79 SASR 54, 74 (Bleby J).

²⁰ For instance, the purpose of a trust or entity cannot: (1) be objectionable on public policy grounds, such as illegality (*Re Lowin* [1967] 2 NSW 140, 145-146 (Wallace P and Holmes JA)); (2) generally, be for ‘political purposes’ (*Bowman v Secular Society* [1917] AC 406, 442 (Lord Parker); *Royal North Shore Hospital of Sydney v A-G (NSW)* (1938) 60 CLR 396, 426 (Dixon J), 412-413 (Cf Latham CJ), 419 (Cf Rich J), 420 (Cf Starke J). However, there is room for debate over what constitutes a ‘political purpose’ and how readily the courts will construe a political purpose as ancillary to an entity’s charitable purpose); (3) be governmental (although this factor has been circumscribed following *Central Bayside* (2006) 228 CLR 168).

²¹ L Carroll, *Alice’s Adventures in Wonderland and Through the Looking-Glass, and What Alice Found There* (H Haughton ed, first published 1865, 1872, 1998 ed) 186.

CHARITABLE FUNDRAISING

Rather surprisingly, despite the Commissioner's discussion of commercial activities in *Taxation Ruling TR 2005/21* ('TR 2005/21')²² and the consideration of 'commercial' conduct in the cases, no precise definition of the term has been endorsed in the charitable context.²³ Although the cases provide some examples, the lack of a definition makes it difficult for taxpayers to determine whether they are carrying out such activities. It may also lead to distinctions being drawn on the basis of traditional labels (such as a charitable opportunity shop as opposed to a funeral business) rather than substance.

Some evidence of such distinctions does exist. The term 'commercial' has occasionally been applied pejoratively to activities as a kind of justification that the positive limbs of charity are not satisfied.²⁴ In a like fashion, there has been some reluctance to ascribe the adjectives 'commercial' or 'business' to activities undertaken by entities traditionally seen as, or found to be, charitable.²⁵

²² The ruling deals with the meaning of the terms 'charitable institution' and 'fund established for public charitable purposes'.

²³ During the hearing for special leave to appeal from *Word*, Hayne J noted that 'the expression "commercial enterprise" is intrinsically ambiguous': Transcript of Proceedings, *Commissioner of Taxation v Word Investments Ltd* (High Court of Australia, Kirby, Hayne and Crennan JJ, 23 May 2008) (Hayne J, during argument). But see R Dart 'Charities in Business, Business in Charities, Charities and Business – Mapping and Understanding the Complex Non-profit/Business Interface' (2004) 18(3) *The Philanthropist* 181, 184. Dart notes that 'business or commercial activity in a nonprofit context can mean fundamentally different things' and considers that 'commercialization' of charities typically relates to 'revenue generation' and it is this aspect that distinguishes commercial from traditional charitable activities.

²⁴ See Fullagar J's criticism of the use of the word 'commercial' as pre-empting the answer to the question whether the production for sale was incidental or ancillary to the charitable purpose of the trust: *Salvation Army (Victoria) Property Trust v Fern Tree Gully Corporation* (1952) 85 CLR 159 ('*Fern Tree Gully*'), 187.

²⁵ *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation* [1968] AC 138 ('*Scottish Burial*'), 147 (Lord Reid); *Brighton College v Marriott* [1926] AC 192, 204 (Lord Blanesburgh). Else-Mitchell J displayed such reticence, even when acknowledging that certain activities were commercial: *McGarvie Smith Institute v Campbelltown Municipal Council* (1965) 11 LGRA 321 ('*McGarvie Smith*'), 329. See

While *TR 2005/21* does not define commercial activities, the ruling assumes that the making of profits or surpluses is a necessary factor.²⁶ In addition, the ruling suggests that the activities must be carried out in a ‘commercial’ manner, whatever that means.²⁷ Some authorities adopt a narrower view, suggesting that carrying on operations commercially means ‘with a view to making profits for private individuals’, not simply making a surplus or profit.²⁸ This reticence to call activities ‘commercial’ is likely to be symptomatic of the preconceived distinctions referred to above.

The existence of a profit making intention, along with evidence of business characteristics, are significant factors²⁹ for the income tax concepts of activities giving rise to ordinary income, such as carrying on a business,³⁰ or entering into isolated profit making transactions.³¹ They are also relevant to at least the first two of the initial three limbs

also *TR 2005/21* [129]-[131]; *Earth Fund v Canada (MNR)* [2002] FCA 498 (‘*Earth Fund*’), [27]-[31] (Sharlow JA, delivering the judgment of the Court); Canada Revenue Agency, *Policy Statement CPS-019, What is a Related Business?* [6]-[7] <<http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html>> at 28 March 2008.

²⁶ *TR 2005/21* [128]-[130].

²⁷ *Ibid* [130].

²⁸ *Re Resch’s Will Trusts* [1969] 1 AC 514, 540 (Lord Wilberforce). See also *Royal Choral Society v. Commissioners of Inland Revenue* [1943] 2 All ER 101 (‘*Royal Choral Society*’), 104-106 (Lord Greene MR); *Scottish Burial* [1968] AC 138, 147 (Lord Reid). *Contra Re Smith (deceased); Executor Trustee and Agency Co of South Australia Ltd v Australasian Conference Association Ltd* [1954] SASR 151 (‘*Re Smith*’), 159-160, (Ligertwood J); *McGarvie Smith* (1965) 11 LGRA 321, 328-329 (Else-Mitchell J); *Incorporated Council of Law Reporting for England and Wales v A-G* [1972] Ch 73, 86 (Russell LJ), 90 (Sachs LJ), 104 (Buckley LJ).

²⁹ See *Miscellaneous Taxation Ruling MT 2006/1* [237]-[239], [244]; *Taxation Ruling TR 92/3* [6]; *Commissioner of Taxation v Myer Emporium* (1987) 163 CLR 199, 209-210, 213.

³⁰ The main factors emphasised in the case law to indicate whether an entity is conducting a business are extracted in *Taxation Ruling TR 97/11* [13].

³¹ See *Commissioner of Taxation v Myer Emporium* (1987) 163 CLR 199, 209-210, 213; *Miscellaneous Taxation Ruling MT 2006/1*, which discusses the revenue law concepts in the context of the definition of an enterprise for GST and ABN purposes.

CHARITABLE FUNDRAISING

of the definition of ‘enterprise’ for GST and ABN purposes,³² which refer to an activity or series of activities done:³³

- in the form of a business;
- in the form of an adventure or concern in the nature of trade; or
- on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property.

Accordingly, the case law and rulings in these areas provide guidance on the content of commercial activities.

In order to explore the implications of a broad range of commercial fundraising activities and avoid distinctions based on matters of form, an expansive definition is adopted in this paper. The definition draws on the income tax and GST guidance and the following Macquarie Dictionary definitions of, respectively, ‘commercial’ and ‘commerce’.³⁴

1. of, or of the nature of, commerce.
2. engaged in commerce.
3. capable of returning a profit: *a commercial project...*

1. interchange of goods or commodities, especially on a large scale between different countries (**foreign commerce**) or between

³² *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 9-20; *A New Tax System (Australian Business Number) Act 1999* (Cth) s 41.

³³ A number of the remaining limbs seek to broaden the reach of the definition to draw in all activities of charitable and religious entities to assist such entities in meeting the eligibility requirements for GST registration in order to obtain access to input tax credits: Explanatory Memorandum, *A New Tax System (Goods and Services Tax) Bill 1999* (Cth) [2.3]; *Miscellaneous Taxation Ruling MT 2006/1* [11]. The legislation also provides for a number of exceptions from the positive limbs of the definition.

³⁴ C Yallop et al (eds) *Macquarie Dictionary Online* (4th ed, 2005) at 17 March 2008.

different parts of the same country (**domestic commerce** or **internal commerce**); trade; business.

That is, ‘commercial activities’ are any activities carried out with the intention of returning a profit or surplus³⁵ and relating to:

- the regular interchange of goods, commodities or services;
- a business or an adventure or concern in the nature of trade; or
- the regular grant of an interest in property.³⁶

3. THE BOUNDARIES OF COMMERCIAL FUNDRAISING

As discussed in Part 2.2, carrying out commercial activities may preclude an entity from passing the positive tests required to characterise it as charitable. The application of *Word* to this issue is explored in Part 3.2, focusing in particular on the relevance of

³⁵ The term surplus may be more appropriate given the reluctance to associate the concept of ‘profit’ with charities.

³⁶ Cf Canada Revenue Agency, *Policy Statement CPS-019*, above n 25, [4] (‘a business involves commercial activity—deriving revenues from providing goods or services—undertaken with the intention to earn profit’); HM Revenue & Customs, *Charities – Trading and Business Activities*

<<http://www.hmrc.gov.uk/charities/trading/tax-vat.htm>> at 28 March 2008 (‘Trading is a term used in relation to income and corporation tax to describe activities, which involve the provision of goods or services to customers on a commercial basis. When deciding whether a trade exists, it is of no relevance that you do not intend to make a profit or that you intend profits to be used only for charitable purposes.’); Department of the Treasury Inland Revenue Service, *Publication 598 – Tax on Unrelated Business Income of Exempt Organisations*, Cat No 46598X (2007) 3 (‘trade or business’ includes ‘any activity carried on for the production of income from selling goods or performing services. An activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities that may, or may not, be related to the exempt purposes of the organization’).

CHARITABLE FUNDRAISING

activities in determining whether a separate purpose exists. Parts 3.2 to 3.7 expand on the question in light of existing authorities and it is concluded in Part 3.8 that *Word* is consistent with the current case law. Reasoning from *Word* and the existing authorities, a ‘but for’ test is posited as supplying the necessary link between activities and purpose to justify when commercial fundraising should be seen as an ancillary means to achieving a charitable purpose.

Finally, Part 3.9 considers the implications of several comments in *Word* for the public benefit requirement.

3.1 *Word*

Word provides an ideal vehicle to trace the boundaries of commercial fundraising.³⁷ For the purposes of this paper, the key issue was the entitlement of *Word* to endorsement as an income tax exempt charitable institution under Div 50 of the ITAA97 despite the fact that it carried on a funeral business to raise funds to support its purpose.³⁸

3.1.1 *The Factual Matrix*

Word was incorporated in 1975 as a company limited by guarantee by a charitable public company, Wycliffe Bible Translators Australia (‘Wycliffe’).³⁹ Wycliffe’s motivation was that *Word* was to operate as a fundraising body for Wycliffe.⁴⁰ *Word*’s memorandum of association

³⁷ It may be for this reason that the Australian Taxation Office (‘ATO’) funded the litigation under its test case program: *Word* (2007) 164 FCR 194, [65] (Allsop J); *Word* (2006) 64 ATR 483, [69] (Sundberg J).

³⁸ The case also raised other matters, in particular, the breadth of the ‘in Australia’ requirement and the influence of Wycliffe’s purpose and motivation on the characterisation of *Word*’s purpose.

³⁹ Wycliffe was characterised by Sundberg J as an ‘evangelical missionary organisation that seeks to spread the Christian religion through literacy and translation work, predominantly in the third world’: *Word* (2006) 64 ATR 483, [4] (Sundberg J).

⁴⁰ *Ibid* [5] (Sundberg J).

commenced with clearly charitable evangelical objects. However, it also contained additional ‘objects’ related to business activities:

(b) To carry on any business or activity which may seem to the Company capable of being conveniently carried on in connection with the objects for which this Company is established.

...

(t) To take money on deposit at interest or otherwise.

...

(u) To set aside out of the profits of this Company such sums as the Board of Directors thinks proper as reserved, for maintaining the whole or any part of the Company’s property or for meeting contingencies and for any other purposes connected with the business of the Company or any part thereof and the Board of Directors may invest the sums so set aside in the business of this Company or in such securities as the Board of Directors selects.

Significantly, Word’s memorandum of association also prevented the distribution of profits or gains to members.⁴¹

From the mid-1980’s Word’s activities involved accepting funds from members of the public for investment. Of the interest, Word forwarded 75% to Christian organisations (predominantly Wycliffe) for use in translating the Bible. The remaining 25% was nominally available to the ‘investors’. In 1996 Word began operating Bethel Funerals in an analogous fashion to ‘commercial’ funeral businesses, by charging a fee for the services in order to generate a surplus. The profits continued to be applied in the same manner as the investment

⁴¹ Therefore Word could not simply distribute its profits by means of a franked dividend to Wycliffe, allowing Wycliffe to potentially claim imputation credits up to the amount of tax paid by Word.

CHARITABLE FUNDRAISING

interest. The holding structure for the funeral business was altered on 1 July 2002.

Following unfavourable decisions on its endorsement applications and objection, Word was successful before the Administrative Appeals Tribunal only in respect of the period from 1 July 2002. On appeal to the Federal Court, Sundberg J held that Word was entitled to endorsement from 1 July 2000.⁴² The Full Court of the Federal Court unanimously upheld his Honour's decision.

3.2.1 First Limb: Charitable Purpose

Allsop J (with Stone J in agreement) delivered the leading judgment, concluding that Word did have a charitable purpose. His Honour stated the 'relevant task' was to:⁴³

...assess the true character or nature of the entity by reference to its objects, purposes and activities. It is an integrated, holistic inquiry directed to whether a body of facts and circumstances satisfies a legal category or conception.

However, Allsop J's judgment suggests that the nature of an activity can generally only be determined by examining the purpose for which the activity was conducted.⁴⁴ What might be characterised as

⁴² The earliest date from which endorsement is required for the income tax exemption.

⁴³ *Word* (2007) 164 FCR 194, [14] (Allsop J).

⁴⁴ *Ibid* [40]-[43] (Allsop J), referring to two Canadian decisions, *Vancouver Society of Immigrant & Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 ('*Vancouver Society*') and *Guaranty Trust Company of Canada in re the will of Dorothy Elgin Towle v Minister of National Revenue* [1967] SCR 133. The Canadian Income Tax Act (*Income Tax Act*, RSC 1985 (5th supp), c 1, s 149.1(1)) defines a 'charitable organisation' as an organisation that, amongst other requirements, devotes all of its resources to 'charitable activities'. The comments of the Canadian Supreme Court in the *Vancouver Society* case confirmed that, although the legislation refers only to activities and not purposes, it is necessary to consider the purposes to determine how the activities should be characterised.

a charitable activity in one context (because of the purpose behind the actions) might seem inimical to charity in another.

His Honour emphasised that the focus in certain cases on the charitable nature of an entity's activities depended on the particular statutory provision or the wording of the entity's constitution.⁴⁵ For instance, legislation imposing local government rates ('ratings legislation') frequently refers to the use of land being charitable, which results in a closer examination of the activities on the land.⁴⁶ Alternatively, the constitution may include an activity as an object of the entity.⁴⁷ Accordingly, Allsop J expressly rejected the notion that commercial activities could preclude an entity from being charitable.⁴⁸

Therefore, while Word's activities and its factual context were relevant, Allsop J focussed on Word's memorandum of association to determine its 'purpose', with Word's activities serving to confirm, rather than define that purpose.⁴⁹ His Honour construed Word's memorandum as evidencing its purpose to be the advancement of religion,⁵⁰ with the business activity objects described as 'ancillary powers' rather than true objects.⁵¹ On this basis, Allsop J concluded that Word's purpose was charitable and that its commercial activities

⁴⁵ *Word* (2007) 164 FCR 194, [15], [19] (Allsop J).

⁴⁶ *Ibid* [15], [18], [21] (Allsop J). Allsop J referred to *Scottish Burial* [1968] AC 138 and *Fern Tree Gully* (1952) 85 CLR 159. See also *Word* (2006) 64 ATR 483, [41] (Sundberg J).

⁴⁷ *Word* (2007) 164 FCR 194, [19], [24], [27]-[28] (Allsop J), in reference to *Incorporated Council of Law Reporting of the State of Queensland v Federal Commissioner of Taxation* (1971) 125 CLR 659 ('*Queensland Law Reporting Case*'); *Roman Catholic Archbishop of Melbourne v Lawlor* [1934] 51 CLR 1 and *Re Smith* [1954] SASR 151.

⁴⁸ *Word* (2007) 164 FCR 194, [12]-[13], [43] (Allsop J).

⁴⁹ *Ibid* [44]-[48] (Allsop J). See also at [94], [96] (Jessup J).

⁵⁰ *Ibid* [47]-[48] (Allsop J). See also at [87], [94], [96] (Jessup J).

⁵¹ *Ibid* [46] (Allsop J). See also Jessup J at [87], [96], who referred to the business objects as 'adjectival'. In addition, Jessup J emphasised at [87] that object (b) required business activities to be 'carried on in connection with' Word's religious objects.

CHARITABLE FUNDRAISING

were a means to fulfil its charitable purpose,⁵² stating ‘[h]ere, on the proper understanding of the memorandum of association, the purpose of all activities was, and could only be, the religious (and charitable) purposes of Word’.⁵³

Allsop J also provided some guidance on the broader question of when commercial activities will have a close enough nexus with purpose to be characterised as a means to achieving that purpose. His Honour indicated that:⁵⁴

a body which conducts only commercial activity and directs the profits from same by donation solely in accordance with the charitable objects of the body is capable thereby of being characterised as a [charitable institution].

The only indication that his Honour intended to limit such an approach is found in several references to an entity being required to use its profits for charitable purposes.⁵⁵

Jessup J did not expressly concur with Allsop J’s comments about the nature of activities. Indeed, his Honour appeared to accept that activities can themselves be construed as ‘charitable’ or not.⁵⁶ Nevertheless, Jessup J also concentrated on Word’s stated objects to

⁵² Ibid [44]-[48] (Allsop J), [87], [94], [96]-[97] (Jessup J).

⁵³ Ibid [48] (Allsop J).

⁵⁴ Ibid [38], [42] (Allsop J).

⁵⁵ Ibid [24], [27] (Allsop J).

⁵⁶ Ibid [88], [91], [95] (Jessup J), referring, respectively, to ‘a productive activity, of itself charitable in accordance with *Pemsel*’, ‘I do not think that *Lawlor* stands as authority for the proposition that a company which is bound by its object to apply its profits to charitable purposes, but which earns those profits by activities not of themselves charitable, may not be a charitable institution’ and ‘conducting business activities not themselves charitable’.

determine its ‘purpose’,⁵⁷ although Word’s activities and its context were taken into account.⁵⁸

The main difference between the judgments was that Jessup J adopted a relatively cautious tone, referring to the limited judicial authority on the matter,⁵⁹ and expressly confining his conclusions to the facts.⁶⁰ His Honour indicated that his judgment did not extend to a ‘trading company’ which donated its profits to charities as a matter of course, rather than due to a constitutional requirement.⁶¹ Accordingly, it is arguable that Jessup J considered the prohibition on the distribution of profits or gains in Word’s constitution relevant to determining its purpose. In addition, the nature of Word’s activities was relevant to Jessup J. His Honour underlined that the funeral business activities were in some ways analogous to the not-for-profit promotion of cremations, the pursuit of which had previously been found charitable,⁶² and that the ‘nature’ of the funeral business and the ‘terms’ on which it was offered to customers were ‘at least in harmony with [Word’s] general religious purposes’.⁶³

Jessup J’s second factor may operate as a significant limit on the applicability of his judgment to other charities as only a discrete range of activities are likely to be ‘in harmony’ with an entity’s charitable purpose.

3.1.3 Second Limb: Public Benefit

As Word’s memorandum of association contained non-profit clauses, the issue of public benefit was not expressly considered.

⁵⁷ Ibid [94] (Jessup J). See also at [96] (Jessup J).

⁵⁸ Ibid [86], [88], [96]-[97] (Jessup J).

⁵⁹ Ibid [88], [96] (Jessup J).

⁶⁰ Ibid [96] (Jessup J).

⁶¹ Ibid.

⁶² *Scottish Burial* [1968] AC 138.

⁶³ *Word* (2007) 164 FCR 194, [97] (Jessup J).

CHARITABLE FUNDRAISING

However, the Court treated these restrictions as relevant to Word's purpose.⁶⁴

In addition, while reserving his view on the matter, Jessup J raised the question whether a trading entity may be charitable if it habitually donates its profits to charities even though it is not required to do so by its constitution.⁶⁵ These comments arguably pose a floodgates risk.

3.2 Determining purpose

While the Court in *Word* considered activities in coming to a view on Word's purpose, there is a real question over the extent to which an entity's activities do shape its purpose. This is particularly so where the carrying out of the activities may amount to a breach of duty. More importantly, as noted when discussing the meaning of commercial activities, the nature of an entity, and hence its purpose, may influence the characterisation of its activities.

The test applied by Allsop J (and to a lesser extent by Jessup J) in *Word* is derived from *Royal Australasian College of Surgeons v Federal Commissioner of Taxation* ('*Surgeons' Case*').⁶⁶ The approach has been endorsed in a number of cases,⁶⁷ including those

⁶⁴ Ibid [24], [27] (Allsop J), [96] (Jessup J).

⁶⁵ Ibid [96] (Jessup J).

⁶⁶ (1943) 68 CLR 436, 444 (Latham CJ), 446 (Rich J), 448 (Starke J), 450-451 (McTiernan J), 452 (Williams J). The *Surgeons' Case* related to whether the College was exempt from income tax as a scientific or charitable institution. However, the Court focused on the question whether the College was a scientific institution on the basis that it would have had to be so categorised in order to be a charitable institution in any event.

⁶⁷ A similar approach was applied by Lord Normand in *IRC v City of Glasgow Police Athletic Association* [1953] 1 All ER 747 ('*City of Glasgow*') when looking at whether the Association was a charitable institution: at 751 (Lord Normand), 754 (Lord Morton), 753 (*contra* Lord Oaksey). See also *Brookton Co-operative Society Limited v Commissioner of Taxation* (1981) 147 CLR 441 ('*Brookton*') in relation to the characterisation of a co-operative company (at issue was whether the relevant company was 'a company which ... is established for the purpose of carrying on any

relating to income tax exempt status for charitable institutions⁶⁸ and other categories of exempt entities.⁶⁹ In some instances the court has justified the focus on activities on the basis that the income tax legislation requires a focus on the purpose of an entity in a particular income year.⁷⁰

However, an entity's activities may not, in practice, have as much weight in determining purpose as the above approach might suggest.⁷¹ The relevance of activities has been questioned in several cases,⁷² other than to assist with determining:

- the relative weight of an entity's objects where its constitution does not make this clear or where there is reason to question whether the entity's stated primary object is, in reality, its primary purpose; or⁷³
- the purpose, of an entity, to the extent that the entity does not have a written constitution.⁷⁴

business having as its primary object or objects one or more of the following: ... (d) the rendering of services to its shareholders').

⁶⁸ *Tasmanian Electronic Commerce Centre Pty Ltd v Commissioner of Taxation* (2005) 142 FCR 371, [43] (Heerey J).

⁶⁹ *Cronulla Sutherland Leagues Club Limited v Commissioner of Taxation* (1990) 23 FCR 82 ('*Leagues Club Case*'), 90-93 (Lockhart J).

⁷⁰ *Leagues Club Case* (1990) 23 FCR 82, 89 (Lockhart J), 116-117 (Beaumont J), 120, 122 (Foster J). See also *Brookton* (1981) 147 CLR 441, 445 (Gibbs CJ), 450-451 (Mason J, Murphy and Wilson JJ agreeing), 461 (Aickin J).

⁷¹ Cf the approach adopted in *Word* and discussed at 3.1.2.

⁷² *A-G v Ross* [1985] 3 All ER 334, 343-344 (Scott J); *Incorporated Council of Law Reporting for England and Wales v A-G* [1972] Ch 73, 84 (Russell LJ), 90-91 (*contra* Sachs LJ), 99 (Buckley LJ).

⁷³ *A-G v Ross* [1985] 3 All ER 334, 343-344 (Scott J). See also G Dal Pont, *Charity Law in Australia and New Zealand* (2000) 228-9.

⁷⁴ For instance, *Fern Tree Gully* (1952) 85 CLR 159. See also Dal Pont, above n 73, 229.

CHARITABLE FUNDRAISING

It is arguable that the resort to activities in cases dealing with professional societies (such as the *Surgeons' Case*) and a number of the other supporting authorities, can be explained on the basis that reviewing the activities helped in weighing each entity's objects.⁷⁵ The objects of professional societies frequently reflect the advancement of a charitable purpose as well as the benefit of members.⁷⁶ Two members of the High Court in the *Surgeons' Case* stated explicitly that they considered the College's activities for this reason.⁷⁷

Further, if the carrying out of the activities constitutes a breach of duty on the part of the entity or its controllers it seems inappropriate to accord much significance to those activities in defining purpose in most circumstances. This is the approach adopted in relation to charitable trusts.⁷⁸ It is arguable that a similar approach to purpose

⁷⁵ For instance, *City of Glasgow* [1953] 1 All ER 747, 751-2 (Lord Normand), 754 (Lord Morton); *Leagues Club Case* (1990) 23 FCR 82, 97 (Lockhart J), 120 (Foster J) (The Leagues Club's objects suggested that it existed either for the encouragement of sport or for the provision of social activities for members. The first object stated that the Leagues Club was established '[t]o establish equip furnish and maintain a Club for the benefit of members and to promote social sporting and educational undertakings for the advancement and benefit of members'); *Commissioner for ACT Revenue Collections v Council of Dominican Sisters of Australia* (1991) 101 ALR 417, 423-424 (Morling, Neaves and Foster JJ) (The issue was whether the Council was a religious institution for pay-roll tax purposes. The Council's objects related to both religious and educational matters. Accordingly, it was necessary to consider the Council's activities in weighing its objects).

⁷⁶ See the *Surgeons' Case* (1943) 68 CLR 436, 444-5 (Latham CJ).

⁷⁷ *Ibid* 448 (Starke J), 450 (McTiernan J).

⁷⁸ *Douglas & Ors v FC of T* (1997) 97 ATC 4722, 4727 (Olney J); *Auckland Medical Aid Trust v Commissioner of Inland Revenue* [1979] 1 NZLR 382 ('*Auckland Medical*'), 396-397 (Chilwell J); *TR 2005/21* [190]. The court may look beyond the trust deed if there is evidence that the charitable objects are a cloak for non-charitable purposes (*Auckland Medical* [1979] 1 NZLR 382, 396-397 (Chilwell J)); *Public Trustee v A-G (NSW)* (1997) 42 NSWLR 600, 617 (Santow J), or the activities are illegal or 'harmful to the public' (*Auckland Medical* [1979] 1 NZLR 382, 395-396 (Chilwell J)). In addition, activities carried out in breach of trust may result in a loss

should apply to incorporated charities.⁷⁹ To the extent such duties apply, they reinforce the primacy of the trust deed or constitution in determining purpose and suggest that an entity may not have an ambulatory nature.⁸⁰ On this basis, attention should be directed at the degree to which the powers and objects of an entity permit commercial activities and the manner in which these powers and objects are linked to the entity's charitable objects.⁸¹

of endorsement on the basis that the trust fund is not being applied for the purposes for which it was established: ITAA97 s 50-60.

⁷⁹ Setting aside property provided to an entity for a specific purpose and so subject to an express trust, the better view seems to be that property given to incorporated charities for their general purposes will be construed as giving rise to trustee (or 'analogous') obligations. Accordingly, if the entity conducts activities which apply its property other than in accordance with the purposes set out in the constitution, in many cases this will be a breach of fiduciary obligations. The position of unincorporated associations is less likely to be relevant in the sphere of commercial activities on the basis that many bodies would incorporate to obtain limited liability before conducting such activities. See especially Dal Pont, above n 73, 377, 381-382; MC Cullity, 'The Myth of Charitable Activities' (1990) 10 *Estates & Trusts Journal* 7, 26-27. See also *Sydney Homeopathic Hospital v Turner* (1959) 102 CLR 188, 221 (Kitto J) (trust); *Sir Moses Montefiore Jewish Home v Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406, 416 (Kearney J) (express trust); *Australian Executor Trustees Ltd v Ceduna District Health Services Inc* [2006] SASC 286, [23] (Vanstone J) (express trust); *Aboriginal Hostels Ltd v Darwin CC* (1985) 75 FLR 197, 208 (Nader J) (constructive trust). Cf the approach in the UK: *Liverpool and District Hospital for Diseases of the Heart v A-G* [1981] Ch 193, 209-211, 214-215 (Slade J) (analogous position); *Latimer v Commission for Inland Revenue* [2004] 1 WLR 1466, [30]. See also Lawbook Co, *Principles of the Law of Trusts*, vol 2 (at Update 31) [20440]; H Picarda, *The Law and Practice Relating to Charities* (3rd ed, 1999) 406-408; J Warburton and D Morris, *Tudor on Charities* (8th ed, 1995) 159-160 (position analogous to that of a trustee); I Dawson and J Alder 'The Nature of the Proprietary Interest of a Charitable Company or a Community Interest Company in Its Property' (2007) 21(1) *Trust Law International* 3, 3 ('trustee proper'); J Warburton, 'Charity Corporations: The Framework for the Future' March-April (1990) *Conveyancer and Property Lawyer* 95 (charitable company in a position analogous to a trustee).

⁸⁰ *Contra Brookton* (1981) 147 CLR 441, 451 (Mason J): the 'purpose for which a company is established may change in the course of time'.

⁸¹ It is clear that an entity's powers are relevant to determining its purpose: *Congregational Union of NSW v Thistlethwayte* (1952) 87 CLR 375

CHARITABLE FUNDRAISING

More significantly, as raised in *Word*,⁸² it is not generally viable to determine the nature of an activity viewed separately from the rationale behind it.⁸³ The same difficulty applies in construing an entity's powers to carry out activities. Canadian courts have closely considered the relationship between purposes and activities as the Canadian tax legislation defines a 'charitable organisation' by reference to charitable activities rather than the concept of charitable purposes developed in trust law.⁸⁴ In this context, the Canadian Supreme Court has read in a charitable purpose requirement to the legislation and stressed the limited relevance of activities:⁸⁵

The difficulty is that the character of an activity is at best ambiguous; for example, writing a letter to solicit donations for a dance school might well be considered charitable, but the very same activity might lose its charitable character if the donations were to go to a group disseminating hate literature. In other words, it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity itself, that determines whether or not it is of a charitable nature. (emphasis added)

Similar comments were made in the minority judgment, along with a question about the required nexus between activities and purpose:⁸⁶

(*Thistlethwayte*'), 442 (Dixon CJ, McTiernan, Williams and Fullagar JJ); *Re Hood* [1931] 1 Ch 240, 247-249 (Lord Hanworth MR); *Re Field* [1951] Tas SR 16, 20-21 (Green J). See also Dal Pont, above n 73, 227.

⁸² *Word* (2007) 164 FCR 194, [40]-[43] (Allsop J).

⁸³ See Cullity, above n 79, 7; Dal Pont, above n 73, 228.

⁸⁴ The *Income Tax Act*, RSC 1985 (5th supp), c 1, s 149.1(1) defines a 'charitable organisation' as an organisation that, amongst other requirements, devotes all of its resources to 'charitable activities'.

⁸⁵ *Vancouver Society* [1999] 1 SCR 10, [152] (Iacobucci J, Cory, Major and Bastarache JJ agreeing).

⁸⁶ *Ibid* [54] (Gonthier J, L'Heureux-Dubé and McLachlin JJ agreeing), in dissent in the result but in agreement on the issue of activities versus purposes.

an activity, taken in the abstract, can rarely be deemed charitable or non-charitable. Rather, it is the purpose underlying the activity to which the courts must look initially in assessing whether the activity is charitable. It must then be determined whether there is a sufficient degree of connection between the activity engaged in and the purpose being pursued, but this is a distinct inquiry involving separate considerations. Purposes are the ends to be achieved: activities are the means by which to accomplish those ends.

In Australia, the distinction between means and ends has been accepted in charities cases relating to ancillary purposes (see Parts 3.5 and 3.6).⁸⁷ The cases confirm that activities or purposes that contribute toward achieving a charitable purpose do not give rise to a separate purpose.

The same means/ends analysis applies to commercial activities. As the cases discussed in Parts 3.3, 3.4, and 3.6 demonstrate, ‘carr[ying] on a trade or business is admittedly not inconsistent with a charitable character’.⁸⁸ Take the act of publishing and disseminating a religious text such as the Bible. Doing so to generate revenue for an entity’s directors and shareholders would not be charitable, whereas it would be charitable if done by an entity whose object is to publish and spread the Bible and which is prevented from passing profits on to directors and members.⁸⁹

Accordingly, when characterising its purpose, an entity’s powers and (to the extent they are relevant) its activities should generally be reviewed in light of the entity’s constitution to determine whether they

⁸⁷ The distinction is also referred to in the *cy-près* context when determining whether property has been given for a specific purpose or with a general charitable intention: *A-G (NSW) v Perpetual Trustee Co* (1940) 63 CLR 209, 223 (Dixon and Evatt JJ).

⁸⁸ *Incorporated Council of Law Reporting for England and Wales v A-G* [1972] Ch 73, 86 (Russell LJ).

⁸⁹ *Ibid.*

CHARITABLE FUNDRAISING

directly effect, or are a method of achieving, the entity's objects.⁹⁰ In most cases, the commercial activities will fall somewhere on a spectrum between no link and a very close link, to a charitable object. For instance:

1. The production and sale of law reports for a fee, where the entity's objects centre on the production of reports of the Queensland Supreme Court.⁹¹
2. The establishment and operation of a canteen selling food and non-alcoholic drinks by the trustees of a trust, the object of which is the promotion of temperance.⁹²
3. The carrying on of a funeral business pursuant to an object which provides for the carrying out of business activities 'in connection with' the entity's other objects, including evangelical objects.⁹³
4. The establishment of factories for and the manufacture and sale of certain goods pursuant to separate objects in circumstances where the motive behind the establishment of the business is religious and the profits of the business are intended and in practice used exclusively in aid of religious teachings, activities and purposes.⁹⁴

⁹⁰ Cf *Vancouver Society* [1999] 1 SCR 10, [53]-[54], [56] (Gonthier J, L'Heureux-Dubé and McLachlin JJ agreeing). In relation to powers, see *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* [1963] NZLR 450 ('Carey's'), 455-456 (Gresson P); *Keren Kayemeth Le Jisroel v Commissioners of Inland Revenue* [1932] AC 650 ('Keren Kayemeth'), 657-658 (Lord Tomlin, Lords Wright, Thankerton and Warrington agreeing). As noted above, there may be circumstances in which the activities have greater relevance.

⁹¹ *Queensland Law Reporting Case* (1971) 125 CLR 659.

⁹² *Dean Leigh Temperance Canteen v Commissioners of Inland Revenue* (1958) 38 TC 315 ('Dean Leigh').

⁹³ *Word* (2007) 164 FCR 194.

⁹⁴ *Re Smith* [1954] SASR 151.

Ultimately, the issue is how close the nexus must be between the commercial activities and the charitable object for the activities to be a means to an end rather than an end in themselves. This question is explored further in Parts 3.3 to 3.8.

3.3 Fees for Services

A number of authorities confirm that charging fees, even ‘substantial fees’ for providing goods or services will not prevent an entity’s purpose from being charitable.⁹⁵ The court’s main concern is typically to ensure that the fees do not translate into profits for private individuals.⁹⁶

3.4 Commercial Activities that Directly Effect a Charitable Purpose

There are a number of instances in which an entity has been held to have a charitable purpose and to be for the public benefit, despite conducting significant commercial activities.⁹⁷ Three of the leading cases are considered below. In each, the activities directly realised the entity’s purpose, suggesting that the link is strong enough for the activities to be seen as a method to achieve the purpose. However, the cases do not state that a direct link is a prerequisite to establishing the

⁹⁵ *Re Resch’s Will Trusts* [1969] 1 AC 514, 541-542, 544 (Lord Wilberforce). See also *Royal Choral Society* [1943] 2 All ER 101; *Municipal Council of Sydney v Salvation Army (NSW Property Trust)* (1931) 31 SR (NSW) 585; *The Abbey, Malvern Wells Ltd v Minister of Town and Country Planning* [1951] 2 All ER 154. See also *TR 2005/21* [129]. There may be some limits to the ability to charge fees where the entity’s purpose is the relief of poverty.

⁹⁶ *Joseph Rowntree Memorial Trust Housing Association Ltd v A-G* [1983] 1 All ER 288, 298 (Peter Gibson J); *Royal Choral Society* [1943] 2 All ER 101, 104, 106 (Lord Greene MR); *Re Resch’s Will Trusts* [1969] 1 AC 514, 541-542 (Lord Wilberforce); *The Abbey, Malvern Wells Ltd v Minister of Town and Country Planning* [1951] 2 All ER 154, 160 (Danckwerts J); *Navy Health Ltd v Deputy Commissioner of Taxation* (2007) 163 FCR 1, [57] (Jessup J).

⁹⁷ See also *TR 2005/21* [129].

CHARITABLE FUNDRAISING

nexus. Instead, to the extent that the ‘commercial’ nature of activities was discussed, the chief issue was the existence of private benefits.

Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation (‘*Scottish Burial*’)⁹⁸ concerned the applicability of an exemption from local government rates for lands ‘occupied by... a charity and [which] are wholly used for charitable purposes’. The objects of the Society were to promote reform in the methods of burial in Scotland, to promote inexpensive and sanitary methods of disposal (in particular cremation) and to publish information supporting these objects. In practice, the Society pursued its objects by providing a cremation service which, by the time of the hearing, involved over 2,000 cremations a year, each for a fee.

The Society was held to be charitable. Lord Wilberforce expressly noted that ‘the charging for services for the achievement of a purpose which is in itself shown to be charitable does not destroy the charitable element’.⁹⁹ The Court appeared to consider it significant that profits could not be distributed to individuals.¹⁰⁰

The second decision, *Incorporated Council of Law Reporting of the State of Queensland v Federal Commissioner of Taxation* (‘*Queensland Law Reporting Case*’),¹⁰¹ related to whether the

⁹⁸ [1968] AC 138.

⁹⁹ *Ibid* 156 (Lord Wilberforce, Lord Guest agreeing).

¹⁰⁰ *Ibid* 147-148 (Lord Reid, Lords Guest and Pearson in agreement), 149 (Lord Upjohn, Lord Pearson in agreement). Lord Reid considered the fee acceptable on the basis that the Society was not supplying cremation services on a ‘commercial basis’. Given the scale of the activity and the existence of a surplus over a number of years, it is arguable that Lord Reid intended to imply that no individuals would derive the profits.

¹⁰¹ (1971) 125 CLR 659. The facts and outcome of *Incorporated Council of Law Reporting for England and Wales v A-G* [1972] Ch 73 are analogous, with all Lords Justice stating that charging for services or products would not prevent an entity from being charitable where those profits cannot benefit the members but must be applied to its objects: 86 (Russell LJ), 90 (Sachs LJ), 104 (Buckley LJ).

Incorporated Council of Law Reporting ('Council') was a charitable institution for the purposes of income tax exemption. The Council's objects centred on the production of reports of decisions of the Queensland Supreme Court 'at a moderate price'.¹⁰²

The fact that the Council charged a fee and made a profit on the sale of law reports was discussed exclusively in the context of the second positive limb. As Windeyer J explained:¹⁰³

Any profits it makes by so doing must be devoted to aiding the law libraries of the Supreme Court of Queensland. They cannot be diverted into the pockets of individuals... Their publication [law reports] has always been for the public benefit; but in times past it was not a charitable undertaking because it was done for private profit.

Finally, Else-Mitchell J concluded in *McGarvie Smith Institute v Campbelltown Municipal Council* that a body selling substantial quantities of anthrax and other vaccines to pastoralists, at 'commercial price[s]',¹⁰⁴ was charitable.¹⁰⁵ In doing so, his Honour emphasised that the carrying out of trading activities by an entity should not impact on its charitable status. Rather, the fundamental issue is the destination of profits.¹⁰⁶

the conduct of trade by a charitable trust does not derogate from its charitable character because any gain from the trading operations must be used in furthering the purposes of the trust. This appears to me at root the critical distinction which must be borne in mind in those cases where the benefits are of a character which can seldom be provided entirely free of charge or where the only mode in which the charity can

¹⁰² *Queensland Law Reporting Case* (1971) 125 CLR 659, 669-670 (Barwick CJ, McTiernan J in agreement).

¹⁰³ *Ibid* 672 (Windeyer J). See also at 666 (Barwick CJ, McTiernan J in agreement).

¹⁰⁴ *McGarvie Smith* (1965) 11 LGRA 321, 329 (Else-Mitchell J).

¹⁰⁵ *Ibid*. Else-Mitchell J was, in part, influenced by the history of the Institution's establishment and the fact that it was a statutory body.

¹⁰⁶ *Ibid* 328-329 (Else-Mitchell J).

CHARITABLE FUNDRAISING

be carried into effect is by the adoption of some commercial transaction. The conduct of educational institutions, hospitals and various other institutions has traditionally been accompanied, in Australia at any rate, by the payment of charges or fees... Each such institution, provided it is carrying out one of the four classes of public purposes which are regarded as charitable in a legal sense, is nonetheless a charity and the fundamental reason why it is so treated is that there is no element or prospect of private profit.

The above decisions emphasise the significance of private profits to purpose. Arguably, they do not indicate that commercial activities can necessarily be classified as charitable or not, viewed apart from their underlying purpose. The cases did examine the relevant entity's commercial activities to determine whether the activities were charitable under the first positive limb. However, in the final two cases, the carrying out of the activities was a stated object of the entity. Further, for *Scottish Burial*, the focus on activities may, potentially, be explained by the fact that the ratings legislation centred on the actual use of the land,¹⁰⁷ or because the activities were relevant to determining the Society's purpose.¹⁰⁸

3.5 Determining purpose

The authorities on incidental commercial operations are relevant for two reasons. First, they bolster the argument in Part 3.2 that

¹⁰⁷ See *Word* (2007) 164 FCR 194, [18] (Allsop J). Although note that Lord Wilberforce indicated that if the Society could demonstrate that it was itself charitable, then any use of the land must also be charitable: *Scottish Burial* [1968] AC 138, 154.

¹⁰⁸ Lord Wilberforce arguably looked at the Society's activities to help in weighing its objects, ultimately construing the objects clause as setting down a general and a particular purpose. The former being to promote methods of disposal of the dead and the latter being to promote cremation: *Scottish Burial* [1968] AC 138, 153-154. Lord Reid did not consider the activities on their own, but linked them to the Society's purpose, to test whether its 'main purpose and activity', being 'to promote and afford facilities for cremation', was charitable: at 148-149. Lord Upjohn asked whether providing a crematorium was charitable, although it is unclear whether this was treated as a purpose or an activity: at 149.

commercial activities can be a means to an end. Secondly, they provide guidance on how closely such activities must be linked to purpose to avoid being characterised as fulfilling a separate objective. In a sense, the commercial activities discussed in Part 3.4 could be said to be incidental or ancillary to a charitable purpose. However, adopting the ATO's approach in *TR 2005/21*, such activities which directly effect a charitable purpose are considered separately from more indirect activities.

For an entity to be charitable, its purposes must be exclusively charitable.¹⁰⁹ Therefore, where an entity has multiple objects, a distinction is drawn between objects which are 'incidental or ancillary' to the entity's main purpose and those which are independent and hence contribute to separate purposes.¹¹⁰ Although the leading cases refer to incidental objects, the same analysis can be applied to activities or powers.¹¹¹

¹⁰⁹ The rule is subject to the application of savings legislation or in some cases to apportionment between the valid charitable and invalid non-charitable objects. See, for instance, G Dal Pont and D Chalmers, *Equity and Trusts in Australia* (4th ed, 2007) [29.245]-[29.255].

¹¹⁰ *City of Glasgow* [1953] AC 380, 397 (Lord Normand), 397-398 (Lord Oaksey), 400 (Lord Morton), 402 (Lord Reid), 405 (Lord Cohen); *Thistlethwayte* (1952) 87 CLR 375, 442 (Dixon CJ, McTiernan, Williams and Fullagar JJ), 450 (Kitto J); *Stratton v Simpson* (1970) 125 CLR 138, 148-149 (Windeyer J), 159-160 (Gibbs J, Barwick CJ and Menzies J in agreement).

¹¹¹ The analysis can be applied to determine whether the object in relation to which the activities are pursued is incidental or to confirm whether the activities evidence a separate purpose: *Navy Health Ltd v Deputy Commissioner of Taxation* (2007) 163 FCR 1, [67] (Jessup J); *Dean Leigh* (1958) 38 TC 315, 324 (Harman J); *Carey's* [1963] NZLR 450, 455-456 (Gresson P); *Vancouver Society* [1999] 1 SCR 10, [157]-[158] (Iacobucci J, Cory, Major and Bastarache JJ agreeing). See also *TR 2005/21* [129]; *Wellington Regional Stadium Trust v A-G* [2005] 1 NZLR 250, [57], [61] (MacKenzie J) (the case was not strictly a charities case, but instead related to whether the stadium trust was a 'council-controlled trading organisation' ('CCTO') under the *Local Government Act 2002* (NZ). If it was a CCTO the stadium trust would lose its charitable, tax exempt status).

CHARITABLE FUNDRAISING

There are two senses in which objects or activities are construed as incidental or ancillary. First, some authorities have referred to objects or activities as being an ‘inevitable concomitant’¹¹² or ‘mere incident’¹¹³ of the charitable purpose. For instance, the profits from the sale of surplus produce generated by farming activities in *Salvation Army (Victoria) Property Trust v Fern Tree Gully Corporation*.¹¹⁴ This category is likely to have limited relevance for commercial fundraising.

In the second sense, an incidental purpose is one which contributes toward achieving or is ‘conducive to promoting’¹¹⁵ the main purpose. As Dixon CJ, McTiernan, Williams and Fullagar JJ noted in *Congregational Union of NSW v Thistlethwayte* (‘*Thistlethwayte*’):¹¹⁶

We are here concerned with the question whether a particular corporate body is a charitable institution. Such a body is a charity even if some of its incidental and ancillary objects, considered independently, are non-charitable.... The fundamental purpose of the Union is the advancement of religion. It can create, maintain and improve educational, religious and philanthropic agencies only to the extent to which such agencies are conducive to the achievement of this purpose. The same may be said... of the other object, the preservation of civil and religious liberty. The object is to preserve civil liberty so that Congregationalists may worship according to their religious beliefs.

¹¹² *Royal Choral Society* [1943] 2 All ER 101, 106 (Lord Greene MR, Mackinnon LJ in agreement). See also at 109 (Du Parcq LJ).

¹¹³ *Fern Tree Gully* (1952) 85 CLR 159, 172 (Dixon, Williams and Webb JJ).

¹¹⁴ Ibid.

¹¹⁵ *Stratton v Simpson* (1970) 125 CLR 138, 148-149 (Windeyer J). See also at 159-160 (Gibbs J, Barwick CJ and Menzies J in agreement).

¹¹⁶ (1952) 87 CLR 375, 442 (Dixon CJ, McTiernan, Williams and Fullagar JJ). Although their Honours refer to an incorporated body in formulating the test, there have been suggestions that similar principles can apply to the objects of a trust: *Dean Leigh* (1958) 38 TC 315, 324 (Harman J); *Carey's* [1963] NZLR 450, 455-456 (Gresson P); *Re Hood* [1931] 1 Ch 240, 247-249 (Lord Hanworth MR), 252 (Lawrence LJ), 253 (Romer LJ). See also Dal Pont, above n 73, 225.

Their Honours considered that two of the Union's objects, the maintenance and improvement of educational, religious and philanthropic agencies, and the preservation of civil and religious liberty might not be charitable if viewed on their own.¹¹⁷ However, read in context they were incidental to the Union's religious purpose. Their Honours were prepared to find the preservation of civil liberty to be sufficiently conducive of religion *and* to read down the relevant object. This indicates that the link between means and ends need not be particularly close, or direct.¹¹⁸

The approach in *Thistlethwayte* can be compared with several statements made by Dixon J in *Roman Catholic Archbishop of Melbourne v Lawlor* ('*Lawlor's Case*').¹¹⁹ The comments in *Lawlor's Case* could potentially be construed as requiring activities or purposes to be 'directly and immediately' linked to a charitable purpose to be characterised as mere means to that end. However, in *Lawlor's Case* his Honour was considering whether a gift for a particular activity could itself be viewed as being for a charitable purpose rather than the question of whether a power or object could be seen as ancillary to another charitable object.¹²⁰

Further guidance can be obtained from the Canadian case of *Vancouver Society of Immigrant & Visible Minority Women v Minister of National Revenue*. Iacobucci J referred to activities 'in direct

¹¹⁷ *Thistlethwayte* (1952) 87 CLR 375, 441 (Dixon CJ, McTiernan, Williams and Fullagar JJ).

¹¹⁸ See Dal Pont, above n 73, 226.

¹¹⁹ (1934) 51 CLR 1, 32 (Dixon J) 'the purposes must be directly and immediately religious. It is not enough that they arise out of or have a connection with a faith, a church or a denomination, or that they are considered to have a tendency beneficial to religion or to a particular form of religion'.

¹²⁰ Jessup J makes this point in *Word* (2007) 164 FCR 194, [90]. In addition, the activity, being 'conducive to the good of religion', was infected by Dixon J's finding that religious purposes are potentially broader than charitable purposes: *Lawlor's Case* (1934) 51 CLR 1, 31, 35 (Dixon J).

CHARITABLE FUNDRAISING

furtherance of a charitable purpose'.¹²¹ However, his Honour's example of writing a letter to solicit donations suggests that fundraising activities can be charitable and, presumably, within the meaning of 'direct'.¹²² The minority suggested the activities must 'bear a coherent relationship to the purposes sought to be achieved',¹²³ or 'be substantially connected to, and in furtherance of, those purposes'.¹²⁴ Gonthier J equated Iacobucci J's direct connection with this test and denied that the term 'direct' necessitated that the activity have an immediate effect on the purpose.¹²⁵

In addition, it is accepted (including by the ATO)¹²⁶ that a charity may adopt 'indirect' means to achieve a charitable purpose.¹²⁷ For instance, 'peak' bodies may be charitable if they coordinate the operations of charities which directly pursue charitable purposes.¹²⁸

Accordingly, it is clear that purposes or activities may be characterised as ancillary or incidental to a charitable purpose where they do not directly effect that purpose. Therefore, it is unsurprising that when these principles have been applied in the context of commercial activities, various linkages have been accepted. In *Dean Leigh Temperance Canteen v Commissioners of Inland Revenue* ('*Dean Leigh*'),¹²⁹ the establishment and operation of a canteen selling

¹²¹ *Vancouver Society* [1999] 1 SCR 10, [158] (Iacobucci J, Cory, Major and Bastarache JJ agreeing).

¹²² *Ibid* [152] (Iacobucci J (Cory, Major and Bastarache JJ agreeing)).

¹²³ *Ibid* [52] (Gonthier J, L'Heureux-Dubé and McLachlin JJ in agreement).

¹²⁴ *Ibid* [56] (Gonthier J, L'Heureux-Dubé and McLachlin JJ in agreement).

¹²⁵ *Ibid* [62] (Gonthier J, L'Heureux-Dubé and McLachlin JJ in agreement).

¹²⁶ *TR 2005/21* [186].

¹²⁷ As opposed to the more restrictive requirements applying to public benevolent institutions. See *Taxation Ruling TR 2003/5* for further information. See also *TR 2005/21* [129].

¹²⁸ See *Ziliani and another v. Sydney City Council* 190 (1985) 56 LGRA 58 (the case concerned an unincorporated association).

¹²⁹ (1958) 38 TC 315. The case did not relate to whether the Dean Leigh Temperance Canteen trust was charitable, but actually turned on whether the income from the canteen activities was exempt from income tax under a provision which stated that the

food and non-alcoholic drinks was characterised as the means to achieve an end, being the ‘promotion of temperance’,¹³⁰ primarily among the immoderate cattle drovers of Hereford.¹³¹ The canteen activities did not realise the trust’s purpose as directly as the activities considered in part 3.4. However, the outcome of the canteen activities was that the drovers drank a smaller quantity of liquor.

Commercial activities undertaken purely to raise funds have a more remote connection as a second set of activities must take place (using the money raised) to achieve the purpose. Nevertheless, there are a number of authorities explored in Part 3.6 which suggest that the relevant nexus may exist even in these circumstances for the fundraising activities to be regarded as incidental.

3.6 Fundraising

As in *Word*, charities are increasingly likely to consider carrying out commercial activities purely to generate revenue to be applied to charitable ends. Although not a direct means of achieving that charitable purpose, the case law suggests that such indirect activities can be ancillary. First, there are a number of passive investment and more active collecting activities, not amounting to commercial activities, which are broadly accepted as being consistent with a charitable purpose. Secondly, certain traditional commercial activities, including the provision of gambling, are acknowledged as being conducted in pursuit of a charitable purpose. Finally, there are authorities which indicate that charities may adopt a broader range of

profits of a trade carried on by any charity were exempt ‘if the profits are applied solely to the purposes of the charity and ... (i) the trade is exercised in the course of the actual carrying out of a primary purpose of the charity’.

¹³⁰ Ibid 324-325 (Harman J). See also *Wellington Regional Stadium Trust v A-G* [2005] 1 NZLR 250, [57], [61] (MacKenzie J). For a discussion of the case, see G Harley, ‘Can a “Business” be a Charity?’ [2005] *New Zealand Law Journal* 69.

¹³¹ It had been a tradition for the parties to each successful cattle sale to have a celebratory beverage at one of the many pubs in Hereford.

CHARITABLE FUNDRAISING

commercial fundraising activities. The authorities rely on a concept of ‘charity’ that is similar to the general law meaning applied in Australia.¹³²

3.6.1 *Passive and Collecting Activities*

Certain non-commercial means of fundraising pose no risk to an entity’s charitable purpose. A charitable entity may ‘passively’ invest funds,¹³³ by purchasing assets such as land¹³⁴ or shares¹³⁵ to generate income for its activities. According to Harman J in *Dean Leigh*, the rationale for this approach is that the ultimate destination of the funds is charitable.¹³⁶

More active fundraising has also been accepted in some contexts.¹³⁷ Most jurisdictions have legislation that specifically regulates and contemplates collecting activities by charities.¹³⁸ The

¹³² See Part 4.2 for the current position in each of the jurisdictions.

¹³³ *TR 2005/21* [129]. The Canada Revenue Agency has suggested that deriving passive investment income may not amount to carrying on a business in relation to the general law meaning of ‘charitable’ for Canadian purposes: Canada Revenue Agency, *Policy Statement CPS-019*, above n 25, [14].

¹³⁴ *University of Western Australia v Commissioner of State Taxation (WA)* (1988) 88 ATC 4020.

¹³⁵ *Dean Leigh* (1958) 38 TC 315.

¹³⁶ *Ibid* 325 (Harman J).

¹³⁷ See M Chesterman, *Charities, Trusts and Social Welfare* (1979) 97. Chesterman treats both ‘running shops, selling Christmas cards and holding dances, fêtes, jumble sales and so on’ and ‘the direct solicitation of legacies and donations by appeals through the press, television and radio’ as forms of the same activity, fundraising.

¹³⁸ *Charitable Collections Act 2003* (ACT); *Charitable Fundraising Act 1991* (NSW); *Collections Act 1966* (Qld); *Collections for Charitable Purposes Act 1939* (SA); *Fundraising Appeals Act 1998* (Vic); *Veterans Act 2005* (Vic); *Charitable Collections Act 1946* (WA); *Street Collections (Regulation) Act 1940* (WA); *Collections for Charities Act 2001* (Tas).

Western Australian legislation, for example, envisages that charities may actively raise funds by:¹³⁹

- collecting ‘money or goods for [a] charitable purpose’;
- obtaining money from ‘the sale of any disc, badge, token, flower or other device for any charitable purpose’; or
- selling tickets to any ‘entertainment or function’ (such as a sporting meet, race, fete, or bazaar) where the proceeds are to be devoted for charitable purposes.

In addition, the ITAA97 itself contemplates active fundraising by charities that also have deductible gift recipient status (such as public benevolent institutions) by providing for the deductibility of certain contributions in respect of fund-raising auctions¹⁴⁰ or fund-raising events.¹⁴¹

¹³⁹ *Charitable Collections Act 1946* (WA) s 6(1); *Street Collections (Regulation) Act 1940* (WA) s 3(1). Subject to the licensing requirements. The approach under the Western Australian legislation is confirmed in *R v Charity Commission for England and Wales; Ex parte Alan George Swain* [1998] EWHC Admin 698 (Unreported, Lightman J, 2 July 1998) in relation to charitable collections. See also *IRC v Yorkshire Agricultural Society* [1928] 1 KB 611 in relation to conducting entertainments or functions. The Canada Revenue Agency also views the solicitation of donations as not amounting to a commercial activity: Canada Revenue Agency, *Policy Statement CPS-019*, above n 25, [5].

¹⁴⁰ Item 8 of the table in s 30-15 of the ITAA97: deductibility for a contribution of cash of \$150 or greater that constitutes consideration for the supply of goods or services (ie not a gift) made because the taxpayer is the successful bidder at a fundraising auction.

¹⁴¹ Item 7 of the table in s 30-15 of the ITAA97: deductibility for a contribution of \$150 or greater (special rules apply to property) for a right to attend or participate in a fund-raising event. The definition of fund-raising events includes a fete, ball, gala show, dinner, performance or similar event; or an event comprising sales of goods if selling such goods is not a normal part of the supplier’s business: ITAA97 s 995-1(1); *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 40-165(1).

CHARITABLE FUNDRAISING

Although such passive or collecting activities would not generally include commercial activities,¹⁴² there appears to be no rationale for finding that they have a closer nexus to an entity's charitable purpose than commercial activities.

3.6.2 *Traditional Commercial Activities*

There is evidence that commercial fundraising activities traditionally undertaken by charities appear to be more readily accepted by the courts and revenue authorities as ancillary to a charitable purpose.¹⁴³ In Canada, the Canada Revenue Agency has suggested that:¹⁴⁴

[c]ertain business operations have gained community acceptance as a useful ancillary service to a charitable program, such as a church operating a religious bookstore, a museum opening a gift store, or a hospital running a cafeteria or "medical arts" building.

It seems that a similar approach has been adopted in Australia. For instance, St Mary's Cathedral Sydney is endorsed as a charitable institution despite the fact that it operates a religious store in the Cathedral.¹⁴⁵

Interestingly, gambling activities also appear to be a socially sanctioned method of charitable fundraising. In Western Australia, the

¹⁴² Only some of the activities fall within the broad definition of commercial activities adopted by this paper.

¹⁴³ *Word* (2006) 64 ATR 483, [60] (Sundberg J). See also *Word* (2007) 164 FCR 194, [97] (Jessup J); Part 2.3.

¹⁴⁴ Canada Revenue Agency, *Registered Charities Guide RC 4143 - Registered Charities: Community Economic Development Programs* 12 <<http://www.cra-arc.gc.ca/E/pub/tg/rc4143/rc4143-e.pdf>> at 26 March 2008. The comments were made in the context of whether such activities constitute a 'related business' under the Canadian tax legislation, and hence do not disqualify the entity from registration as a charity

¹⁴⁵ See Australian Government, *Australian Business Register* <http://www.abr.gov.au/ABR_BC/> at 11 February 2008.

gaming legislation specifically allows charities to apply for permits to conduct games of chance such as two-up, lotteries and bingo.¹⁴⁶

Such activities fall within the definition of ‘commercial activities’ used in this paper. Accordingly, as discussed in Part 2.3, attempting to draw a distinction between traditional and non-traditional activities is likely to be based on matters of form rather than of substance.

3.6.3 *Non-Traditional Commercial Activities*

The authorities, such as *Christian Enterprises Ltd v Commissioner of Land Tax* (‘*Christian Enterprises*’),¹⁴⁷ indicate that a broader range of commercial fundraising activities should be characterised as conducive to a charitable purpose. At issue in *Christian Enterprises* was whether the taxpayer was exempt from land tax on the basis that it was a charitable institution or a religious society. The taxpayer’s objects were to ‘raise funds to spread the Gospel and to spread the Gospel’.¹⁴⁸ The memorandum also provided the company with additional powers and objects, including the conduct of trading activities, solely for the purpose of carrying out its primary objects. In practice the company:

- raised interest free loans, which it invested for a profit;
- purchased, developed and sold a number of landholdings; and
- rented out premises.

Walsh JA (Asprey JA agreeing), decided the case on the basis that the taxpayer was a religious society rather than a charitable

¹⁴⁶ *Gaming and Wagering Commission Act 1987* (WA), ss 51(2), 81(1), 104(1)(a), 104(1a), 95(2)(b).

¹⁴⁷ (1968) 72 SR (NSW) 90.

¹⁴⁸ *Word* (2007) 164 FCR 194, [34] (Allsop J).

CHARITABLE FUNDRAISING

institution.¹⁴⁹ However, Walsh JA's discussion remains relevant to the nexus question as his Honour found that the taxpayer's commercial objects and powers were 'merely a means to the fulfilment of its main religious purposes', rather than a separate purpose.¹⁵⁰ Critical to his Honour's conclusion was that there was no doubt that the taxpayer's stated objects were its real purpose.¹⁵¹

Wallace P found the taxpayer to be an institution and that it was charitable.¹⁵² In doing so, his Honour indicated that the taxpayer's powers to carry out activities were less relevant than the application of its profits:¹⁵³

Under modern conditions it is sometimes not practicable for a substantial charitable institution to conduct its activities on a permanent basis without incorporation and without having the wide powers which almost of necessity go with incorporation and the acquisition and distribution of money for the purpose of carrying out the charitable object. This is the way I would view the constitution of the appellant institution, and I do not think in a relevant sense it is carried on for "pecuniary profit", which is a phrase primarily intended to apply to the shareholders or proprietors of the institution. All of its net income of necessity goes to charity...

The New Zealand decision *Commissioner of Inland Revenue v Carey's (Petone and Miramar) Ltd* ('Carey's')¹⁵⁴ involved fundraising by an entity which was then required to pass those funds on to other

¹⁴⁹ Walsh JA found that the taxpayer was not an 'institution' and so could not be a charitable institution: *Christian Enterprises* (1968) 72 SR (NSW) 90, 98-99 (Walsh JA, Asprey JA agreeing).

¹⁵⁰ *Ibid* 103 (Walsh JA, Asprey JA agreeing).

¹⁵¹ *Ibid* 102-103 (Walsh JA, Asprey JA agreeing). It was partly on this basis that the earlier decision of *Theosophical Foundation Pty Limited v Commissioner of Land Tax* (1966) 67 SR (NSW) 70 was distinguished.

¹⁵² *Christian Enterprises* (1968) 72 SR (NSW) 90, 93-94 (Wallace P).

¹⁵³ *Ibid* 94 (Wallace P).

¹⁵⁴ [1963] NZLR 450. *Carey's* was endorsed in *Auckland Medical* [1979] 1 NZLR 382.

entities to use for charitable purposes, rather than use the funds raised itself.¹⁵⁵ Although this seems to involve a more attenuated connection, there is authority that an object of holding funds for, or providing funds to, charities is itself generally charitable¹⁵⁶ and that the carrying out of an object by the donation of funds to another entity is an application of funds to charity.¹⁵⁷

At issue in *Carey's* was whether certain documents were exempt from conveyance duty as 'conveyances of property to be held on a charitable trust'. The conveyance occurred under a trust deed which provided that Carey's held the property on the terms of an earlier trust. The trust deed required Carey's to pass on any income (after reserving an amount it thought proper) for distribution amongst charities by a Board. The deed endowed Carey's with broad powers, including carrying on business activities.¹⁵⁸

Despite the existence of such a power, the New Zealand Court of Appeal held that the trust was charitable on the basis that the trust capital and income (including profits from the business activities) could only be applied in furtherance of a charitable purpose:¹⁵⁹

¹⁵⁵ Jessup J appears to have considered that Carey's itself applied the proceeds of its business activities to charity: *Word* (2007) 164 FCR 194, [95] (Jessup J).

¹⁵⁶ *Stratton v Simpson* (1970) 125 CLR 138, 161, 163 (Gibbs J, Barwick CJ and Menzies J agreeing), 144 (Windeyer J), 154 (Cf Walsh J). The testator's will provided that his trustees held the trust funds on trust to distribute the income among a range of entities in such proportions as the trustees, in their absolute discretion, determined.

¹⁵⁷ *Queensland Law Reporting Case* (1971) 125 CLR 659, 670 (Barwick CJ): one object of the Council was '[t]o supplement or assist' the Queensland Supreme Court libraries by gifts of the Council's profits. Although Barwick CJ found that this was not a separate purpose of the Council, his Honour held that the passing on of profits to the libraries was in itself 'an application to charity'. See also *IRC v Helen Slater Charitable Trust Ltd* [1982] 1 Ch 49, 55-56, 60 (Oliver J) (at issue was a legislative requirement that a charity's gains be applied for charitable purposes); *Christian Enterprises* (1968) 72 SR (NSW) 90, 94 (Wallace P).

¹⁵⁸ [1963] NZLR 450, 454 (Gresson P).

¹⁵⁹ *Ibid* 456 (Gresson P).

CHARITABLE FUNDRAISING

all the respondent company can do under the wide powers given to it is subordinated to a charitable purpose and no object other than charity is or ever can become entitled to participate in the income yield or in any ultimate distribution of capital. In these circumstances we do not think that any merely incidental power to use the capital commercially in an intermediate income earning operation can change the original charitable nature of the trust.

The Canadian case of *Alberta Institute on Mental Retardation v Canada*¹⁶⁰ concerned the tax exempt status of an Institute established to act as a fundraising body for a number of charities that assisted mentally disabled people. The Institute's memorandum of association provided it with its own charitable objects relating to the welfare of mentally disabled people¹⁶¹ and permitted the Institute to raise funds 'for the purpose of carrying out the objects of the company in a manner not inconsistent with the objects of the company'.¹⁶² Pursuant to this power, the Institute collected used goods which it supplied to a for-profit entity for on-sale, with the Institute receiving a percentage of the for-profit entity's profits.

The majority held that the Institute's fundraising activities were 'merely a means to the fulfillment of the purposes of the charitable organization which are exclusively charitable' on the basis that the Institute's 'sole purpose' was the raising of money for the benefit of mentally disabled people and their families.¹⁶³

In addition, there are a number of UK cases that consider whether a charity is subject to tax on its trading profits from fundraising

¹⁶⁰ [1987] 2 C.T.C. 70 ('*Alberta Institute*').

¹⁶¹ The fundraising motive was not expressly reflected in the Institute's memorandum of association as the Institute had stand alone objects.

¹⁶² *Alberta Institute* [1987] 2 C.T.C. 70, [8] (Heald J, Mahoney J concurring).

¹⁶³ *Ibid* [9]-[10] (per Heald J, Mahoney J concurring). It seems that the majority considered the Institute's activities analogous to soliciting monetary donations. Pratte J dissented in the result, but not in relation to the issue of whether the Institute was charitable.

activities.¹⁶⁴ In each case, the charitable status of the relevant entity was implicitly or explicitly accepted, despite a finding that the entity was conducting commercial activities. The reason that each entity had to pay tax on its trading profits despite the entities' charitable status was because the relevant legislation did not exempt all of a charity's income from income tax.¹⁶⁵ In *Brighton College v Marriott*, Viscount Cave LC referred to these cases as examples of incidental trading activities and accepted that a charitable entity might carry on a subsidiary trade 'for the benefit of its main objects'.¹⁶⁶

For instance, *Coman v Governors of the Rotunda Hospital, Dublin* ('*Coman*') related to a corporation (the 'Governors') incorporated for the purpose of conducting a maternity and gynaecological hospital for poor women.¹⁶⁷ The Governors owned adjoining rooms, as well as the hospital premises, which they customarily hired out for shows, concerts and other entertainments along with chattels, such as seating, and the provision of heating, lighting and certain services. The purpose of hiring out the rooms was to raise funds for the hospital.

The House of Lords found that the activities amounted to a business or trade and hence that the Governors were liable to tax on the profits.¹⁶⁸ Nevertheless, their Honours did not question the

¹⁶⁴ *Coman v Governors of the Rotunda Hospital, Dublin* [1921] 1 AC 1; *St Andrew's Hospital, Northampton v Shearsmith* (1887) 19 QBD 624; *Religious Tract and Book Society of Scotland v Forbes* (1896) 3 TC 415, in particular, 419 (Lord Adam) '...they [the Society] carry on the business of bookselling for the purpose of making profit, and having made profit, they expend it on the charitable purpose for which this Society exists, namely the sale of books by colporteurs [missionary salesmen]'.

¹⁶⁵ See, eg, Part 4.2.

¹⁶⁶ [1926] AC 192, 200 (Viscount Cave LC). *Brighton College* was not a fundraising case. Rather, the question was whether Brighton College was subject to income tax on the surplus of its receipts over expenditure generated from the running of a school.

¹⁶⁷ *Coman* [1921] 1 AC 1.

¹⁶⁸ *Ibid* 14 (Lord Birkenhead), 18 (Viscount Finlay), 24-25 (Viscount Cave), 31 (Lord Atkinson), 39 (Lord Shaw).

CHARITABLE FUNDRAISING

charitable status of the Governors, appearing to acknowledge that they remained charitable.¹⁶⁹ Lord Birkenhead, in particular, stated:¹⁷⁰

When the facts set out in the case stated... are considered as a whole, it becomes plain that the respondents, with the laudable object of raising an income for the support of their charitable activities, have engaged in what can only be described as a business or a concern in the nature of business, and thereby have earned annual profits.

Oxfam v Birmingham City District Council ('Oxfam'),¹⁷¹ a UK ratings case, also contains an acknowledgment that an entity may be charitable while conducting extensive commercial fundraising activities. Oxfam operated 508 'gift shops' in the UK, selling donated goods and village handicraft articles to raise money for its charitable object of relieving poverty, distress and suffering in any part of the world. An exemption from rates applied to premises occupied by a charity and 'wholly or mainly used for charitable purposes'.

The House of Lords held that Oxfam was a charity and that its commercial fundraising was consistent with this status.¹⁷² However, as the exemption referred to both occupation by a charity and use for charitable purposes, only some charitable uses qualified.¹⁷³

Sharpe notes that US courts have previously accepted that a charity may carry on a business,¹⁷⁴ which resulted in the introduction to the Internal Revenue Code of the unrelated business taxable income

¹⁶⁹ Ibid.

¹⁷⁰ Ibid 14 (Lord Birkenhead).

¹⁷¹ [1976] AC 126.

¹⁷² Ibid 135, 140 (Lord Cross, Lords Simon, Edmund-Davies and Fraser agreeing), 147 (Lord Morris). Lord Cross also referred to *Polish Historical Institution Ltd v Hove Corporation* (1963) 10 RRC 73 in which the Institution was acknowledged to be a charity despite letting out rooms in a 53 room building that it owned: at 139-140.

¹⁷³ *Oxfam* [1976] AC 126, 138-9, 146 (Lord Cross).

¹⁷⁴ Sharpe, above n 8, 380-381.

provisions discussed in Part 4.¹⁷⁵ However in some instances, it seems that the commercial nature of activities may have influenced US courts in finding that carrying out the activities amounted to a separate, non-charitable purpose.¹⁷⁶

It is clear that, in Australia, fundraising purposes or activities such as passive investment or collecting as well as fundraising by traditional methods are accepted as ancillary to a charitable purpose. There is also some Australian authority that non-traditional commercial fundraising may be seen as incidental, a position which has been accepted, to varying degrees, in a number of other common law jurisdictions. But what are the limits and how does Word fit in? These issues are explored in Parts 3.7 and 3.8.

3.7 Beyond the Boundaries

As the degree of connectivity between activities and purpose is a continuum, there comes a point when commercial activities can no longer be characterised as ancillary to the charitable purpose. *Re Smith (deceased); Executor Trustee and Agency Co of South Australia Ltd v Australasian Conference Association Ltd* ('*Re Smith*')¹⁷⁷ and *MK Hunt Foundation Ltd v Commissioner of Inland Revenue* ('*Hunt*')¹⁷⁸ help to identify these outer bounds by indicating that an entity may have a separate non-charitable purpose where:¹⁷⁹

¹⁷⁵ Ibid 370-371, 380-383. See also Colombo, above n 8, 497-507.

¹⁷⁶ Colombo, above n 8, 497-507.

¹⁷⁷ [1954] SASR 151.

¹⁷⁸ [1961] NZLR 405. The issue was whether a conveyance to the Foundation was exempt from stamp duty on the basis that it was a conveyance of property to be held on a charitable trust.

¹⁷⁹ Cf the following ratings cases which suggest that using land to fundraise for a charitable purpose is not bound near enough to that purpose for the land to be characterised as used for the charitable purpose. The relevance of some of the cases is limited by the terms of the ratings legislation, which focuses on the use of land rather than the entity itself: *Nunawading Shire v Adult Deaf and Dumb Society of Victoria* (1921) 29 CLR 98; *Oxfam* [1976] AC 126; *Fern Tree Gully* (1952) 85 CLR 159, 170-

CHARITABLE FUNDRAISING

1. Its commercial activities are carried out under an object that is not expressly subject to the entity's charitable objects and for which (unsurprisingly) there is a non-commercial aim other than the pursuit of the entity's charitable objects. This is so even if the profits from the activities would be applied to a charitable purpose.
2. Profits from the activities are devoted to a charitable purpose only upon the winding-up of an entity.

Re Smith evidences the first limit above. In considering the application of the *cy-près* doctrine to a testamentary gift to the Sydney Sanitarium and Benevolent Association Ltd ('Sydney Sanitarium'),¹⁸⁰ Ligertwood J found that the Sydney Sanitarium's purpose was not charitable. His Honour characterised the Sydney Sanitarium's commercial objects as giving rise to a separate purpose from the Sydney Sanitarium's charitable objects¹⁸¹ and came to this conclusion despite finding that:¹⁸²

[t]he motive behind the establishment of the Health Food Company was no doubt religious and its profits were no doubt used exclusively in aid of the teachings, activities and purposes of a religious body.

172 (Dixon, Williams and Webb JJ), 187, 188 (Fullagar J) (although note that the institution conducted by the Trust was found to be using the land exclusively for charitable purposes in *Fern Tree Gully*).

¹⁸⁰ As the Sydney Sanitarium did not exist at the time of death, the court had to determine whether the testatrix had evinced a 'general charitable intention' (ie a charitable intention wider than the specified mode) so that the gift could be applied under the *cy-près* doctrine to the purposes of the Australasian Conference Association Limited (which had taken over the activities of the Sydney Sanitarium). Accordingly, there were two issues. First, there was a question of whether there was a general or specific intention and, secondly, there was a question of whether there was a charitable intention.

¹⁸¹ *Re Smith* [1954] SASR 151, 159-160, (Ligertwood J).

¹⁸² *Ibid.*

Several factors supported the finding that there was a separate objective aim for the commercial activities in addition to fundraising:

- The business objects were not expressly limited by the Sydney Sanitarium's memorandum of association to supporting its charitable objects;¹⁸³
- The business objects related to a number of specifically worded matters rather than a general power to carry on any useful business;
- The 'factual background'¹⁸⁴ in which the Sydney Sanitarium existed was relevant to its purpose. It was established by the

¹⁸³ Cf *Word* (2007) 164 FCR 194, [28] (Allsop J). The apparent absence of an overriding religious object in the Sydney Sanitarium's memorandum would have made it difficult for Ligertwood J to read down the business objects to being pursued only to the extent of fulfilling such a religious purpose, as in *Thistlethwayte* (1952) 87 CLR 375. In any event, as demonstrated in *Tennant Plays Ltd v Inland Revenue Commissioners* [1948] 1 All ER 506, some judges may find it difficult to accept that broad business objects are subordinate to an overriding charitable purpose, even where the business objects are expressed to be ancillary only: at 510 (Cohen LJ, Somervell and Turner LJ agreeing). However, the comments were obiter only, as the objects to which the business objects were expressed to be subordinate were not exclusively charitable.

¹⁸⁴ *A-G v Ross* [1985] 3 All ER 334, 341, 343 (Scott J); *Christian Enterprises* (1968) 72 SR (NSW) 90, 100-103 (Walsh JA); *Dean Leigh* (1958) 38 TC 315, 324 (Harman J). See also Dal Pont, above n 73, 227 and *Word* (2007) 164 FCR 194, [48] (Allsop J). *Contra Incorporated Council of Law Reporting for England and Wales v AG* [1972] Ch 73, 90-91 (Sachs LJ), 99 (Buckley LJ). I do not suggest that the founder's motives can simply be attributed to an entity, although there have been some indications (primarily in other contexts) that motive may be relevant: *Brookton (Cth)* (1981) 147 CLR 441, 453 (Mason J, Murphy and Wilson JJ agreeing), 455 (Gibbs CJ, who left the question open); *Leagues Club Case* (1990) 23 FCR 82, 98 (Lockhart J, who left the question open). Care must be taken in doing so as it is clear that a charitable motive for establishing an entity will not of itself render the entity's purpose charitable: *Taxation Ruling TR 2005/22* [49]-[53]; *Keren Kayemeth* [1932] AC 650, 657 (Lord Tomlin, Lords Wright, Thankerton and Warrington agreeing), 661 (Lord Macmillan); *Re Smith* [1954] SASR 151, 159-160, (Ligertwood J). In addition, a non-charitable motive, at least where it is not the whole motivation, will not necessarily render a

CHARITABLE FUNDRAISING

Seventh Day Adventists, a religious organisation whose teachings included a separate focus on physical health based on a vegetarian diet.

In any event, it is arguable that the persuasive weight of the case is fairly minimal.¹⁸⁵

Hunt stands for the second limit set out above. The Foundation's memorandum of association required it to carry on business in order to pursue certain religious charitable objects and provided that all excess profits (after allowing for reserves or the expansion of the business)¹⁸⁶ were held for the benefit of a charitable entity. However Hardie Boys J construed the memorandum as compelling a distribution of the Foundation's assets to charity only on winding-up.¹⁸⁷ Accordingly, Hardie Boys J considered the Foundation's purpose was commercial, not charitable,¹⁸⁸ noting:¹⁸⁹

It is one thing for a body to exist for charitable purposes but it is quite another thing for a company to exist to pursue ordinary commercial activities even though as a financial consequence some other body is thereby enabled to act charitably in the legal sense. Were it otherwise every commercial firm which makes donations to religious and

charitable purpose non-charitable: *Re Delius (Deceased)* [1957] 1 Ch 299, 307 (Roxburgh J).

¹⁸⁵ First, as *Re Smith* was decided on other grounds, Ligertwood J's comments on commercial activities were *obiter dicta*. Secondly, Ligertwood J was influenced by *Lawlor's Case*, which did not involve the question whether commercial activities are consistent with charity, but whether the sole object of establishing a Catholic daily newspaper was charitable. Cf *Word* (2007) 164 FCR 194, [91] (Jessup J).

¹⁸⁶ Hardie Boys J considered that this potentially allowed the Foundation to retain its profits (and capital) until a winding up: *Hunt* [1961] NZLR 405, 406. Compare the reserve provisions in *Word* (2007) 164 FCR 194 and *Carey's* [1963] NZLR 450.

¹⁸⁷ *Hunt* [1961] NZLR 405, 411 (Hardie Boys J). See also T Molloy QC, 'Tax and Charities' Businesses' [1998] *New Zealand Law Journal* 59, 60. Molloy QC considers the decision in *Hunt* 'dubious on the facts'.

¹⁸⁸ *Hunt* [1961] NZLR 405, 409-410 (Hardie Boys J).

¹⁸⁹ *Ibid* 411 (Hardie Boys J).

charitable causes would be entitled to claim itself to be in part a charitable body.

However, *Hunt* was distinguished in *Carey's*, partly on the basis of its 'special facts'¹⁹⁰ and must now be treated as confined to the facts as found by Hardie Boys J. In addition, as discussed in Part 3.9, the floodgates concern is unlikely to be realised.

3.8 Charitable Purpose – *Word* as the Morning Star of the Reformation?

Rather than a harbinger of change, *Word* is likely to be remembered as finally confirming that commercial fundraising can be pursued in Australia in support of charitable objects. Such activities have already been accepted in a number of other common law jurisdictions¹⁹¹ and acknowledged in the corresponding income tax legislation.¹⁹² The decision in *Christian Enterprises* and the statutory recognition of active fundraising by charities¹⁹³ suggest that a similar approach has already been, or should be, adopted in Australia, subject to *Re Smith*. When one looks at the examples in Part 3.2 of the links between commercial activities and charitable objects, the question remains: on what basis can the dividing line between *Word* and *Re Smith* be drawn?

Reviewing the spectrum in Part 3.2, the nexus in *Word*¹⁹⁴ between the fundraising funeral business activities and its evangelical objects is more remote than for examples one and two (i.e. for activities that directly achieve a charitable purpose or that have a direct outcome of promoting that purpose). One could differentiate between directly and

¹⁹⁰ *Carey's* [1963] NZLR 450, 457 (Gresson P).

¹⁹¹ See Part 3.6.

¹⁹² See Part 3.2.

¹⁹³ See Part 3.6.

¹⁹⁴ Example 4.

CHARITABLE FUNDRAISING

indirectly related activities.¹⁹⁵ However, the authorities do not support a distinction at this point. The third example, *Word*, is analogous to *Oxfam*. Both decisions relate to commercial activities undertaken to raise funds to implement an object that would, viewed alone, be exclusively charitable.¹⁹⁶ In both cases, there appeared to be no other objective aim for the activities.¹⁹⁷ Further, the fundraising activities, in both, were arguably ‘in harmony’ with the overall charitable purpose,¹⁹⁸ satisfying Jessup J’s more restrictive approach.

Cases such as *Christian Enterprises* and *Carey’s*, as well as Allsop J’s judgment, actually go further than the facts of *Word* as they appear to accept commercial activities which are not in the same degree of harmony with an entity’s objects. One could object that *Christian Enterprises* was decided on the basis that the taxpayer was a charitable institution by only one judge and that *Carey’s* is merely persuasive. However, the changing factors driving charities to rely on commercial fundraising indicate that this is an apt sphere in which to apply Lord Wilberforce’s comment that charities decisions ‘have

¹⁹⁵ See Cullity, above n 79, 15-16.

¹⁹⁶ The courts have been reluctant to accept that commercial activity objects are truly ancillary, despite an express provision to this effect, where they are extensive, specific and the primary object is not clearly charitable: *Tennant Plays Ltd v Inland Revenue Commissioners* [1948] 1 All ER 506; *Keren Kayemeth* [1932] AC 650, 657-658 (Lord Tomlin, Lords Wright, Thankerton and Warrington agreeing). However, in *Keren Kayemeth*, Lord Tomlin did acknowledge that an overriding charitable object would not generally be ‘destroyed’ simply because incidental powers are, viewed on their own, non-charitable. In the case, it was the large number of elaborate incidental powers along with the conclusion that the main object was not, even when viewed separately, charitable, that lead the Court to conclude that the entity was not charitable.

¹⁹⁷ Particularly so in *Word*, as the object pursuant to which the fundraising activities were carried out was expressly subordinated to its charitable objects.

¹⁹⁸ The sale of donated goods is likely to be treated as analogous to seeking monetary donations, which is clearly consistent with a charitable purpose: *Alberta Institute* [1987] 2 C.T.C. 70. In addition, *Oxfam* sold village handicrafts made by some of the people intended to benefit from its charitable purpose.

endeavoured to keep the law as to charities moving according as new social needs arise or old ones become obsolete or satisfied'.¹⁹⁹

The bond between activities and purpose in *Re Smith* (the last example in the continuum) and in *Hunt* is not as tight as that in *Word* for the reasons identified in Part 3.7. In both decisions, the entity was held not to be charitable. In drawing the boundary between these cases and *Word*, on the basis of *Hunt* the test cannot be the ultimate destination of profits as suggested in *Dean Leigh*.²⁰⁰ Proposals relating to a 'coherent relationship' or substantial connection give some content to the bond, but would cause uncertainty.²⁰¹ The same difficulties would attend a link determined by the 'natural and probable consequences' of activities.²⁰²

The requirement that an entity's purpose be exclusively charitable, along with the courts' focus on private benefits,²⁰³ potentially provides support for a 'but for' test. On an objective basis, taking into account the matters set out in Part 3.2, would the entity have undertaken the commercial activity 'but for' the purpose of deriving profits to be applied to its charitable objects? If such a test was to be applied in relation to fundraising by charities, it would be necessary to modify it slightly so that the purpose of deriving profits to be applied to charitable objects is a 'necessary' and 'independently sufficient' cause

¹⁹⁹ *Scottish Burial* [1968] AC 138, 154 (Lord Wilberforce). Compare Lord Upjohn at 153.

²⁰⁰ *Dean Leigh* (1958) 38 TC 315, 325 (Harman J). This was the justification provided for accepting passive investment activities.

²⁰¹ *Vancouver Society* [1999] 1 SCR 10, [52], [56] (Gonthier J, L'Heureux-Dubé and McLachlin JJ agreeing).

²⁰² *Hester v Commissioner of Inland Revenue* [2005] 2 NZLR 172, [83] (William Young and Chambers JJ) (leave to appeal refused, *Hester v Commissioner of Inland Revenue* [2005] 2 NZLR 473).

²⁰³ See Parts 3.3 and 3.4.

CHARITABLE FUNDRAISING

of the fundraising activities, rather than merely a cause which is jointly sufficient with other non-charitable causes.²⁰⁴

The courts have typically ascribed relevance to a ‘but for’ test in determining whether an occurrence is factually²⁰⁵ caused by another event.²⁰⁶ Several cases have suggested that a ‘but for’ test may be relevant in the context of determining whether directors have breached their fiduciary duties by exercising their powers for an improper purpose. The question is whether ‘the impermissible purpose was causative in the sense that, but for its presence, “the power would not have been exercised”’.²⁰⁷

²⁰⁴ The terms ‘necessary’ and ‘independently sufficient’ are taken from Fleming’s discussion of alternative sufficient causes: J G Fleming, *The Law of Torts* (9th ed, 1998) 222-223. See also H L A Hart and A M Honoré, *Causation in the Law* (1959) 106.

²⁰⁵ Hart and Honoré have questioned whether the causal test involves strictly separate factual and normative questions: Hart and Honoré, above n 204, 104.

²⁰⁶ For instance, in determining whether damages are available for a person’s negligent act or omission, a ‘but for’ test, while not sufficient or exclusive and subject to a number of restrictions, remains relevant to deciding whether the loss suffered by the plaintiff was caused by the negligent act or omission. See Fleming, above n 204, 219-220; *Chappel v Hart* (1998) 195 CLR 232, [24]-[25] (*contra* McHugh J), [62], [66]-[67] (Gummow J), [93] (Kirby J), [115]-[117] (Hayne J); *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506, 515-517 (Mason CJ, Gaudron J in agreement), 522-523 (Deane J, Gaudron J in agreement); 524 (Toohey J), 534 (c/f McHugh J). A similar approach is taken in relation to the issue of causation for damages in contract: LexisNexis, *Carter on Contract*, (at 29 July 2008) [41-210]). Note that the test of causation also depends upon normative considerations: *Chappel v Hart* (1998) 195 CLR 232, [24] (*contra* McHugh J), [62] (Gummow J), [93] (Kirby J), [115]-[117] (Hayne J). A ‘but for’ test has also been applied in determining whether equitable compensation is available for a breach of trust: Thomson Law Book Co, *Principles of the Law of Trusts* (at 10 August 2008) [17120]. However, at least in relation to a trustee’s duties of loyalty and fidelity the test has been applied more ‘strictly’ against the defendant than that in contract or tort: *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484, [39]-[40], [63] (McHugh, Gummow, Kirby and Hayne JJ); *Caffrey v Darby* (1801) 31 ER 1159, 1162 (Lord Eldon).

²⁰⁷ *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 294 (Mason, Deane and Dawson JJ); *Darvall v North Sydney Brick and Tile Co Ltd* (1987) 16 NSWLR 212; *Haselhurst v Wright* (1991) 4 ACSR 527, 531-533 (Owen J); *Permanent Building*

While criticisms of such a test exist,²⁰⁸ some of these lose their sting where the purpose must be exclusively charitable. The objection that there may be two equal reasons for which an entity has a power to carry out commercial activities cannot apply to a charitable entity, as the ‘but for’ test would operate appropriately to confirm that there is no exclusively charitable purpose. The concern that the ‘but for’ test cannot be applied to successive causal events is diminished in relation to successive objective purposes for commercial activities. To the extent that the purpose for carrying out such activities changes,²⁰⁹ the status of the entity would simply need to be determined afresh from the time of the change.

A ‘but for’ approach would be consistent with the outcome in *Word* and the cases discussed in Part 3.6. In the majority of those cases,²¹⁰ the facts indicate that the relevant entity’s constituent documents required all profits from commercial activities to be applied to a charitable object or else to build the business, with all funds

Society (in liq) v Wheeler (1994) 11 WAR 187, 218 (Ipp J, Malcolm CJ and Seaman J agreeing). See also LexisNexis, *Ford’s Principles of Corporations Law* (at 28 July 2008) [8.240]. It appears that the improper purpose must still be a ‘significantly contributing cause’, which suggests that it must be relatively significant: *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 294 (Mason, Deane and Dawson JJ).

²⁰⁸ See, eg, *March v E & MH Stramare Pty Ltd* (1991) 171 CLR 506, 516-517 (Mason CJ, Gaudron J in agreement), 522-523 (Deane J, Gaudron J in agreement), 524 (Toohey J); Fleming, above n 204, 222-224; Hart and Honoré, above n 204, especially 107-108.

²⁰⁹ The purpose will most likely change as a result of an amendment to the entity’s constituent documents, although possibly also as a result of a change in the entity’s activities.

²¹⁰ That the Institute had such a clause or that such a clause would have been implied into its constitution is implicit in the finding in *Alberta Institute* that the Institute was charitable, as charitable institutions are (and were at the time) required by the Canadian tax legislation not to pay or make available any part of their income ‘for the personal benefit of any proprietor, member, shareholder, trustee or settlor’. It is also implied by the comments of Viscount Cave in *Coman*, who referred to the statute regulating the Governors as requiring all profits to be ‘applied for the maintenance’ of the hospital: [1921] 1 AC 1, 24. The facts in *Oxfam* do not indicate whether the constituent documents contained such a clause.

CHARITABLE FUNDRAISING

ultimately being directed to the charitable object. This is a powerful indicator that the activities would not be conducted unless the charitable purpose existed.²¹¹ A number of the decisions exhibit an additional supporting factor, an explicit statement in the constitution that the power or object to conduct commercial activities is ancillary to a clearly charitable object.

However, as *Re Smith* demonstrates, if there is an alternative objective aim for the commercial activities (other than the assertion that an entity's purpose is 'commercial') then the 'but for' test will not be passed. Likewise, it is arguable that a 'but for' test would not have been satisfied on the facts as found in *Hunt*, due to the potentially limitless time between the commencement of activities and the winding up of the Foundation. The interval between activity and application to charity suggests the existence of another objective for the commercial activities.

Application of a 'but for' test would permit a broader range of commercial fundraising than Jessup J's emphasis that commercial activities be 'in harmony' with an entity's charitable purpose. Such a requirement appears to rely more on tradition than on substance and its main justification seems to be caution. It would therefore be unfortunate if subsequent decisions engraft this limit onto a 'but for' test.

²¹¹ See *Word* (2007) 164 FCR 194, [24], [27] (Allsop J), [96] (Jessup J). These comments are subject, except in the case of a charitable trust, to any change to the entity's constituent documents. See Picarda, above n 79, 408-409. However, there is some doubt about the extent to which an entity is able to amend its constitution to provide for non-charitable objects: *Baldry v Feintuck* [1972] 1 WLR 552, 557 (Brightman J). Some commentators have suggested, in the context of incorporated entities that the entity may have to apply for a *cy-près* scheme in order to vary its objects: Dal Pont, above n 73, 380; Warburton and Morris, above n 79, 449 (in the context of property held on trust by a charitable corporation). To the extent that an entity can amend its objects to include non-charitable objects, in many cases the change would apply to future acquired funds only: *IRC v Yorkshire Agricultural Society* [1928] 1 KB 611, 633 (Atkin LJ).

Regardless of the precise formulation of the test, the fact that commercial fundraising may be acceptable in some circumstances is likely to encourage charities to adopt such activities. However, the degree to which such activities will increase following *Word* is unclear. It is possible that Australian charities have, effectively, already been benefiting from commercial fundraising. For instance, they may have been benefiting by arranging their affairs so that they hold wholly owned trading subsidiaries (with the potential to recoup tax paid by the subsidiary by claiming imputation credits)²¹² or to ensure that they are objects of a trading trust (with the distributed trading income exempt from tax in the hands of the charity).²¹³

Part 4 explores the potential adverse consequences of commercial activities on the assumption that commercial fundraising will increase. If it does not, there is less cause to introduce any amendments to the ITAA97.

3.9 Public Benefit

Jessup J's reference to a trading company with a practice of applying its profits to charity raises the floodgates risk of ordinary trading companies seeking charitable status in respect of particular income years.²¹⁴ However, this concern is unlikely to be realised.

The authorities attach significance to the fact that an entity which charges fees is precluded from distributing its profits to members.²¹⁵

²¹² On the basis that it is an exempt institution that is eligible for a refund under s 207-115 of the ITAA97.

²¹³ Not a public trading trust.

²¹⁴ *Word* (2007) 164 FCR 194, [96] (Jessup J).

²¹⁵ See the cases discussed in Parts 3.3 and 3.4, in particular: *Scottish Burial* [1968] AC 138, 147 (Lord Reid, Lords Guest and Pearson in agreement), 149 (Lord Upjohn, Lord Pearson in agreement), 156 (Lord Wilberforce, Lords Guest and Pearson in agreement); *Queensland Law Reporting Case* (1971) 125 CLR 659, 672 (Windeyer J); *Incorporated Council of Law Reporting for England and Wales v AG* [1972] Ch 73, 86

CHARITABLE FUNDRAISING

Accordingly, while it is not strictly necessary for an entity to have a non-profit clause in its constitution,²¹⁶ in the absence of some requirement that the entity apply its property solely to charitable objects²¹⁷ it is likely to be extremely difficult to satisfy the public benefit requirement. In the case of a typical proprietary limited company, the entity could distribute profits to members in subsequent years after the benefits of tax exemption have been used to build up the business.

In addition, the absence of a requirement to employ profits for charitable purposes, would render it extremely difficult for an entity to satisfy the ‘but for’ requirement for its trading activities.

4. A PYRRHIC VICTORY? DEALING WITH THE CONSEQUENCES OF COMMERCIAL FUNDRAISING

It is all very well to conclude that *Word* conforms with previous authorities and that charities can conduct commercial fundraising activities without losing their income tax exemption if they pass the ‘but for’ test. However, what are the potential ramifications if there is an increase in commercial fundraising? Some of the adverse consequences that have been posited in relation to charities conducting commercial activities generally are set out in Part 4.1. These harmful effects are likely to be exacerbated if there is growth in fundraising activities. The question is whether this requires legislative amendment to deny the income tax exemption to charities when they engage in

(Russell LJ), 90 (Sachs LJ), 104 (Buckley LJ); *McGarvie Smith* (1965) 11 LGRA 321, 328-329 (Else-Mitchell J).

²¹⁶ *TR 2005/21* [77].

²¹⁷ The ATO provides the following examples of situations in which a non-profit clause may not be required, ‘where a corporation is formed by statute and its provisions make the non-profit nature clear, or where a trust is established by deed or will providing that the property can be used for charitable purposes only’: *TR 2005/21* [77].

such activities?²¹⁸ That is the approach taken in a number of jurisdictions, including the US, England and Wales and Canada.

Before adopting any of the methods of regulating commercial conduct under income tax legislation discussed in Part 4.2, it is necessary to determine whether the concerns over commercial activities are justified. Further, if the main increase in commercial activity is in the area of commercial fundraising, this may focus attention on such fundraising. However, is there a particular link between the negative effects and commercial fundraising or do they relate generally to commercial activities by charities? To the extent that the adverse consequences do exist, Part 4.3 suggests that the real challenge is to define a class of ‘unacceptable’ activities in a way that targets those consequences.

4.1 Beyond the Boundaries

There appear to be some misgivings about charities carrying out commercial activities.²¹⁹ Accordingly, it is perhaps unsurprising that a number of other jurisdictions seek to deny an income tax exemption in respect of selected classes of commercial activities.²²⁰ There are, however, reasons to doubt the risk posed by some of the proposed negative effects. This is particularly so when any adverse impact must be balanced against the societal benefits provided by charities.²²¹

Potential adverse consequences include the following:

²¹⁸ See O’Connell, who has mooted whether the income tax exemption should be restricted for income from commercial activities: A O’Connell, ‘The Tax Position of Charities in Australia – Why Does it Have to be so Complicated?’ (2008) 37 *Australian Tax Review* 17, 37.

²¹⁹ See, eg, *Church of the New Faith v Commissioner of Pay-roll Tax (Vic)* (1983) 154 CLR 120, 161 (Murphy J), in the context of religious entities. See also Dart, above n 23, 191.

²²⁰ See Part 4.2.

²²¹ See Maerov et al, above n 8, 1.

CHARITABLE FUNDRAISING

1. The income tax base may be reduced.²²²
2. Non-charitable business operators may be disadvantaged by a loss of ‘competitive neutrality’.²²³
3. As a corollary of the competitive neutrality issue, the different tax treatment of charitable and for-profit businesses might lead to ‘economic inefficiency’.²²⁴
4. Conducting commercial activities may increase the risk of loss of an entity’s charitable assets because commercial liabilities are not quarantined.²²⁵

²²² Some commentators have argued that charities and non-profits have traditionally been viewed as outside the tax base and therefore the tax exemption should not be characterised as producing a loss of revenue but rather the recognition of a right: F Gladstone, *Charity, Law and Social Justice* (1982) 141, referring to Benjamin Disraeli. See also the discussion in S Rodman and M McGregor-Lowndes, ‘Income Tax Exemptions for Non-profit Associations’ in M McGregor-Lowndes, K Fletcher and AS Sievers (eds), *Legal Issues for Non-profit Associations* (1996) 121, 121-125. C/f Chesterman, above n 137, 102-103, who notes that, in England, the tax concessions afforded charities have actually increased since 1900.

²²³ Commonwealth of Australia, Inquiry into the Definition of Charities and Related Organisations, above n 4, 219. See also *Church of the New Faith v Commissioner of Pay-roll Tax (Vic)* (1983) 154 CLR 120, 161 (Murphy J); Gladstone, above n 222, 86; Maerov et al, above n 8, 1; Colombo, above n 8, 529-531; Sharpe, above n 8, 380-412. Justice Kirby appeared to consider this ground during the hearing for special leave to appeal from *Word*, noting that ‘[i]f you think of it in economic terms, if Bethel Funerals [the funeral business conducted by Word] can conduct cheaper funerals because of the fact that they have this tax advantage, then it will not only be believers who go to Bethel Funerals. That is the nature of a market. Therefore that raises a question as to whether taxpayers should subsidise effectively a particular commercial enterprise...’: Transcript of Proceedings, *Commissioner of Taxation v Word Investments Ltd* (High Court of Australia, Kirby, Hayne and Crennan JJ, 23 May 2008) (Kirby J, during argument).

²²⁴ Colombo, above n 8, 538-539.

²²⁵ Ibid 544-546; Charity Commission for England and Wales, *CC35 – Trustees, Trading and Tax: How Charities May Lawfully Trade* section B <<http://www.charity-commission.gov.uk/publications/cc35.asp>> at 28 March 2008.

5. An increased focus on commercial activities by a charity's controllers may 'divert' efforts away from the entity's charitable purpose.²²⁶
6. The public may perceive charities as less altruistic if their commercial activities increase.²²⁷

In relation to the first issue, as the ratings cases demonstrate, a finding that an entity is charitable will not necessarily impact on all taxes. More fundamentally, there is tension between this consequence and the factors promoting commercial activities explored in Part 2.1. Reduction of the tax base must be weighed against the strong desire of governments for charities to become fully or partly 'self sufficient'.²²⁸

A loss of 'competitive neutrality' involves more than mere competition. This outcome will arise where competition is coupled with a particular behaviour, such as 'predatory pricing' or 'subsidized market expansion', on the part of the charity.²²⁹ Some commentators have expressed doubt whether charities are likely to undertake such actions, as they have an incentive to maximise returns for use in carrying out their charitable purposes²³⁰ and, to a degree, to use the returns for their charitable purposes rather than reinvesting in their commercial activities.²³¹ For the third effect, it appears that

²²⁶ See Colombo who notes this potential issue: Colombo, above n 8, 534-535. See also Dart, above n 23, 190-191. At the time of writing, Dart considered that quantitative evidence needed to be gathered to assess the issue.

²²⁷ Dart notes that there have been concerns that public support may be reduced and perceptions impacted if charities conduct commercial activities, but suggests that some initial findings indicate there is public support for charities carrying out certain revenue generating activities: Dart, above n 23, 191.

²²⁸ Commonwealth Department of Health and Aged Care, above n 4, 223

²²⁹ Colombo, above n 8, 529-530.

²³⁰ Ibid 530.

²³¹ Ibid. *Contra* Sharpe, above n 8, 397, 398-400: referring to a charity's ability to borrow money and invest at a higher price due to its tax exemption (with income then covering interest). Using borrowed funds, a charity could do so repeatedly. See also Gladstone, above n 222, 86.

CHARITABLE FUNDRAISING

commentators, at least in the US context, have different views on the gravity of the effect and how best it should be resolved.²³²

It seems likely that the risk of asset loss highlighted by the fourth concern may already, or could in the future, be addressed by a charity's management using typical commercial strategies, such as 'insurance', 'diversification' and business structuring.²³³

In respect of the fifth item, it is arguable that the additional revenue should enable a greater pursuit of the charitable purposes.²³⁴ Further, an independent source of funds may help reduce time spent applying for and complying with the terms of government grants.

The sixth effect seems a valid concern based on the misgivings over charities conducting commercial activities.

Given the uncertainty, further quantitative research should be undertaken in Australia before deciding whether legislative amendment is required. Nevertheless, the following Part examines some options from a cross jurisdictional perspective, if such amendment is required.

4.2 Approach to Commercial Fundraising in Other Jurisdictions

The US, Canada, England and Wales and New Zealand impose limits for income tax purposes on charities conducting commercial activities.²³⁵ In each jurisdiction other than England and Wales, the concept of charity is defined by reference to a general law test similar

²³² Colombo, above n 8, 539-541.

²³³ Ibid 544-546.

²³⁴ See Ibid 535. See also Sharpe, above n 8, 385-387.

²³⁵ The limits are minimal in the case of New Zealand.

to that set out in Part 2.2.²³⁶ In England and Wales, the term has been defined by statute in a way which is based on, but extends, the general law.²³⁷

The tax legislation for England and Wales does not provide a blanket income tax exemption for charity income.²³⁸ Instead, particular categories of income are rendered exempt.²³⁹ One such class of income constitutes the profits of a trade carried on by a charity, if the profits are applied solely to the purposes of the charity and ‘the trade is exercised in the course of carrying out [or ‘the actual carrying out of’, in the case of a charitable company] a primary purpose of the

²³⁶ In the US the term ‘charitable’ takes its general law meaning: US Department of the Treasury Inland Revenue Service, *Exempt Purposes - Internal Revenue Code Section 501(c)(3)*

<<http://www.irs.gov/charities/charitable/article/0,,id=175418,00.html>> at 8 March 2008. However, the meaning is subject to explanation and modification under the Federal tax regulations: 26 CFR § 1.501-(c)(3)-1 (2007). In Canada, see *Vancouver Society* [1999] 1 SCR 10, [28] (Gonthier J, L’Heureux-Dubé and McLachlin JJ agreeing), [143]-[151] (Iacobucci J Cory, Major and Bastarache JJ agreeing); Canada Revenue Agency, *Tax Guide T4063, Registering a Charity for Income Tax Purposes* <http://www.cra-arc.gc.ca/E/pub/tg/t4063/t4063-e.html#P41_345> at 24 March 2008. In New Zealand, the term ‘charitable purposes’ takes its meaning from the general law, with some minor extensions from 1 April 2008: *Income Tax Act 2004* (NZ) s OB1 (from 1 April 2008: cf *Income Tax Act 2007* (NZ) s YA1).

²³⁷ *Charities Act 2006* (UK) ss 1-3.

²³⁸ At the time of writing the tax legislation for England and Wales was undergoing a rewrite. The provisions dealing with charitable trusts had been enacted in the *Income Tax Act 2007* (UK), while those dealing with charitable companies remained in the *Income and Corporation Taxes Act 1988* (UK), with draft replacement provisions released for comment (HM Revenue & Customs, *Paper CC/SC (07) 43 Special rules about charitable companies etc* <<http://www.hmrc.gov.uk/rewrite/ccsc-0743-char-comp-paper.pdf>> 1 at 1 January 2008).

²³⁹ An exemption exists for the profits of small scale trading activities that are applied solely to the entity’s charitable purposes: *Income Tax Act 2007* (UK) ss 526, 528; *Finance Act 2000* (UK) s 46; proposed Draft Clauses Bill 6 (Corporation Tax) (UK) ss 9, 11 (HM Revenue & Customs, *Draft Clauses Bill 6 (Corporation Tax)* <<http://www.hmrc.gov.uk/rewrite/>> at 28 March 2008). For further information on exemptions, see HM Revenue & Customs, *The Tax Advantages of Being a Charity* <<http://www.hmrc.gov.uk/charities/tax/advantages.htm>> at 28 March 2008.

CHARITABLE FUNDRAISING

charitable trust' or 'the work in connection with the trade is mainly carried out by beneficiaries of the [charity]'.²⁴⁰

Accordingly, it is implicit that charities can conduct commercial activities. However, the only trading income which is exempt from tax is income from activities that directly effect a charity's purpose,²⁴¹ or that directly involve those intended to be assisted by the charity and from a limited range of ancillary activities.²⁴² Fundraising income would not generally be covered.²⁴³

In addition, the relevant provisions effectively impose a penalty for carrying out trading activities that generate a loss unless the charitable trade or small scale trade exemptions would have applied to those activities.²⁴⁴

In Canada, an exemption is provided at the federal level for the taxable income of 'registered charities'.²⁴⁵ A charity's registration can

²⁴⁰ *Income Tax Act 2007* (UK) ss 524, 525; *Income and Corporation Taxes Act 1988* (UK) s 505(1)(e); cf proposed Draft Clauses Bill 6 (Corporation Tax) (UK) ss 7, 8.

²⁴¹ HM Revenue & Customs, *Detailed Guidance Notes: Charities – Trading and Business Activities* [11]-[12] <<http://www.hmrc.gov.uk/charities/guidance-notes/annex4/sectionb.htm>> at 28 March 2008.

²⁴² *Ibid* [11], [13].

²⁴³ *Ibid* [10]; HM Revenue & Customs, *Tax Treatment of Charity Trading Activities* <<http://www.hmrc.gov.uk/charities/trading/tax-exemptions.htm>> at 28 March 2008.

²⁴⁴ The penalty is imposed by rendering other income exemption provisions inapplicable to the extent of the loss. See in particular, *Income Tax Act 2007* (UK) s 543(1)(a); proposed Draft Clauses Bill 6 (Corporation Tax) (UK) ss 24-33. Cf *Finance Act 2000* (UK) s55.

²⁴⁵ *Income Tax Act*, RSC 1985 (5th supp), c 1, s 149(1)(f). Registered charities come in three primary forms, charitable organizations, public foundations and private foundations: *Income Tax Act*, RSC 1985 (5th supp), c 1, ss 149.1(1), 248(1). In addition, a registered charity can include a branch, section, parish, congregation or other division of one of the three primary forms. The definition of a charitable organization refers to an entity 'all the resources of which are devoted to charitable activities carried on by the organization itself', whereas the definitions of the two foundations refer to entities 'operated exclusively for charitable purposes'.

be revoked if it ‘carries on a business that is not a related business of that charity’ or ‘carries on any business’ in the case of a private foundation.²⁴⁶ However, the income tax legislation expressly provides that a charitable organisation is deemed to be devoting its resources to its charitable activities to the extent that it carries on a ‘related business’.²⁴⁷

The Canada Revenue Agency (‘CRA’) considers that there are two main categories of related businesses:²⁴⁸

- ‘businesses that are run substantially by volunteers’;²⁴⁹ and
- ‘businesses that are linked to a charity’s purpose and subordinate to that purpose’.

The CRA requires that the business be linked by its ‘nature’ and has stated that carrying out fundraising business activities will not create the required link.²⁵⁰

Therefore, it seems that certain charities are permitted to conduct a narrow band of commercial activities,²⁵¹ but that income tax exemption will be lost in respect of all income if a charity undertakes

²⁴⁶ *Income Tax Act*, RSC 1985 (5th supp), c 1, ss 149.1(2)(a), (3)(a), (4)(a).

²⁴⁷ *Income Tax Act*, RSC 1985 (5th supp), c 1, s 149.1(6)(a). The Canada Revenue Agency adopts the same approach for public foundations: Canada Revenue Agency, *Policy Statement CPS-019*, above n 25, [2].

²⁴⁸ Canada Revenue Agency, *Charity Policy Statement CPS-019*, above n 25, [17].

²⁴⁹ As a general guide, the CRA considers ‘substantially’ to mean at least 90%: *ibid* [18].

²⁵⁰ *Ibid* [20]. There is Canadian authority which supports this position: *Earth Fund v Canada (MNR)* [2002] FCA 498. *Contra Alberta Institute* [1987] 2 C.T.C. 70. For information on when a business will be linked by its nature, see *ibid* [21]-[30].

²⁵¹ Although the commercial activities must be ‘subordinated’ to the entity’s charitable purpose: Canada Revenue Agency, *Charity Policy Statement CPS-019*, above n 25, [3]. See also Canada Revenue Agency, *Registered Charities Guide RC 4143 - Registered Charities: Community Economic Development Programs* 12 <<http://www.cra-arc.gc.ca/E/pub/tg/rc4143/rc4143-e.pdf>> at 28 March 2008.

CHARITABLE FUNDRAISING

commercial activities outside the class. The examples provided by the CRA to outline this class, suggest a test similar to Jessup J's requirement that the activities be in harmony with the entity's charitable purpose. The CRA's approach is alleviated to some extent by its treatment of certain activities, such as those that directly effect a charitable purpose, as generally falling outside the notion of 'business' activities.²⁵²

In New Zealand the tax legislation expressly exempts income derived 'from a business'²⁵³ carried on by, or for, or for the benefit of a 'trustee in trust for charitable purposes' or 'a society or institution established and maintained exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual'.²⁵⁴ However, the entity must carry out its charitable purposes in New Zealand and no controller must be able to direct or divert funds from the business to their own advantage.²⁵⁵ Unlike the UK and Canada, the New Zealand legislation does not distinguish between closely and remotely linked activities.

In the United States, the Internal Revenue Code exempts from income tax the income of 'corporations', 'community chests', 'funds'

²⁵² The CRA appears to consider that the charging of fees for the carrying out of activities to directly effect a charitable purpose may not constitute a 'business': Canada Revenue Agency, *Charity Policy Statement CPS-019*, above n 25, [6]-[7].

²⁵³ The relevant limb of the definition of 'business' states that the term 'includes any profession, trade, manufacture, or undertaking carried on for pecuniary profit': *Income Tax Act 2004* (NZ) s OB1 (from 1 April 2008: cf *Income Tax Act 2007* (NZ) s YA1). The New Zealand Inland Revenue suggests that '[a]ny enterprise or activity intended to make a profit is classed as a business': Inland Revenue, *IR 255 Charitable Organisations* 6 <<http://www.ird.govt.nz/forms-guides/title/forms-c/ir255-guide-charitable-organisations.html?id=righttabs>> at 28 March 2008.

²⁵⁴ *Income Tax Act 2004* (NZ) s CW35(1). From 1 April 2008, *Income Tax Act 2007* (NZ) s CW 42(1), which is in a similar form, will apply. A registration requirement will also have to be satisfied from 1 July 2008: Inland Revenue, *Charitable Organisations* <<http://www.ird.govt.nz/charitable-organisations>> at 28 March 2008.

²⁵⁵ *Income Tax Act 2004* (NZ) s CW35(1). From 1 April 2008, *Income Tax Act 2007* (NZ) s CW 42(1), will apply.

or ‘foundations’ that are ‘organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes...’.²⁵⁶ The federal tax regulations expressly provide that an entity may be deemed charitable for the purposes of the IRC even though²⁵⁷

it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

The IRC also focuses on ‘unrelated’ commercial activities, for the purpose of denying the tax exemption for unrelated business taxable income (‘UBTI’).²⁵⁸ In general terms, UBTI comprises income from a trade or business that is ‘regularly carried on’ by the entity and the conduct of which is not ‘substantially related’ (other than as a source of funds) to the execution of the entity’s charitable purpose.²⁵⁹ As provided by the legislation, the ‘substantially related’ link requires more than a fundraising connection.²⁶⁰

²⁵⁶ IRC § 501(a), (c)(3) (2006).

²⁵⁷ 26 CFR § 1.501-(c)(3)-1(e) (2007).

²⁵⁸ IRC § 511(a), (b) (2006).

²⁵⁹ IRC § 512(a)(1), 513(a) (2006). See also US Department of the Treasury Inland Revenue Service, *Unrelated Business Income Tax* <<http://www.irs.gov/charities/article/0,,id=123293,00.html>> at 28 March 2008; US Department of the Treasury Inland Revenue Service, *Tax on Unrelated Business Income of Exempt Organisations*, Publication 598, (2007) 1, 3; US Department of the Treasury Inland Revenue Service, *Unrelated Business Income Defined* <<http://www.irs.gov/charities/article/0,,id=96104,00.html>> at 28 March 2008.

²⁶⁰ IRC § 513(a) (2006). The Inland Revenue Service notes that ‘[t]o determine if a business activity is *substantially related* requires examining the relationship between the activities that generate income and the accomplishment of the organization’s exempt purpose. Trade or business is related to exempt purposes, in the statutory sense, only when the conduct of the business activities has causal relationship to achieving exempt purposes (other than through the production of income). The causal relationship must be substantial. The activities that generate the income must

CHARITABLE FUNDRAISING

There are a number of exceptions to the concept of UBTI, including certain types of, predominantly passive, income²⁶¹ and income from businesses:

- where ‘substantially all the work’ is undertaken by volunteers;²⁶²
- where it is undertaken for the ‘convenience of [the charity’s] members, students, patients, officers or employees’;²⁶³ and
- where it involves the selling of donated goods.²⁶⁴

In all jurisdictions but Canada, if a charity carries out commercial activities outside the bounds permitted by the income tax legislation, the result is only a loss of the exemption for that income.²⁶⁵ Canada, like Australia, adopts an all or nothing approach. In addition, in

contribute importantly to accomplishing the organization’s exempt purposes to be substantially related’: US Department of the Treasury Inland Revenue Service, *‘Substantially Related’ Defined* <<http://www.irs.gov/charities/article/0,,id=158843,00.html>> at 28 March 2008. However, it appears that some fundraising activities may still have the relevant connection: S Ruth and C Barret, *1999 EO CPE Text – N UBIT: Current Developments* 287 <<http://www.irs.gov/pub/irs-tege/eotopicn99.pdf>> at 28 March 2008.

²⁶¹ IRC § 512(b) (2006). The Inland Revenue Service lists ‘dividends, interest, certain other investment income, royalties, certain rental income, certain income from research activities, and gains or losses from the disposition of property’ as examples: US Department of the Treasury Inland Revenue Service, *Unrelated Business Income Tax Exceptions and Exclusions*

<<http://www.irs.gov/charities/charitable/article/0,,id=123415,00.html>> at 28 March 2008. See also US Department of the Treasury Inland Revenue Service, *Tax on Unrelated Business Income of Exempt Organisations*, above n 36, 9-10.

²⁶² IRC § 513(a)(1) (2006).

²⁶³ IRC § 513(a)(2) (2006).

²⁶⁴ IRC § 513(a)(3) (2006).

²⁶⁵ That is, to the extent that a charity can conduct commercial activities in the relevant jurisdictions and retain its charitable status. In addition, in England and Wales, a penalty may be imposed if the commercial activities generate a loss.

defining the classes of acceptable and unacceptable commercial activities, each jurisdiction, other than New Zealand, permits only activities which are closely related to purpose (not mere fundraising) along with specific categories of commercial activities, such as those provided by volunteers or beneficiaries of the charity, or else activities viewed as traditionally charitable, like operating opportunity shops. The applicability of these approaches in Australia is considered in Part 4.3 below.

4.3 Evaluating the Concerns and the Responses

If further investigation indicates that the negative effects of commercial activities justify a legislative response, should this be based on the predominant approach adopted in the jurisdictions explored in Part 4.2? Defining the class of unacceptable activities by reference to the nexus between charitable purpose and activity, or to traditionally charitable activities, is unlikely to tackle the mischief in the most efficient manner, if at all in some cases. That is because many of the adverse implications do not depend on the relationship between activities and charitable purpose. For those consequences that do appear to be caused to a greater degree by commercial fundraising activities, attacking fundraising is a proxy for addressing the underlying harm.

Adopting a position, similar to that of the US, whereby the tax exemption under Div 50 of the ITAA97 is lost only in respect of income from 'undesirable' commercial activities would more clearly convey fiscal policy than relying on the fear of total loss of exemption.²⁶⁶ To the extent that tax laws are to be measured on the grounds of equity, efficiency and simplicity, such a change would promote equity for charities in respect of their income from 'acceptable' activities. It would, however, be more complex than an all or nothing approach.

²⁶⁶ Cf Colombo, above n 8, 533.

CHARITABLE FUNDRAISING

The real challenge lies in defining ‘unacceptable’ activities. When one looks at the negative consequences in Part 4.1, the degree of relatedness between purpose and activities, or the traditional nature of activities, is not relevant to a number of them. The fourth and fifth²⁶⁷ concerns seem to apply equally to all commercial activities by charities and to passive investment activities.²⁶⁸ Although the sixth consequence is likely to be more marked for indirect, non-traditional activities, the difference is likely to be marginal if directly related commercial activities are substantial.²⁶⁹ Further, the only reason for drawing a distinction in relation to the first concern, lost tax revenue, seems to be an arbitrary positioning of the floodgates to limit revenue leakage.²⁷⁰

There may be more justification for excluding indirectly linked commercial fundraising activities on the basis of the second and third issues. As discussed in Part 3.4, charitable entities have traditionally conducted activities, including commercial activities, to directly effect their purpose in such spheres as health, care for the aged, education and religion. Accordingly, there may be fewer for-profit competitors operating in these areas (particularly for religious organisations. In

²⁶⁷ Gladstone, above n 222, 60-65. Gladstone notes that a number of English public schools with charitable status, such as Eton, switched their focus from educating the poor to educating fee paying students with the introduction of fees.

²⁶⁸ See, eg, Colombo, above n 8, 536-537, 545. However, the risk for passive investments is likely to be restricted to the value of the investment asset: Canada Revenue Agency *Charity Policy Statement CPS-019*, above n 25, [14]-[15].

²⁶⁹ See Gousmett, who suggests that there is some cynicism about whether large charities, such as hospitals, which charge fees for their services, satisfy the public benefit requirement: M Gousmett ‘The Revised Charities Bill 2004’ [2005] *New Zealand Law Journal* 58, 61-62.

²⁷⁰ A loss of income tax revenue already occurs in the case of entities conducting commercial activities that the ATO accepts as being consistent with a charitable purpose.

addition, focusing charities' activities in certain directly linked areas may result in efficiencies of scale.²⁷¹

However, concentrating commercial activities in a limited number of areas is not a guarantee that for-profit competition does not exist. It clearly does in the health, aged care and education fields. Further it may cause greater damage to the fewer for-profit organisations in those areas.²⁷² Therefore, it seems preferable for any legislative limits to be targeted specifically toward commercial activities that involve competition with for-profit entities *and* that may result in economic inefficiency or a loss of competitive neutrality. Sharpe, for instance, has proposed targeted approaches which could potentially also apply under the ITAA97.²⁷³

It would be regrettable if *Word* leads to limits on charities' income tax exemption based on the degree of relatedness between activities and purpose or on the traditional nature of activities, as occurs in the US, England and Wales and Canada. Before limits are introduced, the weight of the potential adverse consequences should be confirmed. Following this step, and if the seriousness of the mischief warrants it, limits should be drafted which specifically target the concerns. As outlined above, although greater commercial fundraising following *Word* may trigger renewed attention to the consequences of

²⁷¹ Colombo, above n 8, 540. Colombo's comments concern the unrelated business income tax levied in the US on income from activities that do not have the required degree of connection to a charitable entity's purpose.

²⁷² Ibid 539-540.

²⁷³ Sharpe has nominated a requirement that charities adopt competitive pricing for commercial activities. Further, Sharpe has raised an 'elective credit' mechanism whereby a charity chooses to either distribute a set percentage of its profits (the percentage would be calculated to prevent the retention of non-taxed profits for use in expansion of commercial activities) to another charity or else pay tax on that proportion of its profits. Alternatively, the choice could be to apply the percentage to the entity's charitable objects. The aim of the elective credit approach being to limit the retention of non-taxed profits for use in expanding commercial activities. See Sharpe, above n 8, 372, 394, 404-405.

CHARITABLE FUNDRAISING

commercial activities, most of the harmful effects do not appear significantly more prevalent for indirect fundraising activities. Accordingly, any amendments should address the negative consequences rather than using indirect commercial activities as an inapt proxy.

5 CONCLUSION

Word comes at a time when charities are under pressure to diversify into alternative funding sources to donations and government grants. As emphasised in Part 3, commercial activities are really just one of the alternatives. Seen in this fashion, the result in *Word* is not surprising. As the trial judge emphasised, the difference between ‘selling lamingtons at a church fête and selling funeral services’ is one of form rather than substance.²⁷⁴

Of course, there is a boundary beyond which commercial activities are no longer a means to an end. Consistently with the case law in Australia and other jurisdictions which have a comparable notion of ‘charity’, a ‘but for’ test seems particularly adapted to setting the boundary. In applying this test, the not-for-private profit nature of charities suggests that commercial activities will frequently be characterised as ancillary to a charitable purpose. Accordingly, *Word* may lead to an increase in commercial fundraising to the extent that charities have not already adopted structures to do so. Further, if extended beyond the fundraising context, a ‘but for’ test may result in a broader range of actions being seen as ancillary to a charitable purpose. For instance, providing business development assistance for individuals in areas of particular socioeconomic disadvantage to combat poverty may be seen as ancillary to a charitable purpose.

However, charities that are celebrating the outcome in *Word* may find that it becomes a pyrrhic victory. A significant expansion in

²⁷⁴ *Word* (2006) 64 ATR 483, [60] (Sundberg J).

commercial fundraising may tempt the government to limit the ITAA97 tax exemption by targeting such fundraising. As emphasised in Part 4, it would be unfortunate if such amendments occurred before:

- the weight of each posited adverse consequence of commercial activities has been determined; and
- confirming whether those consequences are more pronounced for indirect fundraising activities.

Any limits should be targeted to the potential mischief. If introduced, it is likely that they will need to target currently accepted direct and traditional commercial activities, as well as indirect fundraising.

POSTSCRIPT

Since writing this article, the High Court has handed down its decision in *Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55 (Unreported, Gummow, Kirby, Hayne, Heydon and Crennan JJ, 3 December 2008). The Court held, by majority, that Word was entitled to be endorsed as an income tax exempt charitable institution, rejecting the Commissioner's arguments that:

- Word's objects were not limited to charitable purposes;
- an institution cannot be charitable where the only activity it undertakes is fund-raising by commercial means to distribute the funds to charitable institutions which directly undertake 'charitable activities';
- Word could not be a charitable institution because it did not ensure that there were restrictions on the use of its distributed profits; and

CHARITABLE FUNDRAISING

- Word was not entitled to endorsement because it did not meet the ‘in Australia’ requirement of s 50-50(a) of the ITAA97.

Kirby J, in dissent, found that Word was not a charitable institution and that it did not meet the ‘in Australia’ requirement for endorsement. His Honour emphasised the ‘special privilege’ of the taxation concessions afforded to charities and referred to a number of the policy concerns discussed in Part 3 of this paper.

The author intends to analyse the decision in a further article. It will be interesting to see whether legislators and the not-for-profit sector take up Kirby J’s challenge to re-explore the limits and the basis of the concessions for charities.