# A charity by any other name...

# Submission to the Board of Taxation on the draft Charities Bill, 2003

*September 2003*

## Summary

Three years ago, the Federal Government committed itself to modernise the definitions of charity used in tax law, which are based on British laws that are 500 years old.

To that end, the Government established a *Charity Definitions Inquiry*. The Inquiry consulted widely with the charitable sector and delivered its report in June 2001. Broadly speaking, its recommendations were supported by the charitable sector.

Last month, the Government released a draft *Charities Bill, 2003* to define "charity" for taxation purposes and asked the Board of Taxation to consult over its wording.

The Bill does modernise the definition of charity in a number of positive ways, by:

- clarifying the list of charitable purposes to include "advancement of social or community welfare" and of the "natural environment";
- acknowledging that child care services are charitable;
- acknowledging that self help organisations may be charitable, provided they are open and non-discriminatory in their membership.

### Advocacy by charities

However, the Bill seeks to impose outdated and counter-productive restrictions on the advocacy and lobbying activities of charities.

Clause 8 of the draft Bill would exclude from charitable status organisations that have among their purposes:

- "changing the law or Government policy", or
- "advocating a cause";

unless these purposes are no more than "ancillary or incidental" to the other purposes of the organisation.

This ambiguous and confusing formulation is a shaky foundation for 21st century charity law in Australia. "Ancillary or incidental" could be interpreted in at least two different ways.

On a liberal interpretation, this is consistent with the *Charity Definition Inquiry's* recommendation that the advocacy work of charities should not be restricted, provided that it:

- furthers or aids the organisation's dominant charitable purpose;
- does not promote a political party or candidate for political office.

If this is the correct interpretation, Clause 8 is unnecessary (except to restrict *partisan* political advocacy) because Clause 4 of the draft Bill already states that a charity should not "*engage in activities that do not further or are not in aid of its dominant purpose*". There is no need to single out "non-partisan" advocacy for special treatment because *all* the activities of a charity should further or aid a charitable purpose. This was the Inquiry's argument regarding advocacy by charities.

However, a narrow interpretation of Clause 8 would suggest that charities should restrict the *resources* they devote to advocacy (as is the case in the United States and Canada), or that charities should be regulated in terms of the *kind* of advocacy they perform (as in England).

At the very least, this would require intrusive and time-consuming regulation of the advocacy work of charities, and the resources devoted to it. Charities, could, for example, be required to catalogue their advocacy activity and its cost, in case their advocacy activities are audited by the Australian Taxation Office.

At worst, a significant number of charities could lose their charitable status. Whether or not the draft Bill "codifies" existing common law on advocacy by charities as the Government states; the reality on the ground is that the Australian Taxation Office (ATO) has not up until now attempted to regulate these activities in any systematic way. This would change if it interpreted the provisions of Clause 8 narrowly.

A better approach, that is less intrusive and burdensome for charities, is to recognise that charities may engage in non-partisan advocacy that is an integral part of a strategy to promote an underlying dominant charitable purpose, such as relieving poverty or protecting the environment. As outlined above, this is the same basic test that applies to the other purposes and activities of charities.[1]

Given the potential for confusion over the legal status of advocacy by charities, and the need to limit *partisan* political activities, it is best to clarify these issues in the Bill rather than simply relying on the general rules in Clause 4.[2] To clarify and resolve this matter, we strongly recommend that Clause 8 of the draft Bill be re-drafted consistent with the recommendations of the Charity Definitions Inquiry (see *Recommendation 1* below).

If this crucial change is made, ACOSS broadly supports the Bill's basic thrust.

## Other proposed changes to the draft Bill

A number of other recommendations are suggested below to improve the draft legislation:

- to indicate that the dominant purpose of a charity should be altruistic;
- to further clarify the meaning of "Government body", to ensure that public funding of an organisation pursuant to a Government program does not imply that it is a Government body;
- to delete references in the draft Bill to *unlawful activities or conduct*, since this is relevant to the administration of other legislation (such as the criminal law), not the definition of charity;[3]
- to make it clear that the "advancement of social and community welfare" includes assisting people who are disadvantaged in terms of their access to housing;
- to maintain the common-law meaning of the phrase "*other purposes beneficial to the community*", while at the same time leaving scope for its meaning to adapt to changes in social conditions.

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[1] Under this approach, the ATO and the courts would still need to develop a set of legal tests to distinguish between organisations that are charitable and those whose political purposes "overwhelm" their charitable purpose(s). However, this approach is more workable, and more consistent with the intent and purpose of charity law, than any attempt to restrict the *kind* of non-partisan advocacy activities in which charities can engage (as in England), or to arbitrarily limit the *amount* of resources devoted to it (as in the US and Canada). An examination of the objects and activities of a charity based on our preferred approach would go directly to the heart of the matter.

[2] The use of the terms "ancillary or incidental" is appropriate to circumscribe "partisan" public advocacy, but not to limit public advocacy generally.

[3] Further, since paragraph 4 (1) (e) refers to *conduct* rather than *purposes*, one implication is that a charity could lose its status permanently due to an adverse decision or action by a board or executive at any point in time. Note that Clause 8 (1) prohibits charities from having a *purpose* of engaging in unlawful activities. At the least, this should be more clearly expressed to refer to unlawful *purposes* rather than *activities*.

## A second round of charity law reform

We do not believe that it is practicable to modernise the definition of charity for taxation purposes without also adjusting that of *Public Benevolent Institutions*. Indeed, this category is in greater need of modernisation than that of charity. The Charity Definitions Inquiry recognised this.[4]

Public Benevolent Institution status is very closely related to that of charity, both in the public mind and in administrative practice. Indeed, most charities and members of the public confuse the two categories.

Public Benevolent Institution (PBI) status was legislated in Australia early in the 20th Century to restrict certain tax advantages to those charities that assisted the most disadvantaged people in society, such as poor people, sick people, and people with disabilities. ACOSS supports this intention, and considers that benefits such as gift deductability and Fringe Benefits Tax exemptions should be restricted to charities of this kind. However, confusion has since emerged between charitable and PBI status, and the courts have unnecessarily restricted PBI status to organisations providing aid *directly* to disadvantaged people.

The Charity Definitions Inquiry proposed a simple, workable solution to these problems. It proposed that the Public Benevolent Institution category be replaced by a new class of *Benevolent Charity*, being a charity whose dominant purpose is to benefit, directly or indirectly, those whose disadvantage prevents them from meeting their needs.

We urge the Board to recommend that the Government modernise the legislative definition of Public Benevolent Institution. This should be the centrepiece of a second round of legislative reform in regard to charities.

The other key element of this second round of reform should be the establishment of a *Charity Commission*, as also recommended by the Inquiry. Access to charitable status is currently regulated by the ATO. This is inappropriate, since the ATO has limited expertise in the regulation of charities and this role in likely to conflict with its public revenue raising function. For these reasons, in its submission to the Inquiry, the ATO itself recommended the establishment of a separate body to regulate access to charitable status at the Federal Government level.

We propose that a Federal Charity Commission be established to act as the "gate-keeper" of charitable and public benevolent status for the purposes of Federal Government legislation (especially tax law). If such a body is established, it should work cooperatively with the State Government agencies charged with regulating charities. In particular, it should encourage all levels of Government to adopt identical definitions of charitable status and administrative guidelines to implement them.

If this is not supported, another (though less effective) option would be to establish by statute an expert advisory body to assist the ATO to carry out these functions. That body should be separate and autonomous from the ATO, and should be capable of conducting its own inquiries and consultations into relevant trends in the charitable sector and their implications for the taxation status of charities and public benevolent institutions.

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[4] The Government also recognised this in establishing the Inquiry, the full title of which was the "Definition of Charities *and Related Organisations*."

# Recommendations

Our recommendations with regard to the draft Charity Bill are as follows.

### Clause 8: Disqualifying purposes

**Recommendation 1:**

Clause 8 of the Draft Bill should be replaced by a provision along the following lines:

"*A Charity may have public advocacy purposes (which could be described in the explanatory material as including "attempts to change the law or government policy"), provided those purposes:*

*(1) further, or aid, or are ancillary or incidental to, its dominant charitable purpose or purposes; and*

*(2) do not promote a political party or a candidate for political office, unless such purposes are ancillary or incidental to its dominant charitable purpose or purposes.*"

### Clause 4: Core definition

**Recommendation 2:**

Clause 4 of the Draft Bill should be amended as follows:

(1) to indicate that the dominant purpose of a charity should be altruistic;

(2) to express paragraph 4 (1) (c) in the positive rather than the negative. For example using words along these lines:
"*whose activities further, or are in aid of, its dominant purpose*"

(3) to delete paragraph 4 (1) (e) which refers to *unlawful conduct*, since this is relevant to the administration of other legislation (such as the criminal law), rather than the definition of charity;

(4) to clarify the meaning of "Government body" to make it clear that the fact that a body receives public funding, and/or is established under the aegis of a program of public funding, does not imply that it is a Government body

(5) to make it clear that a charity may have more than one dominant charitable purpose (as outlined later on in Clause 6).

### Clause 10: Charitable purposes

**Recommendation 3:**

The Explanatory Material should make clear that the "advancement of social and community welfare" in Clause 10 includes:

"*the provision of housing and accommodation support for people with special needs or who are otherwise disadvantaged in terms of their access to housing*."

**Recommendation 4:**

Consideration should be given to amending Clause 10 to add the word "*similar*" to the phrase "*other purposes beneficial to the community*", while retaining the proposed examples of such purposes in the Explanatory Material.[5] The intention would be to keep this "head" of charity broadly consistent within its present common-law meaning and that of the other "heads".

## A second round of charity reform

We also urge the Board to recommend that the Government institute a *second round* of charity reform along the following lines.

**Recommendation 5:**

We urge the Board to recommend that the Government institute a second round of legislative and administrative reform in regard to charities, consistent with the recommendations of the Charity Definitions Inquiry. This should include:

- legislative modernisation of the definition of *Public Benevolent Institution;* and
- the establishment of a *Charity Commission* as the "gate-keeper" of charitable status for federal legislative purposes, or

  if the ATO continues to carry out that function, the establishment of an autonomous statutory advisory body drawn from representative bodies within the charitable sector, service consumers, and independent experts, to formally advise the ATO on the development and administration of Tax Rulings and guidelines regarding charitable status, relevant trends in the charitable sector, and relationships between the ATO and the sector.

[5] These include "*the promotion and protection of civil and human rights*" and "*the promotion of reconciliation, mutual respect, and tolerance between various groups of people within Australia*".

# 1. The public advocacy role of charities

The proposed Bill is broadly consistent with the Charity Definition Inquiry's recommendations to modernise and clarify the definition of charity for Federal Government purposes.

With one major exception, the Bill provides a workable framework for the Australian Taxation Office, charities, and the courts to identify which organisation are charities for taxation and other purposes.

Given the lack of a substantive recent body of relevant case law, this legislation is necessary to bring the common law up to date and resolve a number of ambiguities in charity law. The Bill strikes a sensible balance between moving the law forward, and leaving scope for the courts to adapt to future trends in the development of the charitable sector.

The major exception is Clause 8 of the Draft Bill, which seeks to limit the scope of *public advocacy* by charities.

Thousands of charities regularly engage in public advocacy and lobbying to further charitable purposes such as relieving poverty, protecting the environment, and improving health or education. This activity includes lobbying Governments and other political parties, researching issues of concern in these areas and developing public policy proposals, and raising these issues in debate in the mass media.

These organisations include direct service providers to the public (such as housing for homeless people); and organisations such as peak bodies that support and represent the concerns of service providers or disadvantaged people as a group. Over many decades, a wide range of such groups have been granted charitable status.

## The public advocacy role of charities

Charities have always engaged in public advocacy to influence Government policies, in order to improve the circumstances of those they are charged with supporting.

Given the resources and authority of Governments, public advocacy can often lead to greater improvements in the lives of poor people, sick people, and others assisted by charities, than direct help.

For example, effective lobbying over poverty among older Australians in the 1970s led to Government commitments to increase pensions to 25% of average earnings - a commitment legislated by the present Government. Poverty research has since demonstrated the effectiveness of this policy in improving the living standards of older people. It is inconceivable that charities acting directly to relieve poverty would have the resources to improve the living standards of older people on this scale.

Recently, a number of charities including ACOSS, the Salvation Army, Mission Australia, Brotherhood of St Laurence, St Vincent de Paul, and the Welfare Rights Network lobbied the Government over the large number of "breach penalties" imposed on unemployed people (390,000 in 2000-01) for alleged failure to meet Newstart Allowance requirements. This led to an upsurge in demand for emergency relief and other services run by these charities. As the peak body in the community welfare sector, ACOSS coordinated this lobbying effort. The outcome of this lobbying was that the Government changed the rules to reduce the severity of penalties, and the number of breaches imposed is significantly lower.

In order to make a consistent impact on public policy in today's political environment, an organisation must have a strong professional reputation as a policy expert and advocate. Governments recognise the value of input from charities to public policy, and often fund community organisations - especially peak and consumer bodies - to carry out this work.

On the other hand, Governments often seek to regulate and restrict the activity of community organisations receiving public funding - especially direct service providers- to achieve "value for money". This narrow "managerial" approach is counter-productive. It means that many community organisations are forced to concentrate their efforts on the *effects* of personal or family crisis rather than prevention; or on assisting individuals rather than improving the capacity of communities. Consistent with this narrow approach, some funding contracts include prohibitions on public advocacy or dealing with the media.

*Some commentators now argue that the very qualities of professionalism in policy and advocacy work that make charities more effective in influencing public policy should disqualify them from charitable status. This would weaken policy development, since in a pluralist society such as Australia, good policy is not developed by Parliaments or bureaucracies "in a vacuum".*

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## The public advocacy role of charities (continued)

There are three "models" of organisation by which charities engage in public advocacy.

*Service based advocacy* is public advocacy that is part and parcel of the direct service delivery role of a charity. By combining "justice and care", direct service providers bring to the policy process their valuable "on the ground" experience. Larger direct service providers often have social policy divisions to coordinate this work.

However, there are limits to the extent to which direct service providers can be effective advocates for improvements in public policy.

- They may not have the resources or expertise to do so.
- There may be real or perceived conflicts between their interests as service providers and those of their clients.
- Their advocacy role may be restricted by Government funding contracts.

*Advocacy by peak bodies* has evolved for these and other reasons. Peak bodies such as ACOSS represent the interests of service providers and their clients to Government.[6] Peak bodies are an efficient way to distil the practice knowledge of direct service providers, and combine it with professional policy development and advocacy. They also enable the charitable sector to speak out on important social policy issues, where individual direct service providers may be restricted from doing so.

*Consumer organisations* also have an important advocacy role. These are established to directly represent the interests of consumers of community services, especially disadvantaged people who lack a strong voice as individuals. Many of these organisations also function as self help organisations within the meaning of the draft Charities Bill, and would therefore be recognised as charities.

If the restrictions on advocacy by charities in Clause 8 of the proposed Bill are narrowly interpreted, this would particularly affect the advocacy role of peak bodies and consumer organisations, because these bodies are more likely to *specialise* in policy development and advocacy work on behalf of their constituencies. The result would be a reduction in the efficiency and effectiveness of advocacy by charities. This would, in turn, reduce the effectiveness of public policy in addressing such problems as poverty, unemployment, illness and disability.

[6] ACOSS has had *charitable* status for many years, although it lost its *Public Benevolent Institution* status in 1985, on the grounds that it does not provide direct services to the low-income people on behalf of whom it advocates.

## 2.1 Codifying existing law?

The stated intention of the advocacy provisions in Clause 8 of the Draft Bill is to "codify existing law". Whether or not the proposed clause achieves that end, the status quo in regard to the treatment of the advocacy role of charities could change markedly. The reason for this is that, in the past, the Australian Taxation Office (ATO) has not attempted in a systematic way to regulate the advocacy activities of charities. If the Bill is passed, this could change. If legislated in its present form, the Bill could lead to:

- cancellation of the charitable status of organisations that are substantially involved in advocacy or lobbying work;

- intrusive auditing of the advocacy activities of all charities by the ATO, for example to measure what proportion of their time or funds they devote to advocacy.

Unfortunately, the existing law in this area is out-dated and ambiguous. There has been little case law in this field over the past 30 years, despite major changes in the charitable sector and wider society. Most of the major authorities are judgements by English courts.[7]

Any attempt to codify it along the lines of the proposed Clause 8 will be subject to conflicting interpretations.

The general approach to the activities of charities in the draft Bill is sound. Clause 4[8] specifies that the activities of charities (including advocacy) should not be pursued in their own right. Rather, they should *further or aid the dominant charitable purpose(s) of the organisation*. This means, for example, that advocacy should be an integral part of a charity's strategy to relieve poverty or protect the environment, not an exercise designed to achieve political power or influence in its own right.

The only problem with this formulation is that it is expressed as a double-negative, that a charity should:

"*not engage in activities that do not further , or are not in aid of, its dominant purpose.*

The *Charity Definitions Inquiry* recognised this as the primary test of whether an organisation engaging in advocacy purposes can be a charity. It argued that, apart from restricting *partisan* political purposes, there was no need to single out advocacy for special legislative treatment.

However, the Draft Bill goes one step further. In Clause 8, it singles out advocacy as a *disqualifying purpose* where it is more than *ancillary or incidental* to the dominant charitable purpose(s) of an organisation. This is a clear departure from the Inquiry's recommendations (see box below).

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[7] A recent decision of the Victorian Civil and Administrative Tribunal raises this problem. It concludes that:

*It is clear that the ACF should prima facie be regarded as charitable and it would in my view be other-worldly if the ACF were to lose that status because of the misgivings expressed by jurists (as it happens, Law Lords) in another context, in another hemisphere, and in another millenium*. See Victorian Civil and Administrative Tribunal, Australian Conservation Foundation and Commissioner of State Revenue No 2002/T34..

[8] At paragraph (1) (c).

**Chalk and cheese: proposals on the public advocacy role of charities**

**Charity Definitions Inquiry**

*The Committee recommends that a distinction be drawn between purposes that advance a political party or a candidate for political office, which will deny charitable status, and non party-political purposes, that will not affect charitable status provided they further, or are in aid of, the charity's dominant charitable purpose.*[9]

**Clause 8 of the draft Charities Bill**

*(2) Any of these purposes is a disqualifying purpose:*

*(a) the purpose of advocating a political party or cause;*

*(b) the purpose of supporting a candidate for political office;*

*(c) the purpose of attempting to change the law or Government policy";*

*if it is, either on its own or when taken together with one or both of the other of these purposes, more than ancillary or incidental to the other purposes of the entity concerned.*

The words *ancillary* and *incidental* have been used in a number of court judgements in regard to the advocacy role of charities. However, they offer very little guidance to the ATO and the courts, because they can be interpreted in at least two different ways:

1. as a re-statement of the above principle that any advocacy purposes should further or aid the dominant charitable purpose(s);[10]

2. as a more restrictive requirement, that advocacy should form only a minor part (or at least not the substantial part) of the organisation's purposes or activities.[11]

If the Bill is passed, much would depend on the Tax Rulings and guidelines drafted by the ATO to give effect to the proposed restrictions on advocacy. As we illustrate below, overseas experience suggests that this formulation could be interpreted in dramatically different ways. Clause 8 is bad law because it implies that the ATO and the courts should restrict the advocacy role of charities, but offers them little or no guidance on how this should be done, or why it should done.

[9] Report of the Charity Definitions Inquiry (2001), page 209.

[10] See, for example, Victorian Civil and Administrative Tribunal No 2002/T34, *Australian Conservation Foundation Vs Commissioner for State Revenue*, October 2002.

[11] See, for example, McGovern Vs Attorney General [1982] Ch 321.

## 2.2 The workability of the proposed treatment of advocacy by charities

If the second, narrow interpretation of Clause 8 described above is adopted by the ATO or the courts, the Bill would not be workable as a guide to determining the scope of legitimate advocacy role of charities. Clause 8 would hamper, rather than assist, the ATOs "gate-keeping" role in determining which organisations are charities for taxation purposes. This could also have serious adverse effects on many charities.

If passed in their present form and narrowly interpreted, the proposed restrictions on public advocacy would:

- generate controversy and litigation;
- lead to unfairness, as organisations with similar purposes are treated differently;
- lead to confusion and apprehension among charities as to how "far" they can engage in advocacy without losing charitable status;
- significantly increase both administrative burdens and compliance costs;
- reduce the effectiveness of many charities in fulfilling their charitable purposes.

There are three basic flaws in Clause 8 of the Draft Bill:

1. Advocacy purposes are introduced into the Bill in a negative way, as *disqualifying purposes.* This in itself would needlessly cause apprehension among charities about whether they might "overstep the line" in performing their advocacy role.

2. Advocacy purposes generally (as distinct from party-political advocacy), are unnecessarily singled out for special treatment and regulation. A more workable solution is to apply the same general principles (as described above) to advocacy as to other purposes and activities. This singling out of advocacy creates a need to define "advocacy", as well as drawing a boundary between "acceptable" and "unacceptable" advocacy. It is not practicable to draw these distinctions in a simple, fair, and consistent way, as the English experience shows.

3. Advocacy purposes are limited by the requirement that they be no more than *ancillary or incidental.* As argued above, this formulation is ambiguous, and could be needlessly restrictive. Of particular concern, it could form the legal basis for administrative rules that set arbitrary limits on the extent of advocacy activity, as is the case in the United States and Canada.

These three flaws are outlined in more detail in the following three sections 2.3 to 2.5 of the submission. We then advance proposals to rectify these problems in section 2.6.

## 2.3 Advocacy as a disqualifying purpose

The Bill should clarify the status of advocacy purposes, such as attempting to change the law or Government policy or advocating a cause. If it is silent on this issue, the present ambiguity in the common law status of advocacy by charities would remain.[12]

However, advocacy is introduced into the Bill in a negative way, as a *disqualifying purpose*. This is counter-productive and unnecessary. This sends a signal to charities that advocacy purposes or activities should be avoided or kept to a minimum, in case they disqualify them from charitable status.

Yet, as argued above, advocacy is an effective means to achieve charitable purposes.

It would be better for the Bill to outline the circumstances where charities *can* engage in advocacy rather than focus on the circumstances in which they *cannot*. Formulating Clause 8 in this way would not of itself change its underlying meaning, but it would affect the way in which it is *understood* by most charities.

## 2.4 Defining and regulating advocacy - the English approach

The draft Bill presents two hurdles for charities seeking to engage in public advocacy.

*First*, paragraph 4(1)(c) of the Core Definition requires that the activities of a charity, including advocacy activities, should further or aid its dominant charitable purpose(s). This is the formulation proposed by the Charity Definitions Inquiry.

This provision does not require the ATO or the courts to *define* advocacy by charities in order to restrict it, since it does not single out advocacy from the other activities of a charity.

*Second*, the advocacy purposes of charities must also fit within the confines of Clause 8, which specifically requires that advocacy purposes should no more than *incidental or ancillary* to the other purposes of the organisation.

This requires a clear definition of public advocacy.[13] On a narrow interpretation of *ancillary or incidental*, it also requires a line to be drawn between "acceptable" and "unacceptable" advocacy. In order to define advocacy generally, the following distinctions must be drawn:

- between direct lobbying and indirect attempts to influence Governments, such as media activity or grassroots campaigning; [14]
- between propaganda and community educational purposes;[15]
- between research and policy development aimed at changing the law or policy and that which supports or enhances it;[16]

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[12] This does not necessarily mean that advocacy must be defined in detail. This is unnecessary, since (as we argue below), non-partisan advocacy activities should not be treated differently from the other activities of charities. However, it is important to signal this legislative intention for charities, the ATO and the courts.

[13] That is, in the terms of Clause 8, of "*attempting to change the law or public policy*" and of a "*cause*".

[14] In the US, a distinction is drawn between "direct lobbying" and "grassroots lobbying", each of which requires detailed definition.

[15] Numerous court judgements have attempted to draw this difficult distinction. See Santow, J (1999)., *Charity in its political voice.*1999 *Australian Bar Review* at 225.

- between advocacy that is consistent with the current policy consensus and that which runs against it (noting that today's controversy is tomorrow's public consensus);[17]

- between advocacy that is part of an established process of collaboration between a charity and Governments to improve policy and that which is initiated by the charity to change the law;[18]

- between charities negotiating the terms and conditions of their Government funding and lobbying for innovation and change in community funding programs runs by Governments.

These examples are not speculative. The Internal Revenue Service and the courts in the United States have devoted many pages of judgements and guidelines to issues such as these. For example, a paper on the IRS website that purports to explain the principles used to determine the limits of acceptable advocacy activity by charities devotes 100 pages to fine distinctions such as these.[19]

Once advocacy is defined, Clause 8 *may* require the ATO and the courts to draw a line between "acceptable" and "unacceptable" advocacy. The Charity Commission of England and Wales attempts to draw this line by distinguishing between "reasoned advocacy" and political activity that is not firmly grounded in reasoned argument.

According to its guidelines on *Political activity and campaigning by charities*, "acceptable" advocacy includes[20]:

- *seeking to influence Government or public opinion through well-founded, reasoned argument based on research or direct experience of issues;*

- *providing supporters, or members of the public with material to send to Members of Parliament or the Government, provided the material amounts to well reasoned argument;*

- *organising petitions;*

- *responding to proposed changes in Government policy.*

"Unacceptable" advocacy includes:

- *basing arguments for policy change on a distorted selection of data in support of a pre-conceived position;*

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[16] For example, should the publication of research into poverty that identifies the main groups affected with a view to informing social policy, be regarded as "advocacy"?

[17] For example, the charitable status of organisations to improve race relations is less controversial than in the recent past. See Santow J (1999) op cit, for a discussion that illustrates the complexities involved in drawing this distinction. It implies that charities should never "get ahead of" public policy or legislation, which would have the effect of stifling public debate on important issues such as how to reduce poverty or protect the environment. Indeed, some argue that such restrictions against charities are inconsistent with free speech (see Chesterman M 1999, *Foundations of charity law in the new welfare state*. Modern Law Review 62:3.

[18] For example, should advocacy by a charity be "allowed" where it responds to a request from a Parliamentary Inquiry or Minister, but not allowed when precisely the same issues are raised at the initiative of the charity? In the US, a distinction is drawn between "lobbying" and "non-partisan analysis". This is another line that is very difficult to draw in practice.

[19] Kindell & Reilly, *Lobbying issues* at www.irs.gov/charities

[20] Charity Commission of England and Wales (1999), *Political activity and campaigning by charities.*

- *claiming public support for its position without adequate justification;*
- *influencing Government on the basis of material which is merely emotive;*
- *inviting its supporters to take action such as writing to their Members of Parliament, without providing them sufficient information to advance a reasoned argument;*
- *participating in a public demonstration that is not well controlled and peaceful.*

One problem with this approach is its intrusive and paternalistic character. It requires the administering body (the Charity Commission) to oversight the political activity of charities, to ensure that they do not overstep the mark by engaging in "unacceptable" activity. These judgements would be highly discretionary and open to challenge.

The fundamental problem with this approach is that it misses the point. What really matters *for definitional purposes* is not *how* charities engage in advocacy, rather whether advocacy is part and parcel of addressing an underlying charitable *purpose*. For example, reasoned argument is a powerful means of achieving political change, if used to good effect. If (on a narrow interpretation) the intention of the law is to keep charities "distant" from the political process, allowing them to lobby using reasoned argument does not achieve that end.

Of course, the way in which advocacy is conducted does matter from the standpoint of public reputation and policy impact, but that is another matter. In these guidelines, the Charity Commission appears to have confused its "gate-keeping" role in defining charity from its broader regulatory role (akin to that of State Government authorities in Australia).

This problem has been recognised by a recently completed review of charity law in Britain. One of the report's recommendations, which has been accepted by the Government, reads as follows:

"*That the Charity Commission guidelines on campaigning should be revised so that the tone is less cautionary and puts greater emphasis on the campaigning and other non party-political activities that charities* ***can*** *undertake. The legal position should continue to be that charities can campaign providing that:*

- *a charity's activities are a means to fulfilling its charitable purpose;*
- *there is a reasonable expectation that the activities will further the purposes of the charity and benefit its beneficiaries, to an extent justified by the resources devoted to those activities;*
- *its activities are based on reasoned argument; and*
- *its activities are not illegal.*

*The Charity Commission should distinguish between this position, which is a statement of legal and regulatory requirements, and good practice, but in doing so should emphasise that trustees have the freedom to pursue whatever activities they judge to be in the best interests of the charity.*" [21]

[21] Home Office (2003), *Charities and not for profits - a modern legal framework*. It is noteworthy that the review also recommends the categorisation of charitable purposes in legislation, as proposed by the Charity Definitions Inquiry here and incorporated in the Draft Charity Bill. The proposed categories are slightly more complex than those proposed in Australia.

This is a more workable rule that the Charity Commission Guidelines referred to above, although the references to "reasoned argument" and "illegal" activity still have more to do with "good practice" than determining whether an organisation is a charity.

Its is fair to say that in England, there has been a steady liberalisation over the past two decades of the rules restricting the advocacy role of charities. This has been led by the Charity Commission in response to trends in the charitable sector and broader society. There is still a paternalistic tone in the Charity Commission rules, but this may change as a result of the current review.

This stands in contrast with earlier court judgements that regarded charitable purposes and purposes to change the law or public policy as incompatible. A good example of this restrictive view was a judgement in the 1980s that a trust established by Amnesty International to support action to prevent the torture and maltreatment of political prisoners overseas was not charitable. The reasoning behind this judgement was that "charitable" and "political" purposes were incompatible, so an organisation whose main purpose was "political" could not be a charity. [22]

The main problem with the English approach to gradual administrative reform in this area is that, in the absence of a change in legislation, the uncertainty generated by previous court judgements still hangs over charities engaged in advocacy.

If the first two dot points of the above recommendation of the British review of charity law were incorporated into legislation, it would help ease that uncertainty. In that event, non partisan advocacy would no longer be singled out for special attention. The same basic principle would apply to advocacy purposes and activities as to any other purpose or activity of a charity: that it must further or aid the dominant charitable purpose(s). This is similar to the formulation in the Charity Definition Inquiry report.

## 2.5 Ancillary or incidental - the US/Canadian approach

We argued above that the words *ancillary or incidental* could either be interpreted broadly or narrowly. If a broad interpretation is adopted - that these words mean to *further or aid* the dominant charitable purpose(s) - this is similar to the formulation proposed by the Charity Definitions Inquiry.

However, the ATO or the courts might adopt a narrow interpretation - that these words imply that advocacy purposes should only form a *minor* part, or at least not the substantial part, of a charity's purposes or activities.

This opens up the possibility that an arbitrary formula might be used to restrict the advocacy activities of charities. This is approach adopted in the United States and Canada.

The Canadian administrative rules regarding the political activity of charities illustrate how the words "ancillary and incidental" might be interpreted in this narrow way: [23]

*"In the context of charity law, an "ancillary and incidental" activity is one that is naturally connected with and subservient to a charitable purpose or charitable activity, or something that exists only in conjunction with a charitable purpose or activity. An activity that is given such prominence that it is no longer subservient or incidental to a charitable purpose ...is not "ancillary and incidental" but has*

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[22] McGovern V Attorney General [1982] Ch 321.

[23] Revenue Canada, *Ancillary/incidental political activities of charities*. www.ccra-adre.gc.ca/tax/charities.

*itself become a purpose. Political activities do not have to be infrequent and can be deliberate, purposeful and sustained. However, there is a **quantitative limitation** (emphasis added) inherent in "ancillary and incidental" activities the parameters of which are set by two tests described in paragraphs 13 to 15 of this circular."*

This paragraph illustrates that the terms "ancillary and incidental" can be read in two ways. It begins by arguing that "political activity" must serve a charitable purpose, then takes a logical leap towards the need for a "quantitative limitation" on such activity. There is a danger that the ATO or the courts might also take this step in Australia.

The United States adopts a similar approach. Charities there can engage in lobbying provided they devote no more than a fixed proportion of their annual budget to such activity, usually 10%. On the surface, this may seem like a neat compromise between allowing charities to engage in advocacy as they see fit and regulating these activities in detail. Charities are free to engage in lobbying up to a certain point, beyond which they pay more tax. In practice, the rules are anything but simple.

The US rules involve the following logical steps:

1. As outlined above, "lobbying activity" is defined. In fact, there is a series of definitions of lobbying, including "non-partisan analysis" (which is not subject to restrictions), and "direct lobbying" and "grassroots lobbying" which are restricted.[24]

2. Charities must divide their budgets into expenditures devoted to lobbying activity and other expenditures, listing these activities in detail in case of audit by the Internal Revenue Service (IRS).

3. A series of elaborate formulae apply to determine the proportion of the annual budget that can be devoted to lobbying without a (tax) penalty.[25]

4. Special rules apply to member communications, mass media activity, and non-partisan analysis.

5. Special rules apply to organisations that are part of "affiliated groups" engaged jointly in lobbying.

As noted above, a paper listed on the IRS website that purports to explain to charities how these rules work runs to 100 pages.[26]

The Canadian rules appear to be simpler. However, at least the first three steps above are followed. There are at least three different classifications of political activity, and two separate formulae applied to calculate whether expenditure on certain political activity falls within allowable limits.[27]

The attempt to impose arbitrary restrictions on the extent to which charities can use their resources for advocacy purposes in the US and Canada has generated elaborate rules of extraordinary complexity, and high compliance costs for charities.

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[24] There are also definitions for "calls to action", "advocacy communications", "highly publicised", "member communications", and "De minimus in-house lobbying".

[25] These include the "ratio method", the "gross-up method" and the "IRC 263A method".

[26] Kindell & Reilly, op cit.. www.irs.gov/charities.

[27] Essentially, no more than 10% of last year's donations, and no more than 10% of the overall "resources" of the organisation, which - oddly enough - includes both financial resources and physical assets (such as buildings).

Yet once again, these rules miss the main point. The fundamental issue should be not *how much* advocacy a charity engages in, but whether or not advocacy furthers or aids the organisation's dominant charitable purpose.

## 2.6 Proposed approach

The overseas examples cited above demonstrate that the common law requirements for the regulation of advocacy by charities can be interpreted and administered in dramatically different ways. This includes the meaning of the words "*ancillary*" and "*incidental*". They also demonstrate that attempts to single out, define, restrict and regulate advocacy activities are counter-productive and ultimately unworkable. Moreover, these regulatory regimes fail to address the core issue, which is whether advocacy furthers or aids a dominant charitable purpose.[28]

It is interesting to note that attempts to restrict the advocacy role of charities in these ways are largely confined to the English language, common law countries. The shadow of the 500 year-old Elizabethan charitable purposes law looms large over charities in these countries. In most other countries, advocacy by charities is not considered to be an important issue.[29]

A better approach, that is less intrusive and burdensome for charities, is to allow charities to engage in non-partisan advocacy that is an integral part of a strategy to promote an underlying dominant charitable purpose, such as relieving poverty or protecting the environment. This is the same basic test that would apply under the draft Bill to the other purposes and activities of charities: that they should *further or aid the dominant charitable purpose(s)* of the organisation.[30]

Using this approach, the ATO and the courts would still need to develop a set of tests to distinguish between organisations that are charitable and those whose political purposes "overwhelm" their charitable purpose(s). However, this approach is more workable, and consistent with the intent and purpose of charity law, than any attempt to restrict the *kind* of non-partisan advocacy in which charities can engage (as in England), or to arbitrarily limit the *amount* of resources devoted to it (as in the US and Canada).

An examination of the objects and activities of a charity based on our preferred approach would go directly to the heart of the matter. It would not require the ATO or the courts to define "advocacy". It need not impose heavy compliance burdens on charities, since it would be clear in the vast majority of cases whether an organisation meets the above requirement. It would offer reasonable guidance to the courts.

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[28] The British regime may come close to meeting this requirement, but this is the outcome of incremental administrative reform that could be overturned by an adverse court judgement.

[29] Randon & Perri, *Constraining campaigning - the legal treatment of non-profit policy advocacy across 24 countries.* in Voluntas 5:1, at p27.

[30] It is also appropriate to allow a charity to engage in advocacy that does not directly further or aid its dominant charitable purpose, where such advocacy is ancillary or incidental to those purposes in the narrow sense - that is, where it forms a minor part of the organisation's purposes that is subordinate to the dominant purpose. This formulation was also proposed by the Charity Definitions Inquiry.

The exception to this would be *partisan* advocacy purposes.[31] It would be appropriate to limit these purposes to those that are *incidental* or *ancillary* to a charity's dominant charitable purpose(s), to prevent charities from "overstepping the line" and surrendering their independence from the political process.[32] In a pluralist democracy such as Australia, charities are inevitably part of the political process.[33] The difference between a charity and a political party or movement is that a charity pursues advocacy for charitable purposes, not with a view to advancing the political fortunes of any party or candidate. In this sense, charities remain at arms-length from partisan politics while participating in the broader policy process. *Partisan advocacy* is narrower and easier to define than advocacy generally.

This approach is more in keeping with the role of charities in contemporary Australia. It recognises the fact that social policy is not developed in a vacuum by Governments or Government Departments, and that the input of charities as experts and commentators is critical. Attempts to regulate the advocacy activities of charities would not be workable in this environment. They would also diminish the effectiveness of charities - and of public policy - in addressing important issues such as poverty and the protection of the environment.

This is essentially the approach advocated by the Charity Definitions Inquiry. If this approach is favoured, it should be spelt out in legislation. Otherwise the ambiguities of existing common law will remain. The status of the advocacy activities and purposes of charities will remain uncertain.

We propose that a provision along the following lines replace the proposed Clause 8 of the Charity Bill.

**Recommendation 1:**

**Clause 8 of the Draft Bill should be replaced by a provision along the following lines:**

***A Charity may have public advocacy purposes (which could be described in the explanatory material as including "attempts to change the law or government policy"), provided those purposes:***

***(1) further, or aid, or are ancillary or incidental to, its dominant charitable purpose or purposes; and***

***(2) do not promote a political party or a candidate for political office, unless such purposes are ancillary or incidental to its dominant charitable purpose or purposes.***

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[31] To use the Charity Definitions Inquiry's more precise terminology: "*the purpose of promoting a political party or supporting a candidate for political office*".

[32] An example where a charity might promote a political party "incidentally" in pursuing its charitable purposes is where it objectively compares the policies of the parties from the standpoint of its charitable purpose (eg the promotion of health). If the organisation publishes its findings, and one party's policies appear to be more beneficial than others in promoting health, one outcome of the exercise might be that that party is "promoted". However, if this was not the intention of the exercise, and it was carried out in an unbiased fashion, this "political" outcome could be said to be "incidental" to the charitable purpose of the organisation.

[33] They are necessarily involved in two ways - through direct lobbying and by influencing public opinion on contemporary policy issues such as poverty and discrimination against disadvantaged groups. However, their involvement in public debate is properly directed towards influencing public policy, not voting trends.

# 2. The core definition

Clause 4 of the draft Bill provides a "core definition" of charity.

ACOSS broadly supports the core definition as a clear and workable formulation. We welcome the special provisions for open and non-discriminatory self-help groups.

We support the proposition that the public benefit test should specify that charities should be altruistic. The Charity Definitions Inquiry defined altruism as "unselfish concern for the welfare of others". This is, in our view, an essential distinguishing feature of charity, as understood by most charities themselves and the general community. It is important to distinguish between altruistic organisations, and organisations that improve health, education or welfare (on the face of it, all charitable purposes) in the direct interest of the individuals that control the organisation (for example, friendly societies).

This change should be drafted so that not adversely affect self-help organisations of the kind referred to in Paragraph (2)(a) of Clause 4 and the explanatory material.

It may lead to the denial of charitable status to organisations that provide health, education or welfare services to an "exclusive" group, such as people on high incomes. This would, in our view, be consistent with the underlying purpose and meaning of charitable status.[34] If it is considered desirable to offer concessional tax status to such organisations, this could be achieved outside charitable status.[35]

We also recommend four changes to this clause to clarify its intent and improve its workability.

*First*, paragraph 4(1)(c) of the draft Bill, regarding the activities of charities, should be expressed positively rather than as a double-negative.

*Second*, paragraph 4 (1) (e), which deals with "conduct that constitutes a serious offence" should be deleted. The reason for this is that such a restriction has no place in legislation to *define* charity. The appropriate remedy in regard to organisations that engage in unlawful activity is to be found in the law that has been broken.

A literal interpretation of this paragraph suggests that a charity that engages in unlawful activity would lose its charitable status permanently. This would be both unreasonable and unworkable in practice. For example, it would mean that the current governing board of a charity would effectively be penalised for activities carried out by its predecessors. More fundamentally, it is a mistake to attempt to *regulate* the activity of charities in detail in legislation designed to *define* charitable status. The main exception to this should be the rule outlined in paragraph 4(1)(c), that the activity of a charity should further or be in aid of, its dominant charitable purpose.

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[34] This view is supported by recommendations in the recent review of charity law in Britain. See Home Office (2003), *Charities and not for profits - a modern legal framework*.

[35] We do not have a strong view on whether non-altruistic non-profit organisations should have access to the tax concessions available to charities generally. However, we do not support the extension of the more "expensive" tax concessions for Public Benevolent Institutions to non-altruistic organisations. In this regard, we support the Inquiry's recommendation that PBI status be restricted to those charities that assist disadvantaged people.

Any attempt to use a Federal law to regulate the activities of charities in detailed fashion also raises concerns about duplication of regulation between the Federal Government and the States.

Further, Clause 8(1) prohibits charities from having a *purpose* of engaging in unlawful *activities*. At the least, this should be more clearly expressed to refer to unlawful *purposes* rather than *activities*.

*Third*, the reference to a "Government body" in paragraph 4(1)(f) requires further clarification, at least in the explanatory material. It should be made clear that the fact that a body receives public funding, and/or is established under the aegis of a program of public funding, does not imply that it is a Government body. If organisations were regarded as Government bodies on this basis, a large number of non-Government community organisations would be unfairly denied charitable status. We not consider that this is the intention of the Bill - indeed the explanatory material suggests otherwise. However, in view of a recent Victorian Supreme Court judgement that departs dramatically from previous case law in this area, it is important that this issue be put beyond doubt.[36]

Fourth, it may be desirable to change the wording of paragraph 4(1)(b) to make it clear that a charity may have more than one "dominant charitable purpose". This is apparent from Clause 6, which refers to "one or more purposes which are charitable". However, the reference to a single dominant purpose in Clause 4 may lead to confusion.

**Recommendation 2:**

**Clause 4 of the Draft Bill should be amended as follows:**

**(1) to indicate that the dominant purpose of a charity should be altruistic;**

**(2) to express paragraph 4 (1) (c) in the positive rather than the negative. For example using words along these lines:**
**"*whose activities further, or are in aid of, its dominant purpose or purposes*"**

**(3) to delete paragraph 4 (1) (e) which refers to *unlawful conduct*, since this is relevant to the administration of other legislation (such as the criminal law), rather than the definition of charity;**

**(4) to clarify the meaning of "Government body" to make it clear that the fact that a body receives public funding, and/or is established under the aegis of a program of public funding, does not imply that it is a Government body**

**(5) to make it clear that a charity may have more than one dominant charitable purpose (as outlined later on in Clause 6).**

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[36] Central Bayside Division of General Practice Ltd. Vs Commissioner of State Revenue No. 8719 0f 2002 (Victorian Supreme Court) on appeal from Central Bayside Division of General Practice Ltd. V Commissioner of State Revenue No. 2002/137 (Victorian Civil and Administrative Tribunal). Previous judgements that defined bodies "controlled by the Government" used indicators such as whether the body was directly established by Government (as distinct from a body established in response to the introduction of a Government funding program) , whether the majority of its governing board was appointed by Government, and whether Government could exercise detailed discretionary control over its activities (as distinct from contracting it to provide services in accordance with a set of policy guidelines or objectives). The Central Bayside judgement appears to adopt a much looser test of "control by Government". It could be read to suggest that a body established pursuant to a Government funding program (for example, in the health or welfare area) that receives the substantial part of its funding from Government, is a "Government body" and not a charity.

# 3. Charitable purposes

Clause 10 seeks to define charitable purposes in a contemporary way. We support this attempt to bring charitable purposes up to date through legislation, because the relevant common law definitions have atrophied. The four "heads of charity" enunciated in Pemsel's case[37], and used for over a century as a guide by the courts, are now out of date. The need for a new, legislative definition of charitable purposes has also been recognised in Britain and New Zealand.[38]

The categories adopted closely follow those recommended by the Charity Definitions Inquiry, which we broadly support. We especially welcome the inclusion of child care in the Explanatory Material as a purpose consistent with the advancement of social and community welfare. We also endorse the "minimalist" approach adopted in drafting this clause. A short and simple list of charitable purposes gives the courts the flexibility they need to keep charitable purposes up to date with changes in society. This is the main reason that the schema used in Pemsel's case survived for so long as a guide to the courts.

It is important, however, that the Explanatory Material provides guidance to the ATO and the courts to the broad meaning of the seven purposes listed in Clause 10, and gives examples to illustrate this. This also appears to have been well drafted.

We propose two changes:

*First*, the explanatory material should make reference to the provision of housing for people disadvantaged in the housing market. Given that housing is one of the key essentials of life, this is an important component of the relief of poverty and the advancement of social or community welfare. However, to our knowledge, the status of organisations such as non-profit social housing providers has not been clarified by the courts. The recent review of charity law in Britain has attempted to address this problem by including "social housing" in the proposed legislative list of charitable purposes.[39]

We do not consider it necessary to include social housing in the list of charitable purposes in Clause 10. However, it should be included in the Explanatory Material as a key example of "the advancement of social or community welfare". This was proposed by the Charity Definitions Inquiry.[40] We propose that the words used by the Inquiry be incorporated into the Explanatory Material.

*Second*, consideration should be given to drawing some form of legislative boundary around the term "other purposes beneficial to the community". This "fourth head" of the classification structure in Pemsel's case performs an important function in the common law of charity. It provides scope for the courts to incorporate new purposes into the meaning of charity, and respond to social change. However, the courts have struck a delicate balance between using this formulation to expand the meaning of charity, and avoiding a completely open-ended or literal interpretation. If an open-ended or literal approach were taken, then a very wide range of non-profit organisations that benefit the community would be included. "Charity" would be indistinguishable from "non-government organisation".

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[37] Income tax special purposes commissioners Vs Pemsel {1891] All ER Rep 28[1891] AC 531.

[38] Home Office (2003), *Charities and not for profits - a modern legal framework*; New Zealand Treasury 2003, *Second report of the working party on registration, reporting and monitoring of charities*.

[39] Home Office (2003), *Charities and not for profits - a modern legal framework*.

[40] Charity Definitions Inquiry, page 172.

The Charity Definitions Inquiry rightly drew a distinction between charity and a proposed broader category of "altruistic community organisation." If the courts interpret "other purposes beneficial to the community" in a very liberal fashion, such a distinction could no longer be drawn. This would be counter-productive, since charities occupy a distinct and important place in the public mind, and in the tax and regulatory framework.

Once the term "other purposes beneficial to the community" is legislated, it would be open to the courts to redefine its meaning and scope. To some extent, this is desirable. The Explanatory Material refers to examples of purposes that fall within this "head" of charity that have not yet been endorsed by Australian courts, but should be included in any modern definition of charity. They include:

- the promotion and protection of civil and human rights; and
- the promotion of reconciliation, mutual respect, and tolerance between various groups of people within Australia.[41]

However, it may be desirable to draw a generous legislative boundary around this category, to assist the courts in balancing the objectives of keeping up with the times and maintaining the integrity of the charitable status.

One option, which we raise for discussion, is to use the formulation "any other *similar* purpose" in paragraph (1)(g) of Clause 10. It could be argued that this is consistent with the approach taken by the courts thus far, to determine whether a purpose falls under this "head". It offers scope for innovation without departing too radically from purposes generally regarded as charitable under the other "heads". If a purpose completely different from those comprehended by the other heads, or traditionally included in this last head, is considered a strong candidate for charitable status, it could be accommodated by amending the legislation.

**Recommendation 3:**

**The Explanatory Material should make clear that the "advancement of social and community welfare" in Clause 10 includes:**

**"*the provision of housing and accommodation support for people with special needs or who are otherwise disadvantaged in terms of their access to housing.*"**

**Recommendation 4:**

**Consideration should be given to amending Clause 10 to add the word *similar* to the phrase *other purposes beneficial to the community*, while retaining the proposed examples of such purposes in the Explanatory Material. The intention would be to keep this "head" of charity broadly within its common-law meaning.**

[41] These purposes are now being recognised as charitable in most overseas common law jurisdictions, though mainly due to legislative or administrative intervention rather than the progression of the common law.

# 4. A second round of charity reform

A legislated definition of charity is just one of three crucial steps necessary to bring Australian charity law into the 21st century. The other two are reform of Public Benevolent Institution status and reform of administrative arrangements, especially the "gatekeeper role".

## 4.1 Public Benevolent Institution status

The Charity Definitions Inquiry was sensibly given a mandate to examine definitions closely related to charity, including Public Benevolent Institution. It recommended major changes to this definition to clarify its relationship to charitable status.

The draft Bill does not address Public Benevolent Institution (PBI) status. This is problematic because charity and PBI status are twin concepts - albeit not identical ones. Few people working in the charitable sector, and almost none of the general public, understand the distinction between a charity and PBI, and that:

- PBI status is separate from charitable status, not a sub-set of charity;
- gift deductibility is attached to PBI status and not charitable status.

Yet, PBI status is closely associated with the "relief of poverty" head of charitable purposes.[42] It was originally legislated to restrict certain tax benefits to charities assisting the most disadvantaged Australians.

For these reasons, any attempt to modernise the definition of charity is incomplete without reform of PBI status. Otherwise, the confusion between the two categories will remain, and changes to the scope and definition of charity could have unintended effects on the scope and definition of PBI status.

Indeed, the PBI category is in greater need of modernisation than that of charity. It imposes much stricter restrictions on the activities of organisations, and attracts more important tax benefits: gift deductibility and an exemption from Fringe Benefits Tax. The attachment, drawn from the Charity Definitions Inquiry, summarises the tax treatment of different categories of community organisation.

Public Benevolent Institution (PBI) status was legislated in Australia early in the 20th Century to restrict certain tax advantages to those charities that assisted the most disadvantaged people in society, such as poor people, sick people, and people with disabilities. ACOSS supports this intention, and considers that benefits such as gift deductibility and Fringe Benefits Tax exemptions should be restricted to charities whose dominant purpose or purposes is to improve the circumstances of disadvantaged people.

However, the definition of PBI status is even more problematic than that of charity for two reasons:

[42] Perpetual Trustee Co Ltd V FC of T (1931) 45 CLR 224.

*First*, confusion between PBI and charitable status was exacerbated by an early judgement that defined "benevolence" separately from the charitable purpose of the relief of poverty (which in charity law includes illness and disability), as the "*relief of poverty, sickness, destitution, or helplessness*" where "*their disability or distress arouses pity*". This very out-dated view of the relief of poverty has since been entrenched in court judgements regarding PBI status, while the common law relating to charities for the relief of poverty took greater account of social change and developments in charitable service delivery. For example:

- the *prevention* of poverty is not generally regarded by the courts as an appropriate purpose for a PBI.[43]

- It is difficult to envisage a *self help organisation* of disadvantaged people obtaining PBI status (as proposed for charities in Clause 4 of the draft Bill) because the concept of "public benevolence" is rooted in early 20th Century notions of charities dispensing benevolent relief to poor people who are unable to help themselves.

*Second*, the courts have unnecessarily and inappropriately restricted PBI status to organisations providing aid *directly* to disadvantaged people. On the face of it, this excludes organisations whose main activity is policy development and advocacy, research, and support for direct service providers (such as most peak bodies), even where this is directed towards improving the circumstances of disadvantaged people.[44]

Many Public Benevolent Institutions that assist disadvantaged people but are not (or are no longer) predominantly engaged in direct service delivery are at risk of losing their gift deductable and FBT-exempt status, now that the ATO has released its Taxation Ruling TR2003/5 clarifying its view of these issues. The finalisation of this Ruling was delayed while the Government considered its response to the Charity definitions Inquiry, on the grounds that PBI status might be changed.

*Reform of this definition is therefore of the utmost urgency.*

The Government has acknowledged this problem and responded in partial fashion, by:

- extending gift deductibility to certain *health promotion organisations* by amending the Income Tax legislation, without changing PBI status.

- extending gift deductibility to organisations involved in the "prevention of control of harmful and abusive behaviour"

These partial responses only highlight the seriousness of the problem, and expose the unfairness and arbitrariness of access to gift deducibility for health and welfare organisations.

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[43] For example, marriage counselling services are not regarded as benevolent. See Marriage Guidance Council Vs FC of T 90ATC 4775.

[44] Peak bodies are not completely excluded from PBI status. For example, if their main role is to represent and support direct service providers who are themselves PBIs, they may attain PBI status. See ACOSS Vs Commissioner of Payroll Tax (NSW) 85ATC 4235. ACFOA Vs FC of T (1980) at 11ATR 343.

The Charity Definitions Inquiry proposed a simple, workable solution to these problems. It proposed that the Public Benevolent Institution category be replaced by a new class of *Benevolent Charity*, being a charity whose dominant purpose is to benefit, directly or indirectly, those whose disadvantage prevents them from meeting their needs. The test of whether a charity is also a benevolent charity would then be whether its dominant purpose is to assist disadvantaged people, not how it goes about doing so. This is consistent with the original intention of Public Benevolent status.

PBI status does not exist in other jurisdictions. Charities overseas enjoy gift deductable status regardless of whether they assist disadvantaged people. The problem with this approach - at least in theory - is that costly tax benefits extend to a much wider range of charities, including many that mainly serve the well-off.

However, in practice many such organisations - including wealthy private school building funds and the "high arts" obtain gift deductibility in Australia in any event, through other provisions of the Income Tax legislation. Ironically, it is only health and welfare organisations - those closest to the general public's view of "charity" - that have to jump the hurdles associated with PBI status in order to secure gift deductibility. A further irony is that, while charities and PBIs are restricted in their advocacy role, political parties and a proliferation of political "think tanks" enjoy gift deductibility.

We urge the Board to recommend that the Government modernise the legislative definition of Public Benevolent Institution. This should be the centrepiece of a second round of legislative reform in regard to charities.

## 4.2 Administration

It is also problematic to modernise the definition of charity while ignoring deficiencies in the administration of access to tax benefits that gave rise to some of the problems with the common law definition in the first place.

If these deficiencies are not addressed, there is a danger that the law will once again atrophy. In that event, the proposed new classification structure for charitable purposes will not be effectively used to respond to changes in society, and further legislative action may be required in the near future.

The main problem with the administration of charity law at the Federal level is that progress in modernising charity law depends largely on case law, and there have been few cases over the past 30 years. This means that the courts have not caught up with dramatic changes in the charitable sector over this period. [45]

A further problem is that the "gate-keeper" of charitable status is the ATO, whose main purpose is the collection of tax revenue rather than the definition or regulation of charities. The ATO has some expertise in charity law, since at the federal level this is mainly tax law. However, charitable status has broader implications than tax law (especially with regard to the status of charitable trusts), and charity law is only an incidental part of the ATOs activity.

[45] McGregor Loundes M 1995, *A taxing definition*.

For these reasons, we consider that a separate specialist body is needed to act as the gate-keeper of charitable status at the federal level; and to work with the relevant State Government bodies (those which regulate charitable donations) to streamline and improve the overall regulation of charities. This would be equivalent to the English Charity Commission, but without the overarching regulatory function exercised by that body.

The most important role for such a body at national level would be to regularly consult and develop guidelines on the definition and scope of "charity". A major advantage of the Charity Commission model in England is that the law has been up-dated *administratively* through Charity Commission inquiries and rulings, even though English case law on charities remains well behind the times.

The Charity definitions Inquiry recommended that such a body be established. It also received a submission from the ATO supporting the establishment of a separate specialist body to carry out this task.

If such a body is not established, a less effective solution to the above problems would be to establish a specialist statutory advisory body to advise the ATO on its administration of tax laws as they relate to charities.

The ATO recently established an informal advisory body, the Charities advisory Committee, to assist it to resolve issues connected with the implementation of the Goods and Services Tax. However, this would not be an appropriate model for the above purposes because:

- It lacks permanency, having been established on an ad-hoc basis by the ATO.
- It lacks clearly articulated advisory functions.
- It lacks a secretariat and budget that is independent of the ATO itself.
- It cannot initiate its own inquiries or consultations.
- There is no process to resolve any differences of view between the Committee and the ATO.
- For the above reasons, it has a limited profile and standing within the charitable sector.

At the least, a formal advisory body at arms length from the ATO, with legislated advisory functions, a small Secretariat and budget, and a capacity to initiate its own inquiries and consultations into trends within the charitable sector, is required.

Such a body would work best if it did not have deliberative powers and did not deal with individual cases, except to draw out the implications for the development of charity law. If it did have such powers it would be best to establish a Charity Commission that takes on the ATO's role in determining whether organisations are charitable. Instead, it would advise the ATO on the development and application of Tax Rulings and administrative practices in this area, and its relations with the charitable sector generally.[46]

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46 One example of an advisory body of this kind that has a key role in interpreting Federal Government legislation and advising on its administration is the *Australian Pharmaceutical Advisory Council*. The council includes individuals from peak pharmaceutical industry and consumer bodies, and independent medical and scientific experts. It advises the Pharmaceutical Advisory Committee, the administrative body that recommends new medicines for listing under the Pharmaceutical Benefits Scheme. The Council does not deal with individual cases, but reports on developments in the industry and advises the Committee (including in some cases formal endorsement) on guidelines, standards

**Recommendation 5:**

**We urge the Board to recommend that the Government institute a second round of legislative and administrative reform in regard to charities, consistent with the recommendations of the Charity Definitions Inquiry. This should include:**

- **legislative modernisation of the legislative definition of *Public Benevolent Institution*, and**

- **establishment of a *Charity Commission* as the "gate-keeper" of charitable status for federal legislative purposes, or if the ATO continues to carry out that function, establishment of an autonomous statutory advisory body drawn from representative bodies within the charitable sector, service consumers, and independent experts, to formally advise the ATO on the development and administration of Tax Rulings and guidelines regarding charitable status, relevant trends in the charitable sector, and relationships between the ATO and the sector.**

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and practices. It may initiate inquiries into relevant issues of its own accord, or deal with references from the Committee or the Government. Its main strengths are its composition, clearly articulated advisory role and authority, and capacity to act on its own motion. Its main weaknesses are the lack of an independent Secretariat and statutory basis.

## Attachment: The tax status of charities and related entities

### TAXATION CONCESSIONS AVAILABLE TO CHARITABLE AND RELATED ENTITIES

| Tax concessions (a) | Entity types (a) | | | | | |
|---|---|---|---|---|---|---|
| | Not-for-profit organisation (b) (d) | Community service organisation (c) (d) | Charity (c) (d) (e) | Public benevolent institution (PBI) (c) (d) (e) (f) | Religious institution (c) (d) | Deductible gift recipient (DGR) (c) (d) (f) |
| Tax-free threshold of $416 | ■ | | | | | |
| Income tax exemption | | ■ | ■ | | ■ | |
| Receives deductible gifts | | | | ■ | | ■ |
| Refund of imputation credits | | | ■ | | | ■ |
| Fringe benefits tax (FBT) rebate | | ■ | ■ | | ■ | |
| FBT exemption | | | | ■ | | |
| GST non-profit concessions | ■ | | | | | |
| GST charity/gift-deductible entity concessions | | | ■ | | | ■ |
| GST religious organisation concessions | | | | | ■ | |

■ Indicates that taxation provisions specify that this entity type is entitled to this tax concession, or conversely, that this tax concession is available to this entity type.

(a) Refer to the glossary that follows for further details of entity types and tax concessions.
(b) 'Non-profit' is the term used in Australian Taxation Office (ATO) publications and relevant legislation.
(c) These entities also have the attribute of being non-profit.
(d) These entity types may also satisfy the criteria for other entity types, eg, all these entity types are non-profit and therefore are entitled to the concessions available to non-profit organisations, a charity or community service organisation could also be a DGR and therefore entitled to gift deductibility, and a PBI could also be a charity and therefore entitled to the concessions available to charities.
(e) A charity must be endorsed as an income tax exempt charity to be entitled to income tax exemption.
(f) An entity falling under one of the general categories of DGR must be endorsed to receive deductible gifts.
(g) The GST concessions apply only to certain transactions of the entities indicated.

Source: Report of the Charity Definitions Inquiry (2001).