

Can operation of a commercial business be considered “charitable”?

COMMISSIONER OF TAXATION V WORD INVESTMENTS LTD [2006] FCA 1414



INTRODUCTION

On 3 November 2006 the Federal Court considered the charitable status of an organisation that had raised funds through a commercial enterprise for a charitable purpose. The court held that where an organisation raises funds exclusively for a charitable purpose, the fact that it does so through a commercial enterprise does not preclude it from being a charitable institution that can be exempted from income tax, where the underlying motivations of the organisation and the purpose for which it raises money through a commercial enterprise are charitable. The Commissioner has commenced an appeal against this decision of the Federal Court.

BACKGROUND

Word Investments Ltd (“Word”) was established in 1975 to provide financial and fundraising support to Wycliffe Bible Translators Australia (“Wycliffe”). Wycliffe and its international counterparts are evangelical missionary associations that seek to spread the Christian religion through literacy and translation work, particularly in third world countries, by translating the Bible into the local languages and teaching it to the local population.

In order to provide financial and fundraising support to Wycliffe, Word’s activities changed over time. Initially, Word was involved in raising funds through housing development. In 1996, Word established Bethel Funerals with the purpose of distributing profits derived from the funeral business to Wycliffe and one other ministry organisation.

Word applied for income tax exemption as a charitable institution in 2001. However, the Commissioner of Taxation (“Commissioner”) refused to endorse Word as exempt from income tax.

Word made a second application for income tax exemption but this was also refused by the Commissioner. This time, however, Word appealed to the Administrative Appeals Tribunal (“Tribunal”), which partially allowed the objection. The Commissioner subsequently appealed the finding of the Tribunal, which is the subject of the present case.

As a side issue, Word created the Word Investments Foundation Trust (“Foundation”) in 2002 to hold Bethel Funerals and from this time onward, Word acted as trustee of the Foundation and conducted Bethel Funerals in that capacity. The Foundation also applied, unsuccessfully, for endorsement as a tax-exempt charitable fund, and a final review of this decision is yet to occur.

Relevant legislation

Division 50 of the *Income Tax Assessment Act 1997* (Cth) (“ITAA 1997”) deals with the exemption of certain entities from paying income tax. Where an entity is covered by Div 50, subject to the conditions required of each type of entity (ie company, trust, partnership, etc), the “total ordinary income and statutory income of the entities covered [in this division] is exempt from income tax”.

The Tribunal considered to be relevant the provisions relating to both charitable institutions (Item 1.1) and funds established in Australia for public charitable purposes

by will or instrument of trust (Item 1.5B). On appeal, the Federal Court only considered Word in relation to the first category. Subsequently, the relevant special conditions include:

50-50 An entity covered by item 1.1 or 1.2 is not exempt from income tax unless the entity:

- (a) has a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia; or
- (b) is an institution that meets the description and requirements in item 1 of the table in s 30 15; or
- (c) is a prescribed institution which is located outside Australia and is exempt from income tax in the country in which it is resident; or
- (d) is a prescribed institution that has a physical presence in Australia but which incurs its expenditure and pursues its objectives principally outside Australia.

50-52 (1) An entity covered by item 1.1...[or]..1.5B...is not exempt from income tax unless the entity is endorsed as exempt from income tax under Subdivision 50 B.

If an entity is entitled to be endorsed as exempt from income tax and has applied for such endorsement, then the Commissioner is obliged to endorse the entity as exempt from income tax.

Tribunal decision

The Tribunal partially upheld Word’s objection to the Commissioner’s decision to refuse its application to be exempt from income tax. It found that:

1. Prior to 1996, Word was entitled to be endorsed as exempt from income tax

as an institution for the advancement of religion (charitable institution under Item 1.1 at s 50-5(a) ITAA 1997). During this time the sole activity of Word was raising funds for Wycliffe and other similar organisations from the interest earned on deposits of supportive individuals in accordance with its memorandum of association. These activities were pursued solely in Australia;

2. Between 1996 and 2002, Word was not entitled to be endorsed as exempt from income tax. During this time Word operated a commercial business with the view of making a profit; and
3. From 1 July 2002 onwards, Word was entitled to be endorsed as exempt from income tax because Bethel Funerals was operated separately from Word through the Foundation. Consequently, Word's activities from 2002 onwards were the same as those prior to 1996.

Furthermore, the Tribunal held that Word was not a fund established by a trust for the purposes of Item 1.5B of s 50-5 ITAA 1997 and would not, in any event, satisfy the special condition attaching to trusts regarding distributions to Wycliffe. The Tribunal also held that because Word is a separate legal entity to Wycliffe, it could not be entitled to an exemption from income tax on the basis that Wycliffe was entitled to an exemption. The Tribunal was not asked to consider whether the Foundation was exempt from income tax.

Issues before the Federal Court

Each party raised issues for consideration by the court. The Commissioner sought the court's consideration of whether Word was a charitable organisation during the periods of 1996-2002, and 2002 onwards. Although not directly an issue before them, the court considered that the activities of Word between 1986 and 1996 were relevant as they provided a basis for the characterisation of Word's activities in later periods.

In order for Word to be exempt from income tax, it must not only be considered to be a "charity" but also to have charitable purposes. Trusts for the advancement of religion fall within the common law definition of "charity" as set out in *Commissioners for Special Purposes of Income Tax v Pemsel*.¹

The court considered whether the activities of Word had a charitable purpose. To do this, it was necessary to determine Word's "essential object" from the "purpose of its formation, its constitution and its activities" which were derived, at least as a starting point, from Word's memorandum of association.

Word's memorandum of association included a list of its evangelical objects, financial activities and other provisions (including those that prohibited the distribution of profits or gains to its members), namely:

1. To teach and expand the Christian religion both in Victoria and through the rest of the world;
2. To provide assistance, both financial and otherwise, for evangelical missionary organisations and evangelical missionaries operating in Victoria or elsewhere in the world;
3. To encourage the enlistment of missionary volunteers;
4. To carry on any business or activity that is conveniently carried on in connection with the objects;
5. To make payments to any fund for religious, charitable or benevolent objects of any description;
6. To invest and deal with monies as determined by the directors; and
7. To set aside out of the profits, funds to maintain Word's property.

In relation to charitable status, the Commissioner argued that the Tribunal erred in finding that Word was exempt from income tax for the period from 2002 onwards on three grounds:

1. There was insufficient evidence for the Tribunal to conclude that the payments made by Word to Wycliffe and other organisations were used by them for charitable purposes and that this was the only basis on which the Tribunal could have concluded that Word's activities were charitable.
2. It is necessary to draw a distinction between purposes of religion and things conducive to the good of religion so that, for example, the generation of funds and their distribution to Wycliffe

between 1996 and 2006, although conducive to the good of religion, were not for the purpose of religion.

3. The Tribunal held that Word pursued its objectives solely in Australia but did not suggest that the three sub-tests contained in s 50-5(a) ITAA 1997 could be met.

The Commissioner also challenged the finding of the Tribunal that the activities of Word were the same in the two periods 1986-1996 and from 2002 onwards, so to entitle Word to be endorsed as a charitable institution from 2002 on three grounds:

1. Word was not entitled to endorsement prior to 1996 and so could not be entitled to endorsement from 2002 onwards.
2. The period from 2002 onwards was not properly before the Tribunal, as the Tribunal was asked to consider Word and the Foundation together when they were separate entities.
3. There was insufficient evidence before the Tribunal to establish that the activities of Word from 2002 onwards were the same as those prior to 1996.

Word appealed against the finding of the Tribunal that it was not entitled to an endorsement for the period 1996-2002. Word argued that the Tribunal erred in finding that by conducting a funeral business, the essential character of Word had changed, and that Word's memorandum of association should have been properly characterised as a fund established for public charitable purposes by the Tribunal.

Decision of the Federal Court

Charitable status of Word: 1986-1996

The court held that the comprehensive list of objects in Word's memorandum of association clearly showed that its main purpose was evangelical, and that their comprehensive nature reflected caution rather than an attempt to cover every possible activity that was desirable for a charitable organisation to undertake.

The court rejected all three submissions made by the Commissioner relating to Word's charitable status. Firstly, the court held that focusing on whether there was



The Tribunal made an unwarranted distinction between the active and passive investment of Word in relation to Bethel Funerals.



sufficient evidence to conclude that funds provided by Word to Wycliffe were used for charitable purposes invited “consideration of the wrong question”. The court reasoned that it was not relevant whether Wycliffe and other recipients of Word’s funds used those funds for religious purposes, but that it was only relevant to consider what Word understood was being done with those funds. The court considered that there was ample evidence about what Word believed was being done with its funds, much of which was provided by three directors of Word (two of whom were also directors of Wycliffe) in relation to Wycliffe’s activities and reasons why Word provided funds for those activities.

Secondly, the court held that it was inappropriate to draw a distinction between purposes of religion and things conducive to the good of religion and, even if it were appropriate, it would not be of assistance to the Commission.

Thirdly, the court found that Word satisfied the requirements of s 50-50(a) of the ITAA 1997, namely that Word has a physical presence in Australia to the extent that it incurs its expenditure and pursues its objectives principally in Australia. The court considered that the issues of physical presence and incursion of expenditure were clearly met, but that satisfaction of pursuing its objectives principally in Australia was more difficult as the organisation in receipt of payments from Word, being Wycliffe, used these funds predominantly overseas. Despite this, the court held that because Word made the payments to Wycliffe in Australia, and its motivations behind such

payments were that “charity begins at home”, they were pursuing their objects principally in Australia to satisfy s 50-50(a) of the ITAA 1997.

Effect of funeral business: 1996–2002

Word either needed to satisfy the requirements of a charitable institution under Item 1.1 of s 50-5(a) or, that it was a fund established for public charitable purposes under Item 1.5B. The court held that the Tribunal had erred in concluding that the running of a funeral business could not advance religion in two respects. Firstly, because it considered the funeral business in isolation from the remainder of Word’s operations; and secondly, because it made an “unwarranted distinction between active and passive investment” as, after the establishment of the funeral business, only the manner of raising money had changed, the purpose “for doing it remained the same”. For these reasons the court upheld Word’s appeal, determining that Word was a charitable institution under Item 1.1 between 1996 and 2002.

Period from 2002 onwards

In relation to the Commissioner’s arguments regarding the similarities of Word’s activities prior to 1996 and after 2002, the court rejected all three submissions. Firstly, as the court considered Word to be a charitable institution prior to 1996, it may also be a charitable institution after 2002. Secondly, despite the Tribunal considering Word and the Foundation as a whole, the court was not precluded from considering the charitable status of Word separately from the Foundation. Thirdly, the court considered that there was sufficient evidence before it to determine Word’s charitable status as an institution as Word was, and is, not required to “prove [its] status on every single day” and once charitable status was established, Word could rely on this finding until it was proven that that status no longer applied.

Decision

The court dismissed the Commissioner’s appeal and found that in all relevant periods, Word should be considered a charitable institution and therefore be eligible for exemption from income tax.

CONCLUSION AND COMMENT

Word Investments has raised funds through various means, including a commercial funeral business, to support the charitable

activities of Wycliffe since 1986. After several unsuccessful applications by Word to the Commissioner for endorsement as a charitable institution exempt from income tax, Word appealed to the Tribunal, which held that prior to 1996 and from 2002 onwards, Word was entitled to be endorsed as income tax exempt. The appeal from the Tribunal by the Commissioner to the Federal Court was dismissed and the cross appeal by Word allowed, thereby the court finding that Word was entitled to exemption from income tax under Div 50 of the ITAA 1997 because, although some funds were raised by Word through a commercial enterprise, this did not affect the purpose for which the funds were raised.

The finding of the Federal Court appears to comment on various questions of fact before the Tribunal. In this way, it raises issues as to whether the court was able to extend its finding to the question of whether Word had a charitable purpose as opposed to stating the correct law and considerations that the Commissioner should be bound by in reaching his conclusion on the issue. Making an order of this kind risked usurping the Commissioner’s power of decision-making, because in the event that more than one outcome to the matter is possible, any discretion to decide Word’s charitable status remains, arguably, with the Commissioner. This would potentially restrict the Federal Court to commenting on the issue and remitting the matter back to the Commissioner for further consideration.

However, if when applying the law as interpreted by the Federal Court to the facts before it, the only possible outcome for the court is to find that Word had a charitable purpose and was therefore entitled to be endorsed as income tax exempt then, pursuant to s 50-105 ITAA 1997, the Commissioner is obliged to endorse Word as such. Word would then be entitled to retain this status until it is proven that this status no longer applies. The court’s findings that the Commissioner had made an unwarranted distinction between Word’s active and passive investment in relation to the establishment of Bethel Funerals, and had not therefore considered the activities of Word and Bethel Funerals as a whole, left the court with only one possible outcome for the case: that Word had a charitable purpose and was therefore entitled to be endorsed as income tax exempt.

Exemption from income tax as a charitable institution or charitable fund is sought after

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by many not-for-profit organisations. In this regard, the ATO published the “Income tax guide for non-profit organisations”, which details entitlement to income tax exemption and other issues that affect not-for-profit organisations. The ATO updated this guide in November 2006.

This case recognises that there is tension between the taxpayer and the Commissioner in relation to how not-for-profit organisations can go about their activities and gain the tax benefits offered to such organisations under various pieces of legislation.

On one hand, the case highlights that just because a charitable purpose is evident in the objects of an institution, this does not necessarily mean that all the tests required by Div 50 of the ITAA 1997 are satisfied so that the institution or fund can be endorsed as income tax exempt. In the alternative, it has the potential to extend the number of not-for-profit organisations that will be able to access the income tax exemption under the ITAA 1997.

However on the other hand, the case provides timely comment on the policy behind the operations and activities of not-for-profit organisations. There are a wide variety of ways in which not-for-profit organisations can raise money to support their cause and, if such fund-raising activities are done correctly, they do not have to be restricted merely to the more “traditional” methods. Charitable organisations are expected to do more with the same resources, and donations alone may not be sufficient, resulting in many charitable organisations pursuing business ventures to support their activities. Although the court’s final view of these issues is still to be decided in the face of a pending appeal by the Commissioner², it does make it clear that “there may appear to be a vast difference between selling lamingtons at a church fête and selling funeral services, but where the object of raising the funds is the same, [there is] no reason to draw a legal distinction between the two”.³

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Reference notes

- 1 *The Commissioner lodged a notice of appeal on 24 November 2006 and came before the Full Federal Court on 21 February 2007.*
- 2 *The Commissioner of Taxation v Word Investments Ltd [2006] FCA 1414 at [60].*
- 3 *[1891] AC 531.*

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