Are all "charities" equal?

Entities falling foul of the Charities Act may actually be the types of organisations the government wishes to support through charitable income tax exemptions.

Some of the entities being deregistered or declined registration appear to be precisely the type of entity the government would wish to support, particularly given current economic and environmental public concerns.

The Charities Commission has stated that it does not see any need to bring forward the review of the Charities Act, currently not scheduled for completion until 2015 (Kathryn Ryan interview with Trevor Garrett, Radio New Zealand, 9 to noon, 16 May 2011). Given the level of concern being expressed, this does not seem consistent with the functions of the Charities Commission to "promote public trust and confidence in the charitable sector", and to "stimulate and promote research into any matter relating to charities" (section 10(1)(a) and (m)). As an autonomous crown entity, the Charities Commission is required to have regard to government policy when directed to do so by the responsible Minister.

Now is the time for charities to advocate on their own behalf, including for the review to be brought forward. They should not be legally restricted from doing that.

Since 1 July 2008, charities have been required to be registered with the Charities Commission in order to be eligible for the charitable income tax exemptions in sections CW 41 and CW 42 of the Income Tax Act 2007 (the Income Tax Act). Since the charities register opened on 1 February 2007, the Charities Commission has registered over 25,500 charities. It has also, often controversially, declined to register over 100 charities and deregistered over 20.

In its 2004 report on the Charities Bill, the Social Services Select Committee (the Select Committee) acknowledged the concerns of many submitters that the definition of "charitable purpose" was too narrow, "excluding sporting groups and groups that undertake advocacy work" in particular. In response to these concerns, the Select Committee was careful not to recommend that the definition of charitable purpose be amended, but instead suggested a review, "to consider carefully whether the definition should be changed", once all initial registrations had been completed.

In November 2010, the Minister for the Community and Voluntary Sector, Hon Tariana Turia, announced a first principles review of the Charities Act 2005 (the Charities Act). The Department of Internal Affairs is expected to start the scoping work for this review later this year, although the review itself is not expected to be completed until 2015. The Law Commission is also expected to review the Charitable Trusts Act 1957 in the context of its review of trusts.

This article considers some of the issues that need to be considered as part of the review.

ACCUMULATION OF FUNDS

The question of whether, or to what extent, the accumulation of funds by charitable trading organisations is consistent with the public support afforded to those entities through the charitable income tax exemptions needs to be reconsidered, particularly if those accumulations are being used in an anti-competitive way.

Is it in the public interest for a charitable trading entity to use the benefit of the charitable income tax exemptions to accumulate large reserves, from pre-tax funds, to reach a dominant position in a market and then to take advantage of that market power to deter or eliminate competitors?

In the current economic climate, particularly as the government searches for funds that can be "freed up" to rebuild Canterbury, the question arises as to whether our hard-earned taxpayer dollars are best "spent" on supporting such entities through the charitable income tax exemptions, or whether those funds would be better utilised elsewhere.

The 2001 discussion document "Tax and Charities" considered that trading charities' competitive advantage arises "only from the ability to grow a business faster by accumulating pre-tax funds".

The discussion document proposed that trading operations owned by charities be subject to tax in the same way as other businesses, but with an unlimited deduction for distributions made to the relevant charitable purposes. The discussion document went on to suggest that "the accumulation of funds could lead to questions from the monitoring authority as to why this is happening".

In the decade that has followed, trading operations owned by charities have not been made subject to income tax, although an amendment has been made to section DB 41 of the Income Tax Act in 2007 allowing companies an unlimited deduction for donations made to charitable entities (capped at the level of their taxable income). In terms of accumulations of funds, there is no evidence that "questions from the monitoring authority" have had any chilling effect on anti-competitive use of accumulated funds by charitable trading organisations. The appropriate "monitoring authority" in this regard is likely to be the Charities Commission, although the Commerce Commission also has an interest, given its role in promoting competition in markets for the long-term benefit of consumers within New Zealand. Inland Revenue (IR) also has an interest through its responsibility for administering the charitable income tax exemptions.

The fact that various aspects of this issue fall within the jurisdiction of more than one agency is problematic, and it seems the issue has fallen through the cracks. It is important that the full combined impact is properly considered, and with some degree of urgency if competition in affected markets is to survive.

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THE DEFINITION OF "CHARITABLE PURPOSE"

A key issue causing difficulty at the moment is the definition of charitable purpose itself, or rather the way the definition is being interpreted. Much controversy has been caused by the Charities Commission's interpretation of "political purposes" or advocacy, which has resulted in entities such as the National Council of Women being deregistered. The Charities Commission's interpretation of economic development as a charitable purpose is also a source of debate (see for example *Canterbury Development Case* [2010] NZLJ 248, *Charity and economic development* [2011] NZLJ 63 and *Charity is a general public use* [2011] NZLJ 60).

What constitutes a charitable purpose is notoriously elusive. For example, of the nine Judges that considered the issue of charitable purpose in the Crown Forestry Rental Trust case, five considered the income in question was derived in trust for charitable purposes, but four did not, for two very different reasons: see *Latimer v Commissioner of Inland Revenue* [2004] 3 NZLR (PC), [2002] 3 NZLR 195 (CA), [2002] 1 NZLR 535 (HC).

The Courts have established a two-step inquiry (referred to below as the "two-step test") in determining whether an entity's purpose is charitable (Latimer v CIR [2002] 3 NZLR 195 (CA), [32] and *DV Bryant Trust Board v Hamilton City Council* [1997] 3 NZLR 342, 348):

- Is the purpose for the public benefit; and if so;
- Is it charitable in the sense of coming within the spirit and intendment of the preamble to the Statute of Charitable Uses Act 1601 (the *Statute of Elizabeth*)

The preamble to the Statute of Elizabeth contained a non-exhaustive list of purposes which had been regarded as charitable by Elizabethan Courts up to that time; those few lines as to what the then English Parliament considered to be charitable have since formed the judicial starting point for a consideration of charity.

Charitable purposes were distilled into four "heads" of charity by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531, 583: the relief of poverty, the advancement of education, the advancement of religion or "any other matter beneficial to the community". The statutory definition of "charitable purpose", contained in section YA 1 of the Income Tax Act and section 5 of the Charities Act, "includes" the four principal "heads" of charity, and imports into the legislation the common law definition of charities.

It is important to recognise that purposes that are beneficial to the public or of public utility, even if not directly analogous to purposes falling within the spirit and intention to the of the preamble to the Statute of Elizabeth, are presumed to be within that spirit and intention, and therefore charitable, in the absence of any ground for holding otherwise (*CIR v Medical Council of New Zealand* [1997] 2 NZLR 297 (CA) per McKay J). This is referred to below as the "presumption of charitability". The question of whether an entity's purposes are charitable should receive a benign construction: "society is unlikely to be prejudiced by attempts at public benefaction, however odd they may seem" (J Bassett, *Charity is a general public use* [2011] NZLJ 60).

A purpose, even if expressed in charitable form, cannot be charitable unless it is directed towards the benefit of the public (*Oppenheim v Tobacco Securities Trust Co Ltd* [1951] AC 297). The "public benefit test" is imported as a key additional element of the charitable purposes test through the medium of the common law. In this regard, it is well-established that the existence of incidental private benefits to individuals does not deprive an entity of its charitable nature.

The courts have not adopted any clear approach to applying the public benefit test to different types of charitable entities; the law in New Zealand has arguably been developing in a different manner from that being followed elsewhere (*Issues Paper IP3168 "The Public Benefit Test"*, January 2000, paras 1.2 and 1.6)

It is important to recognise that the definition of charitable purpose is not static. Concepts relating to charitable purposes generally, or to any particular kind, are constantly changing with changes in social and community attitudes and needs. Purposes once thought to be beneficial, and therefore charitable, may become "superfluous, detrimental to the community or even illegal". Conversely, with the passing of time, a purpose formerly held not to be charitable may come to be regarded as charitable (see Garrow and Kelly's Law of Trusts and Trustees 6ed LexisNexis NZ Ltd, Wellington 2005, cited in Travis Trust v Charities Commission (2009) 24 NZTC 23,273 (HC) at [45]).

Charities carry out important work in our community, and are supported in doing so through the charitable income tax exemptions. This support enables governments to further their social objectives, including by means of increasing support to disadvantaged members of society. It also ensures that those members of society who do not donate to charities but who nevertheless benefit indirectly from charities are contributing through their general tax payments (2001 discussion document "Tax and Charities" para 2.7). The gateway to this public support is the definition of "charitable purpose".

Since the Charities Commission has been established, nine charities have appealed to the High Court under section 59 of the Charities Act challenging decisions of the Charities Commission to decline to register or to deregister them. Of these nine cases, all have been decided in favour of the Charities Commission.

The approach that has been taken has been the source of some debate, including with respect to the effect of section 18 of the Charities Act, the legal distinction between purposes and activities, the public/private dichotomy, and whether it is necessary to "assuage need" (see further discussions in Canterbury Development Case [2010] NZLJ 248, and Charities Act review, *NZ Lawyer* issue 157, 8 April 2011 at 10).

Many of these difficulties might have been resolved differently if a benign construction following from the presumption of charitability had been applied.

However, in not one of these cases has the presumption of charitability been applied. Nor has it been specifically rejected. It appears to have simply fallen off the radar. In addition, the two-step test appears to have been consistently applied in reverse order. The practical effect of this is to place the charity seeking registration "on the back foot".

A decision that a charity is not eligible for charitable registration will likely have significant consequences for the entity, including as to whether it is able to continue to exist at all.

We suspect that many of the 120 or more entities which have been declined or deregistered may well have been found eligible for registration if the above law had been applied.

Many will restructure, as suggested by the Charities Commission itself, but a fundamental question arises as to whether they should have to.

ADVOCACY

A similar concern arises in relation to the Charities Commission's interpretation of the law regarding advocacy.

In considering the Charities Bill in 2004, the Select Committee was careful not to recommend that the definition of charitable purpose be amended. The Committee was concerned that amending the definition would be "interpreted by the Courts as an attempt to widen or narrow the scope of charitable purposes, or change the law in this area, which was not the intent of the bill". The Select Committee was also concerned that amending the definition would result in inconsistencies with other legislation that contains definitions of "charitable purpose" (the income tax definition being a particular case in point). In response to the concerns that had been raised by submitters, however, the Select Committee did recommend that the common law as it relates to secondary purposes be codified, to clarify that an entity with non-charitable secondary purposes, including advocacy, undertaken in support of a main charitable purpose, will be allowed to register with the Charities Commission. Section 5(3) was therefore inserted into the Charities Act, which provides as follows:

"To avoid doubt, if the purposes of [an entity] include a non-charitable purpose (for example advocacy) that is merely ancillary to a charitable purpose of [the entity], the presence of that non-charitable purpose does not prevent [the entity] from qualifying for registration as a charitable entity."

In an ironic twist, the Charities Commission appears (Kathryn Ryan interview with Trevor Garrett, Radio New Zealand, 9 to noon, 16 May 2011) to be interpreting section 5(3) as statutory authority for the proposition that "advocacy is a non-charitable purpose". Many charities now fear that advocating for their causes risks jeopardising their charitable status. However, as mentioned above, section 5(3) was not intended to change the law. It was intended as helpful clarification.

In the context of advocacy, the Charities Commission regularly refers to the 1917 British case of *Bowman v Secular Society* [1917] AC 406. The *Bowman* case concerned the validity of a gift to a society that promoted, among other things, the secularisation of the State. The House of Lords held (obiter) that a trust for the attainment of political objects could not be a valid charitable trust, not because it was illegal, but because the Court had no means of judging whether a proposed change in the law would be for the public benefit. *Bowman* was applied in New Zealand in *Molloy v Commissioner of Inland Revenue* [1981] 1 NZLR 688 (CA) in which the Court of Appeal denied Mrs Molloy's $5 donation to the Society for the

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Protection of the Unborn Child, essentially on the same basis.

The historical path of the law of charities is strewn with the great controversies of the past (*Auckland Medical Aid Trust v Commissioner of Inland Revenue* [1979] 1 NZLR 382, 397). It is not clear why the above authorities are being interpreted to deny Charities Act registration to entities such as the National Council of Women (NCW). For 115 years, NCW has been working for the betterment for women, children and families in New Zealand. In correspondence with the Charities Commission, NCW acknowledged that it engaged in political advocacy, but argued that this was not a purpose in itself; it was merely a *means* of achieving NCW's primary purpose of promoting progress for women. The Charities Commission disagreed, and considered, largely on the basis of NCW's *activities*, that a main *purpose* of NCW was to advocate for changes in the law or the policy or decisions of central government. The Charities Commission considered that this purpose was not ancillary to NCW's other purposes, and accordingly deregistered NCW on the basis that it did not have exclusively charitable purposes.

It seems reasonably possible to judge that the changes in law sought by NCW would be for the public benefit. It therefore seems reasonably clear, on current law, that *Bowman* and *Molloy* might be distinguishable, and that the law may well consider NCW's advocacy to be "charitable", even in the absence of a benign construction.

Since the Charities Commission's decision to deregister NCW in July 2010, the High Court of Australia has delivered its decision in *Aid/Watch Incorporated v Commissioner of Taxation* [2010] HCA 42, suggesting that the generation of public debate seeking to secure peaceful and orderly change can be for the public benefit, and as such not precluded from charitable status. The *Aid/Watch* decision recognises the intrinsic value of democratic participation and provides support for the proposition that charities should not be restricted by the law of charitable purpose from speaking out on issues or funding important advocacy work.

In the recent High Court case of *Re Greenpeace of New Zealand Incorporated*, (HC, Wellington) 6 May 2011 CIV 2010-495-829, Heath J considered himself bound by the Court of Appeal decision in *Molloy* to find that Greenpeace had a political purpose that precluded it from registration as a charitable entity. In doing so, however, his Honour expressed "a degree of reluctance", and stated that, "in modern times, there is much to be said for the majority judgment in Aid/Watch" (para 59).

Greenpeace has announced (press statement, 10 May 2011) that it will appeal the decision to the Court of Appeal. In so doing, Greenpeace referred to the vital public debate about what it means to be a charity in 21st century New Zealand. As a community, we need to consider what types of organisations we wish to support through the charitable income tax exemptions. We need a definition of "charitable purpose" that is "fit for the purpose" for New Zealand 2011. As with the review of the Charities Act, Greenpeace's appeal to the Court of Appeal will be an important opportunity to consider whether, or to what extent, *Bowman* remains relevant to our society and to consider not only what the law is, but also what it should be.

PROCEDURAL ISSUES

The review of the Charities Act should reconsider the appropriateness of some of the procedural rulings that have been made.

Charities bringing legal proceedings challenging a decision of the Charities Commission to decline or deregister them are likely funding such proceedings out of their charitable funds, thereby reducing the amount of funds available for the important work they would otherwise do.

In two thirds of the above nine cases, procedural wranglings have occurred over whether a charity can adduce additional evidence in Court. This arises from the conception of a High Court challenge to a Charities Commission decision as an "appeal". However, the Charities Commission is not a "tribunal" and is not bound by the rules of evidence in reaching

its decisions. The High Court proceeding, which is a hearing de novo (*Re Education New Zealand Trust* (2010) 24 NZTC 24,354 (HC) at [1]), should clearly be cast as a first instance determination of whether the entity in question is "charitable", rather than a review of whether the Charities Commission's decision was "right". While the distinction may be subtle, it leads to a fundamental difference in approach. If material would assist the Court in determining "charitability", surely the Court should have it. The procedural framework should facilitate a determination by all concerned of whether the entity's purposes are charitable.

The question of amendments to entities' governing documents should also be reconsidered. Counsel in *Canterbury Development Corporation v Charities Commission* [2010] 2 NZLR 707 (HC) ("the CDC case") sought the opportunity to amend CDC's constitution to bring itself within the definition of charitable entity. Ronald Young J rejected such a possibility, for more than "simple amendments [having] little effect on the organisational structure", *inter alia* on the basis that it would "skew the legislative process for approval of charitable entities" ([100-101]). Applying CDC, the New Zealand Computer Society Inc's request to have the Court consider its amended constitution was rejected by the Court (*Re New Zealand Computer Society Inc* (HC, Wellington, CIV-2010-485-924, 28 February 2011, [72]).

This means that an entity wanting to make more than "simple amendments" must do so and then make a fresh application to the Charities Commission. Not only would this cause the entity to risk losing the benefit of the transitional concessions available in section CW 41(5) of the Income Tax Act, it puts the entity to significant additional cost, uncertainty and delay. This can only distract the entity from its charitable work. It also seems inconsistent with the role of the Courts as the source of the common law on the definition of "charitable purpose". In addition, one of the Charities Commission's statutory functions is to "encourage and promote the effective use of charitable resources" (section 10(1)(b) of the Charities Act). Surely a more helpful process can be devised.

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Given the nature and importance of charitable entities in our community, and the fundamental uncertainty inherent in the definition of "charitable purpose", it is important that a facilitative approach is applied. The legal test to be applied in determining charitability, and the status of the presumption of charitability, need to be clarified as a matter of priority. The status and rules around "appeals" of Charities Commission decisions also need to be revisited.

In the CDC case, His Honour also expressed reluctance for the Courts to give away the expertise of the Commissioner as a first adjudicative body ([101]). If this is intended as a general deferral by the Courts to the expertise of the Charities Commission, it is of concern: the province of the definition of charitable purpose is the common law. The Charities Bill as introduced provided that the right of appeal against a decision of the Charities Commission was to be to the District Court, whose decision was to be final. The Select Committee amended this, stating that, given its experience in considering matters relating to charitable entities, the most appropriate forum for hearing appeals should be the High Court (Report, 13), with recourse ultimately to the highest Court in the land. The development of the law would be stymied if entities felt the Court would defer to the Charities Commission. Reluctance by Courts to disturb decisions of the Charities Commission would not be consistent with the role of the Courts as the source of the law on charitable purpose.

It should be noted that it would not necessarily be a criticism of the Charities Commission for the Court to reach a different view. As centuries of case law have borne out, the question of what constitutes a charitable purpose often strikes different minds differently.

DUAL ADMINISTRATION

Issues of dual administration between IR and the Charities Commission also need to be further considered. The charitable income tax exemptions reside in the Income Tax Act, with Charities

Act registration being a necessary, but not sufficient, condition of eligibility for the exemption. IR is responsible for administering the charitable income tax exemptions, and must make an independent decision under its own legislation as to whether a particular entity is charitable. IR is also *required* by section 91E(1) of the Tax Administration Act 1994 to issue binding rulings in that regard unless one of the statutory exceptions applies. A binding ruling that an amount of income is derived in trust for charitable purposes, or that an society or institution is established and maintained exclusively for charitable purposes, for the purposes of section CW 41 of the Income Tax Act is legally binding on the Charities Commission (see section 13(2)(a) and (3) of the Charities Act).

Derogation by IR from its responsibility to administer its own legislation out of extra-statutory deference to the Charities Commission raises administrative law issues. The dual process needs to be clarified.

In this context, it is important to note that section 18 of the Charities Act, which states that in considering an application for registration by an entity, the Charities Commission must "have regard" to the entity's activities, does not apply to IR.

Section 18 reflects the Charities Commission's monitoring role. As part of this role, the Charities Commission has the ability to deregister those entities found not to be complying with their charitable purposes. Under section 18(3)(a), the Charities Commission was given the ability to make that assessment at the point of registration, as the alternative – to register then deregister – would not make administrative sense.

However, IR, in administering the charitable income tax exemptions, and in issuing binding rulings in that context to which the Charities Commission must have regard, is not subject to section 18. The position at common law has been that an entity's purposes are to be determined from an analysis of its constituting documents (see eg *IRC v Oldham Training and Enterprise Council* (1996) 60 TC 231 cited in the CDC case at [48]). It might be necessary to have regard to evidence to discover the consequences of pursuing a purpose or object. However, those activities do not determine whether those purposes are charitable in the first place. Ultimately, whether a purpose is charitable is determined "on the papers". This is the legal position as it applies to IR.

The definition of charitable purpose in the Charities Act and the income tax legislation are therefore inconsistent, contrary to the intention of the Government in passing the charities legislation (and one of the key reasons for not amending the definition of charitable purpose at the time of passing the Charities Act).

When section 5(3) and (4) was inserted into the Charities Act, a corresponding amendment was not made to the definition of charitable purpose in the income tax legislation.

Further, clause 7 of the Statutes Amendment Bill (No 2), introduced on 22 February 2011, proposes to amend the definition of "charitable purpose", in the Charities Act only. The proposed amendment will specifically include as a charitable purpose the purpose of an entity that promotes sport, if the purpose is "expressed to be, and is in fact, the means by which a charitable purpose (such as the promotion of health or education) will be achieved". It is not clear why this amendment is proposed to the Charities Act, but not also to the income tax definition of charitable purpose.

As the statutory definitions of charitable purpose in the Charities Act and Income Tax Act 2007 refer to the same concept, the lack of consistency in the definitions is problematic. This should also be addressed as part of the review.

CONCLUSION

The charities register was intended as the means by which government could measure the level of its support given to the charitable sector through the charitable income tax exemptions.

Some of the entities being deregistered or declined registration appear to be precisely the type of entity the government would wish to support, particularly given current economic and environmental public concerns.

The Charities Commission has stated that it does not see any need to bring forward the review of the Charities Act, currently not scheduled for completion until 2015.

Given the level of concern being expressed, this does not seem consistent with the functions of the Charities Commission to "promote public trust and confidence in the charitable sector", and to "stimulate and promote research into any matter relating to charities" (section 10(1)(a) and (m)). As an autonomous Crown entity, the Charities Commission is required to have regard to government policy when directed to do so by the responsible Minister.

Now is the time for charities to advocate on their own behalf, including for the review to be brought forward. They should not be legally restricted from doing that. ◘

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