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Canterbury Development case

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reviews the first major judgment under the new Act

Since 1 July 2008, charities have been required to be registered by the Charities Commission in order to be eligible for the charitable income tax exemptions in ss CW 41 and CW 42 of the Income Tax Act 2007. Canterbury Development Corporation (CDC), which had been informally accepted by the Inland Revenue Department as "charitable" since its inception in the mid-1980s, applied to the Charities Commission for registration in May 2008. In September 2009, its application was declined by the Commission, and in March 2010, its appeal to the High Court against that decision was dismissed (*Canterbury Development Corporation v Charities Commission* [2010] 2 NZLR 707). An appeal against the High Court decision has been lodged.

THE LEGAL TEST

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 157 (PC), [2002] 3 NZLR 195 (CA), [2002] 1 NZLR 535 (HC).

In determining whether an entity's purpose is charitable, there must be a two-step inquiry (*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 statutory definition of charitable purpose imports into the legislation the common law definition of charities. Section 5(1) of the Charities Act 2005 provides that:

> charitable purpose includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community

which wording closely follows the definition of charity put forward by Lord Macnaghten in *Commissioners for Special Purposes of the Income Tax v Pemsel* [1891] AC 531, 583:

> Charity in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

These four principal divisions, or "heads", of charity were themselves a distillation of the many cases considering the issue of charitable purpose following the Statute of Elizabeth. The preamble to the Statute of Elizabeth contained a list of purposes which were regarded as charitable in Elizabethan times. The Preamble was not exhaustive, but was a sample of the types of purposes which English Courts had found to be charitable up to that time. The Preamble said:

> whereas lands, tenements, rents, annuities, profits, hereditaments, goods, chattels, money and stocks of money have been heretofore given, limited, appointed and assigned, as well by the Queen's most excellent majesty and her most noble progenitors, as by sundry other well disposed persons; some for relief of aged, impotent and poor people, some for maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities, some for repair of bridges, ports, havens, causeways, churches, sea-banks and highways, some for education and preferment of orphans, some for or towards relief, stock or maintenance for houses of correction, some for marriages of poor maids, some for supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, and others for relief or redemption of prisoners or captives, and for aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers and other taxes ...

Charitable purposes are those which are consistent with the spirit and intendment of the preamble to the Statute of Elizabeth: those few lines as to what the then English Parliament considered to be charitable form the judicial starting point for a consideration of charity.

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 (*Centrepoint Community Growth Trust v Commissioner of Inland Revenue* [1985] 1 NZLR 673, 679, citing *Inland Revenue Commissioners v McMullen* [1980] 1 All ER 884, 890, per Lord Hailsham LC).

Some purposes have been specifically held not to be charitable. For example, in *Bowman v Secular Society Ltd* [1917] AC 406, 442, it was held 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 (*Molloy v CIR* (1977) 3 NZTC 61,218).

However, a purpose, even if expressed in charitable form, cannot be charitable unless it is directed towards the benefit of the public. This follows the *Oppenheim v Tobacco Securities Trust Co Ltd* [1951] AC 297, where it was held that in order to be charitable, a payment must be made for the benefit of the community or a sufficiently important section of the community: it must not be made for the benefit of a particular individual.

Although the statutory definition of charitable purpose does not specifically refer to the public benefit test, that test is imported as a key element of the charitable purposes test through the medium of the common law.

There are exceptions to the public benefit rule. For example, the relief of poverty head does not require that the public benefit test be met (*Oppenheim*, 305, per Lord Simonds). In addition, what is now s 5(2) of the Charities Act was inserted specifically to overcome certain limitations associated with the public benefit aspect of the charitable purposes test.

What would constitute a sufficient benefit to the public to satisfy the public benefit best has been the subject of much case law over the years. The IRD, which continues to have responsibility for administration of charitable income tax exemptions, published *Issues Paper IP3168 "The Public Benefit Test"*, January 2000, which said at paras 1.2 and 1.6:

> the courts have [not] adopted any clear approach in applying the public benefit test to different types of charitable entities. There is some uncertainty over how the law is to be applied in this area.
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> ...
>
> there is evidence that appears to suggest that the law in New Zealand may be diverging from that which has continued to be followed in the United Kingdom. It is arguable that the law is not entirely clear and is not static, and is developing in New Zealand in a different manner than that being followed elsewhere.

Bearing this in mind, the issue, in determining whether any particular purpose meets the public benefit test, will be whether the purpose will benefit a sufficiently important section of the community in New Zealand.

Richardson J put it this way in *New Zealand Society of Accountants v CIR* [1986] 1 NZLR 147, 148 (CA) (cited with approval by McKay J in *CIR v Medical Council of New Zealand* [1997] 2 NZLR 297 (CA)):

> [the statutory definition of charitable purpose] does not advance the inquiry ... To come within that paragraph a purpose must fall within the opening words "every charitable purpose" and the succeeding formulation which is descriptive rather than definitive simply points in broad terms to the settled classification of charitable purposes into four categories under the general law of charities. It is then a matter of determining whether the particular purposes are charitable purposes under the New Zealand law of charities ...

CDC argued that it was charitable under the first, second and fourth "heads" of charity. However, it seems reasonably clear from the outside that CDC is not "about" relieving poverty, or advancing education. Its raison d'etre is the economic development of the Canterbury community, and the focus on the first and second heads of charity, rather than helping CDC's case, appears instead to have undermined its best argument – that it qualified as a charity under the fourth head: other purposes beneficial to the community.

In considering the fourth head of charity, Russell LJ made the following comments in *Council of Law Reporting v Attorney-General* [1972] 1 Ch 73, 88:

> The Statute 43 Eliz I was a statute to reform abuses: in such circumstances and in that age the courts of this country were not inclined to be restricted in their implementation of Parliament's desire for reform to particular examples given by the statute: and they deliberately kept open their ability to intervene when they thought necessary in cases not specifically mentioned, by applying as the test whether any particular case of abuse of funds or property was within the "mischief" or the "equity" of the statute.
>
> For myself I believe that this rather vague and undefined approach is the correct one, with analogy its handmaid, and that when considering Lord Macnaghten's fourth category in Pemsel's case ... "objects of general public utility", the Courts, in consistently saying that not all such are necessarily charitable in law, are in substance accepting that if a purpose is shown to be so beneficial or of such utility it is prima facie charitable in law, but have left open a line of retreat based on the equity of the statute in case they are faced with a purpose (eg a political purpose) which could not have been within the contemplation of the statute even if the then legislators had been endowed with the gift of foresight into the circumstances of later centuries.
>
> In such a case as the present, in which in my view the object cannot be thought otherwise than beneficial to the community and of general public utility, I believe the proper question to ask is whether there are any grounds for holding it to be outside the equity of the statute: and I think the answer to that is here in the negative.

Importantly, purposes that are beneficial to the public or of public utility, even if not directly analogous to purposes falling within the spirit and intendment of the preamble to the Statute of Elizabeth, are presumed to be within that spirit and intendment, and therefore charitable, in the absence of any ground for holding otherwise (*CIR v Medical Council of New Zealand* [1997] 2 NZLR 297, (5(2)) *Halsbury's Laws of England* (4th Ed, para 37).

APPLICATION OF THE LEGAL TEST TO CDC

Applying the two-step test to CDC produces an interesting result:

Step 1: beneficial to the public?

It is difficult to see how CDC's purposes could be described as other than beneficial to the public. It is often said that our nation's well-being and prosperity depend on economic development, particularly export-led development. This seems even more acutely the case in the current global economic climate. The support and development of exporting businesses in Canterbury benefits the Canterbury region through the generation of jobs and the improvement of the general economic capability and well-being of the area. Although these benefits likely flow-through to New Zealand as a whole, Canterbury is beyond doubt a sufficiently important section of the community to satisfy the "public benefit" test on its own.

The judgment emphasises that not all businesses that ask for, or need, help are offered it: only those within a narrow band ([44]). In assessing whether a business qualifies for assistance, CDC considers whether the company or project is meaningful, material (in the sense of having "potential to add" in the order of $100 million for a sector or "$10 million individual"), timely (in the sense that this potential is likely to be realised in, say, three to five years), enduring and exportable ([13]).

How "narrow" these criteria may be, and the weight to be afforded them, are questions for debate, but more importantly, these criteria do not limit the class of potential beneficiaries in a way which would cause the public benefit test to be failed. The class of potential beneficiaries is not limited on any personal basis, such as by reference to employees of a particular company as in *Oppenheim*. Anyone may apply to CDC for assistance. The criteria do not prevent the "public benefit" test from being met.

Step 2: charitable purposes?

In the writer's view, the purposes of CDC, as set out in its constitution, fall clearly within the spirit and intendment of the Statute of Elizabeth, and there is no apparent ground for holding otherwise. The Statute of Elizabeth specifically refers to such items of "economic development" as the repair of bridges, ports and highways, and the provision of assistance to young tradesmen and handicraftsmen. Had the Elizabethan legislators been endowed with the gift of foresight referred to by Russell LJ in the quotation above, they would surely have considered the economic development purposes of entities such as CDC to be charitable in the circumstances of New Zealand in 2010.

Were any other authority necessary for the proposition that CDC's purposes are charitable, the following cases clearly demonstrate by analogy that economic development is a charitable purpose:

- *Re Tennant* [1996] 2 NZLR 633, regarding the promotion of the dairy industry in the Waikato;
- *Crystal Palace Trustees v Minister of Town and Country Planning* [1950] 2 All ER 857, regarding the promotion of industry or commerce generally;
- *Commissioners of Inland Revenue v Yorkshire Agricultural Society* [1928] 1 KB 611, regarding the promotion of the industry of agriculture, (cited with approval in *Waitemata County v CIR* [1971] NZLR 151);
- *Tasmanian Electronic Commerce Centre Pty Ltd v FCT* [2005] FCA 439, regarding the provision of assistance to business and industry; and
- *Commissioner of Taxation v Triton Foundation* [2005] FCA 1319 regarding the promotion of a culture of innovation and entrepreneurship by assisting innovators to commercialise their ideas.

Accordingly, in the writer's view, CDC's purposes are clearly charitable. Why, then, did the High Court find CDC was not eligible for registration as a charitable entity?

THE *CDC* JUDGMENT

As a preliminary point, the key test for determining whether CDC is eligible for registration as a charitable entity is in s 13(1)(b) of the Charities Act, which requires that a society or institution must be established and maintained exclusively for charitable purposes, and not carried on for the private pecuniary profit of any individual. Although s 13(1)(b) is cited in the judgment, it is not discussed (perhaps because CDC was considered to have fallen at the charitable purposes hurdle).

Several other questions arise in this context, including:

- why the High Court focussed on the "activities" of CDC; and
- whether economic development can only be charitable in circumstances that "assuage need"?

Charities Act, s 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 CDC [48]). It might be necessary to have regard to evidence to discover the consequences of pursuing a purpose or object but, ultimately, whether a purpose is charitable is determined "on the papers".

Nonetheless, the High Court appears to have decided that CDC was not charitable on the basis of an analysis of CDC's activities (see, eg [29], [30], [67]). For example, at [66], his Honour states that CDC's pursuit of its objects is focused on the development of individual businesses. The focus on activities in the judgment has ostensibly derived from s 18(3)(a) of the Charities Act ([29]), which states that in considering an application for registration by an entity, the Charities Commission must have regard to the entity's activities.

If the High Court decision is authority for the proposition that in assessing whether an entity's purposes are charitable, the terms of the entity's constituting documents and its activities are to be given equal weight or, indeed, that an entity's activities can effectively "trump" the wording of its constituting documents, the High Court has changed the law. However, the judgment does not acknowledge any intention to change the law on the definition of charitable purposes.

The government made it clear during the passage of the Charities Bill that the law on the definition of charitable purpose was not intended to be changed (Report of the Social Services Select Committee considering the Charities Bill, 3, 4, 5). The government specifically sought to retain the status quo in the sense of importing the common law into the charities legislation. It was also concerned that there be consistency with other legislation (most notably the definition of charitable purpose in the income tax legislation).

Section 18 is clear in its terms. However, s 18 needs to be seen in context. An additional key policy rationale behind the Charities Act was that charities should be monitored (identified as a key deficiency of the former regime): to that end, the Charities Commission was given the ability to deregister those entities found not to be complying with their charitable purposes. The Charities Commission was also given the ability to make that assessment at the point of registration, as the alternative – to register then deregister – would not make administrative sense. Hence, s 18(3)(a) was inserted.

However, s 18(3)(a) was never intended to be elevated to an amendment to the common law definition of charitable purposes. If an entity's activities are not consistent with its purposes, the entity is acting beyond its powers, and the Charities Commission is not obliged to register such an entity, even if its purposes are charitable within the legal definition. However, those activities do not determine whether those purposes are charitable in the first place.

Section 18 applies to the Charities Commission, but it does not apply to IRD. IRD, in administering the charitable income tax exemptions, and in issuing binding rulings in that context to which the Charities Commission must have regard (s 91E(1) of the Tax Administration Act 1994 and 13(2)(a) and (3) of the Charities Act), is not subject to s 18 of the Charities Act, nor to the apparent change in law based on s 18 brought about by the High Court decision. In assessing whether an entity's purposes are charitable under the income tax legislation, the weight to be given by IRD to an entity's activities is unchanged by the High Court decision.

The definitions 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. This lack of consistency is problematic.

In the writer's view, if an entity's activities are not consistent with its charitable purposes, the entity is not eligible for registration under the Charities Act, but this should not disturb the question of whether it is legally charitable. Consideration of an entity's activities should be directed to the process of monitoring charities, but should not be elevated to an amendment to 410 years of charitable jurisprudence. The situation requires clarification.

Assuaging need

The High Court also appears to hold that economic development can only be charitable where it is directed to assuaging need ([42]), citing *Tasmanian Electronic Commerce Centre v Commission of Taxation* [2005] FCA 439 and *Re Tennant* [1996] 2 NZLR 633.

This raises several issues:

- even if "need" was established in those cases, it does not necessarily follow that "need" must be established in all cases in order for there to be a charitable purpose.
- it is difficult to see why Tasmania, a region of comparable size and economic development to Canterbury, or Gordonton in the prosperous Waikato dairying belt, has economic need sufficient to reach the threshold of charitable purpose, whereas Canterbury does not.
- how can it be said that Canterbury does not have "need"?

As discussed above, the legal test for charitable purpose turns on whether there is public benefit to the community. It is not necessary, as a matter of law, to show that a community, or a section of the community, is deprived in order to show that such community may benefit.

The public/private dichotomy

Another point of difficulty is the weight given by the High Court to the benefit provided to individual businesses as a result of CDC carrying out its work. It is well-established that the existence of incidental benefits to individual businesses does not deprive an entity of its charitable nature (see, for example, Triton [62]). However, the High Court found ([60]) that CDC's assistance to business is its central purpose, despite acknowledging CDC's belief that this assistance will, in turn, result in benefit to the Canterbury community.

It is not clear why this conclusion was reached. CDC's stated focus is the economic development of the Canterbury community, with assistance to selected businesses merely the means by which that overall objective of public benefit is pursued. It is difficult to see how export-led economic development could be achieved otherwise than through assistance to individual businesses.

The whole decision appears to turn on which one sees as "primary": the overall objective, or the means by which that overall objective is pursued. If the public benefit of the economic development of the community is seen as "primary", and the private benefit to businesses merely the means to that end, CDC's purposes are charitable. If the private benefit to businesses is seen as primary, the opposite conclusion can be reached, with (no doubt) significant practical consequences for CDC. Public and private benefits are opposite sides of a coin, and, with respect, the reasoning in this regard seems conclusory, and inconsistent with the presumption of charitability mentioned above.

OTHER MATTERS

There are other difficulties with the judgment, such as the weight to be given to the restrictive wording of the various constituting documents "to the extent that the same are undertaken for the following exclusively charitable purposes", and the treatment of purposes which are expressed in the constituting documents to be ancillary to charitable purposes (in this regard, it is worth noting that this point was specifically considered at select committee stage resulting in the enactment of s 5(3) and (4) of the Charities Act).

Curiously, in the discussion of CDC (a company), his Honour consistently refers to the constituting documents of trusts. Also, equivalent provisions in the various constituting documents are not analysed in the same way.

CDC argued ([100]) that it should be able to amend its constitution, and functions, to bring itself within the definition of a charitable entity. His Honour rejected such a possibility inter alia on the basis that it would "skew the legislative process for approval of charitable entities" ([101]); his Honour noted that, under the legislation, the first body to consider the question is the Charities Commission with the right of appeal to the High Court. In practical terms, 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, and in the process risk losing the benefit of the transitional concessions available in s CW 41(5) of the Income Tax Act.

His Honour then goes on to express reluctance for the Court to give away the expertise of the Commission as a first adjudicative body. 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.

CHARITABLE TRUSTS ACT

Further, the comment at [1] that existing charities registered under the Charitable Trusts Act 1957 are required to apply for registration under the 2005 Act if they want to retain their tax exempt status under the Income Tax Act is curious. The Charitable Trusts Act 1957 allows trustees and members of unincorporated societies to incorporate as a "board", thereby allowing perpetual succession and concomitant ease of dealing with retirements and appointments over time. The

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CTA has a much wider definition of charitable purpose than that in the Charities Act or the income tax legislation, including, for example, "every purpose that is religious or educational whether or not it is charitable according to the law of New Zealand" (s 2, see also s 61A).

It is therefore possible, indeed reasonably common, to achieve registration under the CTA, but not have exemption under the income tax legislation, or registration under the Charities Act. Indeed, registration under the CTA is irrelevant to a determination of eligibility for registration under the Charities Act, due in part to the much wider definition of charitable purpose the former legislation employs. Registration under the CTA continues unaffected by the establishment of the Charities Register, and exists as a parallel and separate regime.

Further, registration under the CTA was, and is, not available to incorporated societies (s 8(2)(a)), such as CDC, which, contrary to the comment at [2] of the judgment, was not previously registered as a charitable entity anywhere. IRD would no doubt have informally viewed CDC as eligible for the charitable income tax exemptions, and may have issued a non-binding letter of comfort to that effect, but no registration was required, nor legally available to CDC, in order for that outcome to be achieved. Thousands of other charities will have been in a similar position.

The discussion on the "blue-pencil" provision of the CTA (s 61B) is also curious. At [97], his Honour states that there is no logic to explain why s 61B of the CTA applies to trusts and not to other entities. While nothing turns on the point, it should be noted that there is logic to the distinction: if a charitable company or incorporated society is found to have some non-charitable purposes, it simply defaults to being an ordinary company or incorporated society. However, if a charitable trust is found to have some non-charitable purposes, it fails altogether, for reasons such as want of beneficiaries. Section 61B allows such a trust to be saved by striking out the non-charitable purposes, thereby enabling the intentions of the settlor to be carried out to the remaining extent. Such a power is simply not required in the case of charitable entities that are not trusts. The finding that Parliament used "trust" in a general sense of being a charitable entity in s 61B is not as obvious as made out.

CONCLUSION

The Charities Register was intended as a means by which government could measure the level of its support given to the charitable sector through the charitable income tax exemptions. Surely, CDC is precisely the type of entity the government would wish to support, particularly in the current economic times. ❐