

CASE NOTE

Charity Means Business —
Commissioner of Taxation v
Word Investments Ltd

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Abstract

*Commissioner of Taxation v Word Investments Ltd*¹ required the High Court to address squarely the issue of commercial trading by charities. A 4-1 majority held in favour of the taxpayer, finding that Word Investments Ltd was entitled to be endorsed as an income tax exempt charitable institution, despite carrying on a funeral business and other commercial activities. In addition, the decision adopts a narrow construction of the legislative requirement that charities incur their expenditure and pursue their objectives in Australia. This paper analyses the reasons for these findings and explores some of the practical effects. In addition, the potential for increased commercial activity by charities and the corresponding policy implications are discussed.

1. Introduction

‘Commercial’ activities and charitable status are not necessarily inconsistent.² In *Commissioner of Taxation v Word Investments Ltd* (‘*Word Investments*’),³ the High Court of Australia held by a 4-1 majority (Gummow, Hayne, Heydon and Crennan JJ, Kirby J dissenting), that Word Investments Ltd (‘Word’) was entitled to be endorsed as an income tax exempt charitable institution. The Court reached this conclusion notwithstanding the fact that Word’s only activities involved raising funds by commercial means, and then distributing those funds to other entities which carried out their activities predominantly outside of Australia. The decision in *Word Investments* requires the Australian Taxation Office (‘ATO’) to

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1 (2008) 236 CLR 204 (‘*Word Investments*’).

2 It is unclear exactly what ‘commercial’ means in this context. The authorities and regulators tend to be reluctant to apply the term to activities traditionally undertaken by charities, while in other instances it has been used pejoratively as a justification for finding that the test for charitable status has not been met: *Scottish Burial Reform and Cremation Society Ltd v Glasgow Corporation* [1968] AC 138 (‘*Scottish Burial*’) at 147 (Lord Reid); *Brighton College v Marriott* [1926] AC 192 at 204 (Lord Blanesburgh). See also Australian Taxation Office, *Taxation Ruling TR 2005/21*: Income tax and fringe benefits tax: Charities, at [129]–[131]; *Salvation Army (Vic) Property Trust v Fern Tree Gully Corporation* (1952) 85 CLR 159 at 187 (Fullagar J).

3 *Commissioner of Taxation v Word Investments* (2008) 236 CLR 204.

reconsider its longstanding position on the range of permissible trading activities that charities can undertake.⁴ It provides charities with comfort in the knowledge that a broad test will be applied to determine whether commercial activities further a charitable purpose. It may also have implications for a wider range of activities.

In addition, the decision circumscribes the legislative requirement linking the incurring of expenditure and the pursuit of objectives by charities to an Australian nexus. The practical effect of this approach may be significant for those charities with offshore activities that are seeking to establish a separate fundraising entity. As the author has noted in a previous article,⁵ in the longer term, the decision may trigger a legislative reaction. *Word Investments* has significant policy implications for government, some of which are aired in Kirby J's dissenting judgment, and echoed in the recently released *Australia's Future Tax System Consultation Paper*.⁶ Further, a number of reviews have also recommended, or are in the process of recommending, a reconsideration of the tax concessions provided to charities and other not-for-profit entities.⁷ Charities will need to be wary, however, that the victory in *Word Investments* may prove ephemeral.

2. Context

A. Factual Setting

Word Investments came before the High Court due to the Commissioner of Taxation's ('Commissioner') refusal to endorse Word as an income tax exempt charitable institution under Division 50 of the *Income Tax Assessment Act 1997* (Cth) ('ITAA97'). Following partial success for the taxpayer, Word, in the Administrative Appeals Tribunal ('AAT'), the Federal Court at first instance and unanimously on appeal, found that Word was entitled to endorsement from the

4 The Australian Taxation Office indicated that it is assessing the impact of the decision: Australian Taxation Office, *Non-Profit News Service No 0226 – Word Investments Ltd: High Court Dismisses Tax Office Appeal* (Press Release, 3 December 2008) and has released a Decision Impact Statement relating to the decision: Australian Taxation Office, *Decision Impact Statement: Commissioner of Taxation v Word Investments Ltd (2009)* <<http://law.at.gov.au/atolaw/view.htm?DocID=LIT/ICD/M41/3008/00001>> at 26 May 2009.

5 Ian Murray, 'Charitable Fundraising Through Commercial Activities: The Final Word or a Pyrrhic Victory?' (2008) 11(2) *Journal of Australian Taxation* (forthcoming).

6 Commonwealth of Australia, *Australia's Future Tax System Consultation Paper* (Canberra: Treasury, 2008) at 162–4 ('*Henry Consultation Paper*'). See also the terms of reference for the recently announced Productivity Commission review of the not-for-profit sector: Julia Gillard, Deputy Prime Minister; Chris Bowen, Assistant Treasurer and Ursula Stephens, Parliamentary Secretary for Social Inclusion and the Voluntary Sector, *Productivity Commission to Review the Contribution of the Not-For-Profit Sector* (Press Release, 17 March 2009).

7 Senate Standing Committee on Economics, Parliament of Australia, *Disclosure Regimes for Charities and Not-for-Profit Organisations* (2008) at [8.46]; Attorney-General's Department and Department of Families, Housing, Community Services and Indigenous Affairs, *Discussion Paper: Optimising Benefits from Native Title Agreements* (2008) at 15–17. See also Inquiry into the Definition of Charities and Related Organisations, *Report of the Inquiry into the Definition of Charities and Related Organisations* (2001).

earliest date possible. The Commissioner then appealed, unsuccessfully, to the High Court.

Word was established as a company limited by guarantee in 1975 by members of Wycliffe Bible Translators Australia ('Wycliffe'). The intention was that Word would generate funds for Wycliffe. Wycliffe had an evangelical purpose, namely, the spread of Christianity, particularly across developing countries. The Australian Business Register indicates that Wycliffe was endorsed by the Commissioner as an income tax exempt charity with effect from 1 July 2000.⁸

Word's memorandum of association reflected the intentions with which it was founded. It contained numerous objects, commencing with clearly charitable religious objects, but also containing objects, among others, permitting it to carry on business activities ('in connection with' its charitable objects), to 'take money on deposit' and to accumulate or reserve profits for the purposes of its business.⁹ Nevertheless, Word was prevented by its memorandum of association from distributing any profits or gains to its members.

Word's only activities consisted of:

- from 1986, accepting deposits from the public (for Word to invest at market rates) in return for the payment of nil or nominal interest;
- from 1996 to 2002, operating a funeral business, 'Bethel Funerals', by providing funeral services for a fee; and
- distributing any surpluses generated to Wycliffe and other entities to support evangelical activities.

B. The ITAA97 Income Tax Exemption

Division 50 of the *ITAA97* provides an exemption from tax for the income of a number of 'charitable' entities, subject to the Commissioner endorsing the entity and the satisfaction of any further special conditions set out in the Table in s 50-5 *ITAA97*. The 'charitable' entities include:

- a charitable institution,¹⁰ and
- a fund established in Australia for public charitable purposes by will or instrument of trust ('charitable fund').¹¹

(i) Charitable Institution

In Division 50, the word 'charitable' bears its technical general law meaning.¹² Broadly, there are two positive tests that must be met:

8 Australian Government, *Australian Business Register* <<http://www.abr.business.gov.au>> accessed 1 March 2009.

9 *Word Investments* (2008) 236 CLR 204 at [20]–[21] (Gummow, Hayne, Heydon and Crennan JJ); *Commissioner of Taxation v Word Investments Ltd* (2006) 64 ATR 483 at [9]–[10] (Sundberg J).

10 *ITAA97* s 50-5 item 1.1.

11 *ITAA97* items 1.5 (established by will before 1 July 1997), 1.5A (additional assets given to a pre-1 July 1997 trust), 1.5B s 50-5.

1. the entity's purposes must be charitable in the technical sense.¹³ Accordingly, its purpose must be: the relief of poverty, the advancement of education, the advancement of religion, or other purposes beneficial to the community,¹⁴ and
2. the entity (unless it is for the relief of poverty) must be for the public benefit. This means that the entity must bestow an actual benefit,¹⁵ and must do so on a section of the public, rather than a private class of individuals.¹⁶

The coverage of these tests has been extended, to a degree, by legislation to include certain additional purposes and benefits.¹⁷

The courts have also identified certain negative factors that preclude charitable status.¹⁸ The mere act of carrying out commercial activities is not such a factor. The ATO has accepted that undertaking these activities is consistent with charitable status where they directly achieve a charitable purpose, or are incidental or ancillary to a charitable purpose.¹⁹ However, the ATO is of the view that carrying on commercial activities purely to raise funds for a charitable purpose evinces a purpose of carrying on a commercial enterprise, which is inconsistent with an entity's characterisation as a charity.²⁰

It is also important to note that the test adopted by the courts to determine charitable status is a relatively flexible one.²¹ The authorities contain a number of statements that the test should be applied in a way that keeps pace with changing social needs.²² *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* provides a recent example of the High Court acknowledging the evolving role of charities in keeping with this approach.²³ In that case, the factors driving change in the role of charities included greater government activity in the

12 *Central Bayside General Practice Association Ltd v Commissioner of State Revenue* (2006) 228 CLR 168 ('*Central Bayside*') at fn 28 (Gleeson CJ, Heydon and Crennan JJ); *Incorporated Council of Law Reporting of the State of Queensland v Federal Commissioner of Taxation* (1971) 125 CLR 659 ('*Queensland Law Reporting case*') at 666–7 (Barwick CJ, McTiernan J agreeing) and 671 (Windeyer J); *Victorian Women Lawyers' Association Inc v Commissioner of Taxation* (2008) 170 FCR 318 ('*Victorian Women Lawyers' Association*') at [124] (French J). Although *Central Bayside* concerned a provision in the *Pay-roll Tax Act 1971* (Vic), their Honours' comments related to the use of 'charitable' in legislation more generally: (2006) 228 CLR 168 at [169] (Callinan J) and [76]–[119] (Kirby J).

13 That is, in the manner discussed in *Commissioners for Special Purposes of Income Tax v Pemsell* [1891] AC 531 at 573 (Lord Herschell, Lord Watson agreeing) and 583 (Lord Macnaghten, Lords Morris and Watson concurring) in light of the preamble to the *Statute of Charitable Uses* (1601) 43 Eliz I, c. 4.

14 The last is a sweep-up category determined by analogy with judicial authorities or the *Statute of Charitable Uses* (1601) 43 Eliz I, c. 4.

15 *Re Elmore (dec'd)* [1968] VR 390 at 392–4 (Gowans J); *Re Pinion* [1965] Ch 85 at 107 (Harman LJ) and 107–8 (Davies LJ); *The Royal National Agricultural and Industrial Association v Chester* (1974) 48 ALJR 304 ('*Chester's case*') at 305 (McTiernan, Menzies and Mason JJ).

16 *Thompson v Federal Commissioner of Taxation* (1959) 102 CLR 315 at 321–3 (Dixon CJ, Fullagar and Kitto JJ agreeing); *Re Income Tax Acts (No 1)* [1930] VLR 211 at 217 (McFarlane J) and 222–3 (Lowe J); *Victorian Women Lawyers' Association* (2008) 170 FCR 318 at [133] (French J); *Strathalbyn Show Jumping Club Inc v Mayes* (2001) 79 SASR 54 at 74 (Bleby J).

traditionally charitable area of health and greater reliance by charities on government funding.²⁴

Previous authorities had suggested that pursuing ordinary government objectives or assisting to carry out government functions may not be charitable.²⁵ Nevertheless, the High Court found the Central Bayside General Practice Association Ltd ('Association') to be charitable, despite finding that:²⁶

- the Association and the Commonwealth had the same or similar health objectives, and the funding of the Association was part of an Australia-wide scheme to promote the Commonwealth's objectives;
- during the relevant years, the Association received approximately 96 per cent of its revenue in the form of Commonwealth grants;²⁷ and
- the Commonwealth funding was provided for programs that were specified or approved by the Commonwealth, and the funding arrangements imposed a number of reporting requirements and staff restrictions upon the Association.

The term 'institution' has been defined relatively broadly to refer to:

'an establishment, organization, or association, instituted for the promotion of some object, especially one of public utility, religious, charitable educational etc.'
 ... 'an undertaking formed to promote some defined purpose ...' or 'the body (so to speak) called into existence to translate the purpose as conceived in the mind of the founders into a living and active principle'.²⁸

17 *Extension of Charitable Purpose Act 2004* (Cth). This legislation deems that the provision of child care services on a non-profit basis and the provision of a rental dwelling (in certain circumstances) under the National Rental Affordability Scheme are charitable purposes. The legislation also deems an institution to be for the public benefit to the extent that it is an open and non-discriminatory self-help group, or a closed or contemplative religious order that regularly undertakes prayerful intervention at the request of members of the public. There are also State extensions (see, eg, *Charitable Trusts Act 1962* (WA) s 5), although it is unclear whether these apply for the purposes of the *ITAA97*. See *Taxation Ruling TR 2005/21*, above n 2 at [99].

18 For instance, the entity's purpose cannot: (i) be objectionable for reasons of public policy (*Re Lowin* [1967] 2 NSW 140 at 145–6 (Wallace P and Holmes JA)); (ii) be for 'political purposes', although there is some uncertainty over the width of this factor (*Bowman v Secular Society* [1917] AC 406 at 442 (Lord Parker); *Royal North Shore Hospital of Sydney v Attorney-General (NSW)* (1938) 60 CLR 396 at 426 (Dixon J), 412–413 (cf Latham CJ), 419 (cf Rich J) and 420 (cf Starke J)); (3) be governmental (although contrast *Central Bayside* (2006) 228 CLR 168).

19 *Taxation Ruling TR 2005/21*, above n 2 at [129].

20 *Id* at [128], [134].

21 This has caused disquiet on occasion: *Scottish Burial* [1968] AC 138 at 153 (Lord Upjohn).

22 *Central Bayside* (2006) 228 CLR 168 at [116]–[117] (Kirby J); *Scottish Burial* [1968] AC 138 at 147 (cf Lord Reid, Lord Guest agreeing) and 154 (Lord Wilberforce, Lord Guest agreeing); *Tasmanian Electronic Commerce Centre Pty Ltd v Federal Commissioner of Taxation* (2005) 142 FCR 371 at [37] (Heerey J).

23 *Central Bayside* (2006) 228 CLR 168.

24 *Central Bayside* (2006) 228 CLR 168 at [71], [142] (Kirby J) and [185] (Callinan J); see also at [39] (Gleeson CJ, Heydon and Crennan JJ).

An entity need not adopt any particular legal structure to be an institution, although a trust fund that is simply managed and applied in the form of distributions to other entities is unlikely to be an ‘institution’.²⁹

(ii) *Section 50-50(a) ITAA97 Special Condition*

In addition to obtaining endorsement, a charitable institution must meet the special condition set out in s 50-50(a) *ITAA97*. Only the first limb, s 50-50(a) was relevant to Word:

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 ...³⁰

(iii) *Commissioner’s Arguments*

The Commissioner raised four grounds before the High Court, challenging Word’s entitlement to endorsement:

1. Word’s objects were not exclusively charitable;
2. Word could not be charitable because its activities consisted only of fundraising by commercial means, and then distributing the funds to other entities that directly undertook ‘charitable activities’;
3. Word was not required by its memorandum of association to ensure that its distributions were restricted to charitable institutions or for charitable purposes and, in fact, there were no restrictions on the use of Word’s distributions by the recipients; and
4. Word did not satisfy the requirements of s 50-50(a) *ITAA97* because the entities to which it distributed funds primarily carried out their purposes outside Australia.

The first two arguments related to whether Word’s commercial activities and its powers to carry out such activities prevented it from being a ‘charitable

25 *In re Cain (dec’d); The National Trustees Executors and Agency Co of Australasia Ltd v Jeffrey* [1950] VLR 382 at 387–8 (Dean J). See also GE Dal Pont and DRC Chalmers, *Equity and Trusts in Australia* (4th ed, 2007) at [29.240].

26 *Central Bayside* (2006) 228 CLR 168 at [40]–[41] (Gleeson CJ, Heydon and Crennan JJ), [143]–[144] (Kirby J) and [185] (Callinan J).

27 *Central Bayside* (2006) 228 CLR 168 at [11] (Gleeson CJ, Heydon and Crennan JJ).

28 *Word Investments* (2008) 236 CLR 204 at [33] (Gummow, Hayne, Heydon and Crennan JJ), referring to: *Stratton v Simpson* (1970) 125 CLR 138 (‘*Stratton*’) at 158 (Gibbs J, Barwick CJ and Menzies J agreeing).

29 *Stratton* (1970) 125 CLR 138 at 158 (Gibbs J, Barwick CJ and Menzies J agreeing), 144–6 (cf Windeyer J), 154–5 (cf Walsh J) — in the context of the construction of a testamentary bequest; *Commissioner of Land Tax (NSW) v Joyce* (1974) 132 CLR 22 at 27 (McTiernan J), 28 (Menzies J) and 32 (Stephen J, Gibbs and Mason JJ agreeing). See also *Trustees of the Allport Bequest v Federal Commissioner of Taxation* (1988) ATC 4436 at 4441 (Northrop J) — in the context of a public benevolent institution.

30 *ITAA97* s 50-50(a).

institution'. The third ground also concerned Word's status as a 'charitable institution', but by reference to the degree of control that such an institution must exercise over its distributions. The final argument related solely to the separate special condition in s 50-50 ITAA97.

3. *Decision*

A. *Commercial Fundraising by a Charitable Institution*

The Commissioner's first and second grounds concerned the issue of whether Word could be a 'charitable institution' given its activities and powers. Although the Commissioner's first ground referred to Word's 'objects', the Commissioner's arguments and the majority's analysis concerned the broader issue of 'the true character or nature' of Word.³¹ In addition to Word's objects as stated in its memorandum of association, the majority indicated that this characterisation test must be carried out by reference to Word's activities, and the 'circumstances of Word's formation'.³²

Their Honours first examined Word's memorandum of association and concluded that it contained 'only one group of objects — a group of objects of advancing religious charitable purposes'.³³ Word's other 'objects', such as its business objects, were construed as powers rather than as true objects.³⁴ Significantly, the majority emphasised that Word's powers to carry out business activities were a means to achieving Word's religious charitable purposes, rather than being an end in their own right:

Word endeavoured to make a profit, but only in aid of its charitable purposes. To point to the goal of profit and isolate it as the relevant purpose is to create a false dichotomy between characterisation of an institution as commercial and characterisation of it as charitable.³⁵

The majority referred to the AAT's finding that the motivation of Word's founders was that Word would operate to raise funds for Wycliffe, but they did not appear to ascribe much significance to this.³⁶ Their Honours also examined Word's activities, noting that the relevant question was whether these activities were 'carried on in furtherance of a charitable purpose', not whether they were 'intrinsically charitable'.³⁷

31 The phrase used by Allsop J in the Full Federal Court decision: *Commissioner of Taxation v Word Investments Ltd* (2007) 164 FCR 194 at [14] (Stone J agreeing).

32 *Word Investments* (2008) 236 CLR 204 at [17], [25], [26] (Gummow, Hayne, Heydon and Crennan JJ).

33 *Word Investments* (2008) 236 CLR 204 at [19] (Gummow, Hayne, Heydon and Crennan JJ).

34 *Word Investments* (2008) 236 CLR 204 at [19], [20] (Gummow, Hayne, Heydon and Crennan JJ).

35 *Word Investments* (2008) 236 CLR 204 at [24] (Gummow, Hayne, Heydon and Crennan JJ).

36 *Word Investments* (2008) 236 CLR 204 at [25] (Gummow, Hayne, Heydon and Crennan JJ).

37 *Word Investments* (2008) 236 CLR 204 at [26] (Gummow, Hayne, Heydon and Crennan JJ).

Ultimately, the majority held that Word's activities were in fact carried on 'only in order to effectuate' its charitable purposes.³⁸ The only caveat issued by the majority was that if an institution, established for charitable purposes, subsequently ceased to carry out those charitable purposes, it would no longer be characterised as charitable.³⁹ As noted by Kirby J, the effect of the majority's approach is that an entity's constitution becomes the 'influential, if not the dominant, factor in characterising the institution's purpose'.⁴⁰ A number of other authorities have stressed that the nature or import of activities should be viewed in light of the rationale behind the activity.⁴¹ This accords with the approach in *Word Investments* of looking to the memorandum of association to determine the nature of an entity's activities.

The inherent difficulty with the majority's approach is determining when powers or activities are to be characterised as being 'carried on in furtherance of a charitable purpose', rather than evidencing a separate, non-charitable purpose.⁴² How close must the nexus be between the commercial activities and the charitable object? Commercial activities that directly realise an entity's charitable purpose are clearly accepted in prior decisions, and by the ATO, as furthering that charitable purpose;⁴³ for instance, the production and sale of law reports (for a fee) by an entity whose object is to produce the reports of the Queensland Supreme Court.⁴⁴ Further, a number of less directly linked fundraising activities (many of which are not necessarily commercial) have been accepted. It is clear that a charity may purchase investment assets, such as land or shares, to generate income for its other activities.⁴⁵ Similarly, collections from the public (including the sale of items or tickets for charitable purposes) are expressly envisaged by State and Territory legislation,⁴⁶ as are gambling activities.⁴⁷

38 *Word Investments* (2008) 236 CLR 204 at [27] (Gummow, Hayne, Heydon and Crennan JJ).

39 *Word Investments* (2008) 236 CLR 204 at [34] (Gummow, Hayne, Heydon and Crennan JJ).

40 *Word Investments* (2008) 236 CLR 204 at [172] (Kirby J). Despite applying a similarly holistic characterisation test, the members of the Full Federal Court also focused on Word's activities as confirming, rather than defining, its purpose: *Commissioner of Taxation v Word Investments Ltd* (2007) 164 FCR 194 at [44]–[48] (Allsop J, Stone J agreeing) and [94], [96] (Jessup J).

41 See especially, *Incorporated Council of Law Reporting for England and Wales v Attorney-General* [1972] 1 Ch 73 at 86 (Russell LJ); *Vancouver Society of Immigrant & Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 ('*Vancouver Society*') at [54] (Gonthier J, L'Heureux-Dubé and McLachlin JJ agreeing — in dissent in the result, but in agreement on the issue of activities versus purposes) and [152] (Iacobucci J, Cory, Major and Bastarache JJ agreeing). See also Maurice C Cullity, 'The Myth of Charitable Activities' (1990) 10 *Estates & Trusts Journal* 7; GE Dal Pont, *Charity Law in Australia and New Zealand* (2000) at 228.

42 *Word Investments* (2008) 236 CLR 204 at [26] (Gummow, Hayne, Heydon and Crennan JJ).

43 *Scottish Burial* [1968] AC 138; *Queensland Law Reporting case*, (1971) 125 CLR 659; *McGarvie Smith Institute v Campbelltown Municipal Council* (1965) 11 LGRA 321 ('*McGarvie Smith*'); *Taxation Ruling TR 2005/21*, above n 2 at [129].

44 *Queensland Law Reporting case* (1971) 125 CLR 659.

45 *University of Western Australia v Commissioner of State Taxation (WA)* (1988) ATC 4020; *Dean Leigh Temperance Canteen v Commissioner of Inland Revenue* (1958) 38 TC 315 ('*Dean Leigh*'); *Taxation Ruling TR 2005/21*, above n 2 at [129].

Cases considering the characterisation of objects⁴⁸ as incidental or ancillary to a charitable object have typically adopted a close factual analysis, rather than a specific test.⁴⁹ Nevertheless, some guidance can be obtained from the question whether the object is ‘conducive to promoting’,⁵⁰ ‘conducive to the achievement of’,⁵¹ or ‘tends to assist, or which naturally goes with, the achievement of’,⁵² the main charitable purpose. In the Canadian case of *Vancouver Society of Immigrant & Visible Minority Women v Minister of National Revenue* (‘*Vancouver Society*’), Iacobucci J indicated that a nexus would exist between activities and a purpose where the activities are ‘in direct furtherance of a charitable purpose’.⁵³ The minority in *Vancouver Society* proposed that the activities must ‘bear a coherent relationship to the purposes sought to be achieved’, or ‘be substantially connected to, and in furtherance of, those purposes’.⁵⁴ The New Zealand decision of *Hester v Commissioner of Inland Revenue* suggests a nexus based on the ‘natural and probable consequences’ of activities.⁵⁵

The Commissioner’s second ground focused greater attention on the nexus between Word’s activities and the achievement of its charitable purposes. In the Commissioner’s view, the nexus was too remote for Word to be characterised as charitable.⁵⁶ The majority noted that this approach would, logically, distinguish between the following entities, each of which might have equivalent charitable objects:⁵⁷

- one which conducted commercial operations, as well as direct charitable activities to spend the profits generated by the commercial activities; and

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

47 For instance, in Western Australia: *Gaming and Wagering Commission Act 1987* (WA) ss 51(2), 81(1), 95(2)(b) and 104(1a).

48 The leading cases discuss incidental objects. However, the same analysis can be applied to activities or powers: *Navy Health Ltd v Deputy Commissioner of Taxation* (2007) 163 FCR 1 (‘*Navy Health*’) at [67] (Jessup J); *Dean Leigh* (1958) 38 TC 315 at 324 (Harman J); *Commissioner of Inland Revenue v Carey’s (Petone and Miramar) Ltd* [1963] NZLR 450 (‘*Carey’s*’) at 455–6 (Gresson P); *Vancouver Society* [1999] 1 SCR 10 at [157]–[158] (Iacobucci J, Cory, Major and Bastarache JJ agreeing).

49 For instance, *Congregational Union of NSW v Thistlethwayte* (1952) 87 CLR 375 (‘*Thistlethwayte*’) at 441–2 (Dixon CJ, McTiernan, Williams and Fullagar JJ); *Royal Australasian College of Surgeons v Federal Commissioner of Taxation* (1943) 68 CLR 436 at 447 (Rich J), 448 (Starke J), 450–1 (McTiernan J) and 453–4 (Williams J) — although that case considered whether the college was a scientific institution, rather than a charitable institution; *Navy Health* (2007) 163 FCR 1 at [65]–[74] (Jessup J); *Inland Revenue Commissioners v City of Glasgow Police Athletic Association* [1953] AC 380 at 397 (Lord Normand), 397–8 (Lord Oaksey), 400 (Lord Morton), 402–3 (Lord Reid) and 405–7 (Lord Cohen).

50 *Stratton* (1970) 125 CLR 138 at 148 (Windeyer J); see also at 159–60 (Gibbs J, Barwick CJ and Menzies J agreeing).

51 *Thistlethwayte* (1952) 87 CLR 375 at 442 (Dixon CJ, McTiernan, Williams and Fullagar JJ).

52 *Navy Health* (2007) 163 FCR 1 at [65] (Jessup J).

- one which conducted commercial operations, and then donated the profits to other entities to carry out the same direct charitable activities.

The majority rejected this distinction, and found that the requisite nexus was present in both scenarios, the latter being applicable to Word.⁵⁸

The majority in *Word Investments* did not consider or adopt Jessup J's suggestion (in the Full Federal Court decision) that a charitable institution's commercial activities must be 'in harmony' with its stated charitable purpose.⁵⁹ Nor did the majority expressly consider a specific nexus test. However, their Honours arguably provided some basis for setting the outer limits of the requisite nexus by reference to the 'natural and probable consequences' of purposes and activities.⁶⁰

This approach reflects that proposed in *Hester* and looks to the effect of, rather than the motivation for, the activities. However, the following comment indicates that the majority also considered the motivation for Word's activities:

Word's position does not depend on the mere fact that its revenues are applied solely to charitable purposes, but on the related fact that those are its sole purposes ... Word is not a company with both charitable and non-charitable purposes which carried on commercial businesses and incidentally conferred benefits on charity; Word is a company having purposes which are solely charitable and which carried on commercial businesses only in order to effectuate those purposes.⁶¹

With what certainty will a court or, more significantly, a charitable institution, be able to apply such a test?⁶² Presumably, the more remote the activities that realise a charitable purpose, the harder it will be to satisfy the test. The majority judgment indicates that the test will be satisfied if the 'natural and probable

53 *Vancouver Society* [1999] 1 SCR 10 at [158] (Iacobucci J, Cory, Major and Bastarache JJ agreeing). The reference to 'direct' is somewhat misleading as Iacobucci J at [152] provided the following example of a direct activity: writing a letter to solicit donations.

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

55 *Hester v Commissioner of Inland Revenue* [2005] 2 NZLR 172 at [83] (William Young and Chambers JJ); (leave to appeal refused in *Hester v CIR* [2005] 2 NZLR 473).

56 *Word Investments* (2008) 236 CLR 204 at [36] (Gummow, Hayne, Heydon and Crennan JJ).

57 *Word Investments* (2008) 236 CLR 204 at [37] (Gummow, Hayne, Heydon and Crennan JJ).

58 *Word Investments* (2008) 236 CLR 204 at [37] (Gummow, Hayne, Heydon and Crennan JJ).

59 *Word Investments* (2007) 164 FCR 194 at [97] (Jessup J).

60 *Word Investments* (2008) 236 CLR 204 at [38] (Gummow, Hayne, Heydon and Crennan JJ), referring to *Baptist Union of Ireland (Northern) Corporation Ltd v Commissioners of Inland Revenue* (1945) 26 TC 335 ('*Baptist Union*') at 348 (MacDermott J). Note, however, that MacDermott J's comments related to the characterisation of a trust's objects, not whether a particular object, power or activity was incidental to another object.

61 *Word Investments* (2008) 236 CLR 204 at [27] (Gummow, Hayne, Heydon and Crennan JJ); see also at [24] (Gummow, Hayne, Heydon and Crennan JJ).

62 See, eg, *Baptist Union Revenue* (1945) 26 TC 335 at 348 (MacDermott J): '[o]n the cases it is permissible to look some distance beyond the expressed objects for the purpose of seeing where they lead. The trouble, as ever, is to draw the line in the right place and distinguish between what is and what is not too remote'.

consequence' of providing funds to another entity is that the other entity will carry out those direct activities. The judgment also appears to suggest the test may be satisfied even if a distribution is made to a charity that accumulates the funds for a period, rather than immediately using these funds for its charitable purposes.⁶³

What are the outer limits (particularly if one looks beyond commercial activities to other activities in support of a charitable purpose), and to what extent are motivating factors relevant? For instance, what of an entity whose constituent document permits the entity to conduct a business, prevents it from providing private benefits to members and related parties, and requires the profits from the business to ultimately be applied to charitable objects — but only upon the winding-up of the entity?⁶⁴ It is arguable that the 'natural and probable consequence' of the business activities in *Re Smith (dec'd): Executor Trustee and Agency Co of South Australia Ltd v Australasian Conference Association Ltd* ('*Re Smith*') was the furtherance of the Sydney Sanitarium and Benevolent Association Ltd's ('Sydney Sanitarium') religious purposes.⁶⁵ The conclusion that Sydney Sanitarium did not have a charitable purpose suggests that causative factors must also be relevant.

The author has previously proposed a 'but for' test, which looks to the motivation for the entity's activities.⁶⁶ There is support for such a test in the requirement that a charitable institution's purpose be exclusively charitable, and the emphasis in the authorities on the prevention of private benefits.⁶⁷ This test requires examining an entity's constitution, activities and the circumstances of its formation, and asking — would it have undertaken the commercial activity 'but for' the purpose of applying the profits to its charitable objects? Such a test should be modified so that the purpose of deriving profits to be applied to charitable objects is a 'necessary' and 'independently sufficient' cause of the fundraising activities, as opposed to being jointly sufficient with other non-charitable causes.⁶⁸

63 *Word Investments* (2008) 236 CLR 204 at [37] (Gummow, Hayne, Heydon and Crennan JJ).

64 Cf *MK Hunt Foundation Ltd v Commissioner of Inland Revenue* [1961] NZLR 405 ('*Hunt*'); the Foundation was found to be not charitable. Although, arguably *Hunt* must be confined to its facts as found by Hardie Boys J following *Carey's* [1963] NZLR 450.

65 *Re Smith (dec'd): Executor Trustee and Agency Co of South Australia Ltd v Australasian Conference Association Ltd* [1954] SASR 151 ('*Re Smith*'). Particularly as Ligertwood J found that '[t]he motive behind the establishment of the Health Food Company was no doubt religious, and its profits were no doubt used exclusively in aid of the teachings, activities and purposes of the religious body': at 159–60. The same comment could be made in relation to *Glebe Administration Board v Commissioner of Pay-roll Tax* (1987) 10 NSWLR 352 ('*Glebe Administration Board*').

66 Murray, above n 5.

67 The obtaining of private benefits would evidence an alternative motivation for the commercial activities. See, eg, *Joseph Rowntree Memorial Trust Housing Association Ltd v A-G* [1983] 1 All ER 288 at 298 (Peter Gibson J); *McGarvie Smith* (1965) 11 LGRA 321 at 328–9 (Else-Mitchell J); *Queensland Law Reporting case* (1971) 125 CLR 659 at 666 (Barwick CJ, McTiernan J agreeing) and 672 (Windeyer J); *Navy Health* (2007) 163 FCR 1 at [57] (Jessup J).

68 The terms 'necessary' and 'independently sufficient' are taken from Fleming's discussion of alternative sufficient causes: JG Fleming, *The Law of Torts* (9th ed, 1998) at 222–3. See also HLA Hart and AM Honoré, *Causation in the Law* (1959) at 106.

A ‘but for’ test would be consistent with the facts and reasoning in *Word Investments*. For instance, Word’s memorandum of association prevented the distribution of profits to members, and required the application of profits to a charitable object or else retained for the benefit of Word’s business, potentially increasing the funds ultimately available for its charitable objects.⁶⁹ As well, Word’s memorandum of association expressly provided that its power to carry on a business was ancillary to its charitable objects.⁷⁰ The ‘but-for’ test is also consistent with the outcome in cases such as *Re Smith*,⁷¹ and in several of the authorities considered by the majority, where the relevant entity had an alternative, non-charitable, objective aim for the commercial activities.⁷²

A ‘but for’ test could potentially be applied in conjunction with a test based on the effect of the activities, such as one looking to the ‘natural and probable consequences’ of the objects or activities. This would provide an explicit basis for considering motivating factors.

B. Control over Distributions by a Charitable Institution

In the context of the Commissioner’s third ground, the majority had little difficulty dismissing the argument that Word’s memorandum of association failed to restrict Word’s distributions to charitable institutions or for charitable purposes (given its finding that Word’s purposes and activities were charitable).⁷³ While their Honours appeared willing to consider whether Word had, in practice, imposed constraints on its distributions, they noted that:

- the limited evidence available suggested that Word had placed limits upon the use of funds by recipient entities,⁷⁴ and
- to the extent that the recipient entities were charities, an outright distribution to those entities would be an application of funds for charitable purposes by Word, unless ‘Word knew or ought to have known that the entities to which it transferred its income would misapply it, or that they did misapply it’.⁷⁵

69 See especially *Word Investments* (2008) 236 CLR 204 at [22] (Gummow, Hayne, Heydon and Crennan JJ).

70 See especially *Word Investments* (2008) 236 CLR 204 at [20] (Gummow, Hayne, Heydon and Crennan JJ).

71 *Re Smith* [1954] SASR 151.

72 See, eg, *Glebe Administration Board* (1987) 10 NSWLR 352 at 365–6 (Priestley and McHugh JJA agreeing). It is harder to identify a separate object on the facts of *R v The Assessors of the Town of Sunny Brae* [1952] 2 SCR 76 (‘*Sunny Brae*’). However, as noted by the majority in *Word Investments*, the Canadian Supreme Court found on the facts that the relevant entity had mixed charitable and non-charitable objects: (2008) 236 CLR 204 at [27] (Gummow, Hayne, Heydon and Crennan JJ). In any event, the majority judges were influenced in their construction of the particular exemption from rates, by the existence of another exemption, specifically directed at the property of religious organisations ‘used exclusively’ for the religious work of the organisation: *Sunny Brae* [1952] 2 SCR 76 at 90–1 (Rand J, Locke J agreeing), 97–9 (Kellock J) and 106–8 (Estey J).

73 *Word Investments* (2008) 236 CLR 204 at [42] (Gummow, Hayne, Heydon and Crennan JJ).

74 *Word Investments* (2008) 236 CLR 204 at [43] (Gummow, Hayne, Heydon and Crennan JJ).

75 *Word Investments* (2008) 236 CLR 204 at [44] (Gummow, Hayne, Heydon and Crennan JJ).

The majority clearly considered that Word would not be a ‘charitable institution’ if it did make distributions to Wycliffe ‘knowing that they would not be expended on charitable objects’.⁷⁶ Arguably, however, making distributions in such circumstances would generally constitute a breach of duty on the part of the entity or its controllers.⁷⁷ If so, it may be inappropriate in most circumstances to accord much significance to those activities when characterising the entity. As the majority appeared to accept in its discussion of s 50-50(a), a breach of trust does not stop a charitable trust from being characterised as charitable.⁷⁸ However, adopting such an approach would entrench the pre-eminent role of the entity’s constituent document in determining its nature, and would run counter to suggestions that charitable institutions and similar entities may have an ambulatory character.⁷⁹

C. ‘In Australia’ Special Condition

In relation to the Commissioner’s fourth ground, only the first limb of s 50-50 of the *ITAA97* was directly relevant to Word. However, while considering the history of s 50-50, the majority also examined the corresponding requirement for charitable funds, contained in s 50-60 of the *ITAA97*.

(i) Section 50-50(a)

In applying s 50-50(a), the parties appeared to agree that Word had a physical presence in Australia. The issue was whether it ‘incur[red] its expenditure and pursue[d] its objectives principally in Australia’.⁸⁰ The Commissioner argued that the place of the pursuit of these objectives should be construed as the place of the direct realisation of those objectives.⁸¹ For Word, this meant the place where Wycliffe (and others) used Word’s distributions to fund missionary activities and bible translations, these being wholly or principally outside Australia.

76 *Word Investments* (2008) 236 CLR 204 at [72] (Gummow, Hayne, Heydon and Crennan JJ). This is reinforced by the caveat issued by the majority to its conclusion on the Commissioner’s first ground: at [34] (Gummow, Hayne, Heydon and Crennan JJ).

77 Failing to comply with the entity’s constitution is likely to be a breach of duty on the part of the controllers. Further, excluding the situation in which property is provided to an entity under an express trust, there is support for the view that property given for the general purposes of an incorporated charity will be treated as giving rise to trustee (or ‘analogous’) obligations. Accordingly, if the entity or its controllers apply their property in breach of the purposes set out in its constitution, in many cases, this will be a breach of fiduciary obligations. When looking at commercial activities, the position for unincorporated associations is likely to be of less significance, as many bodies would incorporate to obtain the benefit of limited liability before carrying out such activities. See especially *Dal Pont*, above n 41 at 377 and 381–2; *Cullity*, above n 41 at 26–7. See also *Sydney Homeopathic Hospital v Turner* (1959) 102 CLR 188 at 221 (Kitto J); *Sir Moses Montefiore Jewish Home v Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406 at 416 (Kearney J); *Australian Executor Trustees Ltd v Ceduna District Health Services Inc* [2006] SASC 286 at [23] (Vanstone J); *Aboriginal Hostels Ltd v Darwin City Council* (1985) 75 FLR 197 at 208 (Nader J); HAJ Ford and WA Lee, *Principles of the Law of Trusts* (vol 2, 1990), at Update 31, at [20440]; Hubert Picarda, *The Law and Practice Relating to Charities* (3rd ed, 1999) at 406–8; Ian Dawson and John Alder ‘The Nature of the Proprietary Interest of a Charitable Company or a Community Interest Company in Its Property’ (2007) 21(1) *Trust Law International* at 3.

While acknowledging some ambiguities in s 50-50(a),⁸² the majority rejected the Commissioner's argument, noting that Word could pursue its charitable objectives by 'making payments to other institutions which have charitable purposes'.⁸³ Accordingly, their Honours held that Word incurred its expenditure and pursued its objectives in Australia:

The decisions to pay were made in Australia, the payments were made in Australia, the payments were made to Australian organisations, and the objects of Word included giving financial assistance to those organisations.⁸⁴

To the extent that s 50-50(a) was to be construed in accordance with an underlying anti-avoidance purpose, the majority noted that the Commissioner already had powers to request information from Word and to revoke its endorsement if the recipients did not in fact use the funds Word distributed for a charitable purpose.⁸⁵ Moreover, the majority emphasised: first, that the language of s 50-50(a) focuses upon the charitable institution in question, not on the activities of any recipients; and second, that s 50-50(a) does not expressly prevent distributions to other entities.⁸⁶ If the Commissioner's argument had been adopted, this would have placed a heavy administrative responsibility upon some organisations — requiring them to investigate and record the location in which distributed funds are used.⁸⁷

It does not appear that the Commissioner sought to apply s 50-50 to those recipients of Word's distributions that were endorsed as income tax exempt charitable institutions,⁸⁸ such as Wycliffe.⁸⁹ This may be because, in applying the s 50-50(a) test, there is a carve-out for 'distributions of any amount received by the institution, fund or other body as a gift (whether of money or other property) or by

78 *Word Investments* (2008) 236 CLR 204 at [70] (Gummow, Hayne, Heydon and Crennan JJ). See also *Douglas v Federal Commissioner of Taxation* (1997) ATC 4722 at 4727 (Olney J); *Auckland Medical Aid Trust v Commissioner of Inland Revenue* [1979] 1 NZLR 382 ('*Auckland Medical*') at 396–7 (Chilwell J); *Taxation Ruling TR 2005/21*, above n 2 at [190]. There are limited circumstances in which the court may look outside the trust deed: *Auckland Medical* [1979] 1 NZLR 382 at 395–7 (Chilwell J); *Public Trustee v Attorney-General (NSW)* (1997) 42 NSWLR 600 at 617 (Santow J). Further, conduct in breach of trust may cause the trust to lose its endorsement, on the basis that the trust fund is not being applied for the purposes for which it was established: *ITAA97* s 50-60.

79 See, eg, *Word Investments* (2008) 236 CLR 204 at [70] (Gummow, Hayne, Heydon and Crennan JJ); *Brookton Co-operative Society Ltd v Federal Commissioner of Taxation* (1981) 147 CLR 441 at 451 (Mason J): the 'purpose for which a company is established may change in the course of time'.

80 *Word Investments* (2008) 236 CLR 204 at [46] (Gummow, Hayne, Heydon and Crennan JJ).

81 *Word Investments* (2008) 236 CLR 204 at [47] (Gummow, Hayne, Heydon and Crennan JJ).

82 *Word Investments* (2008) 236 CLR 204 at [74] (Gummow, Hayne, Heydon and Crennan JJ).

83 *Word Investments* (2008) 236 CLR 204 at [73] (Gummow, Hayne, Heydon and Crennan JJ).

84 *Word Investments* (2008) 236 CLR 204 at [73] (Gummow, Hayne, Heydon and Crennan JJ).

85 *Word Investments* (2008) 236 CLR 204 at [72] (Gummow, Hayne, Heydon and Crennan JJ), referring to then ss 50-140 and 50-155 of the *ITAA97* now contained in ss 426-40 and 426-55 of Sch 1 to the *Taxation Administration Act 1953* (Cth).

86 *Word Investments* (2008) 236 CLR 204 at [73] (Gummow, Hayne, Heydon and Crennan JJ). Contrast *ITAA97* s 50-60(c).

way of government grant'.⁹⁰ Provided that the amounts received by Wycliffe were gifts,⁹¹ the effect of the carve-out is that Wycliffe could have spent the amounts overseas without breaching s 50-50(a).⁹² In a lack of symmetry with the approach to 'charitable institutions', the effect of the concession for gifts is to differentiate between the following companies:

- those conducting fundraising operations as well as direct charitable activities in an overseas location; and
- those receiving distributions from the fundraising operations of an affiliated entity and conducting direct charitable activities in an overseas location.

(ii) *Section 50-60*

Section 50-60 of the *ITAA97* contains a special condition for charitable funds that is similar to that set out in s 50-50 for charitable institutions. However, the introductory words of s 50-60 also require that 'the fund is applied for the purposes for which it was established'.⁹³ The ATO considers that the effect of this phrase is to prevent the 'excessive accumulation of investment income', and to require the 'distribution of a substantial part of the income (but not necessarily the capital gains)' of the fund each income year.⁹⁴

The majority noted that s 50-50 does not contain comparable introductory words, and appeared to accept that the rationale for this difference lay in the fact that a charitable institution's status must be tested from time to time by reference to a range of matters, including its constituent documents and ongoing activities.⁹⁵

87 Cf Oliver LJ's comment that the Crown's argument was a 'startling one', in that it would involve 'the trustees of a grant-making charity, although they may discharge themselves as a matter of law by making a grant to another properly constituted charity, are obliged if they wish to claim exemption under the subsections to inquire into the application of the funds given and to demonstrate to the revenue how those funds have been dealt with by other trustees over whom they have no control and for whose actions they are not answerable. Anything more inconvenient would be difficult to imagine': *Internal Revenue Commissioner v Helen Slater Charitable Trust Ltd* [1982] Ch 49 ('*Helen Slater*') at 56 (Oliver LJ, Waller and Fox LJJ agreeing).

88 A recipient entity will not always be subject to s 50-50 *ITAA97* (or a corresponding provision), as there may be no need for the recipient to be income tax exempt. For instance, if the distributions do not constitute assessable income, or if the entity has sufficient deductions to reduce any assessable income.

89 Wycliffe appears to have been endorsed as an income tax exempt charitable institution, effective 1 July 2000: Australian Government, above n 8. As Wycliffe does not appear to have been prescribed in the *ITAA97* under s 50-50(d), or to be a deductible gift recipient under s 50-50(b), it would be subject to s 50-50(a).

90 *ITAA97* s 50-75(1).

91 See Australian Taxation Office, *Taxation Ruling TR 2000/1*, Income Tax: Endorsement of income tax exempt charities at [55]; *Taxation Ruling TR 2005/13*, above n 2.

92 *Taxation Ruling TR 2000/11*, above n 91 at [16]–[17], [53].

93 *ITAA97* s 50-60.

94 *Taxation Ruling TR 2000/11*, above n 91 at [21], [102]. See also *Taxation Ruling IT 340*, which has now been withdrawn.

95 *Word Investments* (2008) 236 CLR 204 at [70] (Gummow, Hayne, Heydon and Crennan JJ).

A charitable fund's status is instead tested by reference to the terms of the trust.⁹⁶ A trustee may be acting in breach of the trust terms and hence 'not applying the assets to the relevant trust or fund purposes', but this would not prevent the trust from continuing to be for charitable purposes.⁹⁷

Although not explored in the court's decision, the above reasoning suggests that s 50-60 does not require the expenditure of trust funds (as opposed to accumulation), but rather, that the trustees must act in accordance with the trust deed when applying trust funds. Despite some judicial authority for the ATO's position,⁹⁸ subsequent decisions have supported the construction suggested by *Word Investments*.⁹⁹

D. Kirby J's Dissent

Kirby J dissented on all four grounds, adopting a far stricter approach to the entitlement to income tax exempt status and exploring the policy ramifications of the decision to a greater extent than the majority. Kirby J emphasised that income tax exempt status is a 'special privilege' accorded by the *ITAA97*.¹⁰⁰ His Honour noted that permitting charities to conduct commercial enterprises might affect 'competitive neutrality', as charities would have a tax advantage over for-profit businesses, and might erode the income tax base.¹⁰¹ Kirby J also expressed concern that many taxpayers might 'disagree' with the objectives of religious institutions, which they would be indirectly subsidising as a result of the award of income tax exemption.¹⁰² Accordingly, his Honour suggested that providing exemption from income tax to entities such as Word was a matter for Parliament, 'after a full debate about the issues of principle and policy that are to be raised'.¹⁰³ His Honour's concern is likely to be equally applicable to other categories of tax exempt entity — for example, a club established for the encouragement of a sport that operates poker machines to raise revenue.¹⁰⁴

Kirby J conflated the four issues considered by the majority into two: first, whether Word satisfied the 'in Australia' condition in s 50-50 of the *ITAA97* and; second, whether Word was a charitable institution.

96 *Word Investments* (2008) 236 CLR 204 at [70] (Gummow, Hayne, Heydon and Crennan JJ).

97 *Word Investments* (2008) 236 CLR 204 at [70] (Gummow, Hayne, Heydon and Crennan JJ).

98 *Trustees, Executors and Agency Co Ltd v Federal Commissioner of Taxation* (1917) 23 CLR 576 at 586–7 (Isaacs J) and 588 (Gavan Duffy and Rich JJ).

99 *Mahoney v Commissioner of Taxation* (1965) 39 ALJR 62 at 63 (Owen J); *Compton v Commissioner of Taxation* (1966) 39 ALJR 400 at 402 (cf Taylor J); *Mahoney v Commissioner of Taxation* (1967) 41 ALJR 232 at 235 (Taylor J) and 238 (Windeyer J); *TACT v Commissioner of Taxation* (2008) ATC 10-018 at [47]–[51] (Taylor SM). In the UK context, see *Helen Slater* [1982] 1 Ch 49 at 59 (Oliver LJ, Waller and Fox LJJ agreeing).

100 *Word Investments* (2008) 236 CLR 204 at [107] (Kirby J).

101 *Word Investments* (2008) 236 CLR 204 at [118]–[120], [125] (Kirby J).

102 *Word Investments* (2008) 236 CLR 204 at [110] (Kirby J).

103 *Word Investments* (2008) 236 CLR 204 at [126] (Kirby J).

104 *Income Tax Assessment Act 1997* (Cth) s 50-45, item 9.1(c). Cf *Cronulla Sutherland Leagues Club Ltd v Federal Commissioner of Taxation* (1990) ATC 4215; *St Mary's Rugby League Club Ltd v Federal Commissioner of Taxation* (1997) ATC 4528.

In construing s 50-50(a), Kirby J found that under the *ITAA97*, the pursuit of objectives occurs where the activities that directly affect those objectives take place.¹⁰⁵ On this basis, Word's charitable objectives were principally pursued outside Australia.¹⁰⁶

When characterising whether Word was a charitable institution, Kirby J placed greater emphasis upon Word's activities and upon policy implications than the majority.¹⁰⁷ His Honour focused on what Word actually did; namely, the conduct of 'investment and commercial funeral business activities for profit'.¹⁰⁸ These activities were not charitable — only the 'ultimate proposed destination of the profits that Word derived' was charitable.¹⁰⁹ Kirby J considered that the link between Word's activities and the ultimate use of the funds generated was too remote for Word's purpose to be charitable.¹¹⁰ His Honour suggested that a link would, however, exist where commercial activities could be said to be 'related' to the stated charitable purpose.¹¹¹ For instance, 'a Law Reporting body selling law reports would be a related activity'.¹¹²

4. *Implications*

A. *Commercial Activities*

The decision in *Word Investments* confirms that charitable institutions can undertake a broader range of commercial fundraising activities than previously accepted by the ATO. The majority's approach, particularly for those entities already carrying out activities that directly affect their charitable purpose, means that it may no longer be necessary to quarantine commercial operations in a separate entity. Further, while *Word Investments* relates to charitable institutions, the reasoning is also, to different degrees, relevant to charitable funds and other categories of tax exempt entities.¹¹³

However, the degree to which charities may now increase their commercial activities is not clear. There are already arrangements that charities can adopt to conduct commercial fundraising in a potentially tax exempt manner, although

105 *Word Investments* (2008) 236 CLR 204 at [137] (Kirby J). See also the Commissioner's argument, which was endorsed by Kirby J at [47].

106 *Word Investments* (2008) 236 CLR 204 at [156], [159] (Kirby J).

107 *Word Investments* (2008) 236 CLR 204 at [170], [173]–[174], [191] (Kirby J).

108 *Word Investments* (2008) 236 CLR 204 at [177] (Kirby J).

109 *Word Investments* (2008) 236 CLR 204 at [177] (Kirby J).

110 *Word Investments* (2008) 236 CLR 204 at [178], [184] (Kirby J).

111 *Word Investments* (2008) 236 CLR 204 at [180] (Kirby J). Compare the approaches achieved in England and Wales, Canada and the United States by legislative intervention.

112 *Word Investments* (2008) 236 CLR 204 at [180] (Kirby J) with reference to the *Queensland Law Reporting case* (1971) 125 CLR 659.

113 Particularly since the Commissioner appeared to accept the primacy of the trust deed in the case of charitable trusts, and that the existence of a power in the trustee to 'invest [trust] assets, or use them to carry on a business' should not prevent the characterisation of the trust as being for charitable purposes: *Word Investments* (2008) 236 CLR 204 at [13] (Gummow, Hayne, Heydon and Crennan JJ).

these increase the complexity of a charity's affairs. For instance, charities can establish wholly-owned trading companies (potentially claiming imputation credits effectively to recover tax paid by the subsidiary)¹¹⁴ or can arrange to be a beneficiary of a trading trust (the distributed trust income then being exempt from tax).¹¹⁵ However, the specific circumstances of a charity should be carefully considered to ensure that establishing such a structure does not infringe anti-avoidance provisions, such as Pt IVA of the *Income Tax Assessment Act 1936* (Cth).

If commercial fundraising by charities does increase, then, as emphasised by Kirby J, there may be important policy implications for government — for instance, the erosion of the tax base or a loss of competitive neutrality. In addition to those identified by Kirby J, potential issues include:

- as a corollary to the competitive neutrality concern, whether differential tax treatment of charitable and for-profit businesses might cause 'economic inefficiency',¹¹⁶
- a potential increase in the risk of loss of an entity's charitable assets if commercial liabilities are not quarantined;¹¹⁷
- the 'diversion' of the efforts of the controllers of an entity away from its charitable purpose and towards its commercial activities;¹¹⁸ and
- that individuals may view charities as less altruistic if they expand their commercial activities.¹¹⁹

Many of these concerns seem equally relevant to charities conducting commercial activities in ways permitted by the ATO.¹²⁰ For instance, commercial activities that directly realise a charitable purpose, such as the provision, for a fee, of health care by private hospitals.

However, given the number of recent and ongoing reviews that touch upon the activities of charities and their tax concessions, as well as the existence of legislative models in other jurisdictions,¹²¹ legislative change seems likely.

114 *ITAA97* s 207-115.

115 This is not a public trading trust.

116 JD Colombo, 'Commercial Activity and Charitable Tax Exemption' (2002) 44 *William and Mary Law Review* 487 at 538-9.

117 Id at 544-6; Charity Commission for England and Wales, *CC35 — Trustees, Trading and Tax: How Charities May Lawfully Trade* (Liverpool: Charity Commission, 2007) at section B <<http://www.charity-commission.gov.uk/publications/cc35.asp>> accessed 13 January 2009.

118 See Colombo who notes this potential issue: above n 116 at 534-5. See also Raymond Dart 'Charities in Business, Business in Charities, Charities and Business — Mapping and understanding the complex non-profit/business interface' (2004) 18(3) *The Philanthropist* 181 at 190-1. Dart considered that quantitative evidence needed to be gathered to assess the issue.

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

120 See *Taxation Ruling TR 2005/21*, above n 2 at [129].

For instance, the *Henry Consultation Paper* asks the following broad questions that indicate the potential scope of any future legislative reform:

Q7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

Q7.2 Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?¹²²

Importantly, the *Henry Consultation Paper* specifically refers to commercial activity by not-for-profit entities and notes that some submissions have indicated various concerns that mirror a number of the issues set out above.¹²³ The issue of competitive neutrality is expressly discussed in light of *Word Investments*.¹²⁴ However, guidance on the Review Panel's proposed solutions to these issues is likely to be some months away as its final report to the Treasurer is not scheduled to be tabled until December 2009.

It is hoped that any legislative amendment is prefaced by a confirmation of:

- the legitimacy of the potential concerns over commercial activities by charities, identified above; and
- whether indirect fundraising activities raise greater difficulties than traditionally accepted fundraising activities that directly achieve a charitable purpose.

B. Other Indirect Activities

If commercial fundraising can be sufficiently linked to the achievement of an entity's charitable purpose to be a mere means to that end, what of other indirect activities? Arguably, *Word Investments* provides support for a relatively broad nexus test that may assist entities in trying to establish that other indirect conduct, such as sporting or social activities, is incidental or ancillary to a charitable purpose. The decision may also suggest that there is more leeway for advocacy activities, such as making representations to government and conducting public education campaigns to influence public opinion, on the basis that these activities are incidental to a non-political purpose. In any event, this would be consistent

121 *Henry Consultation Paper*, above n 6; Senate Standing Committee on Economics, Parliament of Australia, *Disclosure Regimes*, above n 7; Attorney-General's Department and Department of Families, Housing, Community Services and Indigenous Affairs, *Discussion Paper*, above n 7. Legislative models are provided by England and Wales, the United States and Canada. Each have different methods for income tax purposes to restrict, to a greater or lesser degree, the conduct of tax exempt commercial activities by charities.

122 *Henry Consultation Paper*, above n 6 at 162. The *Henry Consultation Paper* discusses the first round of submissions received by the Australia's Future Tax System Review Panel and calls for further submissions.

123 *Ibid.*

124 *Id* at 163–4.

with an apparent narrowing, of the disqualifying political purpose ground, which such activities potentially offend.¹²⁵

C. Operations Outside Australia

The majority's construction of the 'in Australia' condition in s 50-50(a) of the *ITAA97*, in conjunction with their acceptance of commercial activities, provides charitable institutions with significant scope to raise money in Australia and pass the funds onto an affiliated entity to use outside Australia. Such scope exists provided the affiliated entity uses the funds for a charitable purpose that is consistent with the collecting entity's purposes and does not offend any applicable anti-avoidance provisions. The majority's reasoning also supports a similar construction of the 'in Australia' requirement in s 50-60(a) of the *ITAA97* for charitable funds, particularly given the presence of s 50-60(c), which specifically relates to distributions to certain further funds, foundations or institutions.¹²⁶

5. Conclusion

Word Investments represents a significant boost for charities, if only because it unequivocally confirms that there is no strict dichotomy between a charitable purpose and the carrying out of 'commercial' activities; or potentially, between a charitable purpose and other activities that indirectly aid that charitable purpose. The decision is clearly relevant for the purposes of the income tax exemption provided to charities under Div 50 of the *ITAA97*. It is also likely to be relevant to other tax concessions afforded to charities and other not-for-profits. However, given Kirby J's impassioned dissent and the number of current reviews into charities and not-for-profit tax concessions, charities may wish to wait for further guidance from the government before embarking upon any restructuring.

6. Postscript

Since initially writing this article, in conjunction with the release of the 2009–10 federal budget, the government has provided a preliminary response to *Word Investments*.¹²⁷

The response indicates: first, that the government proposes to introduce legislation to amend the 'in Australia' special condition discussed in Part 2 to limit the ability of tax exempt entities to transfer funds to other organisations for use

125 See especially *Aid/Watch Inc v Federal Commissioner of Taxation* (2008) ATC 2500 at 2501, 2503–4, 2508–9 (Downes P); *Attorney-General v New South Wales Henry George Foundation Ltd* [2002] NSWSC 1128 at [53]–[58], [63]–[65], [85] (Young CJ in Eq); *Public Trustee v A-G* (1997) 42 NSWLR 600 at 607–8, 617, 621 (Santow J); *Victorian Women Lawyers' Association*, (2008) 170 FCR 318 at [128], [149] (French J). See also The Honourable Justice GFK Santow OAM, 'Charity in its Political Voice — a tinkling cymbal or a sounding brass?' (1999) 18 *Australian Bar Review* 225.

126 See also *TACT* (2008) ATC 10-018 at [47]–[51] (Taylor SM).

127 Assistant Treasurer Chris Bowen, 'Government's Interim Response to High Court's Decision in *Word Investments* Case' (Press Release, 12 May 2009).

overseas. It appears that the amendments will be subject to public consultation and be prospective. Second, that the government is monitoring the competitive neutrality concerns raised by charities conducting commercial activities. Although the government has reserved its right to act sooner, it seems that the outcome of the Australia's Future Tax System Review and the Productivity Commission Review will guide its ultimate actions.

