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Charities for the Benefit of Employees: Why Trusts for the Benefit of Employees Fail the Public Benefit Test

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Abstract

Charities are granted significant financial benefits through the exemption from income tax and deductibility of donations under the provisions of the *Income Tax Assessment Act, 1997* (Cth). The concept of what is a charity or a charitable purpose which is a fundamental requirement of the income tax exemption is not defined in any taxation legislation and must be found in the common law. The courts have concluded that a charitable purpose includes charities for the benefit and assistance of

definition was recommended by the 2001 'Report of the Inquiry into the Definition of Charities and Related Organisations'.⁵

They are also words that have a technical legal meaning and which have been discussed and elaborated on over the years by the courts.⁶ Two important issues arise from this, for an entity to be charitable under the 1997 Act its activities must be the promotion of charitable objectives and these charitable objects must come within the legal meaning of charitable.

This article analyses the legal meaning of the words 'charity' and 'charitable' for the purposes of Division 50 of the 1997 Act and explains why an entity established to administer compensation payments to employees and former employees of a company who are suffering from a work related illness does not fall within this meaning as currently established by the Australian and English courts. Such an entity could include a fund established by a company if the fund is limited to compensation for its employees and former employees suffering from a work related illness or injury. The article also examines the public policy rationale for this conclusion and looks at alternative approaches to the current application of the public benefit test to charities.

LEGAL MEANING OF "CHARITABLE"

As far back as 1601 the English courts and legislature were considering the issue of when an entity's objectives were charitable for income tax purposes. The Preamble to the *Charitable Uses Act 1601*⁷ is possibly the earliest record of an analysis of what types of activities may constitute charitable purposes. This Act is referred to as the *Statute of Elizabeth* and its Preamble set out the following charitable purposes:

- relief of the aged, impotent and poor;
- maintenance of sick and maimed soldiers and mariners;
- schools and scholars in universities;
- repair of bridges, ports, havens, causeways, churches, sea-banks and highways;
- education and preferment of orphans;
- maintenance of prisons;
- marriages of poor maids;
- aid and help of young tradesmen and handicraftsmen;
- aid and help of persons decayed;
- the relief or redemption of prisoners or captives;
- the aid or ease of any poor inhabitants concerning payment of fifteens; and
- setting out of soldiers and other taxes.

⁵ Commonwealth of Australia, 'Report of the Inquiry into the Definition of Charities and Related Organisations' (2001) 18; Treasurer's Press Statement "Final Response to the Charities Definition Inquiry" 11 May 2004, <http://www.treasurer.gov.au/tsr/content/pressreleases/2004/031.asp> at 30 November 2006.

⁶ For example refer *Commissioners for Special Purposes of Income Tax v Pemsell* [1891] AC 531, 583 (Lord Macnaghten); *Re Hilditch deceased* (1986) 39 SASR 469, 475 (O'Loughlin J); *Alice Springs Town Council v Mpweteyerre Aboriginal Corporation* (1997) 139 FLR 236, 251-252 (Mildren J).

⁷ 43 Eliz I c4.

This Preamble was not considered, even at that time, to be exhaustive as significant charitable areas such as charities for the advancement of religion and of some educational institutions were not included.⁸

In *Morice v Bishop of Durham*,⁹ an English case that was decided two hundred years later, the court ruled that for a purpose to be 'charitable' it had to be within the spirit and intendment of the Preamble to the *Statute of Elizabeth*.¹⁰

Subsequently, in 1891 Lord Macnaghten in *Pemsel's* case stated that the legal meaning of 'charity' could be classified into four separate divisions. He stated that a charity should be a trust for one of the following:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; or
- for other purposes beneficial to the community.¹¹

The classification of charitable purpose into these four areas was seen as a milestone and has been consistently used in judicial considerations ever since.¹²

Subsequent Australian cases have confirmed the principle that the classes of charities referred to in the Preamble to the

benefit of the public.²⁸

their personal relationship but their physical location.⁵¹ The argument is that as anyone can (theoretically) move to a particular location the section of the public benefited is not restricted by something outside its control such as an employment or family relationship.

Lord Greene MR expressed it in *Re Compton; Powell v Compton*:

[T]hey do not enjoy the benefit, when they receive it, by virtue of their

connection through common employment does not make the group a section of the community, the trust was not charitable.⁵⁸

The court's thinking in this and other cases which have confirmed this line of reasoning was clearly influenced by the fiscal advantages that arise from being granted charitable status. Lord Greene MR makes several references to the tax free status of charities in his comments in *Re Compton, Powell v Compton*⁵⁹ as the rationale for restricting charities to those that benefit the public as does Lord Cross in *Dingle v Turner*.⁶⁰ Lord Cross stated in this case:

In answering the question whether any given trust is a charitable trust the courts – as I see it - cannot avoid having regard to the fiscal privileges accorded to charities...To establish a trust for the education of the children of employees in a company in which you are interested is no doubt a meritorious act; but however numerous the employees may be the purpose which you are seeking to achieve is not a public purpose. It is a company purpose and there is no reason why your fellow taxpayers should contribute to a scheme which by providing 'fringe benefits' for your employees will benefit the company by making their conditions of employment more attractive.⁶¹

ARGUMENTS AGAINST THE PUBLIC BENEFIT RESTRICTION IN ALL SITUATIONS

It is arguable that there are other approaches that will allow distinctions between trusts that are based on a personal relationship and which therefore fail the 'public benefit'

If the rationale for refusing to grant charitable status to a trust for the benefit of sick employees and former employees of a company is that this would grant a fringe benefit to these persons the argument seems illogical. The grant of money in this situation is to enable these employees and former employees to obtain medical assistance and support in cases where they are unable to work. It is very different from a trust for the education of employees' children. Furthermore, public policy would suggest that ambiguous cases should favour assistance towards the sick as this is an important charitable purpose.

CONCLUSION

The law relating to charities needs to be flexible in order to meet the needs of potentially charitable situations that develop due to changes in society. When Lord Macnaghten first considered the four charitable headings he articulated in *Pemsel's* case it was virtually impossible for a successful action to be brought by an employee for an injury suffered at work against his or her employer.⁷⁰ The situation is now very different.

If the scenario is instead considered from the perspective of purpose, then it is

context of society's needs rather than the relationship of its objects when determining charitable status.