

Court reconsiders charitable nature of commercial operation

COMMISSIONER OF TAXATION V WORD INVESTMENTS LTD [2007] FCA FC 171



INTRODUCTION

On 14 November 2007 the Full Federal Court handed down its decision in the case of *Commissioner of Taxation v Word Investments Ltd*¹, where it reconsidered the charitable status of an organisation that had raised funds through a commercial enterprise for a charitable purpose. The Full Court dismissed the Commissioner's appeal from the decision of the Federal Court, finding that Word was entitled to exemption from income tax under Div 50 of the *Income Tax Assessment Act 1997* ("ITAA 1997") (Cth) as it was correctly characterised as a charitable organisation. The Full Federal Court found that Word had charitable purposes, and carried out commercial activities incidental to its evangelical objects, the profits of which were donated only in accordance with those objects. As a result, its commercial activities did not disturb its charitable purposes. Although the decision of this case may still be tested in the High Court pending the outcome of the Commissioner's application for Special Leave to Appeal, it shows that the courts recognise that it is not always possible for not-for-profit organisations to rely on merely charitable activities in order to provide funds to support their cause.

BACKGROUND

Word Investments Pty Ltd ("Word") was established in 1975 to provide financial and fundraising support to Wycliffe Bible Translators Australia ("Wycliffe"). Wycliffe, and its international counterparts, are evangelical missionary associations that seek to spread the Christian religion through

literacy and translation work, particularly in third world countries, by translating the Bible into the local languages and teaching it to the local population.

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

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

Word made a second application for income tax exemption but this was also refused by the Commissioner. This time, however, Word appealed to the Administrative Appeals Tribunal ("Tribunal") which partially allowed the objection. The Commissioner subsequently appealed the finding of the Tribunal, and the Federal Court, in dismissing that appeal, held that Word was eligible to be characterised as a charitable organisation in all relevant periods. The Commissioner then appealed to the Full Federal Court, the decision of which is the subject of the present case.

As a side issue, Word created the Word Investments Foundation Trust ("Foundation") in 2002 to hold Bethel Funerals and from this time onward, Word acted as trustee of the Foundation and conducted Bethel Funerals in that capacity. The Foundation also applied, unsuccessfully, for endorsement as a tax

exempt charitable fund, and a final review of this decision is yet to occur.

RELEVANT LEGISLATION

Division 50 of the ("ITAA 1997") deals with the exemption of certain entities from paying income tax. Where an entity is covered by Div 50, subject to the conditions required of that particular entity, the "total ordinary income and statutory income of the entities covered [in this division] is exempt from income tax".

The relevant special conditions include:

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

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

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

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

TRIBUNAL DECISION

The Tribunal partially upheld Word's objection to the Commissioner's decision to refuse its application to be exempt from income tax. It found that prior to 1996, and after 1 July 2002, Word was entitled to be endorsed as exempt from income tax as an institution for the advancement of religion. This arose because the funds Word raised were distributed to Wycliffe and other similar organisations in accordance with its Memorandum of Association. Importantly, the Tribunal reached this result for the period after 1 July 2002 because Bethel Funerals was operated by a separate entity from Word. However, between 1996 and 2002, the period in which Word operated Bethel Funerals in its own right, Word was **not** entitled to be endorsed as exempt from income tax because the funeral business was conducted with the view of making a profit.

FEDERAL COURT DECISION

The Commissioner of Taxation appealed the Tribunal's decision to the Federal Court, submitting that the Tribunal had erred in its conclusion that Word was a charitable organisation in the period prior to 1996 and from 2002 onwards, and that it was necessary to draw a distinction between Word's purpose and its activities "for the good" of religion.

Justice Sundberg reasoned that Word had sufficient charitable purposes to fall within the legal definition of charity set out in the case of *Income Tax Special Purpose Commissioners v Pemsel*², which were reflected in Word's list of objects in its memorandum of association, namely:

- 1 to teach and expand the Christian religion both in Victoria and through the rest of the world;
- 2 to provide assistance both financial and otherwise for evangelical missionary organisations and evangelical missionaries operating in Victoria or elsewhere in the world;
- 3 to encourage the enlistment of missionary volunteers;
- 4 to carry on any business or activity which is conveniently carried on in connection with the objects;

- 5 to make payments to any fund for religious charitable or benevolent objects of any description;
- 6 to invest and deal with moneys as determined by the directors; and
- 7 to set aside out of the profits funds to maintain Word's property.

Justice Sundberg held that there was sufficient evidence to determine Word's charitable purpose, as the relevant question to be answered was not what the funds distributed by Word were used for, but what Word understood was being done with those funds³. For that reason, there was ample evidence before the Federal Court to determine that Word's motivation for distributing funds to Wycliffe and other evangelical organisations. Furthermore, his honour was satisfied that Word's activities occurred in Australia regardless of where the money was actually spent, thus meeting the requirements of s 50-50(a) of the ITAA 1997.

Furthermore, his Honour overturned the decision of the Tribunal in relation to the period in which Word operated Bethel Funerals in its own right, holding that the Tribunal had made an unwarranted distinction between active and passive investment and had considered the funeral business in isolation from Word's other activities. The Federal Court held that the purpose of raising the money between 1996 and 2002 was for the same purposes as the preceding and following years, it was only the manner of raising funds that had changed.

As a result, the Federal Court dismissed the Commissioner's appeal and found that in all relevant periods, Word should be considered a charitable institution and therefore eligible for exemption from income tax under ITAA 1997.

ISSUES BEFORE THE FULL FEDERAL COURT

The Commissioner again appealed to the Full Federal Court on the grounds of:

1. Whether Word was a "charitable institution" within the meaning of item 1.1 of the table set out in s 50-5 ITAA 1997;
2. Whether Word pursued its objectives principally within Australia in accordance with the special conditions contained in s 50-50(a) ITAA 1997; and

3. Whether the period from 1 July 2002 was properly before the Tribunal.

DECISION OF THE FULL FEDERAL COURT

Could Word be considered a "charitable institution"?

The Full Court upheld the decisions of the lower courts finding that Word could be correctly considered as a charitable institution for the purposes of the ITAA 1997. It was possible for an organisation with charitable objects to undertake commercial activities to be characterised as a charitable organisation, where its commercial activities were incidental to, and profits made were distributed in accordance with, its charitable objects.

The Full Court rejected the submissions made by the Commissioner challenging Word's charitable status. Firstly, it dismissed the Commissioner's submission that Justice Sundberg had incorrectly examined Word's motives instead of its objective purpose. The Full Court held that the approach properly required by the body of authorities was to make an integrated, holistic enquiry directed at whether certain facts and circumstances could satisfy the legal conception of "charitable".

Secondly, the Full Court dismissed the Commissioner's submission that Word's non-evangelical objects and their significance in Word's activities were not taken into consideration. It would have been incorrect of the Court to reach the conclusion that an organisation could not be charitable based on the sole fact that the activities undertaken by that organisation were not charitable on their own⁴. Instead and after detailed consideration of the case law, the Full Court determined that it was not the character of the activity that was itself in question, but the purpose for which an activity is carried out⁵.

Nonetheless, the Full Court did indicate that non-charitable activities must be of the kind capable of being conveniently carried on in connection with the other evangelical objects of the organisation. In the present case, the Full Court determined that this was true of Word's non-charitable activities such that they did not detract from the basic proposition that Word's purpose was to advance religion.

Similarly, the Full Court also rejected the Commissioner's submission that Word's purpose was incorrectly considered in the context of the larger group (that is to say, inclusive of Wycliffe). Instead, the Full Court held that Wycliffe's purpose and subsequent use of the moneys distributed to it from Word, as well as what Word expected would be done with the distributed funds, were also relevant to determine Word's purpose.

The Full Court then turned to the overarching question – could a company which operates a normal commercial business for profit, not being of itself charitable, be regarded as a charitable institution if, as a matter of purpose and of practice, its profits are wholly given over to other bodies which are charitable?

In the present case, the activities that Word carried out (investment and the funeral business) conformed with the subjective purposes of Word from its memorandum of association which were charitable, being for the advancement of religion. On proper understanding of the memorandum of association, the purpose of all activities carried out by Word in pursuance of those objects could therefore only be religious and charitable. The Full Court considered that there was no authority before them supporting the Commissioner's proposition that the predominance of non-charitable activities by an entity denies the possibility of its characterisation as a charitable institution.

There was however authority supporting the contention that a company that is incorporated for the object of charitable purposes that conducts activities of a commercial nature for the "clear and exclusive purpose"⁶ of raising funds in a way that is charitable can be characterised as a charitable institution⁷. Similarly, the Full Court referred to the case of *Christian Enterprise Ltd*⁸ which provided that "where the profits of these commercial activities are donated in accordance with the organisation's charitable objects, the organisation remains capable of being characterised as a [charitable institution]".

Did Word conduct its activities in Australia?

The Full Court held that Word pursued its objectives in Australia. It was clear to the Full Court that the manner in which

Word pursued its evangelical objects was by donating funds to Wycliffe and other organisations. Word donated these funds to the donee organisations in Australia; the fact that these monies may have been spent offshore by the donee organisations was not relevant for the purposes of s 50-50(a) of the ITAA 1997.

Was the period from 1 July 2002 properly before the Tribunal?

The Full Court held that the Tribunal was correct to consider the period from 1 July 2002, being the date from which the Commissioner had endorsed Word as exempt from income tax.

CONCLUSION AND COMMENT

Word Investments has raised funds to support the Bible translation activities of Wycliffe since 1986. The funds raised by Word were raised through various means, including a funeral business. Word made several applications to the Commissioner for endorsement as a charitable institution exempt from income tax, however these were unsuccessful. Word appealed the Commissioner's decision to the Tribunal which held that prior to 1996 and from 2002 onwards, Word was entitled to be endorsed as income tax exempt. On appeal to the Federal Court, the Commissioner's appeal was dismissed and Word's cross appeal allowed so that Word was characterised as a charitable organisation in all relevant periods. The Commissioner again appealed to the Full Federal Court. The Full Court dismissed the Commissioner's appeal from the decision of the Federal Court, finding that Word was entitled to exemption from income tax under Div 50 of the ITAA 1997 as it was correctly characterised as a charitable organisation. The Full Court found that Word had charitable purpose, and carried out commercial activities incidental to its evangelical objects, the profits of which were donated only in accordance with those objects. As a result, its commercial activities did not disturb its charitable purposes.

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

Despite this, the Full Federal Court has made it clear that an organisation can still engage in commercial activities and retain charitable status for the purposes of ITAA 1997.

Although the decision of this case may still be tested in the High Court pending the outcome of the Commissioner's application for Special Leave, it shows that the courts recognise that it is not always possible for not-for-profit organisations to rely on merely charitable activities in order to provide funds to support their cause. This case is timely as not-for-profit organisations must find more imaginative ways to raise money to support and further their cause. Charitable organisations are expected to do more with the same resources, and donations alone may not be sufficient, resulting in many charitable organisations pursuing business ventures to support their activities.

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Reference notes:

- ¹ [2007] FCA FC 171. The Federal Court decision in this case was the subject of our case note in the March 2007 edition of the *TIA Taxation In Australia* journal.
- ² [1891] AC 531.
- ³ *Royal Australasian College of Surgeons v The Federal Commissioner of Taxation* (1943) 68 CLR 436.
- ⁴ *Above n 1*, at [12].
- ⁵ *Vancouver Society of Immigrant & Visible Minority Women v Minister of National Revenue* [1999] 1 SCR 10 at [152]-[153].
- ⁶ *Above n 1* at [32].
- ⁷ See also *Commissioner of Inland Revenue v Carey's Ltd* [1963] NZLR 450.
- ⁸ *Christian Enterprise Ltd v Commissioner of Land Tax* (1968) 72 SR (NSW) 90.