

Bulletin, Wednesday 22 December 2010

Aid/Watch case: Important decision on tax exemptions and concessions relating to charitable institutions

Taxation

On 1 December 2010, the High Court handed down its decision in *Aid/Watch Incorporated v Commissioner of Taxation* [2010] HCA 42 (Aid/Watch case). The majority held that Aid/Watch Incorporated (Aid/Watch) was a 'charitable institution' for the purposes of Commonwealth tax exemptions and concessions.

The significance of the decision is that it establishes the principle that an institution that otherwise has a charitable purpose will be considered 'charitable' notwithstanding that it has 'political objects' and carries out political activities.

Aid/Watch is the second High Court decision in recent times to expand the general law concept of 'charitable institutions' in Australia. The first decision was that of *Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55, in which the majority held that an institution is capable of being charitable even if it carries out business activities, as long as the profits from those activities are used by the institution (or directed to other institutions) for charitable purposes.

Background

Aid/Watch is an organization concerned with promoting the effectiveness of Australian and multi-national aid provided in foreign countries by means that include investment programs, projects and policies. Through media releases and public events designed to influence relevant agencies to alter the way aid programs are administered, Aid/Watch campaigns for changes to the ways in which aid is delivered.

The Commissioner revoked Aid/Watch's endorsement as a 'charitable institution' with effect from October 2006. The Administrative Appeals Tribunal set aside the decision of the Commissioner and determined that Aid/Watch was a 'charitable institution' within the meaning of the relevant legislation. On appeal, the Full Court of the Federal Court set aside the decision of the Tribunal because the immediate and prevailing aim of Aid/Watch was 'to influence government' and this, as a matter of the law of charitable trusts, 'invalidated' any claim to charitable status.

What is a 'charitable institution'?

An institution will be a 'charity' if its sole purpose (which is ascertained by examining both its objects and its activities) is either the relief of poverty, the advancement of education or religion or other purpose deemed beneficial to the community. These are known as the 'four heads of charity'.

In addition to falling within one of the four heads of charity, an institution also has to demonstrate that its charitable purpose is beneficial to the public. Prior to the Aid/Watch case, the Commissioner maintained the view (based on an old line of English case law) that if the political activities of an institution constituted more than a merely incidental component of the institution's activities, the institution could not be charitable.

This conclusion rested on the proposition that it could not be shown that such activities were for the public benefit because it could not be predicted whether the outcome of such political activities (i.e., legislative reform) would be of benefit to the public.

In the High Court, Aid/Watch argued that it was a 'charitable institution' on the basis that it came within the fourth head of charity (other purposes beneficial to the community) and that its activities contributed to the public welfare. The High Court agreed with Aid/Watch's submissions and concluded that "the generation by lawful means of public debate... concerning the efficiency of foreign aid directed to the relief of poverty, itself is a purpose beneficial to the community within the fourth head [of charity]".

High Court's reasoning and conclusions

To understand the implications of the Aid/Watch case it is important to understand the reasoning that the majority applied, in concluding that Aid/Watch was a charitable institution. The key reasoning and conclusions of the majority are summarised as follows:

- the High Court is not in any way bound to follow the old line of English case law. The use of the term 'charitable' in the phrase 'charitable institution' in Australian tax legislation is to be understood by reference to its source in the general law as it is developed in Australia from time to time. The majority noted that the law of charity is a moving subject, which evolves over time to accommodate new social needs as old ones become obsolete or satisfied;
- there is no general doctrine in Australia that excludes 'political objects' from charitable purposes. If the purpose of an institution would otherwise come within one of the four heads of charity, the institution will not be excluded from being classified as a charity because it has political objects and carries out political activities. This is because activities by which entities 'agitate' for legislative and political change contribute to the public welfare because they support the operation of the Constitution of the Commonwealth of Australia, which mandates a system of representative and responsible government. Communication between electors and legislators and the officers of the executive, and between electors themselves, on matters of government and politics is an indispensable incident of the constitutional system; and
- on the basis that it is the processes of such lawful communication that contribute to the public welfare (as opposed to the result of those processes), the High Court concluded that a Court is therefore not called upon to adjudicate the merits of any particular course of legislative or executive action or inaction that is the subject of advocacy or disputation within those processes. This conclusion removed the problem posed by the old case law: that a Court could not determine whether a particular act of legislative reform would benefit the community.



Critical implications of the Aid/Watch case

The critical implications of the Aid/Watch case are summarised below.

Already endorsed 'charitable institutions' are entitled to undertake political activities

There are likely to be many endorsed 'charitable institutions' that are interested in legitimately carrying out political activities in the sense described by the High Court as being an 'indispensable incident of the constitutional system'. Prior to the Aid/Watch case, the fear of an ATO audit may have kept an institution's political activities to a bare minimum in the sense of them being incidental to the institution's main activities and charitable purpose. In light of the Aid/Watch case, it would seem that as long as the institution's purpose falls within one of the four heads of charity, the fact that it carries out political activities should not affect in any way whatsoever its entitlement to be endorsed as a charitable institution.

Institutions now eligible for endorsement as 'charitable institutions'

There are also likely to be many institutions that, up until now have not applied for charitable endorsement because of a genuine concern that they would have been unlikely to be entitled to be endorsed, based on the Commissioner's interpretation, which has now shown to be wrong. It is fair to assume that a fair proportion of organisations that primarily carry on political activities, but have a purpose that would otherwise fall within the four heads of charity, would not have applied for endorsements prior to the Aid/Watch case. Subject to our comments below in relation to illegal activities, these organisations should now be entitled to apply to the ATO for endorsement as 'charitable institutions', with some justifiable confidence that their application will be successful.

It is unclear whether institutions that solely have political objects may be entitled to be endorsed as 'charitable institutions'

There are likely to be a number of institutions that carry out political activities but do not have a purpose that falls within the first three heads of charity (i.e., the relief of poverty and the advancement of education or religion). The issue for these institutions is whether the purpose of engaging the public in the democratic process and agitating for change (regardless of the subject matter of that change), will be considered 'charitable' under the fourth head of charity (other purposes beneficial to the community). The High Court did not rule this conclusion out. Rather, it held that in the circumstances it was unnecessary for the appeal to determine whether the fourth head of charity encompasses the encouragement of public debate in respect of activities of government that lie beyond the first three heads of charity (or the balance of the fourth head), and if so, the range of those activities. This is likely to be a hotly contested issue in the coming years.

We note that institutions seeking endorsement on the basis that they advance education though their political activities may find it difficult to prove that their activities are in fact educational in the relevant sense of the word. This, according to Justice Heydon AC in his minority judgment in the Aid/Watch case, is because influencing public opinion through advocacy and propaganda may not by itself be considered to be educational. Further, such institutions that cannot rely upon the advancement of religion or the relief of poverty for the underlying premise of their charitable

purpose would be precluded by the technical meaning of what constitutes a charity from being considered a charity, unless they can establish that they fall within the fourth head of charity discussed in the above paragraph. The majority in their judgement made no comment on these issues.

Activities of political organisations will need to be closely monitored

Although the Aid/Watch case may have opened the door for a number of political organisations to now become endorsed as 'charitable institutions', these organisations will need to pay particular attention to the means by which they achieve their political objectives.

If the particular activities of political activism of an organisation seek to bring about change in the law by illegal means, such as by revolution, bribery, or illegal lobbying, or bringing improper pressure to bear upon members of the legislature, such organisations will not be considered charitable. In addition, if the change to the law agitated by the institution is itself inconsistent with the rule of law and an established system of government (for example, an institution that promotes anarchy), such an institution would be extremely unlikely to be considered charitable because it would not be seen to support the operation of the Constitution, in the way in which the High Court explained in their decision.

Likely reactions to and developments arising from the Aid/Watch case

Overall, the Aid/Watch case is likely to provide comfort to endorsed charitable institutions that carry out political activities and is also likely to encourage other institutions to seek charitable endorsement under the principles that the case has now established.

Given the importance of the decision, the ATO is likely to release a *Decision Impact Statement* in the coming months setting out the Commissioner's administrative response to the decision.

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