THE DEFINITION OF CHARITY AND ITS NEXUS WITH TAX PREFERENCE ISSUES

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MICHAEL GOUSMETT

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GPO Box 2434
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Phone: 07 3864 1020
Fax: 07 3864 9131
Email: cpns@qut.edu.au
http://cpns.bus.qut.edu.au

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ABSTRACT

Charity, since the Reformation, has been secularised to the extent that the continued use by the courts of analogies to a four hundred year old statute in order to determine charitable purpose with respect to tax exempt status, is giving rise to absurd situations. Tax exempt status is generally assigned by an agent of the government, for example the Inland Revenue Department in New Zealand, without any evaluation of the impact of the activities of the charitable organisation on social or economic policies.

It is only when the activities of the charitable organisation are challenged in the courts, that the charitable organisation may lose its privileged position. From this brief analysis, it can be seen that the situation which is developing is a classic case of 'putting the cart before the horse'. A recent New Zealand case demonstrates the folly of assigning tax exempt status without first having examined the charitable purposes of the trust, and without having conjointly undertaken an evaluation of the social and economic impact of that charitable organisation. It is apparent that there is a need for substantial changes in charity law, with respect to charitable purpose and fiscal issues, in today's social and economic climate.

THE SECULARISATION OF CHARITY

This paper discusses the definition of charity, and the nature of the relationship of "charitable purpose" and "tax preferences". In so doing, I find that it is inappropriate for tax exemptions to be provided to charitable organisations purely on the basis of their stated charitable purpose, without any prior evaluation of the social and economic effects of their activities, nor monitoring of their activities once tax exempt status has been approved.

The concept of charity, which I consider to be a thing of beauty, subliminal, spiritual, untainted, without thought of self has, since the introduction of the Statute of Elizabeth in 1601, evolved as a consequence of judicial interpretation into a secular fiscal tool. I wish to suggest that instead of continuing to broaden the concept of charitable purpose to absurd lengths, humanitarian needs should be thought of as the sole basis of charitable activity. The judiciary have, throughout the course of history, declared what shall be a charitable purpose while at the same time refraining from defining "charity" in legal terms. It may be argued that this is a consequence of the state of England's religious beliefs at the time of Henry VIII, and that charitable purpose has Protestant overtones. If England had remained a Catholic nation it is arguable that the law of charity today would be uniquely distinct from that as it now stands.

Brady argues that: "... the great statute on charitable uses was in many ways the highwater mark of Tudor secularism." Blakeney states that: "... contrary to its avowed policy of even-handedness, the English law relating to religious charities exhibits a Protestant bias." In Gilmour v Coats their Lordships, notably unanimously, held that a gift to a Roman Catholic priory did not establish a valid charitable trust because the purposes of that priory did not demonstrably confer a benefit upon the public. Gifts to all Roman Catholic Orders in England were void as being opposed to public policy until the passing of the Roman Catholic Relief Act 1832. Thirty-nine years were to pass before this legislation was to be tested in the question of a gift to a contemplative order. A testatrix had directed that her property,
real and personal, be sold and after meeting certain legacies, the proceeds were to be distributed in equal shares between two specified convents, the Sisters of Charity of St. Paul at Selley Oak, and the Dominican Convent at Carisbrooke. In this case, the Vice-Chancellor, Sir John Wickens, held the first bequest to be valid, as the Sisters of Charity were "... a voluntary association for the purpose of teaching the ignorant and nursing the sick." The second bequest was ruled as:

... not being able to be upheld as charitable ... [the Dominican order of nuns being] a voluntary association of women for the purpose of working out their own salvation by religious exercises and self-denial ... [and had] none of the requisites of a charitable institution, whether the word charitable is used in its popular sense or in its legal sense. (Wickens)

In Ireland, where Roman Catholicism is the established religion, gifts to contemplative orders of nuns are treated differently. This was illustrated by Gavan Duffy J who based his decision on the pre-reformation law, when discussing the question of a gift to found "... a Convent of Perpetual Adoration in Lisnaskea or elsewhere, his Honour:

... perfunctorily declared that it is a shock to one's sense of propriety and a grave discredit to the law that there should, in this Catholic country, be any doubt about the validity of a trust to expend money in founding a Convent for the perpetual adoration of the Blessed Sacrament. (Duffy)

In Re Sheridan, which was concerned with a gift for a Carmelite Convent, Dixon J in following Maguire v Attorney General held the gift to be charitable, and took the opportunity to indicate that the reasoning in Gilmour v Coats was inapplicable to Irish law. As Blakeney observed:

The Irish case law is interesting in highlighting the legal result of a consideration of the charitable status of contemplative orders of nuns in a jurisdiction in which the courts make no apology for displaying a Roman Catholic bias in their analyses, and in which they have arrived at a position which is opposite to that in England in which no religious bias is declared to be present in judicial decisions. The critical distinction between the two jurisdictions is the English requirement of a demonstrable public benefit, which the Irish decisions suggest is a post-Reformation innovation and hence not as even-handed as the English courts maintain. (Blakeney)

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6 Ibid, at p.213.
7 Cocks v Manners 1871 LR 12 Eq at 585. Ibid, at p.213.
8 Blakeney, above n 2, p.213-4.
9 Ibid, at p.217.
10 Ibid, at p.218.
11 Perpetual adoration of the Blessed Sacrament is "a form of devotion whereby arrangements are made, necessarily by a community, for an unbroken succession of persons to be present in private prayer and in contemplation before the Blessed Sacrament exposed to the view of worshippers." [1943] IR 238 cited in Blakeney, above n 2, p.218.
16 Blakeney, above n 2, p. 220.
Blakeney tested his hypothesis, that the English courts were prejudiced by the influence of Protestantism when considering bequests for religious purposes, in a jurisdiction in which neither Anglicanism nor Catholicism was the established religion, that jurisdiction being none other than the Commonwealth of Australia. Blakeney found that:

… interesting possibilities are now raised by the Australian High Court’s declaration in Parker v R and a line of succeeding authorities, that it no longer considers itself bound by the decisions of the House of Lords, and by the High Court’s more recent declaration in Viro v R, that it does not even consider itself obliged to follow decisions of the Privy Council. (Blakeney)

Blakeney considers that: "It may now be possible for that court as a 'neutral' tribunal to render a decision on the charitable nature of gifts to contemplative orders of nuns untrammelled by religious predispositions."

'CHARITY' DEFINED

'Charity,' therefore, or its adjectival derivative, 'charitable purpose', has been defined according to the religious influence of the determining jurisdiction, whether it be of a secular or non-secular character. Returning to my earlier assertion, the use of the derivative of the concept of charity is an abuse of the English language, charitable purpose being what a particular jurisdiction wants it to be, without reference to the origins of the word, nor its concept in religion. The judiciary have not developed a philosophy or concept of charity in determining charitable purpose, preferring instead to continue developing analogies to the Preamble to the Statute of Elizabeth 1601.

The origins of the concept of 'charity' are late Old English, in the sense of "...Christian love of one's fellows', which is derived in turn from the Old French charite, the root being the Latin caritas, from carus, meaning 'dear.' The New Oxford Dictionary of English defines it in an archaic sense as "love of humankind, typically in a Christian context: faith, hope and charity." As a noun, 'charity' and its plural 'charities' refers to those organisations "... set up to provide help and [to] raise money for those in need" (emphasis added). The New Oxford Dictionary of English refers to its use as a mass noun, as being "... the voluntary giving of help, typically in the form of money, to those in need" (emphasis added). The adjective 'charitable' means "...of, or relating to, the assistance of those in need", [or of being] an organisation or activity ... officially recognised as [being] devoted to the assistance of those in need" (emphasis added).

The emphasis and common thread throughout the definition contained within the New Oxford Dictionary of English is of "those in need" (emphasis added). How is it, then, that today it is permissible to register, in New Zealand at least, the following organisations as a charitable trust which qualifies for tax preferences, with the approval of the Inland Revenue
Department: a trust to promote the adoption of racing horses; a veterinary science scholarship; a dancing association; and a floral society? It is not intended to criticise the activities of those organisations, as no doubt they provide, within the secular definition of "charitable purpose," a role for the "benefit of the public." The functions of such organisations, however, are well-removed from the pure concept of charity as defined for those in need, yet they sit side-by-side in the register of entities which benefit from the unique status of being tax exempt and of conferring pecuniary gains to those who contribute financially to their activities.

THE INFLUENCE OF THE COMMISSIONERS FOR SPECIAL PURPOSES OF THE INCOME TAX V PEMSEL

It is useful to review the key elements of the pronouncement by Lord MacNaghten in this preeminent case, as the effects down the centuries have been, and continue to be, far-reaching. Every Income Tax Act, Lord MacNaghten stated, which had been in force since 1842, had contained an exemption in favour of property dedicated to charitable purposes. However, what charitable purpose might be within the meaning of those Acts was not defined by the legislature. In 1887 or 1888, according to Lord MacNaghten, the Board of Inland Revenue discovered that the meaning of the legislature was not to be ascertained from the legal definition of the expressions actually found in the statute, but was to be gathered from the popular use of the word "charity." Lord MacNaghten also stated that: "No doubt the popular meaning of the words 'charity' and 'charitable' does not coincide with their legal meaning ... and no one as yet has succeeded in defining the popular meaning of the word 'charity'."

This latter statement seemed to me to have been an extraordinary testimony for such an eminent person as Lord MacNaghten to make, and I wish to explore the background to his Honour's statement.

THE EVOLUTION OF THE OXFORD ENGLISH DICTIONARY (OED)

Today, if I wish to ascertain the meaning of a word, I will use an acknowledged authority such as the well-known Oxford English Dictionary (OED). In 1891, as I have learnt, the OED did not exist. It seems that the achievements of the compilers of the dictionaries of the time, while today acknowledged as being distinguished lexicographical works, were but a step towards the creation of a truly great work, which was ultimately the Oxford English Dictionary.

Thirty-five years prior to Pemsel's case, in November 1857 at a meeting of the Philological Society, Archbishop Trent, then Dean of Westminster, read a paper entitled "Some Deficiencies in our English Dictionaries." This led to a resolution on the part of that Society to prepare a Supplement to the dictionaries which existed at that time, containing these deficiencies. It soon became apparent that rather than a Dictionary-Supplement, the desired

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33 Ibid, at 574.
34 Ibid, at 574.
35 Ibid, at 574.
36 Ibid, at 583.
38 Ibid, Frontispiece.
objective was "... a new Dictionary worthy of the English language and of the present state of Philological Science."\textsuperscript{39} In 1859, a "Proposal for the publication of a New English Dictionary" was issued, inviting the public of England and America\textsuperscript{40}: 

\ldots to assist in collecting the raw materials for the work, these materials consisting of quotations illustrating the use of English words by all writers of all ages and in all senses, each quotation being made on a uniform plan on a half-sheet of notepaper, that they might in due course be arranged and classified alphabetically and by meanings.

This was a monumental task, as can well be imagined, at the time. The sequel to this appeal was "... that one of the most remarkable conversations in modern literary history took place on a cool and misty late autumn afternoon in 1896, in the small village of Crowthorne in Berkshire."\textsuperscript{41} The meeting was between Dr James Murray, who at that time was the editor of what was later to be called the Oxford English Dictionary, and an enigmatic figure named Dr W.C. Minor, who was among the most prolific of the thousands of volunteers whose labours lay at the core of the dictionary's creation. For nearly twenty years the two men had been corresponding regularly about the finer points of English lexicography, but had never met, due to Dr Minor’s reluctance to leave his home at Crowthorne in order to travel to Oxford. As the task of compiling the dictionary was nearing completion, and as Dr Murray desired to acknowledge the valuable work done by volunteers such as Dr Minor, Dr Murray telegraphed his intentions to travel to Berkshire to meet with Dr Minor. Arriving at the huge and rather forbidding red-brick mansion that was the home of Dr Minor, Dr Murray telegraphed his intentions to travel to Berkshire to meet with Dr Minor. Arriving at the huge and rather forbidding red-brick mansion that was the home of Dr Minor, Dr Murray introduced himself to the person whom he assumed to be Dr Minor, only to learn, "after a brief pause, an air of momentary mutual embarrassment" that the man he was addressing was the Superintendent of the Broadmoor Asylum for the Criminally Insane. For more than twenty years, the Asylum had been the residency of Dr Minor.\textsuperscript{42}

I commend the story of the OED to you, for this is also the story of a man who is credited with having made a singular contribution to that most august of publications which, when finally completed on New Year's Eve 1927 as the New English Dictionary, "... consisted of twelve volumes, 414,825 words defined, 1,827,306 illustrative quotations used, with the total length of type being 178 miles, comprising 227,779,589 letters and numbers."\textsuperscript{43}

\textbf{A BRIEF EXPOSITION ON THE CONCEPT OF CHARITY}

Charity, as we have seen, is not the same to all people. Therefore in attempting to define it, I shall undertake a brief philosophical and religious perspective of charity in order to examine its nature closely. I begin with a philosophical example, to illustrate that what we think charity is, may not necessarily be what others believe it to be\textsuperscript{44}:

So I found myself halfway between the perception of the concept of 'horse' and the knowledge of an individual horse … if you see something from a distance, and you do not understand what it is, you will be content with defining it as a body of some dimension. When you come closer, you will then define it as an animal, even if you do not yet know whether it is a horse or an ass. And finally, when it is still closer, you will be able to say it is a horse even if you do not yet know whether it is Brunellus or Niger.

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\textsuperscript{39} Ibid, Frontispiece.  
\textsuperscript{40} Ibid, Frontispiece.  
\textsuperscript{41} Ibid, Preface.  
\textsuperscript{42} Ibid, at p.3.  
\textsuperscript{43} Ibid, at p.189.  
\end{flushright}
And only when you are at the proper distance will you see that it is Brunellus (or, rather, that horse and not another, however you decide to call it). And that will be full knowledge, the learning of the singular. (Eco)

CHARITY IN RELIGION

Charity, I believe, when closely examined from a religious perspective, is the empathy of mankind towards their fellow human beings whose 'lot in life' has been less than fortunate.

CHARITY IN EASTERN RELIGION

The essential element of charity is that of providing for those in need. This philosophy is not the sole prerogative of Western religion, for it can be found in Eastern religions as well. Buddhism has an overriding emphasis on compassion, known as Bodhicitta, being that "... integral commitment to developing the good heart."\(^{45}\) Mahayana Buddhism\(^{46}\) states that\(^{47}\): "... the only reason to be a spiritual person is to bring benefit to others."

The philosophy of charity is also evident in Islam\(^{48}\):

> The Prophet gave us the Koran, and left us just five obligations to satisfy during our lives. The most important is to believe only in the one true God. The others are to pray five times a day, fast during Ramadan, and to be charitable to the poor. ... The fifth obligation of every Muslim is pilgrimage. We are obliged, at least once in our lives, to visit the holy city of Mecca. (Caelho)

In the mythology of Islamic economics and theology of the East "... there are 60 verses that stipulate, mandate, encourage charity, discuss its virtues and rewards, [and] warn of punishment to those who eschew [charity]."\(^{49}\)

CHARITY IN CHRISTIANITY

Fausett, in his Cyclopaedia, defines Christian charity as\(^{50}\):

> [From] the Gr. "love," "loving esteem"; Latin caritas. The outward benefaction, or alms, is a mere manifestation of the inward and true charity of Scripture (1 Cor. xiii. 3): 'Though I bestow all my goods to feed the poor, ... and have not charity, it profiteth me nothing'. (Fausett)

Modern humanists and many psychologists urge a more authentic love and empathy for one's fellow man.\(^{51}\) Auman states that\(^{52}\): "...Christ gave the mandate to love both God and neighbour and as a single experience of love." Hence, "... to love another, God or man, is a single operation based upon a single psychodynamic principle - seeing the other as worthy of love ... love, whether of God or man, is a single therapeutic power; it has a single function."\(^{53}\)


\(^{46}\) ...[being] the form of Buddhism practised in Tibet, China and Japan, for example. Ibid, at p.99.

\(^{47}\) Sharples, above n 45, p.99.


\(^{49}\) www.witness-pioneer.org/vil/articles/economics/mythology_of_islamic_economics.htm


\(^{52}\) Mk 12:28-31.

Auman believes that \(^{54}\): "It is extremely important to understand the structure and modality of human love if one is to grasp the meaning of the love that is charity." St. Thomas Aquinas, in his tract on the theological virtue of charity, debates the question of charity as friendship \(^{55}\):

 According to Aristotle \(^{56}\) not all love has the character of friendship, but only that love which goes with wishing well, namely when we so love another as to will what is good for him. For if we do not will what is good to the things we love but rather, we will their good for ourselves, as we are said to love wine, a horse or the like, then that is not love of friendship but a love of desire. For it would be foolish to say that someone has a friendship with wine or a horse. As a participation in divine love, charity has God as its proper object, but it also enables the Christian to love God and self and neighbour the way God does, thus in this respect, charity utterly transcends purely human love, and one must rise from the psychological level to the metaphysical in order to understand the love of neighbour which is charity. The love that is charity, therefore, springs from a source that far transcends human love … [and] achieving this, we fulfill Christ's supreme mandate of charity: 'Love one another as I loved you.' (Aquinas)

CHARITY IN PROVERBS

Charity is also richly represented in many proverbs and sayings, as is evident from the following selection.

"The charitable give out at the door and God puts in at the window."
"Charity and pride do both feedeth the poor."
"Charity covers a multitude of sins."
"Anticipate charity by preventing poverty."
"While society is alive and growing it will not make rigid choices between state action and voluntary action, but both alike will expand as the common expression of its vitality."
"For no sermon or admonition [on charity] is of so much avail as a deep-rooted custom."
"Few institutions are more ticklish than those of charity."
"The Waies to enrich are many, and most of the Foule. Parsimony is one of the best, and yet it is not Innocent; For it with-holdeth Men from Workes of Liberality and Charity."

THE ROLE OF THE COURTS IN DEFINING CHARITABLE PURPOSE

Today, four hundred years after Pemsel's case, the courts continue to grapple with the concept of charitable purpose. This was evident in 1948, according to Owen, who stated that \(^{65}\): "Perhaps the time had come to attempt a new definition of the legal concept of charitable, for neither the enumeration in the preamble to the Elizabethan Statute nor Lord MacNaghtens's classification in Pemsel's case established a precise line." The debate, of course, continues today.

\(^{54}\) Auman, above n 51, p.556.
\(^{55}\) Auman, above n 51, p.556.
\(^{56}\) Ethics VIII, 4.
\(^{58}\) Ibid, at p.88.
\(^{59}\) Ibid, at p.88.
\(^{61}\) Nathan Report quoted in Owen, ibid, at p. 573.
\(^{62}\) St. John Chrysostom quoted in Owen, above n 60, p.9.
\(^{63}\) Lord Kames quoted in Owen, above n 60, p.9.
\(^{65}\) Owen, above n 60, p.575.
While it is governments which write the statutes to create charitable trusts, it is the agents of governments, (such as the Inland Revenue Department (IRD) in New Zealand), that approve the tax exempt status of charitable organisations which make such an application. It is, however, the judiciary who have the task of upholding that decision, or of overturning it, when questions arise regarding the validity of tax exempt status accorded to certain charitable trusts. Thus:

I do not think there is any comfort to be gained from definitions in this branch of law. We must rely, as heretofore, upon the social acumen of judges; but at the same time we are entitled perhaps to ask for a little more boldness in the formulation of principles. This is a branch of the law in which precedents lose their cogency through a change in social conditions, and in which analogies are frequently remote. But I should regard with apprehension any attempt to confine the development of the law of charities within the limits of a statutory definition. (Keeton & Schwarzenberger)

SUBSIDIES AND CHARITABLE PURPOSE

Academics are beginning to question the logic of the decisions by the courts when addressing issues of charitable purpose and tax preferences. Culyer et al state that: "... the desirable distinction between the definitions of charity for the purposes of awarding legal and fiscal privileges is nowhere to be found in the present law."

This is illustrated by two events in New Zealand in recent months, which have both addressed the relationship between government subsidies and charitable purpose. The first is an IRD discussion document entitled "Tax and charities" (the discussion document). The second is a High Court case under the Tax Administration Act 1994.

"TAX AND CHARITIES": A NZ GOVERNMENT DISCUSSION DOCUMENT

The release of the discussion document has been very timely in terms of my research towards my post-graduate qualifications. My main concern in preparing my submission on the discussion document was that it soon became apparent to me that it was not dissimilar to previous reviews undertaken in New Zealand in that they all fail, in my opinion, to address in any substantial depth, the underlying issues of the activities of charitable organisations in New Zealand.

The discussion document has caused considerable consternation amongst charities in New Zealand, particularly the suggestion that tax relief could possibly be a form of government subsidy of the sector. The New Zealand Christian Council for Social Services (NZCCSS) consider that: "... tax-exempt status is a privilege (sic) [and NZCCSS] do not see the support the government gives through the tax system as a subsidy." This appears to be a commonly held view, judging from comments at a Forum held in Christchurch to debate the discussion document. A possible explanation may be that an in-depth knowledge of the

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70 A copy of the author's submission is available on request to mjgousmett@xtra.co.nz
71 Undated Memo to Members of NZCCSS.
72 The Forum was held on Friday 20 July at the Centre for the Blind Hall, and was chaired by a representative of the New Zealand Federation of Voluntary Welfare Organisations (NZFVWO), and conducted by a panel.
economic workings of the sector is not a prerequisite to either employment or voluntary Board membership within the sector. In comparison, directors of public companies, more likely than not, would be members of the New Zealand Institute of Directors, and would be expected to have a comprehensive knowledge of the sector of which those companies were a part. Trustees on the Boards of New Zealand educational institutions, from pre-school to secondary, are similarly required to complete a course of study on assuming their responsibilities following their election to the Boards by the public.

**SUBSIDY THEORY**

What then are the arguments for tax relief as a government subsidy? Brody states that "Under the classic conception of [the] 'quid-pro-quo' [subsidy theory] approach, the state bestows tax exemption in recognition of charities' lessening the burdens of government." Surrey provides an answer in his seminal 1970 paper which was described by Bittker as "The most systematic presentation of the subsidy theory." Surrey argues that "...the tax incentive is generally inferior to the direct subsidy as a means of achieving social goals." Thus by implication, tax incentives are an indirect subsidy of the sector.

Rather than become engaged in debate on the pros and cons of direct expenditure vis-à-vis tax incentives, this paper focuses on tax incentives per se. Nevertheless, it would be useful to define certain terms. Surrey defines tax incentives as "... tax expenditure[s] which induce certain activities or behaviour in response to the monetary benefit available." This definition introduces another discipline to the debate, that of the psychology of human behaviour with respect to altruism, or philanthropy. Therefore, if a subsidy is not intended by government "to induce certain activities or behaviour" then those charities in New Zealand, who do not believe that tax relief is a subsidy, being indifferent to such subsidies, presumably would have no objection to their removal. If this is the case, the New Zealand Government, which in 1999 paid $NZ79 million in rebates to some 491,000 donors to charities, will be able to redirect such expenditure as part of its social policy direct expenditure programmes.

Surrey also states that "... many of the tax expenditures were expressly adopted to induce action which Congress considered in the national interest" (emphasis added). Further, Surrey states that "... many sponsors of tax incentives simply assume that if the benefit sought is helpful to them in reaching a desired result, the incentive is in the public interest."

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76 Surrey above n 74, p.705.
77 Ibid, at p.711.
78 Surrey describes the charitable deduction as intending to foster philanthropy. In my recent submission to the Inland Revenue Department on the discussion document "Tax and charities," I described the proposal to increase rebates to individuals from $500 to $600 as parsimonious.
80 Surrey, above n 74, p.711.
81 In Fiscal 1968, the revenue cost, in millions of dollars, being the cost of deductibility by individuals of charitable contributions, was: Health and Welfare $2,200; Education and Manpower $170. Surrey, above n 74, p.710.
82 Surrey, above n 74, p.713.
To balance the argument over tax incentives versus direct expenditure, Surrey also argues why direct expenditure programmes are superior to incentives, and that83: “… there should be at least [an] evaluation of the effectiveness and operation of the tax incentive.”

THE COURTS AND SUBSIDY THEORY

Turning now to subsidy and charitable purposes in law, is it possible to find support for a direct relationship between charitable purpose and tax preferences? In a very timely New Zealand decision, with respect to this conference, O'Regan J stated that84:

In view of my finding that the Trust has more than one purpose and that one of those is not charitable, I find that the Trust is not entitled to the benefit of the income tax exemption set out in s 61(25) of the [Income Tax Act 1976 (ITA 1976)],85 for the 1994-1996 income years. (O'Regan)

Thus, with the stroke of another judicial pen, the nexus between tax preferences and charitable purpose is confirmed and this case is assigned to the slowly growing body of charitable case law in New Zealand. For without charitable purpose, O'Regan J has confirmed that a trust cannot claim the privileges of tax exemption. But how did this particular case arise, and why does a purpose which is not charitable make null and void the tax preference status when there is, as there was in this case, at least one purpose which is charitable?

NON-CHARITABLE PURPOSE AS NULLIFYING TAX EXEMPTION

I propose to now briefly explore the case on which O'Regan J made his pronouncement. The Crown Forestry Rental Trust (the Trust) was a statutorily appointed body, formed by a trust deed dated 30 April 1990, the settlors to the trust being the Minister of Finance and the Minister of State Owned Enterprises, acting pursuant to s 34 of the Crown Forest Assets Act 1989.86 Summarising the background to the formation of the Trust, O'Regan J in his judgment outlined the historical events leading to the establishment of the Trust, particularly that87:

The State-Owned Enterprises Act 1986 precluded the Crown from effecting transfers of Crown assets until it had complied with the principles of the Treaty of Waitangi.

The Treaty of Waitangi (State Enterprises) Act 1988 provided inter alia that all land transferred from the Crown to State-Owned Enterprises would carry a memorial recording that the land was subject to compulsory resumption for the settlement of Treaty of Waitangi claims.

The Crown subsequently resolved to sell to private purchasers the Crown's commercial forestry assets other than the land on which the forest assets were located.

An Agreement, dated 20 July 1989, provided for purchasers to make payment of an initial capital sum to the Crown, and an annual, market-based, rental for the use of the land.

83 Surrey, above n 74, p.738.
84 Crown Forestry Rental Trust v Commissioner of Inland Revenue. High Court, Wellington, New Zealand, 7 August 2001, CP No. 127/99 and CP No. 221/99 at 48, O'Regan J.
85 The equivalent section is now s CB 4(1)(c) Income Tax Act 1994 (ITA 1994).
86 Above n 84, at 4.
87 Ibid, at p.4-6.
The annual rental was to be set aside in a fund administered by a Rental Trust.

The interest (sic) earned by the investment of the rental proceeds was to be made available to assist Maori in the preparation, presentation and negotiation of claims before the Waitangi Tribunal which claims involved, or could involve, lands covered by the Agreement.

The accumulated rental proceeds relating to a particular piece of land recommended for resumption, would be paid to the successful claimant, or alternatively, to the Crown.

Legislative force was provided by the Crown Forest Assets Act 1989.

Section 34 of the Crown Forest Assets Act 1989 provided at s 1 the establishment by Deed of a Forestry Rental Trust.

All licence fees were to be collected by the Crown and held in an account in the name of the Forestry Rental Trust.

The Deed describes the name of the trust as the Crown Forestry Rental Trust.

At the time of incorporation, the Trust was not charitable - that status did not occur until subsequent events motivated the trustees to apply for charitable status.

O'Regan J explored the nature of the Trust's activities, which in evidence given by the Secretary of the Trust, Ms Waterreus, indicated that: "... the approach that the Trust has adopted to assist claimants has changed over time." While O'Regan J stated that this was not an issue which he intended considering, surely this is one of the issues confronting charitable trusts where, as a consequence of their activities having changed from those of the founding trust deed, and where those activities may no longer be in accordance with the original trust deed, the trust's tax exempt status may be at risk? One of the issues in New Zealand is that there is no monitoring of the activities of charitable organisations, let alone whether that task should be undertaken by the IRD or a Commission as in the UK.

What O'Regan J did consider was how the purposes of the Trust might be established, by considering the terms of the Trust Deed as being the most important indicator of purpose, with reference to statute as well as the surrounding circumstances, to provide further certainty. This was not without difficulty with the consequence that:

... the inconsistency between the statements, the different purposes for which the publications in which the statements appear are used, the different audiences to which those publications are directed and the non-technical nature of the discussion in the publications, means [that] they do not assist me in determining the key legal issues in this case. (O'Regan)

In addition to determining the purpose of the Trust, O'Regan J also had to determine whether s 61(25) ITA 1976 applied to income of the trust. O'Regan J accepted the arguments of the Commissioner's counsel that:

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88 Ibid, at p.9.
89 Ibid, at p.15.
90 Ibid, at p.18.
91 Now s CB 4(1)(c) ITA 1994.
92 Above n 84, at p.20.
... the correct interpretation of s 61(25) ITA 1976 is that it applies to income which is derived by a trust established for charitable purposes. Accordingly the focus of the inquiry as to the application of s 61(25) in this case is on the purposes of the trust, not the purposes of the income derived by the Trust.

Returning to the purpose of the Trust, the question of whether the Trust had more than one purpose and if any of those purposes were not charitable, O'Regan J concluded that:

... the Trust has two distinct purposes (... assisting the defined class of Maori claimants and refers to the income of the Trust, while the second is of receiving the rental proceeds from the Licences, holding them, investing them and distributing them to the appropriate 'Confirmed Beneficiary' following a decision in respect of any Licensed Land by the Waitangi Tribunal) and that neither is ancillary or subordinate to the other, [and] that the 'receive and hold/stakeholder purpose' is not a charitable purpose. The Trust does not therefore fall within s 61(25).

The Trust, which was established on 30 April 1990, applied for charitable status in 1997 as a consequence of the withdrawal of a ruling by the IRD that had previously allowed the Trust to deduct expenditure on assisting claimants, effectively giving the Trust a nil tax position. Prior to the withdrawal of that ruling, there had been no need for the Trust to consider charitable status, a point acknowledged by O'Regan J.

This raises an interesting question with respect to the purpose of tax preferences for charities. Does this mean that any entity, previously having a nil tax position, on being challenged by the IRD, can then seek charitable status? Is this not an abuse of the privilege of tax exempt status accorded to those charitable organisations which, when they were established, sought and were granted IRD approval of their tax status? If the entity was not charitable on being formed, why should it seek charitable status purely as a consequence of a change in its tax position? Is it the intention of the Income Tax Act 1994 to provide a further means of tax avoidance if the tax vehicle currently being used, fails? Does this mean that a trust is able to change its activities to direct them towards a situation which will provide a convenient tax exempt vehicle?

THE CHANGING NATURE OF CHARITY

Notwithstanding the fact that the Trust lost its exemption due to it having a non charitable purpose, the case is significant in that it reveals the changing nature of charitable purpose in the modern world. O'Regan J concluded (obiter) that:

... the Trust's purpose of assisting the defined class of Maori claimants is a charitable purpose, and that if the "assistance" purpose had been the Trust's exclusive purpose, the Trust would have been entitled to the income tax exemption under s 61(25).

(O'Regan)

The authority for this statement seems to be a 1961 case in which it was held that: "... the Arawa Tribe was a 'fluctuating body of private individuals' because the members of the Arawa Tribe were those tracing their ancestry to a person living in a defined area prior to 1840." The consequence of this case was: "... the passing of s 24B of the Maori Trust

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93 Ibid, at p.29.
94 Ibid, at p.17.
95 Ibid, at p.46.
96 Ibid, at p.45.
98 Above n 84, at p.42.
Boards Act 1955,\(^{99}\) which allowed charitable status to certain trusts established by Maori Trust Boards."

Furthermore, the argument that the meaning of charity is changing over time is supported by the House of Lords which, as described by Luxton, recognises that\(^{100}\): "... with changes in the law, and with the increase of knowledge, the meaning of charity can change over time." The changes in the law Luxton refers to are as a consequence of the analogous approach taken by the courts when attempting to determine the existence of charitable purpose.\(^{101}\) This approach is leading to absurd results, as demonstrated by the recent decision of a Canadian court which held that\(^{102}\): "... the provision of Internet facilities was charitable, as the Internet was a form of super-highway and therefore analogous to 'the repair of ... highways' in the Preamble." Can we now take this to mean that salaries earned by academics should be exempt from tax in their hands, being as they are for "the maintenance ... of scholars in universities"? This is unlikely, as the House of Lords acknowledged that the process of analogy was stretching "... the spirit and intendment of the Preamble almost to breaking point"\(^{103}\) and arguably, beyond.

Further evidence, if it were needed, of this process of evolution, is contained in an earlier case from 1986 in the US, where the Court of Special Appeals stated that\(^{104}\):

\begin{quote}
A determination of whether an institution is charitable must include a careful examination of the stated purposes of the organization, the actual work being performed, the extent to which the work performed benefits the community and the public welfare in general, and the support provided by donations.
\end{quote}

In applying that test in his decision in that particular case Mr Young, \textit{inter alia}, testified that\(^{105}\):

\begin{enumerate}
\item [(1)] [the] appellee's stated purpose of "providing mental health services and a substance abuse facility" was not a charitable purpose;
\item [(2)] the actual work performed was not charitable because it was paid for out of government funds;
\end{enumerate}

\(^{99}\) Maori Trust Boards Act 1955, s. 24B. Trusts for charitable purposes-
(1) Any Board may from time to time, in its discretion, execute under its seal a declaration of trust declaring that it shall stand possessed of any of its property, whether real or personal, upon trust for charitable purposes.
(2) Any income derived by the Board from any property to which the declaration relates shall be applied for such purposes referred to in section 24 (Functions of Board) or section 24A (Additional grants and payments by Board) of this Act as may be specified in the declaration of trust; and, for the purposes of the [Income Tax Act 1976], any such income shall be deemed to be income derived by trustees in trust for charitable purposes.
(3) No declaration of trust under this section shall have any force or effect unless it as been approved by the Commissioner of Inland Revenue.


\(^{101}\) Ibid, at p.10.


\(^{104}\) \textit{Supervisor of Assessments v Group Health Association, Inc.}, 308 Md. 151 (1986) at 157, cited in \textit{State Department of Assessments and Taxation v North Baltimore Center, Inc.}, Court of Special Appeals of Maryland, No. 5469 September Term, 1998 at 4.

\(^{105}\) Ibid.
(3) it did not benefit the general public because the government was paying a fee for service; and
(4) the appellee received no significant private donations.

THE ORIGINS OF TAX PREFERENCES

Tax preferences are often justified on both altruistic and economic grounds. Commonly they are justified on economic grounds as encouraging support for programmes that governments may not necessarily wish to fund. The standard argument in favour of tax concessions on donations to charities is that via an income and a price effect, tax concessions increase the level of giving and donors' satisfaction there-from. According to Surrey: "Many of the tax expenditures were expressly adopted to induce action, which the US Congress considered in the national interest, and as such, the charitable deduction was intended to foster philanthropy." However, policymakers "...did not at the outset express a rationale for any of these exemptions, and a variety of rationales are now articulated to defend them." Few recorded expressions exist of legislative intent for enacting a tax benefit for charity. A rare exception appears in the legislative history to the US Congress' 1938 decision that charity begins at home, the House Ways and Means Committee stating:

The bill provides that the deduction … be also restricted to contributions made to domestic institutions. The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of general welfare.

But what were the origins of such incentives? It seems that they were developed particularly as a device to encourage support for funding the costs of war. In Canada, the very first income tax was The Income War Tax Act 1917, which provided for an exemption and deduction, without limit, for "...amounts paid by the taxpayer during the year for the Patriotic and Red Cross Funds, and other patriotic and war funds approved by the Minister." In 1920, the war fund deduction was repealed. It was during the passing of the legislation to repeal The Income War Tax Act 1917 that for the first and only time, the justifiability or advisability of a general charitable donation deduction was debated by Parliament.

A similar event occurred in the UK in 1929, following the 1918 Royal Commission to study the income tax system. In 1930 the first general deduction for charitable donations became available to both corporate and individual taxpayers, as a response to the effects of

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109 Ibid.
110 7-8 Geo 5, c.28 (Can.).
111 The Income War Tax Act 1917, s 3(1)(c).
112 An Act to Amend the Income War Tax Act 1917, 1920, 10-11 Geo 5, c.49 (Can.), s 5.
113 The outcome of the debate was not reported.
the Great Depression on the country's economic and social problems. This deduction was inspired by the US, whose deduction regime had been in place since 1917.115

The origins of the charitable exemption are of interest, as today the exemption is taken for granted by donors, donee's and governments alike and probably no thought is given to its origins. In the US, according to Hall and Colombo,116 both the IRS and many states adopt a per se view of the exemption which is derived from "an impressive and ancient lineage in the law of charitable trusts." The charitable exemption was first enacted in 1894 as part of the original US income tax law, thus "... lifting the concept of charity whole cloth from the established body of precedent."117

It is particularly interesting, in the light of the title of this paper, to read that118: "... commentators have generally ignored, or at least failed to explain, the relationship between [the] body of [charitable] law and the rationale for tax exemption" (emphasis added). Mancino observed that119: "academicians have overlooked the common law of charitable trusts." Thompson maintained that120: "... IRS decisions have 'blurred' the meaning of charity by departing from [the] body of common law precedent." Hall and Colombo state that121: "Charitable trust law serves a wholly different purpose than the charitable exemption, [therefore] the trust definition of charity does not properly identify activities that deserve tax support." Charitable trust law exists "primarily to protect assets which founders choose to devote to worthy causes [and consequently] it covers a far broader subject matter than is deserving of a tax exemption."122

In pondering such questions while writing this essay, it occurred to me that it is possible, in New Zealand at least, to establish a charitable trust without giving any thought to the possible economic effect, by way of tax preferences, nor of the social effects of such trusts. If one wishes to form a public company and to solicit funds from the public, one is required to prepare a prospectus and to issue an investment statement in accordance with the requirements of the Securities Act 1978. Yet, in order to solicit funds from the public for charitable purposes, no such requirement exists. Given that a charitable organisation exists for all intents and purposes in perpetuity, the long-term tax expenditure charge on governments must be considerable.

Charities exist, amongst other reasons, to fulfil functions that government may not otherwise fund, so there is an economic financial advantage to society through the function of charities. The rapid growth of charities in countries such as China and Eastern Europe bears support for that contention.123 In 1999, the New Zealand Government 'paid' rebates of $NZ79m to some 491,000 donors.124 Assuming that these were for donations in the qualifying range of $5 to $1,500, this means that those donors contributed of the order of $NZ118m to New Zealand charities. There will also be many donors who contributed to charity but who did not

117 Ibid, at p.332.
118 Ibid, at p.332.
121 Hall and Colombo, above n 116, at p.335.
122 Ibid, at p.335.
123 This is evident from various articles the author has read in recent months.
124 D Diaz, Taxing good works, The Independent, 8 August 2001 at 8.
claim their rebates - known as "non-itemisers" in the US. Therefore, the New Zealand Government, in 1999, "saved" $NZ39m in direct grants expenditure, being the difference between the donations received by charities and the rebates paid by government. This is assuming that the NZ Government would have directly funded those charities to the full extent in lieu of donations made by individuals and those donating over $NZ1500.

Hall and Colombo further stated that125: "No societal resources are committed to funding [charitable trusts] in contrast to the effects of a tax exemption." Further,126 "...[There is] no test to ascertain when the exemption is either deserved or proportionate to the benefit society receives." Therefore127: "... binding the law of tax exemption to the same category of activities covered by charitable trust law is ... manifestly absurd."

HOW DOES THE NZ INLAND REVENUE DEPARTMENT DETERMINE TAX PREFERENCE STATUS?

The process adopted by the IRD for approving tax exemption and donee status is very straightforward. Providing that the charity can demonstrate, through its trust deed, compliance with one of the four heads of Pemsel's case, approval is given without further investigation into the economic and social benefits of the charity, either at the time the exemption is granted or at a later date. This approach is not unlike Canada, where the question of which organisations qualify for charitable status is determined by the Ministry of National Revenue through its federal agency, Revenue Canada.128 Revenue Canada has been criticised as relying too heavily on common law interpretations of the Charitable Uses Act 1601 and by failing to give sufficient attention to the changing composition and evolving social needs of Canadian society.129 The Executive Director of Volunteer Canada believes that it has been more difficult to get charitable status, and nearly impossible since the 1990s, "because the federal government has increased tax benefits for donors to charity [and] it has been more reluctant to forgo revenue by expanding the pool of charities" (emphasis added).130

Does this situation mean that in Canada, when approving charitable exemptions, Revenue Canada undertakes an exercise in order to ascertain potentially forgone revenue, or is it merely a perception as to the reason why it is difficult to achieve tax exemption status?

Hall and Colombo131 provide an answer through their proposal of certain criteria for evaluating theories of exemption, which should:

1. identify activities deserving social subsidy, which entails a determination of both worthiness and neediness;
2. distribute the subsidy in rough proportion to the degree of deservedness;
3. explain both the income tax and property tax exemption and, ideally, explain the related charitable deduction as well as the various operational constraints that attach to charitable status; and,
4. align generally with an intuitive concept of what constitutes a charity and the major historical categories of exempt activities.

125 Hall and Colombo, above n 116, at p.337.
129 Ibid.
130 Ibid.
131 Hall and Colombo, above n 116, at p.328.
Elaborating on their theory, Hall and Colombo state that in evaluating theories of exemption, the following should be taken into account:\footnote{132}{Ibid, at p.328.}:

*Deservedness:* The exemption is justified only where there is a convincing [argument] showing that the activity in question deserves a social subsidy; the definition of charity should identify activities whose social benefits would be irreplaceably reduced absent the subsidy.

*Proportionality:* An ideal concept of charity in the tax exemption arena should guard against oversubsidising (or undersubsidising) those activities that are deserving. It is not enough to demonstrate that charitable institutions deserve government support; it is necessary to show that tax subsidies represent the most sensible vehicle for support, that some form of direct grant might not more accurately approximate the optimal level of support, or that direct government provision of the same service is not preferable.

*Universality:* Classification as a charitable organisation carries with it not only exemption from the federal corporate income tax but also a host of other benefits and responsibilities:

- eligibility to receive tax deductible donations under § 170(c) IRC (1989);
- exemption from state and local property income, and sometimes sales tax;
- earnings may not inure to the benefit of a private individual;
- it may not engage in substantial political lobbying or in any political campaigning;
- the exemption does not extend to earnings derived from activities unrelated to its exempt purpose.

*Historical consistency:* The charitable exemption has evolved through centuries of experience to take on an almost universal presence and shape.\footnote{133}{C Dickens, "Oliver Twist" (1838). (Source not cited.)}  The process being applied by the courts is epitomised in the saying "A precedent embalms a principle"\footnote{135}{Lord Stowell 1745-1836: An opinion, while Advocate-General, 1788, quoted by Disraeli in the House of Commons, 22 February 1848, quoted in The Little Oxford Dictionary of Quotations, (1994), (ed. S Ratcliffe), University Press, Oxford, at 192.} in that in the process of developing the law of charitable purpose when considering tax preference issues, the ripples from the pebble which was originally the Preamble to the Statute of Elizabeth, four hundred years ago, are spreading wider and wider without consequence for the boundaries of the pond in which they were created.
CONCLUSION

When the question of ascertaining charitable purpose arises in the courts, if charitable purpose can be ascertained by analogy to the Statute of Elizabeth 1601, tax exempt status is confirmed as of right. This is without any forethought to the economic and social consequences of such decisions. This is not a deficiency of the law of charity per se, as the granting of tax exempt status arises as the result of decisions by government agencies which may not have the resources to be able to ascertain the social or the economic benefits of charitable status.

The nexus between charitable purpose and tax preferences as determined by the courts is nebulous, and as a consequence, without a radical change in the thinking of the judiciary, and of those Governments who pass the charitable laws which the judiciary ultimately interpret, there will continue to be charitable organisations with vague purposes, such as maintaining the welfare of donkeys, accepted as being of a charitable nature and as equally deserving of tax preferences as charitable organisations established for those in need.