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# Australian Charity Law Reform Proposal

By Prof. Myles McGregor-Lowndes

## Introduction

England<sup>1</sup>, Ireland<sup>2</sup>, Scotland<sup>3</sup>, Canada<sup>4</sup>, South Africa<sup>5</sup> and New Zealand<sup>6</sup> are actively examining the definition of charity in their respective policy settings. The Australian Federal Government has announced that it intends to statutorily alter the definition of charity for all federal purposes including income tax exemption after receiving the recommendations of the Report of the Inquiry into the Definition of Charities and Related Organisations<sup>7</sup>. The Federal Treasurer has announced that the present common law definition of charity will be augmented by a statutory provision that captures the general broad categories of the common law charity definition and includes examples of specific purposes. The examples extend the common law definition of charity in disputed areas such as “the care, support and protection of children and young people” and “prevention of sickness, disease or of human suffering”. The proposed definition is located in Appendix A.

The article begins by establishing the context of the review of the definition of charity in Australia . It then examines the recommendations made in the review report and identifies those accepted by the government.

## The Australian Charity Law Context

Australian law has received the English common law concerning charitable trusts and the Statute of Elizabeth derived definition of charity. Australian case law has not substantially departed from the English case law, being part of a British Commonwealth interchange of charity case law. It is usual for Australian judges to refer heavily to Commonwealth decisions in appropriate cases. Australia does not have any administrative body such as the Charity Commission for England and Wales that administers charity regulation or other quasi judicial functions.

Charitable organisations have remained exempt from income tax in Australia since the first comprehensive state income tax legislation in 1884<sup>8</sup> through to the current Income Tax Assessment Act 1977<sup>9</sup>. The exemption of charitable bodies follows the English legislative pattern of charitable organizations being exempt from income tax and relying upon the common law definition of charity stemming from the Statute of Elizabeth 1601.

## Place of Charity within the Nonprofit Tax Exemptions

The Australian Income Tax exemption classification specifically refers to charitable “institutions” and “funds” as just one classification among a range of other exempt bodies. The specific exemptions in the Income Tax Assessment Act are not mutually exclusive and often an entity may fall within more than one category. An example is that a school may be both a “public education institution” as well as a “charitable institution”, as may be a religious institution or a scientific institution.

The categories of income tax exemption from Division 50 Income Tax Assessment Act 1997 are reproduced below:

### 50-5 Charity, education, science and religion

<i>Item</i>	<i>Exempt entity</i>
1.1	*Charitable institution
1.2	Religious institution
1.3	Scientific institution
1.4	Public educational institution

1.5	*Fund established for public charitable purposes by will before 1 July 1997
1.5A	*Trust covered by paragraph 50-80(1)(c)
1.5B	*Fund established in Australia for public charitable purposes by will or instrument of trust (and not covered by item 1.5 or 1.5A)
1.6	Fund established to enable scientific research to be conducted by or in conjunction with a public university or public hospital
1.7	Society, association or club established for the encouragement of science

\*Any entity covered by item 1.1, 1.5, 1.5A and 1.5B is not exempt from income tax unless the entity is endorsed as exempt from income tax by the Australia Taxation Office.

### 50-10 Community service

<i>Item</i>	<i>Exempt entity</i>
2.1	Society, association or club established for community service purposes (except political or lobbying purposes)

### 50-15 Employees and employers

<i>Item</i>	<i>Exempt entity</i>	<i>Special conditions</i>
3.1	(a) employee association; or  (b) employer association	the association: (a) is registered under an Australian Law relating to the settlement of industrial disputes; and (b) is located in Australia, and incurs its expenditure and pursues its objectives principally in Australia
3.2	Trade union	located in Australia and incurring its expenditure and pursuing its objectives principally in Australia

Note: Despite items 3.1 and 3.2, certain ordinary and statutory income of some associations of employees and some registered trade unions may be subject to income tax under Division 8A of Part III of the *Income Tax Assessment Act 1936*.

### 50-20 Finance

<i>Item</i>	<i>Exempt entity</i>
4.1	a friendly society (except a friendly society dispensary)

### 50-25 Government

<i>Item</i>	<i>Exempt entity</i>
5.1	(a) a municipal corporation; or (b) a local governing body
5.2	a public authority constituted under an Australian Law

Note: The ordinary and statutory income of a State or Territory body is exempt: see Division 1AB of Part III of the *Income Tax Assessment Act 1936*.

### 50-30 Health

<i>Item</i>	<i>Exempt entity</i>
6.1	Public hospital
6.2	Hospital carried on by a society or association (not carried on for the profit or gain of its individual members)
6.3	the following organisations registered for the purposes of the <i>National Health Act 1953</i> : (a) a medical benefits organisation; (b) a health benefits organisation; (c) a hospital benefits organisation (not carried on for the profit or gain of its individual members)

### 50-35 Mining

<i>Item</i>	<i>Exempt entity</i>
7.1	the Phosphate Mining Company of Christmas Island Limited (incorporated in the Australian Capital Territory)
7.2	The British Phosphate Commissioners Banaba Contingency Fund (established on 1 June 1981)

### 50-40 Primary and secondary resources, and tourism

<i>Item</i>	<i>Exempt entity</i>
8.1	8.1 A society or association established for the purpose of promoting the development of: (a) aviation; or (b) tourism (not carried on for the profit or gain of its individual members)
8.2	A society or association established for the purpose of promoting the development of any of the following Australian resources: (a) agricultural resources; (b) horticultural resources; (c) industrial resources; (d) manufacturing resources; (e) pastoral resources; (f) viticultural resources; (g) aquacultural resources; (h) fishing resources (not carried on for the profit or gain of its individual members)

### 50-45 Sports, culture, film and recreation

<i>Item</i>	<i>Exempt entity</i>
9.1	a society, association or club established for the encouragement of: (a) animal racing; or (b) art; or (c) a game or sport; or (d) literature; or (e) music
9.2	a society, association or club established for musical purposes

9.3	the Australian Film Finance Corporation Pty Limited (incorporated under the <i>Companies Act 1981</i> on 12 July 1988)
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The law generally exempts from tax all income generated by these organisations provided that,

1. the organisation's main purpose or object is exempt and its actual activity is directed to these purposes;
2. the organisation is nonprofit (i.e. it does not distribute, and is constitutionally prohibited from distributing, its surplus to anyone or any purpose, other than its stated exempt objectives); and
3. the organisation has an appropriate dissolution clause which transfers any surplus to a similar tax exempt organisation, not its members or controllers.

Charitable bodies must also have attributes which are:

- the organisation has a physical presence in Australia and to the extent of that presence incurs its expenditure and pursues its objectives principally in Australia

OR

- the organisation is one referred to in Subdivision 30-15 ITAA 1997 (i.e., a Deductible Gift Recipient)

OR

- the organisation is a prescribed institution which is located outside Australia and is exempt from income tax in its country of residence

OR

- that the organisation is a prescribed charitable or religious institution that has a physical presence in Australia, but which incurs its expenditure and pursues its objects principally outside Australia.

Gifts and government grants can be applied overseas without affecting the income status of the exempt organisation and is to be disregarded for the purpose of determining whether it incurs its expenditure and pursues its objects in Australia.

Australian taxation law also has a common law component which imports the doctrine of mutuality, which states that "a person cannot make a profit from themselves."<sup>10</sup> Income derived from trading with non-members only will be subject to taxation.

### **The Inquiry's Recommendations**

The Inquiry was prompted by concerns raised during the introduction of a national valued added tax (Goods and Services Tax), that the definitions used to give concessions to certain nonprofit organisations were inappropriate. As part of a political deal to give the valued added tax passage through Australia's Upper House of Parliament, the Federal Treasurer agreed to an inquiry into the definitions of nonprofit organisations, particularly charities. The terms of reference required the committee of three lawyers to examine the appropriateness of existing definitions, particularly charity, and provide options for enhancing their clarity and consistency. The committee was not to examine the relative taxation issues or merits of nonprofit exemption.

It was decided that the definition of charity should be set down in legislation. The Committee was of the view that the meaning of charity using the common law approach was not being kept relevant due to the lack of litigation in the area. The last major Australian High Court Case was in 1974<sup>11</sup>. The Committee examined five options that could be used to determine charitable purpose in the absence of the requirement that a purpose fall within the 'spirit and intendment' of the Preamble. The options are:

1. to leave the determination of charitable purpose to the courts, relying on guidance provided by Lord Macnaghten's four heads of charity<sup>12</sup>;
2. to define charitable purpose as any purpose beneficial to the community;
3. to list charitable purposes that fall, or in the Committee's view should fall, within charity;
4. to list broad categories of charitable purpose; and
5. to include the purposes listed in Option 3, as appropriate, under the broad categories set out in Option 4.

The Committee recommended that Options 3, 4 and 5 were viable, but favoured Option 5 as providing a principled approach that offered greater certainty and consistency while retaining flexibility.

Under Option 5, charitable purposes shall be:

- the advancement\* of health, which without limitation includes:
  - the prevention and relief of sickness, disease or of human suffering;
- the advancement\* of education;
- the advancement\* of social and community welfare, which without limitation includes:
  - the prevention and relief of poverty, distress or disadvantage of individuals or families;
  - the care, support and protection of the aged and people with a disability;
  - the care, support and protection of children and young people;
  - the promotion of community development to enhance social and economic participation; and
  - the care and support of members or former members of the armed forces and the civil defence forces and their families;
- the advancement\* of religion;
- the advancement\* of culture, which without limitation includes:
  - the promotion and fostering of culture; and

- the care, preservation and protection of the Australian heritage;
- the advancement\* of the natural environment; and
- other purposes beneficial to the community, which without limitation include:
  - the promotion and protection of civil and human rights; and
  - the prevention and relief of suffering of animals

(\*Advancement is taken to include protection, maintenance, support, research, improvement or enhancement.)

Along with this move to a statutory definition for charity there are two other important recommendations. The first was to reform the definition of Public Benevolent Institutions, the term used to describe the bulk of donation deductible organisations in Australia. The second is to reform the administration of the definitions. Unfortunately both these recommendations are not mentioned in the Government's response to the review, but are vitally important for the Australian Third Sector.

The Australian courts have defined public benevolent institutions as being organisations providing direct service provision to those requiring "pity and compassion". The review received many submissions that modern social policy favored prevention of social problems, not just their direct relief. The review agreed that prevention was just as important as direct relief in the tools of modern social relief. The review also agreed with the many submissions that having to characterize an organisation as providing assistance to those who arouse 'pity and compassion' was paternalistic and demeaning. The review made the recommendation that charities be altruistic as a replacement for 'pity and compassion'.

The review recommended that there be a subset of charity, to be known as Benevolent Charity. This would replace the category of public benevolent institutions. Benevolent Charities would meet all the requirements to be a charity and whose dominant purpose is to benefit, directly or indirectly, those whose disadvantage prevents them from meeting their needs. The category of Benevolent Charity distinguishes charities whose dominant purpose is to benefit the disadvantaged from other charities whose dominant purpose is to provide benefits to the community more broadly. This is a very sensible suggestion.

The other major issue that the Government failed to address in the review was that of the administration of the definition. The submission by the Australian Taxation Office to the review stated that 'administration would be better served by a single, independent common point of decision making on definitions leading to conclusions about whether organisations are charitable or non-profit, or not'. This view was mirrored in a number of submissions from charities and related entities that sought greater transparency and accountability. Other submissions raised some concerns about consistency of decision making by the Australian Taxation Office and argued that decisions on charitable and related status should be separate from decisions about taxation liability.

The review recommended that an independent administrative body be established to determine the status of charities and related entities. Its decisions would be binding on the Australian Taxation Office. The independent body would be the central point for ensuring the accountability of charities to the public. The review also encouraged the federal government to seek the co operation of State and Territory Governments to have a national definitional framework. The review clearly stated that, "A clear and consistent accountability framework would help to maintain and enhance public confidence in the integrity of charity and provide scope to develop a common framework of reporting requirements to meet the needs of all relevant government agencies."<sup>13</sup>

## **The Government's Response**

The Federal Treasurer on behalf of the Government announced that the government would legislate after consultation, for a new definition of charity. The new statutory definition would apply to all Federal provisions relating the charitable organisations, not just income tax. The Treasurer also indicated that he would write to all State and Territory Governments seeking a national approach to the definition. It is hoped that this request will be well considered by these governments, as otherwise the definitional landscape will become more, rather than less confused.

The draft legislative provisions provided by the Treasurer significantly depart from those recommended by the review. The draft does include greater clarity in respect of child care, self help groups which have open and non-discriminatory membership, and closed religious orders. The proposed draft adopts the broad categories of purposes suggested by the review, but fails to take up many of the purposes listed under the categories. It may be argued that some of purposes are already permitted. It is unfortunate that this opportunity has not been taken to clarify and modernize the definition.

Of particular note is the proposed definition of what constitutes public benefit. The review submitted that an organisation "be denied charitable status if it has purposes that are illegal, are contrary to public policy, or promote a political party or candidate for public office."<sup>14</sup> The Government has proposed that an organisation "must not have a dominant purpose that is:

- (i) advocating a political party or cause; or
- (ii) supporting a candidate for political office; or
- (iii) attempting to change the law or government policy."<sup>15</sup>

The clause that requires a dominant purpose not to attempt to change the law or government policy is in addition to that proposed by the Review. The Review received submissions from both the sector and government departments indicating that organisations continued to play an important role in policy development. It believed that, "if an entity has a non-party political purpose that purpose must further, or be in aid of, the dominant charitable purpose or be incidental or ancillary to the dominant charitable purpose. Any non party-political activities of a charity should not affect its charitable status provided it acts in good faith and its activities are not illegal or against public policy."<sup>16</sup> The inclusion appears to make little significant difference, but perhaps is a symbolic message of the government's resolve in this area.

## **Conclusion**

Australia's definition of charity is on the brink of significant alteration, being only the second Commonwealth nation to move towards a statutory definition of charity. <sup>17</sup> The Federal Government has rejected the Charity Definition Inquiry's recommendations to accompany any alteration in the definition with new administrative arrangements such as an independent administrative body or establishment of a permanent advisory panel.<sup>18</sup> This may be a fatal flaw in the reform of the definition of charity as the courts currently receive little opportunity to make new law on the definition because of various factors such as the expense of litigation and reluctance of donation seeking bodies to be exposed to adverse publicity through the judicial process.

Perhaps the key lies not only in the actual content and construction of the definition, but in how well the process of administering and refining the definition performs. A common law system without a stream of appropriately decided cases, a competent bar and charity definition aware populace may be no better than a statutory definition with a uninterested legislature, inept and inconsistent administration and an indifferent community sector.

## **Footnotes**

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- 1 Cabinet Office, Performance and Innovation Unit, PIU, Voluntary sector review, 2002.  
URL: <http://www.cabinet-office.gov.uk/innovation/2001/charity/charityscope.shtml>.
- 2 Law Reform Committee, Law Society of Ireland, "Charity Law: The Case for Reform", Dublin, July 2002.
- 3 Scottish Charity Law Review Commission, The Report of the Scottish Charity Law Review Commission, May 2001. URL: <http://www.e-consultant.org.uk/charitylaw.htm>.
- 4 Final Report of the Panel on Accountability and Governance in Canada's Voluntary Sector, "Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector", Ottawa, February 1999 (known as the Broadbent Report).
- 5 The Law Reform Commission was mandated to study "The Legal Position of Voluntary Associations". The issue of taxation and charities is also an ongoing subject of discussion between the South African Revenue Service and the voluntary sector.
- 6 See "Taxes and Charity" at the web site: [www.taxpolicy.ird.govt.nz](http://www.taxpolicy.ird.govt.nz); and "Report by the Working Party on Registration, Reporting and Monitoring of Charities", 28 February 2002.  
URL: <http://www.treasury.govt.nz/charities>.
- 7 Sheppard, I., R. Fitzgerald and D. Gonski. "Report of the Inquiry into the Definition of Charities and Related Organisations", CanPrint Communications Pty Ltd, Canberra, June 2001 (hereinafter "Charity Definition Inquiry").
- 8 The first Act to impose a tax on income (dividends) was Tasmania's Real and Personal Estate Duty Act 1880. However, South Australia was the first State with the Taxation Act 1884 and the Commonwealth's income tax provisions closely followed the State's exemption provision in section 23 of Income Tax Assessment Act 1936 (Cth).
- 9 The Income Tax Assessment Act 1997 (ITAA 1997) was enacted as part of the Tax Law Improvement Project (TLIP) rewrite of the Income Tax Assessment Act 1936 (ITAA 1936). The ITAA 1997 will be progressively amended and added to as instalments of the rewrite are enacted. The parts of the ITAA 1936 which have not been rewritten are adopted directly into the ITAA 1997 by Schedule 1, 52 of the Income Tax (Consequential Amendments) Act 1997.
- 10 *Bohemians Club v Acting FCT* (1918) 24 CLR 334.
- 11 *Royal National Agricultural and Industrial Association v Chester* [1974] 48 ALJR 304.
- 12 Lord Macnaghten's four heads of Charity is discussed in Chapter 2.
- 13 Inquiry Report at p.18.
- 14 Inquiry Report at p.13.
- 15 Federal Treasurer, Press Release [29/08/2002] NO.049
- 16 Inquiry Report at p.218.
- 17 The other country is Barbados – Charities Act 1980.
- 18 Charity Definition Inquiry, p.18.

## **APPENDIX**

### **Proposed Statutory Definition of Charity**

The Commonwealth Treasurer - Press Release - Government Response to Charities  
Definition Inquiry [29/08/2002]  
NO.049

#### GOVERNMENT RESPONSE TO CHARITIES DEFINITION INQUIRY

Today I am releasing the Government's response to the Report of the Inquiry into the Definition of Charities and Related Organisations.

As I noted when I released this Report in August 2001, the Inquiry has made a significant contribution in simplifying such a complex legal and administrative issue.

The Government has decided to enact a legislative definition of charity for the purpose of the administration of Commonwealth laws and to adopt a majority of the Inquiry's recommendations for the definition. While the Commonwealth's predominant requirement for a definition of a charity is for the purposes of deciding which organisations are eligible for tax relief, the definition will apply for all Commonwealth legislation. I will be writing to each of the State and Territory Treasurers to gauge their interest in achieving harmonisation of laws defining charity.

The legislative definition of a charity will closely follow the definition that has been determined by over four centuries of common law, but will provide greater clarity and transparency for charities. The details of the definition are attached. It will explicitly allow not-for-profit child care available to the public, self-help bodies that have open and nondiscriminatory membership and closed or contemplative religious orders that offer prayerful intervention for the public, to be charities. It will provide certainty to those organisations operating in the sector while still providing the flexibility required to ensure the definition can adapt to the changing needs of society.

I will ask the Board of Taxation to consult widely with the charitable sector on an exposure draft of the legislation. The legislation is expected to begin on 1 July 2004.

The Government has decided to establish a new category of deductible gift recipient for charities whose principal activities promote the prevention and control of harmful and abusive behaviour among humans. This will assist these charities in attracting public support for their activities. The new category will apply from 1 July 2003.

To ensure that there is no change to the taxation treatment of public hospitals as a result of these decisions, the Government has also decided that fringe benefits provided to employees whose duties are exclusively performed in, or in connection with, a public hospital will continue to be subject to the \$17,000 capped fringe benefits tax (FBT) exemption, whether or not those hospitals are public benevolent institutions.

Charities and other not-for-profit organisations are pivotal members of society. In order for them to be able to continue to contribute fully, they need to be able to participate in a wide range of activities including, at times, commercial activities. The Inquiry recommends that commercial purposes should not deny charitable status where such purposes further, or are in aid of, the dominant charitable purposes or where they are incidental or ancillary to the dominant charitable purposes. The Government agrees with this recommendation, but is concerned to ensure that the taxation concessions provided to charities are not abused. The Government has therefore decided that from 1 July 2004, charities, public benevolent institutions and health promotion charities will be required to be endorsed by the Australian Taxation Office in order to access all relevant taxation concessions. Depending on the character of the charity, these concessions are the income tax exemption as a

charity, refundable imputation credits, deductible gift recipient status, the FBT rebate, the \$30,000 capped FBT exemption and GST concessions.

I am also announcing today that from 1 July 2004, an organisation endorsed to access these tax concessions will have its status attached to its Australian Business Number and be able to be publicly accessed through the Australian Business Register. This will allow greater scrutiny of the use of taxation concessions by charities and improve public confidence in the provision of taxation support to the charitable sector.

The other changes are:

- The Income Tax Assessment Act 1997 to be amended with effect from 1 July 2003, to allow future additions to the list of organisations specifically named as deductible gift recipients to be prescribed by regulation rather than requiring a legislative amendment. This will allow continued scrutiny by Parliament but will make the process less administratively costly and more timely.
- Entities established in perpetuity by the Parliament to be allowed to be endorsed as deductible gift recipients from 1 July 2003.
  - They are currently denied endorsement because they cannot meet the requirement that their constituent documents or governing rules require that any surplus assets be transferred to another deductible gift recipient if they are wound up.
- The GST law to be amended to ensure that the current GST concessions for gift deductible entities apply only to deductible gift recipients and not to any larger, non-charitable entity that operates the deductible gift recipient.
  - This will ensure that non-charitable entities are not able to access the GST charity concessions and gives effect to the original policy intent of the law.

The cost to revenue of the Government's response is \$2 million in 2004-05 and \$5 million in 2005-06 and 2006-07.

I would like to again thank the Inquiry members for their work in producing the Report. The members of the Inquiry were the Hon. Ian Sheppard AO QC (chair), Mr Robert Fitzgerald AM and Mr David Gonski.

29 August 2002  
CANBERRA

## **ATTACHMENT A**

Elements of the definition of charity

(1) A charity is an entity (other than an entity excluded by paragraph 9) that is not-for-profit and has a dominant purpose or purposes that are charitable and, subject to paragraph 7, for the public benefit.

(2) In addition:

- (a) where the entity has other purposes, those purposes must further, or be in aid of, the dominant purpose or purposes, or be ancillary or incidental to the dominant purpose or purposes; and
- (b) the entity must have activities that further, or be in aid of, its charitable purpose or purposes; and

- (c) the entity must not have purposes, or engage in activities, that are illegal; and
- (d) the entity must not have a dominant purpose that is:
  - (i) advocating a political party or cause; or
  - (ii) supporting a candidate for political office; or
  - (iii) attempting to change the law or government policy.

#### Charitable purposes

- (3) Charitable purposes means the following:
  - (a) the advancement of health;
  - (b) the advancement of education;
  - (c) the advancement of social and community welfare, including without limitation, the care, support and protection of children and young people, including the provision of child care services;
  - (d) the advancement of religion;
  - (e) the advancement of culture;
  - (f) the advancement of the natural environment;
  - (g) other purposes beneficial to the community.

(4) Advancement is taken to include protection, maintenance, support, research, improvement or enhancement.

(5) In determining whether an entity has the purpose of the advancement of religion, regard is to be had to the principles established by the High Court in *Church of New Faith v Commissioner of Pay-Roll Tax* (1983) 154 CLR 120.

#### Public benefit

- (6) To be for the public benefit, a purpose must:
  - (a) be aimed at achieving a universal or common good; and
  - (b) have practical utility; and
  - (c) be directed to the benefit of the general community or a sufficient section of the community.
- (7) The following entities do not have to have a dominant purpose or purposes that are for the public benefit:
  - (a) open and non-discriminatory self-help groups that have open and non-discriminatory membership;
  - (b) closed or contemplative religious orders that regularly undertake prayerful intervention at the request of the public.

#### Open and non-discriminatory self-help group

- (8) An open and non-discriminatory self-help group is a group of individuals where:
  - (a) the group is established for the purpose of assisting individuals affected by a particular disadvantage, discrimination or need that is not being met; and
  - (b) the group is made up of, and controlled by, individuals affected by the particular disadvantage, discrimination or need that is not being met; and
  - (c) any membership criteria relate to the purpose of the group; and
  - (d) membership of the group is open to any individual who satisfies criteria referred to in paragraph (c).

#### Entities

- (9) The following are excluded from being charities:
  - (a) an individual;
  - (b) a partnership;
  - (c) a political party;

- (d) a superannuation fund;
- (e) the Commonwealth, a State or Territory or a body controlled by the Commonwealth or a State or Territory;
- (f) a foreign government or a body controlled by a foreign government.

(10) For the purposes of paragraph 1, entity includes:

- (a) a body corporate; and
- (b) a corporation sole; and
- (c) any association or body of persons whether incorporated or not; and
- (d) a trust.

Not-for-profit

(11) An entity is taken to be not-for-profit if and only if:

- (a) it is not carried on for the profit or gain of particular persons; and
- (b) it is prevented, either by its constituent documents or by operation of law, from distributing its assets for the benefit of particular persons either while it is operating or upon winding up.