

PART I

Charities and Accumulation Delineated

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Excerpt
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Introduction

1.1 WHY INVESTIGATE THE ACCUMULATION OF ASSETS
BY CHARITIES?

Charities matter. They play critical roles in the economy and society, and much is expected and received from them. The accumulation of assets by charities matters, too, as it raises profound ethical, economic and social questions about who might be expected to receive benefits from a charity as well as who makes that decision. As the philanthropist Julius Rosenwald noted almost ninety years ago:¹

What would happen, it might be asked, if the billions tied up in perpetuities in this country should be released over a period of fifty or one hundred years? What would become of education and of scientific research? How could society care for the sick, the helpless and the impoverished? The answer is that all these needs would be as well provided for as the demands of the day justified. Wisdom, kindness of heart, and good will are not going to die with this generation . . .

I believe that large gifts should not be restricted to narrowly specified objects, and that under no circumstances should funds be held in perpetuity. I am not opposed to endowments for colleges or other institutions which require some continuity of support, provided permission is given to use part of the principal from time to time as needs arise. This does not mean profligate spending. It is simply placing confidence in living trustees; it prevents control by the dead hand . . . I have confidence in future generations and in their ability to meet their own needs wisely and generously.

¹ Julius Rosenwald, 'Principles of Public Giving' (1929) 143(5) *Atlantic Monthly* 599, reprinted in Amy Kass (ed), *Giving Well, Doing Good* (Indiana University Press, 2008) 192–3.

This book asks two questions. First, what legal rules constrain the accumulation of assets by charities and how do they address the intergenerational distribution of benefits, the matter of which generation gets to determine that distribution and the risk of increased agency costs? Second, having identified that the rules do not adequately address the intergenerational distribution or the matter of intergenerational choice, this book asks how those rules could be reformed to better incorporate principles of intergenerational justice and the goals of charity law.

1.1.1 *Why Do Charities Matter?*

Charities contribute very significantly to GDP in many countries and also involve a material percentage of the population as employees or volunteers.² In Australia, there are more than 55,000 charities and those charities contribute 4.8 per cent of Australia's gross value added, employ 10 per cent of the Australian labour force and use the services of 3.3 million volunteers.³ Canada has 86,000 registered charities that, along with the broader Canadian NFP sector, generate over 7 per cent of Canada's GDP and employ more than 2 million staff.⁴ The US has around 1.09 million tax registered charities that benefit from volunteering by a little over 25 per cent of US adults and that generate, with the broader NFP sector, around 5.4 per cent of US GDP.⁵ In the UK, the general charity sector contributes around 1 per cent of GDP, directly employs 3 per cent of the total workforce and involves nearly 40 per cent of the population volunteering.⁶ There are 27,000 NZ charities, employing 5 per cent of the NZ labour force, with a further 10 per cent of the labour force volunteering.⁷

Beyond their economic contribution, including the direct benefits from the pursuit of their purposes, charities make very important social and political contributions. Due to the potential for voluntary association and interactions of participants, many play a significant role in acting as vehicles for the formation of preferences and as sites of collective and political action⁸ as well

² See, e.g., *Anheier* ch 4 (in relation to the NFP sector).

³ *Australian Charities Report 2017*, 15–16; Deloitte Access Economics, *Economic Contribution of the Australian Charity Sector* (November 2017) 8.

⁴ *Catalyst for Change* 11.

⁵ Brice McKeever, *The Nonprofit Sector in Brief* (Urban Institute, 2018). Registered charities comprise the majority of the NFP sector.

⁶ NCVO, *UK Civil Society Almanac 2019* (2019), <https://data.ncvo.org.uk>. The 'general charity sector' is a subset of charities, see Section 2.4.1.

⁷ Charities Services, 'Annual Review 2018/19' (NZ Government, 2019) 10.

⁸ See, e.g., Elizabeth Clemens, 'The Constitution of Citizens: Political Theories of Nonprofit Organizations' in *Powell and Steinberg* 207.

as sources of social capital.⁹ In this way, charities assist minorities to express and implement their views.¹⁰ As discussed in Section 2.3.2, they also enhance pluralism by enabling the devolution of decision-making and the development of innovative approaches to social problems as well as enhancing the conditions of autonomy for society as a whole.

Societal and governmental expectations of the charity sector's role in delivering public benefits are also growing. This is partly a result of the retreat of the welfare state with the rise of 'new public management' and its focus on decentralized and market-based decision-making and a smaller role for government.¹¹ This shift derives partly from perceived problems with monolithic public services and a conviction that smaller scale, community-based organizations would be more effective and humane.¹² Moreover, democratic governments may have trouble providing services to a high preference minority in the face of an indifferent majority.¹³ In Australia, for instance, there has been a significant increase in the degree to which non-government bodies, particularly charities, have been funded by all levels of government to provide human and community services, along with other functions.¹⁴ Government collaboration with charities for the provision of services is also evident in the US¹⁵ and across many OECD countries.¹⁶

Increased demands are also partly due to growing expectations of the minimum conditions for a good life as reflected in the initial growth of the welfare state with the objective of meeting a range of health, education and other needs and, at least outside the US, now reflected in further developments such as the National Disability Insurance Scheme in Australia. They

⁹ Robert Putnam, *Bowling Alone: The Collapse and Revival of American Community* (Simon & Schuster, 2000) ch 3; *Anheier* 33, 84–7, ch 7.

¹⁰ *Anheier* 143–6, ch 7.

¹¹ See, e.g., Jennifer Brinkerhoff and Derek Brinkerhoff, 'Government–Nonprofit Relations in Comparative Perspective: Evolution, Themes and New Directions' (2002) 22(1) *Public Administration and Development* 3, 5; *Contribution of the NFP Sector*, 303; *Anheier* 15–16, 35–8, 113–15, 505–6.

¹² Stephen Smith and Michael Lipsky, *Nonprofits for Hire: The Welfare State in an Age of Contracting* (Harvard University Press, 1993) 17–18.

¹³ Burton Weisbrod, *The Nonprofit Economy* (Harvard University Press, 1988).

¹⁴ *Contribution of the NFP Sector* 300.

¹⁵ Peter Dobken-Hall, 'A Historical Overview of Philanthropy, Voluntary Associations, and Nonprofit Organizations in the United States, 1600–2000' in *Powell and Steinberg* 32, 50–7; Lester Salamon, 'Of Market Failure, Voluntary Failure and Third-Party Government: Toward a Theory of Government-Nonprofit Relations in the Modern Welfare State' in Susan Ostrander and Stuart Langton (eds), *Shifting the Debate: Public/Private Sector Relations in the Modern Welfare State* (Transaction Books, 1987) 29, 29–32.

¹⁶ See, e.g., *Anheier* 11–13, *Contribution of the NFP Sector*, 298–300.

are also due to higher anticipated standards of managerial professionalism resulting from the adoption of market sector practices in the charity sector as well.¹⁷ This last shift has also been bolstered by greater government regulation in many fields, implemented despite the goal of smaller government, but with a broader range of regulatory tools.¹⁸

1.1.2 *Why Does Accumulation Matter?*

In thinking about charities' activities and whether they are achieving public benefit commensurate with increased societal expectations, some guidance can be obtained from the goals of charity law, which are explored in Section 2.3. First, charity law aims to facilitate and incentivize the production of goods (including social and political benefits such as pluralism) for the benefit of the public. Second, the pursuit of charitable purposes should occur independently from the state. Third, charity law seeks to maintain and express public trust and confidence in charities.

Implicit in the goal of facilitating and incentivizing the production of goods is the need for some benefits to be produced over time. Arguably, the trust and confidence goal also bolsters this conclusion. However, these goals provide limited guidance about the appropriate time, and current legal scholarship does not equip us to go much further in considering the extent to which charity funds can be accumulated for later, rather than spent now.¹⁹ That is a matter of grave concern as the questions raise weighty ethical, economic and social considerations. Accumulation could mean that, due to the delay in the delivery of benefits, the current generation is being treated unfairly from the perspective of intergenerational justice.

Further, while the charity law goals make clear that the government should have a limited role in determining the intergenerational allocation of benefits by charities, they do not address how past, current and future generations of charity creators and controllers ought to share that decision-making role. If the charity creator's views are too influential, then charity assets may not be used efficiently or in a way that reflects current societal views about intergenerational justice. Further, depending on the extent of their discretion in decision-making, accumulation may exacerbate the provision of private benefits to

¹⁷ See, e.g., *Anheier* 134–5, 137. See also Donald J. Bourgeois, *The Law of Charitable and Not-for-Profit Organizations* (LexisNexis, 5th ed, 2016) 131–2.

¹⁸ John Braithwaite, *Regulatory Capitalism: How It Works, Ideas for Making It Work Better* (Edward Elgar, 2008) 5–12.

¹⁹ There are some notable exceptions. See nn 60 to 66 and accompanying text.

charity controllers, resulting in increased agency costs, involving a loss of public benefit.

If an understanding of the ways in which existing legal rules constrain accumulation by charities is absent, it is difficult to tell whether the rules grapple with the ethical, economic and political considerations. If current legal constraints address these considerations, then it is important to say so in order to promote trust and confidence in the sector. If the constraints do not address the considerations, then reforms could be tailored, remaining mindful of the charity sector's independence from the government.

1.2 KEY CONCEPTS

This book focuses on the accumulation of assets by charities, and each of these concepts is explained below. As an introductory comment, it is apparent from the earlier description of the charity sector that it is extremely heterogeneous, with some types of charity likely to have a relatively short lifespan (e.g., a natural disaster relief charity), while others might be expected to endure for longer, potentially perpetually (e.g., an educational or religious charity). While this book explores the rules applicable to all charities, it mainly focuses on long-duration charities as concerns relating to accumulation are more likely to arise in circumstances where there is a reasonable period over which accumulation can occur.

1.2.1 Charities and Not-for-Profits

Charities are a subset of the broader NFP sector. Some writers have tackled particular issues, such as regulation,²⁰ tax treatment²¹ or productivity,²² at the broad level of the NFP sector/civil society or of for-purpose organizations. However, this book focuses on accumulation by charities rather than by NFPs generally for several reasons. The existence of members and a greater focus on their interests under a number of the non-charity types of NFPs materially reduces the risk that an entity will accumulate assets to the disadvantage of

²⁰ See, e.g., Jonathan Garton, *The Regulation of Organised Civil Society* (Hart Publishing, 2009). Garton acknowledges that while regulatory rules may be developed for the sector as a whole, structural distinctions may warrant differences in the regulatory approach to components of civil society: 143.

²¹ See, e.g., Henry Hansmann, 'The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation' (1981) 91(1) *Yale Law Journal* 54; Anup Malani and Eric Posner, 'The Case for For-profit Charities' (2007) 93(8) *Virginia Law Review* 2017.

²² See, e.g., *Contribution of the NFP Sector*. Cf Weisbrod, above n 13.

present generations or that the NFP creators will be able to extend their view of intergenerational justice far into the future. Indeed, that charities facilitate other-regarding behaviour is identified in Chapter 2 as an important process benefit and one that marks a key distinction with many other types of NFP. Further, as the first question that this book seeks to answer is focused on what legal restraints apply to the accumulation of assets, there is a need to narrow in on a subset of the broader NFP sector to which a relatively homogeneous body of rules applies. As demonstrated by the diversity of accumulation rules even within the charity sector, attempting to elucidate rules for the broader NFP sector (including cooperatives, mutuals, sporting clubs and political parties) would have been unworkable. Nevertheless, as charities are a subset of NFPs and have many similarities to non-charity NFPs, the book remains of relevance to the broader NFP sector.

1.2.1.1 Not-for-Profits

The term ‘not-for-profit sector’ (or ‘nonprofit sector’) relates to an extremely diverse array of entities and has been defined in many different ways for different purposes. The NFP sector is frequently referred to as the ‘third sector’ to emphasize the distinction with the business, government or household sectors,²³ albeit that an inevitable result of the trends described at the outset has been an erosion of those boundaries. It has also been referred to, in a more positive description of what it is than what it is not, as ‘civil society’, broadly meaning ‘the sum of institutions, organizations, and individuals located between the family, the state, and the market, in which people associate voluntarily to advance common interests’.²⁴

For this book, it is useful to refer to two definitions that emphasize different aspects of the NFP sector. The first, that of the Productivity Commission, emphasizes the function of the NFP sector, defining it as ‘organisations established for a community purpose, whether altruistic or mutual in nature’.²⁵ Salamon and Anheier proposed a second definition to focus on the structure and operation of NFPs, noting that NFPs typically display the characteristics of: being ‘organized’ meaning institutionalized rather than informal; ‘private’ rather than a part of the government and ‘self-governing’; ‘non-profit distributing’ in that surpluses are not distributed

²³ See, e.g., Anheier 4.

²⁴ Ibid. 9, 80–4.

²⁵ *Contribution of the NFP Sector* xxv, 3–8.

to owners or controllers; and ‘voluntary’, which imports both voluntarism and volunteerism.²⁶

As is apparent, NFPs combine essential characteristics of the public sector, like the pursuit of public benefit, with key features of the market sector, such as having a private and voluntary nature.

1.2.1.2 Charities

Placing certain disqualifying factors to one side,²⁷ charities are ‘entities’ that satisfy three key positive requirements. First, the entity’s purposes must all be ‘charitable’. Under the technical legal meaning accepted at common law,²⁸ this means the purposes must be for the ‘relief of poverty’, the ‘advancement of education’, the ‘advancement of religion’, or ‘other purposes beneficial to the community’.²⁹ These purposes are typically referred to as the four ‘heads’ or ‘limbs’ of charity. The fourth limb is a general category determined by analogy with the authorities and the *Charitable Uses Act 1601*, 43 Eliz 1, c 4. Some jurisdictions, such as Australia and England and Wales, have enacted statutory definitions of charity for certain purposes, which reword the charitable purposes under a larger number of ‘heads of charity’ that broadly reflect the scope of the common law heads, likely working only minor expansions.³⁰ The reworded heads include, among others, advancing health, advancing education, advancing social or public welfare, advancing citizenship or community development, advancing religion and advancing culture.³¹

²⁶ Lester Salamon and Helmut Anheier, ‘Toward a Common Definition’ in Lester Salamon and Helmut Anheier (eds), *Defining the Nonprofit Sector: A Cross-National Analysis* (Manchester University Press, 1997) 29, 31–4. For the distinction between voluntarism and volunteerism, see Matthew Harding, ‘Distinguishing Government from Charity in Australian Law’ (2009) 31(4) *Sydney Law Review* 559.

²⁷ For instance, an entity’s purpose cannot be against public policy, including because it is unlawful: *Bob Jones University v United States* (1983) 461 US 574; *Royal North Shore Hospital of Sydney v A-G (NSW)* (1938) 60 CLR 396, 426 (Dixon J); *National Anti-Vivisection Society v IRC* [1948] AC 31; *Charities Act* (Aus) ss5(c), 11(a); *Charities Act* (NZ) s 13(1)(b)(ii).

²⁸ References to the ‘common law’ are to case law as opposed to legislation, unless the context requires otherwise.

²⁹ *Commissioners for Special Purposes of the Income Tax v Pemsell* [1891] AC 530, 573 (Lord Herschell), 583 (Lord Macnaghten); *Aid/Watch Incorporated v FCT* (2010) 241 CLR 539, [18] (French CJ), Gummow, Hayne, Crennan, Bell JJ). Cf ALI Restatement of Charity Law (Draft 1) §1.01; *Waters Law of Trusts* §14.IV; *Charities Act* (NZ) s5(1).

³⁰ See, e.g., *Dal Pont’s Law of Charity* [2.29].

³¹ *Charities Act* (Aus) s12(1); *Charities Act* (UK) ss1–3.

Second, the entity must be for the public benefit. This means that the entity's purposes must result in a net benefit³² and must do so in relation to the public or a section of the public rather than a private class of individuals.³³ The second part of this requirement, described by Garton as 'cross-sectional public benefit',³⁴ does not apply so strictly to charities for the relief of poverty, such that it is possible to have a charity for the relief of private groups such as poor relatives or employees.³⁵

Third, whether construed as part of the public benefit test or as a standalone requirement, the entity must be not-for-profit, in that it must not distribute assets or benefits to persons falling outside the section of the public for whom the entity pursues its purposes.³⁶ In reality, this non-distribution constraint is somewhat porous. For instance, members may be able to receive a benefit in their capacity as a person to be assisted in the pursuit of the NFP's purpose rather than in their capacity as a member.³⁷ It is also difficult to track the benefits that controllers provide to themselves, such as greater remuneration and better working conditions.

By 'entity', it is meant that the charity is sufficiently formally organized that it can be differentiated from the household sector.³⁸ Thus, the term is used to cover legal relationships, such as trusts and unincorporated associations, as well as legal persons. While the distinction can be difficult to draw, a charity cannot be governmental (or an individual).³⁹ At common law, the leading explanations of the distinction are based on the degree of government control, or on whether the purpose is chosen and pursued by individuals making autonomous choices ('voluntarism') as opposed to being chosen and pursued by way of the deliberative and administrative processes of the

³² *Re Pinion* [1965] Ch 85, 107 (Harman LJ), 107–8 (Davies LJ), 109–11 (Russell LJ); *Gilmour v Coats* [1949] AC 426, 446 (Lord Simonds); *Charities Act* (Aus) ss5(b), 6; *Charities Act* (UK) s4(1); Westlaw, *Bogert's Trusts and Trustees* (June 2019) §361.

³³ *Thompson v FCT* (1959) 102 CLR 315, 321–3 (Dixon CJ, Fullagar and Kitto JJ in agreement); *Charities Act* (Aus) ss5(b), 6; *Charities Act* (UK) s4(1); Westlaw, *Bogert's Trusts and Trustees* (June 2019) §361.

³⁴ *Garton's Public Benefit* 48.

³⁵ *Re Scarisbrick* [1951] 1 Ch 622 (Court of Appeal); *Dingle v Turner* [1972] AC 601 (House of Lords). Cf *Charities Act* (Aus) s8.

³⁶ At common law, see, e.g., *Re Delius (deceased)* [1957] Ch 299, 308 (Roxburgh J); *Dal Pont's Law of Charity*, [3.23]; *Garton's Public Benefit* 45–6; Westlaw, *Bogert's Trusts and Trustees* (June 2019) §364. See also *Charities Act* (Aus) s5(a), where the term 'not-for-profit entity' is not defined, necessitating regard to common law principles.

³⁷ Cf *FCT v Co-operative Bulk Handling Ltd* (2010) 189 FCR 322 (non-charity case).

³⁸ Cf *Contribution of the NFP Sector* 4–6.

³⁹ Cf *Charities Act* (UK) s1(1); *Charities Act* (Aus) s5(d).