This case concerned the tax-exempt status of The Study and Prevention of Psychological Diseases Foundation Incorporated (SPED). SPED had received the following endorsements from the Australian Taxation Office on 1 January 2005:

- An entity exempt from income tax as a charitable institution under section 50-110 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) in accordance with section 50-5 item 1.1;
- A deductible gift recipient in accordance with section 30-125 of the ITAA 1997 on the basis that it was a health promotion charity under section 30-20 of the ITAA 1997, item 1.1.6.

SPED also obtained the following endorsements from 1 July 2005 (although it was possible that these had been backdated to 1 January 2005 – the point was not argued):

- A health promotion charity under section 123D(2) of the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA).

A review of SPED’s endorsement as an income tax exempt charity under Subdivision 50-B of the ITAA 1997 was commenced in August 2009. By letter dated 6 April 2011 the Commissioner advised SPED that it had not satisfied the requirements for the above endorsements, and that they would be revoked with effect from 1 January 2005. SPED objected but the objection was disallowed by the Commissioner on 27 April 2012. In this case, SPED applied for a review of that decision to disallow the objection. The issues were:

1. Whether SPED was a charitable institution;
2. Whether SPED was a health promotion charity; and
3. If any of SPED’s endorsements were revoked, then from what date (or dates) should the revocation have taken effect.

The founders of SPED had previously been engaged in group living experiments, and ‘research’ since the mid-1980s. One of its founders had published a book on the issue of ‘emotional quotient’, and another had operated multidisciplinary health clinics. They had also developed the ‘Ideal Human Environment’ (IHE) as a means of assisting young people with social disorders.

SPED was formed to engage in ‘24 x 7’ research and then trial and test research findings through the conduct of programs designed to promote the prevention of psychological disease, and included in its objects:

- ‘The Foundation[’s] objects are for public benefit and charitable purposes, in seeking to promote the prevention and control of psychological diseases in human beings and therefore setting out to ultimately create the Ideal Human Environment (IHE).’ (at clause 4 of its Constitution)
- ‘...primarily to operate and fund a research team that functions 7 days a week, 24 hours a day, whose purpose is to research human psychological disease by studying a cross-section of human behav[iour] in a variety of emotional, social and physical conditions, circumstances and environments.’ (at clause 5.1 of its Constitution)
Any person could become a member of SPED, and the number of members was allegedly unlimited. There were two types of membership: full-time research team members (FTRs), and freelance research team members (FLRs, which included anyone who had ever attended a course run by SPED). However, only the FTRs were really regarded as members and as at the present date, they numbered 17. All the members were bound by blood ties, marriage or friendship. SPED had never actively sought membership from the general public.

SPED was said to undertake ‘action based qualitative research whereby research is undertaken in an interactive real time manner’. This involved using ‘the whole number of possible hours in any one week’. All the members were described both as ‘researchers’ and ‘guinea pigs’. However, none of them had any qualifications in psychology or any social science, although one of the founders was a chiropractor.

The range of human experiences examined was said to include dealing with poverty, opulence, crowded living, living alone, living in cities, living in remote isolated communities, living overseas, and living in Australia. In effect, however, the members were just living their normal lives, and referring to that experience as ‘research’.

One of the projects undertaken was ‘Project Inebriation’ which dealt with the experience of owning and using luxury motor vehicles. The vehicles, including a Hummer ($100,000), a Ferrari ($300,000) and a Rolls Royce ($695,000), were purchased by SPED. Another was ‘Project India’ which funded a member’s trip to India to attend a wedding. None of the ‘research’ conducted was ever published in any journal of medicine or social science, although there were apparently internal reports produced.

Membership required payment as described by clause 9 of the Constitution:

Upon joining the SPED SRT [Social Research Team] all your assets become part of the asset base to be available for use by the SPED Foundation. This includes cash and all forms of property. These assets form part of what is termed entry princip[al] assets.

Assets were said to be returnable ‘upon the completion of this agreement’ but no interest was payable. In addition, all the income earned by members (most of whom were employed or self-employed in ‘normal’ jobs) was given to SPED. Thus, all the members paid no income tax. All the members’ expenses (including ordinary household expenses) were paid by SPED, and claimed by it as costs of research.

SPED’s accounts revealed that it engaged in very substantial share trading during 2008–09. It had assets of $10,665,655 and liabilities of $3,151,812 as at 30 June 2009. There were very substantial expenses recorded during 2009 including ‘research expenses’, which at $760,000, embraced ordinary household expenses, travel and ‘personal items’. Moreover, there were questionable amounts included which in evidence were identified as possible loans, but appear to have been advances to companies owned and operated by the founder members.

Was SPED ‘charitable’?

The word ‘charitable’ has a technical legal meaning that can be traced to the law of trusts and, ultimately, to the preamble to the Statute of Elizabeth: Federal Commissioner of Taxation v Word Investments Ltd [2008] HCA 55; (2008) 236 CLR 204. In the absence of a statutory definition of charity in Australia, the meaning of ‘charitable purpose’ has long been derived from the decision in Commissioners for Special Purposes of Income Tax v Pemsel [1891] AC 531, where Lord Macnaghten said (at 583):
‘Charity’ in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

SPED claimed to be a charitable institution having charitable purposes within two of the classes described in *Pemsel*: the advancement of education and other purposes beneficial to the community. However, an institution is charitable if its only purpose, or its main or dominant purpose, is charitable in the technical legal meaning, and it is established and maintained for that charitable purpose: *Federal Commissioner of Taxation v Word Investments Limited* (2008) 236 CLR 204 at 216–217. If an institution’s objects in its constituent documents indicate a purpose that is charitable, but its actual activities and other relevant factors indicate the substance and the reality point to the contrary, the institution will not be charitable.

Taking all the evidence into account, the Tribunal did not accept that SPED’s activities were at all charitable, or in accordance with its objects (at [70]–[71], [74]–[75]):

SPED’s principal activities, as it claims, are the research its members are carrying on 24 hours per day, seven days a week. I do not accept that this is research. The members’ activities, described by SPED as research, are predominantly the ordinary activities of life. They are carried out for the personal benefit of the members themselves. Similarly SPED claims that all of its expenditure is on research. However, overwhelmingly, its expenditure goes on its members’ living expenses, other personal expenditure, and commercial investments. Expenditure in any way beneficial to the community is insignificant compared to expenditure on private purposes.

SPED’s actual activities do not coincide with the stated objects in its Constitution. It does not fulfil the charitable purposes it asserts. It exists, and existed during the relevant years, for the benefit of its small number of members. A considerable part of that benefit is financial.

**Was SPED an institution?**

The Commissioner contended that SPED was neither ‘charitable’ nor an ‘institution’. The latter descriptor depends on the totality of the circumstances. The Tribunal had no difficulty in agreeing with the Commissioner (at [80]–[82]):

SPED’s members are all related by blood, marriage or friendship. The conditions that it places on its members mean that its membership is unlikely to grow. Any new membership is likely to be confined to persons who are born into SPED, or marry or commence a relationship with an existing member. There is little, if any, public utility in SPED’s activities. Its activities, which it calls research, are predominantly its members’ ordinary activities of life, carried out for their own benefit. Its expenditure, in general, is for the personal benefit of its members. SPED is not an institution in the relevant sense.

**Was SPED a health promotion charity?**

In addition to being a charitable institution, there was a requirement (in the context of the deductible gift recipient provisions of the ITAA 1997 and exemption from fringe benefits tax under the FBTAA) that SPED’s principal activity be to promote the prevention or the control of diseases in human beings. Disease includes any mental or physical ailment, or disorder. The Tribunal had few words to spare on this issue (at [86]):

SPED’s principal activity was not, at any relevant time, to promote the prevention or control of diseases in human beings.
What was the relevant date for revocation of endorsements?

The Tribunal said that SPED was not entitled to any of the endorsements granted to it in 2005. Therefore, the relevant date for revocation was 1 January 2005.

The Commissioner’s decision was confirmed.

The case may be viewed at: http://www.austlii.edu.au/au/cases/cth/aat/2013/919.html

Implications

The activities carried out by the organisation and its surrounding context would alert any reasonable person in the street that charitable tax exemptions and deductions for this organisation were too good to be true – and they were. The wheels of ATO’s formal scrutiny appeared to turn slowly with a review of the status being commenced in August 2009 and the letter revoking the status in April 2011. The organisation was also subject to a BAS audit in February 2007, and provided information requested by the ATO, separately, in 2007. The audit and information do not appear to have raised any alarms.

It will be interesting to see how the ATO deals with the issues now that the taxation concessions have been withdrawn. Some comfort may be provided by the mutuality principle, a legal principle established by case law. It is based on the proposition that an organisation cannot derive income from itself. The principle provides that where a number of persons contribute to a common fund created and controlled by them for a common purpose, any surplus arising from the use of that fund for the common purpose is not income. The principle does not extend to include income that is derived from sources outside that group.