FSC FINANCIAL SERVICES COUNCIL

30 August 2012
Parliamentary Joint Committee on Corporations and Financial Services

Dear Sir/Madam,

Inquiry into the Australian Charities and Not-for-profits Commission Exposure Draft Bills

The Financial Services Council (**FSC**) welcomes this opportunity to make a submission in relation to the ACNC Draft Exposure Bill.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees.

The Council has over 130 members who are responsible for investing more than $1.8 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Within the trustee sector of their businesses, trustee corporation members act as trustee or co-trustee for over 2,100 charitable trusts or foundations with assets of around $3.2b.

In summary, the FSC and its members are concerned with the inappropriate application of the ACNC Draft Exposure Bill to licensed trustee companies and public trustees. We believe that the practical outcomes of the provisions of the Bill do not correspond with the overarching purpose of the Bill; to establish a new regulatory framework for the Not-For-Profit (**NFP**) sector (what we later describe as charitable institutions).

While the Bill is supposed to be aimed at regulating charitable institutions, charitable funds and their trustees are inadvertently captured. In our view, the trustees of a charitable fund cannot properly be described as an organisation that is operating in the NFP sector.

Overall, the Bill creates a new layer of regulation that applies to trustee companies and public trustees that is unnecessary and is incompatible with current Federal and State/Territory regulatory regimes.

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If you have any questions regarding the FSC's submission, please do not hesitate to contact Martin Codina, Director of Policy, or myself on (02) 9299 3022.

Yours sincerely

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Attachment 1

1. The difference between charitable funds and charitable institutions

In Australia there are two types of charities. Charitable funds and charitable institutions. A charitable fund is a fund established under an instrument of trust or a will for a charitable purpose. The purpose of a charitable fund is to hold and manage trust property and to make distributions to other entities or persons. A charitable institution is a NFP organisation that is established and run to advance a charitable purpose.

Charitable funds are "giving" charities because they hold trust/fund property and make distributions to charitable institutions or individuals; they do not themselves engage in charitable work or activities. Charitable institutions are "doing" charities because they exist to do charitable work.

A charitable fund may be set up to benefit a particular charitable institution exclusively or for a charitable purpose that is in line with the purposes of one or more charitable institutions. For example, a will trust set up to exclusively benefit Lifeline will pay distributions to the charitable institution that is Lifeline; whereas a will trust set up for the purpose of suicide prevention might also pay distributions to Lifeline because Lifeline is the main charitable institution with a key charitable purpose around suicide prevention.

Charitable institutions receive income to fund their charitable activities from charitable fund distributions and from their own fundraising activities. The charitable institution may have deductible gift recipient (**DGR**) and/or tax concession charity (**TCC**) status. Regardless of whether the income of a charitable institution comes from a fund or from its own fundraising activities or both, the charitable institution is in effect using public money (provided directly or indirectly by the public) that is either tax exempt or tax deductible. For this reason charitable institutions should be regulated and currently they are not.

Charitable funds, on the other hand, are not organisations operating in the NFP sector. A charitable fund or trust is a legal entity for tax purposes although it is best described as a relationship. The trustee of the charitable fund holds the legal title to the fund property but the beneficial interest in that property belongs to the charitable institution beneficiary or, the ultimate beneficiary if the fund is set up for a charitable purpose. The trustee of the charitable fund does not use the fund property in any way; the trustee merely holds the property until it is distributed.

Charitable funds must have an ABN in order to achieve DGR and/or TCC status. If the charitable fund has DGR status this will allow the donors to the fund to claim an income tax deduction equivalent to their charitable donation. The TCC status of a charitable fund provides the trustee with a tax exemption on the income generated by investing the fund property.

Unlike charitable institutions and their directors, trustees and officers, licensed trustee companies and public trustees do not operate in the NFP sector and are highly regulated under different Federal and State/Territory regimes. The trustees of most charitable funds are private trustee companies, licensed to provide traditional trustee services under the corporations law, and public trustees. Individuals can also be trustees of charitable funds however we make no comment as to how the legislation should operate in relation to individuals. It may also be necessary in the legislation to distinguish between licensed trustee companies and public trustees on the one hand and lay trustees on the other, of charitable funds.

The overarching problem with the ACNC Draft Exposure Bill is that it first makes charitable funds as well as charitable institutions eligible for registration and that it then applies the remainder of the Bill to all Registered Entities. As a result, the Bill creates a new regulatory regime for currently unregulated charitable institutions but also creates a new layer of regulation for charitable funds and their trustees. The latter is not only onerous on charitable fund trustees, who are not supposed to be the focus of the legislation, but also entirely inconsistent with the regulatory regimes that currently apply to the majority of charitable fund trustees i.e. licensed trustee companies and public trustees. It is also possible that some of the provisions are unconstitutional in their operation in respect to licensed trustee companies.

2. The Charities Commission of England and Wales

Given that the parliament's clear intent is to establish a new regulatory framework for the NFP sector, we can only assume that the lack of distinction between charitable funds and charitable institutions in the Bill is unintentional.

It should be noted that the system that applies to charities in England and Wales is similar, though not the same as that of Australia. The Charity Commission of England and Wales (**CC**) define charities as voluntary organisations which benefit the public in a way the law says is charitable. In England and Wales these charitable, voluntary organisations are governed by charitable trustees who serve on the governing body of the charity. The great majority of trustees serve as volunteers, and receive no payment for their work. They do not play the same role and are simply not the same as the board of directors of a publically listed or private licensed trustee company or a public trustee that administers a charitable fund.

The CC webpage also mentions 'Exempt' charities that cannot register with the CC. The reason why an exempt charity cannot register is because the CC is not their regulator because they are supervised by another regulator.

From this information it is clear that the CC only registers and regulates what it defines to be a charity which on comparison is equivalent to a charitable institution and not a charitable fund or its trustee.

It appears that in England and Wales the system of administering charitable funds is different to Australia in that there is no separate licensed trustee company or public trustee that looks after the funds in order to make payment to the ultimate beneficiary.

Instead, the trustee directors of what equates to a charitable institution are also the trustees responsible for holding and investing the trust property.

For these reasons, care should be taken to note the differences between England and Wales and Australia and to ensure that the Australian charitable and NFP reforms are suitable and appropriate to Australian conditions.

3. Registration of not for profit entities

3.1. Entitlement to registration

We agree that what we have described above as a charitable fund should be entitled to registration and that registration with the ACNC should be the first point of application for certain tax concessions, ultimately granted by the ATO.

3.2. Revoking Registration

We agree that the ACNC should be able to revoke the registration of a Registered Entity for the reasons outlined in the Bill. Revocation is a suitable penalty to impose upon a Registered Entity that was either not entitled to registration, has contravened the ACNC Act, has provided false or misleading information or has requested revocation of registration.

4. Responsibilities of Registered Entities

4.1. Governance and External Conduct Standards of Registered Entities

The Bill states that the object of the provisions and regulations around governance and conduct standards is to provide a minimum level of confidence that Registered Entities will promote the effective and efficient use of their resources, will meet community expectations about managing their affairs and the use of public money, volunteer time and donations, and will minimise the risk of mismanagement and misappropriation.

These provisions clearly should not apply to charitable funds and their trustees even though they are Registered Entities under the Bill. The regulations around governance and conduct standards should only be applied to charitable institutions that receive and use distributions from charitable funds and other public donations. It is the charitable institution beneficiary of a charitable fund that uses trust resources and public moneys and engages volunteers.

It is not necessary to apply new governance and conduct standards to licensed trustee companies or public trustees. Licensed trustee companies are already subject to the governance standards set out in the corporations law. Public trustees and licensed trustee companies also owe a fiduciary duty to the beneficiaries of all the trusts they are responsible for administering. This is the fundamental feature of trust law.

In addition, many of the charitable funds administered by licensed trustee companies and public trustees are either public or private ancillary funds (**PuAFs and PAFs**). In September 2009 the Assistant Treasurer published the PAF Guidelines, under section 426-110 in Schedule 1 to the *Taxation Administration Act 1953*. Similar guidelines were

published for PuAFs in December 2011. The object of both sets of guidelines is to set minimum standards for the governance and conduct of a PAF/PuAF and its trustee. The guidelines set out the rules that a PAF/PuAF must comply with in order to be endorsed, and remain endorsed, as a DGR. The guidelines state that PAFs and PuAFs must be established, maintained and wound up in accordance with the following principle: (that it) is open, transparent and accountable to the public through the Commissioner.

In light of the above it is completely superfluous for the ACNC to seek to strengthen the transparency, governance and accountability of the trustee industry, as this industry is already highly regulated by ASIC under the corporations law, by State/Territory Governments and the Supreme Courts and by the PAF/PuAF Guidelines that apply to the PAF/PuAF charitable funds under their administration.

The focus of the ACNC legislation is to strengthen the transparency, governance and accountability of charitable institutions operating in the NFP sector ("doing" charities) and for this reason it is essential that the legislation distinguish between Registered Entities that are charitable funds and those that are charitable institutions.

5. Record keeping and reporting

5.1. Reporting

Under the PAF and PuAF Guidelines the trustee of a PAF or PuAF must prepare financial statements showing the financial position of the fund at the end of each financial year. In addition, the trustee must arrange for an auditor to audit the financial statements of the fund and to ensure compliance with the PAF/PuAF Guidelines by the fund and the trustee.

Trustees of PAFs and PuAFs therefore already have a reporting obligation to the Commissioner of Taxation in order to maintain their DGR status. Trustees of these charitable funds should not be required to report the same thing to two different federal regulators for essentially the same purpose.

The costs associated with lodging separate information statements and annual financial reports that may need to be audited, for each charitable fund (that is not a PAF or PuAF) under the administration of a licensed trustee company or public trustee, would be significant. Please see Attachment 2 to this submission for a worked example of the likely additional cost to one of the FSC's trustee corporation members. You will note from the example that the trustee will be entitled to recoup some of the additional costs from the charitable fund and will need to bear some of the cost itself. The costs that may be recouped from the fund will have a direct impact on the balance of the fund and what is available for distribution annually. Charitable funds that are not PAFs or PuAFs, which are established by will, are not set up with large compliance costs in mind and charitable beneficiaries should not be penalised under these proposals.

In addition, a reporting deadline of 31 December will also add to costs. Charitable funds that are not PAFs or PuAFs, regardless of size, currently only have reporting requirements around the lodgement of franking credit refund applications. These

applications have no deadline for lodgements. Other charitable funds (such as PAFs and PuAFs) have an extended reporting deadline of 15 May of the following financial year lodgement due date. We recommend that due dates for reporting should mirror the current taxation arrangements for charitable funds.

We also suggest that Registered Entities that are the trustee of a charitable fund that is not a PAF or PuAF be required to prepare and lodge an aggregate annual information statement only for all of the charitable funds it administers. In our view, this would achieve the purpose of the ACNC legislation in establishing the ACNC to collate information around the amount of moneys distributed annually, and to what types of causes those moneys are applied to further. In other words, this approach would facilitate data collection, be more economical for the community and would have less of a financial impact on the federal government (in terms of resourcing of the ACNC).

5.2. Information

We note that at 6.37 of the Explanatory Materials to the Bill that the ACNC can be expected to require information relating to such things as governance, finances, activities, purposes, objects and beneficiaries of the registered entity.

It would be essential that any list of beneficiaries provided to the ACNC, which contain details of individual recipients, be kept absolutely confidential and under no circumstances should that information be made public. It is not appropriate to leave it up to the discretion of any ACNC officer as to how this kind of private information should be used. Trustees of charitable funds pay distributions to individuals and their private information should never be passed on to third parties.

Please also note that the FSC supports the recommendations made by Philanthropy Australia in regard to the private information of private philanthropists and PAFs. The potential lack of security around release of the private information of individuals is another broad area in which the Bill appears to target the wrong group of people. Private philanthropists and individual beneficiaries are not organisations operating in the NFP sector and should not be the focus of regulatory reform under the ACNC legislation.

6. Suspension and removal of Responsible Entities

6.1. Suspension, removal and replacement of a Responsible Entity

The Bill grants the Commissioner the power to suspend or remove a Responsible Entity (**RE**) of a Registered Entity. The RE of a Registered Entity charitable fund is, in most cases, a licensed trustee company or a public trustee. If the trustee of the charitable fund is a body corporate or trustee company the directors of the company are all REs. The Bill therefore grants the ACNC the power to suspend, remove and replace the directors of a licensed trustee company and trustees, such as public trustees.

Licensed trustee companies are either publicly listed companies or wholly owned private subsidiary companies. The *Corporations Act 2001* says that only the shareholders can remove a director of a public company unless the Federal Court

orders the removal of a director for breach of duty. The directors of a wholly own subsidiary may only be removed by the directors of the parent company shareholder. Directors of both private and public companies are accountable to the shareholder/s of the company and it is for the shareholder/s to decide whether a director should remain in office.

Under the common law of Australia a trustee of a charitable fund that is not a PAF or PuAF can only be removed in accordance with the trust instrument itself or by order of the Supreme Court in its equitable jurisdiction where breach of trust has occurred. Similar to the situation with shareholders, the beneficiaries of a trust are entitled to take action to remove an under-performing trustee, but it is for those with the beneficial interest to make this decision.

Trustees of PAFs and PuAFs, **though not the individual directors of a public listed or private trustee company**, may be removed and replaced as trustee of a PAF or PuAF, by the Commissioner of Taxation for breach of the PAF/PuAF Guidelines. Trustees of these charitable funds should not therefore also be subject to removal and replacement by the ACNC on the same or similar bases.

It is not appropriate that the ACNC be given the power to make a determination as to whether a director of a public listed or private company has breached his/her duty to the company. It is also not appropriate for the ACNC to make a determination as to whether a trustee of a charitable fund that is not a PAF or PuAF is in breach of trust. Like with other federal regulators, such as ASIC or the ACCC, the ACNC should be required to make application to the relevant court if it seeks an equitable remedy against a director of a licensed trustee company or a public trustee of a charitable fund that is not a PAF or PuAF.

If the ACNC seeks to remove and replace a trustee of a charitable fund that is not a PAF or PuAF, they are essentially making a compulsory acquisition of the trustee's property. It is not clear how this power would interplay with ASIC's new role as the Federal regulative body responsible for compulsory and voluntary transfer determinations of the estate assets and liabilities of a licensed trustee company to another licensed trustee company or a public trustee.

There is also no consideration of what will happen to the contracts that the trustee may have entered into in its personal capacity in relation to a charitable fund, if the trustee is removed and replaced with a new entity. There is no facilitative statutory novation of contracts provisions in the *Corporations Act* (that apply to traditional trustees as opposed to the Responsible Entity of a Managed Investment Scheme) that would allow the contracts of the old trustee to automatically pass to a new trustee.

These provisions should not apply to the RE of all Registered Entities. They should apply to the RE of registered charitable institutions that are not publicly listed/private companies or State/Territory government bodies or trustees.

7. Conclusion

Licensed trustee companies and public trustees are not averse to transparency or some form of reporting that would assist the understanding of the uniqueness and importance of charitable entities in the community; however, the bill in its current form does not appear to be designed with this outcome in mind.

The Bill is not appropriately targeted to the currently unregulated NFP sector and instead extends the cost of compliance to other entities that are not supposed to be the focus of this reform. We are therefore seeking amendments to the Bill that would better achieve its overarching purpose; to establish a new regulatory framework for the NFP sector.

Attachment 2

This is example is based on estimations of cost made by one of the FSC's 18 licensed trustee company and public trustee members.

Total number of charitable funds, each with annual revenue greater than $250,000, excluding PAFs and PuAFs, is approx 150.

- Business cost to input data and prepare data for accountant/auditor/all liaison and project management = $2,000 per charitable fund. These costs cannot be recouped from the fund and will be borne by the trustee company;
- Cost of external accountant/auditor = average of approx $4,000 per charitable fund. These costs would be recouped from the fund;
- Cost of external preparation of statements = average of approx $2,000 per charitable fund. These costs would be recouped from the fund.

Therefore, income foregone to the community is $6,000 per charitable fund per annum, multiplied by 150 non-PAF/PuAF charitable funds, totals $900,000 per annum (recurring). Costs absorbed by the trustee would be $300,000 per annum (recurring).

*****Note that the cost to individual trustee corporations may be more or less depending on the number of non-PAF/PuAF charitable funds they are responsible for