

## Submission

**To:** Ross Ellis  
Executive Director / Trustee Corporations Association of Australia

**From:** Tabitha Lovett  
Head of Philanthropy, Equity Trustees

**Date:** 23 November 2011

**Subject:** **A Definition of Charity – October 2011 Consultation Paper**

### 1 Introduction

Equity Trustees Limited welcomes the opportunity to provide input into the Trustee Corporations Association of Australia (**TCA**) submission to Treasury on the Consultation Paper entitled ‘A Definition of Charity’ (**2011 Charity Definition Inquiry**).

In summary, we believe the 2011 Charity Definition Inquiry provides an important opportunity to highlight the difficulties that have arisen in relation to making distributions from charitable trusts to “government connected organisations” which, but for their connection to government would be considered charitable and, to advocate for a statutory definition of charity (in Federal legislation) to provide a legislative basis for determining whether a government connected organisation is a charitable organisation or pursues a charitable purpose and include such organisations within the statutory definition.

We understand that the TCA will prepare a submission to Treasury considering the 2011 Consultation Paper in its entirety. Equity Trustees would be appreciative if you would raise the issues we have set out below in response to question 15 of the Consultation Paper, on behalf of Equity Trustees and the TCA’s other affected members.

### 2 Executive Summary

#### 2.1 Type of Entity - response to Question 15 of the 2011 Consultation Paper

**Question 15 - In the light of the *Central Bayside* decision is the existing definition of ‘government body’ in the Charities Bill 2003 adequate?**

Equity Trustees is of the view that the definition of ‘government body’ in the Charities Bill 2003 lacks clarity and does not resolve the uncertainty for many taxpayers in the philanthropic sector on the issue of whether valid charitable gifts can be made to

## Equity Trustees' Submission

### A Definition of Charity – October 2011 Consultation Paper

organisations that, because of their connection to government, may not be considered “charitable” (which are referred to in this submission as **government connected organisations**).

As discussed at paragraph 119 -121 of the 2011 Consultation Paper, the Charities Bill 2003 defines a ‘government body’ to include a body controlled by the Commonwealth, a State or a Territory, as well as a body controlled by the government of a foreign country.

The Board of Taxation has recommended that the definition be amended to provide a clear definition of ‘government body’ including whether local government is included, and a clear definition of ‘controlled by government’, which we support.

This submission is intended to demonstrate how addressing this matter through a statutory definition of charity at Federal law could resolve the current uncertainty for charitable trusts distributing to entities ‘controlled by government’ and achieve administrative efficiency in determining access to taxation concessions for the affected entities.

The uncertainty around whether government connected organisations can be charitable according to the general law definition of that term is not new: there are cases going back to the 1950’s dealing with the issue. However, a string of more recent cases, including *Central Bayside General Practice Association Ltd v Commissioner of State Revenue (Vic)*<sup>1</sup> has brought the issue into sharper focus for trustees, their advisers and the Australian Taxation Office (**ATO**).

As a result, the practical and administrative problems that are outlined in this submission have been identified and, notwithstanding the genuine efforts of taxpayers and the ATO, a complete solution that is reasonable and effective for all entities affected has not to date been found.

In summary we submit that this issue lends itself to legislative reform and would be best achieved through a statutory definition of charity (in Federal legislation) to achieve the goals of greater certainty and administrative efficiency in relation to the determination of charitable purpose, and should provide the following:

- (a) A legislative basis for determining whether a government connected organisation is a charitable organisation or pursues a charitable purpose and including such organisations within the statutory definition of a charity:
- (b) Federal law adopting the purported policy objectives of the state legislated “saving provisions”, such as section 7K of the Charities Act (Vic) 1978, such that a charitable trust will remain valid at law if it provides gifts or benefits to government connected organisations which are (under the statutory definition but, arguably, not the general law definition) charitable.

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<sup>1</sup> *Central Bayside General Practice Association Ltd v Commissioner of State Revenue (Vic)* (2006) 228 CLR 168.

# Equity Trustees' Submission

## A Definition of Charity – October 2011 Consultation Paper

- (c) Provisions integrating the statutory inclusion of government connected organisations into the definition of charity and the “saving provision” for trust validity with the tax concessions available under the Federal tax law such that a charitable trust or institution may retain its status as a ‘tax concession charity’ by providing gifts or financial support to government connected organisations which satisfy the statutory definition of a charity (irrespective of whether they are also DGRs or have DGR funds).

### **3 Overview**

#### **3.1 What are “Government Connected Organisations”?**

Government connected organisations are organisations which are prima facie charitable but which are connected to government because they are creatures of state or federal statute, receive significant public funding or are subject to governmental control. Typical examples include public hospitals, museums and other like organisations.

Whether a particular government connected organisation remains charitable within the general law definition of the term despite its connection to government is a question of fact and degree and must be established on a case-by-case basis by reference to the applicable case authorities. There are no clear rules or criterion which enable taxpayers to determine whether a government connected organisation is indeed charitable, which is a significant source of uncertainty for taxpayers.

#### **3.2 What taxpayers are affected?**

The taxpayers who are most adversely affected by the uncertainty around whether government connected organisations are charitable are those philanthropic vehicles which are established for the purpose of providing gifts for “charitable purposes” or to charitable organisations. This includes inter vivos charitable trusts, testamentary trusts which provide for gifts to be made for charitable purposes, private ancillary funds and public ancillary funds.

#### **3.3 How are these taxpayers affected?**

Affected taxpayers which are testamentary trusts private ancillary funds or public ancillary funds may:

- (a) Wish to make gifts, or otherwise provide financial support, to government connected organisations but may only do so if they are charitable; or
- (b) be required to make gifts or distributions of income or capital to a government connected organisations as a named “beneficiary” of the trust with a “fixed entitlement” to part of the trust’s income and/or capital.

This may present two problems:

## Equity Trustees' Submission

### A Definition of Charity – October 2011 Consultation Paper

- (1) If the affected taxpayer is a trust, it must be a charitable trust for trust law purposes to overcome the limitation on perpetuities and the fact there are no actual objects of the trust. If the trust is benefitting non-charitable government connected organisations it may not have a charitable purpose and so will be (and never will have been) a validly settled trust.
- (2) For the affected taxpayer to be exempt from income tax and be eligible for a number of other tax benefits on the basis that it is an “income tax exempt charity” or a “tax concession charity” under the Income Tax Assessment Act 1997, it must have a charitable purpose. The Commissioner may deem the affected taxpayer to not be eligible for an exemption if it makes distributions or otherwise provides financial support to non-charitable government connected organisations.

#### 3.4 Current solutions

An uncertainty around the charity status of government connected organisations, and by extension, the validity of trusts which by choice or necessity make gifts to such organisations, has been addressed by state legislation.

Taking Victoria as an example, a solution to the trust validity issue has sought to be achieved by the introduction of section 7K, into the Charities Act 1978. This enables a “charitable trust”, by making an election opting in to the saving provision, to validly distribute income or capital to an “eligible entity” which, “but for” its connection to government, would be a charity. An “eligible entity” is an entity which is approved by the Commissioner of Taxation as a deductible gift recipient (DGR). Section 7K is extracted in full at Appendix A.

In the second reading speech introducing the bill containing section 7K into Victoria's Legislative Assembly, the then Attorney-General of Victoria, Rob Hulls, commented on ability of trust making the election to access Commonwealth government tax concessions:

“It should be noted that the [Bill] will not, of itself, allow Victorian charitable trusts to give to these government linked bodies. Further steps must be taken by Victorian charitable trusts and the commonwealth (sic) government for the bill to have full effect. Charitable trusts that ‘opt in’ to the legislation will only be able to exercise the legal power to make grants to government-linked bodies after they have obtained an appropriate tax endorsement from the ATO.”

To date, our understanding is that the ATO has adopted an administrative response whereby entities that have opted-in to the saving provision can apply for their tax concession status as a “tax concession charity” to be converted to that of an “income tax exempt fund”. The practical effect of this is to preserve the entities income tax exemption, but it will result in the entities only being able to make valid distributions to entities which are DGRs.

## Equity Trustees' Submission

### A Definition of Charity – October 2011 Consultation Paper

Where this can become problematic is where particular government connected organisations are not “eligible entities” for the purposes of section 7K because they are not a DGR or they do not maintain a DGR fund and a particular trust (inter vivos or testamentary) elects or is required to gift funds to that particular entity. In such a case, the making of a section 7K election will not overcome the trust validity problem and its tax concession status could not be converted to that of an income tax exempt fund.

To illustrate this with an example, Equity Trustees, in its capacity as an authorised public trustee company, is the trustee of several hundred testamentary trusts, many of which have been endorsed as income tax exempt charities. Many of these trusts have named beneficiaries with fixed entitlements to the income and capital of the trust that are government connected organisations (where it is uncertain whether, at general law, they can be regarded as charitable or not) and not DGRs. In other cases, there is a mix of fixed beneficiaries which are government connected organisations that have DGR endorsement (or maintain DGR endorsed funds) and other named government connected organisations which are not DGRs (or do not have DGR funds). Equity Trustees faces significant uncertainty in the administration of such trusts.

Equity Trustees has, at considerable expense, sought legal advice, which has confirmed that the correct legal position on the charitable status of particular government connected organisations which are named beneficiaries of the testamentary trusts which it administers is far from clear, and has recommended that a *cy pres* application be made to the Supreme Court of Victoria in respect of each trust to seek to modify its terms and scope of beneficiaries. However, this may not necessarily resolve the matter in all cases (particularly insofar as trust validity is concerned) and will necessitate significant costs, resources and time.

In Equity Trustees' submission, the issues outlined above with respect to government connected organisations calls for legislative reform: ultimately, there is no mischief in the current situation and legislative reform would provide taxpayers with greater certainty and preserve the ability of affected to distribute funds to worthwhile charities around Australia. Moreover, it is submitted that significant improvements could be achieved by addressing the problems presented by the uncertainty over government connected beneficiaries in a legislative definition of “charity” or “charitable purposes” at Federal level.

#### **3.5 Making a gift to government connected beneficiaries for charitable purposes**

*In re Cain (Deceased); The National Trustees Executors and Agency Co of Australasia Ltd v Jeffrey* [1950] VLR 382 Dean J upheld a gift under a will to the Children's Welfare Department as a valid charitable trust whereby the Department would provide extra benefits for children under its care. According to his Honour (at p 387) –

*“...the Court leans in favour of making the testamentary disposition of a testator effective if possible within the limitations and in accordance with the principles of law – per Lord Hanworth MR in In re Smith ... There appears to be open in the present case a view which would enable me to uphold the gift to the Children's*

## Equity Trustees' Submission A Definition of Charity – October 2011 Consultation Paper

*Welfare Department. If the Department is able and willing to undertake for the benefit of children under its care some activities over and above its normal duties and is prepared to apply the present gift to that end, then, if such course is fairly within what the testator intended, the gift would be charitable. Support for this view is to be found in Diocesan Trustees of the Church of England in Western Australia v Solicitor-General (1909) 9 CLR 757.”*

His Honour added (at p 388) that he felt justified in concluding, in the case before him:

*“that the present testator, by his gift to the Children’s Welfare Department, intended to benefit children under the care of the Department in some manner which is not a mere relief of Government expenditure. It is much more likely that the testator was intending to confer upon neglected children some additional benefits than that he intended to make a contribution to the funds of the Department in relief of consolidated revenue.”*

If government connected beneficiaries are willing to accept gifts on terms that require them to apply the gift in a manner over and above their ordinary activities it would be unnecessary for the trustees to elect under s 7K.

The Commissioner has given ‘non-binding advice’ that as an interim measure he would accept that, if trustees make gifts to government connected beneficiaries on this basis, such testamentary trusts can qualify for exemption on the basis that they are tax concession charities. In the letter the Commissioner also approved a standard form of letter that could be used by trustees to send to such beneficiaries to secure their agreement to this effect. But, in the longer term, the legal advice we received concluded that an invalid nomination of a non-charitable government connected beneficiary cannot be converted into a valid nomination simply by having the trustee impose a charitable condition for the receipt of the benefit. As *Re Cain* shows, it must be possible to construe the actual nomination in the will as one which involves the receipt and application of benefit for charitable purposes over and above those ordinary non-charitable purposes of the beneficiary.

### **3.6 Objectives of Legislative Reform**

In Equity Trustee’s submission, in order for a statutory definition of charity (in Federal legislation) to achieve the goals of greater certainty and administrative efficiency in relation to the determination of charitable purpose, it should provide the following:

- (a) A legislative basis for determining whether a government connected organisation is a charitable organisation or pursues a charitable purpose and including such organisations within the statutory definition of a charity: for example, by including in the legislative definition of “charity” an organisation, the objects and activities of which would satisfy the basic elements of that definition “but for” the fact that it is connected to government by virtue of it being a creature of statute, subject to government oversight or control, receiving government funding or implementing government policy.

## Equity Trustees' Submission

### A Definition of Charity – October 2011 Consultation Paper

If the legislature makes a policy decision that particular types of government connected organisations should not in any circumstances come within the definition of a “charity”, then they could be specifically excluded from the definition.

Such rules could be supported by an administrative mechanism which allows affected taxpayers to obtain a binding opinion from the Australian Charities and Not-for-profits Commission (ACNC) as to whether or not a particular government connected organisation is charitable, and/or for the ACNC to prescribe a particular government connected organisation as being charitable (for example, public hospitals).

- (b) Federal law adopting the purported policy objectives of the state legislated “saving provisions”, such as section 7K of the Charities Act (Vic) 1978, such that a charitable trust will remain valid at law if it provides gifts or benefits to government connected organisations which are (under the statutory definition but, arguably, not the general law definition) charitable.
- (c) Provisions integrating the statutory inclusion of government connected organisations into the definition of charity and the “saving provision” for trust validity with the tax concessions available under the Federal tax law such that a charitable trust or institution may retain its status as a ‘tax concession charity’ by providing gifts or financial support to government connected organisations which satisfy the statutory definition of a charity (irrespective of whether they are also DGRs or have DGR funds).

## 4 Conclusion

- 4.1 We would be grateful if the TCA would consider our comments above in relation to question 15 of the 2011 Consultation Paper on ‘A Definition of Charity’ when preparing its submission to Treasury. This issue will affect many of the TCA’s members. .
- 4.2 If you have any questions or require further information please do not hesitate to contact me by email [tlovett@eqt.com.au](mailto:tlovett@eqt.com.au) or (03) 8623 5379. I will be on annual leave from 25 November until 5 December and in my absence, Lachlan Wraith, Head of Private Trusts and Estates can be contacted on [lwraith@eqt.com.au](mailto:lwraith@eqt.com.au) or (03) 8623 5000.

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Equity Trustees' Submission  
A Definition of Charity – October 2011 Consultation Paper

**Appendix A: Section 7K of the *Charities Act (Vic) 1978***

Distribution to certain eligible entities

7K. Distribution to certain eligible entities

(1) The powers of the trustees of a charitable trust include a power to provide money, property or benefits to or for an eligible entity, or for the establishment of an eligible entity, that, but for a connection to government, would be a charity to or for which, or for the establishment of which, money, property or benefits could be provided in accordance with the trust instrument.

(2) Subsection (1) applies despite any provision to the contrary in the trust instrument.

(3) Subsection (1) does not apply to the trustees of a charitable trust unless there is in force a declaration to the effect of the form in the Schedule in respect of the trust.

(4) The exercise of a power conferred by subsection (1) on the trustees of a charitable trust does not affect the status of the trust as a charitable trust.

(5) The provision, before the commencement day, by the trustees of a charitable trust of money, property or benefits to or for an eligible entity, or for the establishment of an eligible entity, that, but for a connection to government, would be a charity to or for which, or for the establishment of which, money, property or benefits could have been provided in accordance with the trust instrument-

- (a) is deemed to be, and always to have been, a provision for a valid purpose; and
- (b) does not affect, and is deemed never to have affected, the status of the trust as a charitable trust.

(6) Subsection (5) applies despite anything to the contrary in the trust instrument.

(7) For the purposes only of this section the factors that may be taken into account in determining whether an eligible entity may be taken to be connected to government include-

- (a) the extent to which the eligible entity is under government direction or control; or
- (b) the extent to which the eligible entity is required to implement



Equity Trustees' Submission  
A Definition of Charity – October 2011 Consultation Paper

government policy; or

- (c) the extent to which a government can appoint, or direct or control the appointment of, the members of the governing body of the eligible entity-

whether or not the eligible entity receives government funding.

(8) In this section-

**commencement day** means the date of commencement of the Charities (Amendment) Act 2006;

**eligible entity** means a deductible gift recipient within the meaning of the [Income Tax Assessment Act 1997](#) of the Commonwealth;

**government** means the government of the Commonwealth or of a State or Territory or of any municipality of a State or Territory.

[Notes omitted]