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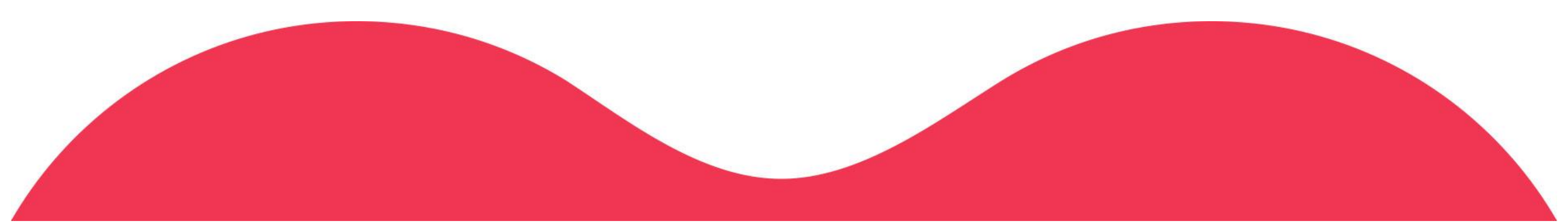
Philea Legal Affairs Committee: Response to the OECD consultation on the Common Reporting Standard



1. Introduction

This submission has been prepared by the Philea Legal Affairs Committee (LAC). Its members serve in a personal capacity and the views expressed in this submission should not be taken to be the formal opinion of the organisations that they represent.

We welcome the fact that the OECD consultation on possible amendments to the CRS recognises that the CRS could lead to “highly undesirable outcomes” on the non-profit sector. We will focus our contribution to provide input on the specific questions on pages 61 and 62 of the consultation document.

The main purpose of the OECD Common Reporting Standard (CRS) is to enable tax authorities to automatically exchange certain types of information on an annual basis to better detect tax evasion and tax crimes/offences. The OECD Common Reporting Standard is primarily aimed at banks and other institutions providing financial management services. Under the current wording, **public-benefit foundations and non-profit organisations (NPOs) can also qualify as “Financial Institutions”**, and therefore can be put under additional reporting requirements, even if there is no danger that they can be misused as an instrument for tax evasion due to registration and transparency requirements and the fact that they are subject to public supervision. Introducing these additional reporting duties would not seem to be risk-based or proportionate and would put significant additional administrative burdens and costs on a sector that needs to prioritise its public-benefit work on important societal issues. The assets spent on additional compliance costs cannot be used for the public benefit and we hence argue for a carve-out for public-benefit foundations and NPOs that fulfil certain requirements.

What are public-benefit foundations/philanthropic organisations?

Public-benefit foundations use their own financial and non-financial resources for the public good as opposed to private interests. These organisations have their own assets, which are dedicated to a public-benefit purpose. Philanthropic organisations support programmes from which we all benefit, in areas such as education, health, science, environment, culture and international development. Public-benefit foundations/philanthropic organisations are clearly distinct from private interest foundations such as foundations/family trusts, which only benefit members of one distinct family.

The relevance of the philanthropic sector

There are more than 147,000 philanthropic organisations in Europe with an accumulated annual expenditure of nearly €60 billion. The sector is very diverse and the vast majority of philanthropic organisations are small- and medium-sized organisations

that would suffer from additional administrative burdens. Besides funding and investments, these organisations combine outstanding expertise, deep knowledge and diverse stakeholder networks.

Philanthropy is part of the wider civil society. According to the 2020 report "Taxation and Philanthropy" by the OECD and the University of Geneva, based on a cross-country analysis, the wider non-profit sector typically contributes between 4.5 and 5.5% of GDP.

2. Comments

We agree that the application of the CRS to the public-benefit sector could lead to "highly undesirable outcomes" for the following reasons:

More costs and administration if considered as reportable Financial Institutions (FI):

If these public-benefit foundations were to qualify as reporting FIs, they would be put under additional reporting duties. They would have to gather information on "reportable account holders", which would in the case of public-benefit foundations include detailed reporting on donor(s) and members of the board as well as grant recipients. Such reporting could lead to very heavy administrative and costly efforts since foundations that benefit the general public sometimes have thousands of grant recipients. They would have to extend their already legally required due diligence on beneficiaries significantly so as to identify all grant payments that have been made to reportable jurisdictions and collect detailed information on those grants and their recipients. Public-benefit organisations would need to follow the common design of the rules and the use of a specific internationally accepted schema for reporting FIs. Even a large foundation such as the Wellcome Trust, which had previously invested many millions in a new grant management system, had to spend a great deal of senior staff time ensuring that the system generated the information required for CRS reporting, and significant time was spent extracting that information from the system in a form that could be used to complete the CRS schema.

As far as we are aware, there is no software product on the market that meets this need. Moreover, foundations would have to design their own due diligence forms for grant applicants to complete (the models generally in use are designed for genuine FIs, not for NPOs), train their staff to deal with queries from applicants, and delay making grant payments until the beneficiary had provided satisfactory responses to the due diligence questions.

Additional reporting burdens would significantly reduce philanthropic funding sources

Many public-benefit foundations in Europe are endowed, and they finance their public-benefit activities with the income generated from the asset allocation/investment of their endowments. Even if not all endowments are very large, in many cases assets are managed professionally. The additional reporting requirements created by the CRS would imply identifying equity and debt interest holders, in particular of founders, donors, and members of the board, but also beneficiaries. Foundations potentially will have to identify and report on hundreds of beneficiaries (be they individuals and/or legal entities). This additional reporting would represent a significant cost and would reduce the amount that they would otherwise spend on public-benefit activities.

For example, estimating that additional reporting efforts would imply a cost to larger foundations of around €4,000 annually – and this for a country with 3,000 relevant foundations – would entail a total €12,000,000 loss per year for that country's foundation sector. That is €12,000,000 that would have to be spent to comply with the CRS rather than on public-benefit purposes for which the assets were initially intended. Considering that there are an estimated 147,000 foundations in Europe, these extra costs would be significant.

We consider that national laws and regulation lower risk of abuse for the following reasons:

Lowered risk for NPO abuse in FATF contexts as well as in comparison to for-profit actors

We consider that the potential risk of Investment Entities claiming to be NPOs is overstated without any clear supporting evidence being provided. Quite to the contrary, we consider that national regulation and supervision, including registration and reporting duties under national laws, reduce the risk of abuse as also evidenced by national and regional risk assessments. In this context it needs to be noted that the Financial Action Task Force (FATF) has revised its assessment of NPO risks downwards since the CRS text was first published in 2014. The FATF approach is relevant to the CRS because we suspect that anyone engaged in AML-CTF activities is not going to be declaring the income they are using to fund those activities.

As the source of the potential risk of tax evasion suggested by those governments referred to in the questions on pages 61-62 is the NPO itself, that risk should be addressed by the government in the NPO's home country through the use of a properly funded registration and supervision system, including the use of tax audits where appropriate, which we consider to be the case for public-benefit foundations and NPOs

(see more below). The NPO sector as a whole does certainly not pose a greater risk than the private sector entities excluded from RFI status when, for example, a typical private company does not have to register with a supervisory body or show that it provides public benefit. Why would tax evaders even try to use an NPO which faces these restrictions when it is so much easier to set up a private company that they can control?

Regulation lowers risks of abuse

Public-benefit foundations are under regulation and supervision, including registration and reporting duties under national laws as follows:

- Regulation

Public benefit foundations constitute legally **autonomous assets which are devoted to a public-benefit purpose**. According to national laws, donors/founders can neither revoke their contributions to a public-benefit foundation, nor induce a return flow of funding to themselves. The assets have to belong exclusively and irrevocably to the foundation. Neither the founder, nor the foundation boards or the beneficiaries can claim it. In the event of the dissolution of a public-benefit foundation, the assets must be transferred to another tax-exempt body with the same or a similar goal. Public-benefit foundations hence follow a **non-distribution constraint**. Furthermore, foundations are governed by an independent board, which must implement the foundation's mission in a fiduciary capacity – for which board members are fully liable. The **tax-privileged status of a foundation depends on specific requirements** outlined by national laws including the pursuance of a public-benefit purpose and benefitting the general public. (For more information please read OECD and Geneva Centre for Philanthropy. Taxation and Philanthropy, 2020 https://www.oecd.org/ctp/taxation-and-philanthropy-df434a77-en.htm and Philea comparative highlights available here: https://philea.eu/wp-content/uploads/2021/12/Comparative-Highlights-Of-Foundation-Laws.pdf).

- **Registration and supervision**

Public-benefit foundations **are registered according to national laws** either with the company register/court or specific foundation register. They are also **monitored by public supervisory bodies and/or fiscal authorities**. As demonstrated by Philea's country reports of the legal environment for public-benefit organisations across Europe, European jurisdictions foresee supervision by either a public administrative body, a court and/or tax authorities.

- **Reporting**

*Public-benefit foundations are **required to report** on their finances on at least an annual basis* to one or more external authorities, be this the tax authority; a state or independent supervisory authority; or a combination of both.

Thanks to national registration and reporting duties, and rules putting public-benefit foundations under monitoring by a public authority, public-benefit foundations present a very low risk of being used to evade taxes or being abused for money laundering or terrorism financing. Additional reporting requirements hence do not seem risk-based or proportionate and are simply not necessary.

We consider that the CRS must align with privacy rights and FATCA

Additional reporting burdens need to take privacy rights into account

Apart from the concern about disproportionate, rather than risk-based, reporting requirements, there are also concerns that the reporting requirements could conflict with the human rights and safety of individual grant recipients, if for example the disclosure of a human rights defender's identity would put his/her safety at risk.

FATCA contains an exemption for charities

The US reporting standard FATCA, from which the CRS is strongly inspired, contains an exemption for charities, and it is simply not understandable why the CRS would not also contain an exemption for NPOs/public-benefit organisations/philanthropic organisations. Under FATCA, non-profit entities are deemed compliant financial institutions and therefore not subject to reporting obligations. There have not, as far as we are aware, been any indications that this has been misused for purposes circumventing FATCA reporting obligations.

3. Conclusion

Public-benefit foundations should be exempt from CRS

The inclusion of public-utility foundations in the OECD Common Reporting Standard cannot be justified because their legal structure and existing transparency and accountability regulation limits the use of foundations for tax evasion purposes to the minimum. Public-benefit foundations should be exempt from CRS for the following reasons:

- Foundations have **legal personality and are made up of independent assets assigned to a public-benefit purpose**.
- The goods belong exclusively and irrevocably to the foundation. Neither the founder, nor the foundation boards or the beneficiaries can claim them.
- The founder(s) of public-benefit foundations cannot revoke the foundation, nor obtain reimbursement of funds in any other way.

- In the event of the dissolution of a public-benefit foundation, a **re-evaluation of the assets for the benefit of the founder or his legal successor is generally excluded**. In this case, they must be transferred to another tax-exempt body with the same or a similar goal.
- Public-benefit foundations are subject to state supervision (by the Supervisory Authority for Foundations and in general by the Tax Administration) and must present an annual audited report including an activity report and annual accounts.
- Foundation boards are fully liable for their actions.

Including public-benefit foundations under the CRS would have a critically negative effect on the sector, putting additional reporting duties on entities which are already closely monitored. It would consume significant resources for reporting duties on beneficiaries that even imply human rights concerns. If we want to ensure that foundations continue to support the public, we need to provide for an enabling space for the sector and avoid an unnecessary increase in bureaucracy and red tape, which will discourage future funders and foundations. **Covering foundations/NPOs under the CRS would lead to heavy administrative burdens that would limit the resources that public-benefit foundations have at their disposal for pursuing activities which are beneficial for all of society.**

Therefore, Philea has since 2019 made an explicit call on the OECD to provide for a carve-out scenario for public-benefit foundations.

The issue could be addressed by including tax-exempt public-benefit foundations that are registered and under supervision as non-reporting financial institutions according to section VIII B.

The issue could be addressed by extending the carve-out foreseen in the definition of Investment Entities with respect to active NFEs to include those entities that are Active NFEs by virtue of being a non-profit entity, as described in subparagraph section VIII D(9)h. The carve-out could be limited to those non-profit entities that are subject to review by a public authority and that have complied with the requirement to register with the relevant authority in the country of residence. This would have the additional benefit of aligning the treatment of non-profit entities under the CRS and FATCA.

Contact

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About Philea

Philanthropy Europe Association (Philea) nurtures a diverse and inclusive ecosystem of foundations, philanthropic organisations and networks in over 30 countries that work for the common good. We unite over 10,000 public-benefit foundations that seek to improve life for people and communities in Europe and around the world.

Philea is a convergence of Dafne and EFC – Donors and Foundations Networks in Europe and the European Foundation Centre – forming a strong, united voice for European philanthropy.

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