LORD MAYOR'S CHARITABLE FOUNDATION

Inspiring Philanthropy
Since 1923

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

General Manager
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

By email: taxlawdesign@treasury.gov.au

10 May 2018

**Submission on the Exposure Draft of amendments to the Private and Public Ancillary Fund Guidelines.**

# 1. Background and scope

## The Lord Mayor's Charitable Foundation

The Lord Mayor's Charitable Foundation was established in 1923 by the then Lord Mayor of Melbourne and incorporated by an Act of Parliament in 1930. We are an independent foundation and Australia's largest community foundation with more than $200 million in corpus. Through a combination of grantmaking, research, partnerships, philanthropic services, community engagement and investment tools, we aim to support and build a strong community by addressing current social, environmental and community wellbeing issues.

The Foundation operates a public ancillary fund, named the Lord Mayor's Charitable Fund. This fund has approximately 200 sub-funds, in respect of which donors make grantmaking requests.

## Scope of submission

This submission responds only to the proposed amendments that are of particular concern or relevance to the Foundation.

We deal in turn below with the Private Ancillary Fund Guidelines and the Public Ancillary Fund Guidelines.

We then comment on a key issue regarding the tax status of community foundations in Australia more generally; namely, the need to recognise community foundations' direct involvement in community projects through a DGR 1 tax status.

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

## 2. Private Ancillary Fund Guidelines

### Item 32, Guideline 51A – Portability

#### Issue:

This proposed Guideline allows a private ancillary fund to transfer assets to another private ancillary fund upon winding up, but does not permit transfer to a *public* ancillary fund.

#### Recommendation:

- **Remove the word 'private' from this amendment, as follows, to allow portability between private and public ancillary funds:**

> ***51A. With the agreement of the Commissioner, a *private ancillary fund may transfer assets to another ~~*private~~ ancillary fund if***

#### Details:

**The current wording of this amendment does not appear to reflect the intention of the Prime Minister's Community Business Partnership.**

As it stands, this amendment appears to be inconsistent with the intention of the Prime Minister's Community Business Partnership, as reported in the joint media release from the Assistant Treasurer and the Minister for Social Services dated 28 May 2015:

> *The Partnership confirmed two measures to encourage philanthropy:*
>
> - *simplifying the valuation requirements for donations of listed shares and managed funds; and*
> - *enhancing portability for private ancillary funds (PAF)s on winding up.*
>
> *…*
>
> *The second measure will provide consistent treatment for PAFs and public ancillary funds in the winding up phase. It will provide PAFs, which are private funds set up to provide money or property to deductible gift recipients, with the flexibility to transfer their net assets to other ancillary funds. This option is already available to public ancillary funds in the winding up phase.*

We understood that the intention of these changes was to provide c*onsistent treatment* for private and public ancillary funds by enabling assets to be transferred to *other ancillary funds.* The explanatory statement for the proposed amendments also states the intention as being to "introduce *consistent treatment* for private ancillary and public ancillary funds".

In other words, there was no intention by the Prime Minister's Community Business Partnership to restrict portability such that a private ancillary fund can only transfer assets to another private ancillary fund, but not to a public ancillary fund. The existing Public Ancillary Fund Guidelines, with which consistency is sought, contain no equivalent restriction.

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

**Portability between private and public ancillary funds will promote more informed and effective philanthropy.**

We endorse the comments of Philanthropy Australia at page 4 of their briefing paper 'Early Wins to Grow Philanthropy and its Impact', which was prepared to inform the work of the Prime Minister's Community Business Partnership. The paper explains the reasons why private ancillary funds ought to be able to transfer assets to public ancillary funds, and calls for amendments to facilitate this:

> *There are Private Ancillary Funds currently in existence, which while set up with the best of intentions, are no longer considered viable by their trustee.*
>
> *For example, the cost and effort associated with maintaining the fund may have become too high given its size. Currently, if they are wound up their net assets must be distributed to Item 1 Deductible Gift Recipients.*
>
> *However, the trustee may wish to transfer the net assets to a Community Foundation or another organisation operating a Public Ancillary Fund so the funds can continue to be managed for the benefit of the community on an ongoing basis.*
>
> *In particular, a trustee may wish to convert a Private Ancillary Fund into a sub-fund of a Public Ancillary Fund, especially if its net assets are small and therefore a sub-fund is a more appropriate and cost-effective giving structure. Currently, they cannot do so.*
>
> *A more flexible approach is needed to address this red tape – the Private Ancillary Fund Guidelines 2009 need to be brought up to date, so that when a Private Ancillary Fund is wound up, its assets can be transferred to a Community Foundation or another organisation operating a Public Ancillary Fund for the ongoing benefit of the community.*

There are strong public policy reasons in favour of private ancillary funds transferring assets to public ancillary funds, especially to community foundations like ours. Community foundations have knowledge about community needs and expertise in effective philanthropic grantmaking. Like other community foundations, our activities are led by a volunteer board of directors who are representative of the community; our mission is focused on the specific needs of our community (Greater Melbourne); our donors bring a range of perspectives and community connections, and we inform our granting through research, partnerships and evaluation.

It is rare for a private ancillary fund to demonstrate these attributes. We expect that many donors who have established private ancillary funds would be inclined (regulations permitting) to transfer assets to a community foundation, recognising the knowledge held by community foundations and the opportunity to practise more effective philanthropy.

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

## 3. Public Ancillary Fund Guidelines

### Item 5, Guideline 17 – Reporting to ACNC

We support this amendment, which will reduce the time our staff need to spend reporting.

### Item 20, Guideline 35.1 – Loan guarantees

We support this change, which gives us an additional tool to support deductible gift recipients.

We also note Philanthropy Australia's submission regarding program-related investments, which explains the growing importance of such investments as alternatives to traditional granting and proposes a model for accounting for such investments as part of the minimum distribution requirement.

We agree with Philanthropy Australia that this is an important area for Treasury to explore, and we look forward to future opportunities to comment on this area.

### Items 6 to 9, Guidelines 19, 19.1, and 19.1 (note) – Amendment to the minimum annual distribution rate

**Issue:**

The existing distribution rate of 4% aligns with community expectations and is simple for donors to understand. The purpose of the proposed amendments could be better achieved by other means.

**Recommendation:**

- **Retain the current requirement that a public ancillary fund must distribute at least 4% of the market value of its net assets (as at the end of the previous financial year).**
- **Achieve the intention of the proposed amendments (that is, to provide additional flexibility for trustees in a weaker investment environment) through rules that:**
  - **a) enable trustees to address a distribution shortfall by drawing on distribution excesses from the five previous years or by distributing an excess in the subsequent year (as per the approach of the Canada Revenue Agency);**
  - **b) allow trustees to apply for a reduction in their distribution percentage where there are extraordinary circumstances which are beyond the trustees' control, and**
  - **c) allow small public ancillary funds with net assets of under $2 million to distribute at a rate of 2% instead of 4%.**

LORD MAYOR'S CHARITABLE FOUNDATION

Inspiring Philanthropy
Since 1923

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

## Details:

**There is an expectation in the community that public ancillary funds make reasonable distributions, including in a weaker investment environment.**

This is especially so given that the needs of the Australian community for support from philanthropy tend to be *greater* in a weak economy. The current 4% minimum distribution rate achieves a reasonable balance between a public ancillary fund's competing aims of meeting community needs while also achieving capital growth. By contrast, the proposed amendments prioritise year-on-year growth. The amendments would permit public ancillary funds to scale back their granting activities in a year of weaker investment returns.

At the current Reserve Bank target cash rate of 2%, the proposed distribution rate could potentially halve the amount of philanthropic funding flowing into the community.

A lower rate of distributions would, in turn, undermine take-up of public ancillary funds as a philanthropic vehicle.

**The 4% minimum is much simpler for donors to understand.**

This is important in a context where there is still a low level of understanding in the community around public ancillary funds. We have made progress in educating donors about how we distribute each year. The minimum annual distribution of 4% has provided an easily understandable benchmark. The proposed requirements will be more difficult for donors to understand as they require separate calculations according to two different methods, the second with four steps.

**Treasury can achieve the intended aim of these amendments – to "provide greater flexibility" – without abandoning the 4% minimum distribution.**

Our view is that generally, trustees of large public ancillary funds have investment expertise and an investment strategy capable of achieving long-term capital growth even with a 4% minimum distribution rate. Some additional flexibility can be provided through the following amendments:

a) **The Guidelines should be amended to enable trustees to address a distribution shortfall by drawing on distribution excesses from the five previous years or by distributing an excess in the subsequent year. This is the approach of the Canadian Revenue Agency (CRA).[1]**

   This approach would give trustees the flexibility to take a longer-term view on their distribution obligations, while still meeting the 4% minimum in aggregate. For example, trustees would have the flexibility to approve a large signature grant in a particular financial year and to offset this the following year with the appropriate lower distribution.

[1] See Canada Revenue Agency, at http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/spndng/menu-eng.html. The annual distribution rate for public and private foundations in Canada is 3.5% of the average value of a foundation's property over 24 months.

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

Conversely, if the fund makes lower investment returns in a particular year but performs well in the subsequent year, the trustees can supplement a distribution shortfall in Year 1 with distributions in excess of 4% in Year 2.

This approach is preferable to the method proposed in Guidelines 19 and 19.1. Under the proposed Guidelines, there is no mechanism to ensure that trustees who distribute at a low rate in Year 1 (in our view, a rate below 4% is low) supplement this distribution in Year 2 where investment returns allow. The Canadian approach, by contrast, ensures a steady distribution rate on aggregate while also allowing trustees to plan their distributions across multiple financial years.

b) **Trustees should be able to apply for a reduction in their distribution rate where there are extraordinary circumstances which are beyond the trustees' control.**

This is again an example of additional flexibility provided by the Canada Revenue Agency, while retaining the 3.5% minimum distribution requirement as a default rule for Canadian foundations. The CRA allows charities to correct a distribution shortfall by written application where the shortfall 'is the direct result of special circumstances beyond the charity's control that are specific and not general in nature'.

Relevantly, when considering whether this exception applies, the CRA will have regard to whether a foundation has exhausted other means to make up the shortfall, such as applying an excess available from the previous five years, or creating an excess in the subsequent year to cover the shortfall, as described at point (a) above.

c) **Small public ancillary funds (i.e: with net assets of under $2 million) should be permitted to distribute at a lower rate of 2% of their net assets.**

We support the submissions of Australian Community Philanthropy and Philanthropy Australia, which both argue for a targeted exemption of this kind. Such an exemption would reflect the fact that the 4% minimum distribution requirement is more difficult for smaller community foundations to meet without eroding their corpus, and having regard to the limited number of local DGR 1 charities in rural and regional areas

LORD MAYOR'S CHARITABLE FOUNDATION

Inspiring Philanthropy
Since 1923

Level 15, 1 Collins Street
Melbourne VIC 3000
GPO Box 1851
Me bourne VIC 3001

T. 03 9633 0033
F. 03 9650 9142
lmcf.org.au
info@lmcf.org.au

## 4. The tax status of community foundations

Community foundations like ours differ from other public ancillary funds. In addition to making grants for charitable purposes, we also advance charitable purposes directly by leading and participating in projects that benefit the communities we serve. For example, community foundations:

- commission research on community needs;
- act as a facilitator or 'backbone organisation' for collaborative projects which bring together key community stakeholders;
- convene groups working on a particular issue to coordinate services (for example, homelessness or respite services) and trial or demonstrate new service models, and
- educate the community about current community needs, philanthropy and the charitable organisations they can support in their local community.

Community foundations are uniquely positioned to perform these roles as a consequence of being community-governed; receiving donations from multiple sources; and having a long-term, place-based mission rather than a specific subject-matter focus.

Unfortunately the current tax regime, which requires community foundations to operate DGR 2 public ancillary funds, restricts the potential of community foundations to fund these important functions; in particular, due to being unable to receive distributions from private ancillary funds.

This issue is a frustration for donors, especially donors with private ancillary funds who want to work with their local community foundations. Many donors want to support the activities of community foundations as 'the glue' in their communities. We expect that, tax laws permitting, many private ancillary funds would make distributions to community foundations like ours to fund our work in communities (without necessarily winding up their fund and transferring their assets into a community foundation; though as discussed earlier, this should also be an option).

**We recommend that the legislation be amended to adopt a separate DGR 1 status for community foundations. This would unlock the potential of community foundations to drive change in the communities they serve. It would also promote growth in community philanthropy by allowing private donors to take advantage of the expertise and community knowledge held by community foundations.**

We support the submission of Australian Community Philanthropy which calls for this change.

### Contact for more information:

Catherine Brown, CEO: [redacted]
Cameron Winnett, Legal Officer: [redacted]
Darren McConnell, CFO: [redacted]