



1 HSF involvement with community foundations

Herbert Smith Freehills has been working on a pro bono basis with community foundations (CFs) since their introduction in Australia, starting with Melbourne Community Foundation (now Australian Communities Foundation). We worked closely with Foundation for Rural and Regional Renewal (FRRR) in supporting the development and growth of CFs over 20 years ago. We provide ongoing guidance on the complex legal and taxation restrictions and template documentation for many CFs operating today.

We have been working to simplify the structure and operations for enabling community philanthropy since the first submission to Government on this in 2003.

2 Objectives of the reform

The principal objective of the reform is to simplify the structure and providing flexibility as to funding for community philanthropy.

The main driver for most CFs is to keep funding and assets in their community and apply it locally by the people in the community who know the needs of their community. Almost all CFs are predominantly managed and operated by volunteers often with only a part time Executive Officer.

The issues included:

- 1 Complexity of structures, requiring:
 - a trust to be a public ancillary fund (PUF) in order to collect tax deductible donations for the broadest range of recipients under the current tax regime. Most PUFs managed donations in the form of sub-funds for particular causes or for one or more donors;
 - a charitable company to be the trustee and also collect money which wasn't tax deductible gifts in order to give or do any charitable activity;
 - other trusts or funds to focus on particular areas as separate entities or funds are required under the current tax regime e.g, PBIs, scholarship funds, disaster relief funds and necessitous circumstances funds.
- 2 Inability to access funding from private ancillary funds (PAFs): within the above structure it was not possible to access donations from locals who had established their own PAFs as PAFs cannot give to a PUF. While the CF can work with the PAF to assist them in their funding, many PAFs wish to give to the CF to support the work of the CF.
- 3 Reliance on FRRR: A work around is available through FRRR for rural and regional CFs, but many donors are sensitive to the funds being directed outside of the community and for the fee FRRR charges to cover the costs of its services.
- 4 The scarcity of item 1 DGRs in rural and regional areas, making funding through the PUF very challenging and often requiring additional administrative burden on the community by requiring auspicing entities.



The complexity of the many structures is not to be underestimated and it is key to this reform that the resultant structure is as permissive and flexible as possible and is also as simple as possible to operate. If this can be achieved, the expectation is for the CF sector to grow with a corresponding growth in community philanthropy – a clear policy aim of this reform.

3 What a CC should be

The legislation, Guidelines and supporting information from Treasury and the ATO should enable CFs to create a Community Charity (CC) which:

- 1 Is one entity ideally (being the CC corporation), or two if structured as the CC trust with a charitable company as trustee.
- 2 Is an item 1 DGR.
- 3 Has clear guidance on what activities it can undertake or give to.
- 4 Can still manage donations and donors by operating sub-funds.
- 5 Can receive funds from PAFs and/or operate a consulting business advising PAFs and local businesses as to the needs of the community to assist in maximising the benefits of the charitable grant making and sponsorship in the community.
- 6 Has a clear set of compliance requirements which is not more onerous than other operating charities of comparable size.
- 7 Does not have duplicate requirements so where there is an existing requirement with the ACNC this is not unnecessarily repeated by the ATO.
- 8 Does not have additional and unnecessary costs added to the compliance requirements (ie review or audit when small).
- 9 Recognises that CCs are all going to be unique to reflect their community and:
 - may operate to raise funds and flow all the money through to the community rather than build an endowment; or
 - may operate as doing entities without making grants to the community; or
 - may hold community assets in furtherance of their charitable purposes.

4 Comments on the Guidelines

With the objectives and desired outcomes of the reform in mind, we make the following comments on the Guidelines:

- 1 Some elements of the Guidelines appear to have adopted the requirements from a PAF whereas many community foundations are more similar to PUFs and therefore there is a mismatch in the requirements. These are noted below.
- 2 Even though many of the CFs in the first tranche of CCs will be operating PUFs and be familiar with these requirements, some do not have PUFs and the next applicants for CCs will also not be familiar with the ancillary fund guidelines. On this basis please review each guideline to carefully consider if it is really



necessary or applicable to the operation of a CC and is not just adding to the regulatory burden without clear policy rationale.

- 3 There are a number of areas where the Guidelines repeat or reflect a similar requirement for registered charities. For the ease of operation and minimising administrative and regulatory burden on CFs please delete areas of overlap with the ACNC. Unless there is a good policy reason which should be explained, unnecessary duplication is not good regulation and inconsistent with the policy objective of the ACNC being the primary regulator of charities. Bear in mind that not all ancillary funds are required to be registered charities and so this may have been why it was considered necessary to duplicate these requirements in the ancillary fund guidelines and this reason is not applicable to CCs:
- Guideline 9(2)(a): delete this requirement to operate as a charity - the ACNC regulates an entity's operation as a charity. In addition, the ATO has s 50-50(2) and has issued guidance in TR 2015/2. It is confusing and unnecessary to have two regulators and a number of overlapping requirements.
 - Guideline 9(3): amend to just require the objects to be consistent with section 30-110 ITAA – it is unclear what is meant by referring to both purposes and objects and by the use of the word 'clearly'. The ACNC just requires the governing documents to include the charitable purposes.
 - Guideline 13(4): the words 'to an eligible DGR in the direct course or furtherance of a purpose of the charity' – appears to be duplication with the ACNC Governance Standards and sec 50-50(2). Delete 'direct course' as this adds an additional requirement and it is not clear what this means or the intention behind adding a requirement for 'directness'. We suggest the words: 'to an eligible DGR in the direct course or furtherance of a purpose of the charity' are deleted as unnecessary and confusing duplication and potentially an additional requirement of directness.
 - Guidelines 15, 16 and 17 all repeat ACNC requirements and should be deleted. No policy rationale is provided as to why CCs should have duplicate regulations and regulators when this is not required of any other registered charity with item 1 DGR status. It is unnecessarily onerous and burdensome to CCs. Guideline 17 places a higher burden in relation to small CCs by requiring they divert their charitable funds to paying for a review of their accounts – again not required for other small registered charities with item 1 DGR status.
 - Guideline 19(4) is covered by the ACNC Governance Standards and should be deleted. If it is retained then an added exception is required so these transactions are permitted where it is in furtherance of the purposes given the individuals identified may be on multiple charity boards which may have transactions with the CC. This is very much the case in small rural communities.
 - Guideline 20 relating to uncommercial transactions and benefits to founders and donors duplicates requirements of the ACNC and ITAA. Guideline 20(3) causes many issues for ancillary funds as it is incorrect and contrary to the wording adopted by the ATO in the ancillary fund model deeds. If you are retaining this guideline (which we urge you not to), the benefit must be noted as a *material* benefit consistent with current requirements of the ACNC and the ATO, and the carve out in brackets currently in paragraph (f) should apply to all



as the entities referred to in paragraphs (a), (c) and (d) can be DGRs/charities.

- 4 There are a number of areas where the corporate director has been added alongside the reference to the trustee but not all these references are appropriate. Some references to the trustee are required as the legal entity for the trust – where this is the case, the reference to the corporate director is not required as the CC corporation will be responsible:
 - Guideline 7: the guidelines are not setting standards for the directors but for the community charity – this should read ‘a community charity trust and its trustee and a community charity corporation’.
 - Guideline 11(1): should apply to trustees and the corporation.
 - Guideline 12: delete its application to the corporate director as unnecessarily duplicative of s 199A of the Corporations Act.
 - Guideline 13(11)(h): the compliance history of any director is not relevant to an application to reduce the MAD.
 - Guideline 19(2): this is a decision of the CC corporation not an individual director and so should refer to the CC corporation.
 - Guideline 23: compliance with laws is presumably intended to apply to the CC corporation not the individual directors.
- 5 Throughout the Guidelines either ‘community charity’ or ‘charity’ is used which is confusing, particularly in the notes providing examples – please use the defined term of ‘community charity’ throughout.
- 6 Where the founder of the CC is referred to please clarify this as the founder of the CC trust only as this term is not applicable for a CC corporation.
- 7 Guideline 8: there is no explanation as to the intent or requirement for being ‘philanthropic in character’ nor a ‘vehicle for philanthropy’. It appears that this could mean building or holding a corpus or endowment which is not reflective of all community foundations nor consistent with the purpose of carrying out DGR category activities. For example, some existing CFs will retain their PUFs and flow money through the CC without using the CC to build an endowment. These paragraphs should be deleted.
- 8 Guidelines 9(3)(b) and 24 relating to winding up is already covered in the ITAA 97 requirements for gift funds in relation to gifts. This should be deleted as confusing and not consistent with the sections in the ITAA relating to revocation of DGR and winding up. No reason is provided for requiring all assets to go to another DGR when this is not a requirement for other item 1 DGRs. It is also confusing to add ‘in accordance with the purposes of the charity’ as the purposes allow distributions to non-DGRs.
- 9 Delete Guideline 10 as para (1) is duplicative of item 1 sec 30-15 and arguable that this guideline goes beyond the ‘in Australia’ requirement in the ITAA. Is this guideline requiring the activities to be only carried out in Australia? This is not clear and no explanation is provided as to why this would be restricted in this manner. Para (2) is incomplete if you are retaining this guideline, as it should also refer to the ability to give to non-DGRs which operate outside Australia and carrying out DGR type of activities outside Australia.
- 10 Guideline 12(c) currently states “...for a loss or liability attributable to: (a) a deliberate act or omission known by the trustee, employee, officer or agent to be a breach *that may result in* loss or liability”. Clearly the reference to “that may result in loss or liability must be amended as the indemnity is for an existing loss or liability (see the lead in wording) and it is unclear what the breach refers to.



We suggest the wording is amended to be "...to be a breach of the guidelines and which resulted in the loss or liability".

- 11 Guideline 13 relating to the minimum annual distributions (MAD) needs a number of amendments. It is essential that the calculation of the MAD is as simple as possible. Given the condition of the creation of the category was only that the CCs would need to have a MAD consistent with PUFs and the policy intent is to ensure funds held on endowment from tax deductible gifts make their way into the community and are not accumulated indefinitely, then it should be made clear that the calculation of the MAD is only to be made on the amount of the net assets held and invested as endowment funds/investment assets as at the end of each financial year. Guideline 13 does not cover accounting for the expenses of activities nor where assets are used for the CC's purposes and not for investment (e.g. a welfare hub; transport vehicles for the elderly or disabled or for food security; building for disaster relief, etc). The simple solution is to make the calculation of the MAD to be made only on the net investment assets and to allow all expenses to be included in the amount of the MAD. Some more specific comments are:
- In para (1) 'distribution' is defined and so delete 'of amounts' as this may imply this doesn't include expenses. On this, Note 1 is incorrect as it states the MAD cannot include expenses of the CC when it can under para (4). We suggest you define the amount the MAD is to be calculated on as 'net investment assets'.
 - Para (2) should be deleted as small CCs should be allowed especially if they are operating through volunteers and therefore operating with very low expenses. It seems out of place for the concept of CCs.
 - CCs are closer to PUFs than PAFs and the 4 year grace period should apply to CCs and inserted in para (3).
 - In paragraph (4) we suggest you just refer to the sections of the ITAA – are you intending to limit it by inserting the words 'to an eligible DGR in the direct course or furtherance of a purpose of the charity' – what does the 'direct course' mean? Is this overlap with the ACNC Governance Standards and sec 50-50(2) or introducing something new?
 - The examples in the notes need to be more reflective of what CFs might be doing.
 - Consistent with the suggested approach to investment assets, Guideline 14 should be restricted to regular valuations of the investment assets only.
- 12 Guidelines 18 and 19 should be amended to relate only to the investment assets. This will assist with paragraphs (7) and (8) of Guideline 19 with respect to collectables by reverting to the ancillary fund guidelines of not allowing a collectable for investment assets purposes. It is not necessary to state the permissive as CCs can only do things in furtherance of their purposes. There is no requirement to restrict this to cultural organisations and this should be deleted. We also note again, and suggest deletion of the unexplained and unnecessary addition of the word 'direct' in paragraph 19(7)(b).
- 13 Portability in Guideline 25 must be amended to:
- reflect the sub-fund provisions in the public ancillary fund guidelines as many CFs operate sub-funds as an essential component of attracting donors;

- allow the MAD to have been distributed from the investment assets attributable to that sub-fund and not to the whole CC as this inability to do this makes the timing of transferring sub-funds in PUFs extremely challenging for the PUFs and for the ATO around 30 June each year; and
- allow portability to ancillary funds.

5 Comments on the Factsheet

With the objectives and desired outcomes of the reform in mind, we make the following comments on the Factsheet:

- 1 The section on eligibility should be clear setting out the steps for the existing 28 CFs and the new applicants i.e.:
 - They will need to establish or identify the entity (either a corporation or a trust with a corporate trustee) which will be endorsed as the CC and ensure it has the required purposes and other elements required under the Guidelines.
 - The entity will need to be registered as a charity by the ACNC.
 - An application will need to be made to the Minister for a declaration – the entities associated with the named 28 CFs will not need to provide any additional information for this step and Treasury expects to be able to release the information on the requirements for applying for the Ministerial declaration by [dd/mm/yyyy]. This step will also contain the information required by the ATO which will be confirmation that the governing document contains the required provisions and the directors or the trustee, as the case may be, has signed the agreement to comply with the Guidelines.
 - Once the declaration is made, the ATO will endorse the entity as a CC with effect from the later of the date it was registered as a charity with the ACNC or the date its governing documents contained all the required provisions.
- 2 The section on the purposes of a CC should refer to purposes and activities of a CC. It is important to explain here:
 - What is meant by 'DGR general categories' and we suggest the word 'general' is confusing and you just refer to DGR categories.
 - The second purpose of 'engaging in a principal activity or pursuing a principal purpose' of a DGR category should be explained as including providing money, property or benefits to any entity or individual for activities or purposes consistent with the principal purpose or activity of the DGR category as well as the CC itself carrying out activities consistent with the principal purpose or activity of the DGR category.
 - More clarity is needed in the guidance on what is the principal purpose or activity of a DGR category as CFs want to be talking about and planning what may be possible with prospective and existing donors. We understand that being an 'institution' is not considered to be part of a principal purpose or activity but having a declaration for a disaster is part of the principal purpose for disaster relief.

- It is contradictory to the section 30-110(4) and the EM (which states that engaging in a principal activity 'must be for a purpose consistent with general DGR categories') to state that CCs are required to meet *any requirements or special conditions that are tied directly, or act as a precondition*, to the principal activity or principal purpose in the DGR categories. Neither the ITAA nor the EM require this – they only require **consistency** with the principal purpose or activity and so it will only be where the requirement or special condition is inherent in the principal purpose or activity that a CC will need to comply with them.
- It will be helpful to confirm that a CC can make a grant to another CC for a specific purpose or activity consistent with one or more of the principal purposes or activities of a DGR category but cannot make a grant to another CC for the CC's general purposes. This will enable other CCs to contribute to disaster relief in the affected CC's community through the CC.

3 With respect to operating a CC:

- As stated above in relation to Guideline 13, it is essential that the calculation of the MAD is as simple as possible. Given the condition of the creation of the category was only that the CCs would need to have a MAD consistent with PUFs and the policy intent is to ensure funds held on endowment from tax deductible gifts make their way into the community and are not accumulated indefinitely, then it should be made clear that the calculation of the MAD is only to be made on the amount of the net assets held and invested as endowment funds as at the end of each financial year.
- The Factsheet correctly identifies that expenditure on a CC for its own activities is part of the calculation of the MAD. However the Guidelines do not reflect this and incorrectly note that the MAD is not to include expenses of the CC (note 1 to guideline 13(1)).
- The Factsheet should not assume that all CCs want to build a long term endowment – this is not a condition of the category. This is referred to in relation to the MAD and in relation to the investment strategy. There should be a recognition that if no investment assets are held at the end of the FY there is no need to calculate a MAD nor to have an investment strategy.
- The example in the Factsheet of giving to a farmer has difficulties and should make it clear that this cannot have a purpose of providing private benefits to the farmer and the steps a CC could take to ensure the funds are used for the environmental purposes are through entering into a grant agreement (though this may also require the farmer not to sell carbon credits and perhaps enter into a conservation covenant to ensure the environmental benefit is achieved). We suggest a simpler example is provided of funding a local community group which is not a charity.