

# **Making community philanthropy work**

*- Overcoming legal and regulatory barriers facing  
community foundations in Australia*

**A submission to the  
Commonwealth Government**

**An initiative of  
Philanthropy Australia &  
Foundation for Rural and Regional Renewal**

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## Contents

<b>1.</b>	<b>An outline of this submission</b>	<b>Page 2</b>
<b>2.</b>	<b>Introduction – the goals of community foundations</b>	<b>3</b>
<b>3.</b>	<b>Where are the barriers?</b>	<b>5</b>
<b>4.</b>	<b>The Australian experience</b>	<b>9</b>
<b>5.</b>	<b>Recent changes charitable law in Australia</b>	<b>11</b>
<b>6.</b>	<b>Community foundations in other jurisdictions – corporate models and tax status</b>	<b>12</b>
<b>7.</b>	<b>Encouraging community philanthropy through a simpler legal structure and tax status</b>	<b>15</b>
<b>8.</b>	<b>Recommendations</b>	<b>17</b>
<b>9.</b>	<b>Contact addresses</b>	<b>19</b>
	<b>References</b>	<b>20</b>

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## 1. An outline of this submission

Community foundations are the fastest growing form of philanthropy in the United States, Canada and parts of Europe, such as the United Kingdom and Germany. Community foundations become a major source of long term philanthropic funding to help communities help themselves. Since its establishment in 2000, the Foundation for Rural and Regional Renewal has provided seed funding for eleven community foundations in regional Australia and more groups are carrying out FRRR funded feasibility studies. Philanthropy Australia also has funded a number of feasibility studies and special projects and is supporting the emergence of community foundations in Australia.

Despite this funding and support, there are a number of legal and regulatory impediments facing new community foundations that need to be resolved. A simpler legal and tax structure will enable donors to realise their desire to give tax-deductible donations to benefit their local community and will enable volunteer Boards of directors and staff to focus on donor development and addressing community needs, rather than on the legal and tax complexities which are currently causing delays and confusion.

The requirements of the tax laws result in structures which are too complex and cumbersome for most communities and which often do not achieve the desired outcomes of the community foundations. To be effective, a community foundation needs to be able to raise funds from the community, therefore tax deductibility of donations is essential.

A grant making entity which is eligible to be endorsed as a deductible gift

recipient ("DGR") must be a trust operating as a public fund or a prescribed private fund (item 2 of the table in section 30-15 Income Tax Assessment Act 1997). The requirement to have a Public Fund under item 2 in order to have tax deductibility is the main barrier to community foundations and gives rise to the following difficulties.

1. Very importantly, donations that are tax deductible and made to the Public Fund may only be given to organisations that also have Deductible Gift Recipient status. While this may be workable in a large metropolitan capital city because of the large numbers of organisations with DGR status, in rural and regional areas of Australia, there is often a lack of suitable grant recipients.

Community foundations need to be able to fund charitable organisations, or even charitable activities that meet the specific community development objectives of a community foundation.

Ideally, sport and educational organisations which are often central to a rural community's wellbeing and youth development (capacity building) but may not be charitable nor DGRs in Australia, would be eligible recipients of grants from community foundations.

2. The legal structure of community foundations is complex. Currently, community foundations in Australia are, for the most part, a company and one or two trusts. It is recommended that using one legal entity created following a Constitution with key clauses agreed by the Australian Tax Office would be much less administratively cumbersome. The Recommendations in this submission draw on successful models in other countries, especially the United Kingdom and Canada, and on some of the requirements of the Register of

Environmental Organisations under the Income Tax Assessment Act 1997 Cth.

The current confusion is also compounded because different components of the legal structure have different tax status. The company is an income tax exempt charity and the Public Fund (trust) is both an income tax exempt charity and a deductible gift recipient. Hence only gifts made to the Public Fund provide donors with a tax deduction.

3. The community foundation under the current structure can create management accounts, also known as subfunds, within the Public Fund for particular donors. However, the Trustee of the Public Fund (usually the company) may not fetter its discretion (decision making power) as trustee and hence donors may only make recommendations about the use of their donation. This is very confusing for those marketing the fund and a difficult concept to understand and explain both to the management and to potential donors. In some other jurisdictions such as the United Kingdom, the Constitution of a community foundation provides a power to create trusts to meet the wishes of particular donors. This matter is currently being reviewed by the ATO within the terms of the current laws.

A change is recommended allowing community foundations to establish separate funds within the single entity which can be “donor advised” provided that the grant is within community development objectives.

### Summary

In summary, this submission recommends that a new category of DGR is created being regional community foundations which are subject to ATO guidelines.

The features of this new tax deductible entity would be:

- (a) a company limited by guarantee or an incorporated association;
- (b) specified limited objects (see section 8 for details);
- (c) charitable activities and grantmaking activities for the benefit of the community within the objects;
- (d) the ability to establish donor funds provided funds are used only for the community foundation’s objects.

Creating community foundations which consist of one legal entity, have DGR status and can make gifts for charitable purposes within their objects, will give community foundations a much better opportunity of becoming a critical source of community capacity building and philanthropic support for many communities, especially those based in rural and regional Australia.

## 2. Introduction – the goals of community foundations

**This report aims to explain the barriers confronting community foundations and to draw on overseas and local precedents to reach some recommendations about a simpler structure and tax status for community foundations. A simpler structure will make it easier for community foundations to grow philanthropy in their area, to engage in community capacity building via strategic grantmaking and leadership activities, and to maintain the enthusiasm of volunteer Boards and staff as they build longer-term endowments to support their communities into the future. This is particularly true of community foundations being developed in rural and regional Australia.**

There are hundreds of community foundations across the US, Canada and Western Europe and a growing number in Eastern European countries, Russia, Africa and Australia. Community foundations respond to the desire of communities to take control of their own destinies by building a long-term endowment to fund projects, which address important community needs, and by providing local leadership via training, employment and volunteering opportunities, and through demonstration projects.

A community foundation is “an independent philanthropic organisation working in a specific geographic area which, over time, builds up a collection of endowed funds from many donors, provides services to those donors and the community, makes grants and undertakes community leadership and partnership activities to address a wide variety of needs in its service area.”

(Adapted from a Statement at the International Community Foundation Support Organisation Meeting, Oct 1998)

The first community foundation was established in Cleveland, Ohio, in 1908, with Australia following many years later when the Victorian Community Foundation was established in 1983. In 2000, the Foundation for Rural and Regional Renewal was created as a partnership between the Sidney Myer Fund and the Commonwealth Government to support rural and regional renewal in Australia with the private sector, philanthropy and government. One of its key achievements has been the support of community foundations serving rural and regional communities. There are more than fifteen community foundations in Australia with more in the process of incorporation.

Community foundations empower communities by:

1. establishing a mechanism for local donors to give to their own community, building the economic strength of the region or municipality; and
2. creating opportunities for community representatives (Board members) to make decisions about the priorities of the community in areas of social, environmental, cultural and economic need; and
3. providing paid and unpaid employment and new skills development opportunities for local people; and
4. making grants for small and large important charitable projects to local charitable organisations; and
5. project managing key demonstration projects addressing community needs.

While some of the few community foundations set up in metropolitan cities in Australia during the 1980s have operated successfully as donor advice and facilitation mechanisms, the newer community foundations which are operating in regional areas and have a more hands on approach to community capacity building, have found the restrictions on grantmaking and current legal structure required to obtain tax deductibility complex and confusing.

In some regional areas, Boards of community foundations have realised that there are very few eligible organisations in their area with DGR status. In most areas, community foundations have found it difficult to explain these complexities to donors who simply want to make a tax-deductible donation to benefit the long and shorter-term needs of their own community.

### 3. Where are the barriers?

**This section explains the difficulties which community foundation Boards and pro bono lawyers are facing as they try to establish a community foundation. Some of these issues, such as a lack of eligible grant recipients, affect rural and regional community foundations more than those based in capital cities.**

#### 1. Achieving Deductible Gift Recipient Status

Community foundations need to have deductible gift recipient status in order to provide tax deductions to donors. The concept of a community helping itself through local philanthropy depends on this incentive to be effective.

In order to be tax deductible, community foundations have had to establish a trust that meets the ATO's requirements of a Public Fund (see below). Amongst other consequences, this has led to a very narrow field of eligible grant recipients to fund from tax-deductible donations.

#### The Public Fund

The complexity of the current structure is now explained in a little more detail. Voluntary Boards of community foundations need to preserve the different tax status of the company and of the Public Fund (and of the Charitable Fund, if applicable). The company is endorsed by the Australian Tax Office as an income tax exempt charity ("ITEC") and the Public Fund is endorsed as both an ITEC and a deductible gift recipient ("DGR").

There are fundamental differences between these two statuses: the Public Fund can give receipts for tax-deductible donations to donors and the

other cannot. However, the grants made from the Public Fund can only be made to other organisations with DGR status, whereas grants from the company, or the "Charitable Fund" if the additional trust is created, can be given for charitable purposes which support the objects of the community foundation.

The Public Fund of a community foundation is granted "deductible gift recipient" endorsement under the category of ancillary fund.

"The DGR category of ancillary fund covers funds with the following characteristics:

- a. the fund is a public fund,
- b. it is established under a will or instrument of trust,
- c. it is allowed, by the terms of the instrument of trust, to invest gift money only in ways that Australian law allows trustees to invest trust money, and
- d. it is established and maintained solely for:
  - i) the purpose of providing money, property or benefits to DGRs, or
  - ii) the establishment of DGRs.

It must not carry on any other activities. It is like a conduit or temporary repository for channelling gifts to other DGRs. " (Gift Pack, May 2000, Australian Taxation Office, p53)

A non-government public fund will be a public fund where the public are invited to contribute to the fund, a significant part of the public does in fact contribute to the fund and the public participates in the administration of the fund. In relation to the last requirement, a majority of the governing body (eg board) must be made up of people or institutions that have a degree of responsibility for the community as a whole because of their tenure of some public office or their position in the community.

The tax status of a community foundation's Public Fund and of the company will also affect its eligibility for other tax relief. These include fringe benefit tax rebate, GST concessions, refundable imputation credits and exemption from state and government taxes. These are not analysed here as this report's focus is on increasing the fund development and grantmaking capacity of community foundations.

It should also be noted that gifts to the community foundation (for which donors are seeking a tax deduction) should have three characteristics: they should be made voluntarily; they should not provide a material benefit to the donor, and should arise from a detached and disinterested generosity.

The model recommended in this report aims for simplicity, enhancing the ability of communities to help themselves through local philanthropy.

### **Lack of grant recipients in some rural areas**

The lack of organisations with deductible gift recipient status in some parts of rural Australia is a real barrier for community foundations using the current model in those areas. The lack of DGR endorsed organisations means that there are few organisations that are eligible to receive a grant from the Public Fund of the community foundation. This can also be a disincentive to donors to the Public Fund.

Another hurdle in this area is in relation to **sporting organisations**, which are generally not recognised as charitable organisations, let alone deductible gift recipients, in Australia. One exception is the Australian Sports Foundation, which has DGR status under section 30-90 of the ITAA. Sporting organisations play a very important role in communities

across Australia. They provide opportunities for healthy activities and for community involvement and support from other players and mentors. In rural areas particularly, they are often the glue that keeps a community together. The tax status of sporting organisations is discussed in much greater detail in the following section.

A further hurdle for community foundations *at present* is that **educational institutions** (eg schools) are charitable. They are not DGRs except for school building funds and library funds, which have been approved by the Australian Tax Office. Hence a tax-deductible donation for educational purposes cannot be processed through the Public Fund unless the grant is to address a library or building need. More often, projects that the community foundation has been asked to fund aim to address early school leaving or develop innovative pre-employment programs for youth. (Universities are in a different category of DGR being research institutions.)

Another current limitation is that organisations that provide direct services to youth at risk may be DGRs but services working towards **prevention** of drug addiction will be charitable, but not always have DGR status. These may not therefore be eligible grant recipients at present.

### **Sporting organisations and charitable status**

As mentioned, the lack of eligible organisations in some rural areas is a barrier to grantmaking for community foundations. Many new Board members of community foundations find it surprising that sporting organisations are not charities in most cases. Local sporting organisations are not eligible to receive grants from either the Public Fund or the charitable company (or

Charitable Fund). (There are a number of exceptions, for example the Australian Sports Foundation and a number of sporting organisations whose predominant purpose is providing services to children and adults with disabilities.)

The Inquiry into Charities recommended: "That the encouragement of sport and recreation for purposes of amusement or competition not be a charitable purpose, it being noted that the advancement of health, education, *social and community welfare*, religion, culture or the natural environment through the encouragement of sport and recreation would be considered a charitable purposes (Recommendation 24) Inquiry into the Definition of Charities, June 2001, p16

The recent review of charities in the United Kingdom by the Strategy Unit of the Cabinet Office included a background research paper that studied sport and charitable status specifically. The *Sport and charitable status* report made much more specific recommendations and summarised the role that sports clubs play in society. The Discussion Paper recommended conditions under which sporting clubs could be regarded as charitable in themselves.

The role of sports clubs is multifaceted: "They provide health benefits to participants, giving them a better quality of life, and can be effective in encouraging participation in civil society, reducing anti-social behaviour and forging stronger communities."

The Strategy Unit Review recommends that "the advancement of charitable sport" become one of the ten new charitable purposes in law in the United Kingdom. To be regarded as charitable, the sporting organisations would need to

meet the proposed definition of amateur and the proposed definition of sport:

"11. *Amateur*" in relation to any club shall mean a club whose constitution prohibits benefit being received from the club by any member save in respect of any direct or indirect exempt benefit. The following shall be exempt benefits:

- Provision to members of sporting facilities relevant to the club's purposes;
- Reasonable provision and maintenance of club-owned playing equipment;
- Reasonable provision of post-play non-alcoholic refreshment for players and match officials;
- Payment for cost of obtaining coaching qualifications; and
- Reimbursement of reasonable travel expenses incurred by players and officials travelling to away matches.

12. The rules concerning the payment to members or to persons connected with the running of the club for payment of goods and services would be subject to the general safeguards in charity regulation. "

"*The definition of sport*"

13. It is intended that "sport" be defined generically, as activities involving an element of physical skill which promote and maintain health, rather than be referenced to a list of eligible activities.

14. This means that non-physical competitive activities such as chess or bridge would not be classified as sport. However, those with strong intellectual content may qualify as educational, and organisations promoting them may be able to

apply for charitable status under the Advancement of Education purpose.

*Open membership requirement: charging for membership*

15. The same principles on charging for services should apply to sports clubs as to any other charity.... Generally speaking, this means that charges should be reasonable, and should not be set at a level which excludes a significant proportion of the community. This would be judged on a case-by-case basis.

*Open membership requirement: selection criteria for membership*

15. Clubs which only accept members who meet a test of aptitude in the sport, or in fitness, would be able to be charities.... However, those which selected members on an arbitrary basis (such as personal connections) would not be eligible for charitable status.”

*(Private Action, Public Benefit: Sport and charitable status, Sept 2002, United Kingdom Cabinet Office Strategy Unit)*

It is suggested that many of these recommendations could be adapted to the Australian situation and should be considered by the government as a way of interpreting the very general Recommendation 24 of the Australian Inquiry into Charities. This submission recommends be permitted to make grants for “charitable sport” within the proposed UK definition – where it is within the community foundation’s objects of community development.

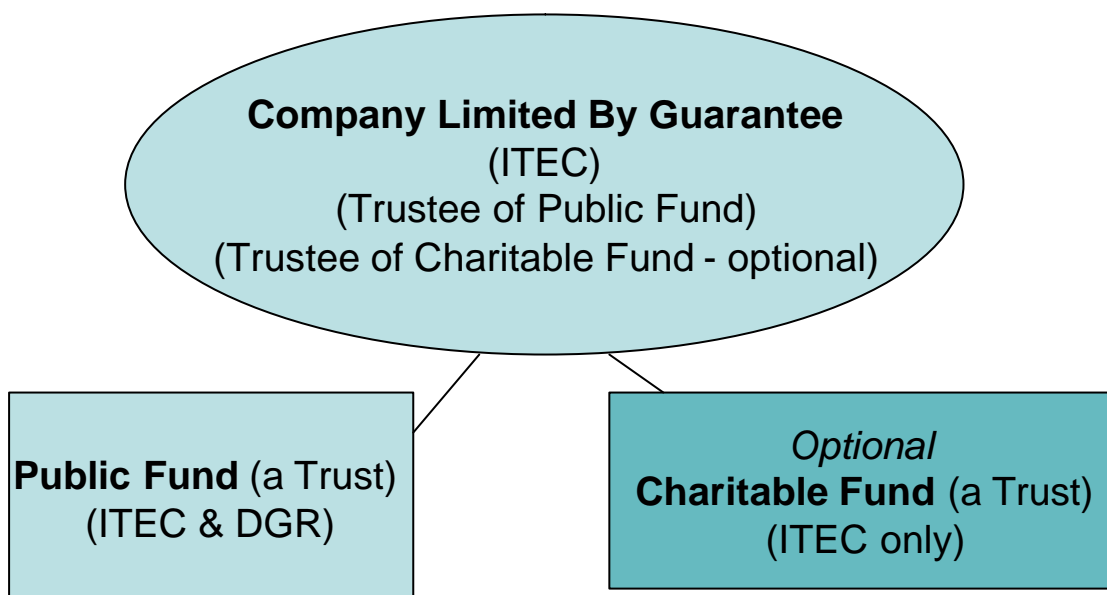
## 2. A complex structure

Community foundations in Australia have been established using two, if not three, legal structures, rather than one. This has been due to tax requirements in relation to tax endorsements.

Community foundations in Australia are usually a company limited by guarantee established for charitable purposes, which is also acts as the trustee of a trust, known as the Public Fund. In South Australia, the preferred structure is for an incorporated association rather than a company. Some community foundations also have a second trust, sometimes known as the Charitable or Open Fund, but this second trust is not a legal requirement. If community foundations take an active role in building the capacity of their communities, their broader charitable purposes are carried out by the company. These activities could include employing a youth worker to advise and help involve youth in philanthropy and in identifying projects which address youth unemployment. They might include conducting community planning meetings and community training in skills, which help run the community foundation.

The Boards of community foundations are responsible for the governance of at least two different entities, each with different tax status, and one governed by the Corporations Law and the other governed by the Trustee Act of the state of establishment and the common law relating to trusts.

The current legal structure of a community foundation can be shown as follows.



Reference

ITEC	income tax exempt charity
DGR	deductible gift recipient
Public Fund	Trust established to hold tax-deductible donations from which organisations with DGR status may be funded; known as an Ancillary Fund by the ATO.
Charitable Fund	Trust established to fund either charitable organisations (those with ITEC status) or charitable purposes; sometimes known as Open Funds but this term has no legal meaning.

If community foundations could carry out all their charitable activities and provide tax deductions to donors from one legal entity much of the present confusion would be avoided. The community foundation could then focus on achieving its objectives of benefiting the local community primarily through current and future grantmaking and by building a long-term endowment for future grantmaking to address community's needs.

### 3. Subfunds

The current issue surrounding the apparent promotion of subfunds within the community foundation's Public Fund as independent funds, rather than part of the whole Fund, needs resolution and

is already under review by the Australian Tax Office.

These issues largely arose because the steering committees of newly formed community foundations did not appear to understand the operation of sub-funds within a Public Fund. In response to the Australian Tax Office's concerns, a memorandum was prepared by FRRR's Community Foundation Program to assist new community foundations avoid these difficulties.

It is expected that the ATO may provide a ruling about the management and application of sub-funds shortly. The following notes, which provide a summary of the key issues, were provided to assist community

foundations working through these matters.

#### **“Fettering a trustee’s discretion**

As you would know, it is not allowable under trust law to fetter a Trustee’s decision-making power. Hence the trustee of the Public Fund, usually the company limited by guarantee part of the community foundation structure, may not undertake to abide by directions given by a donor in relation to his or her donation to the Public Fund. The application of the donation must be a matter for the Trustee’s discretion. Donors may advise their wishes, not direct.

#### **Investment of the Public Fund**

All the donations into the Public Fund must be treated for investment purpose as one fund; they must not be separately invested. The Trustee(s) must make investment decisions for the Fund as a whole. Following a review of investment options, the Trustees may invest the Fund in a number of, for example, managed funds. However, an individual donation should not be invested specifically in a particular way.

#### **Management accounts**

The community foundation may maintain management accounts in respect of donations from a particular donor and report to the relevant donor as agreed with that donor. However, the term “sub-fund” should not be used without an explanation in promotional material that it is in fact a management account within the Public Fund. Without any explanation, the term “subfund” could create the impression that a new Public Fund is being created within the original Public Fund (which is not allowed) and that either a donor

directed or/and separately invested fund is being created.

#### **Publicity**

A number of community foundations have inadvertently placed promotional material on their websites that do not comply with these rules and have caused the ATO concern.

#### **Grantmaking from the Public Fund**

A donor who makes a Donation to the Public Fund receives a tax deduction because the Fund will be applied towards gifts to incorporated charitable organisations holding Deductible Gift Recipient status themselves. Grants made from a Public Fund must be made to an “Eligible Charity” (see definition of Eligible Charity in subclause 2.1 of the Trust Deed)...

For the sake of completeness, it should be noted that donations or grants that are made to the charitable company limited by guarantee can be applied for *charitable* purposes, not just to DGR charitable organisations, but of course donors will *not* receive a tax deduction for these donations. (A business may receive a tax deduction as a business or marketing expense in some instances.)” (Extract from Memorandum from Catherine Brown, Consultant, FRRR Community Foundation Program, July 2002.)

If community foundations are not required to form trusts (to be endorsed as Public Funds), the current problems with sub-funds will be avoided. The situation will then be similar to the UK (see section 6).

## 4. The Australian experience

**This section examines the actual experiences of community foundations, especially those from rural and regional Australia, as they progress through the establishment phase: incorporation of the company limited by guarantee, settling of the trust deed for the Public Fund ( and perhaps also a deed for an 'Open Fund'), obtaining an Australian Business Number, seeking endorsement as an income tax exempt charity for the company and the trust, and finally seeking endorsement of the trust (Public Fund) as a deductible gift recipient.**

It is difficult for a voluntary Steering Committee or Board to maintain enthusiasm as its members work through the incorporation process with the Australian Securities and Investment Commission and then the three stage tax endorsement process, especially when the final outcome is not going to be easy to manage. Community foundations depend on voluntary effort for their establishment and continuation. They also depend on donors and charitable organisations seeing them as "can do", professional organisations. Any delays in the establishment process put both the volunteer effort and image of the community foundation in jeopardy.

In late 2001, the Foundation of Rural and Regional Renewal reviewed its Community Foundation Program. Overall, the review identified the major barrier facing emerging community foundations as being the difficulties working through a multi-step process for incorporation and then achieving deductible gift recipient status as a Public Fund – only to find the

community foundation could not provide donors with tax deductions for all the community foundation's charitable goals. This submission is one of the outcomes of that review.

The responses to the review questionnaire included the following statements:

"Many respondents mentioned the major difficulty as being:

- "Tax Office Response Time";
- "8 months and several compromises and concessions to the ATO to achieve DGR endorsement";
- "Delays because of changes in tax laws" ;
- "Complicated";
- "Incorporation and tax v.v.v. difficult. Really need a lawyer who knows the process."

(Foundation for Rural and Regional Renewal, *Review of Community Foundation Program*, April 2002, Catherine Brown & Associates Pty Ltd, page 8)

The time between incorporation with the Australian Investment and Securities Commission as a company limited by guarantee and achieving DGR endorsement of the Public Fund from the Australian Tax Office has ranged up to nearly two years for some community foundations (for example, Mumbulla Community Foundation). Most of the respondents to the FRRR survey had taken around one year to complete the necessary processes.

This is a major barrier in a community driven initiative where people are spending hours as volunteers and the enthusiasm for a community foundation begins to wane, just when it should be at a peak.

Community Foundation	Date of incorporation	Date of endorsement as an income tax exempt charity	Date of endorsement of the Public Fund as a DGR.
Geelong	23/11/1999	9/8/2000	10/8/2000
Chaffey (Sunraysia)	30/4/2001	19/12/2000	12/12/2001 (achieved with conditions)
Today Tomorrow (Benalla)	15/3/2001	25/9/2001	September 2002
Tasmanian	3/2/21996	1996	1996
Mumbulla	1/7/2000	1/7/2000	November 2002
Wingecarribee	18/10/2001	April 2002	Under consideration

Problems in this area have largely been because of a lack of understanding about both the corporate structure of community foundations in Australia and the reason that a Public Fund can be granted DGR status. In some cases community foundation steering committees have not been clearly aware of the distinction between a donor advised sub fund within the Public Fund and a donor directed fund. Sub funds can only be donor advised – as mentioned, it is not possible at law to *direct* a trustee of a Public Fund to act in a certain way. In addition, donations from a Public Fund must be made to organisations with DGR status themselves. At times, community foundations have inadvertently provided poorly drafted information to the Tax Office or placed promotional information on their websites without realising that this could jeopardise their DGR application. Most recently, a community foundation applied to be a DGR as a public benevolent institution (“PBI”) but was (not unexpectedly) unable to meet the test of providing direct services to those in need.

Recommendations from those surveyed included:

- “Use an experienced legal firm to set up each community foundation and negotiate with the ATO.
- Establish a template that the ATO will endorse.

- Lobby ATO for change in the way their system deals with DGR endorsement.”

(Review of FRRR Community Foundation Program, April 2002)

### **Mumbulla Community Foundation - a case study**

This case study describes the establishment process. The Mumbulla Community Foundation supports the community of the Bega Valley Shire and has been a frontrunner in demonstrating partnerships with local government and in strategic small grantmaking.

The Steering Committee of the Mumbulla Community Foundation began its establishment in May 2000 following a seeding grant from the Foundation for Rural and Regional Renewal. The Community Foundation incorporated as a company limited by guarantee in July 2000 and also achieved endorsement as an income tax exempt charity in July.

The Public Fund was established by a Deed of Trust and also achieved income tax exempt charity endorsement. However, the Public Fund was not granted Deductible Gift Recipient Status largely due to Tax Office concerns about the treatment of subfunds – these issues emerged from marketing material provided to the Tax Office and material on Mumbulla Community Foundation’s website. The Community Foundation has now addressed these concerns and

resubmitted the revised Deed of Trust prepared by Freehills, solicitors. Deductible Gift Recipient status was endorsed in November 2002.

## 5. Recent changes to charitable law in Australia

**Some of the recent changes to the definition of charities are relevant to community foundations. The introduction of Prescribed Private Funds, which was an initiative of the Prime Minister's Community Business Taxation Working Group, was successfully designed to encourage philanthropy in Australia. This is an example of using new organisational models to facilitate philanthropy and to reflect government policies and changing community expectations.**

### Inquiry into the Definition of Charities

The Inquiry into the Definition of Charities was completed in June 2001 and made a number of recommendations about the current definition of charities in Australia. Based on these recommendations, the Federal Government will amend the Income Tax Assessment Act 1997 from 1 July 2004 to enact a legislative definition of charity. This will closely follow the common law definition developed since the Preamble to the 1601 Statute of Elizabeth that includes a long list of charitable purposes. Since the 19<sup>th</sup> century charitable purposes have been characterised by the courts as relief of poverty, advancement of education, advancement of religion and other purposes beneficial to the community. The meaning of these purposes has been interpreted over many years by the courts, and also by Rulings of the Australian Tax Office that administers

tax exemptions and endorsements of charities.

Some of the most significant changes are:

1. the broader definition of "advancement": *Advancement* is taken to include protection, maintenance, support, research, improvement or enhancement;
2. the addition of a new category of DGR for charities whose principal activities promote the prevention and control of harmful and abusive behaviour among humans; and,
3. of particular relevance to this submission, allowing future additions to the list of organisations specifically named as deductible gift recipients to be prescribed by regulation rather than requiring a legislative amendment.

### Prescribed Private Funds

The Prime Minister's Community Business Taxation Working Group made recommendations resulting in several tax reforms to "make Australia's taxation system friendlier to individuals and companies who want to give." (Gonski D, Tax Initiatives to Promote Philanthropy, Community Business Partnership OnLINE, November 2002)

These included the establishment of Prescribed Private Funds that must comply with Guidelines which cover:

- the application process and how an application to be a prescribed private fund should be made; and
- what requirements need to be met for establishing a prescribed

private fund for philanthropic purposes.

(Guidelines for Prescribed Private Funds (Version 2) Issued March 2002)

A simplification of the legal and tax structure of community foundations would further build on these initiatives and would further promote philanthropy in Australia. Guidelines and a Model Constitution could be issued for community foundations. Guidelines are also issued by the relevant Commonwealth Department in respect of applications to be listed as a DGR under the Register of Environmental Organisations and the Register of Cultural Organisations under the ITAA.

## 6. Community foundations in other jurisdictions – corporate models and tax status

**Simpler models of community foundations exist in other parts of the world, including the United Kingdom. Adapting some of the best practice clauses from Constitutions to the Australian situation would help simplify the structure and encourage effective community philanthropy.**

### United Kingdom

#### Current situation

The legal and tax status of community foundations in the United Kingdom is of most relevance to the Australian situation because England is the original source of Australia's law on charity.

A community foundation may be a not for profit company limited by guarantee or a trust – it need not use the dual structure that we are grappling with in Australia.

The model objects clause is a useful reference:

“The objects for which the Charity is established are:

- (a) the promotion of any charitable purposes for the benefit of the community in the (County/City/Borough) of \_\_\_\_\_ and its immediate neighbourhood and in particular the advancement of education the protection of good health both mental and physical and the relief of poverty and sickness.” (Model Declaration of Trust, Sept 2000, Community Foundation Network, United Kingdom)

The issue in relation to subfunds does not arise because the model trust deed or Articles of Association (Constitution) include a power to accept property “upon or for any special trusts institutions or purposes (provided that the same shall be exclusively charitable and connected with the community for whose benefit the Charity is established) including trusts institutions and purposes either specified or to be specified by some person other than the Trustees... with or without such person being named as the donor.”

The Model Declaration of Trust or Constitution also provides some useful guidelines in respect of the appointment of the investment manager which could be used in the Australian situation.

#### Recent recommendations

The very recent work of the Strategy Unit of the UK Cabinet Office in respect of charities entitled Private Action, Public Benefit makes some interesting recommendations in respect of the definition and the legal structure of charities. As mentioned, the report recommends ten heads of charitable purpose, including sport provided the

organisation is able to meet the relevant tests.

Also of interest is that the report recommends two new legal entities: one for charities and one for social entrepreneur organisations. The report indicates that it is possible from time to time in order to reflect community expectations and changing responses to social needs. The new model recommended for social entrepreneur organisations is the Community Interest Company. (Chapter 5, *Private Action, Public Benefit, A Review of Charities and the Wider Not-for-Profit Sector*, UK Cabinet Office Strategy Unit, September 2002.)

The Cabinet Office Strategy Unit recommends the creation of a new form of legal structure for charities, the Charitable Incorporated Organisation. The ambiguity between the application of company and trust law to a charitable entity, which has already been mentioned in respect of community foundations in Australia, is one reason for the suggestion of a new company form.

“Although the company form is popular with many charities, ambiguity over areas of overlap and differing requirements between company and charity law means that sometimes trustees are confused about their obligations. The Charitable Incorporated Organisation is a new legal form specifically tailored to charities, which would remove these difficulties.” (*Private Action, Public Benefit, Charitable Incorporated Organisation*, Discussion Paper, Sept 2002)

While not recommending that Australia fully adopt the features of the Charitable Incorporated Organisation, the UK work does include some useful guidelines when considering a simpler structure for community foundations.

### **Characteristics of the proposed UK Charitable Incorporated Organisation**

- Incorporated legal form.
- Members' liability limited.
- Foundation and membership formats, so that it is appropriate for charities with and without a membership structure.
- Flexible administrative powers, to reflect the diversity of the sector in terms of size and purpose.
- Model constitutions prepared by co-ordinating bodies, tailor-made for particular parts of the sector.
- Requirement for constitutions to be complete and written in plain English.
- Explicit statement of trustees' duty of care, consistent with the Trustee Act 2000.
- Default provisions for new and existing charities to convert to a CIO by special resolution or by unanimous written resolution and transfer mechanisms to ease conversion from other incorporated forms.

(Chapter 5 *Private Action, Public Benefit, A Review of Charities and the Wider Not-for-Profit Sector*, UK Cabinet Office Strategy Unit, September 2002.)

### **Canada**

Community Foundations in Canada may be formed in three ways:

1. incorporate as a not-for-profit corporations under the Canadian Corporations Act.
2. incorporate as a not-for profit corporation under the provincial/territorial Corporations or Societies Act.
3. apply for incorporation by a special act of the provincial legislature through a private members bill.

The first two forms are most common but several community foundations have followed option 3. (Source: The Community Foundation Start-Up Manual, Community Foundations of Canada, Revised 1998.)

Following incorporation, the community foundation applies to Revenue Canada to be accepted as a registered charity. This identifies the community foundation as a public foundation and assign a charitable registration number to it for use in receipting gifts for tax purposes.

Again, there is only one legal entity created and one tax status applies.

Several clauses from the model application for incorporation are useful to consider as possible precedents to include in the Australian model Constitution.

*Objects clause.*

“The objects of the Corporation shall be carried out primarily, but not exclusively, within The Regional Municipality of .....and shall be to raise funds by way of charitable donations for the furtherance of the welfare of the community, specifically,

1. to support social services to advance the welfare of the needy

and the alleviation of human suffering and poverty;

2. to assist and promote the arts and cultural activities including, without limitation, theatre, dance, literature, film and video, music, painting and sculpture;

3. to advance education through the establishment of scholarship funds and the funding of specific educational endeavours;

4. to support and advance the provision of medical services through the funding of medical facilities and medical research;

5. for the furtherance of the welfare of the community solely for distribution to “qualified donees’, as that term is defined ... in the Income Tax Act...

6. to support and advance other community activities or facilities of a charitable nature.”

(Source: Attachment 1 Model Application for Incorporation, The Community Foundation start-Up Manual, Community Foundations of Canada)

## **Germany**

The number of community foundations in Germany is expanding at a fast rate. There were 35 licensed community foundations and another 70 in the planning stage in mid 2002. However non-profit charitable foundations with locally defined social and cultural purpose, which have been initiated by citizens, have existed for centuries. The modern community foundation movement has been reinvigorated since 1997, especially through the support of the Bertelsmann Foundation and also the Association of Foundations in Germany.

Community foundations are non-profit foundations with a broad charitable purpose. There are three main models

of community foundations  
“Bürgerstiftungen” in Germany.

“The foundations started from the bottom up with a number of individual donors providing the initial capital for the foundation, from the top down with a single donor or company to start with and a mixture of both which means some donors and an individual or a company putting up a “matching fund” to double every Euro given by a donor.”  
(Turner N, 2002, Bundesverband Deutscher Stiftungen, Bürgerstiftungen in Deutschland, p32)

Community foundations differ from traditional private foundations set up by one wealthy donor because *many* citizens contribute to the creation and development of *their* foundation. The Association of German Foundations has developed a list of characteristics of community foundations. Several of these are particularly relevant to a consideration of legal structure and tax status.

- “ 1. A Bürgerstiftung is a non-profit, charitable institution that operates for *public benefit* and plays an active and supportive role in civil society.
- 6. A Bürgerstiftung meets a wide array of local needs and therefore has a *broad charitable purpose*, as a rule encompassing *arts and culture, youth and social issues, education, nature and environment and the protection of historic buildings*. A Bürgerstiftung pursues its goals by making grants and/or operating programs.
- 7. A Bürgerstiftung supports programs which foster the engagement of the citizens or provide the means to help people help themselves.

- 10. A Bürgerstiftung conducts its activities in a *transparent and participatory way*. A Bürgerstiftung has several governing bodies (Executive and Advisory Board) that allow members of the community to direct and monitor the performance of the foundation.”

(Source: May 2000, Association of German Foundations, Characteristics of Bürgerstiftungen)

## 7. Encouraging community philanthropy through a simpler legal structure and tax status

Australian community foundations, especially those operating in rural and regional Australia need a simpler and more tax effective structure if they are going to be fully effective.

Boards of community foundations need clarity about what they can fund and from where. Boards should be focusing on identifying the needs of their community and ensuring that the purposes are charitable as defined in Australia. They should also be focused on growing their endowment fund.

The distinction between organisations with income tax exempt status as a charity (“ITEC”) and those also with endorsement as a deductible gift recipient (“DGR”) is not easy to explain to donors.

Donors need tax deductions for all donations to a community foundation, not just those that are made to the Public Fund, which can then only be granted to organisations with deductible gift recipient status.

In summary, a community foundation needs to be a single legal entity which

has broad charitable purposes to advance the community's aspirations in social, economic, cultural and environmental areas. It should be able to hold funds for these purposes, subject to suitable accountability and management accounting requirements. The community foundation should be able to receive tax-deductible donations for these purposes. Several aspects of the Guidelines for applicants to the Registers of Environmental and Cultural Organisations could be a precedent. The Rules in respect of the public fund of environmental organisations are included in the Recommendations section of this submission as a possible model.

There are at least three major public policy reasons supporting adding community foundations, especially those in rural and regional Australia, to the list of organisations specifically named as deductible gift recipients under the Income Tax Assessment Act 1997 ("ITAA").

### **Continuing the Prime Minister's initiatives to encourage philanthropy**

The recommendations in respect of a simpler structure and tax status for community foundations build on the initiatives of the Prime Minister's Community Business taxation Working Group to encourage philanthropy in Australia. A simpler structure will make it easier for voluntary Board members of community foundations to meet their legal and fiduciary duties and engage in progressive and well-targeted grantmaking. The simpler tax status will make it easier for donors to give to their own communities to support important and often innovative charitable projects.

### **Community Capacity Building**

Community foundations act as both grantmakers and community builders and work for the advancement of health, education, social and community welfare, culture, the natural environment and other purposes beneficial to their community. They are hands on organisations, actively engaged in their communities.

The Federal Government has strongly endorsed the concept of community capacity building and self help via a number of key programs. For example, the frameworks of both the Strengthening Families, Strengthening Communities Program and the Regional Solutions Program, amongst many others, are both in harmony with the work and role of community foundations.

### **Foundation for Rural and Regional Renewal**

The Foundation for Rural and Regional Renewal was established in 2000 as an exciting and innovative partnership between the Federal Government and The Sidney Myer Fund to renew rural and regional Australia.

The Foundation for Rural and Regional Renewal's Public Fund was itself listed as a DGR under item 13.22 in section 30-105 of the ITAA from 28 March 2000. In a joint Press Release, the Assistant Treasurer and the Deputy Prime Minister and Minister for Transport and Regional Services explained the purpose of the Foundation:

"The Foundation has been established to raise money for the purpose of providing a viable social and economic future for Australia's rural and regional communities. Tax-deductible gift status will assist the Foundation to attract public support for its activities. It aims to encourage innovative collaboration between business, community and government in philanthropic endeavours that will boost the economic and social

stocks of regional Australia.” (Assistant Treasurer’s Press Release no 11 A54/29 March 2000)

The objects of the Foundation for Rural and Regional Renewal in its Constitution are:

“The company is established for a public charitable purpose, namely, to promote for the public benefit, rural and regional renewal, regeneration and development in Australia in social, economic, environmental and cultural areas in the manner the directors decide from time to time.”

FRRR supports regional and rural Australia via grantmaking and special projects at a strategic macro level. Community foundations in rural and regional areas have the same objects at a micro or local level. Community foundations are likely to be important long-term partners of FRRR.

## 8. Recommendations

### Recommendation 1

This submission recommends a new simpler legal structure and tax status for community foundations operating in regional Australia.

The essential features of a regional community foundation will be:

- A simple and single structure with specific objects.
- Able to carry on charitable activities as well as grantmaking.
- No restriction on grantmaking to only organisations with DGR (deductible gift recipient) status.
- Ability to create donor funds in a straightforward manner.
- External checking and review.

This could be achieved in three ways, depending on the preference of the Commonwealth Government and advice from Treasury and the Australian Tax Office. The new category of DGR regional community foundations could be created by:

1. Adding another category under Division 30, similar to section 30-45 (Public Benevolent Institution) or section 30-105 (Foundation for Rural and Regional Renewal) of the Income Tax Assessment Act 1997, where the ATO would issue a ruling and then check applications against the ruling; or
2. Creating a Register of Regional Community Foundations, similar to the Registers of Environmental (section 30-55(1)) and Cultural Organisations (section 30-100). Requirements for admission to the register would be checked by a Commonwealth Department, for example the Department of Transport and Regional Services; or
3. Prescription, using a similar to process to that used for Prescribed Private funds under item 2 of section 30-15 where the ATO checks and then Treasury prescribes each applicant in the regulations to the Act.

Whichever way the new DGR category is created, there would be either an ATO Ruling or Guidelines setting out:

- The preferred legal structure;
- The required objects;
- Requirements in respect of management of the public fund; and
- Acceptable charitable activities including grantmaking for charitable purposes.

Some suggested guidelines follow:

**Objects clause:**

The objects for which the community foundation is established are the promotion of any charitable purposes for the benefit of the community in the (Region or Rural City) of \_\_\_\_\_ namely, to promote for the public benefit, rural and regional renewal, regeneration and development in social, economic, environmental and cultural areas in the manner the directors decide from time to time.”

For example, the **Model Rules of Public Funds** of an organisation on the Register of Environmental Organisations could be adapted for a Register of Regional Community Foundations as follows:

1. The objective of the fund is to support the organisation's public charitable purposes of rural and regional renewal, regeneration and development in social, environmental, cultural, and economic areas.
2. Members of the public are to be invited to make gifts of money or property to the fund for the social, environmental, cultural and public economic purposes of the organisation.
3. Money from interest on donations, income derived from donated property, and money from the realisation of such property is to be deposited into the fund.
4. A separate bank account is to be opened to deposit money donated to the fund, including interest accruing thereon, and gifts to it are to be kept separate from other funds of the organisation.
5. Receipts are to be issued in the name of the fund and proper accounting records and procedures are to be kept and used for the fund.
6. The fund will operate on a not-for-profit basis.

7. A committee of management of no fewer than three persons will administer the fund. The committee will be appointed by the organisation. A majority of the members of the committee are required to be 'responsible persons' as defined by the Australian Tax Office.

**Activities**

Regional community foundations would carry out a range of charitable activities within their objects as well as grantmaking activities.

These could include:

- Facilitating community meetings and community planning;
- Project managing pilot, demonstration and start up projects;
- Providing training for the community and volunteers on topics designed to build the community's capacity;
- Undertaking research about the needs of the community and the expectations of donors; and
- Grantmaking activities.

**Recommendation 2**

Subject to Recommendation 1 being accepted, the guidelines and model constitution would permit regional community foundations to fund sporting activities where a benefit to the community can be demonstrated. For example, it can be shown that there is an element of remoteness or isolation to which the sporting activity is responding i.e. there is more than a recreational benefit to the community.

This submission recommends that the Australian Tax Office considers adopting the test set out in the recent discussion paper prepared by the United Kingdom's

Cabinet Office in respect of accepting qualifying sporting organisations as eligible grant recipients of regional community foundations.

Sporting organisations to achieve eligible grant recipient status must be:

1. Amateur; and
2. Aim to promote and maintain health; and
3. Have open membership; and
4. Charge a reasonable membership fee, if at all; and
5. Be for the public benefit.

## **9. Contact for information**

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