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Improving the Integrity of Public Ancillary Funds Discussion Paper

Sydney Community Foundation submission December 2010

The Sydney Community Foundation (SCF) is pleased to provide our views on a number of the proposed guidelines outlined in the discussion paper. Our submission takes the following form:

1. Diversity of roles within public ancillary funds
2. Introduction to the Sydney Community Foundation
3. Proposed amendments relating to the Principles
4. Donations from Private Ancillary Funds to Community Foundations and like Public Ancillary Funds

We have also participated in the Philanthropy Australia submission and urge the ATO to closely review this submission as it addresses the collective concerns held across public ancillary funds.

1. Diversity of roles within public ancillary funds

We note that many of the guidelines in the discussion paper refer to the "Private Ancillary Fund Guidelines 2009" and the paper appears to intend that the ATO apply these guidelines to public ancillary funds. Whilst we welcome the ATO's initiative to increase public confidence in the philanthropic sector by ensuring public ancillary funds meet minimum standards, it is important that any ATO Guideline for Public Ancillary Funds recognises their unique role within the philanthropic sector and that they are intrinsically very different philanthropic vehicles to private ancillary funds. The discussion paper appears to assume that public ancillary funds are similar to private ancillary funds when in practice there are substantial differences.

Community foundations are one example of a public ancillary fund and fulfil a different philanthropic role and purpose from a private ancillary fund. A community foundation is an independent public structure comprising a collection of endowed funds established by individuals, families, companies, government agencies, local councils and other charitable trusts – a community of donors – to make a lasting difference to the life of the people in their community. The foundation acts as trustee for such donations, with a Board of Directors made up of community leaders representing a cross section of society.

Funds donated to community foundations are pooled and carefully invested under the supervision of this Board. The income generated each year from this permanent and growing investment is distributed in the form of grants to not for profit organisations delivering services within that particular community. By providing leadership on issues of broad community concern and developing a body of local knowledge, a community foundation helps donors fulfill their charitable goals both during and after their life time. It is this local knowledge of community issues and the perpetuity concept of an endowment fund which attracts many donors to community foundations.

Community foundations are one of the fastest growing forms of philanthropy worldwide. In Australia there are community foundations established in every state, in metropolitan, regional and rural communities.

It is vital for the growth of community foundations within Australia that our efforts to build our endowment funds and develop sustainable practices be nourished, especially during this early period and important growth phase for all within the Australian community foundation network.

2. Sydney Community Foundation

Greater Sydney, with a population of around 4.5 million people, is the nation's foremost economic, cultural and social hub, yet it is also a region of great social divide, economic disadvantage and exclusion.

The Sydney Community Foundation is building a permanent endowment fund which distributes its earnings, as grants, to areas of need within Sydney. It also works with donors to support and engage with innovative community initiatives in their lifetime.

The purpose of the Sydney Community Foundation (SCF) is to connect people who care with causes that matter to Sydney. Our vision is a sustainable and inclusive Sydney community.

What we do:

- & We connect donors with innovative community initiatives and engage them in the process
- & We create a lasting legacy by pooling and prudently investing the gifts of many donors in permanent endowment funds
- & The earnings are used to give grants to a wide range of community groups
- & We work closely with our donors to ensure their gifts achieve their charitable goals and meet immediate community needs
- & We use local knowledge to stimulate partnerships and nurture the relationships that hold our community together
- & We provide leadership, where necessary, on issues of broad community concern

- & We help promote the value of charitable giving

Our mission is to strengthen our community by connecting the people of Sydney. We aim to achieve our mission by:

- & Identifying critical community issues and opportunities.
- & Advocating for awareness and change on these community causes.
- & Supporting and connecting people who can act on these community causes.
- & Creating ways for potential donors to support these causes.

Donors have the choice of a number of funds:

- & The Sydney Community Foundation Tax Deductible Fund which provides full tax deductibility for all money contributed. The income from this fund is directed by the Board of the Foundation to authorised charitable institutions with deductible gift recipient status. This fund also holds all established subfunds, including the Sydney Women's Fund.
- & The Sydney Community Foundation General Fund is a non-tax deductible fund. Gifts from this fund can be distributed for more general charitable purposes or according to specified wishes by their donors.

3. Responses to issues particularly highlighted within the discussion paper

Principle 1 – Public funds are philanthropic

2.1.1 Required distributions

The SCF is concerned about the following specific issues:

a) Accumulation of funds

The ATO's basic premise under Principle 1 Section 2.1.1 that public ancillary funds should not be "prolonged accumulators of funds" is entirely contrary to the basic underlying principle of a community foundation – that funds donated are pooled and carefully invested in a permanent and growing investment or endowment. The income generated each year from this endowment is then distributed in the form of grants. While a community foundation also has flow through donations, the preservation of capital is a key component and major attraction of a community foundation.

The SCF aspires to be a core resource for Sydney, emulating the Community Foundations established over the last 100 years in many great cities in the world which have revitalised local communities through effective charitable giving – New York, Boston, Vancouver and Melbourne Community Foundations are among our models. As such our model is based on the very principle that we are building a permanent and lasting endowment fund for community of Sydney.

b) b) Mandatory distribution rate of 5% of fund's net assets or higher

A mandatory distribution rate which is higher than or equivalent to the 5% recently implemented for private ancillary funds would be severely detrimental to our ability to accumulate funds, especially in this early stage of our existence. Donations to our endowment fund, either as a

general donation or as a request to establish a subfund, are provided by our donors with the understanding that these funds are held in perpetuity and in trust for the long term funding of social issues within their community. This perpetuity factor is a key issue for donors, who believe that they are able to make a lasting gift to the community they live in.

The SCF would contend that the issue of higher standards of accountability for public ancillary funds is independent of/separate from the distribution rate. As an ancillary fund which is governed by trust law we must at all times maintain high standards of accountability. An increase in distribution rates would not necessarily result in higher levels of accountability. If the annual distribution is greater than the investment growth in the funds, the funds will in fact incur significant deterioration over time, contrary to our basic proposition of perpetuity.

The SCF is dedicated to strengthening the local communities of Sydney, to generating and distributing resources to help meet the needs and emerging social issues of Sydney's disadvantaged and excluded. The ability to develop and grow our endowment fund, especially in the early years of our establishment is essential to enable us to continue to generate income for our grants into the future. This will not be possible if the capital of our endowment fund is eroded through distributions.

This proposal also goes against our proposition to enable individual donors to named subfunds to grow their philanthropic giving over a period of time from potentially a small base.

We urge the ATO to reconsider the concept of implementing a mandatory distribution rate which is either equivalent to or higher than the 5% recently implemented for private ancillary funds. The impact of such a distribution requirement would be detrimental to the core proposition of a community foundation. This requirement will make community foundations a less attractive proposition to donors and prevent individuals and the community of individuals created by community foundations from creating a lasting gift to their community. The existing guidelines relating to income distribution should be maintained.

2.1.2 Regular valuation of assets at market rates

The SCF currently values its assets at market rates and sees no problem with implementing this guideline for public ancillary funds.

2.1.3 Increased accountability

The SCF welcomes the concept of increased accountability as we have an obligation of accountability and transparency to those who donate to us. Whilst we are happy to lodge an annual tax return we do note that this will place additional costs on to public ancillary funds, some of which are operating from a very low resource base or on a pro bono basis.

Basic financial statement disclosure would be acceptable to the SCF as we already have our financial statements audited annually.

Whilst we recognise that individuals donating to the SCF are receiving a tax benefit by being able to claim this donation, we strongly urge the ATO to consider preserving their anonymity within the public domain if so requested by the donor. Whilst most of our donors are comfortable with being publicly acknowledged for their support of the SCF, we should not discount the personal request from some donors to remain anonymous.

The ATO must also consider that in some circumstances public ancillary funds may have sourced donations from the general public in such a manner that the donor is not identified (such as coin donations at events, etc).

Principle 2 – Public ancillary funds are trusts that abide by all relevant laws and obligations, and are open, transparent and accountable

2.2.2 Increasing regulatory powers

a) Administrative penalty regime

We note that the private ancillary fund guidelines require them to keep proper accounts, prepare financial statements, arrange for the audit of the financial statements of the fund and advise the Commissioner of Taxation if there is a change to the governing rules of the fund. We agree that it would be appropriate to extend these requirements to public ancillary funds.

The SCF supports the view that the administrative regime that applies for private ancillary funds would most likely be suitable for public ancillary funds.

b) Corporate trustee

The SCF does not have any concerns with requiring public ancillary funds to have a corporate trustee as the SCF is controlled by a public company, the Sydney Community Foundation, which is limited by guarantee and registered as a company under the Corporations Act 2001. This company acts as the trustee of the Sydney Community Foundation's Tax Deductible Fund and its General Fund.

c) Private ancillary fund guidelines on minimum standards of conduct for trustees

At the SCF we have implemented a strong and thorough governance regime. Whilst we acknowledge and agree with the proposition that trustees must adhere to a minimum standard of conduct we urge the ATO to consider the differences between private and public ancillary funds when proposing that the latter adhere to the former's guidelines. We refer specifically to the issue that it is appropriate to restrict the Board, our primary decision makers, by requiring that one of these cannot be a founder, a donor to the fund who has contributed more than \$10,000, or an associate of a founder or such a donor. We do not agree that this would be appropriate for public ancillary fund trustees.

At the SCF an integral component of our strong governance is the role played by the Board of Directors. Our Board operates on a pro bono basis as a team that makes decisions and determines policies to govern, guide and support the Foundation. This includes helping to build the endowment, ensuring that the SCF is an effective grantmaker and assisting the SCF to contribute to the Sydney community through partnerships with community organisations operating in the Sydney area.

We believe that it is important that our Board of Directors believe strongly in our vision and mission, and in our ability to be successful in these. A measure of the extent of our Board commitment is that they are all willing to support the SCF themselves by donating their own funds to the SCF.

As such we do not believe that this guideline is acceptable to public ancillary funds.

d) Minimum training requirements for trustees

As a public foundation, the Directors of the SCF are accountable to the Sydney community. On a day to day basis the SCF Directors work under the direction of the Chair of the Foundation and are governed by the Foundation's constitution. The Board is serviced by the Executive Officer of the Foundation.

Directors should always act in a manner to promote the public profile and integrity of the organisation. We do require that all Directors meet minimum qualification levels but also require that they:

- & Have an active interest in the local community;
- & Be well known and respected in the community, with some degree of relevant influence and experience;
- & Add to the diversity of the Board; and
- & Possess strong communication and teamwork skills

We would need additional information in relation to exactly what minimum training or other qualifications the ATO would like to include as mandatory before we could advise if all of our Directors would qualify. We do not want to miss any opportunities to recruit new Directors by imposing unnecessarily high educational standards, particularly if they meet the SCF requirements, are passionate about the Sydney community and could bring a diversity of networks and skills to the SCF.

2.2.3 Transitional rules

We urge the ATO to consider that a transitional period be provided for public ancillary funds to adhere to any new guidelines. Many of these types of funds, particularly community foundations, are operated largely on a pro bono basis with limited resources to make significant operational adjustments. The ATO may wish to consider the assistance they could provide during any transitional phase.

There may also be issues within the Constitutions and Trust Deeds of public ancillary funds which make it impossible to adhere to a particular guideline, particularly minimum distribution rates, and the ATO may wish to consider how alternate arrangements could be applied in such instances.

Principle 3 – Public funds are public

2.3.1 Public Fund

It would appear that further consultation would be required to determine if the term 'public fund' is codified in the guidelines in accordance with the principles set out in ATO Taxation Ruling TR 95/27. More specifically section 30 states that "ancillary funds may be likened to a conduit or temporary repository for moneys which are to be channeled to particular subsection 78(4) funds" which would appear to go against the underlying proposition of a community foundation that funds are held in perpetuity. We believe it would not be appropriate to include this requirement within guidelines for public ancillary funds.

Principle 4 – Public funds are ancillary funds

2.4.1 Public ancillary fund investment rules should ensure liquidity and low risk

We note that the discussion paper states that “the rules that apply to private ancillary funds for investment and protection of a private ancillary fund’s assets may be suitably applied to public ancillary funds.” We urge the ATO to reconsider this proposition in light of the following two issues.

- a) *Private ancillary funds guideline 43 – the fund’s investments must be made and maintained on an arm’s length basis:*

At SCF we appreciate that the ATO is attempting to bring greater transparency to the management of the investments of public ancillary funds. At SCF we agree with this as a concept as we maintain the highest level of transparency and public accountability about our investments at all time. The ATO has not provided guidance as to the definition of “an arm’s length basis”. We would seek assurance from the ATO that this guideline would not restrict a public ancillary fund from engaging the services of an investment manager to manage the investment portfolio.

The Sydney Community Foundation (SCF) is Trustee of all funds established to receive money and assets donated from the public. The Board of the SCF is ultimately responsible for the prudent management of all SCF funds. The Board has appointed an Investment Committee of three directors to assist it to fulfil its fiduciary obligations under the SCF umbrella.

The SCF aims to manage all funds prudently, in accordance with sound investment principles, in order to optimise the return generated on funds invested, while maintaining a prudent investment risk profile.

- b) *Private ancillary funds guideline 40 – the fund must not carry on a business*

It is fundamental to the success of community foundations within Australia that we have the ability to become sustainable and an integral component of the philanthropic environment. Overseas experience has consistently demonstrated the incredible impact that community foundations can have on addressing and funding areas of social need within their specific communities.

The Victorian Government has recognised this powerful impact of community foundations. The Office of the Community Sector (OCS) within the Victoria Department of Planning and Community Development was established to implement The Victorian Government’s Action Plan: Strengthening Community Organisations. The Action Plan was developed to strengthen the capacity and longer term sustainability of the not-for-profit (NFP) sector. In particular Action 20 was specifically to build a stronger role for community foundations and recognises the vital role that community foundations can play in assisting government with addressing the growing needs of the socially disadvantaged.

For the SCF to have the ability to be a vital and long term proposition for the Sydney community we must be financially sustainable. This means that we must generate sufficient income so that we are no longer reliant upon donor funding for operational costs, be they government or individual donors. Until such time as our endowment fund has grown to a

substantial value we must therefore have the ability to diversify our income base over and above the base fees charged on the endowment fund.

With community strategies now receiving heightened awareness and enthusiasm within the boardrooms of Australia we believe that community foundations are perfectly positioned to assist companies as well as individuals to realise their philanthropic and community engagement targets. We believe there are many ways in which community foundations could diversify their income whilst still maintaining strong alignment with their core proposal and their role and obligations as a public ancillary fund.

The recent closure of the Western Australian Community Foundation only seeks to strengthen our belief that we must move to a self-sustainable model.

4. Donations from Private Ancillary Funds to Community Foundations and like Public Ancillary Funds

A number of our donors have raised with us the current unhelpful restriction on donations from Private Ancillary Funds to Public Ancillary Funds like the SCF. With the great increase in Private Ancillary Funds in the last 10 years, the current restriction removes a significant source of donations to community foundations from wealthy individuals in the community. They are thus unable to take advantage of the Community foundations ability to pool donations from citizens of all levels of wealth in the community in addressing issues of disadvantage in a community focused way.

Community Foundations have deep and thorough understanding of trends in disadvantage and of social change in their particular communities, knowing what is happening at a grass roots level through to government policy contexts. This provides philanthropists working through Community Foundations with the expertise, advice and research to direct the grants and investment where need is greatest and for maximum impact.

We believe that the issue of tracking that donations from Private Ancillary Funds go towards charitable purposes in a timely fashion can easily be reported on and monitored by the ATO by setting up a regime similar to that which operates for donations from Private Foundations to Community Foundations in the United States.

The Sydney Community Foundation would be most happy to provide any further information in relation to issues raised and would welcome the opportunity to partake in any future discussions on the proposed guidelines.