Philanthropy Australia is the national peak body for philanthropy and is a not-for-profit membership organisation. Our Members are trusts and foundations, families and individuals who want to make a difference through their own philanthropy and to encourage others to become philanthropists.

Our vision: A giving and caring nation.

Our mission: To represent, grow and inspire an effective and robust philanthropic sector for the community.

Philanthropy: The planned and structured giving of money, time, information, goods and services, voice and influence to improve the wellbeing of humanity and the community.

Philanthropic sector: Trusts, foundations, organisations, families and individuals who engage in philanthropy.
Trustee Handbook
Roles and duties of trustees of charitable trusts and foundations in Australia
Second Edition

David Ward
Philanthropy Australia
2012
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Disclaimer: This booklet has been prepared as a general introductory guide. It is not advice, and must not be relied upon as advice. It contains generalisations and statements that are not necessarily comprehensive, complete or up-to-date. Some statements in the booklet are subject to legal uncertainty.

This document is written on the basis of the governance regime that applies from 1 January 2012. With the creation of the Australian Charities and Not-for-Profits Commission from 1 October 2012 some of the reporting requirements may change from 2013.
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Introduction

This booklet comments on the role and duties of trustees of charitable trusts in Australia. As mentioned in the disclaimer, it is not a legal document but a “plain English” introductory guide to what may be required and expected of trustees. This 2012 edition is an update on the Trustee Handbook produced in 2008 to reflect recent law changes. The whole charity sector is undergoing significant regulatory change including with the creation of a new regulator, the Australian Charities and Not-for-Profits Commission (ACNC).

Charitable foundations all have one objective in common, to achieve a positive and lasting impact on society. They are a vehicle for directing private resources for public good. Legally, most foundations are trusts; that is fiduciary arrangements with the trustees managing property and exercising powers for the benefit of others. Being a trustee or a director of a corporate trustee of a charitable foundation is an intrinsically rewarding role as it helps deliver the benefactor’s vision for a better world.

However, the trustee role also brings significant responsibilities at law with the will/deed as the cornerstone document and legislative Guidelines, where they exist, defining boundaries. Moreover, as there are different types of foundations, it is important for trustees to understand the structure of the foundation with which they are associated, as that will influence what is required of them.

For Private Ancillary Funds (PAFs) and Public Ancillary Funds (PuAFs), both of which now have explicit legislative Guidelines that must be complied with, this Handbook is an introduction to the principles and key points; the Private Ancillary Fund Trustee Handbook 2009 and Public Ancillary Fund Trustee Handbook 2012 provide comprehensive detail of what is required for those structures (both documents are available for downloading from the Philanthropy Australia website).

Trustees of each foundation have the ultimate responsibility for its governance. They are responsible for directing the affairs of the foundation to ensure it is well run, compliant with the law, relevant Guidelines and its will/deed (including any Court modification,) and provides funds only for charitable purposes for the benefit of the community.

Trust and taxation laws are complex and trustees may be personally liable for any breach of trust, so where there is any concern or doubt, trustees should seek professional legal advice.

In addition to the legal responsibilities, to maximise the impact flowing from the benefactor’s generosity, there are several areas trustees should also consider to enhance the foundation’s effectiveness and transparency. As charitable foundations operate in a tax exempt environment, there is the expectation that there will be significant community benefit. In the Handbook we make the distinction between what trustees are required to do by law, i.e. what they must do, and other actions that trustees should consider doing, as good practice.
Types of Foundations

The word foundation has a number of different meanings and can be used to describe institutions of various types. This Handbook is focused on grant-making charitable trusts. While most foundations are established through a deed or will and as charitable trusts have some common features, there are different structures that have some significant variations including of tax status. Only charitable trusts can be perpetual and they must fund, and only fund, purposes or organisations that are regarded as charitable at law and are within the terms of their will or trust deed. In addition to being familiar with the foundation specific will/deed, it is critically important for trustees to know the legal structure and tax status of their foundation and the implications of that for the foundation’s operations, as this will influence what is required of them. Particularly where the foundations are able to accept tax deductible donations (i.e. PAFs and PuAFs) there are additional rules to comply with.

Testamentary or Will Trusts

These trusts are the oldest form of foundations in Australia with some, including the Wyatt Benevolent Institution and the Felton Bequest, now in their second century. These are/were established by the will of the benefactor and do not come into operation until after his/her death. They can attain income tax exemptions as a Tax Concession Charity (TCC) usually as a charitable fund from the ATO which also facilitates the refund of franking credits. But donations to them are not tax deductible. These trusts must use trust income to fund the charitable purposes specified in the will and they may have an advisory panel or committee to assist the trustees; the exact detail of any such arrangement will be set out in the will.

Private Charitable Trusts

These trusts have been established by a donor through a deed with a charitable purpose. Like Testamentary Trusts, Private Charitable Trusts can attain income tax exempt status as a Tax Concession Charity (TCC) usually as a charitable fund which also facilitates the refund of franking credits. But donations to them are not tax deductible. They must use trust income to fund the charitable purposes specified in the deed.

Private Ancillary Funds (PAFs) Separate PAF Handbook available from PA

A relatively new form of charitable trust, the first were established in 2001 as Prescribed Private Funds (PPFs), as an individual, family or company philanthropic structure. The name and rules changed to Private Ancillary Funds from 1 October 2009 with the passing of new legislative Guidelines. Donations to PAFs are tax deductible. PAFs cannot solicit funds from the public and there are limitations on the level of donations that can be accepted from those not associated with the founder. Trustees/Directors must include at least one “Responsible Person” (someone with a degree of responsibility to the community, page 27 for details), but he/she must not be a family member or associate of the founder or donor. Grants can only be made to charitable organisations with TCC status that are also endorsed as Deductible Gift Recipients (DGR) Item 1 by the ATO. As a result of further changes in 2005, a PAF can now be set up as, or apply to become, an Income Tax Exempt Fund (ITEF), to enable granting to a wider range of DGR Item 1s. In NSW, Qld and WA this includes granting to non-charitable Item 1 DGRs and in Vic and SA it includes granting to Item 1 DGRs that other than for their connection with government would be charitable (eg. public hospitals, museums or libraries. See page 18). The opting in process is not onerous but expert legal advice should be taken.
Types of Foundations (cont.)

Public Ancillary Funds (PuAFs) A separate PuAF Handbook is available from PA

Public Ancillary Funds are established by deed for the support of community organisations with DGR Item 1. PuAFs must be controlled by a board or committee, the majority of who have a degree of responsibility to the general public (i.e. are “Responsible Persons”, see page 27) and public fundraising is required. Donations to PuAFs are tax deductible. Like PAFs grants must only go to charities that have TCC and DGR Item 1 status (unless an ITEF see below). Guidelines for Public Ancillary Funds were introduced from 1 January 2012. The following types of foundations may be PuAFs:

- Public Foundations
- Community Foundations, some with “sub-funds” for individual donors or specific causes
- Charitable Endowment Funds also with donor “sub-funds” run by Trustee Companies, Financial Advisory firms and other organisations
- Foundations established by charities, religious and public institutions as a funding structure for their own activities.

Community Foundations and Charitable Endowment Funds often have advisory panels or other individuals or groups linked to donors to make recommendations to the trustees for the disbursement of grants. Nevertheless, the responsibility for the actual granting decisions and all other matters related to the governance of such foundations in its entirety, rest with the trustees.

Because fundraising is required, Public Ancillary Funds will usually require fundraising licences in at least their home state, and in each other state they fundraise in as well (requirements vary between states). This is one aspect that the entire sector hopes will change with the Australian Charities and Not-for-Profits Commission.

As with PAFs, PuAFs can now be set up as or apply to become an Income Tax Exempt Fund (ITEF) to enable support of DGR Item 1s that are not charitable. In NSW, Qld and WA this includes granting to non-charitable DGR Item 1s and in Vic and SA it includes granting to DGR Item 1s that other than for their connection with government would be charitable. The opting in process is not onerous but expert legal advice should be taken.

Companies

Most grant-making foundations are trusts. However some foundations that operate grant-making through a public fund are companies with their tax exempt status resulting from being specifically named in the tax legislation. The legal responsibilities of directors of such companies are determined by Corporation Act 2001 and are not discussed here. Nevertheless, such company directors are encouraged to consider the issues set out in this Handbook.

Further discussion of the different giving structures is contained in Philanthropy Australia’s A Guide to Giving for Australians (2005).
**Summary Table of Key Attributes**

This table summarises the key generic attributes of the main types of charitable trusts – although there will be individual variation as a result of specific requirements in wills/deeds.

<table>
<thead>
<tr>
<th></th>
<th>Will &amp; Private Charitable Trusts</th>
<th>Private Ancillary Fund</th>
<th>Public Ancillary Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State Trustee Act</strong></td>
<td>Yes</td>
<td>Yes (part in Guidelines)</td>
<td>Yes (part in Guidelines)</td>
</tr>
<tr>
<td><strong>Donations Tax Deductible</strong></td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Income Tax Exempt</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Responsible Persons</strong></td>
<td>No requirement</td>
<td>One Independent active RP Director.</td>
<td>Majority RP – extended definition of who qualifies</td>
</tr>
<tr>
<td><strong>Audited Accounts</strong></td>
<td>Depends on Will/ Deed</td>
<td>Yes and of compliance with Guidelines</td>
<td>Yes and of compliance with Guidelines (review* if &lt;$1m)</td>
</tr>
<tr>
<td><strong>ATO Reporting</strong></td>
<td>No – ACNC 2013</td>
<td>Yes by 28 February each year</td>
<td>Yes by 28 February each year</td>
</tr>
<tr>
<td><strong>FUNDRAISING</strong></td>
<td>No</td>
<td>No soliciting from public</td>
<td>Yes must invite donations and have state fundraising licence(s)</td>
</tr>
<tr>
<td><strong>Penalties</strong></td>
<td>Restitution</td>
<td>Financial penalties &amp; potential trustee removal; restitution</td>
<td>Financial penalties &amp; potential trustee removal; restitution</td>
</tr>
<tr>
<td><strong>Transition Rules</strong></td>
<td>n/a</td>
<td>Finish 30 June 2014</td>
<td>Finish 30 June 2015</td>
</tr>
<tr>
<td><strong>Investment</strong></td>
<td>Annual Review</td>
<td>Investment Strategy and Annual Review; also some investment restrictions</td>
<td>Investment Strategy and Annual Review; also some investment restrictions</td>
</tr>
<tr>
<td><strong>Prudent Person</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Grant Restrictions</strong></td>
<td>Charitable Purpose specified in will/deed</td>
<td>Item 1 DGRs that are charitable with TCC; additional DGR 1 if PAF converts to ITEF.</td>
<td>Item 1 DGRs that are charitable with TCC; additional DGR 1 if PuAF converts to ITEF.</td>
</tr>
<tr>
<td><strong>Support individuals</strong></td>
<td>Yes unless restricted in will/deed</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Grant to non DGR Charities</strong></td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Overseas Granting</strong></td>
<td>Depends on deed/will and date (pre 1997), take advice</td>
<td>DGR1s on AusAid list of overseas relief funds only</td>
<td>DGR1s on AusAid list of overseas relief funds only</td>
</tr>
<tr>
<td><strong>Annual Granting</strong></td>
<td>&gt;80-85% of net Trust Law Income</td>
<td>Minimum 5% of previous 30 June valuation – minimum distribution $11,000. Zero first year.</td>
<td>Minimum 4% of previous 30 June valuation – minimum distribution $8,800. Zero for first four years.</td>
</tr>
</tbody>
</table>

* Although state fundraising licences may require a full audit
Laws Relating to Trustees

Charitable trusts are required to comply with relevant federal, state and common law. All trustees of charitable trusts have a fiduciary duty to manage trust property and exercise powers relating to that property in good faith for the purposes set out in the trust instrument. In Australia, trust law is state-based rather than federal and all charitable trusts are subject to the requirements of the relevant state trustee legislation (which is broadly consistent across all states) as well as common law. Only charitable trusts can be for the benefit of purposes (instead of for named beneficiaries) and perpetual. It is the provisions of the Income Tax Assessment Act 1997 that create the key differences between the types of charitable trust, the implications of which will be discussed throughout this Handbook. Significant differences also arise from the specific terms in the trust instrument. Changes to wills/deeds can only be made within the powers set out in that will/deed or by the Courts, and in some circumstances for PAFs and PuAFs the ATO Commissioner’s approval is also required.

Important legislation, rulings and common law concepts affecting charitable trusts are:
4. From 1 October 2012, ACNC Act 2012;
5. For Private Ancillary Funds: Private Ancillary Fund Guidelines 2009;
6. For Public Ancillary Funds: Public Ancillary Fund Guidelines 2011;
7. For PuAFs, Tax Ruling TR95/27;
8. For PuAFs with “sub-funds”, Tax Determination TD 2004/23;
9. For PuAFs or other charitable trusts which hold fundraising events, State Fundraising laws which are required to raise money for charitable purposes (but will hopefully be replaced by a national framework under the ACNC).
10. The Common law concept of fiduciary responsibility (see Glossary);
11. The Common law concept of charitable purpose (see Appendix 2). This is due to be replaced by a statutory definition of charity from 1 July 2013.

The impact of this legal framework on the activities of charitable trusts is discussed in the following sections in detail. The consequences of any breach of legislation are discussed in the governance failure section on page 20. A new “one-stop-shop” regulator for the not-for-profit sector, which includes charitable trusts, the Australian Charities and Not-For-Profits Commission (ACNC) commences from 1 October 2012. This is part of the Government’s reform program to improve the integrity and efficiency of the sector and reduce red tape to help the sector grow. Structure specific reforms for PAFs and PuAFs have both involved increased accountability and reporting to the ATO. This trend is likely to continue with the ACNC.

Other laws also impact on foundations depending on the structure and range of activities. This includes:
1. If the trustee is a company, the directors of that company, in addition to fulfilling the responsibilities of trustee, are required to comply with the Corporations Act 2001;
2. The federal Privacy Act 1988;
3. If the foundation employs staff, compliance is required with all relevant state and federal legislation such as WorkCover, Superannuation, etc.

The impact of this second group of legislation is not discussed in this Handbook as, where applicable, foundations’ responsibilities are no different from other organisations.
**The Concept of Governance**

There are many definitions of governance; the following three are used to capture the essence. The Oxford Dictionary defines to govern as “to steer, guide, or control”, Ernst & Young use the phrase “system and processes for ensuring proper accountability, probity and openness” and the Australian Institute of Company Directors uses “overseeing business and compliance performance”.

Foundations are often described as “private money for public purposes”. In this context the role of a foundation trustee is a blend between stewardship of private assets and public service. Two useful documents that highlight the core values of what is expected in each of these are: “The Essential Corporate Governance Principles” from the ASX’s “Guide to Corporate Governance” and “The Seven Principles of Public Life” from the Committee on Standards in Public Life (Nolan Committee) in the United Kingdom. These emphasise the core concepts of integrity, honesty, selflessness, ethical and responsible decision making and managing risk. These two documents are set out in full in Appendix 1, although clearly some elements are not relevant to foundations.

Narrowing down specifically to foundations, material from the peak body for foundations in the USA, the Council on Foundations, is useful. It states in the *Preamble to Stewardship Principles and Practices for Independent Foundations*, “As responsible stewards of philanthropic assets, independent foundations should work in ways that benefit the public and also reflect fundamental values that include honesty, integrity, openness, fairness and accountability.” The Council on Foundations also provides a good framework with their 2005 Trustee Principle “We hold ourselves responsible to those who created us, those with whom we currently interact, and those who may look to us in the future”. Breaking this down:

**We hold ourselves responsible**

The prime governance responsibility rests with trustees.

- **to those that created us**
  
  The benefactors of foundations provided their private money with the expectation that public benefit would result, making the community a better place.

- **those with whom we currently interact**
  
  Particularly the community organisations that are actually delivering the much needed services to the community, and also foundation staff. As charitable foundations operate in a government endorsed tax exempt environment, there is an expectation that there will be significant community benefit.

- **and those who may look to us in the future**
  
  The community organisations that will look for support to provide services going forward, an indication of the long term perspective foundations must take (particularly important for perpetual foundations).
Trustees

The trustee of a foundation is usually a group of individuals, a public or private trustee company, a Licensed or Public Trustee or a combination thereof. Again, depending on the type of the foundation, there are some different requirements for the individual trustees or, where there is a company as trustee, the directors of that company. Throughout this Handbook where there is a reference to “trustees” this should be read as including, where a company is the trustee, the directors of that company.

Testamentary Trusts: Founding trustees are usually named in the will and are often associates of the benefactor and/or a Licensed Trustee Company.

Private Charitable Trusts: The initial trustees often include the founder.

Private Ancillary Funds: The trustee of all new PAFs must be incorporated. This is generally a private company or a Licensed Trustee Company. There must be at least one Responsible Person among the directors/trustees who is not the founder, major donor, family member or associate of the founder or major donor (see page 27 for details). PAFs that were PPFs and had individual trustees can continue with that arrangement, including the appointment of replacement individual trustees always having one independent Responsible Person. The Responsible Person must be active, i.e. attend most meetings including those of fundamental importance, such as approving the financial statements and setting and reviewing the investment strategy.

Public Ancillary Funds: The trustee of all new PuAFs must be incorporated. This is generally a company (usually a public company limited by guarantee) or an incorporated association. There must be a majority of directors having a degree of responsibility to the Australian community (see page 27). PuAFs that existed prior to 1 January 2012 and had individual trustee can continue with that structure, including the appointment of replacement individual trustees but maintaining the majority of Responsible Persons. The Responsible Persons must be actively involved in the decision making.

Trustees cannot be minors or mentally incapacitated; in addition, where the trustee is a company directors must meet ASIC criteria for directors. Also, for PAFs and PuAFs no director can have been convicted of a tax offence with a penalty of more than 12 months imprisonment.

Trust law does not specify a retirement age or length of service for trustees, although some wills/deeds may. Replacement of a deceased trustee is a matter for the “appointor” if one is named in the will/deed, or in most cases the continuing trustees, subject to any requirements in the will/deed and the relevant state Trustee Act. In most cases, unless established with only one trustee, trusts cannot be reduced to one trustee other than a Licensed Trustee Company. Restrictions on the number of trustees exist in Vic, NSW, WA and ACT. The replacement of an individual trustee, who desires to be discharged or who is “unfit” or “incapable”, by another trustee, can be done by deed (a registered deed for NSW trusts) or by Court order. Trustees should take legal advice in relation to a change of trustees.

The chairman of charitable trusts plays an important role in ensuring its proper and effective functioning. However, there are no trust specific requirements of the chairman, and the principles that apply for companies and other organisations are equally appropriate and are not repeated here (suggested reference, The Role of the Chairman, AICD, 2007).

Generally trustees of charitable trusts are volunteers and only receive reimbursement of reasonable expenses. However, if the deed, will or any subsequent Court Order allows, trustees can receive remuneration as is reasonable within the provision. The exception is Licensed Trustee Companies where fees are governed by the provisions of the Corporations Act. This fee may be independent of any fee that may or may not be paid to any individual co-trustees. The PAF and PuAF Guidelines allow for the payment of reasonable trustee fees to the trustee company, but if the trustee is a special purpose charitable company, the Constitution will prevent directors’ fees from being paid.
The Duties of Trustees

Trustees of charitable trusts have the ultimate responsibility for the governance of the trust. Trustees are accountable for directing the affairs of the foundation to ensure it is well run, compliant and carrying out the charitable purposes for which it was established. Trustees have fiduciary responsibilities to exercise their powers with integrity and good faith; this has been expressed slightly differently by different authorities but with a strong common thread.

In Charity Law in Australia and New Zealand (Dal Pont, 2000) the duties of charity trustees are set out as being to:

- Acquaint themselves with the terms of the trust document
- Execute the trust according to its terms and the general law so as to benefit the community
- Protect and preserve the trust property
- Exercise discretionary powers in good faith, upon real and genuine consideration and according to the purpose for which the power was confirmed
- Not delegate their powers or discretions except in accordance with the provisions of the trust document
- Not invest trust funds in a manner not authorised by the trust document, statute or the court.

In a similar vein The Charity Commission of England and Wales in The Essential Trustee (2008) identifies the duties of trustees falling into three categories; compliance, prudence and care. Trustees have responsibility to ensure compliance with relevant legislation, and that foundation activities remain true to the charitable purpose and the objects of the will/deed. Trustees must act prudently to protect and invest trust assets to provide a flow of income over time to fund charitable work. Trustees must exercise care, diligence and skill in managing the affairs of the trust.

The Investment Management Code of Conduct for Endowments, Foundations and Charitable Organizations, 2010 produced by the CFA Institute (a global organisation for ethics and education of the investment profession) sets out the general principles of conduct as:

- Act with loyalty and proper purpose
- Act with skill, competence, prudence and reasonable care
- Abide by all laws, rules, regulations and founding documents
- Show respect for all stakeholders
- Review investment strategy and practices regularly

There are three aspects of the principles that require further comment.

The duty of care and responsibility is higher where a trustee’s business or profession includes being a trustee, for instance a Licensed Trustee Company. This is the case even if there are other co-trustees. This higher duty of care is explicit in the various state Trustee Acts on investment matters;

“if the trustee’s profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons”. (Trustee Act 1958, Victoria).

Moreover, under common law the higher duty of care owed by a professional trustee is not restricted to only investment matters (Justice Finn, Australian Securities Commission v As Nominees Limited, Ample Funds Limited, ...1995).

Trustees must act personally and not delegate or fetter trustee powers;

“it is for advisers to advise and for trustees to decide”( J Walker in Scott v National Trust, 1998).

This does not preclude trustees appointing, and paying for out of foundation income, staff or agents to undertake administrative tasks, prepare material and provide advice. Trustees must not fetter future decision making by, for instance, entering into contracts that cannot be reviewed.
The Duties of Trustees (cont.)

Thirdly Trustees must be **active** – explicitly for PAFs and PuAFs as this is part of the Guidelines. This means engagement with the foundation and exertion of real effort, Trustees who are there in name only should be reconsidering their position.

From a practical perspective a detailed consideration of trustee duties can most usefully be achieved using a framework of the three core areas of foundation activity. For Foundations which have a fundraising component to their activities, particularly PuAFs, **fundraising** is the fourth core area. However, given the laws on fundraising are complex and vary between states, trustees are referred to the Fundraising Institute of Australia (fia.org.au) and relevant state departmental websites. The entire sector is hoping that with the creation of the ACNC, national fundraising guidelines and requirements will emerge.

**Administration**
The processes of managing the foundation to ensure its compliance obligations are met.

**Investment**
The investment of foundation assets to protect the real value and generate an increasing flow of income over time.

**Granting**
The distribution of foundation income to eligible entities for charitable purposes.

The following sections set out in detail the legal requirements of trustees. These are what trustees **must** do, but are purely the minimum requirements. They are explained in this section beneath the headings marked “Required”.

Trustees are encouraged to give further consideration to what good practice suggests they **should do**, that is to consider additional aspects based on current practices of leading foundations in Australia and overseas. These aspects are explained in this section beneath the headings marked “For further consideration”. However, this ‘good practice’ is by no means a static concept, and expectations will continue to evolve due to a quest for improvement within the philanthropic sector and changing public and community standards.
Administration

**Required Duties of Trustees**

**Competent administration is central to the good governance of any entity’s activities.**

**Record Keeping**

All trust assets must be held in the name of the trustees or if authorised by the will/deed, statute or the Courts, a custodian of the assets.

Proper minutes of all trustee meetings must be kept. Decision making processes may be set out in the trust deed (or if the trustee is incorporated in the constitution and trust deed). For individual trustees, in the absence of anything to the contrary in the trust deed, decisions are by majority, trust law does not provide for a casting vote for the Chairperson. If a trustee seriously disagrees with a decision, particularly on a fiduciary issue, he/she should insist on getting legal advice, and having a dissenting vote recorded. If the issue goes beyond a single matter of judgement, a trustee should reconsider his/her position.

Key documents including will/deed, Court rulings, minutes, correspondence with the ATO and other regulators should be kept safely. Financial Statements must be kept for at least 5 years.

Trustees are required to avoid conflicts of interest and real possibilities of conflicts. Sometimes conflicts cannot be avoided and must be managed properly including being disclosed, recorded and the affected director not participating in the specific decision making. The trust cannot buy from, or sell trust property to, any of the trustees without court approval. Any transaction with a director of a fund trustee company must not provide a benefit to the trustee, or director thereof. Any such transactions must be on commercial terms. All transactions with the founder, donor, trustee, or director, member or employee of the trustee, must be disclosed in the financial statements.

If the will/deed permits employees or agents, any delegation of discretion to staff needs to be clearly stated, minuted and controlled. Proper receipts (see page 24) including the information required by ITAA97 for tax deductible receipts, need to be issued for all donations to PAFs, when requested for PuAFs and where required by state fundraising licences.

**Accounts**

Accounts must be kept recording assets, income, expenses and distributions and other relevant information. Financial statements are required to be prepared and audited for: those trusts where audit is specified in the will/deed; PAFs; PuAFs - unless assets are <$1m when the financial statements may be reviewed rather than audited; and where required to meet state fundraising licence conditions. Note: if there are small cash donations made to a foundation, the Auditor may find it difficult to verify all of these and may qualify the accounts. Audits of PAFs and PuAFs must include an audit of the compliance with the Guidelines.

Reclaiming franking credits on Australian company dividends from the ATO adds substantial distribution capacity to foundations - this should be done promptly after the end of the financial year, as the ATO does not pay interest (unless the ATO itself causes a delay).

**Reporting**

For PAFs and PuAFs the Annual Return to the ATO is required by the following 28 February, other foundations may need to lodge similar reports to the ACNC from 2014. A company that is a trustee may have annual ASIC reporting requirements (and fees).

**Grants Management**

Conditions attached to grants need to be recorded. If exceeding the standard grant conditions (see page 19), consideration needs to be given to GST rules which may require GST to be paid by the grant recipient. Normally if GST is payable the foundation would gross up the grant amount to cover the GST and claim an input tax credit. Monitoring of grant terms and conditions needs to occur to ensure grants are properly allocated and project reports furnished.
For Further Consideration

Transparency

Additional transparency can be achieved with printed or web-based material including:

- **A legacy statement** setting out the history, benefactor’s vision and objectives
- **A clear statement of processes** used by the foundation, particularly in grant application and assessment
- Trustees of larger foundations should consider having accounts **audited**, even if not required in the will/deed or by law
- **An annual report**, which does not need to be lengthy, expensive or even printed. Core elements of an annual report should be:
  - Objectives of the foundation
  - Summary of areas of interest and funding
  - Abridged financial statements
  - Summary of investment strategy and performance
  - Process summary particularly on granting
  - Grant disbursements by sector highlighting some grants each year with comments
  - Key personnel including trustees, and executive employees.

It is recognised that increased transparency through disclosure may open foundations to public scrutiny and potentially criticism. For instance, foundation expenses are sometimes regarded by the community as diluting public benefit, whereas basic research into community issues and organisation capacity is designed to increase the impact and effectiveness of foundation grants and enhance the public benefit and may need to be explained as such.

Policy Documentation

Have a written **Code of Conduct** covering conflicts of interest, both actual and perceived, disclosure obligations, ability to seek advice, etc. This should include how Trustees will handle and disclose gifts, remembering they cannot personally benefit from the Trust (although immaterial items such as tickets to attend performances of supported groups are reasonable).

Develop a **succession planning framework** for trustees, particularly if all trustees were appointed at same time and are of similar age, as is often the case for will trusts. Wholesale changes in a short timeframe should be avoided, as it is important to ensure maintenance of institutional knowledge and achieve orderly trustee transition. This should start with an assessment of whether there are any skill gaps in the mix of trustees. For PAF/PuAFs identification of replacement Responsible Person(s) will be necessary at some stage. Have a **Trustee Dossier** for each trustee and an induction program for new trustees setting out duties and responsibilities (see page 22).

Value Adding

Philanthropy is more than just making and giving away money. Foundations can also bring expertise, knowledge, influence and voice for the benefit of grantee organisations. A foundation’s own project history, detailing what does and does not work, can be very valuable to community groups as well as to other foundations.

Review

Intermittently trustees should review: the performance of the foundation against its objectives; the key risks facing the foundation and whether policies and processes are addressing those risks, particularly to ensure tax exempt status is not jeopardised nor Guidelines breached; and conduct a self-assessment of their own contributions.
Investment

**Required Duties of Trustees**

The purpose of all charitable trusts is to manage assets for the public benefit. Trustees must act solely in the best interests of carrying out the charitable purposes, **now and in the future**. For perpetual Testamentary and Private Charitable Trusts where the distribution level is likely to relate to the income generated, trustees are required to manage investments for both income and capital growth. Under trust law, income is normal dividends (and related franking credits refunds), rent and interest but **not** capital gains or tax deferred distributions which are capital items but can often be included in distributions from managed funds. For PAFs and PuAFs with minimum distribution levels based on a percentage of assets (5% and 4% respectively) a total return investment approach is acceptable.

The investment powers set out in state Trustee Acts are now very broad whereas in the past they have been much more restrictive. In considering trust investments, trustees must exercise “the care, diligence and skill that a **prudent person** would exercise in managing financial affairs of others”. Where the trustee’s profession includes being a trustee or managing investments, the duty of care is higher - “exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing financial affairs of others”.

**Guidelines**

PAFs and PuAFs are required to have, and adhere to, a written **investment strategy** (which is also best practice for all foundations). There are also some restrictions for PAFs and PuAFs; no borrowing or pledging of assets, not owning collectables and not running businesses.

**Will/Deed**

Any **directions** or **restrictions** in the will/deed or any subsequent Court Orders need to be observed (such as a prohibition on holding mining stocks or tobacco companies).

**Prudent Person**

Under all state Trustee Acts, all trustees are required to consider:

- The benefits of **diversification** of trust investments
- **Investing** not speculating
- The **purpose** of the trust
- Balancing the potential for **capital appreciation** with **income**
- Balancing the **risk** of capital or income loss
- Maintaining the **real value** of capital and income
- The **tax** consequences of investment decisions and choices
- The **liquidity** of the investments (to have cash to distribute)
- The **costs** of investment alternatives and transactions.

**Reviews**

A review of investment assets is required at least annually. This requires examining the performance of the entire portfolio and individual assets relative to the investment strategy, and the foundation’s objectives. This should be documented to ensure any follow-up action is completed. Investment managers’ performance should be reviewed regularly.

**Advice**

Trustees can, and where there is no internal expertise, should take external **advice** on investment matters, which can be paid for as an expense of the trust.
For Further Consideration

Investment Strategy

Formalise an investment strategy for the foundation covering:

- Setting long **term objectives**; for example the Rockefeller Foundation has a long term investment policy of seeking to balance the twin objectives of “maximising funds for current programs and maintaining generational neutrality” (which incidentally they have achieved over 75 years). Of course some benefactors choose to set a finite term to their gifts/foundations, including most recently Gates/ Buffet

- **Benchmarking** performance against appropriate asset class indices;

- Having a focus on **after tax** returns; as the tax exempt status of foundations (and the refund of franking credits) increases the attractiveness of Australian shares paying franked dividends relative to other asset classes

- Having a position on off-market buy-backs, share offers etc.

- Formally incorporating where relevant the **purpose of the trust** into the investment strategy. This may involve excluding investment in companies directly conflicting with the purpose of the foundation, for example tobacco stocks for a trust with a purpose “to reduce suffering from cancer”. If trustees want to consider further restrictions, for example based on moral objections to some companies’ activities, they should obtain advice. Trustees must remember they are not free to use their investment powers to make moral statements at the potential expense of the trust. However, given the long term time horizon of foundations, an investment focus on sustainability may be appropriate. In formulating an investment strategy, trustees may also consider the financial importance to the foundation of key funders and donors whose ongoing support may be influenced by the investment policy. The critical issue for trustees is not to have an investment policy that would introduce a risk of “financial detriment” to the foundation

- Consider **“mission investing”** where social returns consistent with the trust’s purpose are sought from the investment portfolio along with financial returns; for instance advancing soft loans to eligible recipient organisations. This can be seen as an extension of a foundation’s grant-making activities but care is needed and advice should be taken. Trustees need to ensure they still act prudently, have the power to distribute capital and that the investment strategy allows for such investment making up a (probably still modest) percentage of the total investment portfolio.

Analysis of Risk

All investors face risks; foundations are no different. The potential to lose the favourable tax status through breach of trust as a result of inappropriate investment activity demands great prudence.

Because of their long-term time horizons and tax exempt status, foundations’ investment profiles are different from superannuation or personal monies. Therefore, for foundation trustees, rather than being dominated by asset price risk concerns (as is the case for many private investors), inflation risk (the possibility of losing real value of income over time) and income volatility (which is not conducive to consistent granting programs) are of increased concern. Liquidity is necessary to deliver the granting program.

Other things being equal diversification of investments reduces risk, however the benefits of investing in overseas shares or bonds will need to be balanced against the resultant reduction in income and the effect of currency fluctuations on distributable income and the value of assets that flow from investing offshore.
**Required Duties of Trustees**

All trustees have an objective to achieve a positive and lasting impact on society. Providing benefits for charitable purposes, generally through distributions, or grant-making, is therefore central to all charitable trusts’ activities. Granting can range from funding organisations providing immediate relief to those afflicted by current issues of poverty, sickness etc., or advancing education or the fine arts, through to funding organisations and research projects to identify new ways to solve entrenched social problems.

Benefits are usually the distributions of money but are not limited to that, and may include the provision of support such as office space or other property at lower than market rents, low- or no-interest loans, use of employees/volunteers, or other social ‘investments’ within the investment strategy to further the charitable purposes of the trust.

Trustees grant-making decisions must be guided by the objectives and any specific requirements or limitations set out in the trust instrument. There are also requirements based on the specific type and tax status of the trust.

Some foundations have sub-funds linked to specific donors; while trustees may take into account the recommendations made by those donors and/or advisory panels, the trustees are ultimately responsible for making the grant-making decisions.

**Minimum amount**

For **Will Trusts and Private Charitable Trusts** the amount which must be distributed is usually net Trust Law income (i.e. normal dividends, rent and interest after expenses but not capital gains or tax deferred distributions or gifts) but it may depend on the trust instrument. If accumulation is provided for in the deed or by Court Order, the ATO requirement is that the trust makes distributions to show it is carrying out its charitable purposes, eg. at least 80-85% of net trust income must be distributed each year. Trustees may occasionally consider holding over some income to the next year to fund a large project, if so legal advice should be taken and ATO approval may be required.

For **PAFs and PuAFs** different rules apply. Each year PAFs are required to distribute an amount equal to 5% of the net asset value at the previous 30 June or $11,000, whichever is larger (although it can be simply 5% if no expenses are paid by the fund). PuAFs are required to distribute an amount equal to 4% of the net asset value at the previous 30 June or $8,800, whichever is larger (although it can be simply 4% if no expenses are paid by the fund). Transitional Rules may apply to some PAFs and PuAFs.

**Recipients**

**Will Trust and Private Charitable Trusts**

- Grants must be in strict accordance with the will/deed, which may be a general charitable purpose (with no explicit restrictions on potential recipients); a specific charitable cause; to a group of eligible recipients, i.e. only to charitable organisations; or simply to a named charity.
- Grants for general operating expenditure can only go to charitable organisations; this can be checked on the Australian Business Register (shown a “Public Benevolent Institutions”, “Health Promotion Charities”, “Charitable Institutions” or “Charitable Funds”). Grants for legitimate charitable purposes can be made to a wider group of organisations but if the organisation is not charitable then great care and legal advice is recommended to ensure it will still be in furtherance of the trust’s charitable purpose.
- Most will trusts in Victoria established from 1915-1977 are restricted to granting in Victoria, this is a direct result of the high Probate Duties that then applied which had an exemption for charitable trusts with Victorian objects.
- For will trusts established since 1997, (and PAFs and PuAFs) if granting is not restricted to Australia by the will, overseas granting can only be done using overseas aid funds on the AusAid list (see page 24). Will trusts pre 1997 can grant overseas if permitted in will.
PAFs and PuAFs (see separate Handbooks for more detail)

- Each Deed defines the “eligible entities” which a PAF or PuAF can fund.
- As a tax deduction has been given on donations to PAFs/PuAFs they can only grant to organisations that are Deductible Gift Recipients. From the ATO’s perspective PAFs/PuAFs are seen as a holding vehicle in the process of donations passing from individuals to operating DGR entities.
- PAFs and PuAFs cannot make grants to other PuAFs or PAFs (even though they are DGRs), because if they did the grant would be circulating from one fund to another (and potentially back again the following year) and therefore not having the intended beneficial impact on the community. PAFs and PuAFs can be identified on the Australian Business Register (ABR) as they are DGR Item 2s.
- PAFs and PuAFs can only make grants to DGR Item 1 entities.
- For charitable PAFs/PuAFs (those that are not ITEFs): all grants must be to charitable organisations with both TCC and DGR Item 1 tax status i.e. operating charities such as “Public Benevolent Institutions”, “Health Promotion Charities” and “Charitable Institutions” and DGR Item 1 “Charitable Funds” such as school building funds, scholarship funds and necessitous circumstance funds.
- For PAFs/PuAFs that are or have become ITEFs: distributions can be to a wider group of DGR Item 1 depending on state law. For those domiciled (usually the last clause in Trust Deed) in NSW, Queensland and WA all exempt DGRs Item 1 are eligible; for Victoria and SA ITEFs, granting to non TCC Item 1 DGRs that other than for their connection with government would be charitable (eg. public hospitals, museums, and public libraries) is allowed in addition to organisations with DGR Item 1 and TCC. It is the domicile of the fund that determines which state rules apply, not the domicile of the recipient charity.
- Organisations can be searched for by name or ABN using the ABN Lookup website: [http://www.abr.business.gov.au/Index.aspx](http://www.abr.business.gov.au/Index.aspx). This will indicate whether the organisation itself is a Tax Concession Charity and whether it is a DGR Item 1 or it manages a fund or institution that is DGR Item 1 (note all distributions from PAF/PuAFs must go to the actual entity or fund that is the DGR Item 1).

The following table sets out some examples of the differences of eligible recipients between charitable trust structures, but is indicative only as specific circumstances may exist for individual trusts that may prevent a grant.

<table>
<thead>
<tr>
<th>Recipients</th>
<th>Will Trust</th>
<th>Private Charitable Trust</th>
<th>PAF or PuAF with TCC</th>
<th>PAF or PuAF with ITEF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Scholarships</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Charitable Project with TCC organisation but not DGR</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Grant to charity with DGR 1 &amp; TCC</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Grant to Govt entity with DGR 1</td>
<td>No*</td>
<td>No*</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Grant to School Building Fund with DGR 1 &amp; TCC</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Grant to Public Hospital Foundation with DGR 2 &amp; TCC</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Grant to DGR 1 non TCC non Govt Entity</td>
<td>No*</td>
<td>No*</td>
<td>No</td>
<td>Yes/No^</td>
</tr>
</tbody>
</table>

* No for general operating expenditure but a project for a charitable purpose may be possible.
^ Depends on state of domicile (see PAF or PuAF Handbook).
For Further Consideration

Granting Process

Directors are encouraged to apply a similar degree of diligence, skill and care to grant-making as they do to investment matters. To paraphrase Aristotle, "giving money away is easy, but giving it away effectively and having impact is a very different matter".

A critical component of effective grant-making is research into the issue being supported, and knowing what interventions have been tried previously in that field, with what levels of success. This understanding is invaluable in assessing which projects are most likely to achieve a positive impact and make a real difference to the problem at hand.

Then particularly for larger and multi-year grants, conducting due diligence on potential grant recipients is essential in order to assess an organisation’s:

- structure and tax status - to confirm they are eligible
- mission and purpose - to ensure a 'good fit' with the foundation's objectives
- the experience and capacity of key staff and directors - to ensure they are capable of delivering what they say they will deliver, given the grant
- their financial strength including diversity of income– to minimize risk

Granting Strategy

A formal grant-making strategy, rather than just grant guidelines, provides community organisations, and other foundations interested in the same issues, with a clearer understanding of what the foundation is seeking to achieve. This allows grant-seekers to decide whether an application is likely to be successful and to set applications in the context of objectives. A timeframe is always useful for grant-seekers to know when decisions will be made and when they will be notified whether they are successful or not. Particularly for larger foundations or those with multiple objectives, Trustees may wish to allocate indicative amounts to individual programs or geographic regions.

Collaboration with other funders in major projects can enhance effectiveness by extending the experience and resources available. Notwithstanding its enormous resources, the Bill and Melinda Gates Foundation seeks partnerships for its overseas programs.

Grant Conditions

For many grants for general use a simple covering letter and receipt from the organisation is acceptable paperwork (along with a copy of the ABN printout). However, larger grants intended for specific projects can be subject to a grant agreement. The ATO accepts that if the grant agreement provides no material benefit to the grant-maker and specifies only the conditions set out below, then the agreement is not "supply" and the recipient will not be subject to GST in respect of the grant. The grant agreement can:

1. identify the project to which the funds are intended to be applied
2. establish a date for completion of the project
3. require the grantee to maintain separately in its books how the grant has been used
4. require that the grantee acknowledge the assistance in published or display materials
5. require a report on the use of the grant
6. require repayment of any part of the grant not applied for the project.


Grant Evaluation

Acquittal reports detailing how the money provided (inputs) was spent (outputs) and what was achieved (outcomes) are a key part of philanthropy. Beyond whether money was properly spent, trustees should accept a responsibility to evaluate whether grants for significant projects have been effective (impact) in addressing the identified problems; sometimes this evaluation requires the use of external independent parties.
Governance Failure

The trustees have ultimate responsibility for governance of each foundation; in short, “the buck stops” with them. Good internal processes obviously reduce the risk of governance failure. Currently, State Attorneys General have oversight of charitable trusts and can instigate legal action if there is a suspected breach of trust (these powers may pass to the Australian Charities and Not-for-Profits Commission sometime after 1 October 2012). The ATO can take action where there is a failure to comply with the requirements of tax legislation and PAF/PuAF Guidelines.

It is encouraging that the list of foundation governance failure in Australia is not long. Even overseas it is limited, but it must be said that disclosure practices vary greatly and we may not be aware of all the issues. There were certainly some issues of concern with the earlier PPF structure, particularly around the use of assets and granting to ineligible entities which lead to the PAF and PuAF Guidelines being introduced.

Based on identified issues here and overseas, the following are examples of potential foundation specific problems that may arise and should be guarded against.

Administration
- Misappropriation of trust income or assets for benefit of trustees or donors
- Accumulation of income to capital when not permitted in the deed or Court Order
- Expenses being incurred that are not reasonable
- Treating capital losses as (negative) income to reduce distribution obligations
- Failure to have accounts audited when required by deed or Guidelines

Investment
- Speculative investments
- Related party investments not at arm’s length and/or providing benefit to a donor or trustee
- Holding of excluded investments in investment portfolio
- Not following trustee requirement to be prudent
- A PAF/PuAF not having and adhering to an Investment Strategy

Granting
- Insufficient distribution through grants
- Support of activity that was not charitable or outside will/deed objects
- PAFs/PuAFs supporting non DGR charitable organisations
- PAFs/PuAFs supporting Item 2 DGRs
- PAFs/PuAFs (not ITEFs) supporting non charitable DGRs
- Permitting redirection of grants through legitimate recipients to other organisations, particularly if associated with the trustees or staff
- Allowing grant money to be used for other purposes
- Imposing extensive grant conditions but failing to pay GST (see page 19)
Liability

Restitution i.e. putting the trust back to the position it would have been in had the breach not occurred, is the potential penalty for a breach of trust (although the Court may take into account mitigating factors). For PAFs and PuAFs the ATO Commissioner has the power to remove the corporate trustee where a significant breach of trust or tax law is believed to have occurred. The Commissioner may also apply financial penalties where there have been breaches of the PAF or PuAF Guidelines. Any such penalties must be paid by the trustee/directors and cannot be a charge on the fund.

One potential consequence of serious governance failure that trustees should be very conscious of is any threat to the foundation’s income tax exempt status. This status should be regarded as an asset of the foundation. Since 2001 TCC status has facilitated the refund of franking credits attached to dividends from Australian companies, thereby increasing foundations’ income from this source by up to 40%. Loss of TCC status through trustee action or inaction would be serious for any foundation and would compound the losses from the underlying breach of fiduciary duty for which the trustees may be liable. The ATO’s Non-Profit Organisation Guide (Chapter 3, page 54) gives examples of potential activities that might jeopardise a foundation’s tax status including related party investments, distribution of benefits to trustees, and insufficient charitable granting.

Insurance

For larger foundations, particularly those with staff, trustees may wish to consider taking out Directors and Officers Insurance to cover issues where the foundation suffers a loss through the actions of others. However, as indicated above, if there is a breach of trustees’ fiduciary duties, trustees may be personally liable to restore the foundation to the position it would have been in had the breach not occurred. For PAFs and PuAFs trustees/directors cannot be indemnified by the fund for dishonesty, gross negligence or deliberate acts of breach of trust. Trustees should take legal advice should they find themselves in the circumstances where a possible breach of trust may have occurred.

Unsatisfactory outcomes may not be Governance Failure

It is equally important to note that not achieving the desired outcomes from a foundation’s investments does not necessarily mean a governance failure. There may well be assets in foundation investment portfolios that substantially under-perform from time to time. The test is not whether, in hindsight, investment choices were not ideal, but whether prudent investment processes were in place and were followed, including adhering to any Guidelines, consideration of the benefits of diversification of the investment portfolio, and a well documented investment strategy and annual reviews.

Similarly, a well thought through and executed grant project that failed to deliver the expected outcome is not prima facie a governance failure; it may have been simply an overly ambitious new approach to tackle a deep-seated problem. It is what happens next that determines the governance outcome. Like many foundation academics Professor Peter Frumkin, of the RGK Centre for Philanthropy at the University of Texas, distinguishes between ‘constructive failures’ where knowledge of what was tried and what went wrong has been created through effective communication, and ‘unconstructive failures’ where no new knowledge is created - because no-one hears about the experience. Repeated ‘unconstructive failures’ would be a governance issue, as foundation resources are not benefiting the community. Expressed more colloquially, while ‘reinventing the wheel’ is widely recognised as wasteful, ‘reinventing potholes’ is clearly worse (Brest and Canales, 2007).
Trustee Dossier

It is recommended that each foundation has a dossier for trustees/directors as a basic reference document containing key material. This should include the following:

1. A copy of the will or trust deed and any subsequent Court Orders; with a one page executive summary highlighting key aspects including the trust’s purpose and definition of eligible recipients
2. ATO Guidelines where they exist (PAFs and PuAFs)
3. A summary of the legal structure of the foundation and any associated entities, including their respective tax status with the ATO
5. For PuAFs, a copy of the ATO’s TR 95/27 and TD 2004/23 (which is particularly relevant for Community Foundations and Charitable Endowment Funds with “sub-account” structures)
6. A copy of the legacy statement and/or the foundation’s mission statement
7. A copy of all policy documents endorsed by trustees – including, where relevant, investment strategy, granting policy, trustee and staff code of conduct, financial/delegation authorities, sub-committee charters, strategic plan
8. Where investment managers have been appointed with investment mandates - details of the investment managers, the funds allocated to each, and the terms of the mandates
9. A list of trustees/directors, with short CVs, including all organisations for which each trustee has declared a potential conflict of interest
10. A copy of the Directors and Officers Insurance Certificate (if applicable)
11. A copy of this Handbook and/or the specific PAF or PuAF Trustee Handbooks.

This dossier will be particularly useful as the cornerstone of the induction of new trustees, especially those totally new to the trustee role, to ensure they are fully aware of their legal responsibilities and the operational procedures of the foundation.

The dossier should be reviewed from time to time to ensure all documents remain current.
Glossary of Terms

ACNC
Australian Charities and Not-for-Profits Commission, the new regulator of the NFP sector from 1 October 2012.

Associate
(Important for PAFs) Associates of the founder can make unrestricted donations to PAFs. Non-associates cannot donate more than 20% of the fund value in any one year. Associates or major donors or directors of a trustee company of a PAF are ineligible to be the “Responsible Person” for that PAF. Associates include family and employees, but not those linked to the founder/donor only through a professional capacity (i.e. lawyer/accountant). Meaning of Associate is outlined in section 318 of the *Income Tax Assessment Act 1936*.

ATO
Australian Taxation Office.

Charitable Foundation
An entity, usually a trust, established for charitable purposes.

Charitable Purpose
Activities that are charitable in law, see Appendix 2. A Statutory Definition of Charity is scheduled to apply from 1 July 2013.

DGR
Deductible Gift Recipient. An ATO classification of an organisation or fund that enables donors to that organisation or fund to claim a tax deduction (subject to eligibility criteria).

**DGR Item 1** – Public Benevolent Institutions, Health Promotion Charities, some Charitable Institutions and others are DGR Item 1s. PAFs / PuAFs can only distribute to DGR Item 1s (but not all DGR Item 1s are eligible for all PAFs / PuAFs (see page 18).

**DGR Item 2** – Public Ancillary Funds and Private Ancillary Funds are DGR Item 2s. PAFs / PuAFs cannot distribute to another DGR Item 2.

Search facilities online through ABN Lookup (see page 18).

Fiduciary Duty
Common law duty of trustees to exercise rights and powers in good faith for the benefit of beneficiaries of any trust and not in their own interest.

Franking Credits/ Imputation Credits
Under tax law, charitable foundations with TCC or ITEF are entitled to receive cash refunds of franking credits attached to dividends received from Australian companies.

ITAA97

ITEF
Income Tax Exempt Funds: A type of PAF or PuAF able to be created from 1 July 2005 to support certain non-charitable DGRs. In NSW, Qld and WA an ITEF can grant to any exempt DGR Item 1, while in Victoria and SA an ITEF is able to support those Item 1 DGRs that would be charitable other than for their government connection, eg. public hospitals, museums, public libraries.
Glossary of Terms (cont.)

Legacy Statement
A statement drawn up by the benefactor or by trustees setting out the circumstances behind the creation of the trust and the charitable objectives it pursues.

Off-market Buy-back
A capital restructuring by a listed company buying back a number of its shares. The consideration for the buyback is usually a small capital return and a large franked dividend.

Overseas Aid Funds/AusAid list
The AusAid website contains a list of overseas aid funds approved by the Treasurer under ITAA97. www.ausaid.gov.au/ngos/approved_funds.cfm

PPF
Prescribed Private Fund. A charitable trust for individuals and families for supporting DGRs, enabling individuals to obtain a tax deduction on donations which existed from 2001 until replaced by PAFs on 1 October 2009.

Private Charitable Trust
Charitable Trust established through a trust deed, which can be registered with the ATO for exemption from income tax and refund of franking credits (TCC status) but donations to it are not tax deductible (see page 5).

Responsible Person
An individual with broad community responsibilities who is required as trustee(s) for PAFs and PuAFs (see page 27). Definition varies between PAFs, PuAFs and some other charities.

Receipts
For PAFs and PuAFs to facilitate tax deductibility of donations receipts must include:
- name of the donor
- the name and ABN of the foundation
- the date and the amount donated
- that it was a gift

TCC/ITEC
Tax Concession Charity (TCC), previously known as Income Tax Exempt Charity (ITEC), is an ATO classification of a charity that enables it to be exempt from paying tax and enables the reclaiming of any franking credits received on dividends from Australian Companies; includes Public Benevolent Institutions, Charitable Institutions, Charitable Funds and Health Promotion Charities.

Testamentary Trust
A trust created in a will, often also called a will trust.

Trust Law Income
Normal dividends (including franking credits), rent and interest but not capital gains, tax deferred distributions or gifts (which are capital items). Dividends that are part of a capital restructuring such as a buyback are capital items and not part of trust law income.
## Appendix 1: Public Life and Governance Principles

### Seven Principles of Public Life  
Nolan Committee UK 1996

**Selflessness**  
Holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family or their friends.

**Integrity**  
Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might influence them in the performance of their official duties.

**Objectivity**  
In carrying out public business, including public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.

**Accountability**  
Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate for their office.

**Openness**  
Holders of public office should be as open as possible about all the decisions and action that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

**Honesty**  
Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

**Leadership**  
Holders of public office should promote and support these principles by leadership and example.

### Essential Corporate Governance Principles  
ASX 2003

**Lay solid foundations for management and oversight**  
Recognise and publish the respective roles and responsibilities of board and management.

**Structure the board to add value**  
Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

**Ethical and responsible decision-making**  
Actively promote ethical and responsible decision-making.

**Safeguard integrity in financial reporting**  
Have a structure to independently verify and safeguard the integrity of the company’s financial reporting.

**Make timely and balanced disclosure**  
Promote timely and balanced disclosure of all material matters concerning the company.

**Respect the rights of shareholders**  
Respect the rights of shareholders and facilitate the effective exercise of those rights.

**Recognise and manage risk**  
Establish a sound system of risk oversight and management and internal control.

**Encourage enhanced performance**  
Fairly review and actively encourage enhanced board and management effectiveness.

**Remunerate fairly and responsibly**  
Ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.

**Recognise the legitimate interests of stakeholders**  
Recognise legal and other obligations to all legitimate stakeholders.
Appendix 2: Charitable Purpose

Will Trusts and Private Charitable Trusts can only make grants that are for ‘charitable purposes’ while PAFs and PuAFs can only grant to DGR Item 1s. So it is critically important for all trustees of charitable trusts (except perhaps for ITEFs in NSW, Qld and WA) to have some understanding the term ‘charitable purpose’. The Government has indicated that a new statutory definition of charity will be legislated by 1 July 2013 as part of the reforms that include the establishment of the new sector regulator, the ACNC.

The following is provided as summary discussion of the current meaning of the term ‘charitable purpose’ but it is not comprehensive on all the detail. The ATO’s Taxation Ruling TR2011/4 provides a comprehensive analysis. A good discussion of the issues around what are charitable purposes, is contained in Charity Law in Australia and New Zealand by Gino Dal Pont.

The founding document in English law, which flows through to Australia and is the starting point for the two references mentioned above, is the Statute of Charitable Uses, 1601 (also referred to as the ‘Statute of Elizabeth’). The Preamble reads as follows:

“Whereas lands, goods (and) money have been given as by sundry other well-disposed persons, some for the relief of aged and poor persons, some for the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities, some for repair of bridges, ports, causeways, churches, sea-banks and highways, some for education and preferment of orphans, some for or towards relief or maintenance of houses of correction, some for marriages of poor maids, some for aid and help of young tradesmen, which lands, goods (and) money have not been employed according to the charitable intent of the givers and founders thereof, by reason of frauds, breach of trust and negligence in those that should pay (and) deliver same.”

In 1891, in the case Commissioners for Special Purposes of the Income Tax v. Pemsel, the UK Judge Lord Macnaghten set out the ‘heads’ of charity:

“Charity in its legal sense comprises four principal divisions, trusts for the relief of poverty, trust for the advancement of education, trusts for the advancement of religion, and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.”

In Australia, the Macnaghten interpretation of ‘four heads of charity’ currently remains the basis for the definition of charitable purpose (until 1 July 2013). The 2006 Charities Act United Kingdom introduced additional ‘heads’ there. Addressing the special needs of people with disabilities, providing for the aged and societies that promote the fine arts are among the activities regarded as being charitable. Other than for ‘the relief of poverty’ a charitable purpose needs to be beneficial to the community or an appreciable section of the community where the population is still broad, i.e. a geographic region or sufferers of a particular condition.

To approach the issue from the other direction, it is useful to answer the question: what is generally not viewed as charitable? The ATO in TR 2011/4 also sets out the purposes which are not charitable as being:

- The purpose is to confer private benefits
- The purpose is sporting, recreational or social
- The purpose is illegal or against public policy
- The purpose is commercial
- The purpose is governmental
- The purpose is vague or has insufficient value for the community.

For two of these, sport and governmental, it is worth repeating the further explanation.

Social, recreational and sporting purposes are not charitable. However social, recreational and sporting purposes and activities that are merely incidental to a purpose that is otherwise charitable, do not by themselves prevent that purpose being charitable. The purpose of Government in carrying out its functions and activities is not charitable. However, funding by government and establishment by statute can be consistent with a charitable purpose. If considering making grants that may border on any of these non-charitable purposes, trustees should take advice.
Reflecting the interest of the government inherent in the deductibility of donations, the tax law requires that a majority of the trustees of a PuAF are ‘Responsible Persons’, and that at least one trustee of a PAF is a ‘Responsible Person’ not associated with the founder or major donor.

**Public Fund definition of Responsible Persons (Guidelines 2011)**

‘Individuals with a degree of responsibility to the Australian community as a whole’ would generally include: school principals, judges, religious practitioners, solicitors, doctors and other professional persons, mayors, councillors, town clerks and members of Parliament. Generally, individuals who are accepted as having a degree of responsibility to the community as a whole are known to a broad section of the community because they perform a public function or they belong to a professional body (such as the Institute of Chartered Accountants, State Law Societies and Medical Registration Boards) which has a professional code of ethics and rules of conduct. Individuals who have received formal recognition from the Government for their services to the community (for example, an Order of Australia award) will also usually have the requisite degree of responsibility.

Individuals before whom a statutory declaration may be made are also considered “Responsible Persons” and include individuals who are licensed or registered to practice in a range of occupations such as a dentist, legal or medical practitioner; a nurse, a pharmacist, a bailiff, a bank officer or officer of a building society or credit union with 5 or more continuous years of service; a clerk of the court; a justice of the peace, a judge, magistrate; a member of various professional associations including a member of Engineers Australia, a member of Chartered Secretaries Australia; a member of the various professional accounting associations in Australia; a marriage celebrant, mayors, town clerks and members of Parliament; a government employee with 5 or more years of continuous service; a teacher employed on a full-time basis at a school or tertiary education institution.

**PAF definition of Responsible Person (Model Deed 13/2/12)**

A Responsible Person is an individual who:

- performs a significant public function
- is a member of a professional body having a code of ethics or rules of conduct
- is officially charged with spiritual functions by a religious institution
- is a director of a company whose shares are listed on the Australian Securities Exchange
- has received formal recognition from government for services to the community, or
- is approved as a Responsible Person by the Commissioner

and, unless the Commissioner agrees otherwise, is not an employee of the Founder, the Trustee or a Major Donor; and, who is not:

- the founder or a major donor
- an associate of the founder, the trustee or a major donor or of the directors or members of the board or other controlling committee of the trustee other than:
  - in a professional capacity
  - as a member of the board or other controlling committee of the trustee, or
  - as a member of the trustee.
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