

## **EXPOSURE DRAFT EXPLANATORY STATEMENT**

### **Issued by authority of the Assistant Minister for Competition, Charities and Treasury**

#### *Taxation Administration Act 1953*

#### *Taxation Administration (Community Charity) Guidelines 2024*

The *Taxation Administration Act 1953* (the Act) contains the administrative framework for the taxation and superannuation law in Australia.

Sections 426-118 and 426-185 in Schedule 1 to the Act provide that the Minister must formulate guidelines setting out rules that community charity trusts and their trustees, and community charity corporations and their directors, must comply with if these kinds of charities (community charities) are to be, or are to remain, endorsed as deductible gift recipients under the taxation law. The Act also requires the guidelines to set out the amount, or how to work out the amount, of an administrative penalty in relation to community charities for the purposes of subsections 426-120(1) and 426-195(1) in Schedule 1 to the Act.

The purpose of the *Taxation Administration (Community Charity) Guidelines 2024* (the guidelines) is to set out these rules and to specify the amounts, or the method for working out the amounts, of the administrative penalties.

#### *Background*

The income tax law allows taxpayers who make gifts of \$2 or more to deductible gift recipients to claim tax deductions for those gifts, subject to any conditions applying to the deductible gift recipient or the gift. An entity may apply, under Division 426 in Schedule 1 to the Act, to the Commissioner for endorsement as a deductible gift recipient. The criteria for endorsement, set out in section 30-125 of the *Income Tax Assessment Act 1997* (the ITAA 1997), include the requirement that the entity be covered by one of the deductible gift recipient categories set out in Subdivision 30-B of the ITAA 1997 (without being described by name in that Subdivision), or be established to donate funds to an entity covered by one of those categories. As an alternative to the endorsement process, an entity may acquire deductible gift recipient status by being 'specifically listed'; ie, described by name in Subdivision 30-B of the ITAA 1997.

Prior to amendments made by Schedule 3 to the *Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Act 2024* (the amending Act), community charity trusts and community charity corporations did not fit neatly into any of the deductible gift recipient categories. Because a particular charity's activities may have fallen under several of the categories and some activities may have extended beyond them, using the specific listing process created integrity risks, which were heightened by the absence of compliance mechanisms apart from de-listing.

Schedule 3 to the amending Act created a framework for deductible gift recipient endorsement for community charities by creating a new class of entities that may apply for endorsement by the Commissioner of Taxation (the Commissioner) under Division 426 in Schedule 1 to the Act. The class consists of community charity trusts and community

charity corporations. These two kinds of community charities are specified in two new items in Division 30 of the ITAA 1997 and defined in Division 426 in Schedule 1 to the Act. Individual community charity trusts and community charity corporations will be specified by name in a Ministerial declaration made under that Division.

Part 1 of Schedule 3 to the Amending Act included the class of community charities in Subdivision 30-B of the ITAA 1997. The new class listing applies only to community charity trusts that meet certain conditions relating to entity purposes, registration under the *Australian Charities and Not-for-profits Commission Act 2012*, financial obligations set out in entity governing rules, and compliance with the guidelines. Part 2 of Schedule 3 to the amending Act also created a new Subdivision in Schedule 1 to the Act in order to achieve the same result in relation to community charity corporations.

Schedule 3 to the amending Act commenced on 29 June 2024.

The guidelines are mandatory. This is appropriate in view of the activity profile of the entities belonging to the new class of deductible gift recipients. The guidelines are modelled closely on the existing guidelines governing ancillary funds.

The Act does not specify any conditions that need to be met before the power to make the guidelines may be exercised.

The guidelines are a legislative instrument for the purposes of the *Legislation Act 2003*.

The guidelines are subject to disallowance.

The guidelines are subject to sunseting.

Details of the guidelines are set out in Attachment A.

The Office of Impact Analysis (OIA) was consulted (OIA ref: OIA23-04904) and agreed that an Impact Analysis was not required.

**Details of the *Taxation Administration (Community Charity) Guidelines 2024***

**Part 1—Preliminary**

**Section 1—Name of instrument**

This section provides that the name of the instrument is the *Taxation Administration (Community Charity) Guidelines 2024* (the guidelines).

**Section 2—Commencement**

This section provides that the guidelines commence on the day after registration on the Federal Register of Legislation.

**Section 3—Authority**

This section provides that the guidelines are made under the *Taxation Administration Act 1953* (the Act).

**Sections 4 and 5—Interpretation and definitions**

Expressions used in the guidelines have the same meaning as in Schedule 1 to the Act, and, by operation of section 3AA of the Act, have the same meaning as in the ITAA 1997.

Section 5 sets out definitions of key terms used in the guidelines.

Importantly:

- ‘community charity’ is defined to mean a community charity trust or a community charity corporation;
- the definitions of ‘director’ of a community charity corporation and ‘trustee’ of a community charity trust provide that where there are 2 or more such directors or trustees, the terms include all or any of the directors or trustees jointly, or any of them severally, as the case requires;
- ‘governing rules’ is defined to have the same meaning as in the *Australian Charities and Not-for-profits Commission Act 2012*.

**Section 6—Penalties**

The imposition of administrative penalties for non-compliance with the guidelines is provided for in sections 426-120 and 426-195 in Schedule 1 to the Act. While the Act imposes the penalty, it allows the guidelines to determine the amount of the penalty, or the method of working out the amount of the penalty, for non-compliance with a particular provision of the guidelines.

This section provides that the amount of an administrative penalty imposed for a breach of the guidelines is set out or worked out in accordance with the relevant provision of the guidelines that has been breached. For example, the penalty for breach of the prohibition

against providing a benefit to certain persons associated with the community charity is an amount equal to the amount or value of the benefit provided.

It is appropriate for the guidelines to set out penalty amounts, as this allows for them to be customised to the nature and size of the breach, as well as taking account of a trustee or director's level of culpability. The primary law sets out an overarching narrative in the context of which detailed obligations would be out of place. An additional reason for including penalty amounts in the guidelines rather than the primary legislation is that the guidelines may be more readily updated to respond to new factual scenarios and ensure recipients of deductible gift recipient status are being satisfactorily regulated.

Proportionality criteria were considered when setting penalty amounts. The rate of penalties for non-compliance is consistent with penalties applied for similar breaches in the Act. The level of penalty imposed is also consistent with the principles outlined in the Attorney-General's Department's *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers* and with the principles established by the Australian Law Reform Commission *Report 95: Principled Regulation: Federal Civil and Administrative Penalties in Australia*.

Penalties for non-compliance with the guidelines complement other administrative powers of the Commissioner that are contained in the Act, such as the powers to suspend, remove or replace trustees of community charity trusts that intentionally disregard the guidelines or other relevant Australian laws. As such, they form part of an integrated enforcement regime intended to maintain public trust and confidence by ensuring credible and effective deterrents are in place.

Notes to section 6 explain that under the Act, all or part of an administrative penalty may be remitted by the Commissioner, and that a community charity cannot reimburse a trustee or corporate director of a community charity the amount of a penalty.

## **Part 2—Rules for establishing and maintaining community charities as deductible gift recipients**

### **Sections 7 and 8—Object and general principles**

Section 7 provides that the object of Part 2 of the guidelines is to set minimum standards for the governance and conduct of community charities and their trustees or corporate directors.

Section 8 establishes general principles in relation to the establishment, maintenance and winding up of an entity that is a community charity. The principles are that the entity is a community charity, is philanthropic in character, is a vehicle for philanthropy, and that it both:

- seeks to comply with all relevant laws and obligations; and
- is open, transparent and accountable to the public (both through the Commissioner and, in its capacity as a registered charity, to the Commissioner of the Australian Charities and Not-for profits Commission).

A note to section 8 clarifies that the principle of openness and transparency is not intended to affect any obligation to protect the confidentiality of a community charity's information under privacy or secrecy and disclosure laws.

## Section 9—Purposes and objects of a community charity

This section sets out the requirements for an entity to be a community charity trust or a community charity corporation. This ensures community charities have robust governance arrangements, are properly accountable and act in a manner consistent with public expectations of philanthropic organisations.

A community charity, either trust-based or incorporated, must be a registered charity.

If the charity is a community charity trust, it must be established and maintained under a will or instrument of trust as a charity and must be established and maintained as a charity in accordance with item 13.1.1 of the table in subsection 30-105(1) and section 30-110 of the ITAA 1997. That item lists community charities as entities that may seek endorsement as deductible gift recipients, provided that the latter section applies to them.

If the charity is a community charity corporation, it must be operated as a charity and in accordance with item 13.1.2 of the table in subsection 30-105(1) and section 30-110 of the ITAA 1997. The requirement to be maintained or operated as a charity in addition to the requirement to be a registered charity allows the Commissioner to take action to revoke an entity's endorsement as a deductible gift recipient where necessary, to protect the integrity of the tax system independently of any action by the Australian Charities and Not-for-profits Commission, or where deregistration is not warranted.

A community charity's governing rules must include objects setting out the purposes of the charity and must deal with the circumstance where the charity is wound up or ceases to be a community charity as required by this section.

## Section 10—Operated only in Australia

This section provides that a community charity must be established and operated only in Australia and clarifies that this does not prevent it from making a distribution to a deductible gift recipient that operates outside Australia.

## Section 11—Trustees and directors

This section requires the trustee or corporate director of a community charity to exercise the degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others. Section 11 also stipulates that an individual may only be a director of the trustee of a community charity trust or a corporate director, or a member of any other controlling body of the charity, if the individual has not been convicted of a taxation offence that is an indictable offence. An existing director or member who is convicted of such an offence must cease to hold the position within 1 month after the conviction.

## Section 12—Liability of trustee or corporate director

Section 12 requires the governing rules of a community charity to prohibit it from indemnifying a trustee or corporate director, or an employee, officer or agent of a trustee or a community charity corporation, against loss or liability attributable to the relevant person's unacceptable behaviour (including a deliberate breach of duty and dishonesty).

### Section 13—Minimum annual distribution

This section requires a community charity to distribute a proportion of its income and assets to a deductible gift recipient each financial year (other than the financial year in which the charity is established). Generally, the minimum annual distribution rate is an amount equal to at least 4 percent of the market value of the charity's net assets as at the end of the previous financial year. However, if in the financial year any of the charity's expenses are paid out of the charity's assets or income, the minimum annual distribution is the greater of that amount and \$8,800.

The penalty for breach of this requirement is 30 penalty units if the shortfall in the distribution is greater than \$1,000.

A 'distribution' by a community charity means the provision of money, property or benefits to an eligible deductible gift recipient, or expenditure incurred, in the direct course or furtherance of a purpose of the charity. Expenditure incurred would include providing money to entities that are not deductible gift recipients where the expenditure by that receiving entity will further a purpose of the community charity.

Section 13 requires that any distribution of property or benefits made by a community charity be based on the market value of that property or those benefits. The section includes a number of examples of determining the market value of a distribution for the purpose of working out the value of a particular distribution as a proportion of a community charity's assets at the relevant time.

The Commissioner may ask a community charity to rectify a shortfall in the distribution for a financial year. The charity must comply with such a request within 60 days. The penalty for failure to comply within this timeframe is 10 percent of the shortfall as at the end of the 60-day period, reduced by the amount of any penalty imposed for breach of the requirement to make a distribution for the financial year. An amount distributed to rectify a shortfall does not count towards working out distribution for a later year when the rectification occurs.

The Commissioner may, on application by a community charity, lower the minimum annual distribution rate for a financial year in certain circumstances, including after the relevant financial year has ended, and may impose conditions on such a reduction. Those conditions may seek to protect the integrity of the regulatory framework or to improve the operation of the community charity to minimise the likelihood of future requests for a lower distribution being made. The Commissioner must be satisfied that the circumstances warrant the reduction, having regard to specified matters including the general market conditions in Australia, the level of distributions previously made by the charity, its fees and expenses, its history of compliance with the community charity framework and the compliance history of its trustee or corporate director, and any other matter considered relevant by the Commissioner.

A community charity may object to a decision to not reduce the annual distribution rate, or to not reduce it to the extent applied for, or to a decision to impose a condition on a reduced annual distribution rate. The applicable process for doing so is set out in Part IVC of the Act.

## Section 14—Valuations

This section requires the market value of a community charity's assets to be estimated annually. This does not include an asset that is land, the market value of which must be estimated at least every 3 financial years. In each case, the estimate of market value must be as at the end of the relevant financial year and must be conducted within 2 months before or after that time (unless to do so would be unnecessarily onerous and expensive). In the intervals between estimates of the market value of land, the existing estimate is to be used until a new one is obtained.

It is intended that obtaining an estimate should not be onerous or expensive. For assets other than land, the estimation may be carried out by the community charity itself or by a qualified valuer, another appropriate entity or the Commissioner. The latter may occur with the permission, or at the request, of the charity. However, an estimate of the market value of land is required to be undertaken by a qualified valuer or the Commissioner.

Estimates must be based on reasonably objective and supportable data and the methodology and data must be documented. If a qualified valuer is used, the charity must obtain a written estimate from the valuer that sets out the methodology used and refers to any supporting materials used.

The charity must arrange for another estimate to be obtained, in the manner stipulated by the Commissioner, if the Commissioner considers an estimate of the market value of any asset to be unreasonable.

## Section 15—Keeping accounts

This section requires proper accounts to be kept and maintained in respect of a community charity's receipts and payments and all financial dealings connected with the charity. The accounts must be retained for at least 5 years. These obligations are in addition to any relevant requirements for record-keeping under the Act. The charity must make the accounts available if requested by the Commissioner. The penalty for a breach of either of these obligations is 10 penalty units.

## Section 16—Financial reports

This section sets out the obligations of a community charity in relation to reporting the charity's financial position for each financial year.

A financial report must be prepared in accordance with the accounting standards (where that term has the meaning given by the *Corporations Act 2001*) before the charity is required to give its income tax return for the relevant financial year. If the community charity prepares a financial report in accordance with Subdivision 60C of the *Australian Charities and Not-for-profits Commission Act 2012*, that report will satisfy the requirement under this section.

The report must disclose all transactions (other than gifts of money) between a community charity and certain listed entities; for example, founders, donors and their relatives, and associates of those listed entities.

The charity is required make the report available to the Commissioner on request, unless it has already been given to the Commissioner of the Australian Charities and Not-for-profits Commission.

Penalties of 10 penalty units may be imposed for a breach of these obligations.

#### Section 17—Audits

This section sets out the rules for audits of the financial reports of community charities and of the compliance by these charities, their trustees and corporate directors, with the guidelines.

A community charity must, for each financial year, arrange for a registered company auditor (within the meaning of the *Corporations Act 2021*) to undertake such an audit.

This does not apply if the trustee of a community charity trust is the public trustee of a State or Territory, in which case the Auditor-General of the relevant jurisdiction may undertake the audit. Further, unless the Commissioner decides otherwise for a particular community charity, a community charity may have its financial report and compliance with the guidelines for a financial year reviewed instead of audited if, in the relevant financial year, it has both revenue of less than \$3 million and assets of less than \$3 million.

For a review, the reviewer must also be a registered company auditor or a member of a professional accounting body.

An audit or review must be prepared, and a report finalised, before the charity is required to give its income tax return for the relevant financial year and in accordance with the auditing standards (within the meaning of the *Corporations Act 2001*).

The charity is required make the report available to the Commissioner on request, unless it has already been given to the Commissioner of the Australian Charities and Not-for-profits Commission.

Penalties of 10 penalty units are provided for breach of these obligations.

#### Sections 18—Investment strategy

This section requires a community charity to have, and to implement, an investment strategy.

The strategy must set out the investment objectives of the charity and the methods to be adopted to achieve them. It must reflect the purposes and circumstances of the charity having regard to listed factors.

The charity must implement the strategy when making investment decisions, and must make the strategy and a record of decision-making processes available in a form that enables determination of compliance with the guidelines and other relevant Australian laws.

Penalties ranging between 10 and 15 penalty units are provided for breach of these obligations.

## Section 19—Investment limitations

This section requires a community charity to comply with certain investment limitations to protect the charity's philanthropic assets.

The charity's investments must be made on an arm's length basis, unless the guidelines provide otherwise.

Security over an asset of the charity must not be given or authorised by the trustee or corporate director of the charity. This does not apply to a particular financial instrument excluded by the Commissioner or an agreement to guarantee certain repayments for the sole benefit of deductible gift recipients.

Section 19 also limits the acquiring of assets or the making of loans or provision of other financial assistance to certain persons associated with the charity, such as donors to or founders of the charity or their relatives, or associates of any of those entities, except by way of arm's length commercial transactions or on terms more favourable to the charity than such a commercial transaction.

The assets of the charity must be kept separate from other assets, but this requirement does not prevent a licensed trustee company (within the meaning of the *Corporations Act 2001*) or the public trustee of a State or Territory from operating common community charity trusts for investment purposes.

The section also limits the circumstances in which a community charity may acquire assets that are collectables. A collectable may only be acquired by way of gift or if the acquisition of the collectable is in the direct course or furtherance of a purpose of the charity. Where the collectable is a gift, it must be sold or distributed within 12 months after it is acquired unless it is used or kept mainly for a purpose or activity of a cultural organisation listed in the table in subsection 30.100(1) of the ITAA 1997. This exception allows a relevant community charity to keep a collectable donated for the purpose of display in, for example, a museum or library, if the collectable is in fact used or kept for that purpose.

Penalties of 30 penalty units are provided for non-compliance with these limitations.

## Section 20—Uncommercial transactions and benefits to founders and donors

This section generally limits a community charity from entering into uncommercial transactions or providing benefits to founders and donors.

Specifically, section 20 prohibits a community charity from entering into an uncommercial transaction unless it is in the direct course or furtherance of a purpose of the charity covered by section 30-100 of the ITAA 1997, and provides for a penalty of 30 penalty units for a breach. This does not prevent a charity from entering into an uncommercial transaction each of the terms of which is more favourable to the charity than would be expected under an arm's length transaction.

Also, a community charity is prohibited from providing, directly or indirectly, a benefit to the trustee or certain other persons associated with the charity, such as donors or founders of the charity or their relatives, or associates of any of those persons (unless the associate is itself an eligible deductible gift recipient or registered charity). The penalty for a breach is an amount equal to the amount or value of the benefit.

### Section 21—Fees and expenses

This section allows a trustee or corporate director of a community charity to be reasonably reimbursed or remunerated out of the charity's income or capital. It also allows for fair and reasonable remuneration to be paid to an employee of the charity and for an employee to be reimbursed for reasonable expenses incurred on the charity's behalf.

### Section 22—Receipts for donations

This section requires a community charity to issue receipts for gifts received and for the receipt to contain certain details of the charity, the donor and the gift.

### Section 23—Compliance with all relevant laws

This section requires a community charity, and its trustee or corporate director, to comply with all relevant Australian laws, all legally binding directions given by the Commissioner and the requirements of the guidelines. 'All relevant Australian laws' will include any laws that go to a trust's validity or to a corporate director's responsibilities.

### Section 24—Winding up, or ceasing to be, a community charity

This section imposes obligations on a community charity that is wound up or ceases to be a community charity. In these circumstances, all net assets of the charity must be provided to an entity that is a deductible gift recipient, in accordance with the purposes of the charity.

### Section 25—Portability

This section allows a community charity to transfer assets to another community charity in certain circumstances and with the agreement of the Commissioner. The circumstances are that all of the net assets of the transferring charity are transferred to the other community charity; none of those assets have been received by the transferring charity from another community charity in the previous 2 financial years; and the transferring charity has complied with the minimum distribution requirement for the relevant financial year.