Response to the Discussion Paper on improving the integrity of Prescribed Private Funds (PPFs)

Authors: **The authors of this response wish their identity to remain confidential, but their interest in these matters arises because they are Trustees of a recently established PPF and are keen to promote private philanthropy**

Overview

PPFs provide a means for individuals and groups who wish to privately donate funds and still retain an interest in generating income and capital from those funds to benefit worthwhile charitable causes. When you manage a PPF you feel a great sense of pride that you are using your administrative and financial skills as a Trustee to assist worthwhile charities, not just this year but year after year.

The Discussion paper proposes many excellent initiatives to improve the regulation and transparency of PPFs. However in regard to the key issue of the distribution rates we feel that the Government's proposal is too harsh and will discourage Australians from undertaking private philanthropy via the PPF model.

We propose to comment *in seriatim* on the matters raised in the discussion paper:

9. Agreed. Penalties must be applied if the donor misuses funds.
10. Agreed. Legislate for PPFs and give ATO greater regulatory powers.
11. Agreed.
12. Agreed.
13. Agree with the Government's underlying principles to govern PPFs.
14. No comment.

Consultation questions

- What is an appropriate minimum distribution rate? Why?
- Should the Commissioner have the ability to modify the minimum amount according to market conditions (for example, based on average fund earnings)?
- Should a lower distribution rate apply for a period (for example, 1-2 years) to allow newly established PPFs to build their corpus?

We believe an appropriate minimum distribution rate should be much lower than the 15% proposed. The reasons for our view are as follows:

- If the rate of 15% is to apply, PPF funds would be distributed much faster than we believe is appropriate. When we established our Foundation with a target $5M corpus, we had the view that it would run for at least 2 or 3 generations. The maximum time is 80 years but we felt it might run for 50 or 60 years and leave a lasting legacy to charities. With a 15% annual distribution and a relatively conservative investment strategy (5% return), our calculations suggest that the corpus of $5M would be reduced to $1M (approx) after 15 years under a 15% distribution model compared with a $5M corpus in the existing model (See Attachment 1). The calculations we have made assume no inflation and donations in years 1-5 only. It is correct that distributions over the first 15 years are greater with the new model but the breakeven in distributions is 30 years. Thereafter the existing model continues to provide substantial distributions ($250K pa) compared with the new model ($34K pa) which has effectively extinguished its capital reserves.

- When the corpus is reduced to less than $1M with the above 15% distribution strategy, the incentive will be to simply wind up the Foundation as the compliance would not justify the cost. Hence we would see the life of a Foundation under the proposed changes to be approximately 15-20 years. We have the view that the Foundation should run for 40-50 years and even longer if the Trustees are achieving the philanthropic goals.

- <u>We believe the appropriate distribution rate should be 7.5%</u>. We have calculated a breakeven rate of 35 years in the calculations we have attached and the new amended distribution model still has a corpus of $1.8M after 35 years (See Attachment 2). Under this strategy we see a 30 – 50 year life being reasonable for a Foundation similar to ours.

- However should a Foundation receive additional donations once the target corpus has been established, I would be happy to accept that those donations should be distributed at the rate of 100%.

Should the Commissioner have the ability to modify the minimum amount according to market conditions (for example, based on average fund earnings)?

- Yes we believe the Commissioner should be able to modify the minimum amount to be distributed. In the year we have just experienced (2008) most diversified investors have experienced very significant negative investment returns. If the Government was to set an arbitrary distribution percentage it would not encourage good financial management of Foundation funds over time. Trustees should not be forced to sell assets in depressed markets to meet distribution targets. What it will mean that Foundation assets will have to be relatively liquid if a rigid distribution formula as proposed is applied and that would discourage PPFs from investing in growth assets. We believe this is not in the best interest of the PPF's philanthropic goals, good investment practices and the overall long term management of the PPF's corpus.

Should a lower distribution rate apply for a period (for example, 1-2 years) to allow newly established PPFs to build their corpus?

- There is merit in this proposition. We need a simple system and you could consider a situation like the superannuation account based pensions whereby the minimum distribution starts at 4% for say 5 years, 5% for 10 years and thereafter at 7.5%.

21. We agree that PPFs should regularly value their assets at market rates at June 30 and make distributions based on a percentage of that value during the following financial year, similar to a superannuation account based pension.

Consultation question

- Are there any issues that the Government needs to consider in implementing the requirement to ensure PPFs regularly value their assets at market rates?

- The only matter we would see as important is to require PPFs to lodge their financial reports by the end of March at the latest, nine months after the end of the previous financial year.

- *1c Minimum PPF size*

22. Agreed. Suggest $500,000.

Consultation questions

- Is setting a minimum PPF size appropriate?
- What should the minimum PPF size be in dollar terms?
- Should a fund have to distribute all its capital when its total value falls below this minimum amount?

- Yes it is appropriate to set a minimum PPF size. In our view it would be $500,000.
- Yes a fund should distribute all its capital when if falls below $300,000.

1d Increased public accountability

22. We urge caution on this point. The privacy of the PPF needs to be respected while meeting all regulatory requirements.

Consultation questions

- Are there any relevant issues that need to be considered in improving and standardising the public accountability of PPFs?
- Are there any concerns with the proposal to require that the contact details of PPFs be provided to the public? What information should be provided publicly?

- We are in part agreement and part disagreement with the Government's proposals regarding increased public accountability. We have no issues with the requirement to for a PPF to have an ABN or to be recorded on the Australian Business Register as a PPF. However we do not believe the contact details of PPFs should be provided publicly and we do not wish to have representations made to Trustee Directors. While we acknowledge the PPFs receive significant tax concessions, we believe that the PPFs should be accountable to the ATO or any other Government regulator to ensure they are operating in an acceptable and transparent way. PPFs will invite representations from Charities as they see fit and should not be unnecessarily exposed to unsolicited representations.

Principle 2 – PPFs are trusts that: (1) abide by all relevant laws and obligations, and (2) are open, transparent and accountable

2a Give the ATO greater regulatory powers

25. Agreed.

26. Agreed that the ATO have the power to revoke PPF endorsement if the PPF is now longer Charitable or does not meet reporting timelines.

27. Breaches of Guidelines are unacceptable and should be treated seriously.

28. ATO should have discretion as to how it deals with Trustees or PPF who breach guidelines.

29. We agreed that PPF should be required to have a corporate trustee.

30. We do not consider Corporate Trustee a substantial cost imposition in view of the level of funds involved and the years that the PPF might be in existence.

31. We agree with transitional arrangements as PPF are brought under new guidelines.

32. Our Foundation has a corporate trustee.

Consultation questions

- Will two years be a long enough transitional period for existing PPFs to comply fully with the new Guidelines?
- Are there any cost or other concerns relating to the corporate trustee proposal?

- We believe that 2 years is an adequate time to comply with the new Guidelines and we do not see any major cost or other concerns regarding the proposal for a corporate trustee for PPFs.

33. ATO should be provided with necessary power to make enquires as deemed appropriate.

Consultation question

- Are there any privacy concerns that the Government needs to consider?

- We do not see any major privacy concerns under this point.

34. We agree that the ATO should have access to a wide range of penalties to allow it to respond proportionately to misuse of PPFs.

35. We agree with the range of penalties proposed.

Consultation question

- Are there any concerns over particular penalty types?

- No.

2b Introduce fit and proper person test for trustees

36. We believe that PPF trustees should get appropriate advice and it is available through organisations such as the The Myer Family Office and other Charitable Foundations. Not for profit organisations need to improve their knowledge to acceptable standards and it is not good enough to fall back on that old cliché of 'meaning well but lacking in necessary knowledge'.

37. We agree that those trusted with running PPFs should be qualified for the position, and thus proposes considering qualifications for PPF trustees.

38. We disagree that requesting training or other qualification standards may restrict the number of people eligible and/or willing to take on the role of trustee.

39. We agree with a fit and proper test.

Consultation question

- If a fit and proper person test were introduced, what criteria should be imposed on trustees?

We have noted the criteria applied to RSE Licencees and Tax Agents and have adapted those criteria as follows:

- Have had at least 5 years work experience
- be at least 18 years of age;
- be of good fame, integrity and character, with consideration given to: character references and convictions (in particular those relating to fraud, theft or deception);
- not have been convicted of a serious taxation offence during the previous five years; and
- not be under sentence of imprisonment, including being released on parole or good behaviour for a serious taxation offence.

2c Move relevant provisions from Model Trust Deed into the Guidelines

40. We agree the ATO should provide a model deed to assist new PPFs.

41. We are generally happy with the clauses in the Model Trust Deed as proposed.

Consultation questions

- Are there any other provisions presently in the Model Trust Deed that should be covered in the updated Guidelines?
- Are there any provisions not in the Deed that should be in the updated Guidelines?

- We have no further comments to make on the Model Trust Deed.

Principle 3 — PPFs are private

3a Limit the number of PPF donors

43. We strongly agree PPFs should encourage private philanthropy and not involve a public fund.

44. We agree that public donations cannot be the primary source of PPF donations.

45. We agree that if a PPF's circumstances change (for examples, donor numbers exceed the limit), rules provide a mechanism for conversion of a PPF to a PAF.

Consultation questions

33. Would there be any disadvantages if a cap were introduced on the number of donors to a PPF (for example, a maximum of 20 donors over the life of the fund)?

34. Is conversion from PPF to PAF an acceptable mechanism to deal with changing PPF circumstances?

35. What rules could be used to deal with the conversion from a PPF to a PAF?

- We do not see any disadvantages with a cap on the number of donors to a PPF and agree it should be a maximum of 20 over the life of the fund.
- We agree that conversion from a PPF to a PAF is an acceptable mechanism to deal with changing circumstances.

- We do not wish to comment of the rules to be used to convert a PPF to a PAF.

Principle 4 – PPFs are ancillary funds

4a Restrict PPF investment to only liquid assets

47. This issue also relates to the percentage the Government is proposing to impose for annual distributions and whether the Commissioner might vary this percentage in difficult market situations. These two factors determine the level of liquid assets a PPF would need to hold to meet their annual obligations. However we do agree that the PPF should have sufficient liquid assets to meet their philanthropic obligations. However we have seen in the last year that highly regarded (A rated) mortgage funds have had redemptions frozen due to the world wide financial crisis. We would urge the Government not to be prescriptive on liquid assets as it might mean that PPFs would only invest in cash/fixed interest investments which over time have had a lower return than equity type investments.

Consultation question

- Would there be any disadvantages from introducing this limitation to the existing PPF investment rules?

- It is important for the Government to define what it means by liquid assets. We assume assets that can be turned into cash within 28 days. What about term deposits or assets that may have a longer redemption period? Does liquid assets also include shares and managed funds? What about unlisted property funds?
- Provided that the range of liquid assets are similar to that which superannuation funds invest in then it would seem to be reasonable. It is assumed that direct property would not be allowed but there may be good reasons why a PPF would want to hold direct property, assuming it could meet its liquidity obligations.
- We urge the Government to propose more detailed guidelines on this limitation to existing PPF investment rules.

Thank you for the opportunity to comment on this important discussion paper on PPFs.

Attachments (2)

PPF -Comparison of Existing and New Model for Distributions

ITEM	YEAR	Donations	Existing Model			New Model		
			Income @ 5%	Distributions - 100% of Income + 5% Donations	Remaining Corpus	Income @ 5%	15% Distributions	Remaining Corpus
Jun-30	2007	$1,000,000	$0	$0	$1,000,000	$0	$0	$1,000,000
Jun-30	2008	$1,000,000	$61,029	$50,000	$2,011,029	$61,029	$159,154	$1,901,875
Jun-30	2009	$1,000,000	$100,551	$111,029	$3,000,551	$95,094	$449,545	$2,645,548
Jun-30	2010	$1,000,000	$150,028	$150,551	$4,000,028	$132,277	$566,674	$3,211,152
Jun-30	2011	$1,000,000	$200,001	$200,028	$5,000,001	$160,558	$655,756	$3,715,953
Jun-30	2012	$0	$250,000	$250,001	$5,000,000	$185,798	$585,263	$3,316,488
Jun-30	2013	$0	$250,000	$250,000	$5,000,000	$165,824	$522,347	$2,959,966
Jun-30	2014	$0	$250,000	$250,000	$5,000,000	$147,998	$466,195	$2,641,769
Jun-30	2015	$0	$250,000	$250,000	$5,000,000	$132,088	$416,079	$2,357,779
Jun-30	2016	$0	$250,000	$250,000	$5,000,000	$117,889	$371,350	$2,104,318
Jun-30	2017	$0	$250,000	$250,000	$5,000,000	$105,216	$331,430	$1,878,104
Jun-30	2018	$0	$250,000	$250,000	$5,000,000	$93,905	$295,801	$1,676,208
Jun-30	2019	$0	$250,000	$250,000	$5,000,000	$83,810	$264,003	$1,496,015
Jun-30	2020	$0	$250,000	$250,000	$5,000,000	$74,801	$235,622	$1,335,194
Jun-30	2021	$0	$250,000	$250,000	$5,000,000	$66,760	$210,293	$1,191,660
Jun-30	2022	$0	$250,000	$250,000	$5,000,000	$59,583	$187,687	$1,063,557
Jun-30	2023	$0	$250,000	$250,000	$5,000,000	$53,178	$167,510	$949,224
Jun-30	2024	$0	$250,000	$250,000	$5,000,000	$47,461	$149,503	$847,183
Jun-30	2025	$0	$250,000	$250,000	$5,000,000	$42,359	$133,431	$756,111
Jun-30	2026	$0	$250,000	$250,000	$5,000,000	$37,806	$119,087	$674,829
Jun-30	2027	$0	$250,000	$250,000	$5,000,000	$33,741	$106,286	$602,285
Jun-30	2028	$0	$250,000	$250,000	$5,000,000	$30,114	$94,860	$537,539
Jun-30	2029	$0	$250,000	$250,000	$5,000,000	$26,877	$84,662	$479,754
Jun-30	2030	$0	$250,000	$250,000	$5,000,000	$23,988	$75,561	$428,180
Jun-30	2031	$0	$250,000	$250,000	$5,000,000	$21,409	$67,438	$382,151
Jun-30	2032	$0	$250,000	$250,000	$5,000,000	$19,108	$60,189	$341,070
Jun-30	2033	$0	$250,000	$250,000	$5,000,000	$17,053	$53,718	$304,405
Jun-30	2034	$0	$250,000	$250,000	$5,000,000	$15,220	$47,944	$271,681
Jun-30	2035	$0	$250,000	$250,000	$5,000,000	$13,584	$42,790	$242,475
Jun-30	2036	$0	$250,000	$250,000	$5,000,000	$12,124	$38,190	$216,409
Jun-30	2037	$0	$250,000	$250,000	$5,000,000	$10,820	$34,084	$193,145
TOTAL				$7,011,609			$6,992,453	

PPF -Comparison of Existing and New Model for Distributions

ITEM	YEAR	Donations	Existing Model			Amended New Model		
			Income @ 5%	Distributions - 100% of Income + 5% Donations	Remaining Corpus	Income @ 5%	7.5% Distributions	Remaining Corpus
Jun-30	2007	$1,000,000	$0	$0	$1,000,000	$0	$0	$1,000,000
Jun-30	2008	$1,000,000	$61,029	$50,000	$2,011,029	$61,029	$79,577	$1,981,452
Jun-30	2009	$1,000,000	$100,551	$111,029	$3,000,551	$99,073	$231,039	$2,868,033
Jun-30	2010	$1,000,000	$150,028	$150,551	$4,000,028	$143,402	$300,858	$3,710,577
Jun-30	2011	$1,000,000	$200,001	$200,028	$5,000,001	$185,529	$367,208	$4,528,898
Jun-30	2012	$0	$250,000	$250,001	$5,000,000	$226,445	$356,651	$4,398,692
Jun-30	2013	$0	$250,000	$250,000	$5,000,000	$219,935	$346,397	$4,272,230
Jun-30	2014	$0	$250,000	$250,000	$5,000,000	$213,611	$336,438	$4,149,403
Jun-30	2015	$0	$250,000	$250,000	$5,000,000	$207,470	$326,766	$4,030,108
Jun-30	2016	$0	$250,000	$250,000	$5,000,000	$201,505	$317,371	$3,914,242
Jun-30	2017	$0	$250,000	$250,000	$5,000,000	$195,712	$308,247	$3,801,708
Jun-30	2018	$0	$250,000	$250,000	$5,000,000	$190,085	$299,385	$3,692,409
Jun-30	2019	$0	$250,000	$250,000	$5,000,000	$184,620	$290,777	$3,586,252
Jun-30	2020	$0	$250,000	$250,000	$5,000,000	$179,313	$282,417	$3,483,147
Jun-30	2021	$0	$250,000	$250,000	$5,000,000	$174,157	$274,298	$3,383,007
Jun-30	2022	$0	$250,000	$250,000	$5,000,000	$169,150	$266,412	$3,285,745
Jun-30	2023	$0	$250,000	$250,000	$5,000,000	$164,287	$258,752	$3,191,280
Jun-30	2024	$0	$250,000	$250,000	$5,000,000	$159,564	$251,313	$3,099,531
Jun-30	2025	$0	$250,000	$250,000	$5,000,000	$154,977	$244,088	$3,010,419
Jun-30	2026	$0	$250,000	$250,000	$5,000,000	$150,521	$237,071	$2,923,870
Jun-30	2027	$0	$250,000	$250,000	$5,000,000	$146,193	$230,255	$2,839,809
Jun-30	2028	$0	$250,000	$250,000	$5,000,000	$141,990	$223,635	$2,758,164
Jun-30	2029	$0	$250,000	$250,000	$5,000,000	$137,908	$217,205	$2,678,867
Jun-30	2030	$0	$250,000	$250,000	$5,000,000	$133,943	$210,961	$2,601,849
Jun-30	2031	$0	$250,000	$250,000	$5,000,000	$130,092	$204,896	$2,527,046
Jun-30	2032	$0	$250,000	$250,000	$5,000,000	$126,352	$199,005	$2,454,394
Jun-30	2033	$0	$250,000	$250,000	$5,000,000	$122,720	$193,284	$2,383,830
Jun-30	2034	$0	$250,000	$250,000	$5,000,000	$119,191	$187,727	$2,315,295
Jun-30	2035	$0	$250,000	$250,000	$5,000,000	$115,765	$182,329	$2,248,730
Jun-30	2036	$0	$250,000	$250,000	$5,000,000	$112,437	$177,087	$2,184,079
Jun-30	2037	$0	$250,000	$250,000	$5,000,000	$109,204	$171,996	$2,121,287
Jun-30	2038	$0	$250,000	$250,000	$5,000,000	$106,064	$167,051	$2,060,300
Jun-30	2039	$0	$250,000	$250,000	$5,000,000	$103,015	$162,249	$2,001,066
Jun-30	2040	$0	$250,000	$250,000	$5,000,000	$100,053	$157,584	$1,943,536
Jun-30	2041	$0	$250,000	$250,000	$5,000,000	$97,177	$153,053	$1,887,659
Jul-30	2042	$0	$250,000	$250,000	$5,000,000	$94,383	$148,653	$1,833,389
Aug-30	2043	$0	$250,000	$250,000	$5,000,000	$91,669	$144,379	$1,780,679
TOTAL				$8,511,609			$8,506,414	