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Dear Sir

Private Ancillary Fund Guidelines 2009

Thank you for the opportunity to submit our comments in relation to the Exposure Draft Private Ancillary Fund Guidelines 2009 (**PAF Guidelines**), which will improve the integrity and increase the accountability in relation to Private Ancillary Funds (formally called Prescribed Private Funds). We support the PAF Guidelines in principle, but propose that the following aspects be further considered.

In addition, as a general comment, we consider that the PAF Guidelines could be drafted:

- (a) in a simpler and less repetitious fashion (for instance, paragraphs 52 and 52.1 could be combined, paragraphs 29.2 and 50 set out multiple references to obligations already imposed under State and Territory laws); and
- (b) using more precise language (for instance, "not-for-profit status" in paragraph 11, "uncommercial" in paragraph 42),

while still achieving the same minimum standards. Given that the PAF Guidelines set out penalties for failure to comply with the standards, the required conduct should be clearly enunciated for trustees and directors. Complex and vague standards are likely to generate confusion, higher expenses – leaving less funds for distribution – and a focus on technical compliance rather than support for DGRs. Additionally, a higher rate of non-compliance may occur where trustees and directors are unsure of the requirements.

1. Establishing a Private Ancillary Fund

Part 2 paragraph 10 of the PAF Guidelines refers to "paragraph (a) of item 1 in the table in section 30-15" when it appears it should be a reference to "paragraph (a) of item 2 in the table in section 30-15". Similarly, the note to part 2, paragraph 10 refers to "Paragraph (a) of item 1" rather than to "Paragraph (a) of item 2".

Your reference
PAF review

Our reference
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2. The Trustee

Part 2, paragraph 14 of the PAF Guidelines states:

At all times, at least one of the individuals involved in the decision making of the fund must be an individual with a degree of responsibility to the Australian community as a whole. However, that individual cannot be a founder, a major donor to the fund, or an associate of a founder or major donor.

We consider that this requirement is unclear (given that PAFs must generally have a corporate trustee) and requires specific details about the degree of "involvement" required by the "responsible person" when making decisions. Is it required that the responsible person referred to is a director of the trustee company, or is it sufficient that they provide advice in respect of issues, without having a vote?

Additionally, clarification is required with regard to which decisions require the involvement of a "responsible person". In particular, is the responsible person required to be involved with all decisions, or only those specifically relating to the application of the funds of the PAF? If it is required that the responsible person is involved in all decisions, the PAF Guidelines should confirm that a new responsible person can be appointed if the existing responsible person can not be involved in decision making for a period of time (for example, because they are temporarily absent or unexpectedly ill or otherwise incapacitated).

3. Liability of Trustee

We acknowledge that trustees should be held accountable for their actions or lack of action. However, we question whether it is appropriate to prevent a PAF's rules from indemnifying the trustees or employees, officers or agents of the trustee for negligence (part 2, paragraph 18), at least in respect of the responsible person appointed for the purposes of Guideline 14. In many instances trustee directors are likely to be acting in a voluntary capacity. It is likely to be difficult to find volunteers if the potential liabilities associated with the position are too great. If negligence is to be retained, we suggest that only egregious conduct, for instance recklessness, be barred from being indemnifiable.

4. Minimum annual distribution

Part 2, paragraph 19.1 is unclear. Are expenses of the fund paid from the fund's assets or income if they are reimbursed to the PAF? Is there a de minimus threshold for expenses that may be paid from the fund's assets or income without triggering the requirement to distribute at least \$11,000?

In addition, we suggest that there should be a grace period for PAFs to make further distributions to meet the minimum level in situations where the Commissioner subsequently disagrees with the market value of the PAFs assets.

5. Valuation

Under Part 2, paragraph 20 of the PAF Guidelines, the "market value" of a fund's assets (other than land) must be estimated at least annually. We recommend that the PAF Guidelines be amended to clarify what is required in coming to the relevant estimate. In particular, is it sufficient for a trustee to make such an estimate? This is particularly so for non-investment assets held by the PAF. For instance, office equipment. Also, is the trustee obliged to undertake valuation analysis in arriving at the estimate?

6. Financial statements

Part 2, paragraph 26 of the PAF Guidelines appears to require the preparation and presentation to the Commissioner of an "income tax return." It is acknowledged that under section 50-1 of the *Income Tax Assessment Act 1997* the Commissioner can still require an exempt entity to lodge an income tax return; however, in this instance we consider that

it is unduly onerous and unnecessary. We recommend that the PAF Guidelines expressly state that the content of the income tax return will be the same as that for a "simple annual information return" under the Prescribed Private Funds Guidelines, (see paragraph 2.41 of the Explanatory Memorandum).

Additionally, we suggest that further guidance be provided on the accounting standards to be used by PAFs in preparing financial statements. We note that the Senate Standing Committee on Economics' report 'Disclosure Regimes for Charities and Not-For-Profit Organisations', highlighted the difficulties in applying existing accounting standards to not-for-profit organisations. Recommendation 12 of that report suggested that "the Commonwealth Government work with the Sector to implement a standard chart of accounts for use by all departments and Not-For-Profit Organisations as a priority" ..

7. Audit

Paragraph 27 requires that the trustee of a PAF must arrange for an auditor to audit compliance with the PAF Guidelines. We question whether an auditor would generally have the appropriate skills to perform such an audit. We have had experience dealing with auditors performing non-routine audits of charitable trusts and have found that they frequently have difficulty auditing compliance with non-accounting standards. For instance, auditing whether the trustee has ensured that the fund's distributions to DGRs do not put at risk the validity of the trust under State or Territory laws (paragraph 50) would require the interpretation and application of State and Territory trust statutes and case law. In addition, such audits are typically lengthy and expensive.

8. Uncommercial transactions and benefits to founder/donor

We consider the penalty provision contained in Part 2 paragraph 43 of the PAF Guidelines incongruous with the remainder of the provisions. The section does not necessarily remove the benefit from the entity who has been provided with the benefit (at least to the extent that the benefiting entity is not the trustee or a sole director). Accordingly, we recommend that the penalty provision relating to this section be altered so that the value of the benefit is returned to the PAF by the entity benefitting from the inappropriate provision of the benefit (to the extent this is constitutionally possible) before the trustee and directors are obliged to return the value of the benefit, while also subjecting the trustee and directors to a defined penalty as in other sections within the PAF Guidelines.

Further, the reference to "uncommercial" in paragraph 42 is unclear. We assume the PAF Guidelines are intended to apply to transactions of a similar range to those defined as "Uncommercial Transactions" in the model trust deed released by the ATO for prescribed private funds. If so, we suggest that a similar definition is included in the PAF Guidelines. The exclusion from the uncommercial transactions requirement for transactions entered into in the course or furtherance of the PAF's purpose is also confusing. All transactions entered into by a PAF should be in the course or furtherance of the PAF's purpose.

9. Donors

Paragraph 46 states that PAFs must not "solicit donations from the public". This phrase is unclear and we suggest that further guidance be provided on the meaning of "solicit" and "the public".

In addition, there appears to be no penalty set out for failure to comply with the donor requirements of paragraphs 45 to 48. Is this correct?

Please let us know if you would like to discuss any of the issues raised.

Yours faithfully



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