PHILANTHROPY
Australia

22 July 2009

Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

I enclose Philanthropy Australia's response to the Draft - Private Ancillary Guidelines 2009.

Philanthropy Australia is the national peak body for philanthropy and is a not-for-profit membership association. Our mission is to represent, grow and inspire an effective and robust philanthropic sector for the community.

Philanthropy Australia welcomes the new Draft Guidelines for Private Ancillary Funds (PAFs), formerly known as Prescribed Private Funds (PPFs) and is supportive of most of the provisions contained therein.

It is pleasing that Treasury has listened to the recommendation of Philanthropy Australia, its members and the wider philanthropic sector to set a minimum annual distribution rate of 5%. This will ensure the continuing growth of a vibrant and healthy culture of giving and philanthropy. In addition the Guidelines have picked up on and therefore reinforced some of the key concepts in the State Trustee Acts, such as the Prudent Person Principle.

The following comments and requests for clarifications are submitted to ensure that the Guidelines for PAFs are clear, simple and consistent, and easy to comply with. This should lead to an efficient and effective philanthropic structure.

Philanthropy Australia welcomes the opportunity to continue to work closely with the Federal Government and Treasury on this issue.

Yours sincerely,

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PHILANTHROPY *Australia*

Response to the Private Ancillary Fund Draft Guidelines

22 July 2009

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It is pleasing that Treasury has listened to the recommendation of Philanthropy Australia, its members and the wider philanthropic sector to set a minimum annual distribution rate of 5%. This will ensure the continuing growth of a vibrant and healthy culture of giving and philanthropy. In addition the Guidelines have picked up on and therefore reinforced some of the key concepts in the State Trustee Acts, such as the Prudent Person Principle.

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General Comments:

- The model trust deed for current PPFs has worked very well. We suggest that a model trust deed(s) be developed for PAFs that meet the different State requirements.
- The only mention of the requirement that PAFs cannot grant to item 2 DGRs (ie, other ancillary funds) is in a footnote to clause 10. As misunderstanding of this requirement is a major cause of inadvertent noncompliance among PPFs it would be preferable to emphasise this point elsewhere in the Guidelines.
- The use of the phrase “income tax return” is confusing when most PAFs are not subject to income tax and are used to an “information return”. While this is explained in the Explanatory Memorandum to the Tax Laws Amendment (2009 Measures No. 4) Bill 2009, a clarification in the Guidelines would be preferable.
- Philanthropy Australia is very conscious to avoid application of the Guidelines triggering the resettlement of existing PPF trusts and the adverse expense consequences on the PPFs this will entail.
- Part of the rationale of introducing the new legislation and the Guidelines was that previously for PPFs there was an “all or nothing” penalty system. The Guidelines themselves, the tightening of the Audit requirements and move to share appropriate information with State Attorneys General all introduce better balance. However, we would see it as counterproductive to the advancement of the philanthropic sector **if** the introduction of the relatively wide ranging detailed penalty unit system distracted trustee directors from the principles of their fiduciary responsibility and commitment to the community, to focus on a “box ticking” compliance approach. The balance needs to be right.
- Many of the specific comments and suggestions are designed to assist in the clear and efficient audit process.

Specific Comments:

Part 2: Rules for establishing and maintaining private ancillary funds as deductible gift recipients

Clause 8: requires clarification on the phrase "is open, transparent and accountable to the public (through the Commissioner)." Does this mean that the PAF income tax return/information return will go only to the Commissioner, and not be available to the public except in aggregate (as is now the case)? If this is the case, we feel a more accurate phrasing would be "accountable to the Commissioner".

Clause 14: Defining "Major Donor" would be useful (In the Model PPF Deed, the definition is a Donor of more than $10,000)

Clause 17: what is meant by the "governing rules"? Is this a reference to the trust instrument?

Clause 18: remove dot point "negligence of the trustee, employee, officer or agent;" but retain Model PPF Trust Deed wording for dishonesty and deliberate act or omission.

The proposed Guidelines and the Model Trust Deed are essentially the same for dishonesty and deliberate act or omission (dot points one and three). The second dot point on "negligence" is an additional item. We do not believe this is appropriate or consistent with normal liabilities placed on directors. Moreover it is our understanding that to meet the Guidelines all existing PPF Trust Deeds based on the Model Trust Deed will not comply unless the additional clause on "negligence" is inserted, requiring amendment to every Deed. Furthermore, given the sentiment for dishonesty and deliberate act or omission is identical, why not use the exact word from the Model PPF Deed to remove any need for Deed Amendments at all? Deed changes would necessitate additional complications and expense and delay many existing PPFs' transition to the new PAF model. We are also concerned inclusion of this clause will make the position of Responsible Person and/or Independent Director much less attractive, therefore making it more difficult to attract qualified and competent candidates if they can't be indemnified and have a higher liability that they would normally be used to in a commercial environment, particularly when the definition of negligence is so wide.

Clause 19:

1. Does not specify whether the 5% distribution includes expenses or is after expenses. Philanthropy Australia's understanding is that expenses are not part of the 5%, but it would be helpful if this was made absolutely clear.
2. Does not specify whether this is calculated on net assets. In calculating the value of the fund, are annual expenses deductible from the value of the assets before calculating the 5% to be distributed.

Clause 19.1: the wording is complicated. Philanthropy Australia believes a clearer wording to be "The fund must distribute 5 per cent of net assets, subject to a minimum of $11,000".

Add 19.2 The only exception to 19.1 that the Commissioner will accept is where the expenses for managing the fund are not borne by the fund.

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Clause 19.4 through 19.6: it seems to make little sense that the penalty for non-compliance is a payment from the fund to the Commissioner, if the purpose of the fund is to ensure maximum benefit to the community. A more logical penalty would be an additional distribution to be made by the PAF to community organisations to the value of 30 penalty points within six months.

Clause 20: Whose valuation is used? The wording is vague. Philanthropy Australia suggests basing guidance on the ATO's publication on valuing assets for self-managed superannuation fund purposes (http://law.ato.gov.au/pdf/mvc200301.pdf) and inserting the following clauses:

> 20.1: It is not intended that obtaining a market valuation should be onerous or expensive for the trustees.
>
> 20.2: Depending on the situation, a market valuation may be undertaken by either a qualified valuer or a person without formal qualifications which includes the trustees of the fund. In any case, the person who conducts the valuation must base their valuation on reasonably objective and supportable data.
>
> 20.3: Use of a qualified valuer should be considered where the value of the asset represents a significant proportion of the fund's value or where the nature of the asset indicates that the valuation is likely to be complex or difficult.

Clause 23: The use of the phrase “income tax return” is confusing when most PAFs are not subject to income tax. While this is explained in the Explanatory Memorandum to the Tax Laws Amendment (2009 Measures No. 4) Bill 2009, a clarification in the Guidelines would be preferable.

Clauses 24 through 25:

1. There needs to be some clarification on treatment of multi-year grants, given current accounting standards.
   For instance, when a commitment is made to fund a scholarship to attend university for three years, which is included in 5% distribution?
   (a) the annual fee payment in each of the three years; or
   (b) the total cost of the three year commitment in year 1?
   Philanthropy Australia members’ experience is that the first approach is the most sensible and understandable; however, it is often at odds with the Accounting Standard on accruals which suggests accrual of the three year commitment discounted by expected inflation rate for the period of the commitment. It is also possible in some cases that the circumstances of the grant recipient mean the later year(s) payments are not made although the grant may have been allocated a year or more earlier.
   Clarification of whether distribution rate is based on actual cash payments during the year should be made.

2. Particularly taking philanthropy’s tendency to make multi-year grants, some clarification around how long records must be kept would be appreciated. Does section 382-15(1) of the Taxation Administration Act 1953, which specifies that all records must be kept for at least 5 years after the completion of the transactions/acts to which they refer, apply? If that is not the case then 7 years is suggested.

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Clause 26: Add a new clause

26.4 All related party transactions should be disclosed in the financial statements.

Clause 27.2

Amend “in the approved form” to “conforming to Australian audit standards”.

Clauses 32 through 33: The requirement for a distribution plan seems out of place, considering that the 5 per cent minimum distribution rule already ensures efficient distribution to the community, and that PPFs are already limited to granting only to eligible Deductible Gift Recipients. In particular, given that these Guidelines have taken the welcome step of abolishing accumulation plans, why is there a specification that a distribution plan must estimate the quantity of donations expected to the fund? If the issue is the number or identity of donors to the fund, this is dealt with in the annual information return. Philanthropy Australia feels these clauses are unnecessary. (This is not to suggest that Philanthropy Australia does not believe a planned approach to distributions is a central part of the effective operation of each PAF, but we are not sure of the additional benefit of having a requirement that needs to be audited beyond the need to distribute 5% to only Item 1 DGRs which are aspects covered elsewhere in the Guidelines.)

Clause 34: The current PPF Model Trust Deed permits PPFs to borrow money and indeed efficient capital management prompts many to do so for various reasons and varying periods of time (such as when there is a Rights issue). Philanthropy Australia believes this clause is unnecessary and should be deleted.

Clause 37:

1. Should append “except in the course of a normal arms length commercial transaction” to this clause.
2. The definition of who constitutes an “associate” is unclear and should be codified within these guidelines.

Clause 43

Suggest adding the words “except in the course of a normal commercial transaction” in the opening sentence after “indirectly”.

Clause 47: The rationale and the practical considerations behind putting a percentage limit on donations to the fund from entities other than a founder of the fund, associates of the founder or employees of the founder is unclear.

1. Clause 46, prohibiting soliciting of donations, prevents the fund being used as a fundraising vehicle (where a public ancillary fund would be more appropriate).
2. 10% seems an arbitrary number and would prevent an “unassociated” donor from making large donations to an existing fund whose purposes and practices they agreed with, meaning they would have to establish their own fund or give directly to item 1 DGRs. This would prevent desirable situations such as Warren Buffet’s donation to the Gates Foundation where he became a Trustee (rather than establishing a separate fund with its own administration infrastructure), for example, taking place in Australia.
3. The question of who constitutes an associate of the founder is unclear especially where it relates to relatives and family members. Are the fourth and fifth generation of

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descendents still considered as associates of the founder, considering that they may never have met him or her? A clearer suggestion would be to adopt the definition used in various Fundraising Acts by replacing the concept of “associates of the founder” with “those known to the founder/trustee”. Philanthropy Australia feels this clause is unnecessary but if Treasury determines otherwise we would recommend a maximum of 25% as a more reasonable figure.

Part 3: Transitional rules for former Prescribed Private Funds

Clause 54: Clarification is needed around the operation of existing PPFs between 1 July 2009 and 1 October 2009 when the new Guidelines come into effect.

1. Does this mean that a PPF which wants to adopt the 5%distribution rate for the 2009/10 financial year can do so using the fund’s value at end June 2009? We believe this is highly desirable as it will facilitate a swift and easy transition to the new framework.
2. As this legislation is not in effect until 1 October 2009, does this mean that existing PPFs wanting to opt in to the new Guidelines cannot operate under them until 1 October 2009?

Clause 57 through 59: Treasury should be aware that requiring amendments to Trust Deeds may have adverse State duty consequences for many existing PPFs. The PPF Model Trust Deed permits certain provisions to be disregarded if the Commissioner approves, but while a majority of PPFs will have used the Model Trust Deed in their establishment a substantial number have not. For those funds, if their trust deeds have rules inconsistent with the new Guidelines, resettlement may be a requirement and this will have a substantial financial consequence, particularly in regard to State duties.

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