THE SMITH FAMILY

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Manager
Philanthropy and Exemptions Unit
Personal and Retirement Income Division
The Treasury
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Email: ppfreview2008@treasury.gov.au

Dear Sir

Re: Improving the integrity of Prescribed Private Funds

Thank you for the opportunity for The Smith Family and others in the not-for-profit sector to respond to the Discussion Paper *Improving the integrity of Prescribed Private Funds*. The Smith Family's comments are made in the context of the not-for-profit sector and do not seek to address technical issues regrading the construction of Prescribed Private Funds (PPFs).

Background

As an independent non-profit social enterprise, The Smith Family works in 95 communities nationally to achieve its mission of unlocking opportunities for financially disadvantaged Australian families, allowing them to participate more fully in society.

Our facilitation of this participation is supported by the engagement of individuals and groups within the community with the capacity to give time, talent and dollars. As a result, the spectrum of The Smith Family's stakeholders is very broad, connecting the people we help to individual sponsors, donors, corporates, government and academia.

The organisation is heavily dependent on the sustainability of financial contributions from the private sector. Sector data from *Australian Giving Post-Tsunami: Australian Charities Financial Analysis 2004* (Givewell Research Centre, May 2005) indicates the following non-profit sector income sources (excluding hospitals, which of course rely heavily on fee for service income):

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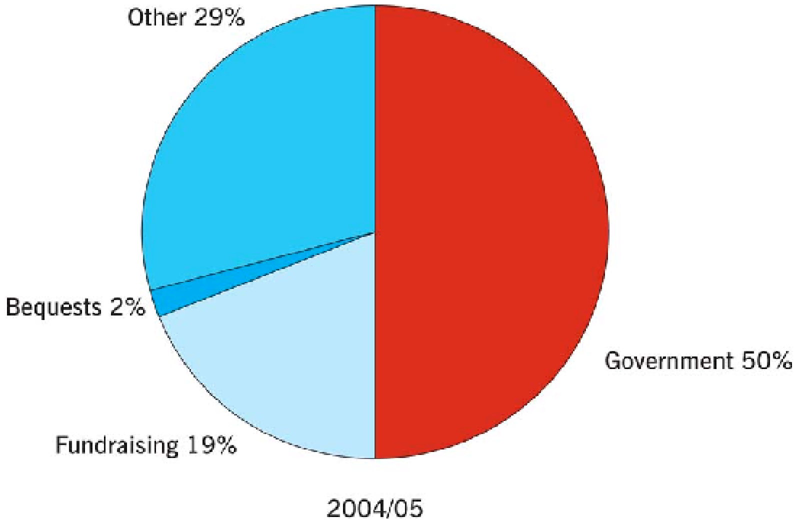

The Smith Family is atypical in this regard, with only 3.5% of its income provided by Government in 2007-08, and more than 75% derived from fundraising activities.

Our vision of creating a more caring and cohesive society is premised upon the family as the central supporting entity for achieving sustainable change at a community level. Drawing on evidence pointing to the importance of family relationships and the home environment in the healthy development of children, The Smith Family has adopted a dual-generational approach, recognising that while education is the key to breaking the cycle of disadvantage, any investment that is made in children must be complemented by providing support to parents to act as role models and create a home environment which is conducive to learning.

This focus on individuals and families is supported by our work in building sustainable, broader and more responsive support systems for families at a community level, reforming traditional ‘silo’ service delivery into an holistic, accessible and integrated system.

Our ‘whole of community’ approach has led The Smith Family to collocate itself in the schools where the students are studying. Embedding our support in this way strengthens the relationship between families and schools, which in turn builds the social capital and broader cohesion of the community, leading to a greater degree of sustainability.

RESPONDING TO THE DISCUSSION PAPER

The Smith Family supports in principle the development and implementation of arrangements designed to ensure that PPFs meet their objectives in a transparent manner, particularly given that the investors in these funds have enjoyed significant public financial support through the tax deductibility of their private contributions.

At the same time we recognise the contribution made by PPFs in providing sustainable long-term funding to the non-profit sector, and would not endorse changes which would provide disincentives to the establishment of new PPFs or lead to the demise of the present funds. The proposed 15% distribution rate would almost certainly lead to both of these undesirable outcomes.

The primary purpose of the Government in establishing the PPF vehicle was to promote and encourage philanthropy, and there was a clear expectation that many of the funds would continue in perpetuity. There is an argument that, while the tax benefits flowing from the establishment of PPFs encourage this type of philanthropy, the outcome actually reduces the overall level of funds reaching their targets in the short term because the corpus of donated funds for which the tax concessions have been granted typically will not be distributed to Deductible Gift Recipients except through distributions based largely on investment income over many years. To the extent that this outcome is correct, it runs counter to arguments that funds spent now have a greater multiplier effect in terms of societal benefit than funds spent later.

In any changes to legislation and guidelines it will be important therefore that a balance is achieved between the competing interests which continue to encourage both contributions to PPFs and an appropriate level of distributions from them.

The Smith Family makes comments on the specific consultation questions in the Discussion Paper as follows:

<u>Principle 1 - PPFs are Philanthropic</u>

- ***What is an appropriate distribution rate?***
- ***Should the commissioner be able to modify the rate according to market conditions***
- ***Should a lower distribution rate apply for period (for example 1-2 years) to allow PPFs to build their corpus?***

The Government's intention in 2001 was that PPFs would be able to be terminating or ongoing trusts. The new proposals say that "PPFs should neither be prolonged accumulators of funds, nor sparse distributors of funds", and this clearly accommodates the original intention. The suggested distribution rate of 15% will effectively result in PPFs being wound down over a period of 10 to 15 years depending on investment performance and fund size and is a very different approach from the CPI/capital maintenance model in the current guidelines.

In allowing for capital maintenance the current guidelines make the assumption that earnings and movements in asset values will together be positive, and therefore make no provision for the impact of negative returns which may result in there being no distributions in particular years.

An alternative approach could be to require the distribution of a minimum meaningful dollar amount, or distributions equivalent to, say, 5% of the value of the assets as measured at the end of the financial year, or to the value of earnings including unrealised gains and/or losses less a provision for capital maintenance, whichever is the greater, in order to prevent undue accumulation or sparse distribution of funds.

This type of approach would ensure a minimum level of distribution without the need for the Commissioner to modify the rate according to market conditions, and would provide certainty to trustees in planning to meet financial obligations.

We see no particular reason to vary the current requirement for the distribution of 5% of assets each year while fund is building its target capital to ensure that the philanthropic purpose is being met. This should be retained.

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

Regular valuation of assets to market is implicit in the current guidelines which deal with the treatment of realised and unrealised capital gains, and specific processes for valuing assets would generally be prescribed by accounting standards. Where the requirements of other legislation apply, then this should be referenced in the proposed PPF legislation rather than the specific requirements being incorporated in it.

Some investments are harder to value than others and also likely to be more costly to value. Consideration of the costs and benefits of annual revaluations of certain asset classes may be appropriate where the matter is not addressed by accounting standards or other legislation.

The impact of both gains and losses should be taken into account in considering how the required distributions should be determined.

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

It is appropriate for a minimum fund size to be set as a means of ensuring that the costs of operating the fund remain within acceptable limits compared to the funds available for distribution. Setting the minimum distribution amount as suggested above would determine the minimum fund size by equating that amount to the alternative "5% of assets" approach – for example, a minimum distribution of $50,000 implies a minimum fund size of $1 million, $100,000 equates to $2 million, and so on.

If the impact of low to negative returns and the minimum annual distribution over time caused the value of the fund's capital to fall and remain below the minimum size then there would be a point where it would be appropriate for the fund to be would up. Alternative approaches would be to develop mechanisms for affected PPFs to be amalgamated or to rebuild their capital base through additional donations.

- ***Are there any relevant issues which 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?***

It would be helpful to the non-profit sector for a register of funds to be readily accessible. Such a register should incorporate contact details and a summary of the purpose and/or grant allocation process. This approach would benefit both the funds and the non-profit sector by helping to filter out time consuming but inappropriate grant applications.

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

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

It is important that trustees have a comprehensive understanding of their obligations as trustees, ranging from the content of the trust deed to making investments, asset valuations, accounting requirements, together with a thorough understanding of relevant legislation and guidelines.

Principle 3 - PPFs are private

- ***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)?***

On the basis that this is a limit on **donors** and not **donations** the placing of a limit is a satisfactory way to maintain two essential characteristics of PPFs, that they be established by businesses, families and individuals and that their primary sources of income are those businesses, families or individuals.

PPFs are established with a target capital base which may take some time to achieve. It would be problematic to limit the number of **donations** in this development stage as this would serve to define the level of donation which would be required from those donors, leading to situations where donations might have to be declined because they were too small to allow the target to be reached with the limited number of donors allowed.

Placing a cap on the number of **donations** to a PPF will also limit the ability of PPFs to replenish their capital if they make distributions either voluntarily (for example to support a particular organisation or program in a larger than normal way) or as a result of meeting minimum distribution requirements which exceed earnings less capital maintenance in any given year.

If particular funds are intended to be perpetual then opportunities to receive donations are likely to continue over time, perhaps over generations in the case of family-established PPFs. Limiting the number of **donors** over time would in such cases be a limiting factor in the success of the funds unless a provision is made in the guidelines to permit the cap on donor numbers to be raised.

Principle 4 – PPFs are ancillary funds

- ***Would there be any disadvantages from introducing a requirement only to invest in liquid assets to the existing PPF investment rules?***

This will depend to some extent on the model which is reflected in the legislation – ie whether funds will effectively wind down over time or continue as perpetual funds. If the former is the case then maintaining assets in relatively liquid forms will be desirable because of the relatively short time horizon, while a fund which expects to continue in perpetuity may benefit from investing in one or more illiquid assets such as buildings to allow it to give full effect to its objectives (an example is where a PPF wanted to provide subsidised accommodation to one or more DGRs in its own premises rather than by subsidising commercial rents).

We would be happy to discuss aspects of this submission with you, or to provide additional information, should this be required.

Yours faithfully

Ben Watkinson
Company Secretary