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

Dear Sir,

Re: Discussion Paper “Improving the integrity of Prescribed Private Funds (PPFs)”

The following is our submission on the above Discussion Paper, and comprises three sections:

- 1. Our own PPF - why it was established and how it operates
- 2. Comments on the specific points raised in the Paper
- 3. Conclusions and Recommendations

We are concerned that the unspoken policy underpinning the Discussion Paper is the elimination of Prescribed Private Funds.

1. Our Prescribed Private Fund: the Tom Davis Foundation

a) Our family established the Tom Davis Foundation early in 2007, in memory of our eldest son, who died some years previously. We had put considerable thought into how we could best preserve Tom’s memory and do so in a manner which contributed to society, particularly areas of social disadvantage. We chose to use a PPF for several reasons:

- A PPF provided a stand-alone vehicle for a commitment which is clearly-focussed, irrevocable and long-term, unable to be reversed if family or economic circumstances change. It enabled us to establish something which would continue to contribute to society and involve future family generations in doing so, whilst continuing to honour Tom’s memory.

- The control provided by a PPF means we can ensure that the distributions are used in the most effective and efficient manner possible. It enables us to direct distributions to the charitable organisations which have demonstrated their ability to be both effective in achieving progress towards their stated aims and able to do so in a cost-efficient manner, thereby maximising the benefit created from every dollar we are able to distribute. Direct engagement with recipient organisations over time creates the opportunity for us to understand their aims, benchmarks and outcomes and direct our support to where it can achieve the best results.

- A PPF is cost efficient (our PPF accounting and audit fees plus ASIC fees for the trustee company totalled $1406 for 06-07 and will only be a little higher for 07-08, about 0.4%). This efficiency, combined with the fact that all earnings from the fund must be distributed meant that the cumulative benefit flowing from even a relatively modest Fund would be very substantial.

- The ongoing nature of a PPF provided the opportunity for us to create a family culture and expectation of contributing to society and engaging with areas of social disadvantage, continuing through future generations. Achieving this would enable us to honour our son’s memory in a sustainable and meaningful way, potentially beneficial to many people.

b) The Tom Davis Foundation is now well-established and making distributions to charities. The Board comprises myself and my wife, our two surviving (adult) children, and a friend who has devoted his life to working with the socially-disadvantaged and is ideally qualified to advise on our distributions.

   Our first commitment has been for a 3 year/$40,000 grant to fund programs for aboriginal mothers and children under five, aiming to break the intergenerational cycle of family disfunction and welfare dependence. The organisation involved has an excellent record of working with families and young children using very experienced and qualified staff and a low-cost operating structure. We have been encouraged by the example of other PPFs which have established on-going close relationships with charities, pledging relatively long-term funding for specific projects, subject to periodic reviews of progress.

Our children have taken an active role in our Foundation, especially the selection of and contact with the recipients, fostering a real engagement with their activities. We are looking forward to our grand-daughter reaching an age where she can be similarly involved.

c) Our family is not at all wealthy nor our income assured, and it took some years to build up to a situation where we were able to fund a PPF. The income tax benefit from contributing to the Fund was quite limited, with much of it effectively being at the 15% rate, not at the 45% marginal rate assumed in page 5 of the Discussion Paper. Furthermore, a significant proportion of the taxable income against which this was allocated was created from the capital gain on assets which were only sold in order to provide the funding for the PPF, and hence of no benefit to us.

The Tom Davis Foundation could be considered quite small, with our contributions in 06-07 and 07-08 totalling $500,000 (the "corpus" of the fund). Our short-to-medium term aim has been to increase these donations, hopefully to $700-800,000, although the recent difficult economic environment has made this task harder for us. Perhaps more importantly though, our long-term aim has always been that upon my and my wife's demise we will be able to arrange for significantly more funding to flow to the Foundation.

d) The clear and unavoidable outcome and intent of the proposed new regulations is that, once the establishment and contribution phase has been completed, Prescribed Private Funds should quickly distribute both earnings and capital and be closed down. Smaller funds, possibly including ours, would not be allowed at all.

If these proposals were to be adopted then all the reasons outlined above for establishing a PPF would no longer exist. Our aim for a long term family philanthropic project would be impossible to achieve. We will have donated $500,000 to a structure which transparently adhered to the Government guidelines encouraging philanthropy, only to have the resultant Fund rendered inoperable.

Our plans for the Fund are now in limbo. Perhaps we were naïve in believing that making such a gift was so undeniably in the public interest that it would not be at risk from the whims of Government.

There is justification for the principle that, taxpayers having irrevocably donated substantial funding to set up a charitable fund using the model promoted by the Government, there exists a moral obligation for subsequent governments not to remove the original incentive of sustainable long-term philanthropy. At worst any changes should apply only to new PPFs.

2. Comments on specific points raised in the discussion paper "Improving the integrity of Prescribed Private Funds"

   "Principle 1, PPFs are philanthropic."

- 1a: Required Distributions

  The primary question underlying this subject is not asked:

  Should PPFs be wound down or should they be encouraged to fulfil their philanthropic purpose?

  Points 16 to 20 address the intent to move from the current requirement for PPF's to distribute all nett earnings to charities, in the year in which they are earned, to one where distributions must be much higher and include a proportion of the Fund's capital. The acknowledged outcome and intent of this is that once the initial establishment stage and financial contributions are completed, the PPF's capital base will be progressively reduced and compulsory closure will follow.

  As justification, it is asserted that "...the Government effectively provides a subsidy of 45 cents for every dollar donated to a PPF...". This is both incorrect and irrelevant to what is the most efficient and effective way to use these funds.

  It is not good policy to close down PPF's such as ours, which have been established specifically to generate sustainable earnings for distribution to charities on an ongoing basis.

  Donors to PPFs would not necessarily donate to charities on the same scale without access to their PPF and its long-term attributes. Put another way, PPFs have resulted in a nett increase in the amounts donated from these individuals and should be preserved.

The proposed policy would not only clearly indicate that establishing a Fund to provide sustainable ongoing contributions to charities is undesirable, but would also make it impossible to do so. The practice would cease, and funds such as ours would be closed. This cannot be a good policy outcome.

In response to the “Consultation questions”:

- The appropriate distribution rate can only be the earnings from the fund, as is now the case, allowing the real value of the capital base to be maintained.

- The Commissioner should not have any ability to modify the minimum distribution rate.

- Arrangements for early-stage distributions should remain as they are.

- 1b: Regular valuation of assets:

  - Earnings, not market valuation, should be the primary basis for making distributions.

  - To the extent that valuation is relevant to the supervision of a fund, the periodic “boom and bust” nature of markets dictates that caution is necessary in acting on apparent “market valuations”. An averaging approach is necessary, rather than making irreversible changes based on a single year’s valuation.

- 1c: Minimum PPF size

  The fact that it would be “...inappropriate for a large proportion of a PPF’s capital to be eroded through operating expenses” is given as justifying limiting PPFs to a minimum size, perhaps of $500,000. Based on our direct experience of the extremely low cost of running a PPF (in our case 0.4%), a fund would need to be extremely small (under $50,000?) for this to occur.

  The suggested alternative of making donations directly to charities would not meet any of the criteria we have outlined for choosing to fund a PPF.

Donors and trustees should be given some credit for their ability to avoid capital erosion due to excess costs, a fundamental skill required for survival in business and life in general.

- A minimum size is not appropriate or required.

- 1d: Increased public accountability

  - Requiring contact details to be made public would for most PPFs simply result in a sharp increase in administration time and costs required to respond to large numbers of requests for funds, including from people who are not DGRs.

    It would be far more useful to (1) establish a register for those PPFs which would like their details made public and (2) establish a similar register for those charities (DGRs) which are seeking funds - this latter move would assist both the potential recipients and PPFs.

"Principle 2: PPFs are trusts etc."

- 2a: Give the ATO greater regulatory powers.

  - Any such proposal should be limited to the regulation required to ensure compliance. It would need to be considered by a working party including representatives outside the ATO who have detailed involvement with PPFs and be followed by public consultation.

- 2b: Introduce fit and proper person test for trustees

  A "fit and proper" probity test is different to a qualifications test. The Discussion Paper recognizes in point 38 that requiring professional qualifications would limit the effectiveness and uptake of PPFs.

  One of the attributes essential to many PPFs is the involvement of a range of family members as Trustees. This needs to be maintained or it will create a disincentive to forming PPFs.

  - Any fit and proper person test should be directed to probity (e.g. solvency, good character) not professional qualifications.

"Principle 3: PPF's are private"

- 3a: Limit the number of donors

  One aim of our PPF is to involve current and future generations of our family in Fund's management and distribution of funds. The opportunity to contribute to the fund should be part of this, and we do not wish there to be any more impediments to doing so. A cap on the number of donors would, in time, become a barrier.

  - The relevant criteria should be "closeness", not number.

"Principle 4: PPFs are ancillary funds."

- 4a: Restrict PPF investment to liquid funds

  - There is nothing in the ancillary nature of the PPF that dictates the character of the underlying capital asset. For instance a PPF is as effective whether its capital is in real estate or in cash. The key issue is to maintain a secure capital base generating income for distribution, in the manner intended and already required.

    PPFs should not be restricted to investing in liquid funds.

3. Conclusion

   - Prescribed Private Funds were established by the then Government to encourage private philanthropy (as stated in Principle 3), an area where Australia has lagged well behind other wealthy countries. The primary impact of the proposed changes would be to constrain and make more difficult the operations of PPFs and severely limit the life of a PPF. It would eliminate the reasons many PPFs have been created and would clearly reduce the rate of new PPF creation.

     Importantly, it would also create the precedent of substantial regulatory changes to the operations and sustainability of already-established PPFs, meaning that potential donors would have no way of knowing what may occur in the future.

   - To go ahead with these proposals would be disastrous for the encouragement of private philanthropy, and they should be rejected.

In the present economic climate DGRs are already complaining of the fall in donations. The Government must try to reverse this trend, and certainly not exacerbate it.

- Unfortunately however, damage has already been done by the existence of the Discussion Paper itself and the appearance of Government interfering in a functioning policy. The Government must give sufficient assurance for existing donors to continue contributions, and for new donors to establish their own PPFs.

- In this context there is justification for the Government to adopt the principle that, taxpayers having irrevocably donated substantial funding to set up charitable funds using the model promoted by the Government, there exists a moral obligation for subsequent governments not to remove the original incentive of sustainable, long-term philanthropy. At worst any changes should apply only to new PPFs.

From our viewpoint, the emergence of these proposals has been profoundly destabilizing to the family's plans, but a timely reality-check nevertheless. Our previous confidence that our long-term family philanthropy project would be inherently safe from destructive government policies was obviously naïve. Whether sufficient confidence can be restored to justify any further donations is difficult to say.

Yours faithfully,

Paul Davis