# Submission to Treasury in relation to PPFs

Submission to Treasury in response to Exposure Drafts of
PRIVATE ANCILLARY FUNDS GUIDELINES 2009
TAX LAWS AMENDMENT (PRESCRIBED PRIVATE FUNDS) BILL 2009

**Eureka Benevolent Foundation**

**20 July 2009**

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## INTRODUCTORY COMMENTS

This submission is made by Eureka Benevolent Foundation Limited (EBFL) (ACN 122 698 766) as trustee for Eureka Benevolent Foundation (EBF[1]) (ABN 11 470 885 302), in response to the consultative draft of the guidelines for Private Ancillary Funds (formerly known as PPFs), released on June 25, the Exposure Draft for the TAX LAWS AMENDMENT (PRESCRIBED PRIVATE FUNDS) BILL 2009 and the Explanatory Memorandum for that bill.

EBF is a PPF[2] established in 2006.

EBF is heartened that the government and Treasury have listened to submissions from the PPF/philanthropic sector. We believe that the guidelines and legislation will support the growth of PPFs and philanthropy for the benefit of Australian civil society. EBF is supportive of most of the changes proposed in the Draft Guidelines for Private Ancillary Funds, Exposure Draft, but is concerned about several substantive matters that we believe need to be addressed before the proposed implementation of the new supervisory regime on 1 October 2009.

## GENERAL COMMENTS

EBF appreciates this opportunity for further consultation and input to the final form of the Guidelines and legislation.

The draft Guidelines are mostly a sensible codification of best practice private philanthropy. While no fundamental issues remain unresolved, some significant issues still need to be addressed and clarification is required in some areas.

The single most important issue affecting founders and trustees of PPFs is the required distribution rate. While EBF supports the proposed distribution rate of 5% of the assets of the fund at the end of the previous year, we believe that it should be enshrined in the legislation rather than in the Guidelines. Although the Guidelines will be a legislative instrument, they are more readily amended than the legislation. Since the issue is so important to founders and trustees[3], and for the future of philanthropy in Austrlia, and because there should be no need to vary the distribution rate in future other than in exceptional circumstances, it should be enshrined in legislation.

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1 References here to EBF can be construed as a reference to EBFL where the context requires it.

2 The terms PPF and PAF (Private Ancillary Fund) are generally used interchangeably in this paper except where the context requires a specific reference.

3 References here to trustees should be construed as a reference to directors of a corporate trustee except where the context requires otherwise.

There is some lingering concern in the philanthropic sector that Treasury is not convinced that private philanthropy should receive support through tax concessions. This concern arose partly because of the initial Treasury proposal in late November 2008 for a 15% required distribution rate, which would have caused most PPFs to distribute substantially all of their funds within 10 years. The sector was also concerned about moves to regulate PPFs (in some cases duplicating existing state and Federal regulation) to improve integrity when there was no publicly available evidence that there had been any significant or widespread integrity problems with PPFs.

Under these circumstances we believe that enshrining the proposed 5% distribution rate in the legislation would provide a robust platform for PPF trustees to focus on supporting those organisations designated by government as worthy recipients through the relevant DGR status. Further, given that the distribution rate should only need to be varied in exceptional circumstances and should form the basis of long-term distribution and investment planning by trustees, we see no persuasive reason why the distribution rate should not be enshrined in legislation.

We believe the Model Trust Deed should form part of the Guidelines, either by reference or by direct incorporation.

EBF has not commented on every issue arising from the draft legislation and Guidelines. Rather, we note and support support the recommendations contained in the submission by Philanthropy Australia dated 16 July 2009[4] and the submission by Myer Family Office dated 20 July 2009, and encourages adoption of all of the recommendations contained in those submissions.

## COMMENTS ON TAX LAWS AMENDMENT (2009 MEASURES NO. 4) BILL 2009

EBF supports most provisions of the Bill.

**426-120, paragraphs (1) to (8) (see also Explanatory Memorandum 2.46 to 2.50)**

While EBF understands that the intent of these provisions of the bill is to improve governance, the actual result is likely to be the reverse. *The combination of strict liability, and joint and several liability for directors with penalties imposed under the Crimes Act will be to diminish the ability for PPFs to recruit high-quality candidates as*

[4] There are some differences in approach between EBF, Philanthropy Australia and MFO, for example in relation to trustees' liability, where EBF believes that its recommendations augment those of PA and MFO.

*"responsible person" directors of trustee companies.* This in turn will diminish the quality of oversight and governance for PPFs.

EBF suggests that:

a PPF may from time to time nominate in writing to the ATO one or more directors who will be prima facie liable for any breaches and administrative penalties (the defences of subsection 426-120(5) should remain available to those directors)

if one or more directors are nominated, all other directors not nominated should remain liable, but without carrying the onus of proof; and

if no directors are nominated, all directors will remain liable as proposed under subsection 426-120(5).

This suggestion will focus responsibility on "insider" directors who are most likely to commit offences, and thereby diminish their likelihood of offending, while at the same time not discouraging high-quality persons from acting as "responsible person" (independent and external) directors.

**426-125 to 426-165, Suspension of a Trustee**

EBF believes that the bill reflects a heavy-handed approach that should be simplified. The proposed "suspension" of a trustee is actually (temporary) removal, and there is a significant risk of unintended consequences under state trust and stamp duty laws. Further, a replacement trustee and its directors are very likely to be reluctant to act without an indemnity (which is prohibited under para 18 of the draft Guidelines).

EBF suggests that it may be better to give the Commissioner powers to:

freeze trust assets;

require a trustee to deal with them according to the Commissioner's instructions;

require a trustee to appoint the Commissioner or a nominee of the Commissioner as attorney of the trustee and/or

disqualify one or more directors of the trustee and/or require appointment of new or additional directors approved by the Commissioner;

because:

the Commissioner will have the power to remove a trustee if necessary;

a trustee should have adequate opportunity for appeal before removal; and

the Commissioner should only remove a trustee as a final step.

## COMMENTS ON THE PRIVATE ANCILLARY FUNDS GUIDELINES 2009

**The Guidelines are actually rules, not guidelines**

The Guidelines will have the force of law and should therefore be renamed in plain English as "Rules". The description "Guidelines" suggests that compliance with the rules may not always be mandatory, whereas the rules actually prescribe required behaviour by trustees. We note that Part 2 of the draft Guidelines is actually entitled "***Rules*** for establishing and maintaining private ancillary funds as deductible gift recipients".

**The proposed name change to Private Ancillary Fund is likely to create confusion**

The proposed name change from Prescribed Private Fund (PPF) to Private Ancillary Fund (PAF) replaces one complex name with another, and risks creating additional confusion because:

the use of "ancillary" in this context is obscure[5]; and

since the acronym PAF already applies to Public Ancillary Funds, the new proposed name will lead to two similar types of entities being described by the same acronym, or to unwieldy or complex language to describe the two types of entities differently.

*EBF suggests that these funds be named **Private Philanthropic Funds**, because this name provides a plain English description of what the funds are, eliminates confusion with existing PAFs and retains the now well-recognised PPF acronym.*

**Gifts to a PPF (para 9), clarification needed**

Can a gift to a PPF be made from a Testamentary Discretionary Trust created under a will?

Is an estate of an "associate" an "associate" for the purposes of paragraph 47?

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5 Although it is true that these funds are "ancillary" to the charitable sector, the description is unlikely to be readily understood by persons outside the sector and Treasury.

**Changes to governing rules (para 17), clarification needed**

What are the "governing rules" referred to in para 17? Is this intended as a reference to the provisions of the fund's trust deed?

Under what circumstances will changes require the fund to seek re-endorsement as a DGR? Will there be a right of appeal to the Commissioner's decision?

**Indemnities (para 18)**

The Guidelines should specifically allow indemnities, other than for the matters set out in paragraph 18. The trustees of PPFs serve for public, not private, benefit and usually without remuneration. Unnecessary exposure to liability will discourage high-quality individuals from taking on trustee responsibilities. This in turn will diminish the quality of governance of PPFs.

Similarly, the guidelines should specifically allow for Directors and Officers insurance to be taken out by PPF trustees, and for the premium to be paid out of the fund. We note that it is not possible to obtain insurance cover against the matters prescribed in paragraph 18, so there should be no objection to insurance.

**Distributions (para 19)**

EBF supports the proposed rules set out in paragraph 19, and thanks the Government and Treasury for their review of the distribution proposals. We note and support the comments of both Philanthropy Australia and Myer Family Office in connection with distribution requirements.

**Audit report (para 27.2)**

Auditors are required to comply with audit standards which frequently conflict with third-party requirements such as an "approved form" required by government. Paragraph 27.2 should require an audit report conforming to Australian audit standards.

**Benefits to associates (para 43)**

The Guidelines should directly address employment of associates (e.g. family of founders, trustees etc). EBF suggests that:

employment of associates should be permitted, but with the onus of proof on the trustee to demonstrate that the terms of employment are at arm's length; and

all related party transactions should be required to be disclosed in the fund's annual accounts as this will minimise temptation for non-arm's length related party transactions, and will provide a basis for the auditor to confirm compliance.

**Fees and expenses (para 44)**

Directors' fees should be confirmed to be allowable as reasonable expenses, provided that the amount paid and other terms are reasonable in the circumstances. This will facilitate appointment of disinterested independent parties as "responsible person" directors, and so facilitate good governance. The Government may consider disallowing payment of directors fees to associates, however.

Further information or clarification on any aspect of this submission can be obtained from

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