

# Improving the integrity of public ancillary funds

## McCullough Robertson submission

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Our submission is in response to the request for feedback to the consultation paper 'Improving the Integrity of Public Ancillary Funds' (**consultation paper**).

### **1 Our involvement**

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- 1.1 In preparing the submission, McCullough Robertson draws on its experience:
- (a) providing legal and tax structure, corporate governance and concessional tax compliance advice to organisations that are considering establishing a philanthropic fund; and
  - (b) providing ongoing governance and compliance advice to organisations operating public ancillary funds.

### **2 Comments in response to consultation paper**

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- 2.1 We have the following general comments in response to the issues raised in the consultation paper.
- 2.2 (**Paragraph 3**) The appropriateness of mandating standards for the operation of public ancillary funds should be considered.
- 2.3 In our view, mandating a distribution percentage may contribute to a culture of compliance, rather than encouraging the public ancillary funds to develop strategies and distribution policies, having given consideration to the particular fund's objects and benefits intended to flow to the community.
- 2.4 (**Paragraph 4**) We note the comment that there should be a higher level of community accountability for public ancillary funds. As there is no higher level of concession available to a public ancillary fund than any other public fund, we cannot see a rationale for a higher level of community accountability than other philanthropic funds entitled to receive tax deductible gifts.
- 2.5 We agree there is a requirement for transparency in the community. We suggest the requirement for the participation by a majority of responsible persons in the administration and management of the fund addresses this issue.
- 2.6 (**Paragraph 9**) We note the expectation that penalties will be introduced. While we are not aware of the circumstances of non-compliance, we expect the majority of circumstances arise from inadvertent error rather than misapplication of funds. On this basis, we would support a program of education and accreditation for individuals involved in the management and administration of funds where non-compliance has occurred.
- 2.7 (**Paragraph 26**) We note the comment that public ancillary funds should neither be 'prolonged accumulators' or 'sparse distributors' of funds. As outlined above, in our view, the appropriateness of distributions requires consideration of a range of circumstances

- 2.8 In our view, a 'one size fits all' approach to distribution may be problematic. We suggest public ancillary funds be provided with guidance on establishing distribution policies and strategies. It may also be appropriate for these policies to be reported to the ATO periodically.
- 2.9 **(Paragraph 32)** We do not agree that a 'distribution rate' is an appropriate criteria by which to characterise a fund as philanthropic. For the reasons outlined above, in our view, this is subjective having regard to the circumstances of the fund.
- 2.10 Again, for the reasons stated above, we query the basis upon which a higher level of accountability should apply to public ancillary funds.
- 2.11 **(Paragraph 37)** We agree the Australian Business Register should detail endorsement of a fund as a public ancillary fund.
- 2.12 **(Paragraph 39)** We have concerns with a requirement for a return to be prepared and lodged by public ancillary funds giving consideration to:
- (a) increased reporting and compliance costs;
  - (b) the transparency currently provided by the participation of responsible persons.
- 2.13 In our experience, public ancillary funds often have a corporate trustee and are registered to undertake charitable fundraising in various states. Accordingly, in some circumstances, public ancillary are already complying with the reporting requirements of three or four regulatory frameworks.
- 2.14 **(Paragraph 40)** The Productivity Commission Report recommended a higher standard of reporting, not an increased level of reporting. We recommend any change to reporting requirements be approached in consultation with the review of the duplication of reporting under the charitable collections regulatory framework and the reporting required by the Corporations Act.
- 2.15 **(Paragraph 44)** The ATO currently requires participation by majority of responsible persons in the administration of a public ancillary fund. In our view, this provides accountability to the community without the need for increased reporting, preparation of returns and associated administrative costs.
- 2.16 **(Paragraph 45)** We note paragraph 9 of Taxation Ruling 95/27 currently requires either:
- (a) an undertaking from the public ancillary fund; or
  - (b) the fund's constituent document to confirm,
- that the ATO will be notified of any changes to the constituent documents of a public ancillary fund.
- 2.17 **(Paragraph 52)** We agree that where there is an intentional misapplication of funds, the ATO should be able to pursue the trustee for reimbursement and that the trustee should be personally liable for those funds.
- 2.18 **(Paragraph 55)** We agree that the requirement for appointment of a corporate trustee ensures a standard of conduct in directors. On this basis, we query the need for further regulation other than in circumstances of misapplication of funds.

- 2.19 **(Paragraph 73)** Again, we do not agree a policy of quick distribution should be encouraged. The appropriateness of distribution by a public ancillary fund should be weighted against the particular:
- (a) requirements of the community to be served by the public ancillary fund; and
  - (b) the sustainability of benefits distributed by the fund.

### **3 Consultation questions**

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#### **Minimum distribution rate**

- 3.1 For the reasons outlined in Part 2 of this submission, we do not agree that a minimum distribution rate for public ancillary funds is appropriate. In our experience, public ancillary funds are established under a charitable trust to enable the fund to access concessional tax endorsement. Accordingly, the trustees are under an obligation to ensure that the trust is pursuing its objects to the extent that it can appropriately be characterised as charitable.
- 3.2 If a minimum distribution rate is to be mandated, we cannot see a rationale for this being higher than the rate imposed on private ancillary funds.
- 3.3 In our view, there should be a focus on guidance in assisting public ancillary funds to establish sophisticated distribution policies and investment strategies having regard to their particular objects and the communities to benefit.

#### **Valuation**

- 3.4 In our experience, the requirement for valuation is less significant in the context of public ancillary funds as assets are often held as cash, shares and other liquid assets.
- 3.5 If valuation requirements are imposed on public ancillary funds, we can not see a rationale for the requirements to be more onerous than those imposed on private ancillary funds.
- 3.6 Where a public ancillary fund holds non-current assets, such as a building rented at below market rates, we believe these non-cash benefits provide a more sustainable benefit to the community and should be encouraged.
- 3.7 We would also suggest consideration should also be given to:
- (a) the administrative burden and cost involved in imposing a requirement for regular valuation on public ancillary funds; and
  - (b) ensuring that reporting on the outcome of valuations does not result in further duplication of reporting.

#### **Appropriateness of private ancillary fund valuation rules**

- 3.8 We do not agree that the same level of regulation is required for public ancillary funds having regard to the participation by responsible persons in management and administration of the fund.
- 3.9 If the valuation rules are introduced for public ancillary funds, we can not see a rationale for these being more onerous than the rules imposed on private ancillary funds.

### **Requirement to lodge a return**

- 3.10 For the reasons stated in Part 2 of this submission, we do not agree that any higher level of reporting is appropriate for public ancillary funds.
- 3.11 If reporting to the ATO is required, we suggest this is introduced in consultation with other regulatory frameworks within which public ancillary funds operate to ensure, to the extent possible, a 'report once, use often' approach is facilitated, as was recommended in the Productivity Commission's Report on the nonprofit sector released earlier this year.

### **Public disclosure and confidentiality**

- 3.12 For the reasons stated in Part 2 of this submission, we do not agree that any higher level of disclosure is required for public ancillary funds.
- 3.13 The imposition of further public disclosure on public ancillary funds should be considered in light of the administrative burden this will impose, having regard to existing reporting obligations.
- 3.14 In our view individual donor information should, in all circumstances, remain confidential.

### **Administrative penalty regime**

- 3.15 We expect, given the requirement for a majority of responsible persons participating in the administration of public ancillary funds, the majority of incidences of misapplication of funds would be inadvertent. We suggest that, where inadvertent misapplication occurs, trustees or directors of trustee companies are required to complete educative programs to reduce the risk of future occurrences.
- 3.16 If the administrative penalties are to be introduced in the regulations of public ancillary funds, we can not see a rationale for the magnitude of those penalties being more onerous than those imposed on private ancillary funds.

### **Requirement for a corporate trustee**

- 3.17 While we expect requiring the appointment of a corporate trustee may create transitional issues for some public ancillary funds, we agree with this approach. In our experience, the majority of public ancillary funds we have assisted to establish have elected to use a corporate trustee.
- 3.18 We agree the requirement for a corporate trustee will simplify regulatory and administrative matters in connection with misapplication of funds.

### **Appropriateness of suspension and removal of trustees**

- 3.19 We can not see why the rules applying to private ancillary funds are not suitable for public ancillary funds. We can not see a rationale for there being a more onerous requirement for public ancillary funds.

### **'Fit and proper' person test**

- 3.20 A 'fit and proper' person test may include more subjective considerations than those prescribed by Taxation Ruling 95/27. We note the examples annexed to the consultation draft include considerations of, for example, an individual's fame and character. In our view, these matters do not necessarily ensure an individual will be appropriately qualified to provide the 'public' participation or apply the requisite integrity and principled approach sought by the participation of the public in the administration of the fund.

- 3.21 In our view, requiring the participation of persons admitted to a professional membership which has a professional code of ethics and rules of conduct (i.e. Law Society, Institute of Chartered Accountants, Medical Registration Board) is preferred. On this basis, persons qualified to be 'Responsible Persons' will:
- (a) have previously satisfied criteria for appropriateness for admission to their particular professional membership; and
  - (b) be familiar with the ethical considerations connected with their position in managing the fund.

**Codifying the 'public fund' principles of Taxation Ruling 95/27**

- 3.22 We agree that rules around establishment and administration of a public ancillary fund should be generally in accordance with Taxation Ruling 95/27.

**Applying the PAF investment and risk minimisation rules to public ancillary funds**

- 3.23 For the reasons stated in Part 2 of this submission, we do not agree that the same level of supervision and regulation is required of public ancillary funds, giving consideration to the requirement for participation by responsible persons.

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