AMENDMENTS TO PRIVATE ANCILLARY FUND GUIDELINES 2009 AND PUBLIC ANCILLARY FUND GUIDELINES 2011

Submission to Treasury in response to the exposure draft

February 2016

RESEARCH AUSTRALIA
AN ALLIANCE FOR DISCOVERIES IN HEALTH

ABOUT RESEARCH AUSTRALIA

Research Australia is an alliance of 160 members and supporters advocating for health and medical research in Australia. Research Australia's activities are funded by its members, donors and supporters from leading research organisations, academic institutions, philanthropy, community special interest groups, peak industry bodies, biotechnology and pharmaceutical companies, small businesses and corporate Australia. It reflects the views of its diverse membership and represents the interests of the broader community.

Research Australia's mission is to make health and medical research a higher priority for the nation. We have four goals that support this mission:

- A society that is well informed and values the benefits of health and medical research.
- Greater investment in health and medical research from all sources.
- Ensure Australia captures the benefits of health and medical research.
- Promote Australia's global position in health and medical research.

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SUBMISSION TO TREASURY IN RESPONSE TO THE EXPOSURE DRAFT

INTRODUCTION

Research Australia welcomes the opportunity to provide a response to the Treasury's consultation on the Exposure Draft of amendments to the Private Ancillary Fund Guidelines 2009 and the Public Ancillary Fund Guidelines 2011.

Philanthropy is a significant source of funding for Australian health and medical research, and many of Research Australia's members are recipients of distributions from Private Ancillary Funds (PAFs) and Public Ancillary Funds (PuAFs). While accurate data is difficult to obtain, it is estimated that health and medical research is the beneficiary of more than $300 million per annum of charitable donations, and data from JB Were identifies Australian researchers as significant recipients of distributions from Private Ancillary Funds.[1] Consequently, Research Australia's submission is made from the perspective of the recipients of philanthropy rather than the perspective of the trustees of Ancillary Funds.

Research Australia's submission is restricted to the proposed change to the minimum annual distribution requirements for PAFs and PuAFs. Research Australia is of the view that the current minimum annual distribution requirements strike an appropriate balance between the interests of the trustees of Ancillary Funds and the interests of their beneficiaries, and does not support the proposed change to the minimum annual distribution, which has the potential to introduce greater year-by-year variation in the distributions made by Ancillary Funds. This greater variation would reduce the capacity of the majority of Australian health and medical research institutions to undertake research, which is typically a long term activity requiring consistent and stable funding over an extended period. This will, in turn, reduce the national capacity for innovation in a field identified by the Australian Government as one where Australia has a competitive advantage.

[1] JB Were, PAF Report 2014, Table 4
http://www.jbwere.com.au/content/dam/jbwere/documents/JBWere%20PAF%20Report%202014.pdf

Research Australia submits that the existing minimum annual distribution requirements for Ancillary Funds should be retained.

PROPOSED CHANGES TO THE MINIMUM ANNUAL DISTRIBUTION

Research Australia does not support the proposal to change the minimum annual distributions requirements for Ancillary Funds. Research Australia submits that the current minimum distribution requirements should be retained for the reasons outlined below.

Minimum distributions and the investment cycle

The explanatory statement notes that *'The minimum annual distribution rate is being amended to provide greater flexibility in unexpected economic conditions.'* The purpose of more closely aligning the minimum distribution to the investment performance in the previous year appears to be to enable Ancillary Funds to preserve their capital value.

The chief difficulty with this short term approach to preserving capital is that it introduces a greater level of volatility in the amount of funds likely to be distributed from year to year by each Ancillary Fund individually and by Ancillary Funds as a whole. The conduct of health and medical research is a long term activity, requiring sustained effort and expenditure over many years. The not for profit health and medical research sector is dominated by universities and medical research institutes. These organisations already struggle to secure long term stable funding for their activities; funding which enables them to employ researchers, purchase essential equipment and maintain facilities. Linking distributions from Ancillary Funds to economic conditions and investment markets will only make this task harder.

Other charities also require long term sustainable funding, and welfare related charities often face greater demand and reduced donations in times of economic downturn. The minimum annual distribution requirements for Ancillary Funds currently provide a buffer; allowing Ancillary Funds to reduce their distributions in these circumstances will only exacerbate the difficulties these types of charity face.

Minimum distributions and the investment strategy

The existing minimum annual distribution is 5% of net assets for PAFs and 4% for PuAFs. Research Australia submits that this minimum distribution rate is sufficient to enable trustees to maintain the capital of an Ancillary Fund in both nominal and real terms over the medium to long term if it is their desire to do so. Research Australia submits that the return over the investment cycle rather than in any one year is a more appropriate consideration for determining the minimum annual distribution and provides a greater degree of certainty for organisations that rely on philanthropy to fund their activities.

Linking the minimum annual distribution to the Reserve Bank of Australia's cash rate could lead some Ancillary Funds to adopt an unnecessarily conservative investment strategy. At the moment, an Ancillary Fund which is keen to preserve its capital is required to adopt an investment strategy which will provide an annual return net of fees which is in excess of 5% for PAFs and 4% for PuAFs. This target is achievable over the medium to long term with a mix of conservative and growth assets and an investment strategy which appropriately balances risk and return over this timeframe while continuing to make annual distributions.

If the required minimum annual distribution is reduced, the objective of capital distribution can be achieved with a more conservative investment strategy. While such a strategy will reduce volatility and preserve the capital in the short term, over the longer term it will lead to lower rates of return and a reduction in funds available for distribution to charities. It also has the potential to reduce the emphasis on controlling investment costs and other fees associated with operating an Ancillary Fund.

Immediate and deferred benefits

Tax concessions are provided to contributors to Ancillary Funds and to the Ancillary Funds themselves in return for the benefit the community derives from the funding of charities by Ancillary Funds.

Individuals who contribute to an Ancillary Fund receive an immediate benefit in the form of a tax deduction and the Ancillary Funds receive an immediate benefit in the form of an exemption from income tax and other tax concessions. This concession is an immediate expense to the Commonwealth and the community. While the subsequent distribution from the Ancillary Fund provides a benefit to the community, the benefit to the community is deferred, and is only realised when funds are distributed from the Ancillary Fund to a charity. Ideally, the immediate benefit to the individual would be reciprocated by an immediate benefit to the community. However, we do not live in an ideal world and it takes time to make good decisions about how and where funds should be distributed. Allowing distributions from Ancillary Funds to be made over time in an orderly and considered manner allows the benefit to the community to be optimised. Immediacy is traded off against maximising the benefit.

The current minimum annual distribution requirements strike an appropriate balance between immediacy and optimisation of benefit; the contributions to an Ancillary Fund do not have to be distributed in the year in which they are received but at least 4% or 5% of the Ancillary Fund's net assets must be distributed each year.

The proposed changes to the minimum distribution would allow the distribution of funds and the subsequent realisation of benefit to the community to be unreasonably deferred, tilting the balance between the benefit to the individual and the benefit to the community too far in favour of the individual.

CONCLUSION

Research Australia does not support the proposal to change the minimum annual distribution from Ancillary Funds for the reasons outlined above. Doing so places an undue emphasis on preserving the capital of Ancillary Funds in the short term over the longer term benefit to the community of encouraging an orderly and stable distribution of funds to charities.

Research Australia is aware that there are other arguments in addition to those provided in this submission for retaining the existing minimum annual distribution requirements. In particular Research Australia draws the Treasury's attention to the submission made by Philanthropy Australia.

Research Australia appreciates the opportunity to make this submission and would be pleased to provide further information or answer any questions that this submission may have raised.

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