Thomson Playford Cutlers

Sydney Adelaide Melbourne

Level 25, Australia Square Tower
264 George Street
Sydney NSW 2000 Australia

GPO Box 3909
Sydney NSW 2001 Australia

DX 69 Sydney

T: +61 2 8248 5800
F: +61 2 8248 5899

www.thomsonplayfordcutlers.com.au

Our Ref:
Your Ref:

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ppfreview2008@treasury.gov.au

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

Dear Sir

Prescribed Private Funds (PPFs) - Submission

We are a law firm and have helped various clients in setting up PPFs. As legal advisers, we submit the following in reply to your invitation for comments on the Discussion Paper.

Summary

We support the:

1. need to keep integrity measures for PPFs;
2. need to encourage wealthy organisations or families to engage in philanthropy;
3. Australian Taxation Office, without the involvement of Treasury, to be involved in the administration of PPFs.

However, we do not support the proposed 15% distribution rate.

Principle 1a – distribution rates of PPFs

We do not support the proposed 15% distribution rate because this will result in a quick depletion of capital of PPFs. Based on our experience in establishing PPFs, this will discourage setting up of PPFs. Many PPF founders source their capital contributions from one-off profit from the sale of their businesses, or from inheritance proceeds. For this reason, they do not expect to have a stream of large cash inflows to enable them to continue to top up the capital of their PPFs as they are reduced by distributions.

The 15% distribution rate would result in PPFs being short-lived rather than being expected to continue on a long-term basis, or in perpetuity. This will reduce a source of sustainable funding of charitable causes that depend on PPFs for their continued existence.

We support the continuation of the current practice of annually distributing amounts that will allow for maintenance of capital taking into account inflation. However, instead of distributions being based on amounts as at the end of the preceding income year, or the beginning of an income year,

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distributions should be based on amounts determined, say, on a three-year average basis to smooth out distributions particularly in times of market volatility.

Principle 1b – regular valuation of assets

We support the regular valuation of assets. Valuation principles applying to superannuation fund assets should apply to PPFs. This is to avoid persons associated with PPFs, including auditors, having to deal with another and different set of valuation rules.

Principle 1c – minimum PPF size

There should be no mandatory minimum capital for PPFs. However, on economic and efficiency grounds, an indicative minimum amount of $250,000 could be suggested. In conjunction with this, there should be an option to transfer the capital of a PPF to another PPF, eg consolidate with another fund with similar primary objects. This would effectively result in the winding up of inefficient PPFs which could not be consolidated with another PPF.

Principle 1d – contact details

For the purposes of administrative efficiency, we do not support giving public access to contact details of PPFs. This should avoid PPFs being bombarded by requests from DGRs wanting to be considered for funding.

Instead, the Australian Business Register database should have a facility to enable the identification of all item 1 deductible gift recipients (item 1 DGRs). These are organisations that are eligible for consideration as or potential recipients of PPF distributions. There should be a separate listing of item 1 DGRs. Item 1 DGRs should be specifically identified rather than simply being shown generally as DGR endorsed. The utility of the current ABR database depends on being able to identify the name or ABN of an organisation to be searched.

The existence of a separate listing of item 1 DGRs should achieve at least 2 things:

1. it can screen out those that are not eligible as recipients of PPF distributions; and

2. by categorising the lists according to the entities' objects, it should help PPFs in the selection of prospective recipients. PPFs would also be confident that the item 1 DGR recipients sourced from the ABR listing qualify as recipients of a PPF distribution.

Principle 2a – Greater ATO regulatory powers

The ATO should have powers to impose a range of sanctions on PPFs that breach the guidelines. However, the ATO's exercise of its powers should be reviewable under the *Administrative Decisions (Judicial Review)* Act.

There should be guidelines on the range of penalties that may be imposed on breaches to help trustees, responsible persons, auditors and others involved in a PPF to determine the consequences of certain behaviours or actions. Penalties should be commensurate to the degree of culpability and severity of the breach.

In relation to the introduction of new guidelines, PPFs that exist at the time of introduction of the new guidelines should be allowed to continue under the old guidelines only as they impact on capital accumulation. The whole of the new guidelines should apply only to new PPFs. This is fair as the founders of existing PPFs have, or would have, organised their long term financial affairs in accordance with the old guidelines.

We support the proposed two-year transition period.

The use of a corporate trustee should be encouraged given the expected long term life of PPFs. Fee and the other ASIC concessions currently applying to corporations acting only as trustees for superannuation funds should apply to corporate trustees of PPFs.

Regarding privacy concerns, as PPFs are required to be audited by appropriately qualified and registered auditors, identification of breaches should be left in the hands of auditors. In the same manner that there are guidelines for auditors of superannuation funds, the ATO should also issue guidelines for auditors of PPFs. Only in extreme circumstances should the ATO report breaches to relevant state or territory bodies. An example of extreme breaches would be the use of PPF funds for illegal activities (eg funding terrorism associated activities).

Principle 2b – fit and proper person

We do not support the proposed qualification requirements that are based on the Registrable Superannuation Entity regime. Trustees and responsible persons for PPFs should hold qualifications as currently prescribed in the Guidelines. However, in addition, they should be persons who are not disqualified from being trustees, or directors of trustees, as required for self-managed superannuation funds under the *Superannuation Industry (Supervision) Act 1993* as amended from time to time.

Principle 3a – limit the number of PPF donors

The donors to a PPF should be limited to relatives and associates of the founder but should not be limited in number. The meaning of relatives and associates could be as defined under s318 of the *Income Tax Assessment Act 1936* as amended from time to time.

If for policy or public interest reasons, PPFs should continue to be allowed to solicit donations from the public, the limit should be set as a percentage of capital as at a certain date determined from time to time, eg 20%, rather than limiting the number of donors.

We support the availability of a mechanism for converting a PPF to a PAF if the PPF is unable to continue to meet the compliance guidelines for PPFs. Alternatively, a PPF that is unable to continue to meet its compliance obligations should be allowed to transfer its assets to a complying PPF with similar primary objects. This is similar to the rules applying to organisations that are eligible for tax concessions as charities or DGRs.

Principle 4a – investments in liquid assets only

The investment of PPFs should not be limited to only liquid assets. The investments of PPFs should be governed by best investment practices and subject to trustee laws in each state or territory. For example, it should take into account risk and return factors, and diversification. This may mean keeping part of the investment in a form that will allow the PPF to meet it s annual minimum contributions. A part of the investment may be kept in a form consistent with the long term objectives of the PPF.

The investments should also be subject to restrictions similar to those applying to self-managed superannuation funds, for example, not to invest in associated entities.

Yours faithfully
THOMSON PLAYFORD CUTLERS

Millie Telan
Partner
T: +61 2 9020 5724
E: millie.telan@thomsonplayfordcutlers.com.au