

**Submission from Arnold Bloch Leibler**

**Improving the integrity of Prescribed Private Funds (PPFs)**

**13 January 2009**

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Lawyers and Advisers



## A Background

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- A.1 This submission has been prepared by Joey Borensztajn, Shaun Cartoon, Lucy Larkins, Matthew Gayed, Margaret Steel, Emma Rattray and Felicity Day as part of the Arnold Bloch Leibler (“**ABL**”) Public Interest Law practice. It responds to the Discussion Paper released by Treasury in November 2008 entitled “Improving the integrity of Prescribed Private Funds (PPFs)” (“**Paper**”).
- A.2 ABL is a commercial law firm with offices in Melbourne and Sydney. A commitment to serving the public has always been deeply ingrained in ABL’s culture. The firm has a significant pro bono public interest practice and a long standing and genuine interest in giving back to the community. ABL is a long time supporter of Australian philanthropy.
- A.3 In addition, ABL acts for a significant number of high net wealth individuals, many of whom are philanthropists or philanthropically minded. ABL has been involved in establishing and providing ongoing advice and guidance to over 50 PPFs since their introduction to the philanthropic landscape in 2001. In this regard, ABL is uniquely placed to provide comment to Treasury in this critical decision-making process.
- A.4 ABL has not been instructed by any of our clients to prepare this submission, but ABL has felt compelled to respond to the Paper out of a sense of genuine concern for the future of PPFs. Two of our clients have provided us with some comments and concerns regarding the Paper, however, this submission has been predominantly prepared internally by ABL.

## B Introduction

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- B.1 The title of the Paper refers to the Government’s desire to improve the “integrity” of PPFs. According to the Macquarie Dictionary the term “integrity” means “soundness of moral principle and character”. In other words, it means “having loyalty to one’s convictions and values; it is the policy of acting in accordance with one’s values, of expressing, upholding and translating them into practical reality”.<sup>1</sup>
- B.2 Philanthropy is a value, the encouragement of which is facilitated by policies that seek to encourage and inspire Australians to *act* philanthropically. The principal

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<sup>1</sup> Ayn Rand, *The Virtue of Selfishness*, at page 46.

reason for the PPF policy initiative was to encourage philanthropic acts, to translate into practical reality the recognised common good value of giving and enable individuals and corporates to *build* a fund for future philanthropy. In our experience, PPFs play a crucial role in building a culture of philanthropy and delivering benefits for the common good on the ground, where the real work of philanthropy is done.

- B.3 If Parliament enacts the proposed Guidelines in their current form, particularly the proposed changes to minimum required distributions and minimum PPF size, the Government will not be able to improve the integrity of PPFs. If Parliament so enacts, it may no longer be possible for PPFs to build a self-sustaining fund in accordance with the original reasoning behind the seminal PPF philanthropic initiative. As a matter of mathematical certainty, a significant number of the PPFs currently in existence could be extinct within 8 years.<sup>2</sup>
- B.4 Although the Paper highlights a number of issues of concern, it is fundamental that any proposed Guidelines do not:
- (a) impact on the crucial role of PPFs in philanthropy in Australia;
  - (b) punish the overwhelming majority of complying PPFs for the "sins of a few";
  - (c) adversely apply to existing PPFs and thereby prejudice, retrospectively, those PPFs which were established within the then applicable regulatory framework. It would be fundamentally unfair for the reasons outlined in this submission to change the ground rules for existing PPFs. Only PPFs established after the new Guidelines come into effect should be subject to the new requirements.

## 1 Principle 1 - PPFs are philanthropic

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### 1a - Required distributions

#### ***What is an appropriate distribution rate? Why?***

- 1.1 The minimum distribution rate should only apply to new PPFs. Existing PPFs that have obtained Treasury and Australian Taxation Office (“ATO”) approval to accumulate funds on a different basis should not be prejudiced retrospectively by a change in the Guidelines. If a PPF has received ATO and Treasury approval for a permanent accumulation for the whole or part of the amount in the PPF (for example,

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<sup>2</sup> See examples and discussion in Section 1 below.

to fund a perpetual gift or endowment or to buy a building) then it would be grossly unfair to now change the approved accumulation plan.

- 1.2 ABL supports the Government's proposal to set a minimum distribution rate for new PPFs. A minimum distribution rate, if appropriately set, would substantially lower the administrative burden around accumulation plans and targets and would simplify the process of both providing funds to the community and retaining them to grow a PPF's corpus.
- 1.3 In determining an appropriate distribution amount, consideration must be given to finding a figure that ensures that PPF dollars reach the community without relegating the PPF philanthropic initiative to a premature demise.
- 1.4 ABL suggests that a minimum distribution rate of 5% - as used in the USA - is appropriate. However, PPFs should not be compelled to value their assets at 30 June every year, but rather PPFs should distribute an amount equal to 5% of the lesser of:
  - (a) the amounts contributed to the PPF in prior years; or
  - (b) the market value of the assets of the fund at 30 June.

Of course, a minimum distribution rate is simply that, a *minimum*. Many PPFs will continue to fund at a much higher rate.

- 1.5 As the economic modelling in the graphs below shows, a 5% minimum distribution rate will allow for growth in the capital base of a PPF. If a minimum distribution rate of 15% is imposed, most PPFs will have a minimal balance within 10 years and will effectively cease to exist in 20 years.
- 1.6 Provision for growth is fundamental to promoting the culture of private and corporate philanthropy in Australia. An imposed distribution rate that will effectively bring PPFs to an early demise will act as a major disincentive to those intending to establish a PPF.
- 1.7 One of the significant advantages of a PPF over a one-off donation is that it allows for an expanding corpus from which grants can continually be made. A PPF that is allowed to grow will eventually make a far greater contribution in dollar terms over time.
- 1.8 If people are discouraged from establishing PPFs it is possible that they will only donate to charitable institutions in the good years. A PPF, on the other hand,

provides funds year in year out, continuing to support charitable institutions when they need it most. This means that charitable institutions are more likely to receive a consistent source of funding rather than donations that rise and fall with the economic conditions of the day. Further, ABL has observed that PPF donors tend to become more sophisticated in their giving over time. With experience, donations are directed to the charitable institutions that produce the most effective results.

- 1.9 Apart from reducing the funds available to charitable institutions, there may be other regrettable consequences if PPFs are forced into a premature demise. In our experience, it is common that when a founder of a PPF talks to friends and family about the personal satisfaction to be derived from becoming involved and giving back to the community, others are more inclined to follow and establish their own PPFs. The phenomenal growth in PPFs in the short time they have been in existence shows that there has been a real desire, by philanthropically minded individuals and corporates, to give something back to the community provided there is an effective means through which it can be expressed. PPFs with longevity set a positive example to others. Significantly, they also provide a training ground for younger family members so that future generations of Australians can learn and ultimately become involved in philanthropy. We have many examples of this among our clients, where a number of generations sit around the table to discuss grant making and where several members of the family have established PPFs. A PPF is considered by many to provide an excellent opportunity to teach the younger generation how to be strategic and professional with grant making and to show them how important it is to give back to the community.
- 1.10 Many of ABL's clients may not have chosen to establish a PPF if they thought it would have a limited lifespan. Discussions with ABL clients over the years indicate that the capacity to involve a founder's children and grandchildren is an essential motivating factor in creating a PPF. ABL considers it important that the spirit of giving is passed from one generation to the next, encouraging the growth of philanthropy in Australia.
- 1.11 A distribution rate of 15% will ensure that over time, PPFs established with an initial endowment that do not solicit further donations will cease to exist. This is acknowledged in the Paper at paragraph 20, which states:

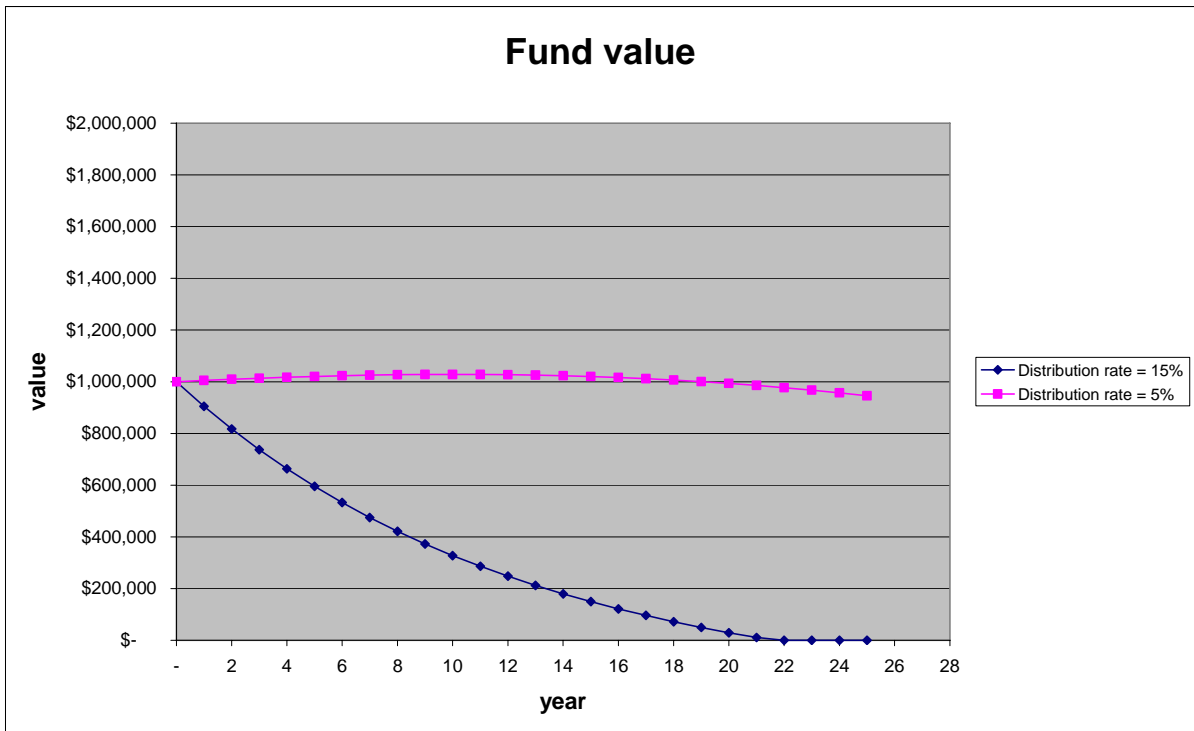
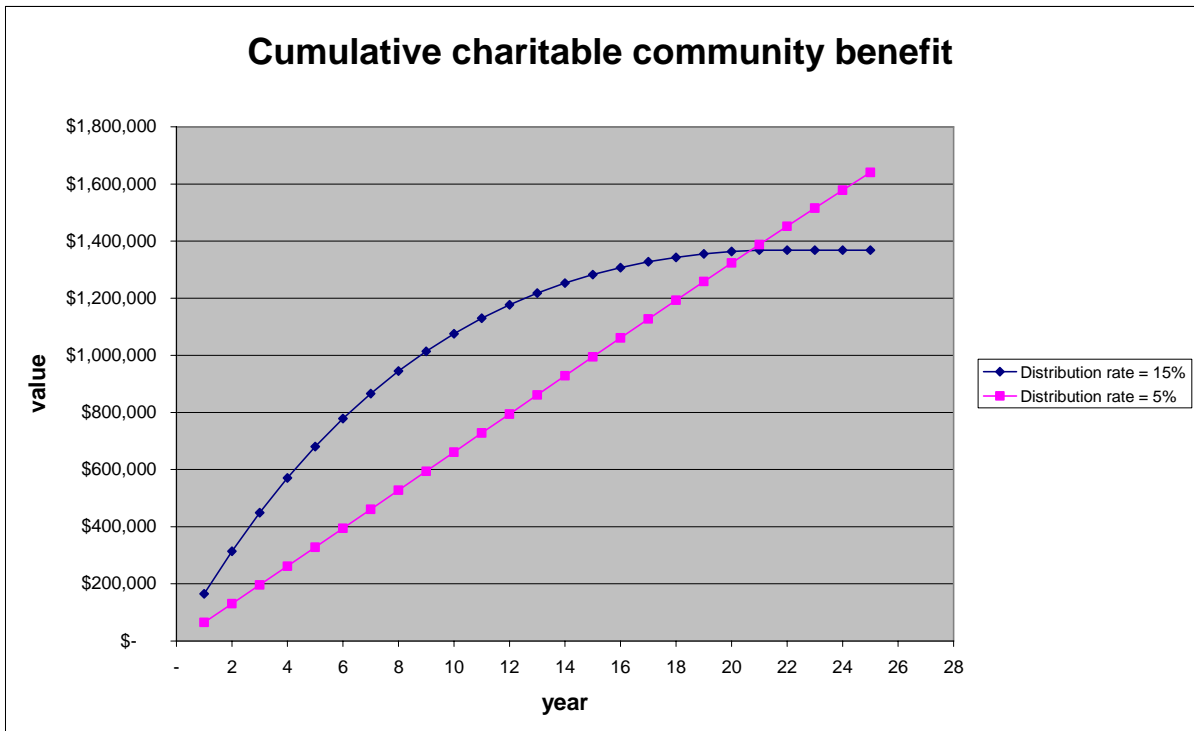
*“Imposing a distribution rate means that PPFs not continuing to receive donations are eventually wound down”.*

- 1.12 One of the stated justifications by the Government is that such a distribution rate will prevent the erosion of a PPF through negative investments, fees and the like. However, the impact of negative investments is not enhanced by providing a minimum distribution rate, particularly the high rate suggested. Irrespective of the distribution rate, negative returns are always possible. In fact, the high distribution rate suggested by the Paper could ensure that, during periods of negative returns, PPFs are unable to survive.
- 1.13 If a distribution rate of 15% is imposed, all PPFs not receiving continuing significant gifts will be forced to close as the funds will be exhausted. It also provides a far lesser benefit over time than if a 5% minimum distribution rate is applied. ABL has constructed a model to illustrate the impact of both a 15% and a 5% minimum distribution rate on fund size and the net benefit provided to the community under each.<sup>3</sup>
- 1.14 The charts below illustrate the benefits provided to the charitable community, and the total PPF size, over time where PPFs are allowed to continue indefinitely.

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<sup>3</sup> The model is based on the following assumptions:

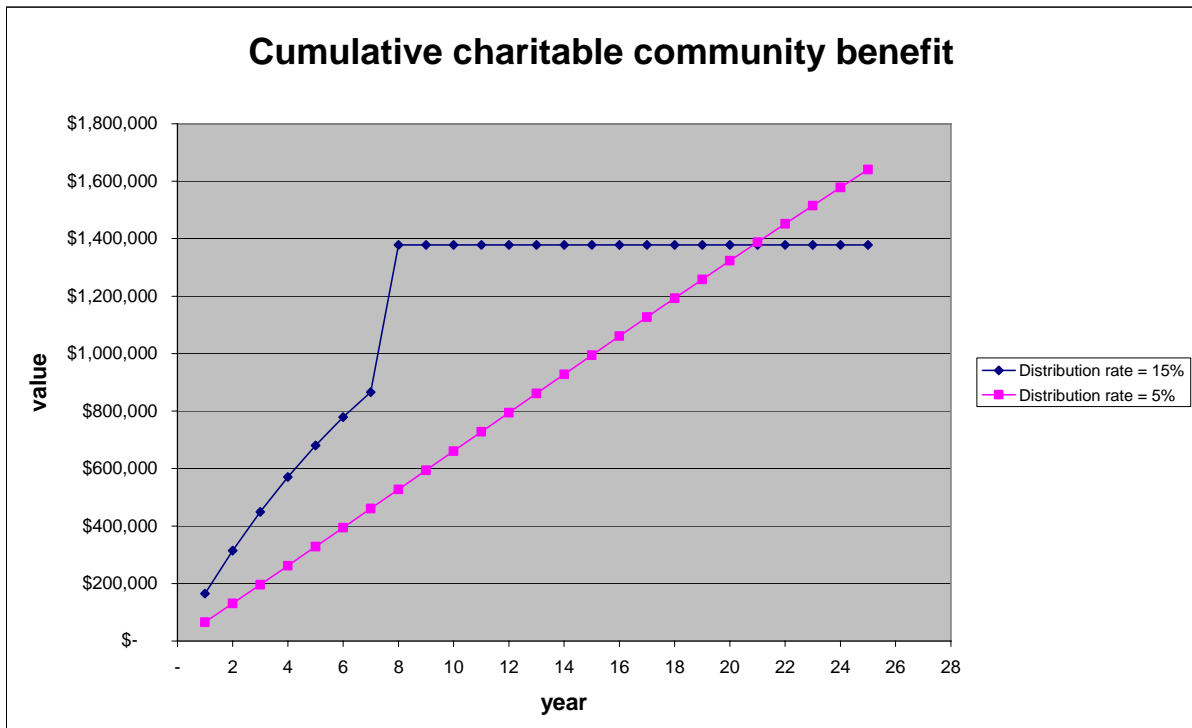
- An initial donation of \$1 million to establish the PPF;
- No further donations over time;
- Annual administrative costs of \$10,000 adjusted for inflation plus 1% of the total fund size;
- A capital rate of return of 5% per annum;
- An income rate of return of 4% per annum;
- An average inflation rate of 2.5% per annum;
- PPF to distribute all income (less an allowance for inflation to maintain corpus size) plus the minimum required capital amount each year.



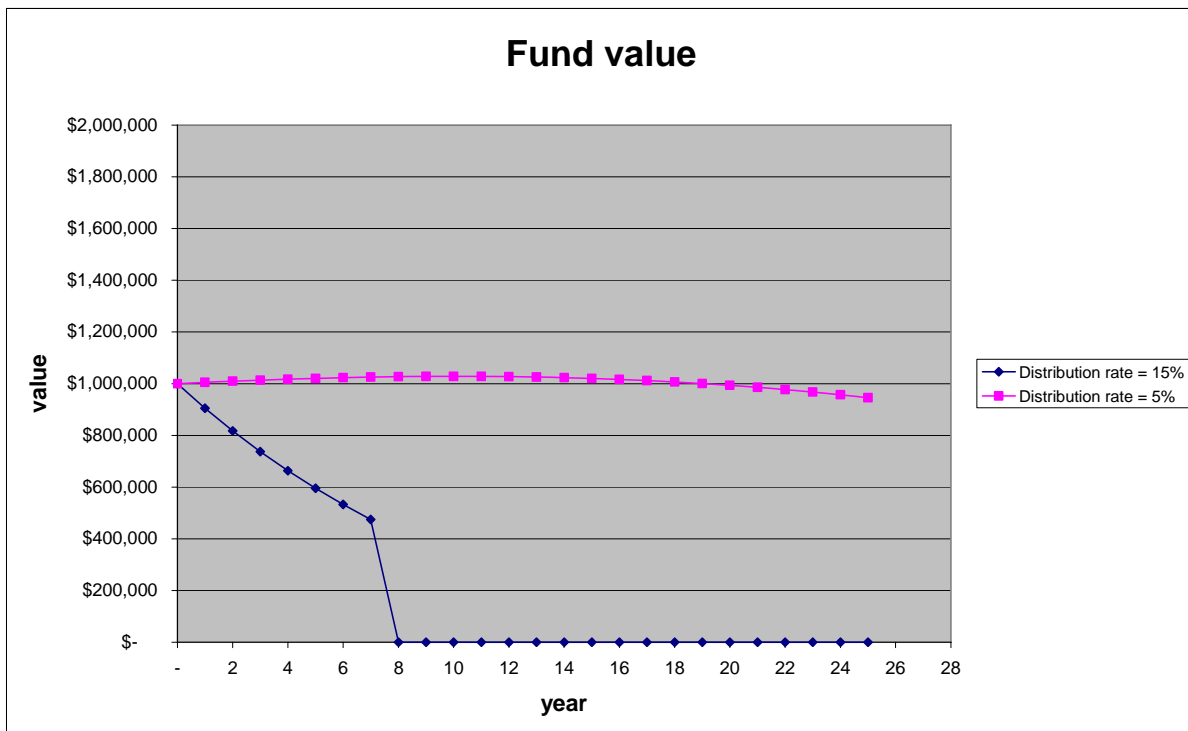
- 1.15 Under this model, a PPF with an initial endowment of \$1 million would provide:
- (a) under a 15% minimum distribution rate: charitable community benefits of \$1,368,009 over a 25 year period, with the fund's assets exhausted. This provides a total benefit \$1.37 per dollar initially invested.

(b) under a 5% minimum distribution rate: charitable community benefits of \$1,640,377 over a 25 year period, with a remaining fund value of \$956,776. A total benefit of \$2,597,153 is provided or available to be provided, thus providing a return of \$2.60 per dollar initially invested.

1.16 The charts below now illustrate the benefits provided to the charitable community, and the total PFF size, over time where PFFs are required to distribute all assets when the fund size falls below \$500,000.







1.17 Where a PPF is required to liquidate all its assets and distribute the funds once the PPF size falls below \$500,000, the following benefits are provided:

- (a) under a 15% minimum distribution rate: charitable community benefits of \$1,378,116 over an 8 year period, with the fund then ceasing to exist, thus providing a return of \$1.38 per dollar initially invested.
- (b) under a 5% minimum distribution rate: charitable community benefits of \$527,450 over an 8 year period, with a remaining fund value of \$1,025,293. A total benefit of \$1,552,743 is provided or available to be provided, thus providing a return of \$1.55 per dollar initially invested. Additionally, after a total of 25 years, as illustrated at 1.15(b) above, a total benefit of \$2,597,153 is provided or available to be provided, providing a return of \$2.60 per dollar initially invested.

1.18 As illustrated, a 5% minimum distribution rate will ensure that the benefit a PPF provides to the community will grow over time. However, a minimum distribution rate of 15% per annum will ensure that PPFs are unable to provide the maximum benefit for each dollar contributed, and will inevitably come to an end.

1.19 When a 15% distribution rate is required, the benefit provided to the community is initially greater, compared to that of a 5% distribution rate. However, over the years, the benefit provided by PPFs with a 5% distribution rate overtakes that of PPFs with

a 15% distribution rate. This enables PPFs to provide a lasting and enduring effect on and benefit to the charitable community.

- 1.20 Additionally, not all PPFs established will seek to distribute at the minimum rate. PPFs are established for a variety of reasons, including as “pass through” vehicles to distribute all donations received in some or all years. As such, a *minimum* distribution rate of 5% would not hinder the immediate provision of charity by the philanthropic community, whereas a 15% distribution rate would ensure that only those PPFs that seek to provide an immediate benefit will be established.

***Should the Commissioner have the ability to modify the minimum amount according to market conditions (for example, based on average fund earnings)?***

- 1.21 ABL does not believe that the Commissioner should have the ability to modify the minimum distribution rate according to market conditions in any given year.
- 1.22 A variable distribution rate will act as a disincentive to donors considering setting up a fund. It is important to provide donors with certainty so that they feel confident that their philanthropic fund will exist into the future and that their philanthropic initiative will have a long-term impact and benefit on the charitable sector.
- 1.23 A fixed minimum distribution rate is essential, as it gives PPFs the freedom and flexibility to adequately plan for the future and provide their intended benefits to the charitable community, while ensuring a satisfactory level of annual distributions during the formation and implementation of such plans.
- 1.24 There is no imperative to change the distribution rate according to economic conditions. In good economic times, the increased value of a fund’s assets will mean that the quantum of gifts made by a PPF will increase. Additionally, the minimum distribution rate set at the outset is simply that - the *minimum* rate. A PPF will always have the ability to distribute greater amounts of its capital during times of economic prosperity to better support the charitable community.
- 1.25 In slower economic times, a minimum distribution rate of 5% may well reduce the worth of the fund, but it is anticipated that such a rate would nevertheless enable the fund to survive a downturn.
- 1.26 **Please note:** If the ability to modify the minimum amount according to market conditions proposal is implemented, then we submit that it should not be applied

retrospectively and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

***Should a lower distribution rate apply for a period (for example 1-2 years) to allow newly established PPFs to build their corpus?***

1.27 A lower initial distribution rate will not be required for newly established PPFs where the minimum rate is set at 5%.

**1b - Regular valuation of assets at market rates**

***Are there any issues that the Government needs to consider in implementing the requirement to ensure PPFs regularly value their assets at market rates?***

1.28 The Government's proposal that PPFs value their assets annually on 30 June, in order to calculate the rate of distribution, is not unreasonable.

However:

- (a) it will add to, rather than reduce, the complexity of administration of PPFs; and
- (b) the method of valuation needs to be carefully considered so as not to impose onerous and expensive valuation requirements on PPFs.

**1c - Minimum PPF size**

***Is setting a minimum PPF size appropriate?***

***What should the minimum PPF size be in dollar terms?***

1.29 ABL recognises that there are start-up costs and long-term administrative costs associated with establishing a PPF.

1.30 If the initial target fund is less than a given amount, these costs ought to be avoided and the donor may be better off making a one-off charitable gift. ABL therefore supports setting a minimum amount for starting a PPF.

1.31 ABL agrees that \$500,000 is a reasonable minimum PPF size, although we have had a number of instances when smaller PPFs have been established and are effective. \$500,000 represents a good entry level that will encourage potential donors to proceed to establish a PPF and subsequently build on it.

1.32 **Please note:** If the minimum PPF size proposal is implemented, then we submit that it should not be applied retrospectively to existing PPFs and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

***Should a fund have to distribute all its capital when its total value falls below the minimum amount?***

1.33 Once a PPF has been established there should be no minimum PPF size. There are a number of factors that could cause a PPF to fall below a certain value. These include market volatility or giving a particularly large amount to the charitable community. Such events would not necessarily have a permanent effect on a PPF. The donor might choose to top up the fund or the market might improve. It would be a pity to lose a PPF because of a temporary event. In addition, setting a minimum PPF size would provide a disincentive for making large capital distributions in a given year.

1.34 If administration costs are taking up a significant amount of the fund's resources it ought to be left to the commercial and common sense of the trustees of the PPF to make a final distribution and close the fund.

1.35 **Please note:** If the distribution of all capital when total value falls below the minimum amount proposal is implemented, then we submit that it should not be applied retrospectively to existing PPFs and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

**1d - Increased public accountability**

***Are there any relevant issues that need to be considered in improving and standardising the public accountability of PPFs?***

***Are there any concerns with the proposal to require that the contact details of PPFs be provided to the public? What information should be provided publicly?***

1.36 ABL agrees that PPFs should be required to have an ABN and that all PPFs should be recorded on the Australian Business Register (“**ABR**”) along with the indication that they are a PPF. It would also greatly assist PPFs if Ancillary Funds were similarly recorded on the ABR, including an indication that they are Ancillary Funds. PPFs encounter a great deal of confusion when trying to establish whether a DGR is one to which the PPF can distribute funds. This has become an administrative

problem for many PPFs that distribute funds to a wide range of DGRs. The amount of time that is spent verifying whether an organisation is an Item 1 DGR and is eligible to receive funds from a PPF is onerous and could easily be avoided by including on the ABR website details of whether an organisation is endorsed as an Item 1 DGR or an Item 2 DGR or otherwise. The ABR website should also include details of whether an organisation is charitable at law, given that some Item 1 DGRs (e.g. public hospitals) are not charitable at law as they are administered by or funded predominantly through a governmental, rather than a charitable, purpose. It is submitted that details of charitable status should also be accurately reflected on the ABR website and PPFs should be entitled to rely on the information on the ABR website.

- 1.37 **ABL does however have serious concerns in relation to the proposed requirement that the contact details of all PPFs have to be made available to the public.**
- 1.38 Many PPFs will encourage grant applications and will make their contact details and funding guidelines available to the public. These PPFs will generally have administrative systems and staff in place to assess grant applications and those that apply are likely to have a real chance of success. It is, however, well accepted that an equally valid model for spending philanthropic dollars is to develop projects in response to community need. Some of the most successful foundations in both Australia and the USA do not operate on a grant submissions model. A PPF with the appropriate expertise can often act far more effectively using a pro-active model rather than simply responding to submissions from institutionalised charities.
- 1.39 If PPFs are forced to provide contact details and receive applications they will be inundated with requests for funding. Most of these submissions will be completely irrelevant to the funding philosophy of the PPF and will have no chance of success. If such submissions are to be taken seriously, it is simply going to increase the administrative costs of PPFs. Many family PPFs are run leanly with limited administration and no staff. The reality is that the great majority of these submissions will not be funded. Meanwhile, the charity concerned has wasted valuable resources in preparing a submission that was doomed to fail. The net result will be increased costs and complexity of administration for both the PPF and the charitable institution with no benefit to either.
- 1.40 There is also another factor of significance. It is not uncommon for people who want to give money to require their gift to be anonymous. Some do not want their wealth

to be known publicly, others simply prefer to avoid the limelight. If by setting up a PPF their wealth becomes apparent or they find themselves in receipt of masses of funding applications, they may well be discouraged from establishing a PPF. Often such anonymous donors are extremely generous and it would be a great pity to lose their contribution simply because they could not preserve their anonymity.

- 1.41 It is important to be clear that this issue has nothing to do with secrecy because the details of all PPFs are available to the Government and the ATO. It is purely an issue of ensuring that the resources of a PPF are used effectively, and in accordance with the founder's wishes, and that the privacy of donors who wish to give anonymously is respected.
- 1.42 We fail to see how the proposal to require that the contact details of PPFs be provided to the public can possibly improve the integrity of PPFs. This proposal seems a counter-productive suggestion.

## **2 Principal 2 — PPFs are trusts that: (1) abide by all relevant laws and obligations, and (2) are open, transparent and accountable**

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### **2a - Give the ATO greater regulatory powers**

***Will two years be a long enough transitional period for existing PPFs to comply fully with the new Guidelines?***

- 2.1 In a number of instances in this submission, ABL has expressed the view that the new Guidelines should not apply retrospectively to existing PPFs and should only apply to PPFs established after the new Guidelines come into effect. Other than in these instances, ABL is satisfied with a two year transitional period.

***Are there any cost or other concerns relating to the corporate trustee proposal?***

- 2.2 Of the 50 PPFs ABL has established since their introduction in 1999, less than 10 have corporate trustees. The Paper states that a sample of 129 existing PPFs revealed that 84% had corporate trustees. This is radically different to our experience where 82% of our clients do not have corporate trustees.
- 2.3 The majority of our clients establishing PPFs have been families. While a few of these families have chosen to administer their PPF with a corporate trustee, for the majority, operating their PPF with a corporate trustee would not only increase the PPF's establishment, operational and compliance costs (which means less money for

DGRs and the charitable community), but it would also represent a fundamental philosophical shift in their rationale for establishing a PPF. A corporate trustee may restrict the ability to involve members of the family in the philanthropy and decision making.

- 2.4 Given that the ATO has the power to regulate individuals, we are uncertain as to why there would be Constitutional limitations on giving the ATO further powers to regulate PPFs that could only be overcome by requiring PPFs to have a corporate trustee.
- 2.5 **Please note:** If the corporate trustee proposal is implemented, then we submit that it should not be applied retrospectively to existing PPFs and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

***Are there any privacy concerns that the Government needs to consider?***

- 2.6 ABL submits that the current provisions in ss 16, 263 and 264 of the *Income Tax Assessment Act 1936* (Cth) (“**Act**”) would not permit the ATO to make inquiries of relevant state and territory bodies and disclose relevant information to state and territory attorney generals in relation to the trust obligations of PPFs. However, we accept that the exceptions encompassed under s 16(4) of the Act are reasonably analogous to the proposed expansion of powers.
- 2.7 Provided the new secrecy disclosure and information gathering provisions are directly related to the trust obligations of PPFs and remain within the spirit of the existing provisions, ABL does not envisage any privacy concerns.

***Are there any concerns over particular penalty types?***

- 2.8 ABL is not aware of any instances of PPFs being abused either to obtain unwarranted tax advantages or to provide private gain to individuals. Certainly, amongst our client base, we are not aware of any examples of the behaviour referred to in the Paper. However, if, as the Paper suggests, there are instances of systematic abuse of PPFs, ABL encourages taking appropriate action to stamp out that behaviour. The taking of such action is consistent with maintaining the integrity of the PPF system. In this regard, ABL has no problem with those parts of the Guidelines that seek to give the ATO greater regulatory powers.
- 2.9 ABL supports greater flexibility in the range of penalties that the ATO can apply to a PPF if its trustees fail to meet the ongoing PPF requirements or engage in

inappropriate behaviour. Sanctions should be proportionate to the breach committed by trustees of PPFs.

- 2.10 We support sanctions for flagrant breaches of the Guidelines.
- 2.11 However, we also note, that while we are aware of PPFs that have committed minor breaches (relating primarily to inadvertent distributions to non-charitable Item 1 DGRs or to Item 2 DGRs), these breaches were unintentional. We suggest therefore, that accessible and central education and information (such as a plain English PPF Handbook) for trustees and advisors of PPFs would assist in reducing these kinds of inadvertent breaches.
- 2.12 The ATO's *Compliance Program 2008-2009* states that "where compliance issues arise, they are mainly due to mistakes or lack of knowledge".<sup>4</sup> The ATO is clear that they "focus on providing non-profit organisations with help and advice so that they can comply with their obligations at minimal cost".<sup>5</sup>

## **2b - Introduce fit and proper person test for trustees**

### ***If a fit and proper person test were introduced, what criteria should be imposed on trustees?***

- 2.13 The majority of ABL's PPF clients have been established by private families, not large corporations. Such families are unlikely to have people readily available to meet a stringent fit and proper person test.
- 2.14 These families regard PPFs as a unifying family bond which they wish to preserve. Frequently, it is intended that younger members of the family will be involved in philanthropy and decision making. Establishing a multi-generational family PPF enables an environment where the philanthropic mind-set of the older generations may be passed on to and encouraged in younger family members, not just now, but for many years to come. A stringent fit and proper person test would necessarily exclude the involvement of younger family members.
- 2.15 The Paper recognises at paragraph 38, "that not all trustees of PPFs are professional trustees, and that imposing training or other qualification standards may restrict the number of people eligible and/or willing to take on the role of the trustee".

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<sup>4</sup> [http://www.ato.gov.au/content/downloads/COR\\_0015516\\_CP0809.pdf](http://www.ato.gov.au/content/downloads/COR_0015516_CP0809.pdf), at page 63

<sup>5</sup> Ibid.



- 2.16 It is submitted that it is undesirable to impose a high threshold requirement of a “fit and proper person” which will not encourage and inspire Australians to act philanthropically, but will in fact restrict or limit the number of family members that can participate in carrying on the PPF activities.
- 2.17 The “fit and proper person” test for a Registrable Superannuation Entity (“**RSE**”) seems to impose two elements to being a fit and proper person:
- (a) being of good character, honesty and integrity among other things; and
  - (b) having the required degree of educational or technical qualifications, knowledge and skills.<sup>6</sup>
- 2.18 It is acceptable to have a high level of criteria imposed regarding the honesty and integrity of individuals. This is something that most people easily satisfy and would not be an impediment to private PPFs wanting family involvement.
- 2.19 In addition, given the essential philanthropic character of a PPF it is desirable that people with good character and integrity are involved. Therefore, a strict test similar to the RES licensees requirements in paragraph 15(b) of the Australian Prudential Regulation Authority’s Superannuation Guidance Note 110.1 in this regard is acceptable.<sup>7</sup>
- 2.20 It is also accepted that some degree of skill and competence is necessary. However, it is too onerous to require a trustee to have experience and expertise at a university or occupational level. This will cause potential difficulties for family-run PPFs with family members who may not yet have attained this level of experience or have chosen an occupational path not deemed “worthy” to be considered relevant knowledge or skills.
- 2.21 It is especially considered too strict to require trustees of a PPF to demonstrate “the appropriate competence in fulfilling occupational, managerial or professional responsibilities previously and/or in the conduct of his or her current duties”.<sup>8</sup>
- 2.22 The existing PPF audit, annual ATO compliance return and Responsible Person obligations ought to be adequate integrity safeguards.

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<sup>6</sup> *Superannuation Industry (Supervision) Regulations 1994*, Regulation 4.14(4).

<sup>7</sup> Australian Prudential Regulation Authority Superannuation Guidance Note SGN 110.1 Fit and Proper, paragraph 15(b) (“**APRA SGN**”). This approach is also similar to the Law Institute of Victoria Admission Requirements for eligibility to apply for a practicing certificate to be admitted to the legal profession.

<sup>8</sup> APRA SGN, paragraph 15(a)(ii).

- 2.23 Increasing the number of trustees who are responsible persons may be an alternative, in a similar manner to an Ancillary Fund. This would not preclude private PPFs from involving family members as trustees, however would still ensure a degree of competence is maintained to preserve the integrity of PPFs.
- 2.24 **Please note:** If the fit and proper person test proposal is implemented, then we submit that it should not be applied retrospectively to existing PPFs and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

## **2c - Move relevant provisions from Model Trust Deed into the Guidelines**

***Are there any other provisions presently in the Model Trust Deed that should be covered in the updated Guidelines?***

***Are there any provisions not in the Deed that should be in the updated Guidelines?***

- 2.25 ABL has no comment.

## **3 Principal 3 - PPFs are private**

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### **3a: Limit the number of PPF donors**

***Would there be any disadvantages if a cap were introduced on the number of donors to a PPF (for example, a maximum of 20 donors over the life of the fund)?***

- 3.1 While the majority of the clients ABL has assisted in establishing PPFs are families, (many of whom would have less than 20 donors to their PPF over the life of the fund), we do not support placing a limit on the number of donors to a PPF.
- 3.2 When PPFs involve multi-generational and extended families, the number of donors, including individuals and family entities, would easily surpass 20, and could potentially even extend to over 100, over the life of the fund.
- 3.3 A similar situation exists in relation to workplace giving programs or for PPFs which support schools, museums or other organisations. A number of the PPFs ABL has established fit into this category and these PPFs would be substantially disadvantaged by placing a cap on the number of donors from which they were permitted to accept gifts. While they may draw from a larger donor base, these PPFs do not have public control, nor is the primary source of their donations from the

public. They do not invite the public to contribute to the PPF. These PPFs therefore retain their “private” nature.

- 3.4 **Please note:** If the proposal to introduce a cap on the number of donors to a PPF is implemented, then we submit that it should not be applied retrospectively and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

***Is conversion from PPF to PAF an acceptable mechanism to deal with changing PPF circumstances?***

- 3.5 While PPFs and Ancillary Funds are similar in some respects, there are also some fundamental differences between the two, and ABL does not support a proposal which would force a PPF to convert to an Ancillary Fund when it takes on characteristics which are deemed “too public”.
- 3.6 One of the fundamental differences between PPFs and Ancillary Funds is that Ancillary Funds are only permitted to accumulate a relatively small amount of funds (generally a maximum of 20%, with 80% of their income being distributed each year). This would mean that a PPF which was forced to convert to an Ancillary Fund would, as with the proposal to mandate a 15% distribution rate, essentially be condemned to a limited lifespan. For multi-generational family PPFs (the very PPFs that would be affected by a donor cap), such an outcome is the antithesis to one of the key rationale for establishing such PPFs: so that older generations can ensure that their philanthropic ideology is encouraged and perpetuated by future generations.
- 3.7 Ancillary Funds must also fundraise annually. They must, as their title suggests, draw a significant amount of their funding from the public. For PPFs established by workplaces, schools or museums, the obligation to fundraise would not only increase their operating costs (again taking money away from potential DGRs) but would also in fact disqualify many of them from being eligible for endorsement as an Ancillary Fund. Simply because the number of donors surpasses a certain level, does not mean that a PPF necessarily takes on the “public” characteristics of an Ancillary Fund.
- 3.8 **Please note:** If the conversion from PPF to PAF proposal is implemented, then we submit that it should not be applied retrospectively and that only PPFs established after the new Guidelines come into effect should be subject to this requirement.

- 3.9 ABL does, however, fully support having conversion mechanisms in place for PPFs that, through change in circumstances or other reasons, find that the Ancillary Fund structure would be better suited to their needs (or vice-versa as the case may be). Such mechanisms would add flexibility for funds and potentially encourage and increase the number of people and organisations wishing to establish a vehicle through which they can channel funds to DGRs.

***What rules could be used to deal with the conversion from a PPF to a PAF?***

- 3.10 As noted above, ABL is opposed to rules which would mandate conversion from a PPF to an Ancillary Fund when the number of donors surpasses a specified level or the PPF takes on other characteristics deemed “too public”.
- 3.11 Any rules or mechanisms implemented to assist the voluntary conversion from a PPF to an Ancillary Fund (or vice-versa) should be easy and cost effective.

## **4 Principle 4 - PPFs are ancillary funds**

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### **4a - Restrict PPF investment to only liquid assets**

***Would there be any disadvantages from introducing this limitation to the existing PPF investment rules?***

- 4.1 The Paper proposes at paragraph 47 that “illiquid assets donated to PPFs should be converted to liquid form as soon as practicable ***if they are likely to affect a PPFs ability to meet its philanthropic obligations***” [our emphasis]. This proposal is merely stating the obvious. One of the trustees’ duties at law is to ensure that there is enough liquidity in the PPF to meet its distribution obligations. This, by necessity, implies that trustees are constantly examining the mix of assets in the PPF to determine not only whether it is a responsible balance for investment purposes, but also whether there is enough liquidity to meet distribution obligations.
- 4.2 Prescribing assets classes, such as the ability to only invest in “liquid assets”, introduces another layer of regulation and complexity for trustees that is unnecessary and may limit the type of otherwise acceptable investments.
- 4.3 There are disadvantages in introducing such a limitation, apart from the fact that it is altogether unnecessary.

- 4.4 By requiring PPFs to only invest in “liquid assets”, a PPF is denied the freedom and flexibility to pursue the investments that will provide a reasonable economic return. PPFs may be forced to invest their funds in more liquid investments, despite not being the most attractive investments on a risk-return basis, purely due to regulatory inflexibility.
- 4.5 Trustees of a PPF are currently obliged, as a matter of law, to consider the benefits of diversified investments; to balance risk of loss; to maintain the real value of capital and to consider liquidity of investments. In addition, the provisions of a PPF Deed prohibit all related-party investments.
- 4.6 ABL believes that the current standards that must be adhered to by trustees are more than adequate to ensure that PPFs are able to meet their minimum distribution requirements while maintaining appropriate short, medium and long-term investments.

## **5 Conclusion**

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- 5.1 In summary, for the reasons articulated in this submission:
- (a) if a minimum required capital distribution rate is considered necessary, it should be limited to 5%;
  - (b) the Commissioner should not have the ability to modify the minimum distribution amount according to market conditions;
  - (c) a PPF should not have to distribute all its capital when its total value falls below a minimum amount;
  - (d) there should be no requirement for the contact details of PPFs to be provided to the public;
  - (e) PPFs should not be compelled to have a corporate trustee;
  - (f) any fit and proper person test should not oblige trustees to have a minimum required degree of education or technical qualification, knowledge and skills;
  - (g) no cap should be introduced that would limit the number of donors to a PPF or the types of assets in which a PPF can invest; and
  - (h) none of the significant proposals, as indicated above, should be applied retrospectively to existing PPFs.

- 5.2 Australia has a great tradition of individuals being actively involved in the community for the common good. From the surf lifesaving clubs on our coast to rural fire brigades in the country and the SES everywhere, Australians volunteer to pitch in and help. The will is clearly there, yet as a country we do not have a strong tradition of philanthropy. The introduction of PPFs, which provide a simple mechanism for private philanthropic funding, has gone a long way towards addressing this issue. PPFs serve as an effective vehicle for Australians to become involved in philanthropy and have made great strides in building a culture of philanthropy in Australia.
- 5.3 Many of the proposals in the Paper would weaken PPFs and discourage donors from establishing PPFs or continuing existing PPFs. Prior to the introduction of PPFs, philanthropy in Australia was in a languid state and Australia lagged behind other comparable countries in the world. The PPF regime has been a monumental step forward in encouraging Australians to make significant charitable donations. It is imperative that any change to the Guidelines proceeds with the utmost care so as not to destroy the future of PPFs.

**Arnold Bloch Leibler**

13 January 2009