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Dear Sir or Madam

Prescribed Private Funds (PPF) Submission

We are solicitors in private practice with one of us being a a director of two separate companies that are trustees of two Prescribed Private Funds.

Fundamental Issue

The main plank of the proposals is to change the role of PPFs in charitable giving to one of a short-term vehicle unless the person/s who establishes the fund is able/prepared to continue to top up the capital of the fund.

If adopted the proposals will lead to a reduction in the amount of funds now and in the future that are available for charitable purposes.

PPFs were introduced to promote private philanthropy. The proposals undermine that as a policy objective. The paper suggests government and thereby Australia would be better off if the government distributed the funds that are otherwise made available to assist with the establishment of PPFs through tax deductions. Such a proposition does not take sufficient account of the remaining portion of funds placed into PPFs ignores the inefficiencies that would thereby be created and would likely result in an inefficient allocation of capital.

PPFs have been eligible to receive deductible gifts since the year ending 30 June 2001. There are now over 600 PPFs established in Australia. Through to 2006 it would appear the volume of funds donated to PPFs exceeded the expectations of Government.

According to the paper *Did tax incentives play a part in increased giving?*[1] the introduction of PPFs increased the total charitable giving by Australians; and, importantly, there has not been a reallocation of funds away from other forms of giving by movement to the PPF environment.

It was also suggested the real benefits of PPFs will only be fully realised once the existing PPF base reaches the capital bases of the various funds, and creates a ***perpetual stream of distributions to deductible gift recipients***[2].

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[1] Myles McGregor-Lowndes paper (2006) 41(4) Australian Journal of Social Issues.

[2] op cit at 507.

If this is accepted the current regulation of PPFs is to be preferred insofar as the proposed changes relate to replacing an accumulation plan with a mandatory percentage distribution of income and capital each year. If the proposals are adopted they will negate the effectiveness of PPFs to provide a ***perpetual stream of distributions to deductible gift recipients***

The proposed requirement to cause a fund to distribute its capital yearly as opposed to allowing maintenance of the capital base of the fund with the income stream flowing to DGR entities annually will cause existing funds to wind up sooner than they would if the existing arrangements remained.

Secondly the not insignificant start up and ongoing costs in managing a PPF would likely discourage the establishment of PPFs in the future; as those costs would be in effect thrown away as they would need to be amortised over a shorter lifespan.

The adoption of the proposed requirements would result in a short term accelerated funds flow to DGR entities followed by what is likely to be a funding vacuum. That vacuum would need to be filled from government sources or the charitable works currently undertaken would fail.

The paper does not provide any detail on the cost to government to takeover the funding nor does it contain any analysis from the perspective of the charitable sector.

The current structure of PPFs has produced benefits to DGR entities on the basis of increased giving beyond that if the government were to simply pay at least the deductible portion of the monies within the funds to DGRs.

If there is evidence of tax avoidance within the PPF structure that does not provide a warrant to remove the structure or to seek to regulate them out of existence. The appropriate response to tax avoidance is to provide the Commissioner with appropriate powers to deal with that avoidance.

We have made general comments about the Paper in the body of this letter and our specific responses to Consultation questions are set out as an annexure to this letter.

General Matters

Paragraph 4 of the Paper states that:

> "*It remains a fundamental concept that a PPF is a trust to which* ***businesses, families and individuals*** *can make tax deductible donations, for the purpose of disbursing funds to a range of deductible gift recipients and a PPF cannot distribute to another PPF or to a public ancillary fund.*" [emphasis added]

We wholeheartedly agree with that as a conception of the scope and use of PPFs.

The move to ATO endorsement rather than Treasurer's prescription seems to proceed on the basis there is a need for greater PPF integrity. We are unable to comment directly on this, as we are unaware of PPFs being used for any mischief other than as cited in the Paper. We have no personal knowledge of mischief but agree if there is mischief it is that which should be attacked.

Para 13 sets out the new principles as follows:

	Principles	
1.	PPFs are philanthropic	PPFs are vehicles for acts of philanthropy by donors, and benefit from significant tax concessions on that basis. The distributions of PPFs should therefore be of a quantity and regularity such that the PPF can be characterised as philanthropic. Donors to PPFs, and their associates, should not benefit from their PPFs. PPFs should provide a benefit to the charitable sector that is much more than if the Government had taken the revenue forgone (by way of PPF tax concessions) and given it directly to that sector.
2.	PPFs are trusts that: (1) abide by all relevant laws and obligations, and (2) are open, transparent and accountable	PPFs provide money and other assets (that have been donated to the trust fund) to non-ancillary DGRs, and PPF trustees are bound by state trust laws. In setting out to achieve philanthropic goals, PPFs must abide by all relevant laws. The Commissioner will take appropriate action against the trustees of PPFs that do not abide by the rules.
3.	PPFs are private	PPFs have been established as a vehicle to encourage private philanthropy. This is in contrast to PAFs, which collect donations from the public. This characteristic necessarily limits who can donate to a PPF.
4.	PPFs are ancillary funds	The purpose of a PPF is to assist in the management of money as it is transferred from the donor to non-ancillary DGRs. PPFs are unsuitable for undertaking charitable work in their own right as this would make them 'institutions' which are subject to a different regulatory environment.

As set out above, the amount donated to DGRs has increased due to the availability of PPFs. In the current economic situation where charities are concerned about falling donation levels, we question whether the imposition of further restrictions on PPFs will further shrink the available donation base? Is not this higher donation base a greater benefit to the charitable system in and of itself? If the base were shrunk that would apply an even greater pressure on the public purse.

The other principles appear to be in accordance with the purposes for which PPFs operate, and we agree with the Paper in that respect.

Principle 1 - Philanthropy

Currently, a PPF is subject to an accumulation plan agreed with the ATO. Under that plan, a PPF is usually broadly free to accept donations and accumulate income up to a pre-determined capital base. Once that capital base is reached, it is able to be maintained at that level adjusted for CPI. Investment income above that level must be paid out and capital gains even unrealised gains over a 2-year period should also be paid out of the fund to DGRs.

Broadly this allows a PPF to act as a long-term body with long term goals being allowed to maintain its capital base and distribute its income.

The Paper proposes annual valuations of the asset base of each PPF and requires distributions of 15% of that asset base ie both income and capital each year. This will effectively cause funds to have a 7-year lifespan unless continually topped up.

Depending on the assets of the fund an annual valuation process could cause an erosion of the fund by way of valuation costs[3]. That would arguably not result in any improvement to administration and compliance by the PPF.

Paragraph 20 of the Paper refers to the top marginal tax rate of 45% and asserts the majority of donors are on a rate of 45%. This may well not be broadly correct and may not be correct for a particular fund such as a fund established by a business to which employees contribute. It may be broadly correct for the overall economy-wide quantum of funds contributed but that is not the language used in the Paper.

Principle 2 - Lawful and Transparent Operation

It is proposed to introduce a *fit and proper person* test for potential trustees whether or not they are directors of a trustee company. It is also proposed to move certain trust deed clauses into Guidelines and giving them the force of regulation.

Some examples of PPF mismanagement are set out in the Paper. We believe that proper enforcement of existing *Crimes Act* and *Taxation Administration Act* provisions would appear to be available in many of the cases listed.

In cases of PPF mismanagement, we understand one concern of the Paper is the inability to remedy any loss of funds. We do not believe the proposed changes will give the Commissioner such ability in any event. Lastly, it would appear to us most such cases cited in the Paper were deliberate breaches of trust rather than innocent errors.

We do not see how there could be public concern that PPFs pose a problem to the integrity of the tax system. We are not aware of any public perception to that effect.

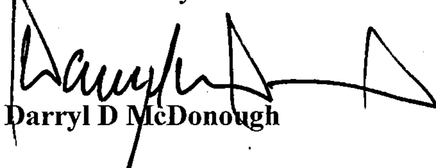
Principle 3 - Private Organisations

Private is generally used in the law and in the creation of PPFs in the sense of *not offered to the public* rather than being a closed class as is proposed. We do not think that imposing a further limitation on the ability to contribute to a PPF is necessary or desirable.

Principle 4 - Ancillary Funds

It is proposed to limit PPF investment to liquid assets. It is stated that this will reduce the (newly proposed) valuation costs. Illiquid assets would have to be converted to liquid ones as soon as practicable. Some flexibility would have to be accorded to any such requirement so as to not to potentially cause the trustee of a PPF to breach its trust law duties to obtain the best price for the illiquid asset.

Yours faithfully



Darryl D McDonough

John Middleton

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[3] Funds in which one of the writers is involved are maintained in readily marketable securities and therefore annual valuation would not be an issue. However some funds may have a different investment profile.

Annexure

Consultation Questions	Submission
Principle 1- Philanthropy Consultation questions	
1. What is an appropriate minimum distribution rate? Why?	No rate should be imposed. It should be left to the fund on establishment to nominate a rate which should not be less than 5%. The fundamental policy objective should be to encourage philanthropy and allow those who provide the bulk of the funds to determine how and when the funds are distributed.
2. Should the Commissioner have the ability to modify the minimum amount according to market conditions (for example, based on average fund earnings)?	Yes subject to the fund being able to provide appropriate reasons for the change. The fund though should not in any year distribute less than 5%. It should be necessary for a PPF to make application to obtain the modification with the onus on the PPF to make its case.
3. Should a lower distribution rate apply for a period (for example, 1 2 years) to allow newly established PPFs to build their corpus?	No. The pressure should be maintained to move to establish a fund quickly. We see no reasons to allow a period of grace for the capital base to be established.
4. Are there any issues that the Government needs to consider in implementing the requirement to ensure PPFs regularly value their assets at market rates?	Valuation costs and administrative requirements may be significant, and may potentially erode the value of the fund.
5. Is setting a minimum PPF size appropriate?	Yes. We understand that currently PPFs are administered so as to de facto impose such a requirement in any event.
6. What should the minimum PPF size be in dollar terms?	We submit that there should be a minimum of $5,000,000 proposed capital base to be achieved in no more than 5 years.
7. Should a fund have to distribute all its capital when its total value falls below this minimum amount?	Yes, but subject to fluctuations in the economy the Commissioner should have the ability to modify this, similar to his ability to modify the distribution rate. For instance, in the present economic circumstances, a fund having a recent value of $20,000,000 in listed shares could conceivably find itself with a market value of less than $5,000,000 in some cases, and be forced to wind up rather than have the ability to ride out the financial storm
8. Are there any relevant issues that need to be considered in improving and standardising the public	We have no submissions on this point as we are not aware of abuses in this area. If there were and we were informed of those we would be happy to

Consultation Questions	Submission
accountability of PPFs?	respond.
9. 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?	We accept that a PPF status places an entity in a position of responsibility to the community at large. However it is quite likely the imposition of such a requirement might impose an administrative burden of the funds that is not currently present.
Principle 2- lawful and transparent operations Consultation questions	
1. Will two years be a long enough transitional period for existing PPFs to comply fully with the new Guidelines?	Adoption of the new guidelines will likely result in the winding up of many PPFs within that two year timeframe.
2. Are there any cost or other concerns relating to the corporate trustee proposal?	We have no submissions on this point
3. Are there any privacy concerns that the Government needs to consider?	We assume standard secrecy requirements of the tax laws would apply
4. Are there any concerns over particular penalty types?	We do not understand how ATO enforcement action would do otherwise than erode the moneys in the fund, irrespective of the type and nature of penalty imposed?
5. If a fit and proper person test were introduced, what criteria should be imposed on trustees?	We have no particular submissions on a fit and proper person test. An alternative might be to increase the *responsible person* requirement from one to 2 or a majority of the board of directors/trustees. However, we query whether or not the responsible person requirement of the existing law is demonstrably inadequate? We are not aware of any evidence that is the case.
6. Are there any other provisions presently in the Model Trust Deed that should be covered in the updated Guidelines?	It is proposed to move certain provisions of the model deed broadly prohibition of benefit and audit into the statutory Guidelines. Rather these requirements should be **mirrored** in the Guidelines rather than imposed as trust duties.
7. Are there any provisions not in the Deed that should be in the updated Guidelines?	Could the Deed obligations as a whole not simply be incorporated in the Guidelines by operation of law for each particular PPF so as to enable the Commissioner to enforce these trust obligations

Consultation Questions	Submission
Principle 3- private organisations **Consultation questions**	
1. 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)?	Yes - how would a business PPF for other than the smallest business run? We note it is still accepted that philanthropy can be business based. Even for family groups, what happens where multiple individuals and entities make contributions to a PPF? How will death, divorce, remarriage be handled? We do not see any need for a cap on the number of proposed contributors to a fund.
2. Is conversion from PPF to PAF an acceptable mechanism to deal with changing PPF circumstances?	We have no submissions on this point.
3. What rules could be used to deal with the conversion from a PPF to a PAF?	We have no submissions on this point.
Principle 4- ancillary funds **Consultation questions**	
1. Would there be any disadvantages from introducing this limitation [to holding only liquid assets] to the existing PPF investment rules?	Perhaps. For instance in the present economic circumstances it may be that illiquid assets such as land or shares in a private company have held value better than listed entities. In some cases the rental return on investment land may exceed that of a return on a share portfolio. We would expect that the majority of PPF funds are already held in liquid assets.