13 January, 2009

Transmitted per email – ppfreview2008@treasury.gov.au

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

Dear Sir

RE: IMPROVING THE INTEGRITY OF PRESCRIBED PRIVATE FUNDS

Thank you for the opportunity to respond to the Discussion Paper **Improving the Integrity of Prescribed Private Funds** and please find attached Nonprofit Australia's submission.

Nonprofit Australia is an independent organisation focussed on effecting social change by building capacity within the nonprofit sector. It is not an industry body nor is it a peak council of representative industry bodies.

The opinions respectfully submitted in this paper have been developed as a result of extensive consultation with a range of individual philanthropists in one on one meetings during early 2008, private foundations, trustees and representatives of the nonprofit sector.

Nonprofit Australia is broadly in agreement with the need for the current review of PPF regulations. However we are also conscious of the balance required in fostering a culture of giving in Australia while providing a taxation framework that continues to encourage private and sustainable investment for the long term. The needs of the Australian community, the Government, the Nonprofit sector and donors will be best served by a transparent and simple compliance model for PPFs.

We need to continue the growth of giving in Australia and Nonprofit Australia is most willing to work with Treasury and the Australian Taxation Office to ensure the most appropriate policy and regulatory framework is created.

Yours faithfully

Elaine Henry
Chairman

PO Box R1910 Royal Exchange NSW 1225
02 908 57104

RESPONDING TO THE TREAURY DISCUSSION PAPER
'IMPROVING THE INTEGRITY OF PRESCRIBED PRIVATE FUNDS'

Introduction

Nonprofit Australia recognises that PPFs are an innovative and simple mechanism to provide and promote philanthropy. Since the launch of the PPF initiative in 2001, 769 PPFs have been established with assets equal to approximately $1.2 billion. This together with the rise in wealth in Australia and the taxation benefits PPFs offer their founders, suggest that despite the limited distribution to date, PPFs are becoming a significant source of sustainable, private philanthropy.

The increasing presence of PPFs presents an opportunity for nonprofit organisations to pursue sustainable philanthropic relationships with PPFs that build upon and follow a similar model to their relationships with foundations while introducing the sector to a new and expanding group of engaged philanthropists.

Initial research by Nonprofit Australia indicates that the approach to philanthropy by PPFs is increasing efficiencies across the nonprofit sector and creating value for the wider community. Funds are granted to a broad range of causes and most PPF founders who are active donors tend to participate with grantees to maximise the impact of funds distributed.

Nonprofit Australia broadly supports the Government's proposal to Improve the Integrity of Prescribed Private Funds (PPFs) but strongly reiterates the original view that the PPF vehicle was established to promote and encourage philanthropy and that any changes proposed by the government should ensure this vision is at the core of those changes.

Principle 1 – PPFS are Philanthropic

- **What is an appropriate distribution rate?**

  Nonprofit Australia believes there are financial experts to provide advice on the specific rate appropriate to distribution of PPF funds. However it is of critical importance to acknowledge that the established rate continues to provide incentive for high net worth individuals to create PPFs thus providing the nonprofit sector with an increasingly important source of funding. Funding that can continue for the long term rather than the short term, the next generation rather than this.

  In establishing this rate it is valid to consider that many nonprofits will be able to establish much more effective programs if they are funded for either capacity building or longer term programs rather than one off short term projects. An appropriate distribution rate by PPFs will ideally encourage this by providing a more effective and strategic approach to giving by the PPFs in partnership with nonprofits.

Should the commissioner be able to modify the rate according to market conditions?

Nonprofit Australia does not support the ability of the Commissioner to modify rates according to market conditions. Presuming the appropriate criteria in establishing the distribution rate, there would be no requirement for this action.

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

  The distribution rate should not be different in the accumulation phase from the corpus. If the minimum distribution rate has been established at say, the much discussed 5% rate, this would remove any need for differentiation. Nonprofit Australia believes that if the rate is different then PPFs will have a natural incentive to stay in the accumulation phase rather than making distributions from their corpus.

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

  Nonprofit Australia supports the proposal that PPFs regularly value their assets at market rates. However Nonprofit Australia holds the view that assets in PPFs should be of a liquid nature and as such, valuation should be a clear cut and noncostly exercise at anytime.

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

- **What should the minimum PPF size be in dollars?**

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

  PPFs with capital accumulation plans under $1million are unlikely to generate sufficient income and therefore unlikely to exist in perpetuity. The relatively small size of these funds is more likely to result in the erosion of the value of the capital and as such it maybe more beneficial to direct this capital to philanthropic causes by alternative mechanisms. At the same time however, lowering the minimum PPF funding requirement and allowing them to increase the size of the endowment would benefit government, the nonprofit sector and PPFs.

  Nonprofit Australia therefore supports the proposal to review minimum size of PPFs but it is an area that needs careful consideration so as not to reduce the incentive to give.

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

  Fostering genuine partnership between private funders and the nonprofit sector requires an equitable level of transparency on behalf of both groups. One sided reporting requirements imposed on nonprofits with no equivalent requirements of private funders perpetuates difficulty for nonprofits in targeting philanthropic sources and in ensuring appropriate partnerships. Increasingly the nonprofit sector itself is being held to more stringent and transparent accountability and similar standardisation and public accountability for PPFs would result in more equitable and stronger relationships with nonprofits and their communities.

  Nonprofit Australia believes therefore that PPFs should be held accountable to the same standards and supports at the very least, the provision to have an ABN and be recorded on the Australian Business Register as a PPF with some indication of their focus.

- **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?**

  Nonprofit Australia believes that donors need to be as transparent as the organisations to which they give and with whom they engage. However, through our PPF research Nonprofit Australia is aware there are divergent views on this issue. Among those opposed there is a view that, given the preference for privacy among PPFs, disclosure may have an adverse effect on the growth in their number. Alternately there is a view that disclosure is essential because charitable deductions enable people to donate assets without paying tax on those assets and thus the public is subsidising the non-taxable portion of the charitable donation and therefore has a right to full disclosure.

  The Petre Foundation has completed extensive research on giving by high net worth individuals in Australia and it is also possible that if full disclosure was in place by PPFs, this may in fact encourage greater levels of giving than previously attained in Australia because of the public availability of information and the awareness by donors of peer contributions.

  While Nonprofit Australia understands that PPFs also do not wish to create administrative organisations or be inundated by unsolicited grant applications and enquiries, in the US many small and very large organisations such as The Gates Foundation circumvent this situation by placing very explicit details and conditions on their publicly available websites.

  PPFs and the sector would benefit from a readily accessible fund register as it would allow both parties a less time consuming yet more targeted and filtered approach to grant making.

<u>Principle 2 – PPFs are trusts that: (1) abide by all relevant laws and obligations, and (2) are open, transparent and accountable</u>

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

- **Are there any costs or other concerns relating to the corporate trustee proposal**

  In considering any proposal, the Government changes need to reflect the underlying principle that the majority of philanthropic funding needs to be distributed direct to the cause. It would not be appropriate for corporate trustees to incur significant administrative costs, thereby reducing the funds available for distribution.

  An underlying motivation for establishing PPFs centred on tax efficiency will result in minimal and long term deferral of distributions to philanthropy. This approach is creating a new and significant source of capital that generates substantial fees for financial advisors and trust companies. While prudent investment of endowments is vital to the growth of philanthropic dollars, long term accumulation of this approach is not in the spirit in which the PPF mechanism was established by government. Nonprofit Australia believes that this is an important criteria for all PPF trustees to understand as for many involved in PPFs, it is now just another fee generating financial product.

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

  The PPFs are a relatively new philanthropic vehicle and Nonprofit Australia supports the Government having a level of flexibility over penalties. However, if sufficient education and training is conducted in relation to PPFs then ideally the knowledge level of those operating PPFs will be strong enough to ensure penalties would be unnecessary.

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

  Nonprofit Australia is unclear as to what is meant in this regard. When PPFs were first established, they were mostly a mechanism for high net worth individuals, philanthropists and family foundations. While all trustees should be held to the same level of accountability, introducing a fit and proper person test in this instance maybe a difficult criteria to implement.

  Increasingly PPFs have become an established financial product and are being utilised by trustees, financial planners and investment banks and thus the introduction of such criteria maybe more relevant. It is presumed however that the financial industry requirements already imposed on its members would be similar and additional regulations may do little apart from add to the cost of administration.

  Nonprofit Australia feels it maybe more relevant to introduce a greater level of understanding of PPF requirements through ongoing education and training for all who are involved with PPFs.

Principle 3 - PPFs are private

- **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)?**
- **Is conversion from PPF to PAF and acceptable mechanism to deal with changing PPF circumstances?**
- **What rules could be used to deal with the conversion from a PPF to a PAF?**

  Nonprofit Australia is supportive of the rationale that PPFs are a mechanism for private philanthropy and therefore establishing a cap on the number of donors maybe a method of maintaining the original characteristics of PPFs. However it could be difficult over the life of a fund to predict the increase (or decrease) of the number of donors as family numbers and businesses are all subject to change. It would be unfortunate to limit the donors only to end up limiting the donations.

  Nonprofit Australia would recommend the government refer to Philanthropy Australia, the national peak body for philanthropists in relation to these more specific issues.

Principle 4 – PPFs are ancillary funds

- **Would there be any disadvantages from introducing the limitation of investment in liquid assets only to the existing PPF investment rules?**

  Nonprofit Australia supports the proposal for PPFs to invest in liquid assets only. Investment in liquid assets ensures that there is little opportunity for trustees, founders or those associated with a PPF to utilise such assets for personal gain. Should a PPF receive an asset that is not of a liquid nature then a timeframe should be in place in which such an asset (e.g. real estate) is to be converted and funds placed in the PPF.

  Liquid assets will also reduce the cost of the PPF administration as it will have a very clear market value at any given time.

Conclusion

Nonprofit Australia welcomes the government's review into Improving the Integrity of Prescribed Private Funds (PPFs).

The creation of PPFs has introduced not just an additional valuable funding source into the Australian community but is also fostering a new form of engaged philanthropy. It is important that any changes to regulation around the philanthropic sector continue to build on the investment already contributed. Nonprofit Australia is happy to discuss further any aspects of this submission.