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

Dear Sir/Madam

Attached please find our submission to the discussion paper, Improving the integrity of Prescribed Private Funds (PPFs).

Yours sincerely

Daniel Petre AO

Trustee

Petre Foundation

Introduction

As background my wife and I established The Petre Foundation initially as a public foundation in 1999 (prior to the existence of the PPF regime) as we wanted to establish vehicle that would allow us and our children, as they reached adulthood, to allocate funds to needy causes (all DGR status) for years to come. Through our foundation we have also funded a number of research papers comparing giving rates amongst Australia's wealthy with those in the U.S., U.K. and Canada and strategies employed overseas to generate greater levels of giving.

With respect to our foundation it is important to note that our ability to create a foundation increased the % of assets we allocated to philanthropy when compared to the situation where we were just making annual donations each year. We are of the strong belief that establishing a foundation does motivate people to allocate a larger share of their net wealth to philanthropy as opposed to making, often random, donations each year. Having a foundation also provides for a regular donation flow (regardless of the personal income of the trustees). This regular flow of donations is of benefit to charities as they can better plan the development of their service offering.

However we did not appreciate the requirement to raise public funds, which we had not seriously contemplated, and so last year converted our foundation to a PPF. It is also worth noting that for the significant majority of expenses required to run both forms of the foundation we have elected to pay these costs personally and not charge the foundation, thus increasing the funds available to donate.

In terms of commenting in the discussion paper we fully support the major principle of ensuring regular valuation of assets at market rates and also agree in principle with the proposition to increase the size of compulsory gifts as long as this is done in a manner to ensure some degree of longevity of a PPF.

We are also in broad agreement with the proposals to increase public accountability and provide the ATO with greater power to oversee the management and reporting of PPFs.

Our specific comments are focused on those parts of the discussion paper where we feel we can add value to the debate. We have also elected to raise related issues, not specifically addressed in the discussion paper.

Research funded by the Petre Foundation (available on our web site, www.petrefoundation.org.au) points to the continued low level of philanthropy by our wealthy. The PPF structure and associated tax changes were positive moves to try to encourage greater giving by our wealthy and over time this will be the case. The ramp up in establishment of PPFs clearly indicates the interest of many to start to give back to society in a meaningful and significant manner.

However as with all new schemes some modifications are required to ensure the PPF structure does in fact increase giving and moreover looks to create a greater giving culture in Australian society. In this context it is not just the money flow that is important. It is also important to create a greater level of engagement of our wealthy with worthy and needy causes. In this way it is not correct to merely compare the tax "lost" when assets are transferred to a PPF to the donations of a PPF. Some value must be attributed to the impact on the level of charitable engagement of our community by having more people working with needy causes and comparing their experiences with others.

Principle 1 – PPFs are philanthropic

Annual Distributions

We agree with the proposition that a PPF should not be allowed to simply accumulate funds over time however we strongly believe that an attraction of a PPF is that it is viewed as a long term giving vehicle that can engage children and grandchildren of the founders in consistent giving to charities. Assuming the average growth of invested funds (in a basket of public shares) over the last few decades is around 7% - 8% annually the suggested 15% distribution would mean that PPFs would run out of funds within 10 years of establishment. Such a lifespan would make PPFs unattractive and we believe that this will in turn stop the current momentum of philanthropy that is in its early stages in Australia.

The goal should perhaps be, as is currently envisaged, to ensure that a PPF retains its real value but does not grow (in real terms). Such a plan would require PPFs to distribute all income and capital above the inflation rate and this would mean that PPFs could exist forever. As is often sighted overseas an absolute distribution of 5% would achieve this goal (solving for the combination of good and bad years but moreover ensuring consistent giving).

There is often an argument that PPFs should not be allowed to exist forever and yet there is no rational explanation for such a view. If PPFs are required to donate only to DGR status organizations, if their expenses are limited to a suggested 1% (covered later) and PPFs can only hold assets that do not provide any benefit at all to trustees (also covered later) then there does not seem to be any issue with the PPF existing forever and donating to charities forever. The combination of funds being donated to charities and the greater level of engagement with the charitable sector are worthy achievements within a scheme that looks to allow PPFs to exist for an extended life.

Notwithstanding the lack of a rational reason to ensure the demise of a PPF, any capital depletion (as opposed to retention) model must at least allow for the long term life of the PPF. In this context long term would be of the order of 50-100 years. Two approaches could be taken to achieve this goal. One approach would be to increase the required distribution slightly (ie slightly more than total of income and growth less CPI). Another approach would be to establish the requirement that at a certain date (50 or 75 or 100 years hence) all assets are made liquid and all funds are distributed.

It would not be appropriate to have the commissioner arbitrarily modify the minimum amount depending on market condition. For planning purposes a PPF is better served by understanding the long term structural requirements and planning accordingly. A distribution rate can be determined to ensure appropriate giving levels but also an appropriate term of life of a PPF.

A consultation question in this section refers to the time required to build a corpus. We do not believe a differentiated approach to a PPF, while it is building its corpus, is valid.

The current PPF regime allows for the accumulation of a corpus below which lower donations are required and beyond which all income and growth must be distributed each year. Changes to both

these characteristics are required. Firstly the accumulation period creates anomalies in behavior and may solve for some PPFs spending inordinate years or decades actually getting to their corpus level, in the meantime distributing very low levels of donation. It is suggested that this concept be removed and that the regime for distributions for PPFs is the same regardless of the size of the corpus and whether or not there are plans for greater accumulation of funds in the corpus.

Further, as discussed above, a PPF should be allowed to retain its real value (or very close to it) and so annual distributions should be total income and growth less CPI or some discount on CPI. As an example if income and growth for the PPF was 9% and CPI was 4% then distributions in that year should be around 4% - 5% (depending on the goal of the depletion rate of the PPF).

Areas not addressed by the discussion paper

Assets held by PPFs

We are of the belief that PPFs should hold assets that are liquid and that can in no way provide any personal or family benefit to the PPF trustees/founders. In the past it seems that a PPF could hold (as assets) Art and Real Estate, Collectibles. These asset classes are generally illiquid (ie liquidity can take time), their market value is unclear (or difficult to determine) and they also run the risk of being used by trustees or those associated with a PPF to provide personal value (e.g. hanging art owned by a PPF in the home or business of a trustee or related party).

We do not think it is appropriate for a PPF to own asset classes such as real estate (direct as opposed to via publicly listed funds), Art, and Collectibles etc. We believe that PPFs should be required to only hold assets that are publicly listed securities. In this situation the asset provides no benefit to the trustees or founders and the asset has liquidity thus meaning the PPF can easily meet its donation level requirements. Further the market value of the asset is clear and unambiguous.

Expenses charged to a PPF

In this area there must be controls to stop PPF funds being utilised to fund inappropriate salaries, expenses or benefits for employees (or related parties) of the PPF. It is important to note that currently the average corpus in a PPF is approximately $200,000.

One model to review as a comparison would be the private equity industry. In this industry for small funds (ie less than $40m) it is normal for the administration of the fund to be capped at a 2% of the fund size (ie $800K for a $40m fund). In the world of philanthropy we believe that expenses of a PPF should be limited to a maximum of 1% of the fund size. This 1% allocation would need to cover all expenses incurred by the fund including administration (salaries, outsourced advice such as tax etc, marketing, etc) and would ensure that the funds managed by a PPF were not utilized to pay for inappropriately high expense levels.

Roll over Relief

In a situation where, for whatever reason, the trustees of a PPF no long wish to maintain the management of the PPF they should be able to roll over the complete corpus into another PPF or Public Philanthropic Fund (both considered ancillary funds) with roll over relief. As long as the funds end up in a similarly managed and controlled entity the focus should be ensuring that all of the PPF's corpus continues to be allocated to philanthropic giving.

Summary

The PPF scheme has significantly increased the assets allocated to philanthropic activities and has, moreover, ensured far more wealthy Australians are thinking about and engaged in philanthropic activities. Changes need to be made to the PPF regime to ensure the structure is not abused, PPF activities and finances are reported on and giving is maintained at acceptable levels. The incorporation of changes highlighted in the discussion paper along with those mentioned above will ensure that the PPF scheme continues to develop a greater level of reported giving, in the short and long term, in Australia.

Those deciding on the final form of the changes should look to the future, long term impact of the PPF scheme and the role the PPF can play in a just and giving society.

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