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Ancillary Fund Distributions

We welcome the opportunity to comment on the Discussion Paper on the Ancillary Fund Distributions <https://treasury.gov.au/sites/default/files/2022-03/c2022-259124-cp.pdf> . Thank you for extending the deadline for our submission.

About Australian Philanthropic Services (APS)

APS is the leading provider of support and governance services to ancillary funds in Australia. Collectively our clients gave over \$100m to 1300 charities last financial year. We are a not for profit ourselves and do three things:

- We establish and administer Private Ancillary Funds (PAFs) with some 300 PAFs using our services
- We manage the APS Foundation, a Public Ancillary Fund (PuAF) with some 365 sub- funds, and support 9 other Public Ancillary Funds
- We provide grantmaking services to philanthropists to make their grants more effective.

APS establishes more PAFs and the APS Foundation establishes more sub-funds than any other service provider and we are well positioned to comment on these matters.

Principles

We believe two important principles have underpinned the success of the Ancillary Fund (AF) framework which has been so successful in fostering and building the philanthropic culture in Australia.

1. Clarity, Simplicity, Transparency and Integrity of the compliance framework
2. Longevity without frequent change and all tweaks involving consultations

Discussion Options

Accumulating funds to support larger projects

In keeping with the principles above we would **not** like to see a complicated process introduced to determine variation of Minimum Distribution requirements but instead see the introduction of a strong mechanism for AFs to support major capital and other projects of eligible entities.

We believe the most comprehensive approach would be to introduce a “Distribution Smoothing” mechanism. This would allow an AF to meet its minimum distribution requirement over say, four years, rather than each year. Carry over distributions could be either positive or negative (and in \$ amounts not percentages).

The proposed mechanism could be modelled on the existing process for spreading a Deductible Gift over several financial years and require completion of an ATO form which would be lodged with Auditors. This would allow for either under or over distributions in any year to be covered or used in subsequent financial years.

Penalties for misuse of this flexibility should be increased to ensure serious consequences for any misuse.

We believe this mechanism would not only address the accumulation for a capital project option, but would also -

- reduce the applications to the ATO Commissioner for a lower distribution rate in a particular year and impose a requirement for catchup distributions,
- remove the requirement for special changes to facilitate additional giving for the next bushfires or floods, and
- provide a practical approach for dealing with unforeseen or other issues that can disrupt distribution payments from time to time.

Alternately, and going back to the details discussed in the Discussion paper, we believe this is also partly possible under current Section 15 (e) which reads:

The ATO Commissioner must have regard to (e) the level of distributions made by the fund in previous financial years.

If this clause was, aided by some interpretation clarity, a PAF supporting a capital project with a grant of equivalent to 10% of its corpus in one year, could apply to the ATO Commissioner for a lower distribution in the following years to offset the larger grant.

As set out in the Discussion paper Section 15 (e) above does not allow a lower minimum distribution in the years preceding a major grant. However, it would make some sense to allow the ATO Commissioner to approve a lower minimum for one or two years preceding a major grant.

Longer time frames than one or two years may raise other issues, such as a market correction causing the value of the PAF to fall, or significant changes in the scope or purpose of the project. Whatever is done, it should be the AUD grant amount that is carried over.

In order to take account of significant changes to the project for which the funds are being accumulated, and/or unforeseen changes generally, APS does not support the idea of administrative penalties being applied to the trustees in the event that the project fails to materialise, making the ancillary fund distributions no longer required. Absolutely, the ancillary fund would need to “make good” by immediately making distributions equivalent to the minimum distribution amount had the lower distribution amount not been agreed.

Transfer (Portability) between Ancillary Funds

At APS we have seen the benefits of the Portability provisions allowing:

1. Philanthropists to move between Public Ancillary funds to access better service or investment options
2. Philanthropists who have established and built up a philanthropic pool of funds within a giving fund of a Public Ancillary Fund, to transfer to a PAF for greater control and engagement
3. Philanthropists who find the investment and or compliance obligations of having a PAF too onerous or have no obvious successor plan, to transfer from a PAF to a sub-fund in a PuAF.

We recognise that the current restriction on Portability from a PAF requiring the entire PAF to be transferred is an issue particularly for Community Foundations (which will be substantially removed with the measure already announced) and again believe a solution consistent with the principles is available.

Section 28 of the PAF Guidelines restricts any PAF port to be of the entire balance of the PAF. This could be modified to allow either the full balance or any part to be ported with the Commissioner’s approval. The requirement to have already met the Minimum Distribution level would still apply. This modification would prevent any integrity issue as the PAF would have already met its community support obligations for that year, and the PuAF would have additional funds on which its community obligations would be determined the following year. In effect this would be applying the current partial porting provision of subfunds in the PuAF Guidelines to PAFs. It would also be consistent with the Canadian practice of such transfers not being counted towards the minimum distribution.

The removal of the restriction on a PAF of only Porting its total assets would also facilitate the splitting of a PAF into two PAFs or a PAF and a sub-fund if family circumstances such as a divorce, necessitated such a change. The requirement for the ATO Commissioner approval and minimum distribution level being reached could remain. This change would add to flexibility without jeopardising the integrity of the Ancillary Fund framework.

Other Matters

Thank you for the invitation to raise other matters.

PuAF Guideline Section 27 (1) (b)

Insert after “ancillary fund”: “or if the public ancillary fund is requesting a sub-fund be transferred, that sub-fund ...”

As we raised during the remake of the PuAF Guidelines we see a practical issue with the current wording of PuAF Guideline Section 27 (1) (b). There are two reasons for this change which we believe align with the original rationale of this portability clause:

- (1) *Ancillary Fund system integrity* - Sub-funds should be required to distribute at least the minimum rate before they can apply to transfer. This is to align with the requirement on entire Public Ancillary Funds and Private Ancillary Funds as there is no minimum distribution in that year required after any transfer. Furthermore, the transfer of a sub-fund in a Public Ancillary Fund does not change the minimum distribution requirement of the overall Public Ancillary Fund to meet in that year (as it is based on the previous 30 June valuation). The requirement that the overall Public Ancillary Fund meets its minimum requirement for the year before any transfer is permitted is just a timing measure. Currently a sub-fund could transfer without meeting this requirement if other sub-fund holders are generous thereby avoiding its community commitment.
- (2) *Practicalities* - Last year, a major Public Ancillary Fund did not achieve its 4% minimum until the last week in June. This meant no transfers could be approved by the ATO until the final week of the financial year, creating significant and unnecessary rush for Trustees and the ATO alike. Portability was introduced to inject a degree of choice into the ancillary fund framework and the wording proposed above would be consistent with other provisions relating to sub-fund transfer.

PuAF and PAF Guidelines Section 22 (3) Reinstate “material” before benefit.

This clause is not designed to capture immaterial benefits and should be consistent with the general wording in TR 2005/3 “what is a gift” which uses the word “material” in relation to benefit.

If there is a benefit which is not material the penalty for the breach under this Section is “the value of the benefit”. So, in the case of an immaterial benefit being inadvertently provided, the penalty will be similarly immaterial and certainly not worth the effort or angst by PAF Trustee or the ATO in working this out. So, what is the point? Are there not more important matters that ATO resources could be focused on?

PAF Section 15 Minimum Distribution level

At some stage there should be a wider discussion about what is the appropriate minimum distribution level for PAFs. Buoyant financial markets have provided growth for most PAFs over

the last 5 years but even with some increase in interest rates from the current historic low levels, it is becoming increasingly difficult to achieve the 5% distribution and maintain the real value of the corpus. An obvious starting point would be why not 4% to be consistent with PuAFs? Philanthropy Australia is holding its biannual Conference in September and perhaps Treasury might consider instigating a panel discussion of the matter of Minimum Distributions at that conference to get a broad range of views.

Valuation of unlisted assets for donation into an AF and annually thereafter

With a significant pool of Australian entrepreneurs wanting to make philanthropy core to their personal and business success, it would be beneficial to increase the clarity of how unlisted assets will be valued. This will provide a further boost to philanthropy. There is strong agreement with the ATO's "market value" principle being determined by "fully informed willing buyer and willing seller". It would be helpful if the ATO could publish what parameters it will use to arrive at its valuation and particularly that the price established in a professionally conducted external funding round will be acceptable. In terms of the annual valuation that then is required by the AF Trustee, it would be useful if the same principle of at least every three years that applies currently to "land" is also adopted as that would ensure unnecessary valuation costs aren't incurred.

Thank you for your consideration. If you wish to discuss any of the detail of these please contact David Ward APS Technical Director dward@australianphilanthropicservices.com.au or 0432 399 954.

Kind regards



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