BY EMAIL

Level 38, Riverside Centre
123 Eagle Street
Brisbane QLD 4000
Australia

Blake Dawson

T 61 7 3259 7000
F 61 7 3259 7111
DX 226 Brisbane

PO Box 7074
Riverside Centre
Brisbane QLD 4001
Australia

www.blakedawson.com

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

17 December 2010

Our reference
TMD IWM

Partner
Teresa Dyson
T 61 7 3259 7369
teresa.dyson
@blakedawson.com

Contact
Ian Murray
T 61 8 9366 8776
ian.murray
@blakedawson.com

Dear Sir

Submission in relation to Public Ancillary Funds

Thank you for the opportunity to submit our comments in relation to the Improving the Integrity of Public Ancillary Funds Discussion Paper (**Discussion Paper**). As a general comment, we support the aim of improving integrity and thereby strengthening public confidence in public ancillary funds (**PubAFs**) and the philanthropic sector more broadly.

In our view, in the context of PubAFs, improved integrity and public confidence can be achieved by providing for greater public involvement in the governance of PubAFs, ensuring transparency and accountability and providing for appropriate character requirements of trustee directors. However, integrity measures which may be appropriate for private ancillary funds (**PAFs**), should be relaxed in the context of PubAFs in order to reduce unnecessary impediments to the efficient and effective operation of PubAFs. This point is especially significant due to our experience of greater variation in types of PubAFs as compared with PAFs, which suits a more flexible approach.

1. Principle 1 – Public Ancillary Funds are philanthropic

Consultation Questions

1.1 What is an appropriate minimum distribution rate? Why?

As a general comment, we are supportive of greater simplicity in the accumulation and distribution rules applying to PubAFs, but consider there should be a degree of flexibility for PubAFs in the manner in which they make their distributions and achieve their philanthropic purpose. That is because, given the public nature of PubAFs, we consider that integrity measures for PubAFs are better targeted toward the governance and accountability of PubAFs, rather than prescriptive distribution requirements, which may be more appropriate for private ancillary funds.

Accordingly, we consider that the following two key matters should be incorporated into any minimum distribution regime:

- The current approach of obtaining ATO approval for accumulation at a higher level than otherwise permitted on a case by case basis should be retained to cater for circumstances which do not fit a set distribution rate.

- The distribution rate should be equal to or less than the 5% rate adopted for private ancillary funds, while still being 'philanthropic'.

In relation to the first point, a PubAF may wish to accumulate for a specific project, particularly for capital expenditure. Accordingly, we suggest that the concept of an optional accumulation plan (to be approved by the ATO) be retained for PubAFs that wish to accumulate funds at a greater level than permitted by a compulsory distribution rate. Failure to apply the accumulated funds to the specified project could result in a higher distribution rate for that PubAF in subsequent years.

For instance, in Canada where registered charities are generally subject to a minimum distribution requirement, it is possible for charities to apply for relief from the distribution requirements on various grounds.[1]

In relation to the second matter, if stricter requirements are adopted in relation to the character of directors, accountability and governance, then using the distribution rate as an integrity measure becomes less relevant. In particular, 'accountability' would be better addressed through governance and the disclosure of information to the public. Further, adopting a higher distribution rate than applies to PAFs appears inequitable as it would likely mean that donors who are not wealthy enough to establish a PAF are less able to provide long-term support for community objectives due to a lesser ability to accumulate funds.

Setting a minimum distribution rate that is too high may discourage members of the public from establishing or donating to PubAFs and hence achieving their philanthropic objective. It is also likely to have a negative impact on DGRs which may rely on a PubAF for on-going funding to carry out their activities. We do not agree that a higher distribution rate will result in a higher level of accountability.

While a rate of 5% or less may be considered relatively low on a measure of the revenue foregone in a particular income year, this must be weighed against the funds irrevocably committed to the public benefit to be distributed in the future and against the 'soft benefits' provided by PubAFs.

In our view, the distribution rate should be set at a level that permits PubAFs to continue in existence for a substantial length of time, although not necessarily indefinitely. In addition, the recent experience of the 'Global Financial Crisis' is a timely warning that investments may decrease in value during a given period.

Too high a distribution rate may have serious consequences for committed projects in circumstances where a PubAFs capital has been reduced.

[1] Sections 149.1(5) and (8) *Income Tax Act 1985* (Canada).

As previously suggested for PAFs, we also consider that:

- PubAFs should be provided credit for exceeding the minimum distribution level in a given year. This could be achieved by adopting a rolling average mechanism. For instance, averaging over rolling 3 year periods in a similar manner to that for non-concessional contributions to superannuation funds.[2]

- Late distributions to 'fix' inadvertent failures to meet minimum distribution requirements should count toward compliance with the distribution requirement so that no penalty is imposed, unlike the position for private ancillary funds. For instance, akin to the offset against the superannuation guarantee charge provided for late contributions.[3]

1.2 Are there any issues that Government needs to consider in implementing the requirement to ensure public ancillary funds regularly value their assets at market rates?

A valuation rules requirement which mirrors the rules applying to PAFs appears appropriate.

1.3 Are the valuation rules that apply to private ancillary funds also appropriate for public ancillary funds? If not, why not?

A valuation rules requirement which mirrors the rules applying to PAFs appears appropriate.

1.4 Are there any issues with requiring public ancillary funds to lodge a return?

A requirement that all PubAFs lodge a return appears appropriate, although we suggest that the form and content of the return be harmonised as far as possible with existing reporting requirements. For instance, under State and Territory collections legislation. This approach would be consistent with the Government's election pledge to support harmonisation between, and simplification of, Federal and State and Territory regulation, including the goal of 'report once, use often'.[4]

1.5 Are there any issues with imposing greater public disclosure requirements on public ancillary funds? What information should remain confidential and what information should be disclosed and why?

The Productivity Commission's Research Report on the Contribution of the Not-for-Profit Sector released in February 2010 recognised that governments and the community are calling for greater accountability of the not for profit (**NFP**) sector.[5] Donors want to see evidence of the effectiveness of activities undertaken by the NFP sector.

---

[2] See s 292-85 *Income Tax Assessment Act 1997* (Cth).

[3] Section 23A *Superannuation Guarantee (Administration) Act 1992* (Cth).

[4] Australian Labor Party, *Strengthening the Non-profit Sector* < http://www.alp.org.au/getattachment/88a7eb81-8b47-4315-ad6e-c1c13c169365/historic-reforms-to-australia-s-not-for-profit-sec/> accessed 14 December 2010.

[5] Productivity Commission, *Contribution of the Not-for-Profit Sector: Research Report* (2010), XXX.

As PubAFs solicit funds from the public, there should be a high level of accountability to the public. However, in accordance with the concerns noted by the Productivity Commission,[6] increased disclosure requirements should not be imposed in such a way as to excessively or needlessly increase compliance costs for PubAFs. We also consider that the timing and format of disclosure requirements should be harmonised, where possible, with existing or proposed additional reporting requirements.

To improve public accountability, it would be appropriate for PubAFs to provide the following information for inclusion on the Australian Business Register (**ABR**) website:

(a) total assets held by the PubAF at the end of the financial year;

(b) donations received during the financial year;

(c) amounts distributed during the financial year; and

(d) the recipients of the distributions.

In relation to 1.5(b) above, we consider it appropriate that the identity of individual donors should not be disclosed on the ABR website.

However, we note that the above information falls largely within the 'input' and 'output' measures discussed in Chapter 3 of the Productivity Commission's report. Any final class of information to be provided should be developed in light of the further measures proposed in Chapter 3 of the Productivity Commission's report. In particular, to improve accountability and transparency of PubAFs generally, in addition to the information identified above, it may be appropriate for PubAFs to be required to make available to the public upon request, the following information in a standard form:

(a) the objectives of the PubAF;

(b) the way in which the PubAF intends to achieve these objectives; and

(c) the identity of the individuals responsible for the governance of the PubAF.

Finally, we suggest that the penalties for failure to meet any disclosure requirement be appropriately tailored to the breach. Late disclosure of total assets, for instance, should not of itself result in loss of endorsement.

2. Principle 2 – Public Ancillary Funds are trusts

Consultation Questions

2.1 Is the administrative penalty regime (including the magnitude of penalties) that applies to private ancillary funds suitable for public ancillary funds?

We agree that the penalty imposed should suit the breach and consider that the administrative penalty regime for PAFs, as provided in the guidelines for PAFs and section 426-120 of Schedule 1 of the *Taxation Administration Act 1953* (Cth) (**TAA**) is generally appropriate for PubAFs.

---

[6] Productivity Commission, *Contribution of the Not-for-Profit Sector: Research Report* (2010), XXX.

It will be important that any administrative penalty imposed relating to an action or omission of the trustee of the PubAF does not affect the entitlement of donors to claim a tax deduction for gifts made to the PubAF or adversely affect the ultimate DGR recipient of distributions made by the PubAF. This is particularly so given the broad class of donors who could be affected by loss of endorsement. Further, it seems appropriate for there to be a mechanism to ensure that any administrative penalties are ultimately provided to DGRs (ie the intended beneficiaries) rather than to the ATO.

In the event of fraud on the part of the PubAF's trustee, other regimes should apply to enable appropriate action to be taken (in a similar manner to PAFs), with the result that no specific criminal penalties should be required in any new PubAF regime.

In addition, we note that the Discussion Paper refers in paragraph 48 to the provision of 'benefits' to non-DGRs as being a breach of the tax law and ATO administrative requirements applying to PubAFs. However, PubAFs typically seek to achieve community involvement in their administration and, in the case of corporate foundations, may also promote staff involvement in their administration. Such involvement can result in intangible benefits, such as higher morale, which accrue to the individuals involved and, if applicable, their employer.

Furthermore, PubAFs may seek to develop a true partnership with the PubAF's corporate founders and its employees and provide tangible benefits, such as training and education generally. We consider that such involvement between a corporation and the PubAF it effectively established, should not be discouraged and it is important that the guidelines clarify that the generation of such intangible benefits and appropriate tangible benefits does not breach existing PubAF requirements.

The current guidelines for PAFs include restrictions on funds providing benefits to various associated persons and entities including the founder. We consider that it is generally appropriate for PubAFs to be subject to similar restrictions that target the mischief of the fund providing benefits, particularly financial benefits to associated persons. However, the proposed guidelines for PubAFs should not prohibit a corporate foundation from maintaining a relationship with and providing incidental benefits to its corporate founder and its employees, that is consistent with the PubAF's philanthropic status.

2.2 Are there any difficulties in requiring public ancillary funds to have a corporate trustee?

We welcome the Discussion Paper's confirmation that transitional arrangements will be provided. However, we consider that, unlike the transition mechanism for PAFs, the transition provisions should ensure that there are no adverse tax consequences from the change of trustee.

2.3 Are the rules for suspension or removal of trustees of private ancillary funds suitable for public ancillary funds?

It is noted at paragraph 55 of the Discussion Paper that requiring PubAFs to have a corporate trustee should ensure that directors meet a minimum standard of behaviour as the behaviour of the directors will be regulated by the *Corporations Act 2001* (Cth) (**Corporations Act**). It is further stated that, assuming PubAFs are required to have a corporate trustee, then similar rules may be adopted regarding the suspension or removal of trustees that are in breach of the relevant laws and guidelines.

We consider it appropriate for the corporate trustee of a PubAF to be held to a high standard and to be required to comply with relevant laws and guidelines. However, a measured approach must be adopted and the Commissioner of Taxation should only have the power to remove or suspend the trustee of a PubAF, in situations that, as stated at paragraph 56 of the Discussion Paper, involve serious non-compliance by a PubAF. This limit on the Commissioner's power to suspend or remove a trustee should be incorporated within the guidelines or the legislation itself, which we note is not the case for PAFs under section 426-125 of the TAA.

2.4 What fit and proper person requirements should be imposed on trustees of public ancillary funds?

It is appropriate for trustees of PubAFs (including directors of a corporate trustee) to be held to a high standard and be required to exercise appropriate care, diligence and skill in discharging their obligations. The Discussion Paper notes, in broad terms, at paragraph 60 the minimum standards of conduct for trustees of PAFs. These include that at least one of the individuals involved in the decision making of the fund must be an individual with a degree of responsibility to the Australian community. We consider that it is appropriate that tighter requirements be imposed on trustees of PubAFs in the manner outlined in Taxation Ruling TR 95/27 (**TR 95/27**). Paragraph 9 of TR 95/27 provides that a public fund (a broader concept than a PubAF) is required to be managed by members of a committee, a majority of whom have a degree of responsibility to the general community.

To the extent that additional qualification standards are imposed, it appears appropriate that the standards apply to the trustee as a whole (as opposed to each individual trustee or individual directors of a corporate trustee) as is the case for RSE licensees.[7] The trustee as a whole should then possess the relevant attributes to enable the trustee to properly discharge its duties and responsibilities. However, the standards for an RSE licensee appear too strict in the context of PubAFs where many committee members will be volunteers and a variety of different PubAFs exist. Instead, we consider that a general requirement that a PubAF trustee possess the relevant attributes to enable the trustee to properly discharge its duties and responsibilities, should suffice, if supported by training for trustee board members. Such a general requirement applies (with other additional standards) for RSE licensees and is analogous to the declaration that is required for new trustees of self managed superannuation funds.

In terms of training support, To the extent that the Government wishes to address the competence of all trustees or board members, we suggest that compulsory on-going training be provided for trustees or board members who do not meet the required minimum levels. The training should be provided at a relatively basic level with the aim of alerting trustees or board members to their duties, rather than comprehensively dealing with the content of those duties.

Further, to the extent that the current guidelines for PAFs are adopted, it will be important to ensure that the rules are modified to take into account the differences between PAFs and PubAFs.

---

[7] Discussion Paper, appendix A.

For example, the restriction in the PAF guidelines on an individual with the requisite degree of responsibility to the Australian community not being a donor to the fund who has contributed more than $10,000 to the fund, is unrealistic for PubAFs given the likely greater size of a PubAF fund in comparison to a $10,000 donation.[8] If such a requirement is adopted for PubAFs, the amount should be increased considerably from $10,000.

2.5 What transitional arrangements are required for existing public ancillary funds to conform to the new arrangements?

We are supportive of a transitional period for existing PubAFs. Given the broad range of existing PubAFs and the more stringent requirements to be applied, particularly for disclosure of information, the transitional period should be at least the same length as that provided for PAFs. Further, the variety of existing PubAFs highlights the importance of providing transitional mechanisms dealing with the potential impacts of any new rules. For instance, trust deed restrictions on distributing capital or, given the quantum of assets held by some PubAFs, the risk of a trust resettlement due to any required trust variations.

In addition, we suggest that the focus of transition measures should not be solely on implementing appropriate legal mechanisms. As acknowledged in the Discussion Paper, compliance problems experienced by NFPs are typically due to lack of understanding than to avoidance of regulatory requirements. Accordingly, to support compliance with any new regime, there should be a significant focus on, and funding support for, education for trustees of PubAFs in this period. The educational role could be carried out by the Australian Taxation Office, or, if established, the Registrar for Community and Charitable Purpose Organisations most recently recommended by the Productivity Commission.[9]

3. Principle 3 – Public Ancillary Funds are public

Consultation Questions

3.1 Should the term 'public fund' be codified in the guidelines in accordance with the principles set out in ATO *Taxation Ruling TR 95/27*?

As a preliminary point, the concept of a 'public fund' is used for a number of categories of DGR, not just PubAFs. Therefore, before any additional explanation of the term (additional to the discussion in TR 95/27), or any changes to the understanding of the term as set out in TR 95/27, are adopted, their impact on the non-PubAF categories of DGR should be considered. Ideally, this process would involve separate consultation with the affected DGRs.

We consider that the 'public' nature of PubAFs involves public elements in:

- Fundraising (by reference to TR 95/27 and *Bray v FCT*).
- Information disclosure (as recommended by the Productivity Commission - see section 1.5 above).
- Governance arrangements (by reference to TR 95/27 and *Bray v FCT*).

As stated previously, we suggest that this greater public involvement should result in less need for prescriptive integrity measures.

---

[8] Paragraph 14 of the Private Ancillary Fund Guidelines 2009.

[9] Productivity Commission, *Contribution of the Not-for-Profit Sector: Research Report* (2010), recommendation 6.5.

The concept of what makes a fund 'public' is discussed in TR 95/27, with reference to the decision in *Bray v FCT*.[10] The ruling notes that a fund is public where:

- It is the intention of the promoters or founders that the public will contribute to the fund.
- The public, or a significant part of it, does in fact contribute to the fund.
- The public participates in the administration of the fund.

The ATO's view of the content of these requirements is enunciated in paragraph 9 of TR 95/27.

> 9. For the ATO to accept a fund as a public fund, the founding documents of the public fund must reflect the following:
>
> (a) the objects of the fund must be clearly set out and reflect the purpose of the fund (see Objects of the fund below);
>
> (b) gifts to the fund must be kept separate from any other funds of the sponsoring organisation (if there is one). A separate bank account and clear accounting procedures are required;
>
> (c) receipts must be issued in the name of the fund;
>
> (d) the public must be invited to contribute to the fund;
>
> (e) the fund must operate on a non-profit basis. Moneys must not be distributed to members of the managing committee or trustees of the fund except as reimbursement for out-of-pocket expenses incurred on behalf of the fund or proper remuneration for administrative services;
>
> (f) the fund must be managed by members of a Committee, a majority of whom have a degree of responsibility to the general community (this requirement does not apply to funds established and controlled by governmental or quasi-governmental authority); and
>
> (g) should the fund be wound-up, any surplus money or other assets must be transferred to some other fund qualifying under subsection 78(4) or 78(5) (see Dissolution clause below).
>
> The ATO also requires an undertaking in writing, or the inclusion of a clause in the constituent documents, that the ATO is to be notified of any changes to the fund's constitution or other founding documents.
>
> These requirements are intended to ensure that moneys and property donated to the fund, and which attract a taxation concession, are used for the purpose for which the fund has been granted tax deductible gift status.

Subject to our comments about considering the impact on non-PubAF DGRs, codifying these requirements for PubAFs appears appropriate. However, we consider the following points should also be addressed in any codification.

Fundraising

The concept of fundraising incorporates the notions in TR 95/27 that the intention of the promoters or founders of a PubAF be that the public will contribute to the fund and that the public, or a significant part of it, does in fact contribute to the fund. These were the critical characteristics identified in *Bray v FCT*. Example 1 in TR 95/27 also refers to whether donations are actually received. However, the factors in paragraph 9 of TR 95/27 appear to implicitly acknowledge that the level of actual contributions will not be critical.

[10] (1978) 140 CLR 560.

We support such an approach. We consider that a fundraising requirement should require genuine efforts to raise money from the public rather than private individuals. However, it should not be a requirement that the persons approached actually donate money. Donations are likely to vary depending on circumstances both within and outside the control of a PubAF. For instance:

- The state of the Australian and the global economy.
- The occurrence of natural disasters.
- The comparative popularity of the objects of the ultimate DGR recipients from time to time (eg environmental versus cultural objects).
- Whether the PubAF is fundraising for a particular project or general distributions.

The issue of whether the public actually contributes to a PubAF is adequately dealt with by a minimum distribution rate requirement and by the proposed information disclosure and governance requirements.

Information disclosure

Although the public disclosure of information is not expressly addressed in TR 95/27, such disclosure would build greater public confidence in PubAFs, as recommended by the Productivity Commission (see section 1.5 above). In conjunction with an appropriate minimum distribution rate, the disclosure of information should assist self-regulation of PubAFs.

Governance

We believe that public involvement in the administration and governance of the fund is appropriate. We consider that in accordance with the fit and proper person requirements discussed in section 2.4 above and with TR 95/27, a majority of the management committee of the PubAF should be persons with a degree of responsibility to the general community.

Finally, we note that any codification of the concept of 'public' involving more onerous administration and governance requirements is likely to result in increased compliance costs. Significantly more onerous requirements are likely to result in significantly increased costs and less willingness on the part of individuals to become involved with PubAFs. Significantly more onerous costs would also be inequitable in that the donors to PAFs (as opposed to PubAFs) are likely to be wealthier individuals.

4. Principle 4 – Public Ancillary Funds are ancillary funds

Consultation Questions

4.1 Can the investment and risk minimisation rules that apply to private ancillary funds be suitably applied to public ancillary funds?

The public nature of PubAFs involves stricter governance and accountability requirements than for PAFs. We consider that in this context, appropriate risk taking and liquidity of investments can be achieved by public review of investment performance and by the appropriate board composition, rather than prescriptive investment rules. This is particularly so for the 'rules to protect the assets of the fund' referred to in the fourth bullet point of paragraph 74 of the Discussion Paper. While such rules may be appropriate for PAFs, they are not appropriate for PubAFs.

We would welcome the opportunity to be further involved in the process of amending the PubAF regime, including in any working party addressing the matter.

Please contact Teresa Dyson on (07) 3259 7639 if you have any questions.

Yours faithfully

Blake Dawson.