



PHILANTHROPY
Australia

**Review of Prescribed Private Funds (PPFs) Regulations
Submission to Treasury
by
Philanthropy Australia
August 2008**

As the peak body for philanthropy in Australia, Philanthropy Australia is supportive of a clear regulatory framework for Prescribed Private Funds (PPFs).

Philanthropy Australia's recommendation to Treasury is based on the need for transparency, efficiency, and choice, to ensure that the maximum benefits of philanthropy flow to the community in perpetuity. We believe that it is in the interests of charities and the community, the Federal Government and the philanthropic sector that a clear regulatory framework for Prescribed Private Funds (PPFs) is simple to administer, monitor and comply with.

To that end Philanthropy Australia recommends that from the date of set-up onwards, distributions from PPFs should be a fixed percentage of total assets at 30 June balance date, to be distributed within twelve months of the financial year end.

Background

The introduction of the Prescribed Private Fund (PPF) structure in 2001 was designed to increase giving and provide a mechanism for increasing privately controlled investment for long term community benefit. At the same time PPFs included mechanisms for accountability and transparency.

While we have seen the growth of PPFs from start up in 2001 to 610 in November 2007, we know that the current lack of clarity around the day to day administration and interpretation of the guidelines is holding back many who would otherwise be committing significant funds to a PPF for the long term benefit of the community, due in part to ambiguous PPF guidelines..

Review of PPF Regulations

In the 2008 Budget the Federal Government made the following announcement:

Philanthropy — improving the integrity of prescribed private funds

*The Government will legislate guidelines to improve the integrity of prescribed private funds (PPFs), with effect from 1 July 2009. This integrity measure has no impact on revenue as the measure will initially have greatest impact on new PPFs which are not currently included in the forward estimates until prescription (see, for instance, the measure *Philanthropy — additional prescribed private funds*). The estimated potential savings are expected to be \$20 million in 2010-11 and \$40 million in 2011-12.*

PPFs allow businesses, families, and individuals to establish and donate to a charitable trust of their own, for the purposes of disbursing funds to a range of other deductible gift recipients.

This measure will provide the trustees of PPFs with greater certainty as to their philanthropic obligations by amending and legislating the PPF guidelines, including to ensure regular valuation of assets at market rates, to increase the size of compulsory distributions and to give the Australian Taxation Office greater regulatory powers.

Issues arising from the current PPF structure

The PPF structure was designed to be simple. However in practice, compliance with the PPF rules has proven challenging particularly in the consistent interpretation and implementation of the guidelines, which are ambiguous in many cases.

The guidelines are ambiguous in part, particularly in regard to accumulation of capital and the distribution of funds, making compliance complex and monitoring difficult. They are also unclear in other areas relating to day to day administration.

- Accumulation – definitions are unclear and vague. PPFs are the only form of charitable trust in the country with an accumulation plan limiting accumulation of capital growth. High Net Worth individuals are not setting up PPFs while rules around accumulation are unclear. It has also been suggested that they will shy away if future amendments restrict the ongoing ability to generate a growing income stream to preserve the real value of future grants; ie allowing capital to grow while also annually supporting the community at a consistent level after inflation. The requirement to distribute capital gains is contrary to trust laws principles.
- Distribution – timing of distributions is unclear i.e. must the income be distributed in the year it is earned or in the 12 months following it being earned. It is very difficult to distribute income in the year that it is earned (particularly franking credits which are not actually received until after year end), if total income earned is not confirmed until after year end. Furthermore Philanthropy Australia does not believe a short time frame to make grants is conducive to maximising the beneficial impact for the community as philanthropic grants require appropriate due diligence and process
- Compliance – Through our consultations we have received consistent feedback that there is a variety of interpretations of existing guidelines. Issues such as clarity of treatment re share buy backs, any distinction in treatment between realized and unrealized gains, and capital retention, were identified as requiring further clarification.
- Rollover of assets between PPF's and Ancillary Funds. There is some evidence that people starting out on the endowment path are conceptually more comfortable initially making a smaller contribution to an ancillary fund where the day to day administration and the financial commitment is smaller than is required to establish a PPF. As they increase their level of commitment and potential involvement in the administration of their endowment a PPF may be a more appropriate vehicle. Due to the inability to roll from one structure to another this is having the unintended consequence of reducing the level of new endowments formed as donors are concerned about establishing a vehicle that may not be best suited to their circumstances in the long term.

In other cases where a PPF has been established and the circumstances of the founder changes so that they can no longer provide day to day responsibility for administering a PPF currently they are precluded from outsourcing that function to another party.

The ability to roll funds from an ancillary fund into a PPF and vice versa has no tax consequences and no impact on annual distributions to the community and would act a positive encouragement donors to who are considering endowing a Philanthropic structure without needing to know what their future circumstances are. The current situation potentially discourages such donors where that uncertainty exists.

Having some opportunity to rollover the assets either from a PPF to an ancillary fund or from an ancillary fund to a PPF or from one Ancillary Fund to another, would not only provide lower level entry level to new philanthropic structures, but also introduce a degree of flexibility, consistent with the superannuation industry, and provide a greater choice of providers in the market. The rollover of assets between PPF's and Ancillary Funds would be a transfer of capital only between

similar vehicles with the same taxation status; there would therefore be no additional taxation consequences or impact on annual distributions to the community.

RECOMMENDATION:

Philanthropy Australia's recommendation to Treasury is based on the need for transparency, efficiency, and choice, to ensure the maximum long term benefits flow to the community. We believe that it is in the interests of charities and the community, the Federal Government and the philanthropic sector that a clear regulatory framework for Prescribed Private Funds (PPFs) is simple to administer, monitor and comply with.

To provide a mechanism for increasing private investment for long term community benefit and ensure that the real value of grants made can be sustained over the long term, Philanthropy Australia proposes:

1. Administration of Prescribed Private Funds (PPF's)

- That from the date of establishment, distributions from PPFs should reflect the long term growth rates of invested funds and defined as a fixed percentage of total assets at 30 June balance date.
- The distributions at a fixed percentage of total assets therefore removing the detail and debate of calculation of costs of administering a PPF from the discussion.
- The distributions must be made within the following financial year
- Assets to be valued as at 30 June each year. Unlisted assets such as real property should be valued every 5 years due to the high cost of such valuations.
- There would be no limits on gifts and no accumulation plans.
- Reporting requirements to the Australian Tax Office to remain as is.
- Existing PPFs may apply to the Australian Tax Office to opt into the new regulations.

Benefits:

After consultation with the sector and advice from investment professionals, it was felt by our members that 5% was a reasonable level of distribution. 5% is generally agreed as an appropriate and simple to calculate proxy for the long term average real return. 5% over the following financial year is the approach used in some states of the USA. This is easy to understand, easy to comply with and monitor. It also provides an efficiency boost to both the Government and philanthropists by simplifying and reducing the need for clarifications on treatments of realized and unrealized gains, franking credits, share buybacks and the like.

Sanctions:

We propose that Australian Tax Office be given more flexible sanctions to deal with PPFs, such as those in the US and Canada known as Intermediate Sanctions. This allows a proportionate response to defaults in PPFs as at the moment the only real sanction is to revoke the PPF tax status. The flexible sanctions could include barring someone from management of a PPF or requiring upgraded systems of education of staff etc.

2. Rollover of assets between PPFs and Ancillary Funds.

- That barriers be lifted to allow an opportunity under defined conditions to rollover assets from a PPF to an ancillary fund or from an ancillary fund to a PPF or from one ancillary fund to another.

3. Other Issues

- That the Australian Tax Office issues any changes to requirements for the PPF Information Returns by 30 July to fit in with the preparation and audit of PPF Financial Statements. At the moment these forms are being received in December with lodgments expected by end of February, making compliance difficult.
- More transparency and provision of information by the ATO on the aggregates of grant distributions of PPFs to the different parts of the charitable sector, including distributions by state.