

Prescribed Private Funds – A change of name, new guidelines and legislation amendments

Taxation

In the May 2008 Federal Budget, the Treasurer announced that the Government would legislate to improve the integrity of prescribed private funds (PPFs) and to provide the trustees of PPFs with greater certainty as to their philanthropic obligations. In November 2008, Treasury released a discussion paper entitled *Improving the Integrity of Prescribed Private Funds* (Discussion Paper) and invited submissions in response to the Discussion Paper. The 137 submissions received, which included a submission from Arnold Bloch Leibler, were critical to the outcome.

On 25 June 2009, Treasury released a draft of the legislative guidelines (Guidelines) that outline and govern the creation and administration of PPFs, and the *Tax Laws Amendment (2009 Measures No 4) Bill 2009*, to amend the existing PPF legislation (Legislation).

It is clear that the overwhelming opposition by the philanthropic community to many of the measures in the Discussion Paper has paid dividends. It is encouraging to see that both the Legislation and Guidelines are less onerous than originally proposed by Treasury in the Discussion Paper and the fact that some concessions are extended to existing PPFs is welcome news.

The changes will apply to all PPFs and take effect from 1 October 2009, from which point onwards a PPF will become known as 'Private Ancillary Funds' (PAF).

Guidelines

The object of the Guidelines is to set minimum standards for the governance and conduct of a PAF and its trustees. Some of the key changes and features outlined in the Guidelines and the firm's comments on these changes are set out below:

- During each financial year, a PAF must distribute 5 per cent of the market value of the fund's assets, as at the end of the previous financial year. A minimum distribution of \$11,000 per year is required.
- Under the transitional arrangements, PAFs approved prior to 25 June 2009 do not need to meet this new 5 per cent per annum minimum requirement and can continue to operate under their agreed accumulation plans until the earliest of: when the fund meets its target capital amount; the end of the 2013-14 financial year; or when the plan expires provided that the PAF must distribute 5 per cent of each gift received in the previous financial year and distribute its trust income (less CPI adjustment) within one year after receiving it.
- The market value of a fund's assets (other than land) must now be estimated annually by trustees. Land must be valued by an independent certified valuer or the Commissioner of Taxation (Commissioner) every three years. At present, no valuation requirements exist. These requirements may add significant cost to the operation of a PAF.

- The trustee of a PAF must:
 - exercise the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others;
 - prepare and maintain an investment strategy. The investment strategy should outline the investment objectives of the PAF and detail the methods the trustee will adopt to achieve these, as well as consider risk. The investment strategy and a record of the associated decision-making must be in writing. This requirement may add significant cost and complexity;
 - prepare and maintain a distribution strategy. The distribution strategy must reflect the quantity of donations expected to be received by the PAF, the expected distributions and recipients of distributions. Again, the distribution strategy and a record of the associated decision making must be in writing; and
 - arrange for an auditor to audit the financial statements of the fund and compliance with the Guidelines by the PAF and the trustee each financial year. Presently, only the financial statements of a PPF, and not compliance, must be audited.
- The PAF must not acquire any asset from a founder, trustee or associates except as a gift.
- The PAF must not acquire any 'collectables' (artwork, jewellery, antiques, coins, rare books, etc.) except as a gift and if it holds any collectables, whether acquired by gift or otherwise, they must be sold within 12 months of acquisition or by 1 October 2010 for collectables currently held by a PPF.
- The PAF must be private in nature, requiring that there must be a close relationship between those who establish the PAF and those who donate to it. A PAF must not solicit donations from the public, and cannot accept donations of more than 10 per cent of its market value per annum except from a founder of the fund, an associate of the founder or an employee of the founder. At present, a number of PPFs are set up as 'quasi-public' funds. This requirement may prevent their continued operation. All PPFs and PAFs will have the opportunity to 'convert' into a public ancillary fund. However the basis of this conversion is not clear at this stage.
- PAFs approved prior to 25 June 2009 are given some reprieve in transitional arrangements in the Guidelines. Where PPF governing rules prevent compliance with a requirement in the Guidelines, the PAF is not required to comply with that provision until 1 October 2012 (except for any collectables held). However, trustees must comply with the Guidelines to the maximum extent possible without breaching the PAF's governing rules.

- The Trustees must seek to have the PPF Trust Deed amended to comply with the new Guidelines.
- The Guidelines include various monetary penalties for non-compliance.
- The following changes proposed in the Discussion Paper have not been implemented:
 - no minimum fund size has been set;
 - PAFs will not be required to make their contact details available to the general public;
 - no ‘fit and proper person’ test has been adopted for trustees; and
 - PAFs will not be restricted to only investing in liquid assets.

Legislation

The Legislation, among other things:

- Renames PPFs to ‘Private Ancillary Funds’.
- Requires the use of a corporate trustee by all PAFs. Fortunately, under the transitional arrangements PAFs approved prior to 25 June 2009 will **not** be required to appoint a corporate trustee.
- Gives the Treasurer power to make the Guidelines. The current PPF guidelines outline the process to be followed and requirements to be met in establishing a PPF. These guidelines are unlegislated and therefore have no legal status in their own right.
- Require PAFs to submit an annual income tax return similar to the current annual information statement. Funds that fail to lodge their return will be subject to the same general penalty regime that currently applies to all taxpayers.
- Moves the full administration of those funds under the authority of the Commissioner. At present, the Treasurer is responsible for both approving a fund as a PPF (including the approval of its accumulation plan) and declaring a fund to no longer be a PPF.
- Facilitates changes to the Australian Business Register so that the register will expressly identify PAFs.
- Additionally, and long overdue, the ABR will from 1 January 2010 identify the deductible gift recipient (DGR) endorsement category for all DGRs. This will assist a PAF to determine which DGRs they can donate monies to.
- Gives the Commissioner power to impose administrative penalties on PAF trustees that fail to comply with the Guidelines and to remove or suspend the trustees of non-complying PAFs. Previously, the only action that could be taken against non-complying trustees and PPFs was to revoke a funds status as a PPF. For constitutional reasons, existing PPFs with individual trustees will not be subject to the Commissioner’s new powers to suspend or remove trustees.
- Make the trustees of a PAF jointly and severally liable for any administrative penalty imposed on a PAF. Where there is a corporate trustee, the directors of the corporate trustee will also be joint and severally liable for any administrative penalty that cannot be reasonably recovered from the corporate trustee.

Contacts

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