Private Ancillary Funds Trustee Handbook

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From 1 October 2009 philanthropic trusts previously called Prescribed Private Funds (PPFs) became Private Ancillary Funds (PAFs). The legislative changes included the introduction of detailed Guidelines (*Guidelines for Private Ancillary Funds, 2009*). This Handbook comments on what is required of the trustee, and directors thereof, of PAFs under the Guidelines and at law. It is not a legal document but a "plain English" introductory guide to the role and duties of the trustee(s) and all directors thereof. It draws on general information on charitable trust governance contained in the *Trustee Handbook: Roles and Duties of Trustees of Charitable Trusts and Foundations*, published by Philanthropy Australia in 2008; detail about other charitable trust structures can be found in that document.

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Private Ancillary Funds
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Background

Philanthropic trusts have existed in Australia for more than a century. While such trusts were generally exempt from income tax, it was not until 1963 with the introduction of Public Ancillary Funds that a form of charitable trust allowed for tax deductible donations. These funds required control by a majority of 'responsible persons' and had a public fund raising obligation. Up until 2001 private or family philanthropy was not as tax efficient as similar structures elsewhere, particularly in the UK and the USA.

Following a 1999 report on how to foster philanthropy, provision to create a new form of philanthropic structure, the Prescribed Private Fund (PPF), was announced by the Howard Government in 2001. The then Prime Minister stated that "*This measure will open up a new vehicle for private philanthropy, similar to that existing in the United States, so that families and individuals can donate to a trust of their own, which then disburses funds to a range of other gift-deductible recipients*." (Prime Minister's Press Release 30 March 2001.)

Key features of PPFs included:

- tax deduction for donations;
- exemption from ongoing income tax; and
- no public fundraising requirement.

Key governance requirements included requiring:

- an approved Accumulation Plan;
- granting restricted to only eligible organisations with DGR;
- one independent 'responsible person' as Trustee/Director; and
- an annual audit of Financial Statements and an Annual Information Return to the ATO.

Between 2001 and 2008, 775 PPFs were established.

To facilitate granting to a wider range of DGRs, provision for charitable funds to apply to become an Income Tax Exempt Fund (ITEF) was introduced in 2005. By late 2009 state legislation to give effect to this change (albeit slightly differently) had been passed in NSW, Victoria and Queensland.

The Treasurer of the incoming Rudd Government announced in the 2008 Budget that the Government would legislate guidelines "to improve the integrity of PPFs and to provide trustees of PPFs with greater certainty as to their philanthropic obligations." Subsequently in November 2008 a discussion paper "Improving the Integrity of Private Prescribed Funds" was published by Treasury which received over 130 public submissions. Following consultations, new legislation and guidelines for what are now called Private Ancillary Funds (PAFs) was announced in June 2009 to come into force from 1 October 2009, with transition arrangements provided for. The Explanatory Statement released with the final Guidelines on 28 September states "The Guidelines aim to ensure that private ancillary funds are properly accountable and act in the manner expected of an entity holding philanthropic funds for a broad public benefit".

The major changes for PAFs (from PPFs) are:

- trustees must be corporations (existing individual trustees of PPFs can continue);
- the Accumulation Plan is replaced by a 5% minimum distribution requirement;
- PAFs must have a formal Investment Plan;
- the annual audit must be of compliance with the Guidelines as well as the Financial Statements; and
- the Commissioner of Taxation has increased powers to tighten the compliance regime including administrative penalties, sharing information about non-compliance with the relevant state Attorneys General and ultimately suspending or removing the trustee.

Legislation Relating to Private Ancillary Funds

The *Private Ancillary Fund Guidelines 2009* (the Guidelines) is the primary legislative document for the operation of PAFs. This flows from the *Tax Laws Amendment (2009 Measures No. 4) Act* and consequential amendments to the Income Tax Assessment Act. It is the taxation aspects that make PAFs an attractive vehicle for individual and family philanthropy.

However, as PAFs are legally trusts, in addition to complying with the Guidelines and related federal income tax law, PAFs must also comply with the requirements of the relevant State trustee legislation (which is broadly consistent across all States) and common law as it relates to fiduciary responsibility.

The trust deed is the fund's governing document and may require or prevent additional specific activity. Changes to the deed can only be made within the powers set out in the deed or by the Courts and may need to be approved by the Commissioner of Taxation. A Model Deed for new PAFs and other ATO information can be found on the ATO website at:
http://www.ato.gov.au/nonprofit/content.asp?doc=/content/00215720.htm&page=1&H1

The most important legislation and common law concepts affecting PAFs are:

1. *Private Ancillary Fund Guidelines* 2009, issued 28 September 2009;
2. *Tax Laws Amendment (2009 Measures No. 4) Bill 2009; Schedule 2 – Private Ancillary Funds* (which amended Acts listed in 3 below);
3. The *Income Tax Assessment Acts of 1997 & 1936 and Taxation Administration Act 1953;*
4. The relevant State Trustee Acts, which while broadly similar do have some variation; *Trustee Act 1925 (NSW). Trustee Act 1936 (SA). Trustee Act 1958 (Vic). Trustees Act 1962 (WA). Trusts Act 1973 (Qld). Trustee Act 1898 (Tas). Trustee Act 1925 (ACT). Trustee Act 1907 (NT);*
5. The Common law concept of fiduciary responsibility (see Glossary); and
6. Relevant State Charity/Charitable Trust legislation governing Income Tax Exempt Funds; *Charities Amendment Bill 2006(Vic), Charitable Trusts Amendment Bill 2006 (NSW), Amendment to Trusts Act 1973, Part 5 of Criminal Proceeds Confiscation and Other Acts Amendment Act 2009 (Qld).* Legislation for other states has not yet been enacted.

The impact of this legal framework on the activities of PAFs is discussed in detail in the following sections. The consequences of any breach of the Guidelines and/or legislation are discussed in the governance failure section on page 12.

Other legislation may also impact on PAFs depending on the structure and range of activities. The impact of such legislation is not discussed in this Handbook as, where applicable, directors' responsibilities are no different from other organisations. This includes:

1. Company compliance with the *Corporations Act 2001*;
2. The federal *Privacy Act 1988*; and
3. If the fund employs staff, compliance is required with all relevant state and federal legislation such as WorkCover, Superannuation law, etc.

The Trustee

The trustee(s) has the ultimate responsibility for the governance of each PAF. The trustee of a PAF must be a private trustee company, an incorporated association, a Statutory Trustee Company, or (less likely) a combination of the above. This is different to the earlier Prescribed Private Funds and other charitable trusts which allow individuals to be trustees; although existing PPFs with individual trustees can continue with individual trustees under the PAF rules.

As the majority of PPFs had a corporate entity as trustee, as will all new PAFs, throughout this Handbook reference to "the trustee" also applies to all trustees should there be more than one; and references to "directors of the trustee" should be read as also referring to individual trustees where they remain. The directors of the trustee are responsible, accountable, and potentially joint and severely liable for the proper execution of the trustee's duties as set out in the following pages.

Most directors of trustee companies will be family members and/or business associates. Directors cannot be persons who are minors, mentally incapacitated or who have been convicted of an indictable taxation offence. In addition every PAF must have at least one individual director who has a degree of responsibility to the community as a whole (a '*responsible person*') who is not the founder, a donor of more than $10,000, family member or associate of the founder or such a donor. This does not preclude a person linked to the founder by business (such as the founder's accountant or lawyer) being the '*responsible person'*. The Guidelines define this;

> *'Individuals with a degree of responsibility to the Australian community as a whole' would generally include: school principals, judges, religious practitioners, solicitors, doctors and other professional persons, mayors, councilors, town clerks and members of parliament. Generally, individuals who are accepted as having a degree of responsibility to the community as a whole are known to a broad section of the community because they perform a public function or they belong to a professional body (such as the Institute of Chartered Accountants, State Law Societies and Medical Registration Boards) which has a professional code of ethics and rules of conduct. Individuals who have received formal recognition from the Government for their services to the community (for example, an Order of Australia award) will also usually have the requisite degree of responsibility".*

The *'responsible person'* must be active in the on-going management of the fund, but there is no additional defined role beyond that of other directors. Nonetheless, particularly if his/her background is not in trust law or accounting, professional training is highly recommended. Should circumstance come about whereby the independent responsible person resigns, retires or is not able to be actively involved in the fund, the Guidelines require that the trustee cannot exercise any power or discretion (there are limited exceptions such pressing decisions to protect trust assets) until a new 'responsible person' is appointed a director.

The Commission of Taxation has the power to suspend or remove a corporate trustee, and appoint an Acting Trustee if satisfied that the fund has breached the law or the Guidelines.

Directors should acquaint themselves with the remuneration provision (if any) set out in the deed as that, or any subsequent Court Order, determines what the trustee can be paid. Where remuneration is permitted by the deed, the Guidelines require any trustee remuneration to be 'reasonable' (with the explanatory material referencing state trustee legislation and the Model Deed suggesting a maximum of 1.056% of fund value – the maximum allowed under Victorian Trustee Company legislation). Where the deed is silent, only Statutory Trustee Companies can be paid trustee fees which are governed by the provisions of the relevant state Trustee Companies Act.

The Responsibilities of the Trustee

The trustee has the ultimate responsibility for the governance of each PAF. Directors of the trustee are accountable for directing the affairs of the fund to ensure it is well run, compliant with the law and the Guidelines, and supporting the eligible organisations for which it was established. Directors have a fiduciary responsibility to protect and prudently invest trust assets and avoid any personal conflict of interest or real possibility of conflict of interest. They must exercise their powers with integrity and good faith and show care, diligence and skill in managing the affairs of the trust.

In *Charity Law in Australia and New Zealand (*Dal Pont, 2000), the duties of charity trustees are set out as being to:

- Acquaint themselves with the terms of the trust document;
- Execute the trust according to its terms and the general law so as to benefit the community;
- Protect and preserve the trust property;
- Exercise discretionary powers in good faith, upon real and genuine consideration and according to the purpose for which the power was confirmed;
- Not delegate their powers or discretions except in accordance with the provisions of the trust document; and
- Not invest trust funds in a manner not authorised by the trust document, statute or the court.

The duty of care and responsibility is higher where a trustee's business or profession includes being a trustee, for instance a Statutory Trustee Company. This is the case even if there are other co-trustees.

Directors of the trustee must act personally and not delegate or fetter trustee powers; "it is for advisers to advise and for trustees to decide" (Robert Walker J in Scott v National Trust, 1998).
This does not preclude directors appointing, and paying for out of trust income, staff and or agents to do administrative tasks, prepare material or provide advice. Directors must not fetter future decision making by, for instance, entering into contracts that cannot be reviewed.

From a practical perspective a detailed consideration of trustee duties can most usefully be achieved using a framework of the three core areas of any foundation activity.

- **Administration**
  The processes of managing the fund to meet its compliance obligations.
- **Investment**
  The investment of fund assets to protect and grow the real value of the fund.
- **Distribution/Grantmaking**
  The distribution or granting by the fund to eligible entities.

The following section sets out in detail the legal requirements of trustees of PAFs; what directors **must** do as a minimum. This is followed by a section covering what directors are encouraged to give further consideration to, as good practice. This is based on current experience of leading foundations in Australia and overseas. This 'good practice' is by no means a static concept, and expectations will continue to evolve due to a quest for improvement within the philanthropic sector and changing public and community standards.

The Duties of the Trustee: Administration

Competent administration is central to the good governance of PAFs.

Record Keeping

- All trust **assets** must be held in name of the trustee(s) or if authorised by the deed, statute or the Courts, a custodian of assets. The fund can only **borrow in limited circumstances** for short terms (i.e. to fund distributions or to settle transactions). The trustee cannot pledge fund assets.
- Proper **minutes** of all trustee meetings must be kept. Decisions are by **majority**; trust law does not provide for a casting vote. If a director seriously disagrees with a decision, particularly on a fiduciary issue, he/she should insist on getting legal advice, and recording the dissenting vote. If the issue goes beyond a single matter of judgement, a director should reconsider his/her position. **Key documents**; minutes, deed, Court rulings, etc. should be kept safely; financials for at least 5 years.
- Directors are required to avoid **conflicts of interest** and real possibilities of conflicts. Potential conflicts must be disclosed and recorded along with the absence of the affected director from the specific decision making. Any transaction between the fund and directors of the trustee, the founder or associates must be at arms' length and on a commercial or more favourable to the fund, basis. These must be disclosed in the annual financial statements.
- The trustee cannot delegate other than in accordance with the deed and trust law; any **discretion** to staff needs to be properly minuted and professional advice should be taken.
- Proper **receipts**, including the information required by ITAA97, need to be issued for **all** donations to PAFs to facilitate the tax deduction. PAFs **cannot solicit** funds from the **public**, and unrelated parties cannot donate to the fund more than 20% of the value of the fund in any one year.

Accounts

- **Annual Financial Accounts** are required to be prepared for each PAF. These must be **audited** by a qualified auditor**.** In addition the auditor must audit **compliance with the Guidelines** by the Fund and Trustee (which includes investment, valuation and distribution activities). An objective estimation of the market value of the fund must be done annually (ideally 30 June); property assets must be valued by a Certified Valuer at least every 3 years.
- Reclaiming **franking credits** attached to Australian company dividends from the ATO adds substantially to every PAF's income - this should be done promptly after the end of the financial year.

Reporting

- PAFs are required to lodge an annual income tax return (replacing the PPF Return)
- The trustee company will have ASIC reporting requirements.

Grant Management

- **Conditions** attached to grants need to be recorded. If exceeding the Standard Grant Conditions (see Glossary of Terms), consideration needs to be given to GST rules which may require GST to be paid by the grant recipient. Normally if GST is payable the PAF would gross up the grant amount to cover the GST and claim an input tax credit.
- Monitoring of grant **terms and conditions** needs to occur to ensure grants are properly allocated and project reports furnished.

The Duties of the Trustee: Investment

The purpose of all trusts is to manage assets for the benefit of others. In considering trust investments, the trustee must exercise "the care, diligence and skill that a prudent person would exercise in managing financial affairs of others". Where the trustee's profession includes being a trustee or managing investments, the duty of care is higher - "exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing financial affairs of others" (State Trustee Acts).

Investment Policy and Review

Each PAF must have an **Investment Policy** which includes the objectives of the fund. The tax exempt status of foundations (enabling the refund of franking credits) increases *ceribus paribus* the attractiveness of Australian shares paying franked dividends relative to other asset classes. This means for instance, consideration of the diversification benefits of investing in overseas shares or bonds needs to be balanced against the reduction in income from not getting any franking credits attached to foreign dividends.

A review of investment assets is required at least annually, examining performance of the entire portfolio and individual assets, including:

- Performance relative to fund Investment Policy and objectives;
- A review of any **managers and advisers** used; and
- Documenting action taken to implement the Investment Policy and Review.

Directors can take outside **advice** on investment matters, which can be paid for by the fund.

Prudent Person

State trust law and the Guidelines require the trustee to consider inter alia:

- The benefits of **diversification** of trust investments;
- **Investing not speculating;**
- The **purpose/objectives** of the fund;
- Balancing the **risk** of capital or income loss;
- Maintaining the **real value** of capital and income;
- The **tax** consequences of investment decisions and choices;
- The **liquidity** of the investments having regard to cash flow and liability requirements including the timing of imminent and future distributions; and
- The **costs** of investment alternatives and transactions.

Investment Limitations

- Any **directions** or **restrictions** in the deed or any subsequent Court Orders need to be observed (such as a prohibition on holding mining stocks).
- PAFs **cannot** run a **business**.
- Investment transaction with founder, donor, trustee, directors, employees or associates thereof must be at by way of **arms length** transactions on commercial terms, or terms more favourable to the fund.
- **Collectibles** cannot be purchased and any donated must be sold within 12 months.

The Duties of the Trustee: Distribution/Grantmaking:

All philanthropists want to achieve a positive and lasting impact on society through their foundation's benevolence. Making distributions to eligible organisations, often called grantmaking, is therefore a core activity for every PAF. Grantmaking can range from funding organisations providing immediate relief to those afflicted by poverty, sickness etc., to advancing education or the fine arts, through to funding organisations and research projects to identify new ways to solve long term social or environmental problems. There is no single right way to grant; part of the benefit of philanthropy is the pluralist diversity it brings.

Level

- Other than those in transition, PAFs must distribute at least 5% of the net value of the fund at 30 June during the following financial year (with a minimum annual distribution of $11,000 unless expenses of the fund are being met from outside the fund).
- Distributions do not include expenses of the fund but may include provision of "in kind" services; for instance, where subsidised accommodation is provided to an eligible DGR, the value of that subsidy is part of the fund's distribution.
- Future years of a multi-year grant can be counted only once, either at commitment (where a future liability is created) or each year on distribution, but not both.
- Those PAFs in transition to the new Guidelines (under Clause 55 of the Guidelines) are required to distribute 5% of each gift received the previous financial year and distribute trust law income (interest, rent and normal dividends and related franking credits) within the financial year of receiving it. However, an amount of trust income equal to the effect of the previous year's inflation on the opening capital value of the fund may be retained.

Purpose

A charitable PAF (non ITEF), can only fund DGR organisations with **charitable purposes**, i.e. for the relief of poverty, sickness or the aged, the advancement of education or religion or other purposes beneficial to the community (see Glossary) within the terms set out in its deed.

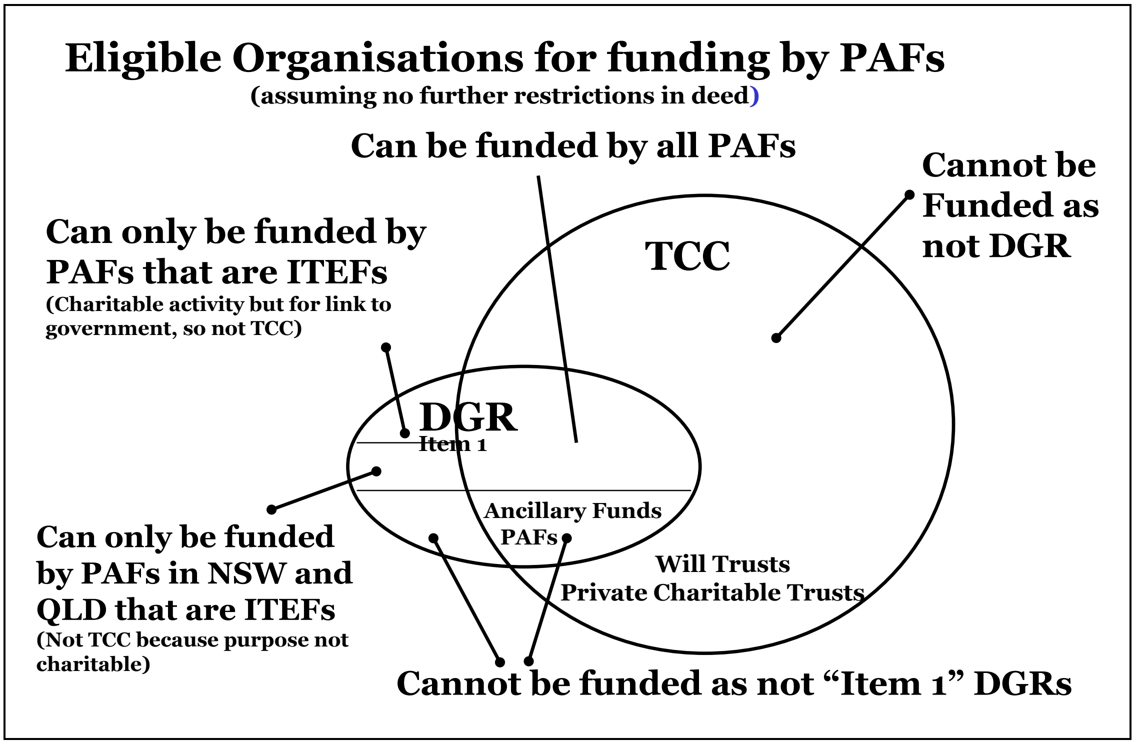
Recipients

PAFs can only distribute to **"eligible organisations"**: Determining which organisations are eligible to receive distributions is one of the trustee's key compliance duties.

- As a tax deduction has been given on donations to PAFs they can only grant to organisations that are also Deductible Gift Recipients **(DGR)** In effect, from the ATO's perspective PAFs are seen as a holding vehicle in the process of donations passing from individuals to DGR entities. (Many other charitable trusts are not so restricted in their distributions because donations to them are not tax deductible).
- In **no** circumstances can PAFs distribute to other PAFs or Public Ancillary Funds (even though they are DGR), because if they did the money would be circulating from one fund to another (and potentially back again the following year) and therefore not having the intended beneficial impact on the community.
- **For charitable PAFs (those that are not ITEFs):** all grants must be to charitable organisations with both **TCC** and **DGR** tax status i.e. operating charities such as "Public Benevolent Institutions", "Health Promotion Charities" and "Charitable Institutions" or non Item 2 DGR "Charitable Funds" such as school building funds, scholarship funds and necessitous circumstance funds.
- **For PAFs that have become ITEFs:** distributions can be to a wider group of DGR depending on state law. For those domiciled in NSW and Queensland all non Item 2 DGRs are eligible and in Victoria granting to non Item 2 DGRs that other than for their connection with government would be charitable, is allowed. Legislation for other states has not been enacted. It is the domicile of the fund that determines which state rules apply not the domicile of the recipient organisation.

The Duties of the Trustee: Distribution/Grantmaking (cont.):

The discussion on the previous page on eligible recipients can be summarised in this diagram.



- **Overseas** granting (where this is permitted in the deed), can only be done using DGR overseas aid funds endorsed by the Treasurer for work overseas; these appear on the **AusAid** listing (www.ausaid.gov.au/ngos/approved_funds.cfm). The payment must be to the "overseas relief fund" or "overseas aid fund" on that list, confirming that fund also has DGR.

There are two tools to assist establishing an organisation's tax status.

The Australian Business Register (ABR)

Organisations can be searched for by name on the ABR using the ABN Lookup website: www.abn.business.gov.au . This will indicate whether the organisation itself is one of the types of charitable organisations discussed above and, separately, whether it is a DGR or it manages a fund or institution that is DGR (note all distributions from PAFs must go to the actual entity that is the DGR). However, most Private Ancillary Funds and Public Ancillary Funds are also Income Tax Exempt Charitable Funds (or occasionally Charitable Institutions) and DGRs (under Item 2) but they are not eligible recipients. The ABR site is being upgraded so Private Ancillary Funds and Public Ancillary Funds will be identified as being "Item 2" DGRs, thereby making it much easier to exclude them from consideration for distributions.

ATO DGR Endorsement Notice

Nevertheless, for larger or multi-year grants it is still recommended that a copy of the organisation's DGR Endorsement Notice from the ATO be requested. If the DGR endorsement reads "**Item 1** of the Table in Section 30-15 of the ITAA 1997" or "specifically listed in Act of Parliament as being DGR in subdivision 30B of the ITAA 1997" then the organisation meets the DGR criteria to receive a grant. If it reads "**Item 2** of the Table in Section 30-15 of the ITAA 97 " it is another Ancillary Fund to which grants **cannot be paid**. (If the ABN upgrade is not completed by in early 2010 as planned, or there is some doubt, requesting the DGR Endorsement Notice is the only way of confirming whether an organisation is eligible).

Issues for Further Consideration

In addition to the legal responsibilities, there are many issues directors of PAFs trustees should also consider to enhance the fund's effectiveness and transparency. As all charitable foundations operate in a tax exempt environment, the expectation is that there will be significant community benefit.

Administration

- Have a written **Code of Conduct** covering conflicts of interest, actual, potential and perceived, disclosure obligations, ability to seek advice, etc.
- Develop a **succession planning framework** for directors; in particular identification of a replacement *'responsible person'* will be necessary at some stage.
- Develop a **Trustee Dossier** (see page 14) and an induction program for new directors.
- Additional **transparency can** be achieved through reports, printed or online, including:
  - **A legacy statement** setting out the history, vision and objectives of the foundation;
  - **A clear statement of processes**, particularly in grant application and assessment.
  - **An annual report**, which does not need to be lengthy, expensive or even printed.

Investment

PAFs tax exempt status means the **Investment Strategy** should have a focus on **after tax** returns. While less prevalent now, off-market buy-backs have the capacity to significantly benefit tax exempt funds and directors should consider a policy in regard to them.

An **Investment Strategy** linked to the fund's objectives is required; however some directors may want to consider further refinements including adopting an ethical, socially responsible or sustainable investment approach. Any such change needs to be considered carefully and advice should be taken. Under trust law the purpose of holding investments is to generate funding to support the objects of the trust. Certainly, investments contrary to the trust purpose should not be held. The long term horizons of perpetual foundations may warrant including an assessment of the sustainability of business practice as part of the investment criteria. Also investment restrictions without which there would be a risk of alienating critical financial supporters may be considered. However, the trustee must be careful not to introduce additional risk of "financial detriment" by applying a restrictive investment policy.

All investors including PAFs face **risks**. However, because of their long-term time frame and tax exempt status, foundations' investment profiles are different from superannuation or personal monies. Assessed risks should not be limited to possible falls in capital value. The danger of inflation eroding the purchasing power of fund distributions over time and the potential volatility of distributions are also important risks that need to be considered.

Distribution

Directors are encouraged to apply a similar degree of diligence, skill and care to grantmaking as they do to investment matters. To paraphrase Aristotle, "giving money away is easy, but giving it away effectively and having impact is a very different matter". Critical components of effective grant making include issue **research** and knowing what interventions have been tried previously. Conducting due diligence on potential grant recipients is important including assessment of organisation structure and tax status, organisation mission, the experience and capacity of key staff and directors, and the financial strength including diversity of income. Collaboration with other funders on major projects can enhance effectiveness by increasing the funding, experience and resources available; Philanthropy Australia's **Affinity Groups** are a good starting point.

Beyond whether money was properly spent, trustees should accept a responsibility to evaluate whether grants for significant projects have been **effective** in addressing the identified problems; sometimes this requires the use of external independent parties.

Philanthropy is more than just making and giving away money. PAF directors can also bring **expertise, knowledge, influence and voice** for the benefit of grantee organisations.

Governance Failure

The trustee has ultimate responsibility for governance of each PAF; in short, "the buck stops" with the trustee directors. They are responsible, accountable and potentially personally liable for the good management of the fund. Good internal processes obviously reduce the risk of compliance breaches. Based on issues identified here (particularly by the ATO) and overseas, directors should be wary of the following (but of course not limit their vigilance to only the following):

Administration

- **Misappropriation** of trust income or assets for personal benefit;
- Operating without an independent **responsible person;**
- Excessive **expenses;**
- **Soliciting** funds from the public**;**
- Failure to prepare **audited financial statements;**
- **Issuing receipts** when fund not meeting guidelines**;** and
- **Claiming franking credit refund** when fund not meeting guidelines;

Investment

- **Non arms length related party** transactions including loans;
- **Use** of investments by donor or associates;
- **Breaching** investment limitations, i.e**. c**arrying on a **business** through a PAF**;**

Distribution

- **Insufficient** distribution – less than 5% of preceding 30 June value;
- Granting to **ineligible** organisations;
    - Distribution to **non DGR** charitable organisations;
    - For non ITEF PAFs distribution to **non charitable DGRs;** and
    - Distribution to other **PAFs or Public Ancillary Funds**;
- Imposing additional grant conditions but failing to pay **GST**; and
- Permitting **redirection** of grants through legitimate recipients to others.

For varying degrees of compliance breaches, the Commissioner of Taxation has significant powers to impose administrative penalties as set out in the Guidelines, which must be paid by the trustee or directors of the trustee but not by the fund. For more serious breaches the Commissioner can suspend or remove corporate trustees. Under the Guidelines the fund cannot indemnify the trustee, or an employee, officer or agent of the trustee for dishonesty, gross negligence or deliberate act of breach of trust by the trustee, employees, officers or agents. The Commissioner is also permitted to share PAF compliance information with State Attorneys General who have oversight of all trusts including PAFs and can instigate legal action if there is a suspected breach of trust or fiduciary duty to seek restitution (to restore the foundation to the position it would have been in had the breach not occurred). Depending upon the circumstances and processes that had been followed, State trustee legislation identifies mitigating factors that may be taken into account when the level of restoration is being determined. Directors should take legal advice immediately when they think a possible breach of trust may have occurred.

Not achieving the desired outcomes from a foundation's investments or grants does not necessarily mean a governance failure. There will be times when the PAF's investments decline. The test is not whether, in hindsight, investment choices were not ideal, but whether prudent investment processes were in place and were followed, including proper diversification of the investment portfolio and annual reviews. Similarly, a well thought through and executed grant project that failed to deliver the expected outcome is not prima facie a governance failure; it may have been simply an overly ambitious new approach to tackle a deep-seated problem.

Annual Checklist

The following checklist is prepared to assist directors check off their compliance obligations to ensure trustees "do not hold the fund out ... as entitled to remain endorsed as a PAF ... when the fund is not so endorsed or entitled" (TAA 1953 426-120);

	ANNUAL PRE 30 JUNE
Administration	
Has there been any change to the Deed and was the Commissioner notified?	√
Is the Responsible Person actively engaged?	√
Does the Audit cover both the Financial Statements and compliance with the PAF Guidelines 2009?	√
Are there any additional grant conditions that may require GST to be paid?	√
Confirm no benefit has been provided to the founder, major donors, the trustees, directors or associates.	√
Investment	
Is the Investment Policy current?	√
Has there been a Review completed in last 12 months?	√
Have all investment decisions been consistent with the investment policy?	√
Have there been any related party transactions? Were they all on commercial terms ?	√
Confirm there has been no borrowing or pledging of fund assets and no purchase of restricted assets (collectables)	√
Distribution	
Has at least 5% of the 30 June value been distributed?	√
Are all grants being paid to "eligible organisations"? (do they all have DGR status - but are not Item 2 DGRs?)	√
Is all distribution activity consistent with the Deed?	√

This planner provides a base document for directors to plan annual activities (assuming a 30 June year end);

FIRST QUARTER July - September	Prepare annual financial statements. Lodge claim for refund of franking credits with ATO. Review investment performance during previous year. Review investment strategy. Approve accounts. Complete audit. Confirm appointment of Auditor for current year.
Second Quarter October -December	Based on Audited Financials, set 5% minimum distribution level. Review existing commitments and set level of new granting.
Third Quarter January - March	Confirm sufficient liquidity for grant payments. Lodge Tax Return. Confirm engagement of Responsible Person for next 12 months.
Fourth Quarter April - June	Actively review pre 30June Compliance Checklist. Ensure 5% (of previous 30 June fund value) minimum distribution to eligible organisations has been achieved by 30 June.

Trustee Dossier

It is recommended that each PAF has a **dossier** for directors as a basic reference document containing the following:

1. A copy of the Trust Deed and any subsequent Court Orders and copies of correspondence to/from the ATO approving the Fund;
2. A copy of the Private Ancillary Fund Guidelines 2009;
3. A copy of the contents pages of the appropriate Trustee Act (for example for Victorian foundations the Victoria Trustee Act 1958) and the Investment section (Part 1 SS4-8 in Victoria's case); www.austlii.edu.au/au/legis/vic/consol_act/ta1958122/ ;
4. A copy of all policy documents endorsed by the trustee – particularly the Investment Strategy, and where relevant, the Legacy Statement or Mission Statement, Trustee and Staff Code of Conduct, and Financial/Delegation Authorities;
5. Where investment managers have been appointed with investment mandates - details of the investment managers, the funds allocated to each, and the terms of the mandates;
6. A list of directors, including disclosure of other organisations each director is involved with;
7. A copy of the Directors and Officers Insurance Certificate (if applicable); and
8. A copy of this Handbook.

The trustee dossier should be reviewed from time to time to ensure all documents are current. There should also be an induction program for new directors, particularly those totally new to the trustee role, to ensure they are fully aware of their legal responsibilities and the operational procedures of the foundation.

Transition Arrangements

The Guidelines came into effect from 1 October 2009. This means the minimum 2009/10 distribution level, unless under transition rules set out below, is set at 5% of the 30 June 2009 valuation. Existing PPFs with deeds that can comply with the new Guidelines can opt in immediately by passing a resolution to that effect. Legal advice should be taken to confirm compliance. If the existing deed prevents compliance, modification of the deed will be required (in accordance with the powers set out in the deed) and the Commissioner notified. Some deeds may require Court authorisation for changes. Care needs to be taken as amendments to a deed may require re-settlement of the trust, which can have tax and other implications.

The Guidelines also set out arrangements for the transition of those PPFs that cannot or do not wish to adopt the Guidelines with effect from 1 October 2009.

Administration (Clauses 56, 57 & 59):
Where the governing rules (Deed) of the PPF as at 25 June 2009 prevent compliance with the Guidelines the fund is exempt and has until 1 October 2012 to change the deed to comply. However the trustee must comply with the Guidelines as far as possible without breaching the deed.

A PPF with individual trustees can continue as a PAF without changing trustees. One of these must be a 'responsible person', and while the Commissioner does not have powers to suspend or dismiss such individual trustees they must still comply with the Guidelines and the Commissioner has power to revoke DGR endorsement and pursue legal action should breaches occur.

Investments (Clause 58 & 60):
Where a PPF holds investments that are prohibited by Clause 38 of the Guidelines (borrowings, asset pledged as security, collectables, non arms length investments) then the trustee has until 1 October 2010 to rectify.

Where a PAF has current borrowings as at 30 September 2009 these may be maintained but any change in terms requires the Commissioner's approval.

Distribution (Clauses 53- 55):
Funds can operate in accordance with an existing approved Accumulation Plan until the earliest of the plan expiring; meeting the target capital amount; 30 June 2014; or adopting for full transition into new Guidelines. During this transition period the fund must distribute;

- 5% of each gift received the previous year; and
- Trust income (rent, interest, normal dividends and franking) within the financial year, but an amount equal to the 30 June capital value of the fund multiplied by the CPI of the previous year may be retained.

Winding up of a Fund

Each deed will have a clause dealing with winding up of the fund to ensure that on wind up assets, after meeting liabilities, are transferred to eligible organisations (Item 1 DGRs) or with the Commissioner's approval the fund may convert into a Public Ancillary Fund.

Administrative Penalties

Under the Guidelines there are Administrative penalties for various breaches of the Guidelines that must be paid by the trustee or the directors of the trustee company but specifically **cannot be paid by the fund** (TAA 426-120(4)). Currently penalties are $110 per penalty unit as defined under Schedule 1 of the Taxation Administration Act 1953 and Crimes Act 1914.

Issue	Guidelines	Penalty
Failure to notify change of Deed	Clause 17	5 Units
Failure to distribute 5% of capital	Clause 19	30 Units*
Failure to rectify shortfall in distribution	Clause 19.5	10% of shortfall
Failure to keep proper accounts	Clause 24	10 Units
Failure to provide accounts to the Commissioner on request	Clause 25	10 Units
Failure to prepare financial statements	Clause 26	10 Units
Failure to provide financial statements to the Commissioner	Clause 27	10 Units
Failure to have accounts and compliance with Guidelines audited	Clause 28	10 Units
Failure to provide audit to the Commissioner	Clause 29	10 Units
Failure to have an Investment Strategy	Clause 30	10 Units10
Failure to implement the Investment Strategy	Clause 31	10 Units
Breach of Investment limitations including related party transactions, pledging and borrowing, and collectibles	Clauses 33 -38	30 Units
Running a business in the fund	Clause 40	25% of profit
Uncommercial transactions	Clause 41	30 Units
Provision of benefit to founder, trustee, donor, director or associates thereof	Clause 42	Value of benefit
Soliciting donations from public	Clause 45	30 Units
Accepting donations > 20% of fund value from those not the founder or associates thereof	Clause 46	10 Units
Acting trustee not following instruction from Commissioner	TAA** 426-160	100 Units
Former trustee failing to provide books to Commissioner within 14 days	TAA 426-165(1)	50 Units
Former trustee failing to act as instructed by the Commissioner	TAA 426-165(5)	50 Units

* If shortfall in distribution is greater than $1000. The shortfall must also be rectified which is an additional distribution in the year of rectification.
** Taxation Administration Act 1953.

In addition to the Administrative Penalties, the Commissioner of Taxation has the power to suspend or remove the trustee and to appoint an acting trustee where the Commissioner is satisfied the fund, or any trustee of the fund, has breached the Guidelines or Australian law.

Glossary of Terms

Associate

Associates of the founder or major donors or directors of a trustee company of a PAF are ineligible to be the "Responsible Person" for that PAF. Associates include family and employees but not those linked to the founder/donor only through a professional capacity (i.e. lawyer or accountant). Section 78A Income Tax Assessment Act 36.

Charitable Purpose

Activities that are charitable in law; the guiding definition of charity in Australia remains the 1891 judgement by the UK Judge Lord Macnaghten, in interpreting the *Statute of Charitable Uses* 1601 (the Statute of Elizabeth), in the case *Commissioners for Special Purposes of the Income Tax v. Pemsel*:

> "Charity in its legal sense comprises four principal divisions, trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion, and trusts for other purposes beneficial to the community, not falling under any of the preceding heads."

The ATO in TR 2005/21 also sets out the purposes which are not charitable as being:

> The purpose is to confer private benefits; is sporting, recreational or social; is illegal or against public policy; is political or lobbying; is commercial; is governmental; or is vague or has insufficient value for the community.

For more information see Attachment 2 of *Trustees Handbook: Role and Duties of Trustees of Charitable Trusts and Foundations in Australia*, Philanthropy Australia, 2008.

DGR

Deductible Gift Recipient. An ATO classification of an organisation or fund that enables donors to that organisation or fund to claim a tax deduction (subject to eligibility criteria). Search facilities on line through ABN Lookup (see page 10).
www.abn.business.gov.au

Fiduciary Duty

Common law duty of trustees to exercise rights and powers in good faith for the benefit of beneficiaries of any trust and not in their own interest.

Franking Credits/ Imputation Credits

Under Australian tax law, charitable foundations with TCC are entitled to receive cash refunds of franking credits attached to dividends received from Australian companies.

Indictable Taxation Offence

A taxation offence that is punishable by imprisonment for a period exceeding 12 months is, when committed by a natural person, is an indictable offence. *Taxation Administration Act 1953 - Sect 8ZA*

ITAA97 & ITAA36

Income Tax Assessment Act 1997 & Income Tax Assessment Act 1936.

ITEF

Income Tax Exempt Fund: A type of Ancillary Fund able to be created from 1 July 2005 to also support certain non-charitable DGRs. In NSW and Queensland an ITEF can grant to any DGR, while in Victoria an ITEF can support those DGRs that would be charitable other than for their government connection. Legislation is yet to be enacted in other states.

Item 2 DGR

Gifts to Private Ancillary Funds and Public Ancillary Funds are deductible under item 2 of the table in section 30-15 of Income tax Assessment Act 1997.

Off-market Buy-back

A capital restructuring by a listed company buying back a number of its shares. The consideration for the buyback is usually a small capital return and a large deemed franked dividend.

Major Donor

A donor to the fund of more than $10,000

Overseas Aid Funds

The AusAid website contains a list of overseas aid funds approved by the Treasurer under ITAA97. www.ausaid.gov.au/ngos/approved_funds.cfm

Penalty Unit

Currently $110 as defined under the Crimes Act 1914

Private Ancillary Fund (PAF)

Philanthropic structure available from 2009, replacing PPFs

Private Prescribed Fund (PPF)

Philanthropic fund available from 2001 until 2009, replaced by PAFs

Responsible Person

An individual with broad community responsibilities who is required as director for each PAFs (see page 5).

Standard Grant Conditions

The ATO accepts that if the grant agreement provides no material benefit to the grantmaker and specifies only the conditions set out below, then the recipient will not be subject to GST in respect of the grant. (This issue is currently under review at the ATO and Philanthropy Australia will advise its members of any changed interpretation.)

1. stipulate the project for which the funds are to be used;
2. establish a date for completion of the project;
3. require the grantee to maintain separately in its books of account records on how the grant has been used; and
4. require that the grantee acknowledge the assistance of the grantor in any published or display material;
5. require a report on the use of the grant.

TAA 1953

Taxation Administration Act 1953

TCC/ITEC

Tax Concession Charity, previously known as Income Tax Exempt Charity (ITEC), is an ATO endorsed charitable organisation which is exempt from paying tax and enables the reclaiming of any franking credits received on dividends from Australian Companies.

Attachment 1

Extract from the Prime Minister's Press Release of 30 March 2001

COMMUNITY-BUSINESS PARTNERSHIP DEVELOPS NEW TAX INITIATIVESTO PROMOTE PHILANTHROPY

" The Government has also taken a further significant step to encourage private philanthropy, with the release today of guidelines for Prescribed Private Funds, which will become a new form of charitable trust enjoying tax deductibility for donations made to it. These guidelines will be followed up with a model trust deed, to be released early next week. The establishment of Prescribed Private Funds was part of the package announced in March 1999.

These new trusts will provide businesses, families and individuals with greater flexibility to start their own trust funds for philanthropic purposes. Funds that comply with the guidelines and the model trust deed will be prescribed in Regulations as gift deductible entities under the Income Tax Assessment Act 1997. This means that donations made to the funds will attract tax deductions.

This measure will open up a new vehicle for private philanthropy, similar to that existing in the United States, so that families and individuals can donate to a trust of their own, which then disburses funds to a range of other gift-deductible recipients. By creating opportunities for private philanthropy, the Government is building up the social coalition, in which government, business, community organisations and individuals work together on social issues.

The guidelines released today specify the criteria by which private funds will be prescribed in the regulations as gift deductible. They also prohibit any payments from the funds that directly or indirectly benefit the donor to the fund.

Limits will apply to the accumulation of money within the fund, such that investment income can only be accumulated at a rate equivalent to the CPI, with the rest disbursed to public philanthropic funds. In addition, funds will be required to provide a simple annual return to the Tax Office outlining the source of funds, and the payment of funds to various gift-deductible public funds as well as the extent and recipients of management fees.

These guidelines will ensure that tax deductibility will only be given where private charitable funds are used for the purposes for which they are intended – providing money for philanthropic purposes. The guidelines and model trust deed strike the right balance between maintaining the integrity of the tax system, at the same time as providing tax incentives for private giving."

30 March 2001

Assistant Treasurer Announcement 25 June 2009 (extracts)

The Assistant Treasurer, Senator Nick Sherry, has today introduced into Parliament the *Tax Laws Amendment (Measures No 4) Bill 2009*, which establishes for the first time a comprehensive legal framework for prescribed private funds that will boost the integrity of our tax system and ensure such funds deliver strong philanthropic outcomes.

Prescribed private funds, which are now to be known as Private Ancillary Funds (PAFs), are a type of fund designed to encourage private philanthropy by providing businesses, families or individuals with greater flexibility to start and run their own trust funds for philanthropic purposes.

"The Rudd Government places a strong policy premium on charitable giving - and all in our community who engage in philanthropy should be rightly acknowledged."
"Private Ancillary Funds are a very important feature of charitable giving in our country and the Rudd Government strongly supports their use. That said, we must ensure that they are not being misused for tax purposes and the Bill introduced today will do this."

The Bill introduced today also moves the full administration of PAFs under the authority of the Commissioner of Taxation, gives the Treasurer the power to make legislative guidelines about the establishment and maintenance of PAFs, and gives the Commissioner of Taxation the power to impose administrative penalties on trustees that fail to comply with the guidelines, and power to remove or suspend trustees of non-complying funds.

The draft Guidelines released today contain the following key reforms:

- replaces the existing complex rules based on accumulation targets with a simpler minimum annual distribution rate for funds, proposed to be set at 5 per cent, being a rate the Government considers to strike the right balance between ensuring resources flow to the charitable sector now, whilst also allowing PAFs to grow for the benefit of the sector in the future;
- a requirement that funds develop and maintain an investment strategy, which requires consideration of investment objectives and risk;
- the introduction of valuation rules that seek to minimise the compliance costs associated with making regular valuations; and
- a requirement, in lieu of setting a minimum fund size, that trusts distribute at least $11,000 per year unless the expenses of the fund are met from outside the fund, to ensure philanthropists have the freedom to establish smaller trusts whilst protecting funds from being eroded by expenses.

For ease of transition into the new regime, applicants seeking to newly establish a prescribed private fund prior to the commencement of the regime on 1 October 2009 should seek to comply with the proposed arrangements, including having only corporate trustees.
The Assistant Treasurer has also indicated that the Government will closely consider prescribed private fund applications received from today until the new regime commences against all of the new requirements to be established by the Bill.

CANBERRA
25 June, 2009

Key References

For a fuller reference list refer: *Trustee Handbook: Role and Duties of Trustees of Charitable Trusts and Foundations in Australia,* David Ward, Philanthropy Australia, (2008)
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