



16. December, 2010.

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

Dear Sir/Madam,

You have invited comments on the Discussion Paper issued in November 2010 entitled "Improving the Integrity of Public Ancillary Funds".

The George Alexander Foundation was established in 1972 by George Alexander who had come to Australia from England at the age of 14 under the "Big Brother Scheme". He worked on soldier settlement farms and then did a technical course at night in engineering and later in life invented the Neta Sprinkler. He and his wife had no children and when his wife died George Alexander retired to Queensland and set up a foundation to which he gave a substantial part of his income each year. In those days it had to be a Public Ancillary Fund.

During his life he was not a Governor of his own foundation and as he wished senior members of the community to be his Governors he appointed The Ian Potter Foundation Limited as the trustee of his foundation so that the Governors of the foundation are the same as the Governors of The Ian Potter Foundation. The Governors currently comprise Mr. Charles Goode AC (Chairman), Lady Potter AC (Life Governor), Professor Geoffrey Blainey AC, Mr. Leon Davis AO, The Hon. Sir Daryl Dawson AC KBE, The Hon. Sir James Gobbo AC CVO, Mr. John Gough AO OBE, Professor Thomas Healy AO, Dr. Thomas Hurley AO OBE, Mr. Allan Myers AO QC, Mr. Frank Nelson, Dr. John Rose AO and Professor Graeme Ryan AC. The trust deed requires any Governor prior to appointment either to meet certain criteria of being a leading citizen in the community or to be nominated by a unanimous resolution passed by all the Governors and approved as a Governor by the Chancellor of the University of Melbourne.

The George Alexander Foundation has established nine scholarship programmes at the University and TAFE level of education. The universities at which George Alexander Foundation Scholarships operate are Australian Catholic University (Vic), Charles Stuart University (NSW), Deakin University (Vic.), Griffith University (Qld), Murdoch University (WA), Swinburne University (Vic), and University of South Australia (SA). Scholarships are also provided at two TAFE's namely The Gordon (Vic.) and RMIT University and TAFE (Vic) as well as The International Specialised Skills Institute and the Centre for Sustainable Leadership.

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JANET L HIRST

The George Alexander Foundation since 2001 has assisted over 140 students across Australia through scholarships. It distributes most of its income by way of scholarships to talented students who, due to their financial position, may not have been able to achieve their educational potential.

The total value of the Scholarship Programme for the 2010/11 financial year is \$727,000.

The George Alexander Foundation is available to receive public donations and this is advertised on its website and it has from time to time held functions to seek donations so that it is carrying out its responsibilities in this area. Public donations in any one year have not exceeded 10% of its income.

When George Alexander died five years ago at the age of 95 his foundation had grown in value to around \$17 million and he left nearly all his Estate to his charitable foundation. His Estate was valued at around \$20 million and half of it comprised his home and surrounding land which he wished the foundation to hold for five or ten years until it appreciated in value due to becoming a sub-division proposition. His home and the land around his home comprise around 25% of the assets of his foundation. It provides no income. It does not lend itself to selling part of the land and therefore 5% distribution of the net assets of the foundation is punitive to his foundation.

We consider that charitable foundations make a significant contribution to our society in supporting the disadvantaged, the less well-off, research, health, education and the arts and they also improve the structural social fibre of our community. They encourage an attitude of helping one's neighbours and developing a spirit of goodwill and assistance to others. They are also the financier of much innovation in the delivery of social welfare and other charitable areas.

They are therefore to be encouraged and any legislation needs to be supportive and encouraging of their formation and for people to make donations. As well as ensuring there is accountability there needs to be considerable flexibility and scope for honouring the wishes of the donor. It should be realised that while \$100 of donations might give rise to \$48 of tax concessions, the donor is still giving the other \$52 over and above the tax deduction and making an irrevocable gift to the community.

A characteristic of a Public Ancillary Fund in the Discussion Paper is one in which it was the intention of the donor or founder that the public would contribute to the fund and that the public participate in the administration of the fund. However there is considerable diversity within the Public Ancillary Fund sector and there are broadly three groupings of Public Ancillary Funds:

- (i) Funds that are not focussed on maintaining or increasing capital and are "pass-through" foundations with a short time period between donations received and donations made.

Examples would be foundations established to support a particular institution such as a university, hospital or art gallery; foundations established to raise funds for a particular cause such as medical research into say cancer or for environmental protection; and foundations used to

raise funds from a particular group of people such as staff or customers or members of a club or organisation.

This group of Public Ancillary Funds would not be particularly concerned by the proposed minimum distribution requirement.

- (ii) Funds where the amount given by the donor does not justify the establishment of a private ancillary fund.

Examples would be the Community Foundations which establish sub-funds for individuals and the charitable endowment funds established by trustee companies and wealth management companies.

This group would in general wish to maintain the capital of the fund as the individual donor is often attracted by the perpetual nature of a sub-fund and its on-going benefit to the community. In general they would probably not mind a minimum distribution requirement similar to that which applies to Private Ancillary Funds.

- (iii) Funds that are similar to a testamentary endowment under a Will but have been established during the lifetime of the donor and substantially augmented by a bequest under the donor's Will.

In this case the funds donated are often substantial and the donor is attracted by:

- (a) The perpetual nature of the Foundation and the on-going benefit it will provide to the community;
- (b) Its prospects to grow its capital and thereby have the opportunity to employ staff to professionally assess prospective recipients of donations;
- (c) Its prospects to grow to a size that allows it to initiate new projects and make a significant financial contribution which would be a foundation brick on which other fundraising could be built.

This letter addresses the third group of Public Ancillary Funds and the proposed minimum distribution requirements.

The funds in this category are usually established by a person who during their lifetime wished to "give back to the community" and they established a fund, which, prior to the legislation allowing Private Ancillary Funds, needed to be a Public Ancillary Fund in order for them to receive a tax deduction for their donations. These people then usually made a substantial bequest in their Will to the charitable foundation that they established and there was no tax deduction for that donation.

These funds were established under the law of the day and their trust deeds were approved by the ATO and had as their essence and a major reason behind the promoter making the donation, the motive of establishing a perpetual fund for the on-going benefit of the community. These funds are not of the character of a Public Ancillary Fund as set out in paragraph 28 of the Discussion Paper that states "Ancillary funds may be likened to a conduit or temporary repository for moneys'".

The George Alexander Foundation Trust Deed, for example, provides "It shall not be necessary for the Trustee to pay or apply income of the Foundation in the year of its

receipt and the Trustee may in its absolute discretion pay or apply any income at any time or times or hold or carry forward the same for subsequent payment or application”.

It concerns us greatly that the trustees of a foundation, the donor of which gave irrevocably for the establishment of a perpetual trust and envisaged that trust growing over time, and had this accumulation of income provided in a Trust Deed which was approved by the Australian Taxation Office, now find a proposal to retrospectively introduce a minimum annual distribution that is contrary to the terms of the Trust Deed.

There are both Australian and English legal precedents supporting our view that the ATO has no power to interfere with the Trustee’s bonafide exercise of its discretionary power provided in the trust deed to accumulate income nor does it have the power to withdraw DGR endorsement or tax exemption because of the manner in which the Trustee exercises that discretion.

In *Bray vs. Federal Commissioner of Taxation* (1978) 140 CLR 560 the authority of the trust deed is clearly established and in the appeal to the Full Court of the High Court in *Mahoney’s Case* (1967-68) 41 ALJR232 Taylor J. said that if the fund was being administered in accordance with its constituent provisions, that will normally justify the conclusion that it was “being applied” for the purposes for which it was established. Windeyer J. expressed a similar opinion.

In the English Court of Appeal decision in *Inland Revenue Commissioners v. Helen Slater Charitable Trust Ltd.* (1982) 1 Ch 49 an issue arose whether an accumulation by a trustee is “applied to charitable purposes only”. Oliver LJ. Said:

“Charitable trustees who simply leave surplus income uninvested cannot, I think, be said to have “applied” it at all and, indeed, would be in breach of trust. But if the income is reinvested by them and held, as invested, as part of the funds of the charity, I would be disposed to say that it is no less being applied for charitable purposes than it is if it is paid out in wages to the secretary. I share Slade J’s difficulty in seeing why an accumulation for a specific charitable purpose resolved on by the trustee as being a desirable way of carrying out their charitable objects should be, as it is conceded it is, an “application”, whereas an accumulation for the general purposes of the charity is not”.

We therefore do not consider as a matter of law that you should provide for a minimum distribution for established Public Ancillary Funds whose trustees are empowered to accumulate income at their absolute discretion.

Should this opinion be found not to prevail we proceed to make recommendations on the Discussion Paper.

Recommendation No. 1:

It is recommended that these foundations that are structured as perpetual foundations with power to accumulate income at the trustee’s absolute discretion be grand-fathered and the minimum annual required distribution not apply to them.

The reason for this proposed grand-fathering are:

- (i) These trusts were established as perpetual trusts with the trust deed structured to provide the trustees with the discretion to accumulate income and grow the fund over time;
- (ii) Distributions can vary from year to year depending on the quality of applications received in any one year, the state of the assets of the trust and commitments that may be under discussion for a particularly large donation.
- (iii) These trusts were established under the law at the time and it would be unfair to apply retrospective legislation in respect to a minimum annual distribution;
- (iv) These trusts are similar to testamentary trusts except that the donor wished to commence donations during his/her life as well as leaving the major part of his/her donations under his/her Will;

For a charitable foundation to be grand-fathered it is proposed that the amount of non income tax deductible donations received since its establishment must be greater than the amount of income tax deductible donations received.

It is further proposed that in any future year should tax-deductible donations received exceed 10% of the market value of its assets then for that year it needs to make a minimum distribution of 5% of its net asset value at the close of the previous financial year.

Recommendation No. 2:

Turning now to the proposed minimum distribution of 5% of the net asset value at the close of the previous financial year for Public Ancillary Funds, other than those grand-fathered as recommended above, it is recommended that the proposed minimum distribution be modified as follows:

- (a) the costs of operating a charitable trust up to 1% of net assets at the close of the previous financial year be included as part of the minimum distribution of 5%. A charitable fund of size employs a professional staff to receive public applications and investigate the worthiness of various proposals with a view to the effective channelling of donations. This is an important operation for the charitable fund and the cost of its operations should form part of the 5% distribution as it comes out of the capital funds;
- (b) the 5% minimum distribution be a rolling average over five years. This is proposed because in some years the applications may be below the average standard and in other years above the average and it would allow the charitable fund to respond to good applications in a particular year and should be of no disadvantage to the community as long as the charitable fund met the minimum distribution of 5% per annum over a rolling five year period.

This proposal also has the advantage that if asset values were very high at the close of the previous financial year and fell sharply then the charitable fund would not have to liquidate assets in a depressed market to the same extent as it would have a longer period to meet its required minimum distribution;

- (c) the charitable fund has the option each year of distributing a minimum of 5% of the net asset value at the close of the previous financial year or 80% of its net investment income defined as interest, dividend and rental income (but not including donations received, capital gains and losses and capital revaluations and devaluations of assets) less operating expenses. The distribution under the option of 80% of net investment income would be substantial but move each year in line with the income of the charitable foundation;
- (d) there be a transition period of three years in cases where twenty-five percent of the assets are illiquid;
- (e) a Public Ancillary Fund be provided with the option to give up its right to receive tax deductible donations and then be allowed to make distributions at the discretion of the Governors which would involve distributing a significant proportion of its net income each year such that it can continue to be deemed to be carrying out its charitable purposes.

As funds in a charitable foundation will ultimately be spent for the benefit of the community we do not see the disadvantage in the accumulation of funds and this may well be desired by a charitable fund so that it is in a position to make a larger grant for a new initiative in the community. A major grant often forms the base finance to allow a project to proceed and it also can be an encouragement to fundraisers and to other charitable funds to contribute.

We have a different view concerning the need for a minimum distribution at all but Recommendation No. 2 is based on the assumption that there will be a required 5% distribution of the net assets at the close of the previous financial year, or a modification of that proposal, for Public Ancillary Funds other than for grand-fathered foundations which do not meet some of the important characteristics of a Public Ancillary Fund as set out in the Discussion Paper. We have made suggestions as to how the minimum distribution could be defined so that it would be in a more suitable form for the on-going operations of the charitable foundations to which it would apply.

We would be very pleased to discuss these comments on the discussion Paper should you wish.

Yours faithfully,

Charles Goode AC
Chairman
The George Alexander Foundation