

## A new source of fundraising

Many charities and non-profit organisations which are DGRs have not heard of prescribed private funds, more commonly referred to as "PPFs". They are a brilliant new source of fundraising which, to date, remains largely untapped.

In 2001 the Commonwealth Government introduced PPFs as an initiative to encourage private philanthropy. PPFs are a relatively new form of charitable trust which enjoys tax deductibility for donations made to it. PPFs are established by families, individuals and businesses for philanthropic purposes and are not required to seek contributions from the public. Funds that comply with the guidelines (discussed below) and have a trust deed approved by the Australian Taxation Office will be prescribed by the *Income Tax Assessment Regulations* 1997 as gift deductible entities under the *Income Tax Assessment Act* 1997. This means that donations made to these PPFs

will attract tax deductions. Distributions from these funds can only go to DGRs (that are not ancillary funds or other PPFs).

Three sets of requirements apply to PPFs:

- the fund must be established under a will or instrument of trust solely for the purpose of providing money, property or benefits to DGRs or towards establishing DGRs;
- the fund must meet the public fund requirements (without the need to invite donations from the public or the requirement for certain public participation in its administration, which is usually required of public funds); and
- the fund must meet the requirements of the integrity assurance measures mentioned in the guidelines.

The integrity assurance measures are as follows:

- the controlling body of the PPF must include at least one person who is a responsible person (ie a person who has a general responsibility to the community, for example, a lawyer, priest, a director of a company whose shares are listed on the



Australian Stock Exchange etc) who is not associated with the founder or major donor in anything other than a professional capacity;

- the fund must be audited;
- the founding documents must prohibit the provision of any benefit to the trustee, the donor, the founder or to any associate;
- the founding documents may allow accumulation of income (excluding gifts, donations, government grants and other voluntary transfers of property) to an extent which maintains the real value of capital of the fund.

A person wishing to set up a PPF must first apply to the Australian Taxation Office which then forwards valid applications to the Government for consideration.

PPFs are required to provide an annual information return which contains details of donations received and distributed; income of the PPF; expenses of operation; and

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## A new source of fundraising

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the net worth of the PPF. When a PPF issues a receipt for a tax deductible gift or a deductible contribution, certain details need to be included in that receipt.

Limits apply to the accumulation of money within a PPF, such that investment income can only be accumulated at a rate equivalent to the CPI (ie inflation), with the rest disbursed to public philanthropic funds. In other words, the amount of income retained must be limited to an amount which maintains the capital value on hand at the start of the financial year in line with the All Groups Consumer Price Index for the previous financial year. Therefore charities and non-profits which are DGRs can greatly benefit from these PPFs as, by law, they are required to distribute most of their income each financial year.

PPFs are listed by name in the *Income Tax Assessment Regulations 1997* as a prescribed private fund. There are a few hundred of them in existence in Australia, with 112 new PPFs having been added to the list as late as November 2006. They are rapidly growing in number as their attraction to individuals, families and businesses increases. They are appealing to tax payers as it allows them to make a donation to a PPF, claim the tax deduction immediately and then distribute the income of the PPF to a DGR at a later time.

A list of PPFs:

- is set out in the fact sheet entitled *Deductible gift recipients listed by name in the tax law* (NAT 8443); and
- can be searched on the Australian Business Register at [www.abn.business.gov.au](http://www.abn.business.gov.au).

By researching this fact sheet or searching the Australian Business Register, charities and non profits which are DGRs are

able to identify PPFs and approach them directly to seek distributions from them.

The trust deed of a PPF does not list the DGRs which are to receive donations from the PPF by name. In other words, your charity or non-profit organisation does not need to be mentioned in the trust deed of the PPF to receive a donation from it. You can become a beneficiary of that PPF at any time.

The NSW Government has just passed an amendment to its *Charitable Trusts Act 1993* in relation to PPFs (*Charitable Trusts Amendment Act 2006*). When PPFs were initially introduced into Australia, PPFs were only permitted to donate to DGRs which were charities. This meant that bodies such as the Sydney Opera House Trust and the Powerhouse Museum could not receive gifts from PPFs as they were not charities at law (due to their connection with government). In 2005, the Commonwealth Government amended the *Income Tax Assessment Act 1997* to allow a PPF to donate to any DGR, regardless of whether or not the DGR was a charity. However, the trust deeds of most existing PPFs did not allow for such donations. If the trustees made grants to bodies that are not considered charitable at law, then the trustees are technically in breach of their trust deeds. It is difficult to amend existing trust deeds, so the NSW Government has just amended the *Charitable Trusts Act 1993* to allow existing PPFs to distribute to non-charitable DGRs. This is encouraging news to non-charitable DGRs as they can now also target PPFs for donations (subject to any other limitations which may exist in the trust deed of the particular PPF in question). ■

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- The trustee of a PPF called the Jones Foundation proposes that the Jones Foundation will establish a capital base of \$15 million.
- This \$15 million capital base is to be achieved over a 15 to 20 year accumulation period with annual donations by the donor of \$1 million (subject to the donor's financial capacity).
- It is intended that the Jones Foundation will operate indefinitely.
- 10% of the amount donated each year to the Jones Foundation during the accumulation period will be distributed in the following year. For example, if \$1 million is given in year 1, \$100,000 will be distributed in year 2. This is in addition to the required distribution of the investment income.
- All investment income must be distributed each year except for an amount that may be retained so as to maintain the real capital value of the PPF based on the CPI figure for the previous financial year.
- Once the target amount of \$15 million is reached, the Jones Foundation will continue to distribute all investment income except for an amount that may be retained so as to maintain the real capital value of the \$15 million fund based on the CPI figure for the previous financial year. Any subsequent donations received by the Jones Foundation after the \$15 million target is reached will be distributed within 12 months of receipt unless otherwise approved by the Tax Commissioner.

## PPFs and attracting 'high net worth individuals'

High Net Worth Individuals are defined as those people with around \$1.5m in assets in addition to the family home, according to the *Merrill Lynch Capgemini World Wealth Report 2005* and they number over 150,000 in Australia. The rate of growth of this group is 9% per annum and 70% are aged over 55.

They are an obvious target as potential donors and, more importantly, may already be in your own support backyard!

Here are some interesting characteristics of High Net Worth Individuals. It is worth giving some thought as to how you might capitalise on these features:

- they like to control;
- they are strategic by nature;
- they value sustainability;
- they expect a value proposition before taking action;
- they are professional in their work and expect the same back;
- they all use financial advisers.

Also:

- 33% have gained their wealth through their business success;
- 25% through high incomes;
- 18% through inheritances;
- 10% from investing.

Prescribed Private Funds (or "PPFs") can be used as part of a wider strategy to attract funds from these people. The strategic nature and controllability of such funds, along with built-in features of sustainability, are extremely attractive to High Net Worth Individuals.

They are like an "investment" approach to giving. Sure, the money is not theirs any more, hence the tax deduction, but the founder can control the investments of the fund and who benefits from annual distributions. There is a clear accountability of the fund and it helps to formalise the giving process.

So High Net Worth Individuals need to know about these

structures, whether they be in your own support base or in the world outside. And there is value in you telling them. Even the mere fact that you are educating them about this new type of giving gives them a clear signal that you are talking on their level.

They may or may not wish to give in this way immediately, but will be impressed at the way you have related to them, rather than the traditional ask. This might, however, still lead to a traditional way of giving, that is, the writing of a cheque!

The tax deductibility angle will certainly interest them, and PPFs can act as a useful way of managing people's overall tax liabilities, according to their personal tax circumstances. This is where a financial adviser or accountant can help.

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## Fundraising charity dinners and events

**“Recent changes allow a greater number of charities to use this measure for fundraising”**

The Minor Benefits Measure allows a tax deduction for a payment to a charity where a benefit is received by the taxpayer provided that the value of the benefit received does not exceed the designated percentage of that payment. Deductions allowed under this Minor Benefits Measure are separate to deductions currently allowed for gifts.

The changes which were announced will reduce the minimum contribution threshold from \$250 to \$150. This will allow a greater number of charities to use this measure for fundraising. The value of the minor benefit allowed will be increased from 10% of the gift (or ticket price) to 20%, but not exceeding a value of \$150 (where previously it was \$100).

An example of how the new measures operate is as follows:

- A ticket to a fundraising dinner costs \$200.
- The market value of the benefit (eg the cost of the dinner per person) could be up to \$40.
- The participant would be entitled to a tax deduction of the balance of approximately \$160.

These changes to the Minor Benefits Measure will apply from 1 January 2007. As with the existing measure, these amended provisions will apply to specific one-off fundraising events held by deductible gift recipients. ■

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## PPFs and attracting 'high net worth individuals'

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As already mentioned, all High Net Worth Individuals go to financial advisers, including accountants, for advice. These advisers can certainly play an immense role in the giving process as more and more they are realising that the notion of considering their clients' giving wishes can form part of the discussions they have in wealth planning. What better situation to decide if, as part of planning for financial security, a client's personal values can incorporate the notion of philanthropy? And various tax angles might also be explored.

Moreover, the potential for involving family in the establishment and processes of philanthropy holds great attraction to people setting up structured giving. This is because it provides situations where family members

can unite around how the family's philanthropy has impacted in the areas that represent the group's values and priorities. Choosing the causes to which the vehicle gives and how this can be most effective, plus the actual running of the fund, encourages responsibility, communication, accountability, business acumen and understanding of the needs of others across all generations. ■

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## The National Safety Council case

The outcome of the *National Safety Council* case for the directors of the charity are often referred to but little understood.

The National Safety Council of Australia Victorian Division went into liquidation in 1989 with an estimated shortfall of \$200 million including approximately \$107 million owed to the State Bank of Victoria and \$17 million owing to the State Bank of South Australia.

The collapse of the National Safety Council resulted from a massive fraud perpetrated by its chief executive officer, John Friedrich.

The Commonwealth Bank of Australia (as successor to the State Bank of Victoria) sued John Friedrich and nine non-executive directors of the company and a senior full-time manager. Friedrich did not defend the proceedings and judgment was entered against him.

On the 45th day of the trial, the plaintiff reached a compromise settlement with all of the other defendants other than the former chairman, Mr M W Eise, and the case proceeded against Mr Eise and judgment was ultimately given against him for the sum of \$96.7 million.

The judgment makes it clear that there was no question of fraud on the part of any defendant other than John Friedrich but nonetheless the Court found Mr Eise liable for the whole sum.

In determining whether a director has a defence that he had no reasonable cause to expect that a

company would be unable to pay its debts, an objective standard applies to the facts known to the defendant. The Court held that a director ought usually to know, in general terms at least at the time of the annual general meeting, what the accounts in the audited report contain. On the balance of probabilities, the Court held that a person seeking to perform the duties of a non-executive director of the National Safety Council would, at the time of its 1998 annual general meeting, have had reasonable grounds to expect that the company would not be able to pay its debts as and when they became due.

In the circumstances of this case, Mr Eise was not entitled to rely on assertions by Mr Friedrich, the chief executive officer, and on his own assumption that the company was financially sound. Those assertions and his own assumptions did not entitle him to say that he would not have had reasonable cause to expect that the company would be unable to pay its debts.

The liability of Mr Eise arose under section 556 of the *Companies (Victoria) Code* which then read as follows:

"556(1) If

(a) a company incurs a debt, whether within or outside the State;

(b) immediately before the time when the debt is incurred –

(i) there are reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due; or

(ii) there are reasonable grounds to expect that, if the company incurs the debt, it will not be able to pay

*all its debts as and when they become due; and*  
(c) the company is, at the time when the debt is incurred, or becomes at a later time, a company to which this section applies,  
any person who was a director of the company, or took part in the management of the company, at the time when the debt was incurred is guilty of an offence and the company and that person or, if there are 2 or more such persons, those persons are jointly and severally liable for the payment of the debt. Penalty: \$5,000 or imprisonment for 1 year, or both."

The provisions of this section have been superseded by the *Corporations Act 2001*. The offence of being a director or taking part in the management of a company which trades whilst insolvent has been continued, but the right to recover the debt has been shifted from the creditor to the liquidator (except in limited circumstances not presently relevant).

Despite the alterations to the law, the lessons of the *National Safety Council* case remain as relevant as ever.

Not only are the directors of a company which trades whilst insolvent liable to criminal prosecution, they are also liable to pay the debt which the company is unable to pay because of its insolvency. In the *National Safety Council* case, that liability resulted in a judgment against a director of \$96.7 million plus a substantial part of the bank's costs of a 52 day hearing as well as his own costs. ■

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## Actions may not speak louder than Word Investments

**“... any organisation can conduct any business activities and still be endorsed as a charity provided that the profits are applied for a charitable purpose ... ”**

**W**ord Investments Limited (Word) is a company established primarily to raise funds for Wycliffe Bible Translators which is a charitable institution providing funds for overseas missionary and bible translating activities and other similar activities. Word's objects as stated in its constitution include “the spread of Christianity” as well as carrying on any business conveniently able to be conducted in connection with its objects.

Over the years, Word engaged in a number of business and investment activities which created surpluses which were principally distributed to Wycliffe and other similar organisations.

In 1996, Word began operating as a commercial funeral director actively operating a funeral parlour. This business was transferred into a separate foundation in 2002.

The Australian Tax Office (ATO) contended that Word had been carrying on commercial activities and was therefore not entitled to endorsement as a charity. Word did not accept that position and took the matter on appeal to the Administrative Appeals Tribunal (AAT). The AAT determined that Word was entitled to be endorsed as a charity except for the period whilst it was conducting the funeral director's business. The ATO was not happy with that decision and appealed to the Federal Court. Similarly, Word was unhappy with the decision relating to the period whilst it operated the funeral parlour and cross-appealed in the Federal Court.

On 3 February 2006, Mr Justice Sundberg of the Federal Court of Australia dismissed the ATO appeal, upheld Word's cross-appeal and effectively held that where an organisation raises funds exclusively for a

charitable purpose, the fact that it does so through a commercial enterprise does not preclude it from being a charity.

Mr Justice Sundberg states that the “true question to be asked is the purpose of the making of the profit” and goes on to state:

*“The Commissioner's argument is inconsistent with the corporate structure of many contemporary charities which are complex and involve the use of separate legal entities to perform separate functions. Where they are all working together to pursue a common charitable purpose, it is artificial to consider the purpose of each entity separately.”*

He adds:

*“There may appear to be a vast difference between selling lamingtons at a church fete and selling funeral services, but where the object of raising the funds is the same, I can see no reason to draw a legal distinction between the two.”*

The implications from this judgment if taken to their extreme are that any organisation can conduct any business activities and still be entitled to be endorsed as a charity provided that the profits are applied for a charitable purpose. The judgment went further to say that such an organisation could still be entitled to charitable status and be said to be pursuing its objectives in Australia even if these funds were distributed to a charitable organisation which existed in Australia but in turn used the surplus funds to pursue its objects overseas.

The ATO is concerned about these implications and has lodged an appeal in the High Court against Mr Justice Sundberg's decision. We will advise you when the High Court has resolved the issue. ■

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## Corporate governance

The Australian Stock Exchange (ASX) in its document *Principles of Good Corporate Governance and Best Practice Recommendations*, sets out the principles recommended for boards of Publicly Listed Companies and other listed entities, to ensure that they can demonstrate that sound processes are followed in regard to management and governance. The document can be found on the special ASX website at [www.asx.com.au/supervision/governance/index.htm](http://www.asx.com.au/supervision/governance/index.htm).

More and more boards of non-listed companies are also referring to these guidelines to assist them in regard to corporate governance processes expected to be followed by them in meeting their fiduciary responsibilities.

Most of the principles listed in these ASX guidelines would also be appropriate for boards in the non-profit sector, particularly the larger organisations, whether separately incorporated or not, which have external stakeholder and accountability responsibilities.

The 10 best practice principles identified in the ASX document are summarised below.

As almost all the principles detailed below would be relevant to boards in the non-profit sector, there would be real benefits to them in using these recommendations to ensure that the approach being taken in regard to corporate governance is in accord with best practice. ■

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### ASX Principles

- 1 Lay solid foundations for management and oversight by the Board**  
Recognise and publish the respective roles and responsibilities of board and management.
- 2 Structure the Board to add value**  
Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.
- 3 Promote ethical and responsible decision making**  
Actively promote ethical and responsible decision making.
- 4 Safeguard integrity in financial reporting**  
Have a structure to independently verify and safeguard the integrity of the company's financial reporting.
- 5 Make timely and balanced disclosures**  
Promote timely and balanced disclosure of all material matters concerning the company.
- 6 Respect the rights of shareholders**  
Respect and facilitate the effective exercise of those rights.
- 7 Recognise and manage risk**  
Establish a sound system of risk oversight and management and internal control.
- 8 Encourage enhanced performance**  
Fairly review and actively encourage enhanced board and management effectiveness.
- 9 Remunerate fairly and responsibly**  
Ensure that the level and composition of remuneration is fair and reasonable and that its relationship to corporate and individual performance is defined.
- 10 Recognise the legitimate interest of stakeholders**  
Recognise legal and other obligations to all legitimate shareholders.

## Financial reporting by public interest entities in receipt of government funding

There is a continuing focus by regulators and others on financial reporting for “public interest entities”, including public sector and not-for-profit entities. This has seen proposals to define the term “public interest entity”, as well as developing a conceptual financial reporting framework that better reflects the differences in public sector and not-for-profit entities, and the needs of users of their financial reports.

This has the potential to affect certain charities, particularly those in receipt of government funding and/or other forms of public support. We

have recently seen significant developments in the area of residential aged care in receipt of government funding with their annual financial reports now being required to be prepared as a general purpose financial report complying with all applicable accounting standards. We have also seen the passing in October 2006 of amendments to the *NSW Education Act 1990* which sets out what “for-profit” means in terms of operating a school. This amendment has implications for all non-government schools in receipt of State Government funding.

These developments are likely to have impacts in future periods on the financial reporting obligations of charities and other not-for-profit entities, with risks as to the ongoing receipt of government funding if these obligations are not complied with. If your situation requires any consideration at the present time in terms of these current or possible future developments, please contact the person below. ■

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### Back issues

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#### Issue 2, September 2006

- Bequests - Be Sure You Get Your Share
- Are you really a charity? Read on...
- Government Funding Won't Forfeit Charitable Status
- New Legislation for DGRs
- How does the SPAM Act apply to charities?
- How does the Privacy Act apply to you?
- The Tax Man Cometh
- Beware – Read The Fine Print – Know Your Duty

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**Disclaimer:** This publication is a non-comprehensive general outline of the law as at 15 December 2006. You should not act upon or rely on any information contained in this newsletter without obtaining specific legal advice.

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