Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2015

Submission to:

The Treasury

February 2016

Ben Watkinson
Company Secretary
Level 9, 117 Clarence Street
GPO Box 10500
Sydney NSW 2001

Telephone 02 9085 7100
Facsimile 02 9085 7299
ben.watkinson@thesmithfamily.com.au

Introduction

The Smith Family recognises the importance of both Private and Public Ancillary Funds as financial contributors to the not-for-profit sector through the making of donations to Deductible Gift Recipients in line with the original purposes for which the funds are established in a tax concessional environment.

Present arrangements apply minimum annual distribution rates which require the funds to make donations equivalent to fixed percentages of net assets in any given year. The Smith Family considers that in the absence of compelling evidence to support the proposed changes to the distribution guidelines from a community perspective, the guidelines in relation to this matter should not be changed.

This short submission focuses on the proposed changes to minimum annual distribution rates, while endorsing generally the proposed updating of present guidelines to reflect the role and requirements of the Australian Charities and Not-for-Profits Commission and associated red tape reduction arrangements, and updates to the investment strategy rules, particularly with regard to related party transactions.

The Smith Family

Our mission

The Smith Family's mission is to create opportunities for young Australians in need by providing long-term support for their education. We are a national charity with Deductible Gift Recipient status and have provided support to children, young people and families for over 90 years.

The Smith Family is Australia's largest education-oriented charity and delivers programs in 94 communities across all states and territories. In 2014 we supported around 125,000 disadvantaged children, young people and their families. This included over 14,400 from Aboriginal and Torres Strait Islander backgrounds.

Our largest program, *Learning for Life,* includes providing long-term educational scholarships for children and young people. The scholarship can begin in the first year of school and continue right through school and tertiary education. Our students attend disadvantaged schools in disadvantaged communities and analysis shows that as a group, they are more disadvantaged than their peers in the same school. Data clearly show that we are targeting children, young people and families who, if not supported, are likely to have poor educational outcomes.

Given that there are over 600,000 children and young people living in a jobless household, there is also significant unmet need for our programs. We have an aspiration to support more disadvantaged children to improve their educational outcomes given this unmet need.

In line with our mission, we are working to improve three key longer-term outcomes for the young people we support, namely: school attendance, school completion and engagement in employment, education or training post-school. Improving the educational outcomes of disadvantaged children and young people is the most cost effective way of breaking the cycle of long-term disadvantage and welfare dependency. Our mission and work is therefore clearly of benefit not only to the young people and families we support but also to the Australian community as a whole.

The importance of contributions from Foundations and Ancillary Funds

Developing financial support from across the community is vital to our ongoing ability to address more of the unmet need for our programs in Australia. Foundations and Ancillary Funds are key sources of revenue for the organisation, last year having provided up to $3 million in donations.

Our finances

Our revenue in the 2014-15 financial year was approximately $87 million, an increase of 7.4% on 2013-14. The sources of our 2014-15 revenue were:

- $51.5 million from donations, corporate support and bequests. $22.6 million from government.
- $2.4 million surplus from our recycling operation and other commercial activities. These activities make a significant contribution to offsetting our administrative costs.
- $1.0 million net contribution from the VIEW (Voice, Interests and Education of Women) Clubs.
- $9.3 million from investments and other income including the surplus on the sale of certain surplus fixed assets.

In 2014-15, 82 cents in every dollar donated was spent on The Smith Family's community programs. We have modest reserves accumulated over a number of years, which are available over time for investment in initiatives which build organisational capability, ensure we are meet our legislative and compliance obligations and work to reduce organisational risk.

In summary, we are a mission-focused organisation and our purpose is of great public benefit. We raise significant funds from non-government sources including Private and Public Ancillary Funds, and are both highly effective and efficient as an organisation, contributing significantly to the wellbeing of thousands of disadvantaged children and young people, as well as that of the nation as a whole. Changes to guidelines relating to potential funding sources such as Private and Public Ancillary Funds should take into account their impact on organisations such as ours, given the contributions they make to the well-being of our society.

Changes to current arrangements will have an adverse impact on The Smith Family and the not-for-profit sector generally.

The Smith Family does not support the changes to the distribution guidelines for Private and Public Ancillary Funds.

Under current distribution guidelines, funds are required to distribute 5% and 4% respectively of the market value of their assets at the end of the previous financial year. The proposal to amend this requirement to the lower of the average of the Reserve Bank of Australia's target for the cash rate over the previous financial year and the fund's investment earnings of the fund less expenses with the stated purpose being *to provide greater flexibility in unexpected economic circumstances*, will almost certainly result in lower fund distributions in times when these distributions are most needed by the beneficiaries of the distributions.

The establishment of Public and Private Ancillary Funds as vehicles for attracting significant philanthropic contributions has been encouraged by the granting of tax concessions. The trade-off intention has always been for such funds to generate returns to the not-for-profit sector, and the current minimum fixed percentage distributions achieve this outcome in a consistent way from year to year. The extent to which fund returns may exceed or fall below the required distribution levels is a matter for each fund to manage over time as with any other investment business, if the view of its trustees is that the fund should maintain itself in perpetuity.

The proposed changes may in effect reduce the incentive for assets to be managed prudently by linking distributions to earnings rather than the value of the assets, virtually guaranteeing the preservation of fund capital in adverse economic times at the expense of distributions to the not-for-profit sector which were the purpose for establishing the funds in the first place.

The potential community benefit which may flow from the proposed changes to the guidelines is unclear, and the only benefits which are apparent are those to the funds themselves. There is no evidence provided to support or explain the need for minimum distributions to be reduced, yet on the other side there is a compelling and growing body of evidence that there is a greater social return on community investment if it is made sooner rather than later. This might indeed be used to argue that the minimum distributions should be *increased* (as was proposed in 2009 but ultimately rejected in favour of the present arrangements) rather than *minimised* to no obvious purpose (as is being proposed in 2016).

It is The Smith Family's view that funds should be managed to maximise their capacity to make regular and significant contributions to the sector. In taking this position we recognise that while there may be periods of negative returns, equally there will be years with higher than average returns which make the current minimum distribution levels achievable with prudent funds management over time in a tax exempt environment.

If evidence exists that there has been a sustained shortfall in returns for funds in recent years which make it difficult to meet the current distribution guidelines, then there may be an argument for the averaging of the minimum distributions over a period of, say, two or three years. This would allow for higher and lower minimum distribution rates in given years, provided that the average distribution over the required period is maintained at 5% (Private) and 4% (Public) per annum.

Conclusion

This submission has focussed particularly on proposed changes to minimum distribution rules in relation to Private and Public Ancillary Funds which The Smith Family believes will provide no obvious benefit to the not-for-profit sector which these funds are established to support. The support of such funds is of significant value to the sector and any decision to change the guidelines must take account of the likely adverse impact on revenue flowing to it.

The Smith Family considers that in the absence of compelling evidence to support the proposed changes to the distribution guidelines from a community perspective, the guidelines in relation to this matter should not be changed.