Australian Executor Trustees

Estate and Trustee Services

Estate affairs

Welcome to Estate affairs – September 2013 edition

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Do you have clients wanting to establish a charitable foundation during their lifetime?

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The gift of giving

Australians are known for their generous spirit of giving. During the 2011 financial year, Australians donated more than $2.2 billion to charity[1], and an increasing number of high net worth individuals are creating long-term giving structures.

If philanthropy is a priority for your clients during their lifetime, rather than making a series of charitable donations it might be appropriate for them to consider establishing a long-term giving structure that can perpetuate their long-term philanthropic intentions.

There are two long-term giving options available to your clients whilst they are alive:
- they can set up an account within a charitable endowment fund (CEF), or
- they can establish their own private ancillary fund (PAF).

In determining the most suitable option for your clients, you should consider matters such as how much they would like to give and how involved they want to be in the process of giving, as well as the reasons that drive their philanthropy.

You also need to consider whether they would like to be engaged and involved on a long-term basis, if they would like to leave a significant sum of money, or if they would like to leave a legacy and involve future generations of their family.

What is a charitable endowment fund?

A charitable endowment fund (CEF) is a public charitable fund in which clients can establish an account. They can nominate the charity or charities to which they would like to donate. While the trustee will consider their nomination, it is the trustee who makes the final decision about the distribution of funds and your client will not have any input in the investment strategy of the fund. This type of fund would be appropriate if you have clients who want to establish a long-term charitable giving program but do not have the desire to be involved in the investment management or decision-making process.

What is a private ancillary fund?

A private ancillary fund (PAF) is a private fund established by trust deed, into which your clients can make tax deductible donations. Controlled by either an individual or family, this type of fund allows your clients to build an investment portfolio of carefully selected assets to support the philanthropic causes that have significant meaning to them. This type of fund is appropriate if you have clients who want to apply a significant amount of their wealth to charitable purposes and be involved in the ongoing decision making and application of that money.

A PAF has several benefits over short-term giving. Instead of a one-off donation, the perpetual structure of a PAF allows your clients to create a long-term giving strategy for their nominated charities that will provide funding in their (and their family's) name forever.

Using a perpetual structure also means that clients can give the trustees discretion as to how the PAF is managed. This ensures that, if necessary, the trustees can redirect funds to where they are most needed in order to fulfil the purpose of the PAF.

How does a PAF operate?

In the PAF deed, while clients can specify the causes they wish to support, the trustee discretion also gives the trustee the flexibility to address the current issues of the day and decide how the funds are to be applied. For example, as a result of medical advancements, there are many areas of research requiring funding today that would not have been thought possible 50 years ago.

The trustee of a PAF must be a corporation. The directors of the trust must include at least one party who meets the definition of a 'responsible person' and is actively involved in the decision-making of the PAF. The 'responsible person' cannot be the founder, a major donor or an associate thereof. The trustee of a PAF is subject to both the common-law principles of trust law and the Trustee Act of the state or territory in which the PAF operates.

There are also major tax advantages that come with establishing a long-term giving program, as the income and capital gains earned within this type of structure are exempt from tax. This also means these funds can attract a refund of franking credits attached to dividends received, which can further enhance the amount available for distribution to beneficiaries. These tax concessions mean these long-term giving structures often generate income and capital faster than the same portfolio held in any other way. In addition, the PAF is a deductible gift recipient (DGR), meaning contributions made to the PAF are tax-deductible.

Why would a client choose a PAF over making direct donations?

For some clients, making regular donations to registered charities may be a suitable way to contribute back into the community. However your client's giving may add more value if it assists a charity in perpetuity.

Consider a one-off donation of $1 million compared to the establishment of a PAF with the same amount. By establishing a PAF which distributes five per cent per annum and generates capital growth of five per cent per annum (assuming constant annual returns), after 20 years it will be worth more than $2.5 million and will have distributed close to $1.6 million.

This is a simple illustration but there are many real examples of PAFs established many years ago that now have a significant capital sum and have distributed millions of dollars to benefit the community.

How can we help?

At Australian Executor Trustees (AET), we will work in partnership with you to establish a PAF for your clients and put in place the necessary documents and governance structures so it will operate smoothly and efficiently in the future. We can provide a trustee solution, acting as a trustee and overseeing the investment of funds held in trust.

Our company directors are highly experienced in trust management and fiduciary services, and will ensure your client's PAF meets the active 'responsible person' requirements at all times.

As the fiduciary, we take on the risk and take on the compliance and daily management responsibilities of the PAF. This allows you to focus on the investment management and your client to focus on engaging with philanthropic organisations and finding worthy programs to fund.

The Australian Taxation Office has issued strict guidelines that must be adhered to when establishing and managing a PAF, and may penalise the directors of the corporate trustee for failing to comply with prescribed guidelines. By utilising professional services, you can be sure that your client's PAF will be established correctly and managed prudently and efficiently into the future.

[1] Australian Centre for Philanthropy and Nonprofit Studies (CPNS), Giving Australia, 2013.

Charitable foundation - case study

The John Brooks Foundation

John and Maggie had been married for 30 years, built a very successful carpentry business and had two children, James (23) and Sally (25). Sadly, last year, Maggie passed away after a very long battle with breast cancer.

After Maggie died, John (56) contacted his financial adviser to review his financial affairs. During their meeting, John's adviser also recommended that he should review his Will and estate plan. In his Will, John had nominated his children, James and Sally, as beneficiaries of his estate, but was now thinking about leaving a large bequest to a cancer research organisation.

Given cancer research was a cause so close to his heart, John's adviser thought that it may be more beneficial for him to establish a long-term charitable giving structure whilst he was still alive.

Having worked with us before, John's adviser asked for some advice about what would be the best option for his client. Our suggestion was that he should establish a private ancillary fund (PAF). Because this type of fund is established during the client's lifetime, John would be rewarded with seeing the benefits of his philanthropy. It would also give Sally and James the opportunity to be involved in honouring the memory of their mother and to understand and appreciate the value of philanthropy. We worked closely with John and his adviser to establish The John Brooks Foundation, a private ancillary fund to provide support for cancer research and patient assistance.

John made an initial contribution of $500,000, which he was able to claim as a tax deduction in his own name, thereby reducing his taxable income significantly. James and Sally also contributed $50,000 each and were also able to claim these amounts as tax deductions. Each year they planned to contribute significant sums of money to the Foundation.

John's financial adviser was appointed to manage the investments of the Foundation and we were appointed as trustee. By appointing us as trustee, the family had more time to research potential charities that the Foundation could support and, as they were appointed as members of the Foundation's Advisory Committee, they could recommend which charities should benefit from the annual distribution of income.

In establishing the Foundation, there were major tax advantages - all income and capital gains earned by the Foundation were tax-exempt and any imputation credits attached to Australian franked dividends were able to be refunded to the Foundation by the Australian Taxation Office. As a result, the family watched the capital of the fund grow.

Each year the family looks forward to deciding on which charities the Foundation will support. It is a very rewarding time for all of them. Sally and James often visit the charities in person to deliver the cheques and to hear about the cancer research and patient assistance programs that the Foundation's donations will assist.

If you have any questions, or need more information, please call us on 1800 882 218 or visit www.aetlimited.com.au

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