

EXPLANATORY STATEMENT

Taxation Administration Act 1953

Private Ancillary Fund Guidelines 2009

Authority

Section 426-110 in Schedule 1 to the *Taxation Administration Act 1953* gives the Minister the power to set out rules for private ancillary funds and their trustees in the form of guidelines made by legislative instrument.

Section 426-110 is being inserted into the *Taxation Administration Act 1953* by Schedule 2 to the *Tax Laws Amendment (2009 Measures No. 4) Act 2009* which commences on 1 October 2009. Section 4 of the *Acts Interpretation Act 1901* provides that the Minister may make the guidelines prior to the commencement of section 426-110.

Commencement

The *Private Ancillary Fund Guidelines 2009* (the Guidelines) commence on 1 October 2009. This coincides with the commencement of the new regulatory regime governing private ancillary funds. The commencement is after the day the guidelines are registered on the Federal Register of Legislative Instruments.

Purpose

The purpose of the Guidelines is to set minimum standards for the governance and conduct of a private ancillary fund and its trustee. 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.

A private ancillary fund is a form of ancillary trust fund designed to encourage private philanthropy by providing private groups, such as businesses and families, with greater flexibility to start their own trust funds for philanthropic purposes.

Context

The Guidelines implement the final part of the Government's 2008-09 Budget measure to improve the integrity of prescribed private funds. The first part of the measure involved introducing a new legislative framework which, amongst other things, renamed and converted prescribed private funds into private ancillary funds, moved the full regulation of these funds to the Commissioner of Taxation, provided the Commissioner with new administrative powers in relation to these funds and gave the Minister the power to make legislative guidelines about the establishment and maintenance of these funds.

The existing prescribed private fund guidelines were not binding in nature, nor were they subject to review by the Parliament. The only remedy available to enforce the existing guidelines was to prospectively remove the prescribed private fund status of a non-complying trust fund.

Consultation

Treasury conducted public consultation on the draft Guidelines between 25 June 2009 and 23 July 2009. There were 19 submissions in response to the consultation, which are available on the Treasury website.

Some amendments were made to the draft Guidelines in response to comments by respondents. Additional explanatory notes were also added into the text of the Guidelines to clarify particular issues of concern.

Penalties

The Guidelines are enforced through the imposition of administrative penalties. The Guidelines contain the details of those penalties.

While the *Taxation Administration Act 1953* imposes the penalty, the Guidelines determine the amount of the penalty. The amount of the penalty was left to be determined by the Guidelines so that it could be appropriately tailored to the nature and size of the breach, taking account of the trustee's level of culpability and the particular requirement that the private ancillary fund has not complied with.

The penalties complement other administrative powers of the Commissioner of Taxation that are contained in the *Taxation Administration Act 1953*, such as those to suspend, remove or replace trustees of private ancillary funds that breach the guidelines or other relevant Australian laws.

Detailed explanation of guidelines

The guidelines have been drafted using plain English with a view to them being a self-explanatory set of governing rules for private ancillary funds and their trustees.

Guideline 1. The Guidelines are to be referred to as the *Private Ancillary Fund Guidelines 2009*.

Guideline 2. The Guidelines commence on 1 October 2009. This coincides with the commencement of the new regulatory regime governing private ancillary funds.

Guideline 3. The Dictionary to the *Income Tax Assessment Act 1997* contains the definitions of terms used in the Guidelines. The rules for interpreting the *Income Tax Assessment Act 1997* also apply to the Guidelines.

Guideline 4. The Guidelines specify the amount of the administrative penalty imposed under the *Taxation Administrative Act 1953* for breach of these guidelines. The amount of the penalty depends on the particular guideline that has been breached and may be a fixed amount or an amount determined by a formula. The amount of the penalty (if any) is set out under particular guidelines.

Guidelines 5 and 6. The on-going rules that a private ancillary fund must comply with are set out in Part 2 of the Guidelines. The transitional rules that apply to private ancillary funds that were prescribed private funds before 1 October 2009 are set out in Part 3 of the Guidelines.

Guideline 7. Sets out the object of the Guidelines.

Guideline 8. Sets out general principles that private ancillary funds must observe. These principles underpin the remainder of the rules in the Guidelines.

Guideline 9. Mandates that a private ancillary fund must be established as a valid trust. The validity of a particular trust will be determined under the relevant state or territory law (particularly the law of equity as affected by statute).

Guideline 10. A private ancillary fund must be set up and run solely to benefit other deductible gift recipients. However, a private ancillary fund cannot provide money to another ancillary fund. The governing rules of the fund must contain this purpose. References to the ‘governing rules of the fund’ throughout the Guidelines are generally references to the trust instrument of the fund but may also refer to the other documents governing the establishment or operation of the fund.

Guideline 11. A private ancillary fund must be a not-for-profit entity. A not-for-profit entity is one which is not operating for the profit or gain of its members, whether these gains are provided directly or indirectly. Any surplus made by the entity must be directed towards carrying out the entity’s purposes.

The Commissioner of Taxation accepts an entity as being not-for-profit where its constituent or governing documents prevent it from distributing profits or assets for the benefit of particular people – both while it is operating and when it winds up. These documents should contain clauses providing for the entity’s not-for-profit character. The entity’s actions must be consistent with this requirement.

Guideline 12. A private ancillary fund must be operated solely in Australia. However, this does not prohibit the fund from distributing to deductible gift recipients that operate outside Australia.

Guidelines 13 to 16. Trustees have an obligation to exercise appropriate care and skill in managing private ancillary funds. Each fund must have at least one director on the board of its trustee who is an individual with a degree of responsibility to the community as a whole (a responsible person). The responsible person must be a director of the trustee and a member of any other controlling body of the fund. This rule applies to deductible gift recipients more generally and is intended to ensure that an independent and publicly trustworthy and accountable person is actively involved in the management and protection of these monies which have been donated for the benefit of the broader public and supported by significant philanthropic tax concessions. To ensure the protection of these monies, some individuals are ineligible to be involved in the decision making of a private ancillary fund. Some of these limitations are contained in the Guidelines but further restrictions in the *Corporations Act 2001* and state and territory law may also apply.

Guideline 17. If the governing rules of the fund change, the trustee must notify the Commissioner.

Guideline 18. Trustees must remain accountable for certain decisions they make. The fund must not indemnify a trustee in relation to those decisions.

Guideline 19. A private ancillary fund, as a philanthropic intermediary vehicle, must distribute a certain amount of its income and assets to active deductible gift recipients each year. This guideline determines that minimum.

A fund must be careful not to double-count a later year grant when calculating its minimum annual distribution. That is, a committed grant or grants in later years cannot both reduce the calculation of the fund’s net assets and be counted towards the fund’s distribution in those years.

Guidelines 20 to 25. Set out rules for when, and how, to work out the market value of the funds’ assets.

Guidelines 24 to 29. Set out record keeping requirements of trustees and a trustee’s obligations to prepare financial statements and have an audit undertaken into the fund’s affairs.

Guidelines 30 to 32. Trustees must prepare an investment strategy in relation to the fund's assets. The strategy aims to ensure the long term protection of the fund's philanthropic assets. Imposing an obligation to put in place an investment strategy avoids the need to impose inflexible and prescriptive investment limitations upon the fund. The rules applying to superannuation funds were used as a guide to the development of these rules.

Guidelines 33 to 40. In order to maintain the integrity of the tax system and to protect the philanthropic funds under management by trustees, some investment limitations are imposed on funds.

Guidelines 41 and 42. Trustees are generally prohibited from entering into uncommercial transactions or from providing benefits to related parties. An uncommercial transaction would include a transaction that is not entered into at arm's length or that a reasonable person in the position of the trustee would not have entered into having regard to all relevant circumstances.

Guideline 43. Allows the trustee to be reimbursed or remunerated out of the fund's assets for expenses incurred in managing the fund and for their services in administering the fund. However, those expenses and remuneration must be reasonable having regard to all the circumstances. A number of remuneration benchmarks are published by state and territory public trustees and representative bodies of professional trustees.

Guidelines 44 to 47. Private ancillary funds are private in nature and must be operated on that basis. As a different regulatory framework applies to private ancillary funds than for public ancillary funds, private ancillary funds are prevented from seeking donations from the public. Donations must generally come from the founder, or parties related to the founder. However, there is some flexibility to allow a limited amount of unsolicited donations from unrelated parties.

Guidelines 48 and 49. Private ancillary funds must comply with all relevant Australian laws. As philanthropic vehicles entrusted with the management of monies for the broad public benefit, they must operate in a manner consistent with public expectations and responsibilities.

Guidelines 50 and 51. Private ancillary funds must ensure that all their monies on winding up or on ceasing to be private ancillary funds are distributed to deductible gift recipients. However, private ancillary funds may convert into public ancillary funds if, over time, their activities expand and evolve.

Guidelines 52 to 60. Transitional rules apply to private ancillary funds that were prescribed private fund before 1 October 2009. The transitional rules are intended to help a prescribed private fund make the transition into the new regime. Generally, the rules allow time for prescribed private funds to bring their existing affairs into compliance with the new arrangements.