



Private Ancillary Fund Guidelines 2009

Taxation Administration Act 1953

I, Nick Sherry, Assistant Treasurer, make these Guidelines under section 426-110 in Schedule 1 to the *Taxation Administration Act 1953*.

Dated [## September 2009]

[DRAFT – NOT FOR SIGNATURE]

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Contents

Part 1: Preliminary	2
Part 2: Rules for establishing and maintaining private ancillary funds as deductible gift recipients	3
Object	3
General principles	3
Establishing a private ancillary fund	3
Operation of a private ancillary fund	5
Winding up a private ancillary fund	10
Part 3: Transitional rules for former prescribed private funds	11
Introduction	11
Distributions	11
Governing rules inconsistent with these guidelines	12

PART 1 PRELIMINARY

1. Name of Guidelines

These Guidelines are the *Private Ancillary Fund Guidelines 2009*.

2. Commencement

These Guidelines commence on 1 October 2009.

3. Interpretation

Expressions have the same meaning in these Guidelines as in the *Income Tax Assessment Act 1997*. The interpretation rules in Division 950 of that Act also apply to these Guidelines.

*Note 1: *To find definitions of asterisked terms, see section 995-1 of the Income Tax Assessment Act 1997.*

Note 2: See section 4AA of the Crimes Act 1914 for the current value of a penalty unit.

If a fund has 2 or more trustees, *trustee* means all of those trustees jointly, or any of them severally, as the case requires.

4. Penalties

If a person is liable to an administrative penalty under section 426-120 in Schedule 1 to the *Taxation Administration Act 1953* because of a contravention of a provision of these Guidelines, the amount of the administrative penalty is the penalty that these Guidelines set out, or the penalty worked out in accordance with these Guidelines, in relation to that provision.

Note: The Commissioner may remit all or part of an administrative penalty, see section 298-20 in Schedule 1 to the Taxation Administration Act 1953.

5. Part 2: Rules for endorsement as a deductible gift recipient

Part 2 sets out the rules that a *private ancillary fund must comply with in order to be endorsed, and remain endorsed, as a deductible gift recipient.

6. Part 3: Transitional rules for funds established before 1 October 2009

Part 3 sets out transitional rules modifying how Part 2 applies to a private ancillary fund that was a prescribed private fund at the end of 30 September 2009.

PART 2

RULES FOR ESTABLISHING AND MAINTAINING PRIVATE ANCILLARY FUNDS AS DEDUCTIBLE GIFT RECIPIENTS

OBJECT

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

GENERAL PRINCIPLES

8. A *private ancillary fund must be established, maintained and wound up in accordance with the following principles:
 - it is an ancillary fund, it is philanthropic in character, and it is a vehicle for private philanthropy; and
 - it is a trust that:
 - complies with all relevant laws and obligations; and
 - is open, transparent and accountable to the public (through the Commissioner).

ESTABLISHING A PRIVATE ANCILLARY FUND

PURPOSE AND OBJECTS OF THE FUND

9. A *private ancillary fund must be established and maintained, under a will or an instrument of trust, as a valid trust under *State law or *Territory law.
10. It must be established and maintained solely as mentioned in item 2 in the table in section 30-15 of the *Income Tax Assessment Act 1997*.
 - 10.1. Its governing rules must include objects that clearly set out and reflect the purpose of the fund.
 - 10.2. Its governing rules must require that, on the fund winding up or ceasing to be a private ancillary fund, its property must be provided as mentioned in paragraph (a) of item 1 in the table in section 30-15 of the *Income Tax Assessment Act 1997*.

Note: Paragraph (a) of item 1 in the table in section 30-15 provides that the sole purpose of an ancillary fund must be to provide money, property or benefits: to a fund, authority or institution gifts of which are deductible under item 1 of that table; and for any purposes set out in an item of the table in Subdivision 30-B of the Income Tax Assessment Act 1997 that covers the fund, authority or institution.

NOT-FOR-PROFIT

11. It must be established and operated on a not-for-profit basis.

11.1. Its governing rules must clearly set out and reflect its not-for-profit status.

OPERATED IN AUSTRALIA

12. It must be established and operated only in Australia.

Note: Australia includes the external territories – see section 6AA and 7A of the Income Tax Assessment Act 1936.

THE TRUSTEE

13. The trustee of the fund must exercise the same degree of care, diligence and skill that a prudent individual would exercise in managing the affairs of others.

14. At all times, at least one of the individuals involved in the decision-making of the fund must be an individual with a degree of responsibility to the Australian community as a whole. However, that individual cannot be a founder, a major donor to the fund, or an *associate of a founder or major donor.

Note: This requirement is similar to (but less strict than) the requirement applying to public ancillary funds.¹ Those individuals with a degree of responsibility to the community as a whole are generally known as 'responsible persons'.

Example 1:

'Individuals with a degree of responsibility to the Australian community as a whole' would generally include: school principals, judges, members of the clergy, solicitors, doctors and other professional persons, mayors, councillors, town clerks and members of parliament. Generally, individuals who are accepted as having a degree of responsibility to the community as a whole are known to a broad section of the community because they perform a public function or they belong to a professional body (such as the Institute of Chartered Accountants, State Law Societies and Medical Registration Boards) which has a professional code of ethics and rules of conduct. Individuals who have received formal recognition from the Government for their services to the community (for example, an Order of Australia award) will also usually have the requisite degree of responsibility

Example 2:

An individual would be considered to be involved in the decision-making of a fund if he or she is a director of the trustee and is active in the on-going management of the fund.

15. The trustee must not exercise any discretion or power while guideline 14 is not being complied with.

15.1. However, the trustee may exercise a discretion or power:

- to appoint a new trustee; or
- to protect the property of the fund; or
- to deal with an urgent matter that cannot be postponed.

¹ *Bray v. Federal Commissioner of Taxation* 78 ATC 4179; 8 ATR 569.

16. An individual must not be a director of a trustee of the fund if he or she has been convicted of a taxation offence (within the meaning Part III of the *Taxation Administration Act 1953*) that is an indictable offence.

16.1. If an existing director is convicted of such an offence, he or she must cease to be a director within 1 month of the conviction.

CHANGES TO GOVERNING RULES

17. The trustee must notify the Commissioner in the *approved form (within 21 days) of any change to the fund's governing rules.

Note: Changes to the governing rules may require the fund to seek re-endorsement as a deductible gift recipient.

PENALTY: 5 penalty units.

LIABILITY OF TRUSTEE

18. The governing rules of a *private ancillary fund must not indemnify the trustee, or an employee, officer or agent of the trustee, for a loss or liability attributable to:

- dishonesty of the trustee, employee, officer or agent; or
- negligence of the trustee, employee, officer or agent; or
- a deliberate act or omission known by the trustee, employee, officer or agent to be a breach of trust.

Note: An administrative penalty under section 426-120 in Schedule 1 to the Taxation Administration Act 1953 cannot be reimbursed from the fund, see subsection 426-120(4).

OPERATION OF A PRIVATE ANCILLARY FUND

MINIMUM ANNUAL DISTRIBUTION

19. During each *financial year, a *private ancillary fund must distribute at least 5 per cent of the *market value of the fund's assets (as at the end of the previous *financial year).

19.1. The fund must distribute at least \$11,000 (or the remainder of the fund if that is worth less than \$11,000) during that *financial year if:

- the 5 per cent is less than \$11,000; and
- the expenses of the fund for that financial year are paid from the fund's assets or income.

19.2. No distribution is required during the *financial year in which the fund is established.

19.3. A distribution includes the provision of money, property or benefits. If the fund provides property or benefits, the *market value of the property or benefit provided is to be used in determining whether the fund has complied with this guideline.

Example 1:

If a private ancillary fund makes a gift of a painting to a museum, it would include the market value of the painting in calculating how much it has distributed.

Example 2:

If a private ancillary fund leases office space to a deductible gift recipient at a discount to the market price, the fund is providing a benefit whose market value is equal to the discount.

19.4. The penalty for a contravention of this guideline is 30 penalty units if the shortfall is greater than \$1,000.

19.5. If the Commissioner requests the trustee to rectify a shortfall in the distribution for a *financial year, and the trustee fails to comply with the request within 60 days, the penalty for failing to comply is 10 per cent of the shortfall as at the end of the 60 days reduced by any penalty (but not below nil) under guideline 19.4.

19.6. A distribution made to rectify a contravention of this guideline does not count towards compliance with this guideline in the year of the rectification.

VALUATION

20. The *market value of the fund's assets (other than land) must be estimated at least annually.

Note: See section 22 of the Acts Interpretation Act 1901 for the meaning of 'land'.

21. The *market value of land must be estimated at least once every 3 years.

21.1. The *market value of land must be estimated by a certified and independent valuer or by the Commissioner (through the Australian Valuation Office).

21.1.1. The trustee must obtain from the valuer a written estimate of the *market value of the land. The written estimate must also include the valuation methodology and a reference to supporting materials used in making the estimate

Note: The trustee may ask the Commissioner (through the Australian Valuation Office) to undertake the valuation. The Commissioner may charge the trustee for undertaking a valuation.

21.2. The trustee may use the estimate as the *market value of the land for the next 3 *financial years.

22. If the Commissioner considers the estimate of the market value of any asset to be unreasonable, the Commissioner may request the trustee to arrange for another valuation to be undertaken. The trustee must comply with the request.

Note: The Commissioner may seek the Trustee's agreement to undertake the valuation (through the Australian Valuation Office) or the trustee may ask the Commissioner (through the Australian Valuation Office) to undertake the valuation. The Commissioner may charge the trustee for undertaking a valuation.

23. Valuations must be completed before the fund is required to give to the Commissioner its *income tax return for the relevant *financial year.

ACCOUNTS

24. The trustee must keep, or cause to be kept, proper accounts in respect of all receipts and payments of the fund and all financial dealings connected with the fund.

Note: See Subdivision 382-B in Schedule 1 to the Taxation Administration Act 1953 for rules about recording keeping obligations of deductible gift recipients.

PENALTY: 10 penalty units.

25. The trustee must make the accounts available to the Commissioner upon request.

PENALTY: 10 penalty units.

FINANCIAL STATEMENTS

26. The trustee must prepare, or cause to be prepared, financial statements showing the financial position of the fund at the end of each *financial year.

26.1. The financial statements must be prepared in accordance with the *accounting standards.

26.2. The financial statements must be prepared before the fund is required to give to the Commissioner its *income tax return for the relevant *financial year.

26.3. The trustee must provide the financial statements to the Commissioner with the fund's *income tax return for the relevant *financial year.

PENALTY: 10 penalty units.

AUDIT

27. Each *financial year the trustee must arrange for an auditor to audit:

- the financial statements of the fund; and
- compliance with these Guidelines by the fund and the trustee.

27.1. The auditor must be registered under Part 9.2 of the *Corporations Act 2001*.

27.2. The auditor must provide the fund with an audit report in the *approved form.

28. The trustee must provide the audit report to the Commissioner with its *income tax return for the relevant *financial year.

PENALTY: 10 penalty units.

INVESTMENT STRATEGY

29. The trustee must prepare and maintain a current investment strategy for the fund.

29.1. An appropriate investment strategy should set out the investment objectives of the fund and detail the investment methods the trustee will adopt to achieve those objectives.

29.2. The strategy must reflect the purpose and circumstances of the fund and have particular regard to (but not be limited to):

- the risk involved in making, holding and realising, and the likely return from, the fund's investments, having regard to the fund's objects and its expected cash flow requirements;
- the composition of the fund's investments as a whole, including the extent to which the investments are diverse or involve the fund being exposed to risks from inadequate diversification;
- the liquidity of the fund's investments, having regard to its expected cash flow requirements (including distribution requirements);
- the ability of the fund to discharge its existing and prospective liabilities; and
- the investment requirements imposed by *State laws or *Territory laws.

PENALTY: 10 penalty units.

30. The trustee must implement the investment strategy, and must ensure that all investment decisions are made in accordance with it.

PENALTY: 10 penalty units.

31. The investment strategy (and a record of the associated decision-making processes) must be available in a written form so that the trustee, an auditor or the Commissioner can determine whether the fund has complied with these Guidelines and other *Australian laws.

DISTRIBUTION STRATEGY

32. The trustee must prepare and maintain a current distribution strategy for the fund. The strategy must reflect the quantity of donations expected to be received by the fund, the expected recipients of distributions of those donations and the size of the distribution the fund is expecting to make.

PENALTY: 10 penalty units.

33. The distribution strategy (and a record of the associated decision-making processes) must be available in a written form so that the trustee, an auditor or the Commissioner can determine whether the fund has complied with these Guidelines and other *Australian laws.

INVESTMENT LIMITATIONS

34. The trustee must not *borrow money or maintain an existing borrowing of money.

35. The fund's investments must be made and maintained on an *arm's length basis.

36. The trustee must not give a security over, or in relation to, an asset of the fund.

37. The fund must not acquire an asset (except by way of gift) from, and must not make a loan or provide any other kind of financial assistance to, a founder of the fund, a donor to the fund, the trustee, a director, officer, agent, *member or employee of the trustee, or an *associate of any of these entities.
38. The trustee must keep the assets of the fund separate from all other assets.
39. The fund must not acquire an asset (except by way of gift) if the asset is capable of being a *collectable.
- 39.1. If the fund acquires such an asset by way of gift, it must sell or distribute the asset within 12 months after acquiring it.
40. The penalty in relation to guidelines 34 to 39 is 30 penalty units.
41. The fund must not *carry on a *business.
- 41.1. The penalty for a contravention of this guideline is an amount equal to 25 per cent of the net profits of the business for each *financial year during all or part of which the contravention continues.

UNCOMMERCIAL TRANSACTIONS AND BENEFITS TO FOUNDER/DONOR

42. The fund must not enter into any transaction that is uncommercial when entered into, unless the transaction is:
- with a *deductible gift recipient covered by item 1 in the table in section 30-15 of the *Income Tax Assessment Act 1997*; and
 - in the course or furtherance of the fund's purpose.

PENALTY: 30 penalty units.

43. The fund must not *provide any benefit, directly or indirectly, to:
- the trustee (except as set out in guideline 44 (about fees and expenses));
 - a *member, director, employee, agent or officer of the trustee;
 - a donor to the fund;
 - a founder of the fund; or
 - an *associate of any of those entities.

PENALTY: An amount equal to the amount or value of the benefit provided.

FEES AND EXPENSES

44. The trustee may apply income or capital of a *private ancillary fund:
- to reimburse the trustee for reasonable expenses incurred on behalf of the fund; and
 - to pay fair and reasonable remuneration for the trustee's services in administering the fund.

DONORS

45. The fund must be private in nature. This characteristic implies that there must be a close relationship between those who establish the fund and those who donate to it.

*Note: The features of a *private ancillary fund can be contrasted with those of a public ancillary fund, which can collect donations from the public.*

46. The fund must not solicit donations from the public.
47. In any *financial year, the fund must not accept donations totalling more than 10 per cent (in total) of the *market value of its assets (determined at the end of the previous financial year) from entities other than:
- a founder of the fund; or
 - *associates of the founder; or
 - employees of the founder.
48. The fund must issue a receipt for every gift it receives.

48.1. The receipt must include the name and *ABN of the fund and name of the donor and must state that the receipt is for a gift received by the fund.

COMPLIANCE WITH ALL RELEVANT LAWS

49. The fund must comply with all relevant *Australian laws, all legally binding directions given to it by the Commissioner and all the requirements contained in these Guidelines.
50. The trustee must ensure that the fund's distributions to *deductible gift recipients do not put at risk the validity of the trust under *State law or *Territory law.

Note: In some states and territories, distributions cannot be made from a charitable fund to a non-charitable deductible gift recipient.

WINDING UP A PRIVATE ANCILLARY FUND

WINDING UP OR CEASING TO BE A PRIVATE ANCILLARY FUND

51. If the fund winds up or ceases to be a *private ancillary fund, all the fund's assets (after meeting its liabilities) must be provided as mentioned in paragraph (a) of item 1 in the table in section 30-15 of the *Income Tax Assessment Act 1997*.

CONVERTING A PRIVATE ANCILLARY FUND INTO A PUBLIC ANCILLARY FUND

52. With the agreement of the Commissioner, the fund may amend its governing rules to convert the fund into a public ancillary fund.

52.1. Nothing in these Guidelines prevents a conversion agreed to by the Commissioner.

PART 3 TRANSITIONAL RULES FOR FORMER PRESCRIBED PRIVATE FUNDS

INTRODUCTION

53. These transitional rules apply to a *private ancillary fund that was a prescribed private fund (within the meaning of the *Income Tax Assessment Act 1997* (as in force immediately before the commencement of Schedule 2 to the *Tax Laws Amendment (2009 Measures No. 4) Act 2009*)) on 30 September 2009.

53.1. These transitional rules are intended to help a prescribed private fund make the transition into the new regime.

DISTRIBUTIONS

ACCUMULATION PLANS

54. If the fund is subject to a continuing agreed accumulation plan, it may continue to act in accordance with that plan until the earliest of these times:

- when the plan expires;
- when the fund meets its target capital amount;
- the end of the 2013-14 *financial year; or
- the start of a financial year for which the fund chooses *not* to apply this transitional rule.

55. So long as the fund continues to act in accordance with the plan as permitted by guideline 54, it is not subject to the distribution rules set out in guideline 19 but will instead apply the transitional distribution rules in guideline 56.

TRANSITIONAL DISTRIBUTION RULES

56. The fund must:

- distribute during a *financial year 5 per cent of each gift it received in the previous financial year; and
- distribute its trust income within one year after receiving it.

56.1. However, an amount of trust income may be retained to maintain the capital of the fund calculated at the start of a *financial year to reflect movements in the All Groups Consumer Price Index published by the Australian Statistician for the previous financial year.

GOVERNING RULES INCONSISTENT WITH THESE GUIDELINES

57. If the fund's governing rules prevent compliance with a requirement of Part 2 to these Guidelines, the fund is exempt from that requirement until 1 October 2012.

57.1. However, the trustee must comply with the requirement as far as is possible without breaching the governing rules.

57.2. This rule does not apply to the extent that an inconsistency between the governing rules of the fund and Part 2 to these Guidelines results from a change made to the governing rules after 25 June 2009.

58. The trustee must seek to have the governing rules of the fund amended to comply with Part 2 to these Guidelines.

59. If at 30 September 2009, the fund holds investments that are prohibited by guideline 39, then the fund is exempt from complying with that requirement in respect of those investments until 1 October 2010.