



# Private Ancillary Fund Guidelines 2009

## *Taxation Administration Act 1953*

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

Dated 28 September 2009

Nick Sherry  
Assistant Treasurer

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# 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. However, some defined terms may not be asterisked: see section 2-15 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 1: The Commissioner may remit all or part of an administrative penalty: see section 298-20 in Schedule 1 to the Taxation Administration Act 1953.*

*Note 2: 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).*

## 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:
    - seeks to comply with all relevant laws and obligations; and
    - is open, transparent and accountable to the public (through the Commissioner).

*Note: This does not affect the Commissioner's obligations to protect the confidentiality of taxpayers' information under taxation secrecy and disclosure laws.*

### **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 described 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 net assets must be provided as described in paragraph (a) of item 2 in the table in section 30-15 of the *Income Tax Assessment Act 1997*.

*Note: Paragraph (a) of item 2 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 to which are deductible under item 1 of that table; and for any purposes set out in an item in a 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 as a not-for-profit entity.
  - 11.1. Its governing rules must clearly set out and reflect that it is established and operated as a not-for-profit entity.

## OPERATED IN AUSTRALIA

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

*Note: 'Australia' includes the external territories: see sections 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 donor to the fund who has contributed more than \$10,000, or an \*associate of a founder or such a donor.

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

*Example: 'Individuals with a degree of responsibility to the Australian community as a whole' would generally include: school principals, judges, religious practitioners, 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.*

- 14.1. That individual must be an active director of the trustee and a member of any other controlling body of the fund.
15. The trustee or any other controlling body of the fund must not exercise any discretion or power while guideline 14 is not being complied with.

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<sup>1</sup> *Bray v Federal Commissioner of Taxation* (1978) 140 CLR 560; 78 ATC 4179; 8 ATR 569.

15.1. However, the trustee or other controlling body 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.

16. An individual must not be a director of a trustee or a member of any other controlling body of the fund if he or she has been convicted of a taxation offence (within the meaning of 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 after 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: Certain 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 prohibit the fund from indemnifying 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
- gross negligence or recklessness 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 net assets (as at the end of the previous \*financial year).

*Note: While net assets are used to determine the fund's minimum distribution, the amount of the distribution itself is not net of any amount (for example, expenses of the fund).*

- 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
  - any of the expenses of the fund in relation to that financial year are paid directly or indirectly from the fund's assets or income.

*Note: This means that if a fund's expenses are met from outside the fund, its minimum annual distribution is 5 per cent of the market value of the fund's net assets. If a fund's expenses are paid out of the fund's assets or income, its minimum distribution is \$11,000 or 5 per cent, whichever is greater.*

- 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 land to a public benevolent institution, it would include the market value of the land 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, the trustee must comply with the request within 60 days. If the trustee does not the penalty 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 for 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'.*

- 20.1. Subject to guideline 22, the trustee may estimate the \*market value itself or arrange for a qualified valuer or another appropriate entity to make the estimate.

*Note 1: It is not intended that making or arranging for an estimate of market value be onerous or expensive.*

*Note 2: A trustee should consider using a qualified valuer if the value of an asset represents a significant proportion of the fund's value or if the nature of the asset means that the valuation is likely to be difficult or complex.*

*Note 3: The trustee may ask the Commissioner (through the Australian Valuation Office) to undertake a valuation. The Commissioner may charge the trustee for undertaking a valuation.*

20.2. Whoever makes the estimate must base it on reasonably objective and supportable data. The methodology and data used for an estimate should be documented in the fund's records.

20.3. The estimate should be of the \*market value as at the end of the relevant \*financial year. Unless to do so would be unnecessarily onerous and expensive, the estimate should be conducted within 2 months before or after 30 June for each asset.

21. The \*market value of land must be estimated at least once every 3 \*financial 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. Estimates must be completed before the fund is required to give to the Commissioner its \*income tax return for the relevant \*financial year.

*Note: A private ancillary fund will be required to lodge an income tax return whether or not it is exempt from income tax. The Commissioner will approve an appropriate income tax return form for private ancillary funds.*

## **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, and must retain those accounts for a period of at least 5 years after the completion of the transactions or acts to which they relate.

*Note: See also Subdivision 382-B in Schedule 1 to the Taxation Administration Act 1953 for rules about record 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. All transactions between the fund and 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 must be disclosed in the financial statements.

26.3. 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.

PENALTY: 10 penalty units.

27. The trustee must make the financial statements available to the Commissioner upon request.

PENALTY: 10 penalty units.

## **AUDIT**

28. 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.

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

28.2. The auditor must provide the fund with an audit report in accordance with the \*auditing standards.

28.3. The audit must be finalised before the fund is required to give to the Commissioner its \*income tax return for the relevant \*financial year.

PENALTY: 10 penalty units.

29. The trustee must make the audit report available to the Commissioner upon request.

PENALTY: 10 penalty units.



## INVESTMENT STRATEGY

30. The trustee must prepare and maintain a current investment strategy for the fund.
- 30.1. 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.
- 30.2. 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 (including distribution requirements); and
  - 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; and
  - the liquidity of the fund's investments, having regard to its expected cash flow requirements (including distribution requirements); and
  - 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.

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

PENALTY: 10 penalty units.

32. 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.

PENALTY: 10 penalty units.

## INVESTMENT LIMITATIONS

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

33.1. However, this guideline does not prohibit a trustee from \*borrowing money if:

- the purpose of the borrowing is to enable the trustee to make a distribution to a \*deductible gift recipient which the trustee must make under these guidelines and which, apart from the borrowing, the trustee would be unable to make; and

- the period of the borrowing does not exceed 90 days; and
- the borrowing, when made, would not result in total borrowings exceeding 10 per cent of the \*market value of the fund's assets.

33.2. This guideline also does not prohibit a trustee from \*borrowing money if:

- the purpose of the borrowing is to enable the trustee to cover settlement of a transaction for the acquisition of a financial instrument; and
- at the time the relevant investment decision was made, it was likely that the borrowing would not be needed; and
- the period of the borrowing does not exceed 14 days; and
- the borrowing, when made, would not result in total borrowings exceeding 10 per cent of the \*market value of the fund's assets.

33.3. Guideline 33 also does not apply to the acquisition of a financial instrument excluded by the Commissioner from that guideline.

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

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

35.1. However, this guideline does not apply to the acquisition of a financial instrument excluded by the Commissioner from that guideline.

36. 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 except:

- by way of an arms' length commercial transaction; or
- on terms more favourable to the fund than would otherwise be expected under an arms' length transaction.

37. The trustee must keep the assets of the fund separate from all other assets.

38. The fund must not acquire an asset (except by way of gift) if the asset is capable of being a \*collectable.

38.1. If the fund acquires such an asset by way of gift, it must sell or distribute the asset within 12 months after acquiring it.

39. The penalty in relation to each of guidelines 33 to 38 is 30 penalty units.

40. The fund must not \*carry on a \*business.

*Note: The holding of investments, such as shares or rental properties, for the purpose of deriving income that can be distributed to deductible gift recipients is not considered to be carrying on a business.*

- 40.1. 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**

41. 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.

- 41.1. However, the fund may enter into an uncommercial transaction if it is on terms more favourable to the fund than would otherwise be expected under an arms' length transaction.

PENALTY: 30 penalty units.

42. The fund must not \*provide any benefit (except as set out in guideline 43), directly or indirectly, to:

- the trustee; or
- a \*member, director, employee, \*agent or officer of the trustee; or
- a donor to the fund; or
- 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**

43. 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

44. 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.*

45. The fund must not solicit donations from the public.

PENALTY: 30 penalty units.

46. In any \*financial year, the fund must not accept donations totalling more than 20 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; or
- a deceased estate of any of those entities.

PENALTY: 10 penalty units.

47. The fund must issue a receipt for every gift it receives.

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

## COMPLIANCE WITH ALL RELEVANT LAWS

48. 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.

49. 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 lawfully 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

50. If the fund winds up or ceases to be a \*private ancillary fund, all the fund's net assets must be provided as described in paragraph (a) of item 2 in the table in section 30-15 of the *Income Tax Assessment Act 1997*.

*Note: see note to guideline 10.*

## CONVERTING A PRIVATE ANCILLARY FUND INTO A PUBLIC ANCILLARY FUND

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

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

*Note 1: This means that after receiving the agreement of the Commissioner, the trustee may ignore any guideline to the extent that it would prevent the conversion of the private ancillary fund into a public ancillary fund.*

*Note 2: After the conversion, the rules applying to public ancillary funds apply to the converted fund.*

## **PART 3                      TRANSITIONAL RULES FOR FORMER PRESCRIBED PRIVATE FUNDS**

### **INTRODUCTION**

52. 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.

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

### **DISTRIBUTIONS**

#### **ACCUMULATION PLANS**

53. 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; or
- when the fund meets its target capital amount; or
- 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.

53.1. A choice by a fund *not* to apply this transitional rule must be made before the day the fund is required to give to the Commissioner its \*income tax return for the relevant \*financial year.

*Example: If a fund wishes to adopt the new distribution rules in relation to the 2009-10 financial year, it must make the minimum distribution in accordance with guideline 19 during the 2009-10 year and make the choice not to apply this transitional rule before lodging its 2009-10 income tax return.*

54. So long as the fund continues to act in accordance with the plan as permitted by guideline 53, it is not subject to the distribution rules set out in guideline 19 but will instead apply the transitional distribution rules in guideline 55.

#### **TRANSITIONAL DISTRIBUTION RULES**

55. The fund must (at a minimum):

- distribute during a \*financial year 5 per cent of each gift it received in the previous financial year; and
- distribute its trust income within the financial year in which it is derived, unless otherwise allowed by the Commissioner.

- 55.1. 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**

56. 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.

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

56.2. 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.

57. The trustee must seek to have the governing rules of the fund amended to comply with Part 2 to these Guidelines by 1 October 2012.

*Note: The fund's governing rules only need to be amended where they operate in a manner contrary to these Guidelines. Governing rules may incorporate these Guidelines by reference, but this is not required. No changes are required to the governing rules of the fund if the fund can already comply with these Guidelines under its existing governing rules.*

58. If at 30 September 2009 the fund holds investments that are prohibited by guideline 38, the fund is exempt from complying with that guideline in respect of those investments until 1 October 2010.

59. If a fund does not have a trustee that is a \*constitutional corporation, then guideline 14.1 does not apply to the fund. Instead, at least one individual with a degree of responsibility to the Australian community as a whole must be a trustee of the fund.

60. If a fund has an existing borrowing as at 30 September 2009, the fund may maintain that borrowing despite guideline 33. However, the fund may not alter the terms of the borrowing without the prior agreement of the Commissioner.