

## **EXPLANATORY STATEMENT**

### **Issued by authority of the Assistant Treasurer**

*Taxation Administration Act 1953*

*Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2015*

Sections 426-103 and 426-110 in Schedule 1 to the *Taxation Administration Act 1953* (the Act) provide that the Minister must, by legislative instrument, set out rules in the form of guidelines for public ancillary funds and private ancillary funds and their trustees.

#### **Purpose**

The *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2015* (amending guidelines) amend the *Private Ancillary Fund Guidelines 2009* and the *Public Ancillary Fund Guidelines 2011* to:

- update the *Private Ancillary Fund Guidelines 2009* to reflect improvements incorporated in the later made *Public Ancillary Fund Guidelines 2011*;
- introduce portability into the *Private Ancillary Fund Guidelines 2009*;
- update both sets of Guidelines to reflect the introduction of the Australian Charities and Not-for-profits Commission (ACNC);
- remove red tape by ensuring that material provided to the ACNC is not also requested separately by the Australian Taxation Office and allow smaller private funds to seek a review instead of an audit;
- update the investment strategy rules to, amongst other things, ensure funds must consider both their status as a registered charity and conflicts of interest in preparing and maintaining a strategy;
- allowing ancillary funds to provide loan guarantees over borrowings of deductible gift recipients;
- reduce the minimum annual distribution rate;
- remove references to the Australian Valuation Office following its closure on 30 June 2014; and
- repeal spent guidelines.

#### **Context**

The *Private Ancillary Fund Guidelines 2009* and the *Public Ancillary Fund Guidelines 2011* were made in 2009 and 2011, and set minimum standards for the governance and conduct of ancillary funds and their trustees. The introduction of each set of Guidelines coincided with the commencement of a new regulatory regime governing ancillary funds. Both sets of Guidelines have not been updated since they were made.

On 18 March 2015 the then Parliamentary Secretary to the Prime Minister announced a number of deregulation initiatives to be implemented in conjunction with the 2015 Autumn Repeal Day, including some of the amendments to each set of Guidelines.

The then Assistant Treasurer provided further details on these changes in a Media Release of 28 May 2015.

**Application**

The amending guidelines commence on 1 July 2016.

**Conditions**

The Act does not specify any conditions that need to be met before the power to make the amending guidelines may be exercised.

EXPOSURE DRAFT

**Details of the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2015***

**Section 1**

The amending instrument is named the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2015* (the amending guidelines).

**Section 2**

The amending guidelines commence on 1 July 2016.

**Section 3**

The amending guidelines are made under sections 426-103 and 426-110 in Schedule 1 to the *Taxation Administration Act 1953*.

**Section 4**

The amending guidelines make various changes to the *Private Ancillary Fund Guidelines 2009* and *Public Ancillary Fund Guidelines 2011* as set out in the Schedules to the amending guidelines.

**Schedule 1 – amendments to the *Private Ancillary Fund Guidelines 2009***

The amending guidelines made various changes to the *Private Ancillary Fund Guidelines 2009* as set out below.

Update the *Private Ancillary Fund Guidelines 2009* to reflect improvements incorporated in the later made *Public Ancillary Fund Guidelines 2011*

The amending guidelines make a number of changes to the *Private Ancillary Fund Guidelines 2009* to incorporate improvement made in the later *Public Ancillary Fund Guidelines 2011*. [Schedule 1, items 4, 10, 28 to 31, guidelines 14.2, 19.3(example), 37.1, 40.1A, 42 and 43(note)]

The changes predominantly provide additional guidance on the operation of particular Guidelines. The more substantive changes:

- allow a greater number of individuals to qualify as responsible entities;
- provide exceptions for Public Trustees better reflecting their statutory obligations and limitations under the various Public Trustee Acts of the states and territories; and
- incorporate an example on the treatment of social impact investments for the purposes of calculating annual distributions.

Further details on these guidelines can be found in the explanatory statement to the *Public Ancillary Fund Guidelines 2011* and related guidance on the Australian Taxation Office (ATO) website.

### Introduce portability into the *Private Ancillary Fund Guidelines 2009*

The amending guidelines introduce consistent treatment for private ancillary funds and public ancillary funds. This provides private ancillary funds, which are private funds set up to provide money or property to deductible gift recipients, with the flexibility to transfer their net assets to other private ancillary funds to facilitate the portability of funds between trustees and managers. This option is already available to public ancillary funds. [*Schedule 1, item 32, guideline 51A*]

With the agreement of the Commissioner of Taxation (Commissioner), a private ancillary fund is permitted to transfer all its assets to another private ancillary fund. This allows for the portability of funds between trustees, introducing flexibility in the management of funds and greater contestability with regard to fees and charges.

A fund is eligible for portability if, with the agreement of the Commissioner, the fund transfers all its net assets to another ancillary fund, complies with the minimum annual distribution rules for the year in which the transfer occurs, and any of the assets of the fund have not been received from another ancillary fund during the two previous financial years.

### Update the Guidelines to reflect the introduction of the *Australian Charities and Not-for-profits Commission* and the *Charities Act 2013*

Since the introduction of the *Private Ancillary Fund Guidelines 2009*, the regulatory framework applying to private ancillary funds has changed with the introduction of the Australian Charities and Not-for-profits Commission (ACNC) and the *Charities Act 2013*.

Many private ancillary funds will be registered charities by the ACNC (as affected by the *Charities Act 2013*).

The amending guidelines have made some minor changes to reflect the new regulatory framework in which ancillary funds operate. [*Schedule 1, items 1 and 2, guideline 8*]

### Reduce red tape

The amending guidelines introduced a number of changes to reduce red tape for private ancillary funds.

Firstly, the amending guidelines ensure that materials provided to the ACNC do not also have to be provided to the Australian Taxation Office (ATO). [*Schedule 1, items 5, 18 and 23, guidelines 17.1, 27 and 29*]

Secondly, a small private ancillary fund with both revenue and assets of less than \$500,000 (that is, revenue of the fund is less than \$500,000 and assets of the fund are less than \$500,000) can seek a review of its financial report and compliance with the *Private Ancillary Fund Guidelines 2009* rather than a full audit, reducing compliance costs from audit fees. [*Schedule 1, items 19 to 22 and 26, guidelines 28, 29 and 32*]

Lastly, the amending guidelines provide guidance to clarify that compliance with the ACNC financial reporting requirements also meets the requirements of the *Private Ancillary Fund Guidelines 2009* for funds that are registered charities. [*Schedule 1, item 17, guideline 26.1*]

### Update the investment strategy rules

The amending guidelines adjust the matters to be considered by trustees in developing and maintaining an investment strategy.

The new matters to be considered are the status of the fund as a registered charity (where the fund is a registered charity) and any perceived or actual material conflicts of interest in holding particular investments, including those relating to individuals involved in the decision-making of the fund. [*Schedule 1, item 24, guideline 30.2*]

The new matters were developed following a review by the ATO into the compliance of ancillary funds with their respective guidelines. The ATO identified a small number of ancillary funds that held substantial investments with related parties or had entered into a number of related party transactions with donors and founders of the fund. The investments of these funds tended to be undiversified, may have been structured to increase tax deductions available to donors, and did not reflect prudent investment strategies that trustees of charitable entities are expected to undertake.

The amending guidelines have made some minor adjustments to the investment strategy rules as a reminder to trustees of the core obligations of trustees to manage perceived or material conflicts of interest and to operate a charitable fund for the public benefit.

The amending guidelines also incorporate a small increase in the penalty (from 10 to 15 penalty units) for failing to comply with the investment strategy rules to better align with other penalties set out in the guidelines. [*Schedule 1, item 25, guideline 31*]

### Allowing private ancillary funds to provide loan guarantees over borrowings of deductible gift recipients

The amending guidelines amend the investment limitations to allow a private ancillary fund to provide a loan guarantee over its assets for the sole benefit of a deductible gift recipient provided such a guarantee is consistent with the governing rules of the fund. [*Schedule 1, item 27, guideline 35.1*]

This will allow private ancillary funds to provide greater assistance to those deductible gift recipients they were established to support.

### Amendment to the minimum annual distribution rate

The amending guidelines amend the minimum annual distribution rate for a private ancillary fund to the lesser of:

- the average of the Reserve Bank of Australia's target for the cash rate, which is the overnight money market interest rate, over the previous financial year (expressed as a percentage); or
- the rate calculated using the following method (expressed as a percentage):
  - Step 1.* Work out the market value of the fund's net assets as at the end of the previous financial year.
  - Step 2.* Subtract from the amount worked out under step 1, the market value of the fund's net assets as at the end of the financial year before the previous financial year.

*Step 3.* Add to the result of step 2, any expenses the trustee has been notified of that Commissioner is satisfied do not comply with these Guidelines.

*Step 4.* Divide the result of step 3 by the market value of the fund's net assets as at the end of the previous financial year.

*Note: The result of step 3 will generally be the fund's net investment earnings or returns (according to accounting concepts) for the previous financial year less any reasonable expenses. It is this amount that will need to be distributed under this method.*

**[Schedule 1, items 6 to 9, guidelines 19, 19.1, 19.1 (note)]**

The minimum annual distribution rate calculated under the second dot point is the investment earnings of the fund (less expenses). The minimum annual distribution rate is being amended to provide greater flexibility in unexpected economic conditions.

#### Remove references to the Australian Valuation Office

The amending guidelines remove references to the Australian Valuation Office from the *Private Ancillary Fund Guidelines 2009*. [Schedule 1, items 12 to 15, guidelines 20 to 22]

The Australian Valuation Office closed on 30 June 2014.

#### Repealing spent guidelines

The amending guidelines also fix spelling errors and repeal spent and redundant guidelines. [Schedule 1, items 3, 11, 16, 33 and 34, guidelines 12 (note), 20(note), 23, 53 to 58]

### **Schedule 2 – amendments to the Public Ancillary Fund Guidelines 2011**

The amending guidelines made various changes to the *Public Ancillary Fund Guidelines 2011* as set out below.

#### Update the Guidelines to reflect the introduction of the ACNC and the Charities Act 2013

Since the introduction of the *Public Ancillary Fund Guidelines 2011*, the regulatory framework applying to public ancillary funds has changed with the introduction of the ACNC and the *Charities Act 2013*.

Many public ancillary funds will be registered charities by the ACNC (as affected by the *Charities Act 2013*).

The amending guidelines have made some minor changes to reflect the new regulatory framework in which ancillary fund operates. [Schedule 2, items 1 and 2, guideline 8]

#### Reduce red tape

The amending guidelines introduce a number of changes to reduce red tape for public ancillary funds.

The amending guidelines ensure that materials provided to the ACNC do not also have to be provided to the ATO. [Schedule 2, items 5, 15 and 16, guidelines 17.1, 27 and 29]

The amending guidelines also provide guidance to clarify that compliance with the ACNC financial report requirements also meets the requirements of the *Public*

*Ancillary Fund Guidelines 2011* for funds that are registered charities. [*Schedule 2, item 14, guideline 26.1*]

#### Update the investment strategy rules

The amending guidelines adjust the matters to be considered by trustees in developing and maintaining an investment strategy.

The new matters to be considered are the status of the fund as a registered charity (where the fund is a registered charity) and any real or perceived material conflicts of interest in holding particular investments, including those relating to individuals involved in the decision-making of the fund. [*Schedule 2, item 17, guideline 30.2*]

The new matters were developed following a review by ATO into the compliance of ancillary funds with their respective guidelines. The ATO identified a small number of ancillary funds that held substantial investments with related parties or had entered into a number of related party transactions with donors and founders of the fund. The investments of these funds tended to be undiversified, may have been structured to increase tax deductions available to donors, and did not reflect prudent investment strategies that trustees of charitable entities are expected to undertake.

The amending guidelines have made some minor adjustments to the investment strategy rules as a reminder to trustees of the core obligations of trustees to manage perceived or material conflicts of interest and to operate a charitable fund for the public benefit.

The amending guidelines also incorporate a small increase in the penalty (from 10 to 15 penalty units) for failing to comply with the investment strategy rules to better align with other penalties set out in the guidelines. [*Schedule 2, item 18, guideline 31*]

#### Allowing public ancillary funds to provide loan guarantees over borrowings of deductible gift recipients

The amending guidelines amend the investment limitations to allow a public ancillary fund to provide a loan guarantee over its assets for the sole benefit of a deductible gift recipient provided such a guarantee is consistent with the governing rules of the fund. [*Schedule 2, item 20, guideline 35.1*]

This will allow public ancillary funds to provide greater assistance to those deductible gift recipients they were established to support.

#### Amendment to the minimum annual distribution rate

The amending guidelines amend the minimum annual distribution rate for a public ancillary fund to the lesser of:

- the average of the Reserve Bank of Australia's target for the cash rate, which is the overnight money market interest rate, over the previous financial year (expressed as a percentage); or
- the rate calculated using the following method (expressed as a percentage):
  - Step 1.* Work out the market value of the fund's net assets as at the end of the previous financial year.
  - Step 2.* Subtract from the amount worked out under step 1, the market value of the fund's net assets as at the end of the financial year before the previous financial year.

*Step 3.* Add to the result of step 2, any expenses the trustee has been notified of that Commissioner is satisfied do not comply with these Guidelines.

*Step 4.* Divide the result of step 3 by the market value of the fund's net assets as at the end of the previous financial year.

*Note: The result of step 3 will generally be the fund's net investment earnings or returns (according to accounting concepts) for the previous financial year less any reasonable expenses. It is this amount that will need to be distributed under this method.*

***[Schedule 2, items 6 to 9, guidelines 19, 19.1 and 19.1 (note)]***

The minimum annual distribution rate calculated under the second dot point is the investment earnings of the fund (less expenses). The minimum annual distribution rate is being amended to provide greater flexibility in unexpected economic conditions.

#### Remove references to the Australian Valuation Office

The amending guidelines remove references to the Australian Valuation Office from the *Public Ancillary Fund Guidelines 2011*. ***[Schedule 2, items 10 to 13, guidelines 20 to 22]***

The Australian Valuation Office closed on 30 June 2014.

#### Repealing spent guidelines

The amending guidelines update references and repeal spent and redundant guidelines. ***[Schedule 2, items 3, 4, 19, 23 to 27, guidelines 12, 14.1, 32, 50, 52 to 55]***

#### Other minor changes

The amending guidelines also provide guidance to trustees of public ancillary funds about good practice in relation to the fund's status as a public fund. Specifically, it reminds trustees that it is good practice to review the non-binding preferences of donors prior to making distributions from the fund to deductible gift recipients. ***[Schedule 2, items 21 and 22, guideline 44 (note 2)]***