THE TAX INSTITUTE

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Mr Stephen Jones
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The Treasury
Langton Crescent
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By email: dgr@treasury.gov.au

Dear Mr Jones,

Remake of Sunsetting Private Ancillary Fund Guidelines

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the *Remake of Sunsetting Private Ancillary Fund Guidelines Exposure Draft* (**Draft Guidelines**).

Comments on specific parts of the Draft Guidelines are contained in the Appendix. More broadly, we note the inference that all private ancillary funds are to be regulated by the Australian Charities and Not-for-profits Commission (**ACNC**) in future from the recent proposal[1] to reform Deductible Gift Recipients (**DGR**). However, the Draft Guidelines do not seem to yet cater for this inference. We query whether Treasury should provide for this in the Draft Guidelines or whether Treasury is able to confirm that the inference that private ancillary funds will be regulated by the ACNC in future is not correct

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours faithfully,

Tim Neilson
President

[1] https://treasury.gov.au/sites/default/files/2019-03/Final-Deductible-Gift-Recipient-Reform-Consultation-Paper.pdf.

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APPENDIX

Guideline	Comment
Subsection 8(a)	Section 8(a) effectively says that a "*private ancillary fund" must be an "*ancillary fund" but this is circular as the definition of "ancillary fund" in the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**) provides that the term means a public ancillary fund or a private ancillary fund.
Subparagraph 8(d)(ii)	The wording in brackets is a little difficult to follow. We suggest it should be (through *regulation* by the Commissioner of Taxation….). In the 'Note', we suggest removing the word 'and' after 'privacy,' and before 'secrecy'.
Subsection 9(3)(b)	We suggest adding the words 'an endorsed' before 'private ancillary fund'. Also, it would be easier to read if the full description in para (a) of item 2 of the table in section 30-15 of the 1997 Act were included here rather than just a reference to the description – if a reference is only included to the relevant provision containing the description then it should be specified that the reference is to para (a) of *column* 1 of item 2.
Section 11	Section 11 should clarify that the requirement does not limit distributions to item 1 DGRs (of section 30-15 the 1997 Act which refers to DGRs in Subdiv 30-B) that have overseas activities.
Subsection 12(1)	The reference to a 'prudent individual' is a bit vague – for example, should it be a reference to a prudent individual exercising fiduciary obligations under trust law requirements?
Subsection 12(7) and Note 1	Note 1 to subsection 12(7) says that the requirement for a responsible person "is similar to (but less strict than) the requirement applying to public ancillary funds (see *Bray v Federal Commissioner of Taxation* (1978) 140 CLR 560)". It would improve readability of the Guidelines if it was expressed in the Guidelines to say what the requirement means on its own terms without the reader having to refer to, and determine the meaning of, another two documents. Similarly, new Note 2 includes reference to TR 95/27 and a link to the ATO's website instead of the list of examples that was contained in the previous Guidelines. Further, TR 95/27 not only concerns a different type of fund (public funds) but also the since-repealed section 78 of the *Income Tax Assessment Act* 1936 (Cth) so it provides guidance that is likely to confuse readers. The reference may well be superseded if the ATO refreshes the ruling. What is more concerning is the treatment of ATO guidance as having authority the equivalent of a legislative instrument. At most, TR 95/27 could be referred to in the Explanatory Materials. Examples which are intended to be authoritative and relevant to the Draft Guidelines should be separately included in the Guidelines themselves. There is a lot of confusion in the community about what is a 'responsible person'. It would be more useful if Treasury included a substantive definition of 'responsible person'. It would be more helpful to a user of these Guidelines to have a clear

	agreed-upon definition. It could be an inclusive definition rather than an exclusive one and can pick up on the one everyone is used to using. As noted above, relevant examples should also be provided. Though, we query the value of continuing to rely on the concept of 'responsible person' for private ancillary funds.
Subsection 12(8)	The drafting of new section 12(8) is a little awkward and could be read as meaning that a founder, etc cannot be an individual with a degree of responsibility to the community. It might be better to re-combine subsections 12(7) and (8) more along the lines of the original Guidelines.
Section 15 (minimum distributions) and Section 16 (valuations)	Founders of companies (eg technology, resources, etc) could be further assisted/encouraged to put their shares (including non-listed shares) into a private ancillary fund so that the future growth in value can be applied to charitable causes down the track. While this is suggested by the Guidelines, statements of policy and intent could be taken into account by the Commissioner in deciding a reduced distribution rate under Section 16. With the sunsetting of the current guidelines, there is the opportunity to support philanthropy in this context. We request clarification of the types of contributions that can be made to a private ancillary fund and statements of policy where they can encourage the potential for significantly greater value to be realised in the future, and later applied in ways that are beneficial to the community.
Subsection 15(2)	Section 15(2) starts with the words "Further to subsection (1)" which could be read as indicating a requirement additional to that in subsection 15(1), though the note underneath clarifies this isn't the intention. Perhaps the introductory wording should be clarified.
Subsection 15(4)	Section 15(4) provides a definition of "distribution" but the term used in subsections 15(1) and (2) is "distribute". Presumably the definition is meant to apply to other forms of the word but it would be better to clarify this by using the defined term consistently instead (eg, fund must make a *distribution…").
Subsections 17(2), 18(5) and 19(7)	Subsections 17(2), 18(5) and 19(7) all require information to be provided to the Commissioner "on request" with penalties for failure to do so – these should each at least provide for a reasonable time for the trustees to comply with the Commissioner's request rather than triggering automatic penalties and potential loss of the right to endorsement.
Subsection 20(5)	Subsection 20(5) provides that a fund's investment strategy must be in a written form so that the trustee, an auditor/reviewer or the Commissioner can determine "whether the fund has complied with this instrument and other Australian laws; otherwise they may be subject to penalty. This provision has not changed since the earlier version of the Guidelines. However, it is unclear what this provision means or what triggers the penalty, eg is it the investment strategy not being in written form? Or is it a relevant person not being able to determine whether the fund has complied with Australian laws (even if those laws have nothing to do with the

	investment strategy)? Or both? Further, unlike powers given to require production of accounting records, the Commissioner is not given any specific power to request the trustees provide a copy of the investment strategy. Therefore, is it that the penalty is triggered by failing to provide the investment strategy to the Commissioner or not? We suggest this provision be clarified.
Subsection 21(1)	We suggest adding at the start the words 'Subject to subsections (2) and (3) ….' to subsection 21(1).
Subparagraph 22(3)(e)	Subparagraph 22(3)(e) specifically mentions DGRs are excluded from the rule that a fund cannot provide a benefit to an associate of related entities, but it is unclear whether this reference to DGRs applies only to associates under (e) or similarly qualifies (a) – (d) above. There does not appear to be any reason why a founder or donor that is itself a DGR should not be excluded from the rule – that is, the reference to "(other than a deductible gift recipient)" should apply to the whole list of persons, not just (e). A private ancillary fund should be able to deal with any DGR, particularly as the overriding purpose for a private ancillary fund is to work with DGRs.
Subsections 21(4), 21(7) and section 22	There seems to be quite a degree of overlap between subsection 21(7) and section 22 as they both deal with uncommercial transactions (without defining what is meant by "uncommercial") but with slightly different terms and triggers. For instance, subsection 21(7) specifically excludes a gift but section 22 does not while subsection 22 specifically excludes uncommercial transactions with other DGRs but 21(7) does not. It seems likely that the same transactions would trigger both sections and both penalties. It would be better to provide one clear statement of the kinds of uncommercial or related party transactions that are unacceptable. The interplay between subsection 21(4) on the one hand, and each of subsections 21(7) and 22(2) on the other hand is of concern. We presume that if the private ancillary fund makes a loan to a founder etc on terms that are not at arm's length but are in fact more favourable to the private ancillary fund than arm's length terms, then subsection 21(7) overrides subsection 21(4). However, what if the borrower is not a founder, or one of the other persons referred to in subsection 21(7)? Presumably there is no override? Or can the private ancillary fund then look to subsection 22(2) as the override provision, even though subsection 22(2) is not aimed at loans specifically? And if subsection 22(2) has a wide application, then it may be that subsection 21(4) is not determined to serve any purpose? These subsections have a similar function though they have different carve-outs.
Subparagraph 24(2)(c)	The inclusion of new subparagraph 24(2)(c) is welcome.
Section 25	Which 'Commissioner' is being referred to in section 25? Is it the Commissioner of Taxation or the Commissioner of the Australian Charities and Not-for-profits Commissioner?

Section 26	As per the comments above on section 9, we suggest inserting the description rather than referring to a provision that contains the description.
Section 27	Either the section or the note should clarify here that conversion into a public ancillary fund creates an exception to the general rule that one ancillary fund can't distribute to another.