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TAXATION INSTITUTE of AUSTRALIA
IT'S ESSENTIAL

22 July 2009

The Manager
Philanthropy & Exemptions Unit
Personnel & Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email ppfreview2008@treasury.gov.au

Dear Manager,

Private Ancillary Fund Guidelines 2009

The Taxation Institute of Australia (**Taxation Institute**) is pleased to provide this submission on the draft Private Ancillary Fund Guidelines 2009 released for public consultation on 25 June 2009 (**Draft Guidelines**).

As noted in the Taxation Institute's previous submission regarding the Exposure Draft Tax Laws Amendment (Prescribed Private Funds) Bill 2009 dated 28 May 2009, the Taxation Institute supports the Government's commitment to improving the integrity of prescribed private funds (which will be known as private ancillary funds).

Further, the Taxation Institute commends the consultation process in relation to the proposed amendments regarding prescribed ancillary funds. The consultation process has provided opportunities for consultation on the discussion paper, the exposure draft and now the Draft Guidelines.

However, the Taxation Institute has some concerns and recommendations in relation to the Draft Guidelines which are outlined below.

Comments and recommendations

The Taxation Institute is pleased that the Draft Guidelines deal with a number of areas of potential concern in a balanced and reasonable manner. The Taxation Institute considers that this approach will achieve the underlying objectives of the integrity measures in a manner which is not counter productive to the encouragement of greater levels of philanthropic support from the private sector in Australia.

Prior to the release of the Draft Guidelines, there was significant concern regarding the proposed minimum annual distribution requirement. While many may still disagree with the need for a minimum annual distribution, the Taxation Institute considers that the requirement set out in Draft Guideline 19 is not overly onerous and should be acceptable to the majority. In this regard, the Taxation Institute considers that the 5 per cent requirement in Draft Guideline 19 is not at a level which would deter citizens from establishing a private ancillary fund.

However, clarification is needed regarding the qualification in the second dot point in Draft Guideline 19.1. Although it is not entirely clear, the Taxation Institute considers that Draft Guideline 19.1, bullet point 2 should be interpreted as follows:

- if 5 per cent of the fund's assets are less than $11,000 and *no* expenses are paid from the fund's assets or income then the fund must distribute 5% (being an amount that will be less than $11,000) of the market value of the fund's assets; and
- if 5 per cent of the fund's assets are less than $11,000 and expenses *are* paid from the fund's assets or income then the fund must distribute at least $11,000.

The Taxation Institute also has concerns regarding the definition of "market value" in Draft Guideline 19.1. For these purposes, the term "market value" is defined by reference to the *Income Tax Assessment Act 1997* (**ITAA 97**). Under the ITAA 97, the market value of a non-cash benefit (i.e. property or services in any form except money) is to be determined, disregarding anything that would prevent or restrict conversion of the benefit to money.

The effect of will be to force trustees to disregard anything that would prevent or restrict conversion of property into money when valuing the fund assets thereby inflating the minimum annual distribution required under Draft Guideline 19.1.

The Taxation Institute also recommends that consideration be given to introducing a "phasing in period" by extending the period in Draft Guideline 19.2. Draft Guideline 19.2 provides that no distribution is required during the financial year in which the fund is established. The Taxation Institute recommends extending this period to allow time for the fund to become established. A period of three or five years is suggested for this purpose.

The Taxation Institute is concerned about the potential that exists for the Draft Guidelines to impose greater costs on private ancillary funds and thereby subtract from the money available for philanthropic purposes. Two areas in the Draft Guidelines where there is potential for this problem to arise are in the valuation and the audit provisions.

In relation to the valuation provisions, one concern is the requirement that the market value of land be estimated at least once every three years by a certified and independent valuer or by the Commissioner (through the Australian valuation office). This will potentially involve significant costs for funds that hold land. Although the Taxation Institute understands that it may not be common for such funds to hold land, the Taxation institute recommends that further consideration should be given to this requirement and the period between valuations should be increased from three years to at least five years. Further, the Taxation Institute recommends that, rather than being mandatory, valuations should be required upon request by the Commissioner (acting reasonably) and at intervals of no less than five years.

The Taxation Institute is also concerned that there may be an increase in audit costs given the requirements in Draft Guideline 27 for fund auditors to audit compliance with the Draft Guidelines by the fund and the trustee. The Taxation Institute acknowledges that this is consistent with other areas of the law, for example superannuation. However, considering private ancillary funds are established to benefit the community rather than the individual, the relatively small number of such funds and the desirability of encouraging greater levels of philanthropic support from the private sector in Australia, the Taxation Institute submits that this burden should not be transferred from the ATO to the funds or their auditors. Accordingly, the Taxation Institute considers that Draft Guideline 27 should be amended to delete this requirement.

A further concern of the Taxation Institute is with the requirement in Draft Guideline 32 that the trustee must prepare and maintain a current distribution strategy for the fund. Some funds may have a developed pattern of distributions. However, the Taxation Institute expects that there are many other funds that make distributions on a needs basis from time to time and they may be hampered by this provision. Further, this requirement may also diminish emergency relief for the Australian community. Accordingly, the Taxation Institute considers that this Draft Guideline should be amended.

Draft Guideline 52 provides that with the agreement of the Commissioner the fund may amend its governing rules to convert from a private ancillary fund into a public ancillary fund. In this regard, the Taxation Institute recommends that guidance be provided in relation to whether a converted public ancillary fund will be permitted to retain any accumulation plan that has been previously agreed between the private ancillary fund and the Australian Taxation Office. The Draft Guidelines do not make it clear whether this will be the case.

The second dot point in Draft Guideline 56 provides that as part of the transitional distribution rules, the fund must “distribute its trust income within one year after receiving it”. The Taxation Institute considers that this Draft Guideline needs to be clarified to make it clear whether the reference to “one year” is a reference to one calendar year, one financial year or a distribution in the succeeding financial year.

Draft Guidelines 57-59 are transitional rules that apply where the governing rules of the fund are inconsistent with the Draft Guidelines. Under Draft Guideline 58, the trustee must seek to have the governing rules of the fund amended to comply with the rules in Part 2 of the Draft Guidelines (which set out the rules that a private ancillary fund must comply with to become, and remain, endorsed as a deductible gift recipient. It is not clear whether this requires specific amendments to be made to the governing rules of the fund to address any inconsistency or whether it is sufficient if the trustee amends the governing rules to include a provision that provides that the trustee will covenant to be bound by the Draft Guidelines. The Taxation Institute considers that the Draft Guidelines need to be clarified to make this issue clear.

Further, Draft Guideline 58 does not impose a date by which the governing rules need to be amended to comply with Part 2 of the Draft Guidelines but merely requires the trustee to seek to have the rules amended. The relevant date appears to be 1 October 2012 but this is confusing given the various dates that are stated in Draft Guidelines 57 and 59. Accordingly, the Taxation Institute considers that the Draft Guidelines need to be clarified to make this clear.

If you require any further information or assistance regarding our submission please contact Joan Roberts on 03 9611 0178 or the Taxation Institute’s Tax Counsel, Angie Ananda on 02 8223 0011.

Yours sincerely

Joan Roberts

Joan Roberts
President