
EXPOSURE DRAFT – PUBLIC ANCILLARY FUNDS

EXPLANATORY MATERIALS

DRAFT

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ABR	Australian Business Register
ATO	Australian Taxation Office
Commissioner	Commissioner of Taxation
DGRs	deductible gift recipients
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
TAA 1953	<i>Taxation Administration Act 1953</i>

DRAFT

Chapter 1 **Public ancillary funds**

Outline of chapter

1.1 Schedule # to this exposure draft amends the *Income Tax Assessment Act 1997* (ITAA 1997), the *Taxation Administration Act 1953* (TAA 1953) and the *A New Tax System (Australian Business Number) Act 1999* to improve the integrity of public ancillary funds. The amendments among other things:

- rename this type of ancillary fund as a public ancillary fund (their more commonly used name);
- give the Treasurer the power to make legislative guidelines about the establishment and maintenance of public ancillary funds; and
- give the Commissioner the power to impose administrative penalties on trustees that fail to comply with the guidelines and to remove or suspend trustees of non-complying funds.

Context of amendments

1.2 A public ancillary fund is one of two types of ancillary trust fund that can qualify for deductible gift recipient status (DGR) status and income tax exempt status under the ITAA 1997. A public ancillary fund collects tax deductible donations from the public which they on-distribute to other DGRs that they consider to be for worthwhile causes.

1.3 The other type of ancillary fund is a private ancillary fund, which allows businesses, families and individuals to establish and donate to a charitable trust of their own, without the need to seek contributions from the public, for the purposes of disbursing funds to a range of other DGRs.

1.4 A public ancillary fund is distinct from a private ancillary fund in that it must invite the public to contribute to the fund. These funds are commonly used for community and fund raising appeals. These funds have been in existence for some time.

1.5 Public ancillary funds are required to meet the DGR conditions in the income tax law (item 2 in the table in section 30-15(2) of the ITAA 1997) and also comply with the public fund requirements as described in Australian Taxation Office (ATO) Taxation Ruling TR 95/27.

1.6 The requirements set out in TR 95/27 set out the rules for public funds and ensure a reasonable standard of governance as these rules are intended to ensure that moneys and property donated to the fund are applied for the purpose for which the fund was established.

1.7 A fund is a public fund where: it is the intention of the promoters or founders that the public will be invited to contribute to the fund; the public, or a significant part of it, does in fact contribute to the fund; and the public participates in the administration of the fund. These requirements are intended to ensure that moneys and property donated to the fund, and which attract a taxation concession, are used for the purpose for which the fund has been granted DGR status.

1.8 A public ancillary fund currently requires endorsement by the Commissioner of Taxation to access DGR concessions. To be eligible for endorsement, the fund must have the following characteristics:

- the fund is a public fund; and
- it is established and maintained under a will or instrument of trust; and
- it is allowed, by the terms of the will or instrument of trust, to invest gift money only in ways that an Australian law allows trustees to invest trust money; and
- it is established and maintained solely for:
 - the purpose of providing money, property or benefits to DGRs, or
 - the establishment of DGRs.

1.9 A public ancillary fund must be exclusively for these purposes. It must not carry on any other activities. It is like a conduit or temporary repository for channelling gifts to other DGRs.

1.10 From 1 October 2009, changes were made to improve the integrity of private ancillary funds. To provide similar treatment for public ancillary funds, the Government announced in the 2010-11 Budget,

similar changes to improve the integrity of public ancillary funds. The changes are:

- providing the Treasurer with the power to make legislative guidelines about the establishment and maintenance of public ancillary funds; and
- providing the Commissioner of Taxation with greater regulatory powers in respect of trustees for breaches of the guidelines including the ability to impose administrative penalties.

1.11 The amendments in the exposure draft implement the Government's Budget announcement to give the Treasurer the power to make legislative guidelines and to give the ATO greater regulatory powers.

1.12 The guidelines will be implemented by way of a legislative instrument and will be the subject of further consultation.

1.13 The proposed changes for public ancillary funds are similar to those for private ancillary funds but take into account the differences between the two types of funds.

Consultation

1.14 The Government released a discussion paper in November 2010 seeking public input into the implementation of the new integrity arrangements. Forty six submissions were received in response to the paper.

1.15 Many respondents to the discussion paper were encouraged by the Government's interest in the philanthropic sector, and in giving the ATO greater regulatory powers. However, the majority of respondents also cautioned against increasing the minimum distribution rate for public ancillary funds to a point where these funds are unable to exist in perpetuity. These matters will be considered by the Government along with other matters before the new guidelines are finalised.

Summary of new law

1.16 The amendments rename public ancillary funds in the income tax law and thus ensure that public ancillary funds still require the endorsement of the Commissioner of Taxation.

1.17 The amendments give the Treasurer the power to make guidelines about the establishment and maintenance of public ancillary funds. Those guidelines are enforced through the imposition of administrative penalties.

1.18 The Commissioner will also have the power to suspend or remove trustees of public ancillary funds that breach the guidelines or other relevant Australian laws. The Commissioner's decisions can be reviewed by the Administrative Appeals Tribunal and the Federal Court of Australia.

1.19 It is necessary to require that all of the trustees of public ancillary funds are corporate trustees. This ensures there is an increased range of regulatory powers available to protect the charitable funds of public ancillary funds. This requirement will not apply where the trustee is the Public Trustee of a state or territory as these trustees are subject to an appropriate level of supervision under state and territory legislation. In addition, not all states and territories have created their Public Trustees as constitutional corporations.

1.20 The amendments also ensure that the Australian Business Register (ABR) can identify public ancillary funds.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
No change. However these funds are renamed as public ancillary funds in the taxation laws.	In order to be a DGR, a public ancillary fund must be endorsed by the Commissioner of Taxation. A public ancillary fund (a 'public fund') must meet the requirements in item 2 in the table in section 30-15(2) of the ITAA 1997. The public fund requirements are described in ATO Ruling TR 95/27. The Commissioner's decision is reviewable by the Administrative Appeals Tribunal and the Courts.
The Treasurer will have the power to make binding guidelines about the establishment and maintenance of public ancillary funds. The guidelines are a legislative instrument and are subject to review	No equivalent.

or disallowance by the Parliament.	
<i>New law</i>	<i>Current law</i>
The guidelines are enforced through a tailored system of administrative penalties.	No equivalent. The ATO must revoke the DGR status of non-complying funds.
The Commissioner of Taxation will have the power to suspend or remove the corporate trustees of public ancillary funds that consistently breach the guidelines or other relevant Australian laws.	No equivalent.
For constitutional reasons, all of the trustees of public ancillary funds must be corporate trustees. This requirement will not apply where the trustee is the Public Trustee of a state or territory as these trustees are subject to an appropriate level of supervision under state and territory legislation.	Trustees of public ancillary funds can be either individuals or corporations.
The ABR will identify whether an entity is a public ancillary fund.	The ABR currently only identifies as to whether an entity is a DGR and whether it is an ancillary fund.

Detailed explanation of new law

Endorsement as a DGR

1.21 The Commissioner will maintain the role for considering whether a public ancillary fund is entitled to be endorsed as a DGR.

1.22 To ensure this outcome, amendments are made to item 2 in the table in subsection 30-15(2) to replace references to ‘public fund’ and ‘private ancillary fund’ to ‘ancillary fund’ to cover both private and public ancillary funds. *[Schedule #, items 2, 3, and 7, item 2 in the table in subsection 30-15(2) of the ITAA 1997; subsection 995-1(1) of the ITAA 1997]*

1.23 A definition of ‘public ancillary fund’ is included in the ITAA 1997 and in the TAA 1953. A trust fund that meets the definition will be entitled to be endorsed as a DGR (subject to the fund meeting all other requirements that apply to public ancillary funds seeking endorsement as a DGR). *[Schedule #, items 8 and 16, subsection 995-1(1) of the ITAA 1997 and section 426-102 in Schedule 1 to the TAA 1953]*

1.24 The Commissioner will be responsible for considering whether a trust fund meets the definition of a ‘public ancillary fund’ and whether that fund is then entitled to be endorsed as a DGR. *[Schedule #, items 4 and 5, subsection 30-125(1) of the ITAA 1997]*

1.25 The exposure draft makes amendments to Subdivision 426-D in Schedule 1 to the TAA 1953 which deals with private ancillary funds to ensure that it applies to both private and public ancillary funds (‘ancillary funds’). *[Schedule #, items 11 to 15]*

1.26 A trust is a **public ancillary fund** if:

- all the trustees of the trust are constitutional corporations; and
- all the trustees have agreed to comply with the guidelines made by the Treasurer.

[Schedule #, item 16, section 426-102 in Schedule 1 to the TAA 1953]

1.27 Public ancillary funds were not previously required to have corporate trustees. However, for constitutional reasons, it has been necessary to impose this new requirement on public ancillary funds in order to provide the Commissioner with additional regulatory powers.

1.28 An exception from this requirement will be provided for Public Trustees of the states and territories. The requirement to be a corporate trustee should not prevent the Public Trustee of each of the states and territories from being trustees of public ancillary funds as they are subject to an appropriate level of prudential supervision under state and territory legislation. In addition, not all states and territories have created their public trustees as constitutional corporations. *[Schedule #, item 16, subparagraph 426-102(1)(a)(ii) in Schedule 1 to the TAA 1953]*

1.29 A constitutional corporation is a corporation covered by section 51(xx) of the *Constitution*. A corporation established and operated solely as a trustee of a public ancillary fund would be considered a constitutional corporation. Professional trustee corporations would also be considered constitutional corporations.

1.30 Imposing a requirement for public ancillary funds to have a corporate trustee also ensures that directors meet a minimum standard of behaviour. The *Corporations Act 2001* details the circumstances under which an individual will automatically be disqualified from managing corporations. These include where the person has:

- a conviction on indictment of an offence in relation to decisions that affect the business of a corporation or its financial standing;
- an offence involving a contravention of the *Corporations Act 2001* punishable by imprisonment for 12 months or more;
- an offence involving dishonesty punishable by more than three months imprisonment;
- conviction for an offence against the law of a foreign country punishable by more than 12 months imprisonment; or
- is a undischarged bankrupt.

1.31 In order for a trust fund to become a public ancillary fund, the trustee(s) will need to agree to be bound by the public ancillary fund guidelines. The trustee(s) will indicate their agreement to be bound in a form approved by the Commissioner. *[Schedule #, item 16, section 426-102 in Schedule 1 to the TAA 1953]*

1.32 If the Commissioner refuses to endorse a prospective public ancillary fund as a DGR, the fund can request a review of the decision by the Commissioner, Administrative Appeals Tribunal or appeal the decision to a Court under section 426-35 in Schedule 1 to the TAA 1953.

Public ancillary fund guidelines

1.33 The Treasurer will be able to make binding guidelines about the establishment and maintenance of a public ancillary fund. *[Schedule #, items 9 and 16, subsection 995-1(1) of the ITAA 1997 and section 426-103 in Schedule 1 to the TAA 1953]*

1.34 Compliance with guidelines is a requirement for a public ancillary fund's continued endorsement as a DGR. *[Schedule #, items 4 and 5, subsection 30-125(1) of the ITAA 1997]*

1.35 Similar to the *Private Ancillary Fund Guidelines 2009*, the guidelines are a legislative instrument and are therefore subject to disallowance by either House of Parliament.

1.36 The guidelines may specify requirements about purpose, structure and governing rules of a public ancillary fund. The guidelines may also specify matters about the ongoing governance and permitted and prohibited activities of the fund.

1.37 It is envisaged that the guidelines will specify a similar range of matters as the *Private Ancillary Fund Guidelines 2009*. These matters include the role and purpose of public ancillary funds; the class of entities that the fund may donate to; that the fund be not-for-profit in character; the individuals that may be directors of the fund's trustees; the minimum distribution requirements of the fund; the permitted investment strategies of the fund; and any ongoing audit requirements.

1.38 The guidelines will ensure that public ancillary funds have appropriate governance arrangements, are properly accountable and act in a manner consistent with an entity holding philanthropic funds for a broad public benefit.

Income tax returns

1.39 Commencing from the 2011-12 income year, public ancillary funds will be required to lodge an annual income tax return. The income tax return for public ancillary funds will be similar to the current annual information statement that is required to be lodged by private ancillary funds.

1.40 Public ancillary funds that fail to lodge their income tax return by the relevant due date will be subject to the general penalty regime that applies to all taxpayers who do not provide their income tax return to the Commissioner by the due date.

1.41 Similar to private ancillary funds, it is anticipated that information provided on the income tax returns will be used by the ATO to provide publically available annual statistics on these funds. It is expected that the statistics will provide information on the number of public ancillary funds, donations and assets and a breakdown of public ancillary fund donations by DGR category.

1.42 Similar to private ancillary funds, it is anticipated that information provided in these returns will also be used by Treasury to provide additional information in its annual taxation expenditure statement publication.

Administrative penalties

1.43 Similar to private ancillary funds, administrative penalties will apply to trustees and the directors of trustees that hold a public ancillary fund out as being endorsed; entitled to be endorsed; or entitled to remain endorsed, as a DGR and where they fail to comply with the guidelines.

1.44 The administrative penalties will apply to public ancillary funds in the same way as they apply to private ancillary funds. This outcome is

achieved by amending the references in section 425-120 in Schedule 1 of the TAA 1953 so that it applies to both private and public ancillary funds.

[Schedule #, items 18 to 22]

1.45 These amendments will have the following affect:

- the amount of the penalties will be determined by the guidelines;
- trustees of a public ancillary fund are jointly and severally liable to any administrative penalty;
- the penalty can only be imposed on directors where any of the penalty cannot reasonably be recovered from a trustee;
- a director that did not take part in the management of the trustee at the time the public ancillary fund breached its obligations may in certain circumstances avoid an administrative penalty;
 - the circumstances that the director must demonstrate are that the director was not aware of the breach and it would not have been reasonable to expect them to have been aware of the breach; or the director took all reasonable steps to ensure that the breach did not occur; or there were no such steps that the director could have taken;
- an administrative penalty must not be reimbursed from the fund; and
- the *Corporations Act 2001* cannot apply to provide relief to a director from the administrative penalties.

1.46 The Public Trustee of each state or territory can be the trustee of a public ancillary fund. An exception is provided so that, in addition to directors of trustees that are registered trustee companies, directors and statutory office holders of public trustees will not be personally liable to administrative penalties. Public trustees have an appropriate level of prudential supervision and regulation to cover their liabilities so similar to registered trustee companies, there is no need to extend the administrative penalty regime to their directors. Public trustees are those trustees that are governed by the relevant state and territory public trustee legislation.

[Schedule #, item 20, paragraph 426-120(2)(b)(ii)]

1.47 The machinery provisions on administrative penalties in Division 298 in Schedule 1 of the TAA 1953 will also apply to the new

administrative penalty regime for public ancillary funds. Under these rules, the Commissioner has the discretion to remit all or a part of the penalty under the normal machinery provisions for penalties.

Suspension or removal of trustees

1.48 As for private ancillary funds, the Commissioner will also be given the power to remove or suspend a trustee of a public ancillary fund that breaches the guidelines or any other Australian law. The references in section 425-125 of Schedule 1 of the TAA 1953 are amended so that the rules for suspending or removing a trustee, apply to both private and public ancillary funds. *[Schedule #, items 23 to 33]*

1.49 However, the Commissioner will not be provided with the power to suspend or remove Public Trustees of each State and Territory as this is a matter for the States and Territories. *[Schedule #, item 16, section 426-102(3) in Schedule 1 to the TAA 1953]*

1.50 If the Commissioner suspends a trustee, the amendments provide that:

- the suspension will be for a period that the Commissioner determines by reference to the circumstances and it is subject to modification;
- the Commissioner must provide the suspended trustee a written notice advising them of the decision, explaining the reasons why the decision was taken and in the cases of suspension, setting out the period of suspension;
 - the trustee may seek a review of the decision by the Administrative Appeals Tribunal or a court following the process outlined in Part IVC of the TAA 1953 (taxation objections, reviews and appeals).

1.51 If a trustee is suspended or removed, the amendments provide that:

- the Commissioner must appoint an acting trustee to undertake the duties of trustee until the suspension period has ended or a replacement trustee is appointed (as the case may be);
 - an acting trustee may be an individual, body corporate or a government agency or the Commissioner. The acting trustee must have agreed to comply with the public ancillary fund guidelines. The Commissioner cannot

appoint an acting trustee who is not a constitutional corporation for a period exceeding 6 months;

- the Commissioner may determine the terms and conditions upon which an acting trustee is appointed. The terms and conditions determined by the Commissioner are valid despite any limitation in an Australian law or the governing rules of the public ancillary fund;
- the Commissioner may give directions to an acting trustee to do or not to do certain things. The acting trustee commits an offence if they contravene a direction;
- the Commissioner may terminate the appointment of an acting trustee at any time. If the Commissioner were to do so, he or she would be required to appoint a new acting trustee;
- an acting trustee may resign as acting trustee. However, the acting trustee must do so in writing given to the Commissioner. The resignation is not effective until seven days after the Commissioner receives the written resignation;
- the Commissioner must make an order transferring the property of the public ancillary fund from the former or suspended trustee to the acting trustee;
 - the order has the legal effect of immediately transferring that property subject to certain limitations. The property covered by the order is both legal and equitable property;
- the Commissioner must also make a subsequent order transferring the property when the appointment of an acting trustee ends. The subsequent property transfer order may be to a new acting trustee, to the previously suspended trustee or to a newly appointed trustee as appropriate;
 - the Commissioner's order to transfer property does not immediately transfer property if the property is of a kind whose transfer is registrable under an Australian law. Instead, the property is transferred only after the registration process has been completed;
- a former trustee is required to comply with a number of obligations (for which they are strictly liable and which are an offence if not complied with). These obligations are:

- providing the acting or new trustee with all books relating to the fund’s affairs that is in their custody, possession or control;
- providing notice to the acting or new trustee identifying all the property of the fund (as much as they possibly can);
- providing notice to the acting or new trustee explaining how that property was accounted for; and
- assisting with the transfer of the property of the public ancillary fund.

1.52 In addition, the amendments ensure that former trustees of public ancillary funds are strictly liable for their actions relating to books, identification of property and transfer of property (that is, liable regardless of fault). This liability has been established to compel former trustees which have already been removed on the grounds of misconduct to deal fairly with the trust’s property during the handover period.

1.53 As for private ancillary funds, it is expected that the Commissioner would only take action to remove or suspend a trustee in situations that involve serious non-compliance by a public ancillary fund. Whether the Commissioner decides to merely suspend a trustee or to remove them permanently will depend upon the nature of a breach, the circumstances of the trustee and the history of compliance.

Change to the Australian Business Register

1.54 For each public ancillary fund, the ABR must include a statement on the ABR indicating that the fund is a public ancillary fund. *[Schedule #, items 1 and 16, paragraph 26(3)(ga) of the A New Tax System (Australian Business Number) Act 1999 and section 426-104 in Schedule # to the TAA 1953]*

1.55 The ABR currently distinguishes between DGRs in items 1, 2 and 4 in the table in subsection 30-15(2) of the ITAA 1997. However, the ABR does not distinguish between public and private ancillary funds.

1.56 This additional requirement will clearly identify that a where a fund is a public ancillary fund. This will provide clarity to the ABR and assist donors in determining which ancillary funds are public ancillary funds as opposed to private ancillary funds.

Application and transitional provisions

1.57 The amendments generally apply from 1 January 2012. *[Clause #]*

Transitional rules for existing public ancillary funds

1.58 Existing public ancillary funds will be taken to be endorsed by the Commissioner as DGRs under the reformed category on 1 January 2012. All existing public ancillary funds will also be taken to have agreed to comply with the guidelines as from 1 January 2012. This mechanism will ensure a smooth transition of existing public ancillary funds into the new regime. *[Schedule #, item 37, 39]*

Public ancillary funds with non-corporate trustees

1.59 Public ancillary funds (that were public ancillary funds before 1 January 2012) will not be required to replace their non-corporate trustees with corporate trustees. Mandating the replacement of trustees will create unnecessary compliance costs for existing trustee. *[Schedule #, item 38]*

1.60 Those public ancillary funds that continue to have non-corporate trustees will not be subject to the Commissioner's new powers to suspend or remove trustees. It is for constitutional reasons that the new powers cannot be extended to these existing public ancillary funds.

1.61 In cases of serious non-compliance by public ancillary funds with non-corporate trustees, the Commissioner has the ability to refer the matter to the relevant State or Territory Attorney-General for action.

1.62 If at any point after 1 January 2012, a public ancillary fund with non-corporate trustees replaces all its non-corporate trustees with corporate trustees, the public ancillary fund will become subject to the Commissioner's new powers.

1.63 Under the existing integrity arrangements, public ancillary funds and other ancillary funds are prevented from distributing to one another. However, in order to assist public ancillary funds move fully into the new regime, public ancillary funds with non-corporate trustees will be permitted to transfer all of their property to another public ancillary fund with trustees that have only corporate trustees. This transitional arrangement will give public ancillary funds the option of restructuring their trustee arrangements by establishing a new public ancillary fund to hold the assets of the old fund. *[Schedule #, item 40]*

1.64 Transitional public ancillary funds that wish to restructure (either by establishing a new public ancillary fund, or replacing their

existing trustees) should make themselves familiar with the state and territory laws on replacing trustees or transferring assets between trusts.

Progressive changes to the ABR

1.65 The Australian Business Registrar will be given until 1 July 2012 to update the ABR with the additional public ancillary fund category. The changes are commencing at a later time to give the Registrar sufficient time to make the necessary systems changes in support the new requirements. *[Schedule #, item 35]*

Consequential amendments

1.66 An amendment is required to paragraph 31-10(1)(b) of the ITAA 1997 to update references from public fund to public ancillary fund. *[Schedule #, item 6, paragraph 31-10(1)(b) of the ITAA 1997]*

Miscellaneous amendments

1.67 This Bill repeals the definitions of private ancillary fund in subsection 6(1) of the ITAA 1936 and subsection 2(1) of the TAA 1953 as these definitions are now redundant. *[Schedule #, items 41 and 42]*

1.68 It also replaces a reference to ‘private ancillary fund’ in subsection 355-65(8) in Schedule 1 to the TAA 1953 with ‘ancillary fund’. This provision relates to the disclosure of information to the Attorney-General of a State or Territory in relation to the non-compliance of a private or public ancillary fund. *[Schedule #, item 10]*

EXPOSURE DRAFT