Public Ancillary Funds - Requirements

1 Public Ancillary Funds

Public Ancillary Funds (**PUFs**) are grant making trusts able to receive tax deductible donations from the public.

This paper provides information on the requirements to become a PUF and for ongoing compliance. There have been a number of changes to the requirements since the introduction of the Public Ancillary Fund Guidelines and the Charities Act. The paper provides an outline of the regulatory framework, a compliance check and further detail of the various requirements.

2 Regulatory Framework

There are a number of regularity requirements governing the operation of PUFs and these include:

- the Public Ancillary Fund Guidelines 2011;
- divisions 30 and 50 of the *Income Tax Assessment Act 1997*;
- *Taxation Administration Act 1953*;
- Tax Ruling 95/27;
- Tax Determination 2004/23;
- *Australian Charities & Not for Profit Commission Act 2012*;
- *Charities Act 2013*;
- State & Territory legislation covering charitable trusts;
- State & Territory legislation covering fundraising from the public;
- common law covering charitable trusts.

As a result of there being numerous regulations, there are also a number of regulators, principally the Australian Taxation Office (**ATO**) and the Australian Charities & Not for Profit Commission (**ACNC**).

Information on the operation of PUFs can be found on the ATO website as well as in a recommended Handbook for Trustees of Public Ancillary Funds, produced by Philanthropy Australia and also available on their website.

3 Compliance check

	Requirement	Part
Trust Deed:	The trust deed must comply with Guidelines, and include certain provisions.	4.1
Trustee:	The trustee must be incorporated (or if it is a pre-2012 PUF there may be individual trustees). The majority of board members (or individual trustees) must meet the 'responsible persons' requirement, and be actively involved in decision making.	4.2
Grantees:	The grant recipients must meet the requirements and be eligible recipients.	4.3
Distribution:	An amount equal to at least the minimum distribution requirement must be distributed in each financial year.	4.4
Investment:	• There must be a documented and minuted investment strategy. • Review investments to ensure compliance. Review any borrowings, securities, collectables.	4.5
Accounts:	• Accounts and financial statements must be prepared at the end of the financial year. • Systems should be in place to document all transactions between the PUF and the founder, trustee, donor (other than receipt of gifts), officer, agent, member or employee of the trustee or an associate of any of these entities, and ensure these transactions are commercial, on an arm's length basis and no material benefit is given by the PUF.	4.6
	• Estimate the market value of assets within 2 months before or after the end of the financial year, and document methodology. Ensure land value is estimated at least every 3 years.	4.7
	• An auditor must be appointed to review or audit, as required, the financial statements and compliance with the Guidelines.	4.8
	• Lodge the annual return with the ACNC or ATO and claim a refund of any franking credits.	4.9
Fundraising:	• The public must be invited to contribute to the PUF and receipts must be issued. The relevant State and/or Territory fundraising legislation must be complied with. • Make sure any sub-funds are not separate funds or trusts.	4.10, 4.11 4.12
Other activities:	Ensure no business activity is carried out by the PUF.	4.13

4 Requirements

4.1 Trust deed

1 The ATO provides a model trust deed on its website which should be used to establish a PUF.

2 For existing PUFs, we recommend the trust deed is amended where possible, and as far as possible, to reflect the ATO's model deed for a PUF.

3 If the existing trust deed enables the PUF to comply with the Guidelines and the trustee has passed a resolution specifically agreeing that Guidelines 10.2, 11.1 and 18 apply, there is no requirement to amend the trust deed in line with the model deed or to incorporate the specific elements of the Guidelines.[1] The resolution must be kept with the trust deed. However it may assist in ongoing compliance to reflect the Guidelines in the deed and adopt the ATO's model deed.

4 All amendments to the trust deed must comply with the requirements for amending the deed in the trust deed and must be notified to the ACNC and ATO within 21 days of the amending deed being signed.

4.2 Trustee requirements

5 New PUFs must have a constitutional corporation (generally a company limited by guarantee) as the trustee[2]. Existing PUFs may continue with the existing trustee or trustees whether they are individuals or incorporated.

6 All PUFs must ensure, at all times, a majority of board members (or trustees, if individual trustees) are 'responsible persons'[3]. Existing PUFs should already satisfy this requirement, as it is consistent with the previous requirements for PUFs . A 'responsible person' is an individual who:

- performs a significant public function;
- is a member of a professional body having a code of ethics or rules of conduct;
- is officially charged with spiritual functions by a religious institution;
- is a director of a company whose shares are listed on the ASX;
- has received formal recognition from government for services to the community;
- is an individual before whom a statutory declaration may be made (this type of responsible person is not available if the trustees are individuals[4]); or
- is approved by the ATO as a responsible person.

7 All PUFs must ensure none of the directors or trustees:

- have been convicted of a taxation offence which is an indictable offence[5];

[1] See ATO website – 'Transitional arrangements for existing public ancillary funds'.

[2] Section 426-102 in Schedule 1 of Taxation Administration Act 1993

[3] Guideline 14 or, if the trustee is not a constitutional corporation, Guideline 56

[4] If the trustees are individuals, Guideline 56 provides Guideline 14 does not apply and this type of responsible person is provided for in Guideline 14.1

- are disqualified from acting as a director by either ASIC or ACNC.[6]

8 Some PUFs may have other specific requirements for trustees in the trust deed which must still be complied with.

9 The Guidelines require the responsible persons to be actively involved in the decision making[7]. To demonstrate compliance with this, the trustee should ensure the meetings of the board:

(a) include consideration of fundamental issues, such as:

(1) investment strategy

(2) valuation policy

(3) operating budget and expenses

(4) distribution policy and grant making

(5) fundraising strategy;

(6) compliance and audit; and

(b) are minuted showing who is in attendance and the resolutions relating to the fundamental issues for the PUF.

10 If the trustee also acts in its own capacity or as trustee of other trusts (ie, it does not act only as trustee of the PUF), the minutes for the trustee, acting as trustee of the PUF, must be separated from the other roles of the trustee.

11 The trustee must exercise the discretion as to grant making. This is particularly relevant if the trustee receives requests from donors as to the application of the gift either through sub-funds or other arrangements. The trustee must not be directed or under any obligation or give any assurance that it will follow a request as to grant making from a donor[8]. For further information on sub-funds see part 4.12.

12 There are also governance requirements relevant to operating a charity, further details of which can be found on the ACNC website.

4.3 Purposes and grant making – eligible recipients

13 The sole purpose of an ancillary fund must be to provide money, property or benefits to other tax deductible entities (other than other ancillary funds). These are referred to as ‘item 1 DGRs’, which are funds, authorities or institutions, gifts to which are deductible under item 1 of the table in section 30-15 of *Income Tax Assessment Act 1997*[9]. This can be identified on the Australian Business Register. The item 1 DGRs must generally also be charities though this will depend on a number of issues which are explained in further detail in paragraphs 14 – 17. Some trust deeds further restrict the purposes to certain types of, or to specific item 1 DGRs.

14 Some of the item 1 DGRs are not charitable due to their connection with Government or because their purposes and activities are not charitable. Examples of item 1 DGRs which carry out the work of the government or are controlled by government, and therefore are not charitable, are government public hospitals, many museums, art galleries and libraries. An example of an

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[5] Guideline 16

[6] ACNC Governance standards

[7] Guideline 14.2

[8] TD 2004/23

[9] This requirement has not changed and is in item 2 of the table in section 30-15

item 1 DGR which is not charitable because its purposes are not charitable, is the Australian Sports Foundation.

15 A PUF can only grant to non-charitable item 1 DGR if it has ‘opted in’ to certain state charities legislation.

16 Some State governments (Victoria, New South Wales, Western Australia, Queensland, and South Australia) have inserted an amendment into their relevant legislation in respect of charitable trusts, allowing PUFs to remain charitable at law while making grants to non-charitable item 1 DGRs. The amendments do not apply automatically to all PUFs, the PUF must ‘opt in’ either on establishment in the trust deed or by declaration (in Victoria it can only be done by declaration). You will see these options for each jurisdiction in the ATO’s model trust deed on the ATO website. For Victorian PUFs, the declaration must be kept with the trust deed and should be part of the constituent documents lodged with the ACNC. The *Charities Act (Cth)* 2013 recognises these trusts which have opted in as charities for tax and any other Commonwealth purposes.

17 Depending on if, and when, the PUF opted in, there will be a differing range of item 1 DGRs it can, subject to the terms of its trust deed, make grants to:

- Charitable item 1 DGRs only (if the PUF has not opted in).
- Charitable item 1 DGRs and item 1 DGRs which would be charitable but for being a government entity and are exempt entities – Victorian PUF which has opted in at anytime and any PUF which opted after 1 January 2014.
- NSW, Queensland and WA PUFs which opted in prior to 1 January 2014 - charitable item 1 DGRs and any item 1 DGR which is an exempt entity.

This paper does not cover the South Australian position, which is more complex.

18 The trustee must check any limitations or specific requirements in the trust deed and should develop a checklist to ensure, and a system to retain documentation to confirm, each grant recipient is an eligible recipient. This will cover:

- any specific requirements in the trust deed;
- confirmation from the ABR[10] that the proposed recipient is an item 1 DGR and trustees may want to confirm the category of item 1 DGR and check if there are any special conditions that apply;
- confirmation from the ABR and the ACNC Register that the proposed recipient is charitable;
- where the PUF has opted in, and the proposed recipient is not charitable, confirmation that the recipient meets the applicable requirements (see paragraph 17).

19 An eligible recipient can receive a grant of money or property or benefits from the PUF.

20 Paragraphs 35 to 37 of Taxation Ruling TR 95/27 comment on the benefits that can be provided to DGRs.

"35. A benefit arises where some discernible advantage has been bestowed on a specified institution. It may take the form of some tangible addition to, or the removal of some detriment from, the conduct of the particular institution.

[10] Australian Business Register http://www.abr.business.gov.au/AdvancedSearch.aspx

36. The creation and maintenance of a holiday camp exclusively for children in orphanages would represent [an appropriate] benefit to the orphanages …. So also, the creation of a scholarship scheme where, for example, a university generally controlled the terms and award of the scholarship would be a benefit to the university. On the other hand, if an ancillary fund awarded and generally controlled the scholarship and its only connection with the university was that it was tenable there, there would not be [an appropriate] benefit to the university - it would not add to the affairs and activities for which the university is responsible.

37. In the first two examples in paragraph 36 above the fund is providing benefits directly to a qualifying fund or organisation. (The orphanage and university it is assumed are qualifying [DGRs].) In the third example, however, the ancillary fund is providing the benefit or advantage to the students. The scholarship is not providing a direct benefit to the university."

21 As the benefit must be provided to the item 1 DGR, grants cannot be made on the requirement or understanding that the funds will simply ‘flow through’ the item 1 DGR to another entity (this is generally referred to as ‘auspicing’). There may be genuine occasions where the item 1 DGR is carrying out a program or project with the other entity and outsourcing or contracting with that entity to perform the services. Care should be taken where the PUF is aware the funding will be used by an entity other than the eligible recipient, to ensure the requirement to benefit the eligible recipient is met.

4.4 Grant making – minimum distribution

22 The amount distributed each year to eligible recipients must comply with Guideline 19 which sets out the minimum annual distribution of a PUF.

23 Even though the Guidelines set the minimum amount for distribution, the trustee must decide how much should be distributed in order to carry out the philanthropic purposes of a PUF, and in many instances may decide to distribute more than the set minimum amount. In certain circumstances an application by a PUF, the ATO may agree to reduce the minimum annual distribution.

24 Whether any distribution is required, and if required, the minimum amount of that distribution, depends on:

- when the PUF was established
- whether the net assets were greater than $220,000 as at the end of the previous financial year;
- if the ATO agrees to a reduced amount of distribution.

25 **Newly established PUFs:** No distribution is required in the financial year a PUF is established nor for the next 4 financial years.[11] However, the note in the Guidelines suggests the trustee should consider an appropriate distribution each financial year in accordance with the purpose of the PUF.

26 **PUFs with net assets greater than $220,000:**An amount equal to at least 4% of the net assets as at the end of the previous financial year must be distributed prior to the end of each financial year.[12]

27 **PUFs with net assets less than $220,000:** PUFs with net assets of less than $220,000 at the end of a financial year, which are not in the first 4 years from establishment, must distribute in the following financial year:

[11] Guideline 19.2

[12] Guideline 19

- at least $8,800, or
- an amount equal to at least 4% of the net assets, provided all expenses of the fund in that financial year are not paid out of the PUF's assets or income ie externally funded and not through a donation to the PUF for administration expenses.[13]

28 **Application to ATO:** The ATO may, on receiving a written application from a PUF, agree to reduce the minimum annual distribution rate. The circumstances the ATO will consider include:

- general market conditions;
- past, current and expected returns from investments;
- long term impact on assets from not reducing the rate;
- level of distributions previously made;
- investment and distribution strategy.

29 A distribution can include more than making grants of money to eligible recipients. The PUF can provide property or benefits to an eligible recipient including providing loans or guarantees and investing in social impact bonds. The market value of the property or benefit must be used in determining amount of the distribution for the purposes of the minimum distribution requirement in Guideline 19.[14] There are a number of examples provided in the notes to Guideline 19 which are useful if a PUF is considering this.

4.5 Investment

30 An investment strategy must be documented[15], followed[16] and reviewed annually and must:

- set out the investment objectives and details the methods by which the trustee will achieve those objectives[17]
- reflect the purpose and circumstances of the PUF
- have particular regard to (though not be limited to)
  - the risk and likely return
  - the cash flow requirements and liquidity
  - diversity
  - the ability to discharge liabilities
  - State and Territory requirements.

31 State and Territory requirements include, in addition to the above issues:

- a requirement that the investments to be made with the care, diligence and skill that a prudent person would exercise in managing financial affairs of others (or where the board member's profession includes being a trustee or managing investments, the duty of care is higher requiring the exercise of care, diligence and skill that a prudent person

[13] Guideline 19.1

[14] Guideline 19.3

[15] Guideline 32

[16] Guideline 31

[17] Guideline 30

engaged in that profession, business or employment would exercise in managing financial affairs of others)[18]

- the likely income return and the timing of income return
- the length of the term of the proposed investment
- the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment
- the costs (including commissions, fees, charges and duties payable) of making the proposed investment.

32 The trustee must also ensure:

- all transactions are made on an arm's length basis and are not uncommercial (except in favour of the PUF)[19]
- the investments do not include borrowing or the giving of security except as permitted under the Guidelines[20] (borrowings in existence at 31 December 2011 may be maintained but the terms may not be altered without prior agreement from the ATO)
- there is no investment in collectables and any gift of a collectable is sold within 12 months[21].

33 If the PUF manages sub-funds, the sub-funds must not be separately invested.

34 If a PUF wishes to invest in a social impact bond where the return is less than the market rate of return on a similar corporate bond issue, this will be considered a benefit to an eligible recipient not an investment. The value of the benefit equal to the value of the interest saved by the eligible recipient by issuing the bond at a discounted rate of return.

4.6 Financial statements and accounting records

35 Financial statements must be prepared after the end of each financial year, which:

- comply with accounting standards[22];
- disclose all transactions, except for gifts, between the PUF and:
  - the founder
  - a donor
  - the trustee
  - a director, officer, agent, member or employee of the trustee
  - an associate of any of the above[23];
- include an estimate of the market value of the assets other than land (annual estimate) and land (estimate at least every 3 years).

[18] Guideline 13 imposes this duty on the trustee with respect to all its activities not just investment activities

[19] Guideline 41

[20] Guideline 33

[21] Guideline 38

[22] Guideline 26.1

[23] An associate is defined in s 318 Income Tax Assessment Act 1936 and broadly includes for an individual - a relative and a company influenced or controlled by the person, for a company – a controlling company or person, or a controlled company, for a trustee – any beneficiary of the trust.

36 The PUF must not provide a material benefit (except reasonable remuneration and expenses) to any of the founder; donor; trustee; director, officer, agent, member or employee of the trustee; or any associate of any of these entities (other than when the associate receives a grant as an eligible recipient).[24]

37 The financial statements should not show any sub-funds separately but the accounts may include separate internal management accounts to record gifts received from one or more specific donors or for a specific cause, and the application of those funds.[25]

38 Accounts must be kept of all receipts and payments of the PUF and all financial dealings and retained for at least 5 years[26].

39 Where funds are obtained separately (eg fundraising events, sponsorship) from gifts and money earned on those gifts, a gift account should be maintained recording gifts and money earned on those gifts. On a revocation of DGR status, any surplus in the gift account must be distributed to eligible recipients[27].

4.7 Valuation

40 The Trustee must ensure the market value of the assets are estimated at least annually by the trustee, a qualified valuer or another appropriate person. The valuation, the methodology and data used must be documented. The valuations must be based on reasonably objective and supportive data[28]. The valuation should be of the market value as at the end of the relevant financial year. It must generally be conducted within 2 months before or after the end of each financial year, unless to do so would be unnecessarily onerous or expensive[29].

41 Land must be valued in writing at least every 3 years by a certified and independent valuer or the AVO[30].

4.8 Audit or review

42 An auditor must be appointed to either audit or review[31] (review is possible only if the revenue and assets are less than $1 million in a financial year) both:

- the financial statements, and
- compliance with the Guidelines.

43 An audit must be done by a registered company auditor as provided in the *Corporations Act*. A review may be done by a registered company auditor or an individual taken to be a registered company auditor under section 324BE Corporations Act.

4.9 Information return

44 An Annual Information Statement (AIS) must be lodged with the ACNC. A separate return may be required by the ATO.

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[24] Guideline 42

[25] TD 2004/23

[26] Guideline 24

[27] Section 30-125 ITAA 97

[28] Guideline 20

[29] Guideline 20.3

[30] Guideline 21

[31] Guideline 28

4.10 Public

45 The fund must be public in nature[32]. This was discussed in a decision of the High Court of Australia in *Bray v. FCT*[33]. In this case, a public fund was set up on the sole initiative of Mr Bray and, though the trust instrument allowed contributions to be received from members of the public, at all material times Mr Bray was the only contributor to the fund.

46 From the case, to be public in nature the following issues should be considered:

- Has the PUF originated from a public initiative?
- Are the members of the public actively involved in the management and administration of the PUF ie on the board of the PUF?
- Is the PUF genuinely open for contribution by the public?

47 Members of the public are considered to be those not associated with the initiator of the PUF. The term "associated" is not defined in this sense but it can be expected that if there is a personal tie such as being members of a family or a group which is based on personal relationships to a particular person or a contractual relationship (for example the employees of a particular employer) or on membership of a particular body, then that is likely to be considered as "associated".

4.11 Fundraising policy

48 A policy should be documented to confirm:

- invitations will be made to the public to contribute to the PUF[34]
- all relevant State and Territory fundraising laws are being complied with.

49 As seen from *Bray v. FCT,* seeking contributions from the public must be genuine. In *Bray v. FCT,* the public were invited to participate in the fund by advertisements in three local community papers simply stating "Donations invited from the general public to the ....Foundation" with an address. No further information was given in the advertisement. This was not sufficient to satisfy the requirement to raise funds from the public.

50 The fundraising policy or strategy must take into account the nature of sub-funds and ensure the marketing of the sub-funds is not misleading and does not create a separate fund. Donors should not be given the impression or understanding from the promotional material that the sub-fund belongs to the donor. A trustee should control fundraising done by donors for the a sub-fund of a PUF.

51 Fundraising policies will also typically cover the types of fundraising and how this will be done. It should include procedures to ensure the information is not misleading or deceptive.

4.12 Sub-funds

52 Some PUFs establish “sub-funds”. This may be expressly permitted in the trust instrument. The trustee must ensure these sub-funds are not a separate trust or fund. The consequence of the sub-funds being treated as separate trusts or

[32] Guideline 44

[33] 78 ATC 4179, (1978) 140 CLR 560, (1978) 8 ATR 569, (1978) 52 ALJR 484, (1978) 19 ALR 309

[34] Guideline 45

funds by the ATO is that the donor or donors to that sub-fund may not be entitled to a tax deduction[35].

53 Sub-funds must:

- clearly form part of the whole trust fund and should not be referred to separately by the name of the sub-fund;
- not have separate purposes, ie they are no more than internal management accounts;
- not be separately accounted for in the statutory financial statements of the PUF (though separate internal management accounts can be maintained); and
- not be separately invested.

54 The trustee must not be under any obligation or give any assurance to a donor in relation to a sub-fund. A donor may make requests but the trustee must decide:

- whether to establish the sub-fund
- the name of the sub-fund
- which sub-fund to attribute any donation or income
- how to invest the trust fund as a whole
- how much and where to distribute money attributed to any sub-fund
- when to close a sub-fund.

55 Particular care must be taken not to allow oral or written statements by the trustee that the trustee will :

- always comply with the donor's requests, provided they come within the purpose of the fund, or the donor make directions to the trustee as to grant making;
- not distribute money from a sub fund without first obtaining and considering a recommendation from the donor;
- inform or discuss with the donor if the trustee cannot, or does not intend to, follow a request from the donor.

4.13 Business activities

56 The PUF cannot operate a business as part of its activities even if it is using its research or grant making or other skills[36].

57 Investment activities and fundraising appeals are not considered to be business activities.

4.14 Systems to be put in place to ensure compliance

58 The following systems are recommended to assist a PUF in demonstrating compliance with the Guidelines and other PUF requirements:

- board or trustee composition policy
- investment strategy and valuation policy
- operating budget and expenses

[35] TD 2004/23

[36] Guideline 40

- distribution policy and grant making checklist
- fundraising strategy.

4.15 Portability of assets

59 Subject to the terms of the trust deed, the duties as a trustee and the prior agreement of the ATO, a PUF or private ancillary fund may transfer assets to another PUF or private ancillary fund if:

- It has the express power to do so in the trust deed;
- it transfers all of its net assets, or for PUFs, all the net assets of a sub-fund, to that ancillary fund; and
- it has distributed at least the minimum distribution required under Guideline 19 for that financial year; and
- the net assets have not been transferred from another ancillary fund in the previous 2 years; and
- if a PUF is transferring to a private ancillary fund, the sub-fund assets do not include funds contributed by the general public.

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