

## **NOTES RE PUBLIC ANCILLARY FUNDS**

The Public Ancillary Fund (PAF) provisions in the Income Tax Assessment Act 1997 (ITAA 1997) were established to provide a structure to serve as a conduit for remitting tax deductible money to other tax deductible funds (commonly known as Deductible Gift Recipients (DGR). The PAF would receive donations from the public and issue a tax-deductible receipt. The funds could be held by the PAF until a decision was made regarding its ongoing distribution (which was originally intended to be within a 12-month cycle).

The PAF structure has diverse uses. Larger churches and charities use the facility to more effectively guide the transfer of DGR funds throughout their areas of interest. Some groups of philanthropic people use it as a medium to encourage others with similar objectives. It is also a helpful budgetary control tool.

A PAF needs to be established as a trust that complies with the Trustee Laws for the State in which it is created. It needs a complying not-for-profit clause and be established and operate only in Australia. It cannot be used as a vehicle to send funds overseas except through an **approved** overseas aid fund which is itself a DGR.

**New rules regarding the operation of PAFs came into force from 1 January 2012.** Any new PAF established is now required to have a corporate trustee. It needs to be managed by a committee or board of individuals – the majority of whom must satisfy the “Responsible Person” requirements of the ITAA 1997.

There is a legal difficulty about the structure of the trustee as the new legislation requires the trustee to be a “constitutional corporation”. This presents problems as such a legal entity needs to be either a financial or a trading entity. A PAF trustee will not be able to become a financial entity and would have great difficulty in meeting the trading entity requirements even if incorporated under Corporations Act. It would seem there will need to be a law change to resolve this. There is however a helpful statement in paragraph 8.30 of the Explanatory Memorandum to the amending Bill presented to Parliament which states that where the trustee’s sole function is to be the trustee of a PAF it would be considered a constitutional corporation. We suggest that until the legal problem is resolved that those established PAF’s with an association as trustee should continue under that corporate structure. With any new PAF the Trustee should be either a special purpose non-profit company or a company limited by guarantee under Corporations Act (Commonwealth).

The new Rules require a PAF to distribute income regularly and in accordance with the following rules: -

- Distribute at least 4% of the market value of the funds net assets as at the end of the previous financial year;
- If 4% is less than \$8,800 then the trust must distribute either \$8,800 or the balance of the fund (if it is less than that figure). These provisions presume that some of the PAF’s resources can be accumulated provided these rules are complied with. This would also depend on the Objects of the trust itself.
- The trustee is required to estimate the market value of the trust assets at least annually. If shares or real estate are amongst the assets, a reasonable determination of the market value of those assets needs to be undertaken. The market value of land can, at the discretion of the trustees, be estimated on a three-yearly cycle. The land value should be estimated by a

certified valuer independent of the trustees. Listed shares should be valued on the basis of stock exchange information. The valuation of other assets, other than funds at bank or in fixed deposit elsewhere may be more difficult to value and will introduce valuation expenses.

A PAF will need to be audited annually or have an annual review, depending on its size. Where the trust has revenue and assets exceeding \$1M for the year an audit needs to be carried out by a Registered Company Auditor (RCA). Where revenue and assets are less than \$1M the lesser obligation of a review can be conducted by either an RCA or an accountant who is a member of a professional accounting body referred to in Section 324BE of the Corporations Act 2001 and Regulation 2M.4.01A.

Each PAF needs an investment strategy. As most PAFs operate as mere conduits such an investment strategy may be simple. The Board could determine that the trust will hold all funds prior to distribution in a cash management trust or term deposit with a recognised Australian bank. Where the assets are in some part invested in the share market the investment strategy should set out the objectives of the share market investment and under what circumstances investments should be reviewed. The provisions of the Trustees Act WA would impose a minimum standard here. That area would need more specific detail than that for a simple cash management account. The trustee is not allowed to borrow money.

The PAF needs to lodge an annual tax return with ATO. This is an information type return for compliance purposes. The first return is required for the year 1 July 2011 to 30 June 2012. Where a different financial year to 30 June is required the specific agreement of the ATO must first be obtained through an application for a Substituted Accounting Period (SAP). Such consent may not be granted unless the application is supported by clear evidence in support. Where a PAF is a part of a group of related entities and they have a common reporting date different to 30 June this would be likely to be accepted as sufficient grounds, but other reasons should also be provided where possible.

Fees and expenses of operating the PAF would be expected to be met from within the resources of the PAF itself.

Where a PAF was established and endorsed by ATO prior to 1 January 2012 there are transitional provisions. They allow the PAF to operate under the existing Ancillary Fund Rules until 30 June 2015. The PAF would be required to amend the governing Rules to comply with the new guidelines by no later than that date.

For DGR endorsement as a PAF the Objects Clause (sometimes referred to as 'Purposes') needs to clearly identify that it exists for the benefit of another entity or group of entities that are defined as 'eligible charities' (that have tax deductibility endorsement as DGRs). This is to enable the income of the PAF to be distributed to these DGRs in accordance with Sub-Division 30-B of ITAA 1997.

A reference to an 'eligible charity' refers to a fund, authority or institution which is both charitable at law and gifts to which are deductible under Item 1 of the Table at Section 30-5 of the ITAA 1997. The PAF itself qualifies for DGR status under Item 2 of the Table which enables it to make distributions to DGRs which falls within Item 1 of the Table at Section 30-5. That means that a PAF is prohibited from providing funds to another PAF.

#### **January 2014 Note:**

The ATO Model Trust Deed has been modified as a result of the Charities Act coming into force on 1st January, 2014. The ATO advise that the principle matter arising from the modifications is that a PAF will now be automatically endorsed with ACNC if it was not already so endorsed. The ACNC have also made a similar comment.

The ATO comments re the changes are -

*“Funds endorsed by us as ITEFs as at 31 December 2013 will be transitioned into the new arrangements as follows:*

- *the purpose of each fund will be treated as a charitable purpose*
- *they will be automatically registered with the Australian Charities and Not-for-profits Commission (ACNC) as charities and endorsed by us to access income tax exemption as a charity from 1 January 2014*
- *they will be provided with an opt-out provision, should they not wish to be a registered charity and income tax exempt.”*

An ITEF is an Income Tax Exempt Fund. Only a small number of PAFs are endorsed as ITEF. Most are endorsed as Tax Concession Charity (TCC) by ATO and have previously been recognised as a charity by ACNC. No action is required by either type of PAF currently but those that were previously recognised as ITEF will now be subject to ACNC reporting obligations in addition to the requirement to lodge a tax return annually with ATO.

**Noel Harding**

**Add-Ministry Inc.**

June 2015 revision