

IT 340 - Accumulation of income by charitable funds

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TAXATION RULING NO. IT 340

ACCUMULATION OF INCOME BY CHARITABLE FUNDS

F.O.I. EMBARGO: May be released

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CHARITABLE TRUSTS

23(j) (ii)

PREAMBLE

This ruling concerns a claim for exemption made under paragraph 23(j) (ii) by the trustees of a fund established by will for charitable purposes. The point at issue was whether the fund could be said to be "applied for the purpose for which it was established" in circumstances where some 18% of income (25% less expenses of administration) was accumulated.

FACTS

2. The will of the late 'C' directed that the residue of his estate should be set aside to a fund to be invested and held by this trustees on trust for charitable purposes. The resulting income was to be divided into 40 units, 30 units of which were to be distributed amongst specified charitable institutions. The remaining 10 units were to be initially held by the trustees as a "reserve fund" out of which all outgoings and administration expenses were to be paid; any balance was then to be re-invested as part of the general trust fund.

3. It is considered that the will creates a single trust; the reserve fund is inseparable.

4. It will be observed that the trustees of the 'C' Trust have little discretion as to how the income of the Trust is to be applied. As to 75% it must be divided amongst the institutions and organisations listed in the will. All of these bodies fall under one or other of the accepted heads of charity. The remaining 25%, after depletion by administrative expenses, must be re-invested for the ultimate benefit of the same charitable organisations. The apparent object of assigning 10 units to the reserve fund was to provide a means by which the real value of the trust corpus could be maintained.

5. There is in this case no suggestion that benefits are being provided, for example, indirectly through investment of funds, to persons or organisations other than the nominated charitable organisations.

6. The proper conclusion in all the circumstances would seem to be that the fund is being applied for the purpose for which it was established and that the income is exempt under section 23(j) (ii). As far back as 1917, in the case of Trustees, Executors and Agency Co. Ltd v Actg FCT, 23 CLR

576 it was recognised that the fact that income was being accumulated would not necessarily prevent a conclusion that a fund was being applied for a charitable purpose. At pages 586/7 Isaacs J. said :

"Argument was addressed to us on the meaning of "applied", though it does not directly fall within the question asked. It must be observed, as pointed out by Mr Mitchell, that a distinction is made between the "income" and the "fund", and "applied" is attached to "fund" and not to "income". Further, the words are "the fund is being applied" - not simply "applied". I agree that some elasticity must be given to the phrase. For instance, if a fund were established to purchase radium for free curative purposes, and if it were found that (say) /20,000 were required as a minimum, but the fund could accumulate only at the rate of /5,000 a year, and the Commissioner were satisfied that each year's income was deposited in a bank for the special purpose of getting together /20,000, and buying the radium, he could well say he was satisfied the fund was "being applied" to the charitable purpose".

RULING 7. In this office it has been accepted over a long period of years, within limitations, that a public charitable fund may :

- a. use some of its income to acquire assets which, in future, will produce more income for charitable purposes; and
- b. accumulate some of its income for later distribution. Generally speaking, however, distribution of a substantial part of the income of such trusts has been regarded as essential. Of course, it would be very relevant to consider whether the accumulated fund was invested in a manner which could benefit private organisations or individuals.

8. After consideration of the documents provided in this case it has been decided to accept that the income of the 'C' Trust is exempt under section 23(j) (ii).

9. A case by case examination is necessary before exemption can be conceded. However, some guidance may be obtained from the following brief summary of some cases examined in this office :

- (a) the H.V. 'M' Charitable Trust (this office reference J78/25) capitalised 29% of its income over an eleven year period (which included the depression years of the 1930's). Exemption was conceded;
- (b) the 'N' Trust (this office reference J49/245 Pt 1) was permitted to accumulate all income for a two year period. The trustees were advised that, if

they desired to accumulate income for a longer period, the position would be reconsidered according to the relevant circumstances at the time;

- (c) the 'W' Fund (this office reference 80/5964) where, after distributing all income over a number of years, the major part of the income of a three year period was invested for the purpose of providing additional future income. Exemption was conceded;
- (d) the 'K' Foundation (this office reference 81/3425) retained 10% of its annual income as a means of preventing erosion of its capital in times of inflation. Exemption was conceded;
- (e) 'V' Foundation (this office reference J49/195) argued that it was necessary to accumulate funds, rather than distribute, in order that it could derive a larger income in the future, commensurate with inflationary trends. The Foundation was advised that "it must apply all or substantially all of its annual income for public charitable purposes and avoid excessive accumulation and investment if it is to continue to be regarded as being exempt from income tax".

COMMISSIONER OF TAXATION