

TR 94/D12 - Income tax: public funds



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Draft Taxation Ruling

Income tax: public funds

other Rulings on this topic

CITCM 806 ; CITCM 837;
IT 2194; IT 2259

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What this Ruling is about

1. The gift provisions of the *Income Tax Assessment Act 1936* (ITAA) require certain organisations to have **public funds** into which gifts of property or money are placed if those gifts are to qualify as allowable deductions. The more commonly known organisations which are required to have **public funds** include those established under item 2.1.10 of table 2 in subsection 78(4) (**school building funds**), item 9.1.1 of table 9 in subsection 78(4) (**overseas aid funds**), item 12.1.1 of table 12 in subsection 78(4) (**cultural organisations**) and item 6.1.1 of table 6 in subsection 78(4) (**environmental organisations**).

2. This Ruling deals with the criteria applicable to public funds under the general gift provisions. It does not deal with the specific criteria for public funds in relation to cultural and environmental organisations. However, most of the criteria applicable under the general gift provisions will apply to the cultural and environmental public funds as well. The ruling updates guidelines set out in Canberra Income Tax Circular Memorandum CITCM 806 and Taxation Ruling IT 2194 and sets out the conditions that need to be satisfied before a fund can qualify as a **public fund**.

3. This Ruling also explains the operation of the ancillary fund provisions set out in subsection 78(5). Funds established and maintained under the ancillary fund provisions are required to be **public funds**.

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Ruling

Public funds - general

4. The word 'public' as applied to a 'fund' refers to the source, constitution and management of the fund rather than to the objects for which it is established.

5. The term 'public fund', in so far as it applies to subsection 78(4) generally, is not defined in the ITAA. Following the decision in *Bray v. FC of T* 78 ATC 4 179; 8 ATR 569 a fund will be 'public' where:

- (a) it is the intention of the promoters or founders that the public will contribute to the fund;
- (b) the public, or a significant part of it does in fact contribute to the fund; and
- (c) the public participates in the administration of the fund.

6. There are two types of funds which are considered to be 'public funds':

- (a) funds established and controlled by a governmental or quasi-governmental authority; and
- (b) funds to which the public is invited to subscribe and which are controlled or administered by persons or institutions having a degree of responsibility to the community as a whole arising from their tenure of some public office or their position in the community.

7. Having regard to the purposes for which a fund has to be established if gifts to the fund are to qualify as allowable deductions, the founding documents of a **public fund** should reflect the following requirements:

- (a) the objects of the fund must be clearly set out and reflect the purpose of the fund;
- (b) gifts to the fund must be kept separate from any other funds of the sponsoring organisation (if there is one). A separate bank account and clear accounting procedures are required;
- (c) receipts must be issued in the name of the fund;
- (d) the public must be invited to contribute to the fund;
- (e) the fund must operate on a non-profit basis. Monies must not be distributed to members of the managing committee or trustees of the fund except as reimbursement for out-of-pocket expenses incurred on behalf of the fund or proper remuneration for administrative services;

- (f) the fund must be managed by members of a Committee a majority of whom have a degree of responsibility to the general community; and
- (g) should the fund be wound-up any surplus money must be transferred to some other fund qualifying under subsection 78(4).

In addition to the above, the founding documents must state that the Commissioner is to be notified of any changes to the fund's constitution or other founding documents.

Objects of the fund

8. A fund, authority or institution seeking approval of its public fund under one of the items mentioned in the tables in subsection 78(4) must ensure that its objects conform with the requirements of that particular item.

Dissolution clause

9. A fund seeking recognition under subsection 78(4) must have an acceptable dissolution clause.

10. The precise form of wording of a dissolution clause is a matter for the founders of the fund. However, the wording must specify that on dissolution, all remaining assets of the fund after all liabilities have been satisfied must be distributed:

- (a) to a named fund, authority or institution known to have been approved under subsection 78(4); or
- (b) to any fund, authority or institution falling under one or more of the items listed in the tables in subsection 78(4) of the Act, e.g., to public benevolent institutions approved under item 4.1.1 of table 4 in subsection 78(4) of the Act.

Location of fund

11. Public funds will generally only be approved if the funds are established and operated in Australia for the benefit of causes or beneficiaries located in Australia. This requirement applies, for example, to public hospitals, non-profit hospitals and public benevolent institutions. Exceptions are:

- (a) overseas aid funds established under item 9.1.1 of table 4 in subsection 78(4);
- (b) organisations which are separately listed in subsection 78(4) where the government of the day approved the organisation

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using donated moneys or property to aid overseas beneficiaries/causes; and

- (c) environmental organisations registered under item 6.1.1 of table 6 in subsection 78(4).

In the case of these exceptions, while the moneys in these funds may be used overseas, the actual public fund must be in Australia.

Public funds under the ancillary fund provisions of subsection 78(5)

12. To satisfy the conditions regarding deductibility of a gift under the ancillary fund provisions in subsection 78(5), the public fund has to be established and maintained under a will or instrument of trust exclusively for the purpose of providing money, property or benefits to:

- (a) any fund, authority or institution which satisfies the requirements of subsection 78(4); or
- (b) to any combination of funds, authorities or institutions which in their own right satisfy the requirements of that subsection.

Date of effect

13. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Public funds - general

14. It should be noted that not all of the items in subsection 78(4) stipulate that an organisation that is specifically listed by name, or an organisation which falls within one of the categories, must have a public fund. However, in agreeing to specifically list an organisation by name the Government of the day will generally require that it has a public fund which satisfies taxation requirements. This is to safeguard property and moneys donated to the fund and to ensure that they are used for the purpose for which approval for specific listing was given.

15. Where an organisation is required to have a public fund, that fund must have its own rules and objects. The rules and objects can be set out in a separate founding document or incorporated in the constitution or other founding documents of the organisation. The organisation's constitution or founding document must authorise the establishment of the fund possibly by including it in the organisation's objects.

Responsible persons

16. For the purposes of paragraphs 6(b) and 7(f) above, persons who are considered to have a degree of responsibility to the community as a whole include church authorities, school principals, judges, clergymen, solicitors, doctors, and other professional persons, mayors, councillors, town clerks and members of parliament. Generally, persons who are acceptable as having a degree of responsibility to the community as a whole are known to a broad section of the community because they perform a public function or they belong to a professional body with a professional code of ethics. Other persons who are acceptable are appointees of a Chief Justice of the Supreme Court. Persons who have received formal recognition for their services to the community will also be considered to have the requisite degree of responsibility.

17. The meaning of the word 'public' will be discussed in a future Taxation Ruling that will deal with public benevolent institutions.

18. Organisations such as Rotary, Lions and Apex Clubs often sponsor funds having objects covered by one of the items listed in the tables in subsection 78(4). Although the sponsoring organisation itself may not have a public character because of some reason, such as selective membership, the committee controlling the fund may have a public character if it includes persons who have a degree of responsibility to the community in general, as distinct from obligations as members of the sponsoring organisation.

19. Even though a public fund is required to be controlled by an executive committee made up of a majority of responsible persons (see paragraph 16) the day-to-day running of the organisation need not be carried out by those persons. The fund must, however, be set up in such a way that it is not possible for public control to lapse for any period.

Objects of the fund

20. In order to obtain approval under subsection 78(4), an organisation and in particular its fund, must ensure that its objects satisfy the particular requirements, if any, set out in the relevant

table's item. For example, the objective of overseas aid agencies must be exclusively to provide relief to persons in a certified developing country [see subsection 78(21)]; or donated moneys in school building funds can only be used in the acquisition, construction or maintenance of a school building [see item 2.1.10 of table 2 in subsection 78(4)].

21. Alternatively, if an organisation is seeking specific listing in the gift provisions, it will have to ensure that its objectives, and consequently the use of any donated moneys, conform with the purpose or objectives for which the Government of the day agrees to its being granted tax deductible gift status.

22. In some instances, subsection 78(4) does not expressly stipulate how deductible donations made to a fund, authority or institution mentioned in the tables in the subsection must be used. Examples of this are items 12.1.2, 12.1.3 and 12.1.4 of table 12 in subsection 78(4) which are concerned with public libraries, public museums and public art galleries. There is, however, an implied condition that donated moneys will be used only for those purposes which fall within the scope of the objects for which a particular organisation was established. Generally, it will be required that the moneys must be used solely for approved and agreed objectives. For example, moneys donated to cultural organisations and environmental organisations can only be used in relation to the organisation's cultural or environmental purposes.

Dissolution clause

23. Generally speaking, a dissolution clause must provide that, upon the winding-up of the fund, authority or institution, all assets remaining after the payment of just debts and liabilities are to be transferred to one or more funds, authorities or institutions having similar objects and which come within the scope of subsection 78(4).

24. In some instances the legislation requires that moneys be transferred upon the dissolution of a fund to another fund or organisation of the same type. Paragraph 78AB(2)(d) concerning funds admitted to the Register of Environmental Organisations for example, has such a requirement. The Commissioner may also specify such a requirement as, for example, in paragraph 6 of Taxation Ruling IT 2478 which concerns approval of overseas aid agencies.

Public funds under the ancillary fund provisions of subsection 78(5)

25. The essence of the ancillary funds referred to in subsection 78(5) is that they collect money, property, etc, which is passed on, less any administrative expenses, to subsection 78(4) funds, authorities or

institutions. Ancillary funds may be likened to a conduit or temporary repository for moneys which are to be channelled to particular subsection 78(4) funds.

Tests

26. There are four tests that have to be satisfied for subsection 78(5) to apply. These are:

test number one: there must be a public fund;

test number two: the fund must be established and maintained under a will or an instrument of trust;

test number three: the fund must be established and maintained exclusively for specific purposes (see paragraph 29 below); and

test number four: moneys paid or accrued directly or indirectly to the fund as a result of any gift may only be invested in a specified manner (see paragraph 37 below).

Test number one - public fund

27. The fund must be a public fund as explained in this Ruling.

Test number two - will or instrument of trust

28. The fund must be established and maintained under a will or an instrument of trust. The word 'maintained' in this context does not require that the fund must be continually operative or established for an indefinite period but rather that the fund must, not only at its establishment but throughout its existence, comply with the terms of the provision. Consequently, ancillary funds set up under subsection 78(5) could include public funds established in relation to isolated acts of relief including public funds for the relief of one individual, family or similar group in necessitous circumstances.

Test number three - purposes

Provision of money, property or benefits

29. The purpose of the public funds to which subsection 78(5) applies is to provide money, property or benefits exclusively to and for other qualifying institutions or funds.

30. A benefit arises where some discernible advantage has been bestowed on a specified institution. It may take the form of some

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tangible addition to, or the removal of some detriment from, the conduct of the particular institution.

31. The creation and maintenance of a holiday camp exclusively for children in orphanages would represent a benefit to the orphanages in terms of subsection 78(5). 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 a special provisions fund awarded and generally controlled the scholarship and its only connection with the university was that it was tenable there, there would not be a benefit to the university in terms of subsection 78(5) - it would not add to the affairs and activities for which the university is responsible.

Manner of provision

32. Subsection 78(5) does not apply to a fund set up by will or instrument of trust that has as its objects, or one of its objects, the providing of money, etc. to a fund, authority or institution in such a way that the money may be used for a purpose beyond a purpose specified in the relevant item of subsection 78(4).

33. For example, a fund would not qualify under subsection 78(5) if it could provide money, etc. for the general purposes of an institution specified in table 1 of subsection 78(4). This provision requires that moneys or property donated to certain organisations be used only for the purpose of education or research in medical knowledge or science.

34. A fund established by the relevant will or instrument of trust to provide money etc. to any of the public funds specified, or authorities or institutions referred to, in any item of subsection 78(4) may satisfy the tests of subsection 78(5). However, a fund established to provide money etc. directly (and not through another public fund) for a purpose referred to in subsection 78(4) would not qualify under subsection 78(5).

35. For instance, a public fund would be outside the scope of subsection 78(5) if it had a right to provide money etc. directly to persons in Australia who are in necessitous circumstances or for the acquisition, construction or maintenance of a school building. It should be noted that the gift may be deductible under another provision of subsection 78(4).

36. On the other hand, a right to provide money etc. directly to, for example, a public hospital, public benevolent institution or public university could be within the scope of the provision since these are all institutions referred to in items of subsection 78(4).

Test Number Four - investments

37. Moneys which have been paid or accrued directly or indirectly to the fund as a result of a gift and which have not been applied for the purpose of the fund, can only be invested by the trustee in securities in which a trustee may, under any State, Commonwealth or Territorial law, invest without special authorisation. This applies to moneys accruing from each particular gift. This condition must be included under the terms of the will or trust instrument.

38. The required restriction on investment which applies to funds set up under the subsection 78(5) applies not only to the amount of each particular deductible gift, but also to income derived by the fund from investment of deductible gifts made to it and to any amount representing proceeds of realisation of investment of moneys arising from the gift. It also applies to any other moneys that the fund receives, in any way, as a result of a deductible gift having been made to it.

39. The restriction on investment means that investments are confined to securities that are 'trustee securities' under any statute law in force in Australia that restricts the investment powers of trustees. A trustee can only lawfully invest trust funds in securities permitted by such a law or in securities specially authorised by the terms of the governing document. In effect, the limitation requires only that the will or instrument of trust does not give the trustees power to invest other than in trustee securities. A will or instrument of trust that is silent on the trustees' power of investment would meet this test because the trustees would then be restricted to trustee investments prescribed by the trustee law appropriate in the circumstances of the particular case.

Gifts of property

40. As in the case of all gifts other than of money, subsection 78(5) will not authorise a deduction if the property gifted to the public fund by the donor was not purchased by the donor within the twelve months before the date of the gift. A gift of property (other than money) purchased by a donor within that period may be deductible under the subsection even though the trustee of the fund is not required to dispose of the property and invest the proceeds in trustee securities. A deduction would not, however, be permitted in respect of a gift other than money if the will or instrument of trust permitted any income accruing from such a gift or any proceeds of its sale to be invested other than in trustee securities.

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Administrative Expenses

41. The restriction on investment of moneys received by a fund does not, of course, prevent the will or instrument giving the trustee power to meet proper administrative expense.

Examples

Public funds

Example No. 1

42. A taxpayer created a trust fund to which substantial donations are made. The trust deed provides that the fund is exclusively for the purposes of providing money, property or benefits to or for funds, authorities and institutions referred to in subsection 78(4). The deed also stated that the fund would solicit and accept donations from members of the public. The taxpayer was the sole contributor to the fund. There were two invitations to the public to subscribe made in 'extraordinary' advertisements published in local papers.

43. The trust fund is not considered to be a 'public fund' as there were no public elements in the establishment and maintenance of the fund. There was no public initiative in its establishment and no public participation in its maintenance. (*Bray v. FC of T* 78 ATC 4179; 8 ATR 569.)

Example No. 2

44. A foundation was established by a taxpayer and others to help needy pupils of a particular State school in a disadvantaged area. The involvement of persons other than the taxpayer was minimal and the cause being promoted was established and maintained as a private cause of the taxpayer. In this context, the foundation was held not to be a public fund for the purposes of subsection 78(5). (*Case X13*, 90 ATC 165; 21 ATR 3132.)

Dissolution clause

Example No. 3

45. The following is an example of a commonly used dissolution clause:

'If upon the winding up or dissolution of the ... there remains, after satisfaction of all its debts and liabilities, any property whatsoever, the same shall not be paid to or distributed among the members of the ... but shall be given to or transferred to some other institution or institutions having objects similar to

the objects of the ... and which is a fund, authority or institution approved by the Commissioner of Taxation as a fund, authority or institution referred to in subsection 78(4) of the *Income Tax Assessment Act 1936*.'

Ancillary provision funds

Example No. 4

46. A shire council organises an annual charitable appeal (for example, a Christmas appeal). A fund is established by trust deed which is open to contributions from the public. The fund is administered by three trustees who are the president, secretary and chairman of the Finance Committee of the shire. The trust deed requires that any replacement trustees are to have a degree of responsibility to the public. The funds of the trust are to be applied exclusively for the purposes set out in subsection 78(5). The trustees are expressly limited to making investments in approved 'trustee securities'. The dissolution clause requires any remaining assets in the fund to be distributed solely to funds mentioned in items 1.1.1 or 4.1.1 in tables 1 and 4 respectively of subsection 78(4).

47. The fund would be approved as an ancillary fund.

Example No. 5

48. Employers may set up a foundation or fund into which staff make periodic donations. The purpose of the fund may be to channel donations to public benevolent institutions or overseas aid agencies; or alternatively, to assist staff members who have been affected by natural disasters such as earthquakes or floods. These foundations may obtain tax deductible gift status by setting up a public fund which satisfies the requirements set down in subsection 78(5). Alternatively community chests may be set up in such a way as to fall within the ancillary fund provisions.

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- ITAA 78AB

case references

- Bray v FC of T 78 ATC 4179
8 ATR 569
Case X13, 90 ATC 165; 21 ATR
3132