TR 95/27 - Income tax: public funds

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Taxation Ruling
Income tax: public funds

other Rulings on this topic

CITCM 806; CITCM 837; IT 2194; IT 2259

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*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Ruling is about

1. The gift provisions of the *Income Tax Assessment Act 1936* (the Act) requires in some instances **public funds** to be established into which gifts of property or money are placed if those gifts are to qualify as allowable deductions. The more commonly known **public funds** include those established under item 2.1.10 of table 2 in subsection 78(4) (**school building funds**), item 4.1.3 of table 4 in subsection 78(4) (**public funds which are established for the relief of persons in Australia who are in necessitous circumstances**), item 6.1.1 of table 6 in subsection 78(4) (**environmental organisations**), item 9.1.1 of table 9 in subsection 78(4) (**overseas aid funds**) and item 12.1.1 of table 12 in subsection 78(4) (**cultural organisations**).

2. This Ruling deals with the criteria applicable to public funds under the general gift provisions of subsection 78(4) of the Act. It does not deal with the specific criteria for public funds in relation to cultural and environmental organisations. The ruling updates guidelines set out in Canberra Income Tax Circular Memoranda CITCM 806 and CITCM 837 and Taxation Rulings IT 2194 and IT 2259 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) of the Act. Funds established and maintained under the ancillary fund provisions are required to be **public funds**.

Class of persons/arrangement

4. This Ruling applies to persons seeking:

(a) to be specifically listed in the gift provisions of the *Income Tax Assessment Act 1936*;

(b) to satisfy the public fund requirements under the general gift provisions of subsection 78(4); or

(c) to establish an ancillary fund to which subsection 78(5) applies.

Ruling

Public funds - general

5. 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.

6. The term 'public fund', in so far as it applies to subsection 78(4) generally, is not defined in the Act. In our view, the decision in *Bray v. FC of T* 78 ATC 4179; 8 ATR 569 establishes that 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.

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

(a) funds established and controlled by governmental or quasi-governmental authority; and

(b) funds to which the public is invited to contribute and in fact does contribute. These funds must be controlled or administered by persons or institutions having a degree of responsibility to the community as a whole. This could arise, for example, from a person's occupation or tenure of some public office, or a person's or institution's position in the community.

8. While it is not strictly necessary for a fund to be formally approved by the Australian Taxation Office (ATO) before it commences seeking and accepting donations, it is in the interests of the persons in control of the fund to seek approval. This is so they will avoid the possibility that donors will have to demonstrate individually that all the requirements for deductibility have been satisfied, and to enable prospective donors to be assured in advance

that gifts will be allowable deductions (either in full or to a specified extent as the case may be).

9. For the ATO to accept a fund as a public fund, the founding documents of the public fund must reflect the following:

(a) the objects of the fund must be clearly set out and reflect the purpose of the fund (see ***Objects of the fund*** below);

(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. Moneys 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 (this requirement does not apply to funds established and controlled by governmental or quasi-governmental authority); and

(g) should the fund be wound-up, any surplus money or other assets must be transferred to some other fund qualifying under subsection 78(4) or 78(5) (see ***Dissolution clause*** below).

The ATO also requires an undertaking in writing, or the inclusion of a clause in the constituent documents, that the ATO is to be notified of any changes to the fund's constitution or other founding documents.

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 tax deductible gift status.

Objects of the fund

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

Dissolution clause

11. A fund seeking recognition under subsection 78(4) or 78(5) must have an acceptable dissolution clause.

12. The precise form of wording of a dissolution clause is a matter for those in control of the fund. However, the wording must ensure that on dissolution, all remaining assets of the fund after all liabilities have been satisfied must be distributed:

(a) to a fund, authority or institution specifically named in subsection 78(4);

(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 a public benevolent institution under item 4.1.1 of table 4 in subsection 78(4); or

(c) to a fund to which subsection 78(5) applies.

13. A fund, authority or institution seeking approval of its public fund under one of the items listed in the tables in subsection 78(4) must be mindful that in some instances the provisions require that upon dissolution of a fund any surplus assets are to be transferred to some other fund qualifying under the same item.

Location of fund

14. In all cases the public fund itself must be established and operated in Australia. The fund's causes or beneficiaries must also be located in Australia, except for:

(a) overseas aid funds established under item 9.1.1 of table 9 in subsection 78(4);

(b) organisations which are separately listed in subsection 78(4) where the Government of the day approved the organisation 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).

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

15. 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:

(a) the purpose of providing money, property or benefits to or for funds, authorities or institutions referred to, and for the purposes (if any) referred to, in any of the items in the tables in subsection 78(4); or

(b) the establishment of funds, authorities or institutions referred to in the tables in subsection 78(4).

16. It is essential that the terms of the will or instrument require that the capital and income of the fund, and any moneys from realisation of its assets, are to be applied exclusively for the purposes required by the ancillary fund provisions. The ancillary fund provisions also stipulate how moneys and property donated to an ancillary fund can be invested.

Date of effect

17. 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

18. Funds, authorities or institutions have two major avenues under which they may obtain tax deductible gift status. The first is where the fund, authority or institution falls within one of the general items listed in a table in subsection 78(4). For example, the fund or institution is a public library or a public university. The second is that the Parliament amends the law to specifically list/name a fund, institution or organisation in one of the tables in subsection 78(4). Examples of funds or institutions currently listed are: Landcare Australia Limited (item 6.2.3 of table 6) and the Australian Sports Foundation (item 10.2.1 of table 10).

19. 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 general items in a table, must have a public fund. However, in agreeing to specifically list an organisation by name, the Government will generally require that it has a fund which satisfies public fund requirements. The reason for insisting upon the establishment of a public fund is to ensure that there are administrative and legal frameworks in place which will safeguard

property and moneys donated to the fund, authority or institution and which will, as far as possible, ensure that tax deductible donations are used for the purpose for which approval for specific listing was given.

20. Where a public fund is required, 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 its constitution or other founding documents of the sponsoring organisation. The organisation's constitution or founding document must authorise the establishment of the fund, for example, in the organisation's objects.

Responsible persons

21. For the purposes of paragraphs 7(b) and 9(f) of this Ruling, 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 (such as the Institute of Chartered Accountants, State Law Societies and Medical Registration Boards) which has a professional code of ethics and rules of conduct. Other persons who are acceptable are appointees of a Chief Justice of the Supreme Court. Persons who have received formal recognition from the Government for their services to the community (for example, an Order of Australia award) will also be considered to have the requisite degree of responsibility.

22. 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. Generally, funds which are established by organisations which have well-recognised community service functions and whose members are drawn from many sectors of business and the professions can be accepted as having a public character.

23. Even though a public fund is required to be controlled by an executive committee made up of a majority of responsible persons, 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

24. In order to obtain approval under subsection 78(4), an organisation and in particular its public fund, must ensure that its objects satisfy the particular requirements, if any, for the relevant item. For example, the objective of an overseas aid fund 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)).

25. 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.

26. 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 (a public library), 12.1.3 (a public museum) and 12.1.4 (a public art gallery) of table 12 in subsection 78(4). 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

27. Generally speaking, a dissolution clause provides 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) or 78(5).

28. Where an organisation consists of different parts and not all of those parts have tax deductible gift status, the organisation is not allowed to transfer any surplus assets or property upon winding-up of that part which has tax deductible gift status to another part of the organisation which does not have that status. The restrictions on the wording of dissolution clauses are to ensure that, in the event of an organisation with tax deductible gift status being wound-up, gifts

which have attracted tax deductibility for the donor flow to, and are ultimately used by, an entity which attracts that concession.

29. 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) of the Act 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(f) of Taxation Ruling TR 95/2 which concerns approval of overseas aid funds.

Public funds under the ancillary fund provisions

30. 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 proper and reasonable 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

31. 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; 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.

Test number one - public fund

32. The fund must be a public fund as explained in this Ruling at paragraphs 5 to 9.

Test number two - will or instrument of trust

33. 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) of the Act can include those which have the object of channelling funds to public funds established in relation to isolated acts of relief including public funds for the relief of one individual or family or a community adversely affected by a natural disaster. That is, an ancillary fund can be established to provide money, property or benefits to or for a fund which is established for a limited time and which has tax deductible gift status under one of the items in subsection 78(4) such as item 4.1.3 of table 4.

Test number three - purposes

Provision of money, property or benefits

34. The purpose of the public funds to which subsection 78(5) applies is to provide money, property or benefits **exclusively to or for** other qualifying institutions or funds. This includes the establishment of funds, authorities or institutions referred to in subsection 78(4).

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.

36. 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 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 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.

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 subsection 78(4) funds or organisations.) 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.

Manner of provision

38. 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).

39. 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 item 1.2.4 of table 1 in subsection 78(4). This provision requires that moneys or property donated to the College of Radiologists in Australasia be used **only** for the purpose of education or research in medical knowledge or science.

40. A fund established by the relevant will or instrument of trust to provide money, etc., to or for 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 or organisation with tax deductible gift status) for a purpose referred to in subsection 78(4) would not qualify under subsection 78(5).

41. In other words, ancillary funds can not provide moneys, etc., directly to 'beneficiaries' of subsection 78(4) funds or organisations, but the moneys, etc., must be provided to or for organisations which are allowed to provide such benefits under subsection 78(4). 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. Where the settlors/creators of a fund want the fund to provide moneys, etc., directly to or for beneficiaries or to perform the function of a fund/organisation approved under subsection 78(4), then they should apply under the specific provisions of subsection 78(4) to obtain tax deductible gift status for their particular fund.

42. On the other hand, a right to provide money, etc., directly to or for a public hospital, public benevolent institution or public university, for example, 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

43. 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 Commonwealth, State or Territory 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.

44. The required restriction on investment which applies to funds set up under 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.

45. 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

46. 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.

Administrative expenses

47. 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. Proper and 'reasonable' costs of establishing, promoting and managing an ancillary fund include such inevitable and incidental items as bank charges, stationery costs and accounting and audit fees relating expressly to the fund. However, 'reasonable' costs would not include an apportionment of normal expenses which an organisation may have necessarily incurred prior to the establishment of an ancillary fund.

Examples

Public funds

***Note:** the cases described in Examples 1 and 2 dealt with the former paragraph 78(1)(a) (now subsection 78(4)) and its special provisions (now subsection 78(5)).

Example 1

48. A taxpayer creates a trust fund and makes donations of property (shares) to that fund. 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 states that the fund will solicit and accept donations from members of the public.

49. Two invitations to the public to subscribe are made in 'extraordinary' advertisements published in local papers, but in a form which is designed to discourage, rather than encourage, donations. No public donations are in fact received, so that the taxpayer is the sole contributor.

50. The trust fund is not considered to be a 'public fund'. There was no public initiative in its establishment, nor did it attract any public financial participation. From its actions there did not appear to be any intention to attract public participation (*Bray v. FC of T* 78 ATC 4179; (1978) 8 ATR 569.)

Example 2

51. A foundation is 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 is minimal and the cause being promoted is established and maintained as a private cause of the taxpayer. In this context, the foundation is not a public fund for the purposes of subsection 78(5) (*Case X13* 90 ATC 165; *AAT Case 5560* (1989) 21 ATR 3132.)

Example 3

52. A trust fund is established to provide benefits to a child with a severe medical condition. The trustees of the fund are the guardians of the child and the family lawyer. Although it is stated that donations would be sought from the public, the only donors to the fund are the guardians and family members. If the child's guardians needed to purchase some item for the child, then they 'donated' the money to the

fund and the fund purchased the item. The fund in this instance will not be considered to be a public fund for the purposes of subsection 78(5).

Dissolution clause

Example 4

53. The following is an example of a commonly used and acceptable dissolution clause:

> 'If upon the winding up or dissolution of the ABC Fund 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 ABC Fund but shall be given to or transferred to some other institution or institutions having objects similar to the objects of the ABC Fund 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*.'

It should be noted that any surplus money or other assets held by public funds can be transferred to funds qualifying under subsection 78(4) or 78(5) or a combination of subsections 78(4) and 78(5) funds.

Example 5

54. A church establishes a public fund for the relief of persons in necessitous circumstances in terms of item 4.1.3 of table 4 in subsection 78(4). As gifts to the general funds of a church are <u>not</u> deductible to donors it is not acceptable to provide that on the dissolution of the fund surplus cash and property are transferred to the general funds of the church. Surplus cash and property may only be transferred to some other fund, authority or institution with tax deductible gift status. That entity may be, for example, another tax deductible fund conducted by the church, a tax deductible organisation associated with the church or some other unassociated entity, as long as it is recognised in terms of subsection 78(4) or 78(5).

Ancillary funds

Example 6

55. 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 'trustee securities'. The dissolution clause requires any remaining assets in the fund to be distributed solely to institutions which qualify for gift deductibility status under items 1.1.1 (a public hospital) or 4.1.1 (a public benevolent institution) in tables 1 and 4 respectively of subsection 78(4).

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

Example 7

57. 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 funds; or alternatively, to a public fund set up 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 (that is, a fund for unspecified charitable purposes) may be set up in such a way as to fall within the ancillary fund provisions.

Previous Rulings

58. Taxation Rulings IT 2194 and IT 2259 and Taxation Determinations TD 92/111 and TD 93/191 are now withdrawn. To the extent that the principles in those Rulings are still applicable they have been incorporated into this Ruling.

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