

Freehills

PRESCRIBED PRIVATE FUNDS¹ Technical outline

Overview

A prescribed private fund (**PPF**) is a fund established by will or trust instrument with:

- deductible gift recipient (**DGR**) status (so that, among other things, gifts to it are income tax deductible to the donor);
- normally, income tax exempt charity (**ITEC**) status (so that, among other things, its income is exempt from income tax); and
- the ability to attract a variety of other Commonwealth, State and Territory tax and duty concessions.

There is no need for gifts to a PPF to be sought and received from the public and a PPF can be controlled by an individual, family or corporate group.

Legislative provisions

1 Section 30-15 of the *Income Tax Assessment Act 1997* (**ITAA 97**) provides for the deductibility of certain gifts to the recipients outlined in the table in that section. One type of recipient is described in item 2 of the table as being a " ... prescribed private fund, established and maintained under a will or instrument of trust solely for ... the purpose of providing money, property or benefits to a fund, authority or institution gifts to which are deductible under item 1 of this table ... [or for] ... the establishment of such a fund, authority or institution".

Item 2 also provides that a gift will not be deductible unless the instrument of trust allows the trustee to invest money received because of a gift only in a way that a Commonwealth or State or Territory law allows trustees to invest trust money.

2 In turn, "prescribed private fund" is defined in section 995-1 of ITAA 97 as being a fund prescribed by the regulations for the purposes of the definition.

3 Accordingly, subject to the limitations in paragraph 1 above, as the Government makes regulations (subject to a right of either House of Parliament to disallow a regulation²), the Government has a broad discretion to implement and amend its policy with regard to the attributes of prescribed private funds.

History of PPFs

4 In 1963, the *Income Tax Assessment Act 1936* (**ITAA 36**) was amended to permit deductibility for gifts to "public funds" meeting certain requirements. These funds are now commonly called **ancillary funds** and have similar statutory characteristics as prescribed private funds except for the requirement they be "public funds"³.

¹ This paper is updated to take into account version 3 of the guidelines and the model deed released by the ATO in May 2004. It contains hyperlink text in paragraph 66 and in a number of footnotes.

² Section 48(4) of the *Acts Interpretation Act 1901*

³ Item 2 requires that an ancillary fund be "[a] public fund ... established and maintained under a will or instrument of trust solely for ... the purpose of providing money, property or benefits to a fund, authority or institution gifts to

- 5 In a 1978 decision, *Bray v FCT*⁴, the High Court of Australia commented upon the scope of the legislative provisions in relation to public funds. While the judges had a variety of views as to certain of their attributes, three of the five judges indicated that a public fund must be open to receive gifts from the public. They noted also that it was useful evidence if the public in fact makes gifts to the fund.
- 6 Taxation Ruling TR 95/27⁵ states that a public fund will have the following characteristics with regard to the "public" requirement:
- it must be the intention of the founder that the public will contribute to the fund;
 - the public must in fact contribute; and
 - the public must participate in the administration of the fund so that a majority of those controlling the fund must be persons with responsibility to the community⁶.
- 7 The requirements that gifts be sought and received from the public and those with regard to the control of ancillary funds were considered by the Government to be a disincentive to private philanthropic giving.
- 8 The proposal to amend the legislation to permit the creation of PPFs was announced by the Government in March 1999. The first Government guidelines and model deed were released in April 2001 and the first PPFs approved by the Government in June 2001. The third version of the guidelines and model deed was released in May 2004⁷.
- By April 2004, about 155 PPFs had been approved by the Government.

Purpose of PPFs

- 9 The sole purpose of a PPF, as with an ancillary fund, must be to provide money, property or benefits to funds, authorities or institutions, gifts to which are deductible under item 1 of the table in section 30-15. Item 1 refers to recipients covered by any of the tables in Subdivision 30-B.
- 10 The trust instrument normally permits grants to be made to all Subdivision 30-B recipients or, if less commonly, the instrument names specific DGRs or specific types of DGRs.
- 11 It is important that the trust instrument permits grants to be made only to funds, authorities or institutions which are either named in Subdivision 30-B or which are described in Subdivision 30-B and endorsed under Subdivision 30-BA⁸.

which are deductible under item 1 of this table ... [or for] ... the establishment of such a fund, authority or institution".

⁴ 78 ATC 4179, (1978) 140 CLR 560, (1978) 8 ATR 569, (1978) 52 ALJR 484, (1978) 19 ALR 309 and:

http://www.austlii.edu.au/au/cases/cth/high_ct/140clr560.html

⁵ <http://law.ato.gov.au/pdf/tr95-27.pdf>

⁶ See paragraph 6 of the ruling

⁷ See paragraph 66 below

⁸ Subdivision 30-BA provides for the endorsement by the Australian Taxation Office of DGRs who are not named specifically in the table in section 30-15. DGRs must be named or endorsed as a DGR to qualify to receive grants from PPFs (and, of course, to qualify to receive tax deductible gifts).

- 12 It is also important that grants be able to be made to a DGR only for any particular purposes specified in Subdivision 30-B in respect of the DGR. For example, a grant to an approved research institute as described in item 3.1.1 in the table in section 30-40 of ITAA 97⁹, must be made for the purposes of scientific research in the field of natural or applied science.

The model deed contains wording acceptable to the Australian Taxation Office (ATO) with regard to the requirements in paragraphs 11 and 12¹⁰.

Examples of extrinsic purposes

- 13 In *Bray's case*, the taxpayer established a trust and transferred to it by way of gift, all but one of the shares in a private company. The taxpayer had purchased the shares shortly before making the gift. The taxpayer claimed the value of the shares as a deduction on the basis that they were a gift by him to a public fund established for the sole purpose of benefiting the organisations of the type described in paragraph 1 above.

The company had significant cash funds and subscribed for preference shares in another company controlled by the taxpayer. A significant part of the funds were ultimately lent interest free to the taxpayer.

As mentioned above, the High Court had concerns with a number of issues in connection with the deduction claim. While the issue of whether or not it was a public fund was the primary focus of the Court, one judge, Jacobs J, also believed that the fund was not maintained for the sole purpose of benefiting deductible gift recipients. In his view, the facts evidenced that one of the purposes of the taxpayer was to obtain control of the private company and therefore have access to its funds¹¹.

Jacobs J provided an example of another type of extrinsic purpose. If a trust employed a manager whose salary absorbed the income of the trust, he felt it would be open to conclude that the trust was not being maintained exclusively for the purpose of providing benefits to its beneficial objects¹².

- 14 Extrinsic purposes would also exist if a PPF was established to, say, collect and exhibit artefacts or if a PPF itself awarded scholarships to university students or carried out scientific research.
- 15 While there does not appear to be a difficulty in PPFs making grants to DGRs on condition they are used by the recipient for a particular program or purpose, the PPF must not itself carry on that program or purpose.
- 16 It is, of course, quite appropriate for a PPF to carry on activities for the purposes of assessing appropriate DGRs to receive grants and these activities may well involve an ongoing relationship with DGRs. However, this investigation and relationship must be directly related to the grant making purposes of a PPF, not to enable it to carry out its own programs etc.
- 17 Paragraphs 35 to 37 of Taxation Ruling TR 95/27¹³ provide some examples of appropriate benefits that can be provided to DGRs.

⁹ <http://scaleplus.law.gov.au/html/pasteact/1/597/0/PA002880.htm>

¹⁰ Clauses 4.1(b), 6.3(b) and 17(b)

¹¹ ATC at 4189

¹² ATC at 4188

¹³ See footnote 5

"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 [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."

Excluded DGRs

- 18 Public funds of the type referred to in paragraph 4 above (ancillary funds), other PPFs, political parties, or Artbank are not DGRs referred to in Subdivision 30-B and so can not receive grants from PPFs.
- 19 Further, it is normally a provision in instruments establishing PPFs (as in the model deed), that the DGR recipients of grants be charitable. This is not a compulsory requirement for a fund to be prescribed as a PPF but if grants can be made to recipients who are not charitable, the PPF will not be entitled to be endorsed as an Income Tax Exempt Charity and accordingly, will:
- (a) not be exempt from tax on its income;
 - (b) not be covered by section 160ARDAB of ITAA 36¹⁴ and so will not be entitled to cash rebates of franking credits on dividends received by it; and
 - (c) be ineligible for some other Commonwealth, State and Territory tax and duty concessions.

Ascertaining eligible recipients

- 20 To provide a degree of comfort that a grant will only be made to a recipient entitled to it having regard to:
- (a) the requirements outlined in paragraph 9;
 - (b) the exclusions in paragraph 18; and
 - (c) normally, the charitable status outlined in paragraph 19,
- the PPF should obtain from the proposed recipient:
- (d) except where the recipient is specifically named in Subdivision 30-B (see paragraph 21), a copy of its "Endorsement as a deductible gift recipient"¹⁵; **and**

¹⁴ <http://scaleplus.law.gov.au/html/pasteact/2/3036/3/PA018640.htm>

- (e) whether or not the recipient is specifically named, a copy of its "Endorsement as an income tax exempt charitable entity".

21 If the proposed recipient is specifically named in Subdivision 30-B as a deductible gift recipient, it will not also have been endorsed as a deductible gift recipient¹⁶. The PPF should satisfy itself that the proposed recipient is the same entity as the entity named in Subdivision 30-B to avoid confusion over similar names. The entry for the recipient on the Australian Business Register can be checked to ensure that it is shown as a deductible gift recipient.

Integrity measures

22 Two integrity measures in the guidelines specific to PPFs are the Responsible Person requirement and prohibition of uncommercial transaction provisions.

Responsible Person

23 The trustee of the PPF must be:

- a Responsible Person;
- two persons, at least one of whom is a Responsible Person; or
- a body corporate whose board includes at least one Responsible Person.

It is not necessary for Responsible Persons to control the trustee.

24 The role of the Responsible Person is to monitor the administration of the PPF to ensure it is complying with the terms of the trust instrument, the particular version of the ATO guidelines applicable to it¹⁷, and any special arrangements made with the ATO (such as a gift accumulation plan). The ATO does not expect Responsible Persons to conduct quasi audits of the PPF or be "whistle blowers" but does expect them to give particular attention to the compliance issues¹⁸ and insist on a high level of integrity in the administration of the PPF. Where issues arise, the Responsible Person should ensure that proper professional advice is obtained and acted upon.

25 The definition of "Responsible Person" in the model trust deed is as follows:

"Responsible Person means an individual who:

- (a) performs a significant public function;
- (b) is a member of a professional body having a code of ethics or rules of conduct;
- (c) is officially charged with spiritual functions by a religious institution;
- (d) is a director of a company whose shares are listed on the Australian Stock Exchange;

¹⁵ This Endorsement notice is on a single sheet accompanied by a letter from the ATO. The Notice is important as it states the item in Subdivision 30-B applicable to the proposed recipient. If there is no reference to an endorsement under Subdivision 30-B, then the grant can not be made.

¹⁶ Section 30-125(1)(b) at <http://scaleplus.law.gov.au/html/pasteact/1/597/0/PA003160.htm>

¹⁷ Each version of the guidelines applies only to PPFs established from the date of their release until the date of release of the next version

¹⁸ See paragraphs 46 and 47 below

- (e) has received formal recognition from government for services to the community; or
- (f) is approved as a Responsible Person by the Commissioner¹⁹, and who, unless the Commissioner otherwise agrees, is not:
 - (1) the Founder or a Donor;
 - (2) an employee of the Founder, the Trustee or a Major Donor;
 - (3) an Associate of the Founder, the Trustee or of a Major Donor or of the directors or members of the board or other controlling committee of the Trustee other than:
 - (A) in a professional capacity;
 - (B) as a member of the board or other controlling committee of the Trustee; or
 - (C) as a member of the Trustee."

Words commencing with an uppercase letter have the meanings defined in the model deed.

- 26 The person is not prohibited from being a Responsible Person simply because he or she is an acquaintance of the Founder or Major Donor.

Uncommercial transactions

- 27 The guidelines require that the trust instrument must prohibit the provision of a direct or indirect benefit from the trust to the founder, the trustee, a donor or their associates by way of an Uncommercial Transaction. In broad terms, this prevents the provision of a financial or other benefit on terms which would not be reasonable in the circumstances if a benefit were provided on an arm's length basis and which a reasonable person in the position of the trustee would not have entered into having regard to all relevant circumstances.
- 28 This requirement is similar to the concepts used in the *Corporations Act* with regard to Uncommercial Transactions²⁰ and the exceptions to the requirement for member approval for a transaction with a related party where a transaction is on arm's length terms²¹.

Gift fund

- 29 The guidelines require PPFs to maintain a gift fund²². The requirements for this fund are outlined in clause 6 of the model deed. In short, they require the trust to quarantine gifts and money received because of gifts (eg, interest and dividends from the investment of gifts) from other receipts and assets of the trust. In practical terms, it is unlikely that a PPF will receive any other money or property.

¹⁹ I understand that the ATO approves authorized trustee companies under the Trustee Companies Acts whether or not a person who is otherwise qualified is on the board.

²⁰ Section 588FB *Corporations Act*

²¹ Section 210 *Corporations Act*

²² Paragraph 15

- 30 Taxation Ruling TR 2000/12²³ outlines the views of the ATO on the operation of gift funds. It is unlikely that a PPF will need to operate more than one bank account having regard to the points made in the preceding paragraph.

Investments by PPFs

- 31 As mentioned in paragraph 1 above, PPFs may invest money they receive because of a gift only in a way that a law of the Commonwealth, a State or Territory allows trustees to invest trust money.
- 32 In turn, the State and Territory *Trustee Acts* and *Trusts Acts* require trustees to exercise a power of investment with, at a minimum, the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons²⁴. A higher level of prudence is required where a trustee's profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons. At least once in every year, a trustee must review the performance (individually and as a whole) of trust investments.
- 33 In making an investment, a trustee must have regard to a number of matters including the desirability of diversifying trust investments²⁵. It seems that this requirement would normally prevent a PPF investing in a single investment such as shares in a particular company or a single income producing building. Similarly, where a single asset is given to a PPF, this requirement would often prevent it retaining that asset for an inappropriate period. It is suggested that specific financial advice be obtained in relation to this requirement where a single or limited holding is proposed.

Accumulation of gifts

- 34 Paragraphs 26 to 28 of the guidelines outline the Government policy with regard to accumulation of gifts by PPFs.
- 35 While the guidelines state that the initial settled sum can be retained indefinitely, this is unlikely to be of practical benefit as the initial settled sums are normally a nominal amount - they are not deductible to the donor as at the time the trust is established, the PPF is not approved as a DGR.
- 36 All other accumulations of gifts, Government grants and of any other voluntary transfers of property must be approved by the ATO. The ATO recognises the desirability of establishing a significant capital base and attachment C to the guidelines outlines four types of accumulation plans that have been approved by the ATO. This approval is best sought when applying for the approval of the PPF – see paragraph 54 below.
- 37 Example 3 – The Green Foundation, illustrates an acceptable basis for obtaining ATO approval to accumulate a capital base of \$40 million.

²³ <http://law.ato.gov.au/pdf/tr00-012.pdf>

²⁴ Trustee Act 1925 (NSW) sec 14A(2)(b) (ACT) and (NSW), The Trustee Act sec 6(1)(b) (NT), Trusts Act 1973 sec 22(1)(b) (QLD), Trustee Act 1958 sec 6(1)(b) (VIC), Trustees Act 1962 sec 18(1)(b) (WA), Trustee Act 1898 sec 7(1)(b).(SA), Trustee Act 1898 (TAS) sec 7(1)(b).

²⁵ Trustee Act 1925 (NSW) sec 14C(1) (ACT) and (NSW), Trusts Act 1973 sec 24(1) (QLD), Trustee Act 1936 sec 9(1) (SA), Trustee Act 1898 sec 8(1) (TAS), The Trustee Act sec 8(1) (NT), Trustee Act 1958 sec 8(1) (VIC), Trustees Act 1962 sec 20(1) (WA)

- 38 Where ongoing gifts are proposed, the ATO typically requires there to be some distribution of each gift that is made, normally in the year following the date of the gift. The normal requirement is a minimum of 5% or 10% of the amount of the gift on a one-off basis.

For example, if a donor proposes to give, say, \$100,000 to a PPF in the year the PPF is established, not less than \$5,000 must be distributed by the PPF by way of grant to DGRs on a one-off basis in the following year. The balance of \$95,000 can be retained indefinitely by the PPF.

Accumulation of income

- 39 Generally, the earned income derived by a PPF in a particular year (eg interest and dividends) may be accumulated only to the extent necessary to maintain the real value of the capital of the PPF at the end of the previous year²⁶. The balance must be distributed to DGRs.

Accumulation of capital gains

- 40 These are covered in paragraphs 29 to 32 of the guidelines.
- 41 Realised capital gains do not need to be distributed by the PPF provided the approved capital base (including adjustments for CPI movements) has not been reached.
- 42 After the approved capital base as so adjusted has been reached, then:
- (a) income from earnings of investments could be accumulated to the extent necessary to maintain the real value of the capital of the PPF at the end of the previous year and the balance distributed; and
 - (b) to the extent realised capital gains exceeded the adjusted capital base, they would need to be distributed.
- 43 Unrealised capital gains also can be disregarded until the approved capital base as adjusted has been reached.

"[Once the] approved capital base has been reached the trustee must continue to monitor the fund's investments. If the capital base continues to appreciate beyond the approved level, adjusted each year in accordance with the CPI formula, then the trustee must give consideration to selling that portion of the current capital base which exceeds the approved capital base and distributing the proceeds as income

As a guide, if unrealised gains in excess of the approved capital base, adjusted each year in accordance with the CPI formula, have occurred over any two consecutive financial years the excess should be sold and the proceeds distributed

Alternatively, the trustee may consider applying to the Commissioner to increase the approved capital base of the fund... Such an application must include sound fiduciary reasons as to why the capital base should be increased. Long term or unfettered accrual of capital gains within a PPF would be construed as being contrary to the fund's sole intended philanthropic purpose."²⁷

Other requirements

²⁶ See clause 4.4(a)(1) of the model deed

²⁷ Paragraphs 30 to 32 of the guidelines

- 44 Paragraph 43 of the guidelines states that PPFs may not carry on a business. This does not prevent limited dealings with share investments.
- 45 A PPF may solicit and receive gifts from the public²⁸ but gifts from the public can not be the primary source of gifts to it²⁹.

ATO compliance requirements

- 46 An annual information return must be lodged for each financial year, normally by the end of the following February. The form of the 2003 return and instructions for its completion can be found at the website in this footnote³⁰. The returns are mailed to PPFs by the ATO.
- 47 The PPF may also be asked to respond to specific requests for information. The annexure to this paper outlines the terms of a letter from the ATO issued to PPFs in July 2003.

Administrative processes

- 48 The approval of a PPF is made by the Minister for Revenue and Assistant-Treasurer, not the ATO. However, the ATO receives applications for approval and after assessing them, recommends approval to the Minister. They should normally be lodged with the Penrith office of the ATO³¹.
- 49 After the ATO receives notice from the Minister that a PPF has been approved, the ATO advises the applicant of that approval and, normally, advises that subject to the regulations being made and becoming effective in accordance with the requirements of the *Acts Interpretation Act 1901*³², gifts to the PPF from the date of approval will be deductible. The making of regulations and their gazettal has, to date, occurred some months after the date of approval but in each case, was effective from the approval date.
- 50 The ATO recommends that if there are aspects of a proposed PPF which do not comply with the requirements of the guidelines or where a gift accumulation plan is desired which does not reasonably fall within one of the examples in the guidelines, a preliminary inquiry be made of the ATO to ascertain its in-principle view of the particular issue.
- 51 Paragraph 33 of the guidelines provides that in "sufficiently exceptional circumstances, the Government may consider prescription of funds that do not strictly meet the normal integrity assurance requirements". It must be appreciated, however, that the Government is not authorised to approve PPFs that do not meet the statutory requirements (see paragraph 1 above). In these circumstances, the ATO would not submit the application for the Government's consideration.
- 52 After receiving in-principle approval to a particular issue or, where the PPF application is in a standard form, it is necessary to establish the trust before making the formal PPF application to the ATO.

²⁸ Note the possible requirement to register under the fundraising appeals legislation of each state and territory other than Northern Territory

²⁹ See also paragraphs 39 and 40 of the guidelines.

³⁰ http://www.ato.gov.au/content/downloads/n7235_10_2003.pdf

³¹ Australian Taxation Office, Small Business, PO Box 1130, Penrith, NSW, 2740.

³² Section 48

- This means that there must be a trustee³³ in existence and the trust deed executed by the founder and the trustee. The founder must pay the nominal (non deductible) settled sum³⁴.
- 53 The Responsible Person requirements outlined in paragraphs 23 to 26 above must of course also be met.
- 54 Attachment A to the guidelines contains a form of application for approval. This application should be forwarded to the ATO together with:
- a photocopy of the dated and executed trust deed;
 - details of the directors and members of the trustee company (an ASIC Form 201 is appropriate if it is a newly incorporated company). If individuals act as trustees, their details should be provided;
 - CV of Responsible Person indicating, in particular, the qualifications or grounds for the person being a Responsible Person;
 - CVs of founder and major donor or donors including any areas of personal charitable interest (eg, welfare, environment, arts);
 - details of any proposed grants policy; and
 - details of desired gift accumulation plan.
- 55 An Australian Business Register "Application to register for companies and other organisations"³⁵ should also be lodged with the ATO so as to obtain an ABN for the trust and to trigger procedures for the ATO to forward to the trust a pre-printed form known as an "Application for endorsement as an Income Tax Exempt Charity". It is not necessary for the ABN to issue before the government approves the PPF as a DGR.
- 56 Because PPFs are prescribed in the regulations, they are not required to be endorsed as DGRs.³⁶ Once a PPF is prescribed in the regulations, the ATO will ensure the Australian Business Register indicates the PPF's DGR status.
- 57 As mentioned above, the lodgement of the ABN application form triggers procedures for the ATO to forward to the contact person for Australian Business Register purposes, an Application for Income Tax Exempt Charity endorsement. This normally is received a

³³ We normally recommend a company limited by guarantee act as the trustee if the PPF will have a material public profile (eg, in awarding grants) (companies limited by guarantee are a common form of entity used for charities and the Australian Securities Commission and Investments Commission fees payable on their incorporation and as their annual review fees (formerly, the fees payable on lodging their annual returns) are considerable lower than for proprietary companies). But there is no legal reason prohibition on a proprietary limited company acting as the trustee. Individuals can also act but this can cause practical problems with the documentation needed when they change (eg, instruments of retirement and appointment of new trustee and changing the registered ownership of investments)

³⁴ We suggest the nominal settled sum be paid in cash (bank notes), placed in an envelope identified as containing it, and kept with the trust records. This enables ready identification of the settled sum for accounting purposes in future years.

³⁵ Box 1 should be checked "Discretionary trust-investment", Box 2 completed with the name of the trust, not the trustee, Boxes 24 and 25 "Yes" and in Box 26, the Box "Income Tax Exempt Charity" checked. In Attachment A, the names of the trustee company or individuals acting as trustee should be inserted and the Position held Box "Trustee" checked.

³⁶ Section 30-17(1)(b) of ITAA 97 and paragraph 34 of the guidelines.

few weeks after the ABN is issued. It is a pre-printed form that should be completed³⁷ and lodged with the ATO to receive endorsement.

- 58 It should be noted that the ITEC endorsement date and the PPF approval date are not the same. While, normally, ITEC endorsement will have effect from the date of establishment of the trust, PPF approval and consequentially DGR status will not be granted before the date of Government approval.

When are PPFs useful?

- 59 It is suggested that before establishing a PPF, consideration be given to simpler options. These include:

- (a) making direct gifts to the DGRs;
- (b) making direct gifts to ancillary funds (see paragraph 4 above); and
- (c) where gift deductibility is not needed, establishing a private charitable trust, .

- 60 Arguably, the making of direct gifts to the DGRs you wish to support is of as much benefit as establishing your own PPF - the issue largely depends upon whether one takes a short or long term view of philanthropic giving. For example, is it more advantageous for a social welfare agency to receive, say, a gift of \$100,000 now, or for the \$100,000 to be given to a PPF so that it can, hopefully efficiently and profitably, invest the \$100,000 for the future benefit of the particular social welfare agency?

- 61 There are a number of ancillary funds that receive gifts from the public and take into account the wishes of donors when making grants to DGRs. Many of these have "sub-fund" capabilities under which management accounts can be maintained in the name of a particular donor. While these ancillary funds have some administrative costs which must be met before grants are made to DGRs and are not subject to the control of the donor, they can be a cost effective way of benefiting DGRs.

- 62 It is possible for a single donor to establish and maintain a private charitable trust. These trusts are not subject to the restrictions contained in the PPF guidelines with regard to, say, the appointment of a Responsible Person and an auditor. Subject to complying with the conditions outlined in section 50-60 of ITAA 97, they are entitled to be endorsed as ITECs and in consequence, their income is exempt from tax and they are entitled to cash refunds of franking credits. They are also entitled to the other Commonwealth and State and Territory tax concessions attributable to charities. They are, however, not DGRs and cannot receive tax deductible gifts³⁸.

- 63 This having been said, a PPF can well be the appropriate structure where it is desired to establish a perpetual trust controlled by a family or corporate group with DGR (and ITEC) status to:

- (a) accumulate gifts in a tax free environment with cash refunds of franking credits so as to create a capital base enabling, hopefully, the making of more effective grants to DGRs than simply making annual gifts;

³⁷ When completing the Application form, Box 4 should be completed with the code *ABF* in relation to the description of the trust. Although not strictly accurate, we suggest that Box 13 "Are you endorsed or have you applied to be endorsed as a deductible gift recipient?" be answered "Yes". The ATO supports this approach.

³⁸ In certain circumstances, they can receive distributions of income from family discretionary trusts in a way that means that the family effectively gets a tax deduction for the distribution.

- (b) permit deductible gifts to be made in one year (perhaps in the year a large capital gain subject to tax has been made) and to have time to consider what DGRs should receive grants from the PPF in later years;
 - (c) make conditional grants to DGRs (there is an issue as to the extent to which conditions can be attached to gifts from individuals or corporates to DGRs);
 - (d) perpetuate a family or other name;
 - (e) assist parents to instil in their children an ethos of philanthropy (by, for example, including adult children on the board of the trustee company or otherwise consulting them in the grant-making processes); and
 - (f) create an entity to receive capital gains tax exempt testamentary gifts of property valued by the ATO at more than \$5,000³⁹.
- 64 Other considerations that should be taken into account before establishing a PPF are the costs and effort of administering the trustee company and the trust. These include bookkeeping, accounting and audit costs and the costs of lodging a short annual information return with the ATO⁴⁰. In addition, there can be costs associated with obtaining investment advice and in paying fees to a professional trustee company if one acts as trustee of the PPF.
- 65 Regard should also be had to the duties and liabilities of directors of a company acting as trustee or attaching directly to individuals acting as trustees. Directors' and officers' insurance cover can well be appropriate where a company is involved. Finally, it should be recognised that a PPF and those controlling it have direct accountability to the ATO and, if it is charitable, to the Attorneys-General of the States and Territories.

MORE INFORMATION

66 The guidelines and model deed released in May 2004 can be found at:

<http://www.ato.gov.au/content.asp?doc=/content/notforprofit/20926.htm>

More general information can be found at:

www.ato.gov.au/content.asp?doc=/content/notforprofit/8724.htm&bn=AS/NP/GD/GD05/A

The ITAA 97 can be found here:

<http://scaleplus.law.gov.au/html/pasteact/1/597/top.htm>

This site provides a search facility for tax legislation:

<http://law.ato.gov.au/atolaw/findleg.htm>

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June 2004

³⁹ It should be noted that while technically a PPF can be established under a will, a testamentary gift to a PPF so established would normally not be exempt from capital gains tax under section 118-60 of ITAA 97. The PPF would not have been approved by the Government as a PPF at the date the will became effective, namely, the date of death. While it might be possible to establish a PPF under a will and for there to be a deferral of a testamentary gift to the PPF until after the approval, it seems more prudent that the PPF be established by a trust instrument, and the PPF approval be obtained before the date of death so that there is certainty as to the tax outcome.

⁴⁰ See paragraph 46 above

Annexure (paragraph 47)

Terms of letter from the ATO to certain PPFs sent in July 2003

"Dear Trustee

Prescribed Private Fund (PPF) Information Return 2002

As part of the Australian Taxation Office's (ATO) ongoing compliance activities, regular reviews are conducted of a variety of matters affecting the taxation liability of individuals and entities.

On this occasion all Prescribed Private Funds (PPF), for the year ended 30 June 2002, have been selected to participate in a review.

Please provide, within 28 days, the following information in respect of your PPF Information Return for the year ended 30 June 2002:

- (1) copy of the audited report of the Prescribed Private Fund;*
- (2) copy of the bank statement/s or other investment records verifying the receipt into and retention of monies in the PPF;*
- (3) copies of the minutes of Trustee meetings;*
- (4) evidence of source of each donation of property, as listed in the Return, confirming the transfer of ownership to the PPF;*
- (5) where not already provided with the return, valuation certificates from the Australian Valuation Office (AVO) for any donations or gifts that were in the form of shares or other property;*
- (6) documentary evidence to support distributions to Deductible Gift Recipients (DGR's);*
- (7) evidence as to how the Fund decided which DGR(s) were to be supported (if not shown in the minutes of the Trustee meetings;*
- (8) where your Prescribed Private Fund had a negative balance as at 30 June 2002, an explanation as to why it was negative;*
- (9) where your fund has made a claim for expenses, documentary evidence to verify/explain the expenses – in the case of wages, a summary of the employee/s name, tax file number, total wages paid and position held will suffice;*
- (10) where loans have been made by the PPF, please outline the amount loaned, the repayment schedule, the interest rate applicable and the name and relationship to PPF, if any, of the recipient of the loan;*
- (11) what is the Fund's investment policy? Please provide examples of how you have followed this policy.*

For the purpose of this review, documentary evidence may include:

- receipts for donations or contributions;*
- valuations by 2 or more approved valuers for any donations of property under the Cultural Gifts Program or to a body of the National Trust;*
- valuation certificates from the Australian Valuation Office (AVO) for any donation of property valued at more than \$5000;*

You are also asked to provide a brief comment about how you feel you are progressing toward the achievement of your accumulation plan."