ANFPAN Conference 2012

Ancillary Funds – New Obligations

What is an Ancillary Fund?

An Ancillary Fund is a Trust established under special rules in Tax Law as a Deductible Gift Recipient (DGR). Its primary purpose is to be a conduit for tax-deductible donations to other DGR entities.

There are two distinct types of ancillary funds, with the most common being the Public Ancillary Fund (PuAF). There is also a structure available known as a Private Ancillary Fund (PrAF).

The PrAF was originally known as a Prescribed Private Fund, but its title and legal structure was changed in 2009 to establish greater governance and reporting obligations. From January 2012, similar governance and reporting obligations have been imposed on the PuAF.

Both of these structures are approved under the provisions of Section 30-15 Item 2 of ITAA 1997.

The Private Ancillary Fund (PrAF):

The purpose of the PrAF is to provide a facility for a company, a family group or an individual philanthropist, with a medium for philanthropy without the obligations and controls of a public fund. It provides privacy, simplicity in control, and the potential for the primary donor to use the DGR benefits as a tax-planning tool.

A PrAF is established under a Will or instrument of trust solely for the purpose of providing financial support to DGR's. It cannot distribute to other entities. Donations to the PrAF are tax deductible in themselves.

Under the new Guidelines introduced in 2009 the administration of a PrAF has been tightened. The current requirements include: -

- The trustee must be a corporation
- The controlling board must include at least one person who is a 'responsible person'. In this it differs from other DGR's, which require the board to comprise a majority of 'responsible persons'.
- It must have an investment strategy.
- It must distribute annually, at least 5% of the market value of its net assets as at the end of the previous year.
- The current market value of the trust's assets must be estimated annually. There are guidelines regarding valuation.
- The accounts must be audited annually by a Registered Company Auditor and accounts need to comply with accounting standards.
- The trust must lodge a tax return annually to provide statistical data.

Recent statistics are not available, but by 2008, having been in operation for only 8 years, there were 769 PrAF's approved. They controlled $1.8 Billion in assets and in 2008 distributed $129 million to other DGR's.

The Public Ancillary Fund (PuAF)

The PuAF tax structure was first introduced in 1963 and was at that time called an Ancillary Fund. The new name was introduced from 1 January 2012. At the same time major changes were made to the operational requirements to bring them to a basis consistent with the PrAF's, while upholding their public fund status.

The PuAF structure was established to provide a public fund conduit facility for channelling tax-deductible receipts to other DGR funds. They can be particularly beneficial to larger churches that control several DGR entities (PBI, School Building Funds, ROCO Fund etc) as a planning and control tool. By using the PuAF, funds can be channelled to the area of appropriate need, thus preventing imbalance in funding between several potentially competing entities. As a public fund it is expected that the public will contribute to the fund and will be invited to make such contributions. The public should also participate in the administration of the fund. In this context "public" includes a significant portion of the public. (Not all DGR entities are public funds).

While the PuAF has many similar features to the PrAF there are some other variations from the governance criteria mentioned above. Instances include: -

- The Board managing the PuAF needs to comprise a majority of "Responsible Persons".
- The annual distribution needs to be at least 4% of the market value of net assets. There is also a provision to require that if 4% represents less than $8,800.00 then the PuAF must distribute $8,800,00.00, or the balance of the fund.

The trust deed needs to be in a format that complies with the ATO model trust deed. The Object's clause needs to clearly identify that the Objects of the Trust are to benefit another entity or group of entities that are defined as "eligible charities", (entities that have tax-deductibility endorsement as DGRs).

As the governance requirements for PuAFs have just changed effective from 1 January 2012, most of these governance requirements will not currently be provided in present trust deeds. Accordingly the trust deeds need to be upgraded in the foreseeable future. The transitional provisions appear to allow the trust to operate under the old rules until 30 June 2015. However it is recommended that arrangements are made at an early date to upgrade the trust deed, and notify ATO of compliance so that the new provisions are established and set in place at an early date.

One of the special requirements that apply to the PrAF and the PuAF is that the trustee must be a constitutional corporation. This is a direct reference to the Constitution of Australia, which requires such an entity to be either a financial or trading entity. Legal advice received indicates that it would be most unusual for an ancillary fund structure to meet either of the specific legal requirements to qualify as a financial or trading entity. Paragraph 8.30 of the Explanatory Memorandum of the amending Bill states that where it is the trustee's sole function of a PAF, it would be considered to be a constitutional corporation. Regretfully there is no equivalent in the amending legislation itself. It appears this was missed in drafting. ATO are aware of the technical details and have confirmed to Murray Baird of Moores Legal that pending an adjustment to the appropriate legislation they will accept corporate structures that do not meet the specific requirement.

More information in relation to tax-deductible funds in general can be found on the Add-Ministry Inc. website at www.addministry.org.au under Publications – Seminars "Tax-Deductible Funds March 2011".

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