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The effective use of Public Ancillary Funds and other DGR funds by Schools to fund recurrent and capital expenditure with deductible giving

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BACKGROUND

Schools are often familiar with the concept of philanthropic fundraising to the extent of a "Building Fund", however with adequate active fundraising by the school itself, the benefits of tax deductible gifts can be applied in a variety of ways to assist with both capital and recurrent needs. Through careful structuring of various philanthropic funds by schools, it is possible for these income streams to not only assist with fundraising for capital purposes, but also boost the recurrent income of the school.

1 PHILANTHROPIC STRUCTURES – AN OVERVIEW

As an overview, there are several key Deductible Gift Recipient (DGR) Funds which schools may operate in order to either raise funds or utilise these funds for capital or recurrent income purposes. These are:

- Public Ancillary Funds;
- Building Funds;
- Scholarship Funds;
- Libraries (often incorrectly referred to as 'Library Funds"); and
- Necessitous Circumstances Funds.

Generally, it will also be necessary to schools to establish a 'trustee company', normally a company limited by guarantee to act as trustee of the Public Ancillary Fund.

Broadly and practically speaking, the trustee company acts as trustee of the Public Ancillary Fund, which then distributes funds raised to the various other DGR funds operated by the School at its discretion, depending on the particular capital and recurrent income needs of the school in any given financial year.

2 ANCILLARY FUNDS & FUNDRAISING

In recent years, the Australian government has given considerable attention to the promotion and development of ancillary funds. Despite these Funds having strict requirements for both their establishment and continued operation, these Funds are an effective vehicle for public philanthropy for schools.

2.1 <u>What are Ancillary Funds?</u>

Ancillary funds are funds which are entitled to deductible gift recipient (DGR) endorsement, and are therefore entitled to receive donations which are tax deductible. These funds essentially operate as a tax deductible fundraising mechanism to distribute to other DGRs, and cannot engage in any other activities.

Ancillary funds fall within two categories:

- Private ancillary funds – these allow private entities to establish and donate to a charitable trust of their own, without the seeking contributions from the public, for the purpose of disbursing funds to other DGRs.

- Public ancillary funds (PAFs) – these funds are distinct from private ancillary funds in that they invite the public to contribute to the fund, and it is these funds which are generally utilised by schools to conduct their philanthropic fundraising.

There are clear public policy benefits to the effective operation of a PAF by schools - the intention of the Government is that such Funds will grow to a point of becoming self-perpetuating (or endowed), with growth occurring each year over and above minimum distribution requirements, to provide long-term solutions to schools for deficiencies in both capital and recurrent income streams.

PAFs are classified as Item 2 DGRs pursuant to the *Income Tax Assessment Act 1997* (Cth), meaning that they are a fund set up solely for providing money, property or benefits to Item 1 DGRs, or the establishment of such DGRs – a PAF can therefore not distribute funds to another ancillary fund (public or private).[1] Item 1 DGRs include most other funds, authorities or institutions with DGR endorsement, and certainly include all typical funds to which PAF disbursements may be made in a school environment.

Careful consideration should be given to the *Public Ancillary Fund Guidelines 2011* ('the Guidelines') regarding the extensive requirements for such Funds prior to their establishment and indeed throughout their operation to ensure compliance – the considerations set out below are by no means exhaustive.

2.2 Establishment of a PAF

PAFs are established by trust deed. Pursuant to the Guidelines, the Fund must be maintained as a valid trust under State legislation.[2] Being a trust, there must be a trustee for the PAF who is willing to submit to the strict requirements imposed by the ATO for the operation of the Fund.

The Guidelines require that the majority of individuals involved in the decision-making of the fund must be 'individuals with a degree of responsibility to the Australian community as a whole'.[3] The majority of directors of the trustee company must therefore be 'Responsible Persons' as defined by the ATO.[4]

The Rules of the Fund must also clearly set out the Objects and purpose of the Fund, which must be the sole purpose of providing money property or benefits to eligible entities in accordance with the Guidelines (other DGRs who are not ancillary funds).[5] The Rules must also stipulate that the Fund is established and must operate as a not-for-profit entity.[6]

In order to conduct fundraising activities, PAFs will also need to be registered with the Office of Fair Trading pursuant to the *Collections Act 1966* (Qld) or the equivalent in the State or Territory in which the PAF makes public appeals for support.

[1] Income Tax Assessment Ac 1997, 30.15

[2] Public Ancillary Fund Guidelines 2011, 8.

[3] Public Ancillary Fund Guidelines 2011, 14.

[4] Public Ancillary Fund Guidelines 2011, 15.

[5] Public Ancillary Fund Guidelines 2011, 10.1

[6] Public Ancillary Fund Guidelines 2011, 11.

2.3 Distribution requirements

Given the maintenance costs for operating a PAF and acknowledging that it can take some time to build a substantial Fund, PAFs are not required by the ATO to make distributions during the financial year in which the Fund was established or within the next 4 financial years.[7] Ideally, this allows trustees to accumulate funds in the trust to the point where the Fund is self-perpetuating.

Following this 5-year grace period, each financial year PAFs are required to distribute 4% (with a minimum distribution amount of $8,800.00) of their market value of the Fund's net assets as valued at the end of the previous financial year.[8]

3 UTILIZING OTHER DEDUCTIBLE GIFT RECIPIENTS

Once a PAF is established by a school and raising income through philanthropic donations and investments, there are a wide variety of DGRs that schools can establish for PAF funds to be distributed to in accordance with the mandatory distribution requirements.

A major benefit to utilizing a PAF for raising income to later distribute to other DGRs is the level of control that the trustee of the PAF retains in deciding where to direct distributions. Depending on the needs of the school, and the terms under which the funds were raised, distribution can be made in proportions that reflect the particular capital or recurrent funding needs of the school in any given year.

Common DGR Funds maintained by schools may include a building fund, scholarship fund, library and necessitous circumstances fund.

3.1 Building Funds

Building Funds are a principal mechanism through which schools are able to raise capital funds for the purpose of expanding, developing and maintaining school buildings.

Building Funds are established by Rules adopted by a trustee company.

3.1.1 Building Fund Requirements

School building funds must have the following characteristics:

a The Fund must be a 'public fund';

b There must be a building (or planning for a building);

c The building must be used as a school by a qualifying body; and

d The use of the fund must be for an acquisition, construction or maintenance of a building.

3.1.2 Allowable expenditure of Building Funds

Once established, a school building fund must be used solely for the purpose of providing money for the acquisition, construction or maintenance of school buildings *for the purpose of using that building as a school*. TR 2013/2 provides quite extensive

[7] Public Ancillary Fund Guidelines 2011, 19.2

[8] Public Ancillary Fund Guidelines 2011, 19

guidance as to what costs are appropriate to be paid from a school building fund, and these allowances are quite broad. Issues may arise where buildings are to be shared use with another institution, for example a church.

We also note that the cost of building and maintaining facilities that are not buildings, such as sports fields, landscaping, playgrounds and open air car parks, cannot be paid from a school building fund.

The fact that DGR funds can be used for maintenance of buildings allows some recurrent expenditure to be defrayed by DGR funds. Taxation Ruling 2013/2 provides some guidance as to disbursements that may be made from the Fund in respect of maintenance.

3.2 Scholarship Funds

Scholarship Funds are the principal means by which a school may boost their recurrent income whether through funds distributed by the PAF or given directly to the Scholarship Fund.

Scholarship Funds are established by Rules adopted by a trustee company.

3.2.1 Scholarship Fund requirements

To operate as a Scholarship Fund, a Fund must have the following characteristics:

a It is a 'public fund' (discussed above);

b It is a registered charity (ie. registered with the ACNC); and

c It is established and maintained for the sole purpose of providing funds for eligible scholarships, bursaries or prizes.

3.2.2 Recurrent expenditure – value of scholarships

The PAF distributes to the Scholarship Fund which in turn 'funds' the school in terms of 'usual fees forgone' for the 'cost' of the scholarship or bursary. In this way, general purposes income of the school is substantially increased via DGR funds. Schools can offer interest donors in "sponsoring" children who may not otherwise have the capacity to attend the school. The donors may give more if they can obtain a tax deduction on further giving.

3.3 Libraries

Often incorrectly referred to as 'Library Funds', schools may apply for DGR endorsement for their Library, allowing tax deductible giving to be utilized for the purpose of purchasing resources, and the maintenance and development of the Library's facilities and the recurrent pay of expense of Library staff.

3.3.1 Library requirements

To obtain DGR endorsement, Libraries must be registered as a charity with the ACNC.

Additionally, the following requirements apply:

- The Library must be owned or controlled by persons having a degree of responsibility to the community;
- The collection must be made available to the public (a school community is usually sufficiently public);
- It is constituted as a Library, recognised as such by other people, and conducts itself in a way consistent with such a character; and
- It is an Institution (as defined by the ATO).

3.3.2 Recurrent expenditure – all Library expenses

If separately structured as an 'Institution' (which is the basic requirement for all DGR Libraries in any event), all expenses of the Library including staff wages and subscriptions can be funded through DGR funds.

3.4 Necessitous Circumstances Funds

Necessitous Circumstances Funds are defined by the ATO as a public fund established and maintained to provide relief for persons in Australia who are in necessitous circumstances.

Necessitous circumstances refers only to financial necessity, rather than extending to need more generally due to factors such sickness, incapacity or age. Whilst the term may refer to poverty, a person need not be in abject poverty or destitution in order to be considered 'in necessitous circumstances' – simply put, a person may be considered to be in necessitous circumstances when they don't have enough financial resources to have a modest standard of living by Australian standards.

3.4.1 Recurrent expenditure – Fee Relief to Families in Necessitous Circumstances.

Likely examples in a school context may include the loss of employment for a tuition-paying parent, or an illness which puts significant financial pressure on the family resulting in the inability to meet tuition fees. Fee relief for families in need is common place in schools and generally a large "hole" in the recurrent budget. Funds that have been accumulated in a necessitous circumstances fund can be paid to the school for the cost of the fee relief provided to families in the necessitous circumstances.