PRIVATE ANCILLARY FUNDS

Structuring to achieve your philanthropic objectives can be done in various ways, including by establishing a Private Ancillary Fund (PAF). PAFs are usually established by businesses, families and individuals, in order to enable private philanthropy and to provide flexibility in making charitable donations, without the need to seek and receive contributions from the public.

In this material, we provide some background information on PAFs, explain the steps involved in establishing and maintaining these types of funds, as well as explore some of the advantages and disadvantages of PAFs.

BACKGROUND

Broadly, a PAF is a fund that has charitable purposes and is structured as a trust. It may be endorsed as a Deductible Gift Recipient, in which case it is able to make donations to certain other Deductible Gift Recipients with the donations it receives itself. Further, if it's endorsed as a Deductible Gift Recipient, donors that contribute to a PAF are able to claim tax deductions for the donations (in excess of $2 cash or $5,000 in property) which they have made to it.

Although the operation of a PAF is similar to that of a public charitable fund, the public must not be invited to make donations to it – it is private. Although a PAF may receive donations from the public, such must not be a significant source of its donations.

ESTABLISHING A PAF

A PAF's governing document (usually a trust deed) should outline its purpose, as well as the rules surrounding its operation. This includes a requirement that the PAF is maintained so that donations received by it are for charitable purposes.

A trustee must be appointed to maintain the PAF. Although one of the duties of the trustee will be to protect the property of the fund, the trustee cannot be indemnified for any loss attributable to:

- its dishonesty, or that of its employees, officers or agents
- its gross negligence, or that of its employees, officers or agents, or
- a deliberate act or omission known by the trustee, or its employees, officers or agents, to be a breach of trust.

Following the execution of the PAF's trust deed, applications are made to the Australian Taxation Office (for Deductible Gift Recipient, Income Tax Exempt Charity, Australian Business Number, Tax File Number, GST, tax withholding and/or Fringe Benefits Tax purposes) and the Australian Charities and Not-for-profits Commission (for charitable status).

ROLE OF THE TRUSTEE

The trustee of a PAF must be a corporation. At least one of the individuals involved in the decision-making of a PAF must have some degree of responsibility within the Australian community. This requirement may be met where a director of the corporate trustee of a PAF is actively involved in its ongoing management.

However, that individual cannot be a founder of the PAF, nor a major donor to it (nor be an associate of a founder or major donor). Additionally, an individual who has been convicted of an indictable taxation offence must not be a director of a trustee of a PAF.

The trustee of a PAF must exercise the same degree of care, skill and diligence that a prudent individual would exercise when managing the affairs of others, and is subject to common law principles and relevant State and Territory trustee laws which regulate its conduct.

The trustee of a PAF (or its employees, officers or agents) will be personally liable for any loss or liability incurred by the PAF, if it's attributable to its dishonesty, gross negligence or wilful act or omission.

DONORS

A PAF must not:

- solicit donations from the public, or
- accept donations in any financial year which total more than 20% of the market value of its assets from entities other than its founder, or the associates, employees, relatives or deceased estate of the founder.

In this context, the fund must issue a receipt for every gift it receives. Such receipt must include the name and Australian Business Number of the PAF, the name of the donor and a statement that the receipt is for a gift received by the PAF.

DISTRIBUTIONS

In each financial year, a PAF must distribute at least:

- 5% of the market value of its assets at the end of the prior financial year, or
- $11,000 if fund expenses have been paid from the PAF's income and assets (or the remainder of the fund, if it is less than $11,000).

The provision of property or benefits can satisfy these distribution requirements. In those circumstances, the market values of such property or benefits will be used to determine the value of the distributions. For example, if a PAF makes a gift of a painting to a museum or lets office space at a discount to the market price, it would include the market value of the painting and the rental discount in calculating its annual distribution.

Failure to make a distribution or an adequate distribution (of more than $1,000) may result in penalties. These penalties may be reduced, where the Commissioner of Taxation requests a trustee to rectify by making distributions and the PAF promptly does so.

The trustee of a PAF must develop and maintain a written distribution strategy, which details the quantum of its expected distributions and their recipients. Penalties may also apply for a failure to prepare an appropriate distribution strategy.

In addition, the trustee of a PAF must develop and maintain a written investment strategy, which addresses the key objectives, potential risks and the investment methods which it will adopt. All subsequent investment decisions must then be made in accordance with this strategy. Failure to implement an investment strategy or to have regard to the relevant matters described in the *PAF Guidelines* (see www.legislation.gov.au/Details/F2019L01227), e.g. risk, liquidity and diversification, when developing the investment strategy may attract further penalties.

A PAF must not carry on a business. In addition, the trustee of a PAF is expressly prohibited from:

- borrowing money or maintaining an existing borrowing of money
- making investments on a non-arm's length basis, and
- providing security over or in relation to assets of the fund.

There is a requirement that the assets of a PAF (other than real property) are valued prior to the lodgement of each of its income tax returns (which it is required to prepare and lodge annually). The value of the assets of a PAF which are real property must be estimated at least once every 3 years by a certified and independent valuer.

COMPLIANCE

A PAF must prepare annual financial statements at the end of each financial year. This material must be submitted to the Australian Taxation Office (if not already provided to the Australian Charities and Not-for-profits Commission), together with the PAF's annual income tax return for the relevant financial year.

The PAF's financial statements must be prepared in accordance with Accounting Standards and audited/reviewed by a registered company auditor. Failure to comply with these annual requirements may also result in penalties.

WINDING UP A PAF

If a fund winds-up or ceases to be a PAF, any surplus assets must be distributed to a Deductible Gift Recipient. Appropriate notifications should also be made to the Australian Taxation Office and the Australian Charities and Not-for-profits Commission.

MORE INFORMATION

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