

1 Educational scholarship funds as deductible gift recipients

On 1 July 2006, a public fund for the provision of educational scholarships, prizes and bursaries was included as a category of deductible gift recipient (DGR) in Division 30-B of the Income Tax Assessment Act 1997 (ITAA 97) (as item 2.1.13 of the table in section 30-25(1)).

2 What is required to be an 'educational scholarship fund'?

The 'educational scholarships' category applies to funds which meet the conditions specified in ITAA 97. These conditions relate to specific requirements for the new category (educational purposes requirements) and requirements relating to its categorisation as a public fund.

In summary, the **educational purposes** requirements are:

- 1 the fund's purposes must be charitable;
- 2 the fund must be to **solely** provide money for scholarships, bursaries or prizes;
- 3 the recipients must be Australian citizens or permanent residents of Australia;
- 4 the scholarship, bursary or prize must be open to at least an entire state or territory of Australia, or to a region of at least 200,000 people;
- 5 the scholarship, bursary or prize must be to promote the recipient's education in either or both:
 - (a) a pre-school, primary, secondary or tertiary course;
 - (b) an overseas educational institution, by way of study of a component of a pre-school, primary, secondary or tertiary course;
- 6 the scholarship, bursary or prize must be awarded on merit or for reasons of equity.

The educational scholarship fund must also be a public fund. In summary, the requirements to be a **public fund** are:

- 7 the fund must be established as a separate fund, generally by a separate trust deed;
- 8 the fund must invite and receive donations from the public;
- 9 the fund must be administered by a majority of people who meet the ATO's 'community responsibility' test;
- 10 the fund must operate a gift fund to separate gifts from fundraising or sponsorship money.

3 Educational purposes

3.1 Educational purposes requirements

The requirements in ITAA 97 specific to educational scholarship funds are:

- 1 The fund's purposes must be charitable.
- 2 The fund must be established and maintained for the sole purpose of providing money for eligible scholarships, bursaries or prizes.
- 3 The recipients must be Australian citizens or permanent residents of Australia.
- 4 The scholarship, bursary or prize must be open to at least an entire state or territory of Australia, or to a region of at least 200,000 people.
- 5 The scholarship, bursary or prize must promote the recipient's education in either or both:
 - (a) a pre-school, primary, secondary or tertiary course;
 - (b) an overseas educational institution, by way of study of a component of a pre-school, primary, secondary or tertiary course.
- 6 The scholarship, bursary or prize must be awarded on merit or for reasons of equity.

3.2 What is required to be charitable?

In order for the fund to be charitable, its sole purposes must be charitable, it must be not for profit and must be for the public benefit.

If it is to operate and be part of an existing charitable institution, it can be established as an internal fund with rules meeting the requirements for educational scholarship funds. Otherwise it will need to be set up as a separate trust with a trust deed and be separately endorsed as a Tax Concession Charity as a charitable fund by the ATO (under item 1.5B of the table in section 50-5 of ITAA 97).

The fund must be **not for profit** so it must have, in its rules, provisions specifying that no distributions of profit can be made to the trustee or its members or directors nor can any surplus on a winding up be made to the trustee or its members or directors.

The fund must be **for the public benefit** in order to be charitable. It cannot be for private benefit and cannot be controlled by government, local or state, eg:

- 1 scholarships must not be limited to children of employees of a particular company or, of parents who belong to a particular club;
- 2 scholarships should not go to relations of the board of the trustee;
- 3 there must be no reduction of school fees if a donation is made to the scholarship fund;
- 4 state school or local council appointees should not control the board of the trustee, in their capacity as representatives of the government.

3.3 Can the fund have other purposes?

The **sole** purpose of an educational scholarship fund must be to provide money for scholarships, bursaries or prizes which meet the requirements in ITAA 97.

It must not be established for an extrinsic or ulterior purpose, ie, to benefit the students of one particular school, to benefit the students in a suburb or region of less than 200,000, as a means of recruiting graduates, as a benefit offered to children of employees.

If a scholarship fund is established for another purpose (irrespective of the objects as stated in the trust deed), eg a broader purpose, for which the existence of the fund is part of a wider scheme, or a specific purpose, where the fund provides a way to achieve an end, it will not meet the requirement of being established and maintained for the sole purpose of providing money for scholarships.

The extrinsic purpose may be apparent from the conditions or eligibility criteria attached to the scholarships, eg a condition that at the end of the study the recipient works for a particular employer or in a particular region.

3.4 What is promoting education?

The scholarship, prize or bursary will generally promote education by rewarding achievement in education and therefore encouraging achievement and greater effort in education, or it will assist in providing or achieving education by the provision of monetary assistance or equipment.

Due to the requirement to promote education prizes will need to be related to achievement in education. Scholarships which pay for education may be awarded for other reasons of merit (or equity) though promoting education must clearly be the purpose of the scholarship eg

- a scholarship to study at a secondary school which is eligible to those who are at state or national level of Scottish Highland dancing – is not likely to meet the requirements of an educational scholarship fund as it is more likely to be for the promotion of Scottish Highland dancing rather than education
- however, if the scholarship was awarded for, or included as part of the eligibility criteria, excellent football skills and the school included football as part of its curriculum then it is likely to meet the requirements of an educational scholarship fund.

3.5 Can it be any education, subject or course?

Only an **approved course** as defined in the GST legislation can be the education being promoted by the scholarship, bursary or prize. It cannot promote education in subjects or courses not covered by this definition.

A pre-school course, primary course, secondary course or tertiary course which is GST free by virtue of being covered by the definition in the GST Act, is eligible. As well as, study at an overseas educational institution where the course is a component of an approved Australian course.

Most of these courses must be recognised under State or Territory law, or be provided by accredited institutions:

- 1 **Pre school course** is a course delivered:
 - in accordance with a pre school curriculum recognised by the relevant State or Territory education authority, or
 - by a school recognised as a pre school under State or Territory law.
- 2 **Primary course** is a course of study or instruction delivered:
 - in accordance with a primary curriculum recognised by the relevant State or Territory education authority, or
 - by a school recognised as a primary school under State or Territory law (as in practice, schools may vary the delivery of the primary curriculum), or
 - any other course that the Federal Education Minister has determined is a primary course.

- 3 **Secondary course** is a course of study or instruction that is a course determined by the Federal Education Minister under the *Students Assistance Act 1973*, or any other course of study or instruction that the Federal Education Minister has determined is a secondary course.

Under the *Students Assistance Act* the current determination was made by the Education Minister in October 2002 and defines a secondary course as:

- a course accredited as a secondary course by the relevant State or Territory authority and provided by a recognised secondary school, a registered training organisation, a higher education institution or a special school (being a school conducted primarily for students with a disability.)
- English as a second language course conducted by a secondary school or a special school
- a preparatory course being an accredited vocational education and training course providing remedial education or preparatory activities to enable participation in, and aims to achieve basic skills and standards or prepare students for, further education or a preparatory course offered by higher education institutions designed to assist people gain entry into a higher education course (including enabling and bridging courses), provided the preparatory course is conducted by a secondary school, registered training organisation, higher education institution or special school
- a course leading to an accredited secondary course qualification involving accredited secondary and accredited vocational education and training course subjects, conducted by a secondary school, registered training organisation or higher education institution
- school based apprenticeship or traineeship program conducted by a secondary school.

- 4 **Tertiary course** is a course of study or instructions that the Federal Education Minister has determined as a tertiary course for the purposes of the *Students Assistance Act 1973* and any other course which the Federal Education Minister determines is a tertiary course.

The determination by the Federal Education Minister in October 2002 covers:

- pre-vocational courses conducted by registered training organisations (RTOs)
- English as second language course conducted by RTOs, higher education institutions and any other body approved by the relevant State or Territory authority to conduct the course
- a vocational education and training program that is not a secondary course conducted by a higher education institution or an RTO
- an under-graduate or post-graduate accredited higher education course conducted by a higher education institution and RTO
- a program of assessment based study provided through the Open Learning Agency, Melbourne, conducted by a higher education institution participating in the open learning program or an RTO participating in the open learning program.

3.6 What is included in the definition of an education course?

The ATO has issued a tax ruling explaining the GST definitions for pre-school, primary, secondary and tertiary education courses. GSTR 2000/30 provides that the supply of curriculum related activities is part of the supply of an education course. Curriculum

related activities include visits by organisations such as an animal farms, theatre companies and science fairs. Also part of an education course is instruction by external tutors or any third parties engaged by the school to deliver part or all of the curriculum. It includes remedial and advanced (extension) teaching provided by the school for individual students.

Therefore if a school engages an external provider of music lessons to provide music lessons to the students as part of the curriculum, then this is part of the education course. However, if the school allows an organisation to offer private music lessons to its school students but the lessons are arranged independently by the parents and are not delivered by the school as part of its curriculum, then these will not be part of the education course.

3.7 On what basis must the scholarship be awarded?

The scholarship, bursary or prize must be awarded on **merit**, or for reasons of **equity**. The eligibility criteria for the scholarship, bursary or prize and its application will show whether it is awarded on merit or for reasons of equity.

As the scholarship, bursary or prize must promote education in approved courses, the merit must be connected with education in an approved course. In order for merit to be a basis for the award of a prize and meet the criteria of promoting education in an approved course, it will generally need to be academic merit. Scholarships and bursaries, however, can consider non-academic merit provided it is still relevant in the conduct of the education course.

Reasons of equity will generally cover disadvantage or financial hardship or special needs arising from disability, ethnicity or geographic location.

3.8 Who must it be open to?

It must be open to Australian citizens or permanent residents of Australia, in Australia, a state, a territory or a region of at least 200,000 people.

The eligibility criteria or application forms should make it clear that only people who are Australian citizens or permanent residents of Australia can apply for and receive the scholarship, bursary or prize.

In estimating whether a region has a population of at least 200,000 people, the Australian Bureau of Statistics information or other reasonable basis can be provided and relied on.

For example, a scholarship, bursary or prize will satisfy these requirements if it is open to all students studying Latin at secondary schools within a region of at least 200,000 people. There does not need to be 200,000 people meeting the criteria that they are secondary school students studying Latin.

A school may offer a scholarship or bursary throughout Australia or a state to study at that particular school or for study in a particular course.

It is not possible to limit the scholarship, bursary or prize to students at a particular school or members of a particular association or club.

3.9 Can an educational scholarship fund operate several scholarships?

A scholarship fund may operate several scholarships, bursaries and prizes, in respect of different donors, schools or courses, if the trustee decides to do this.

An educational scholarship fund may wish to establish different internal management accounts (sometimes referred to as 'sub-funds' in public ancillary funds) to name a particular scholarship after a significant donor or a significant teacher, or to identify a particular scholarship or school or region.

Care must be taken in operating these accounts – this is covered under Operations in this paper.

4 Public fund requirements

The public fund requirements are familiar to those involved with school building funds or ancillary funds, which are grant making foundations. The requirements are set out in a tax ruling TR 95/27.

4.1 Does the public have to contribute?

The public character of a 'public fund' comes from the involvement of the public in contributing to and managing the fund.

The public must be invited to contribute and must in fact contribute to the fund.

If the fund has not originated from a public initiative, ie it was created by an individual, family or small private group or business, then it is likely that it will have to attract significant public financial contributions, as well as having public involvement in the administration, to satisfy the public character.

If the fund has originated from a public initiative, has substantial involvement of the public participating in its administration, and is genuinely open for contribution by the public, then comparatively few actual contributions by persons not associated with the settlor or promoter of the trust fund, may be enough to satisfy the requirement of public character.

4.2 Who must be on the board of the trustee?

If the fund is a separate trust, the trust will generally have a company limited by guarantee as the trustee of the trust.

As part of the public component of a public fund, the ATO requires the majority of the people responsible for managing and administering the fund, which means the board of an incorporated trustee where there is a separate trust, to have a degree of responsibility to the general community, often referred to as the "community responsibility test".

This requirement should be set out in the trust deed and includes an individual who:

- 1 performs a significant public function;
- 2 is a member of a professional body having a code of ethics or rules of conduct;
- 3 is officially charged with spiritual functions by a religious institution;
- 4 is a director of a company whose shares are listed on the Australian Stock Exchange;
- 5 has received formal recognition from government for services to the community;
or
- 6 is approved as a Responsible Person by the ATO.

Explanations of the meanings of these categories are included in the attachment to this paper.

4.3 Gift fund

The ITAA 97 requires DGRs to maintain a gift fund. The purpose of this requirement is to quarantine gifts, and money received because of gifts (eg interest and dividends from the investment of gifts), from any other receipts and assets of the trust.

An educational scholarship fund will need a separate bank account for gifts and income from the investment of gifts, and another bank account for other receipts such as those from fundraising events and sponsorship.

A gift must be made:

- 1 voluntarily;

- 2 without receipt, directly or indirectly, of any material gain; and
- 3 altruistically.

The rules of the fund must specify that if the DGR status of the fund is revoked or the fund is wound up, the assets of the gift fund must go to a charitable DGR.

Taxation Ruling TR 2000/12 and its addendum outlines the views of the ATO on the operation of gift funds.

5 Operations

5.1 Activities

The activities for an education scholarship fund must be restricted to those necessary to carry out the educational purposes. They can include marketing and fundraising, administration, investment, deciding on scholarships, bursaries and prizes, setting and reviewing eligibility criteria (within the requirements in the ITAA 97), advertising for applications, researching, assessing, awarding the scholarships and monitoring the progress if the scholarship is of an ongoing nature.

The money can be given directly to the individual or it can be given to a school or other organisation for the purposes of the scholarship. The trustee must ensure as far as reasonable that the money is applied for the purposes of promoting education on the terms provided by the trust.

5.2 Administration expenses

Funds can be used for reimbursement of expenses or proper remuneration for services. The trust instrument may specify a level of remuneration, if any, for the trustee. If not specified, the common law principle is that a trustee may not profit from its position. A trustee is entitled to reimbursement of the reasonable costs and expenses relating to the administration of the trust.

5.3 Accumulation

The trust deed may specify that all income must be distributed or set percentage amounts which must be distributed.

In the absence of a strict requirement in the deed, the trust fund must be applied for its purposes. Not all of the income, gifts and receipts need to be distributed but not all of it can be accumulated.

The ATO has accepted that, as a minimum, 20% of the income of a public fund, other than gifts, government grants and any other voluntary transfers of property can be accumulated, ie 80% of income (which does not include, for this calculation, gifts, government grants and other voluntary transfers of property) must be distributed. The gifts, government grants and other voluntary transfers of property can be added to the capital base.

Alternatively rather than 20% of the income, a percentage equal to CPI can be retained from the income.

This issue is subject to further views of the ATO in any tax ruling it may release on educational scholarship funds.

If the ancillary fund is to build a significant capital base, the ATO's approval can be sought for a specific accumulation plan.

5.4 Trustee's duties

The main common law duties of a trustee can be briefly outlined as:

- 1 to exercise the powers in good faith and for a proper purpose;
- 2 to protect and preserve trust property;
- 3 to acquaint themselves with the terms of the trust;
- 4 not to delegate or fetter their powers or discretions except as permitted in the trust instrument;
- 5 to invest the trust funds only as permitted by the trust deed and the law; and
- 6 to avoid a conflict of interest.

5.5 Investments

Public funds may invest trust fund money only in a way that a law of the Commonwealth, a state or territory allows trustees to invest trust money.

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 persons¹. 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.

In making an investment, a trustee must have regard to a number of matters including the desirability of diversifying trust investments². It seems that this requirement would often prevent a public fund 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 public fund, 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.

5.6 Advisory committees

The trustee may set up advisory committees to assist in its carrying out its activities. The advisory committees may assist in recommending to the trustee suitable eligibility criteria and assist by recommending appropriate recipients of the scholarships, bursaries or prizes.

The trustee must not delegate its discretion to make the decision to the advisory committee. The advisory committee's role is to review and advise or make recommendations only.

¹ 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).

² 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)

5.7 How do separate management accounts or sub funds operate for separate scholarships?

It is possible for funds to establish “sub-funds” or management accounts for the purpose of managing different scholarships, bursaries or prizes or different donors or groups of donors who may want to have input in an advisory fashion in assisting set the eligibility criteria or scholarship.

The ability to set up management accounts and their restrictions in operation may be expressly permitted in the trust deed. A sub-fund is not separate from the trust fund. It is a management account set up within the trust fund by the trustee to track donations and outgoings relevant to a particular scholarship, bursary or prize.

Extreme care must be taken that these sub-funds do not become separate trusts or funds, as the consequence is that tax deductibility status will not be available for gifts to that fund.

The ATO has issued a Taxation Determination TD 2004/23³ setting out the limitations of operating sub-funds in ancillary funds but this would apply equally to the educational scholarship funds.

Requirements for operating sub-funds are:

- 1 It is essential that sub-funds are not held out to be and are not operated as separate funds in their own right, ie the trustee must not be under any obligations or give any assurances to a donor in relation to a sub-fund. The trustee must retain the discretion as to the conduct, operation and awarding of the scholarships, bursaries and prizes.
- 2 Sub-funds must:
 - clearly form part of the whole trust fund;
 - not have separate purposes, ie they are no more than internal management accounts;
 - not be separately accounted for in the statutory financial statements of the trust fund (though separate internal management accounts can be maintained); and
 - not be separately invested.
- 3 A donor cannot direct the trustee to apply the money in a particular sub-fund or in a particular manner. It is up to the trustee to decide where to apply, and what to do with, a donation and the income from the trust. A trustee cannot agree to be bound by any direction from the donor as to awarding or eligibility of the scholarship, bursary or prize, or give an assurance that a request will be followed.

Particular care must be taken not to allow:

- 1 references in marketing material to the donor directing the application of the sub-funds (rather than requesting or stating a preference);
- 2 oral or written statements that the trustee will always comply with the donor's requests or the donor may direct the trustee as to selection of the recipient of the scholarship, bursary or prize;
- 3 oral or written statements or understandings that the trustee will not distribute money from a sub-fund without first obtaining and considering a request or preference stated by the donor;

³ See: <http://law.ato.gov.au/pdf/td04-023.pdf>

- 4 the trustee being required to inform the donor if it wishes to depart from the donor's stated preference;
- 5 a donor being orally advised not to be too concerned about the forms for donating as we always follow the donor's preferences provided they come within the terms of the trust.

6 Further assistance

There is information in the ATO's gift pack on this category of DGR. Further information may be available from time to time on the ATO website for non-profit organisations or by contacting Freehills.

Alice Macdougall
Freehills
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Attachment 1 - Explanations of the paragraphs in the definition of Responsible Persons

This may be subject to the ATO's views. It is drawn from TR 95/27 as updates from the guidelines for environmental organisations and for cultural organisations.

- 1 performs a significant public function
 - persons known to a broad section of the community because they perform a public function
 - people who hold (or have held) other public positions (ie appointments made by Government Ministers, member of the Australia Council)
 - trustees or board members of a non-profit school or college
 - justices of the peace
 - judges/magistrates
 - public servants with more than five years service
 - persons holding public or elected office: mayors, town clerks, councillors and members of parliament
 - school principals, teachers in senior positions, senior academics (professors, deans, principal lecturers – appointments made by chancellors), senior academics or senior teachers with more than five years experience
 - past or present office holders of other community organisations (President of Parent and Citizens Association, Secretary of Lions Club, Treasurer of Rotary)
 - appointees of a Chief Justice of the Supreme Court
- 2 is a member of a professional body having a code of ethics or rules of conduct
 - solicitors, accountants (must be CPA, ASA, NIA or ICA registered), medical practitioners and other professional persons (who belong to a professional body, which has a professional code of ethics and rules of conduct, eg Medical Registration Board)
- 3 is officially charged with spiritual functions by a religious institution
 - members of the clergy, church authorities or equivalent or similar positions in any religious institution
- 4 is a director of a company whose shares are listed on the Australian Stock Exchange
- 5 has received formal recognition from government for services to the community
 - people with honours (AO, AM, OBE, etc)
- 6 is approved as a Responsible Person by the Commissioner
 - generally people who have held a responsible and preferably public position or have had significant involvement in the community.