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1 June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Tax White Paper Process – Tax Discussion Paper

Please find attached Philanthropy Australia's submission in response to the Tax Discussion Paper.

If the Treasury wishes to discuss the matters raised in this submission further, please contact Krystian Seibert, Policy & Research Manager, on (03) 9662 9299.

Yours Sincerely

Chris Wootton
Acting CEO

Philanthropy Australia Submission – Tax Discussion Paper

Key Points

- This submission sets out Philanthropy Australia's response to the Tax Discussion Paper released as part of the Tax White Paper process.
- Philanthropy Australia notes that the Australian Government has established the Prime Minister's Community Business Partnership.
- The Partnership is also considering options to enhance the taxation and regulatory framework for philanthropy, and therefore we would encourage coordination between the Tax White Paper process and the work of the Partnership.
- The taxation framework for philanthropy is critical to supporting a vibrant and growing culture of giving in Australia.
- Therefore Philanthropy Australia believes that this taxation framework should be based around principles of simplicity, clarity, certainty and ensuring there are appropriate incentives to encourage philanthropy.
- Philanthropy Australia's submission is informed by these principles and addresses a number of issues.
- Firstly, there are certain structural components of the existing taxation framework which work well.
- Both the income tax exemption and the dividend imputation system, including the refundability of imputation credits, are critical to the growth of philanthropy in Australia.
- Philanthropy Australia does not believe that any change to these is warranted.
- Secondly, although broadly speaking, Australia has a set of taxation arrangements which are reasonably well suited to growing philanthropy, one major exception is the taxation and regulatory framework for international philanthropy.
- Philanthropy Australia believes that we need an enhanced and simplified taxation and regulatory framework for international philanthropy, which provides certainty and supports the contribution which Australian philanthropy can make beyond our borders.
- Thirdly, there are a number of new taxation arrangements which Philanthropy Australia believes would support the growth of philanthropy.
- Broadening and simplifying the deductible gift recipient framework would make it easier to access philanthropy.
- In the event that such a structural reform is not undertaken, a new category should be created within the existing DGR framework for 'philanthropic infrastructure entities' whose purpose is to support and grow philanthropy.
- The introduction of Charitable Remainder Trust and Charitable Gift Annuity structures in Australia should be examined further, given how they could grow planned giving in Australia.
- There would also be merit in exploring the introduction of a tax incentive for companies to match employee workplace giving donations, to grow workplace giving in Australia.

1. Introduction

Philanthropy Australia is the national peak body for philanthropy and is a not-for-profit membership organisation comprising around 800 Members and Associates. Our vision is for 'A More Giving Australia' and our mission is to 'Lead an innovative, growing, influential and high performing philanthropic sector in Australia.'

Philanthropy plays an important role in Australia, supporting initiatives and organisations which help build more resilient, inclusive and vibrant communities. The philanthropic sector is diverse – our Members include trusts and foundations, businesses, families and individuals who want to make a difference through their own philanthropy and encourage others with their giving.

The sector is also changing, with new and innovative forms of philanthropy emerging such as giving circles, and an increased focus on impact leading to closer collaboration both within the sector and with partners within the broader not-for-profit sector and beyond.

Philanthropy is not just a financial activity – it includes the planned and structured giving of time, information, goods and services, voice and influence, as well as money. Through its financial contribution towards a broad range of charitable causes, philanthropy supports the development of new and innovative approaches to addressing complex social and environmental challenges.

In 2012-13 philanthropy in its various forms accounted for more than $5 billion of the not-for-profit sector's income.[1] Giving structures such as private and public ancillary funds are playing an increasingly significant role within philanthropy, with nearly 3000 such funds in existence, holding over $4 billion in assets and distributing over $500 million in 2012-13.[2]

It is an exciting time for philanthropy in Australia. The sector is growing in size, but there is still much scope to inspire more philanthropy in Australia.

For example, of those taxpayers with a taxable income above $1 million per year, 40 per cent didn't claim a single tax deductible gift in 2012-13. When it comes to workplace giving, fewer than 5 per cent of employees who can access a workplace giving program actually donated through one.[3]

Government and policy makers recognise the importance of growing philanthropy, and initiatives such as the re-established Prime Minister's Community Business Partnership are very welcome developments in this regard.

The taxation framework for philanthropy is critical to supporting a vibrant and growing culture of giving in Australia. Philanthropy Australia believes that this taxation framework should be based around principles of simplicity, clarity, certainty and ensuring there are appropriate incentives to encourage philanthropy.

Philanthropy Australia's submission in response to the Tax Discussion Paper (Discussion Paper) is informed by these principles, and is divided into a number of sections.

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[1] Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13, Australian Bureau of Statistics, June 2014. Available here: http://www.abs.gov.au/AusStats/ABS@.nsf/MF/5256.0

[2] Taxation Statistics 2012-14, Australian Taxation Office, April 2015. Available here: https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2012-13/

[3] Above No.2

Section two of the submission considers the importance of retaining important structural components of the existing taxation framework, such as the dividend imputation system and the refundability of imputation credits. Section three considers enhancements to the existing taxation framework, and ways in which the framework could be simplified to encourage more philanthropy. Section four considers new taxation arrangements which could support the growth of philanthropy.

Philanthropy Australia notes that as pointed out above, the Australian Government has established the Prime Minister's Community Business Partnership. The Partnership is also considering options to enhance the taxation and regulatory framework for philanthropy, and therefore we would encourage coordination between the Tax White Paper process and the work of the Partnership.

2. Structural Components of the Existing Taxation Framework

Philanthropy Australia believes that broadly speaking, Australia has a set of taxation arrangements which are reasonably well suited to growing philanthropy.

Tax effective giving structures such as private and public ancillary funds provide a good basis for structured giving. The availability of pre-tax workplace giving arrangements provides an attractive way employees can give through their pay.

However, whilst the basic foundations for growing philanthropy are there, Philanthropy Australia certainly does not believe that the existing taxation arrangements are without deficiencies, and there are various improvements which would enhance the existing taxation framework and help support further growth in philanthropy.

Some of these improvements involve relatively simple and inexpensive regulatory or legislative changes, such as those outlined in Philanthropy Australia's 'Early Wins to Grow Philanthropy and its Impact' submission to the Prime Minister's Community Business Partnership.[4]

Philanthropy Australia does not propose to discuss these 'Early Wins' in more detail in this submission, however we underline the importance of implementing the taxation related 'Early Wins' in order to address existing barriers to philanthropy within the taxation framework.

In particular, we emphasise the importance of allowing public ancillary funds to receive distributions from other ancillary funds, which is currently a barrier to giving.

Other improvements may be less simple, but still worthwhile. These are discussed in sections three and four of this submission.

However, before examining the need for change to some aspects of the taxation framework for philanthropy, Philanthropy Australia would emphasise there are certain important structural components of this framework where no change is warranted.

These include the income tax exemption, as well as the dividend imputation system and in particular the arrangements which allow for the refundability of imputation credits.

In addition, although no scaling back of access to deductible gift recipient status is warranted, broadening and simplifying the deductible gift recipient framework is necessary. This is discussed in section four of this submission.

[4] 'Early Wins to Grow Philanthropy and its Impact', Philanthropy Australia, November 2014. Available here: http://www.philanthropy.org.au/images/site/blog/Early_Wins_to_Grow_Philanthropy_and_its_Impact.pdf

The Income Tax Exemption

The income tax exemption is a vital tax concession which underpins philanthropy in Australia.

On p.126 of the Discussion Paper, a comment is made that:

> *. . . there appears to be no clear rationale underlying this exemption.*

Philanthropy Australia would point out that conversely, there is no clear rationale for removing this exemption.

Income is generally taxed where it is directed towards *private benefit*, but philanthropic trusts and foundations and other charities exist for the *public benefit* and apply their income towards charitable purposes. The exemption allows for more funds to be applied towards these charitable purposes, for the benefit of the broader community.

Therefore Philanthropy Australia does not believe that any change to the income tax exemption is warranted.

Recommendation 1

That no changes are made to the income tax exemption for philanthropic trusts and foundations and other charities.

Dividend Imputation and 'Refundable Franking Credits'

As the Discussion Paper points out, dividend imputation was introduced in 1987 to relieve double taxation. This is achieved by ensuring that distributed corporate profits face only one layer of tax, equal to the marginal tax rate of the resident shareholder that receives a share of the profits through dividends.

In 2000, the former Treasurer, the Hon Peter Costello MP, introduced reforms to the dividend imputation system to make imputation credits refundable for some taxpayers, including registered charitable and deductible gift recipient organisations.[5] These are commonly referred to as 'refundable franking credits'.

Given that registered charitable organisations, such as philanthropic trusts and foundations, are income tax exempt, they are eligible for a refund of the full value of franking credits from the Australian Taxation Office (ATO).

Philanthropy Australia is of the strong view that the existing refundable franking credit arrangements applying to philanthropic trusts and foundations and other charities should be retained. No changes should be introduced which may have an adverse impact upon philanthropy, and by extension the various charities and charitable causes supported by philanthropy.

The reasons for this are twofold.

Refundable Franking Credits and the Income Tax Exemption

Because of the charitable purpose of philanthropic trusts and foundations and the fact that their funds are applied for public rather than private benefit, they are entitled to an income tax exemption.

[5] 'Refunding Excess Imputation Credits to Charities', Treasurer of Australia, 13 April 2000. Available here: http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2000/024.htm&pageID=003&min=phc&Year=2000&DocType=0

Philanthropic trusts and foundations generate income in various ways, but most commonly it is by investing their corpus in a variety of asset classes including equities, property, fixed interest and cash. Any returns from these investments, in the form of capital gains, dividends, rents, or interest, are exempt from income tax. These returns can then be applied to support important charitable causes in the community.

The availability of refundable franking credits is relevant in the case of dividend income, and is consistent with this income tax exemption. That is because refundable franking credits ensure that no income tax is paid either directly or indirectly by the philanthropic trust or foundation.

If refundable franking credits were no longer available, then this would in effect impose a 'philanthropy tax' – philanthropic trusts and foundations would no longer be fully income tax exempt as they would be indirectly paying tax on some of their income through the corporate taxation system.

This would offend the principle that where funds are applied for charitable purposes for the public benefit, they should be exempt from income tax.

In pointing this out, it is important to emphasise that in the case of philanthropic trusts and foundations, the debate around the dividend imputation system does not involve questions about double taxation. Rather it involves questions about whether these organisations are entitled to be fully income tax exempt rather than just partially.

Refundable Franking Credits and Support for Charitable Causes

When announcing the introduction of refundable franking credits in 2000, the then Treasurer, the Hon Peter Costello MP, stated that:

> *The Government's announcement will provide a significant financial boost (around $50 million annually) to charities and they will therefore be in a position to provide more services and assistance to their beneficiaries.*[6]

This was recognition of the fact that the availability of refundable franking credits will make more funds available to support charities and charitable causes in the broader community. This has indeed been the case.

Based on ATO data, between 2001-02 and 2013-14, refundable franking credits have provided a cumulative total of over $5.2 billion dollars to philanthropic trusts and foundations and other charities. The growth in this income source is illustrated in Table 2.1.

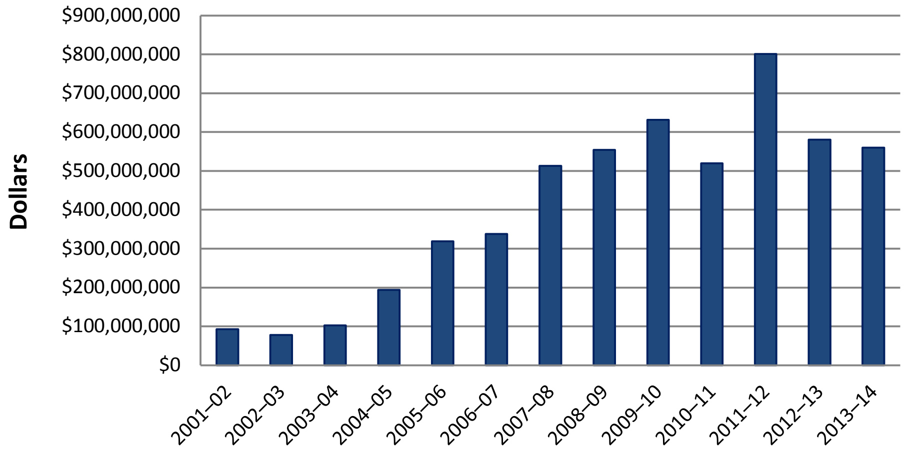
As is evident from Table 2.1, the value of refundable franking credits grew considerably between 2001-02 and 2009-10.

In 2013-14, the value of refundable franking credits claimed was just under $560 million. This is $560 million which has been available to be applied towards supporting charities and charitable causes in our community.

If refundable franking credits were no longer available, this would mean a drastic reduction in income to philanthropic trusts and foundations and other charities of more than half a billion dollars per year.

Although it would have a major impact on the operations of philanthropic trusts and foundations, the second round impacts would be even more devastating.

[6] Above No.5



Source: ATO

Figure 2.1: Refundable Franking Credits 2001-02 to 2013-14

As outlined using practical examples below, there would be a very large decrease in the amount of grants philanthropy can provide to charities and charitable causes.

At a time when government funding for charities is being reduced, and there is an increased reliance on philanthropy and other non-government funding sources, this would have very negative consequences for charities as well as the broader community.

Figure 2.2 provides a case study which illustrates this impact at the level of an individual trust or foundation, showing the importance of refundable franking credits as a source of income for philanthropic trusts and foundations, and the impact upon grants to charities and charitable causes if refundable franking credits were no longer available.

Total Refundable Franking Credits Received	$2.05 million
Refundable Franking Credits as a Percentage of Operating Surplus (Granting Income)	35%

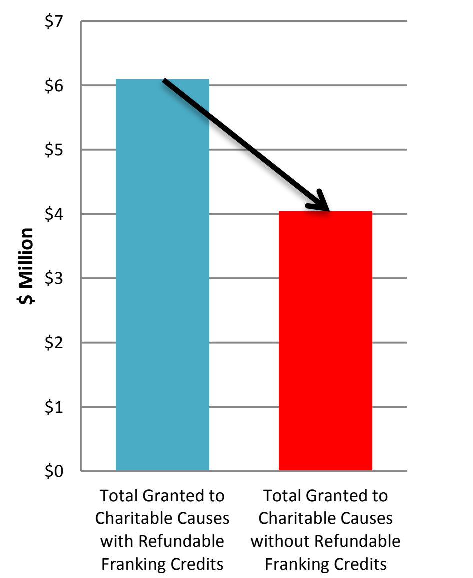


Figure 2.2: Refundable Franking Credits – A Case Study of a Large Victorian Based Philanthropic Trust

In financial year 2014, this large Victorian based philanthropic trust received $2.05 million in refundable franking credits. This equated to 35% of income available for granting. Therefore if refundable franking credits were no longer available, based on 2014 figures, granting would be reduced from $6.1 million to $4.05 million.

Although this is just one philanthropic trust, it is representative of many other similar philanthropic trusts and foundations around Australia in terms of the impact of removing the availability of refundable franking credits.

This is evident in Figure 2.3, which provides data from a number of other philanthropic trusts and foundations around Australia, including the value of refundable franking credits claimed and what this represents as a percentage of their granting income.

	Value of Refundable Franking Credits Claimed in 2014	**Percentage of Granting Income**
Trust/Foundation A	$2.34 million	33%
Trust/Foundation B	$1.34 million	21%
Trust/Foundation C	$1 million	33%
Trust/Foundation D	$1.62 million	16%
Trust/Foundation E	$600,000	35%

Figure 2.3: Refundable Franking Credits as a Source of Granting Income – Cross-section of Philanthropic Trusts and Foundations

This data confirms the critical importance of refundable franking credits as a source income for philanthropic trusts and foundations, and how the amount of grants to charities and charitable causes in the community would be drastically reduced if refundable franking credits were no longer available.

There would also be many other smaller philanthropic trusts and foundations, for whom the impact of removing the availability of refundable franking credits would also therefore be smaller. But the cumulative impact would still be very considerable.

Distortions Created by Removing Refundable Franking Credits

Apart from the two primary reasons for retaining refundable franking credit arrangements set out above, it is important to note that if refundable franking credits were no longer available then this would have the potential to distort the investment decisions of philanthropic trusts and foundations and other charities, and lead to less efficient use of financial resources.

This was highlighted in the former Industry Commission's report 'Charitable Organisations in Australia'. Produced in 1995 and before the introduction of refundable franking credit arrangements, the report concluded that:

> *The dividend imputation system in Australia may bias the investment decisions of tax-exempt bodies. As CSWOs are tax exempt, they may favour investments in shares offering unfranked rather than franked dividends. Similarly, a CSWO may prefer other forms of business ownership than publicly listed shares. This may result in a less efficient use of financial resources by CSWOs.*[7]

The Industry Commission went on to recommend that the Treasury conduct a review to determine the most cost effective way of removing any distortions faced by charities due to the dividend imputation system in Australia.

[7] Charitable Organisations in Australia, Industry Commission, June 1995. Available here: http://www.pc.gov.au/inquiries/completed/charity. Note: 'CSWO' refers to 'Community Social Welfare Organisations'.

Refundable franking credits were subsequently introduced in 2000, addressing the distortions identified by the Industry Commission.

Revenue Concerns with Refundable Franking Credits

On p.86 of the Discussion Paper, it is pointed out that:

> *There are some revenue concerns with the refundability of imputation credits. As mentioned earlier in this chapter, it provides a greater incentive for shareholders of closely-held companies to delay distributions until a time when individual owners are subject to a relatively low tax rate, to receive a refund of tax paid by the company. A similar incentive also exists under classical systems.*

At most, this appears to be a very minor concern, which would not apply in the case of philanthropic trusts and foundations and other charities given they are income tax exempt and therefore subject to a constant tax rate of zero percent.

Notably the Discussion Paper also highlights that a similar incentive exists under 'classical' systems where there is no dividend imputation, therefore it is unclear how removing the availability of refundable franking credits would address this concern.

In terms of the cost to government, in terms of taxation revenue forgone, Figure 2.1 shows that the initial estimates of the cost of introducing refundable franking credits, $50 million per year, were too low. However, since 2009-10 there has been no discernable pattern of growth in the value of refundable franking credits.

Although there has been some volatility, this lack of growth would counter an argument that the value of refundable franking credits poses an increasing risk to taxation revenue.

Refundable Franking Credits are Critical to Philanthropy and the Broader Community

Philanthropy Australia welcomes and shares the Australian Government's desire to grow our culture of philanthropy. We strongly support initiatives such as the Prime Minister's Community Business Partnership, which brings together leaders from the business, philanthropic and community sectors to advise the Government on strategies to grow philanthropy, impact investment and volunteering.

Therefore, Philanthropy Australia is of the firm view that the existing refundable franking credit arrangements applying to philanthropic trusts and foundations and other charities should be retained. No changes should be introduced which may have an adverse impact upon philanthropy, and by extension the various charities and charitable causes supported by philanthropy.

Any such changes would run contrary to the Australian Government's desire to grow our culture of philanthropy, and would be harmful to the broader community. Philanthropy Australia would strongly oppose them.

Recommendation 2

That the existing refundable franking credit arrangements applying to philanthropic trusts and foundations and other charities should be retained. No changes should be introduced which may have an adverse impact upon philanthropy, and by extension the various charities and charitable causes supported by philanthropy.

3. <u>Enhancements and Simplifications to the Existing Taxation Framework</u>

As stated at the beginning of section two of this submission, Philanthropy Australia believes that broadly speaking, Australia has a set of taxation arrangements which are reasonably well suited to growing philanthropy.

One major exception to this is Australia's taxation and regulatory framework for international philanthropy, which is very restrictive when compared with similar jurisdictions such as the United States.

This severely limits the ability of Australian philanthropy to make an impact beyond our borders, and requires reform to address the barriers currently in place.

<u>Enhancing and Simplifying the Taxation and Regulatory Framework for International Philanthropy</u>

Philanthropy Australia appreciates that not all philanthropists will seek to engage in international philanthropy. However, those who do wish to make a contribution in this way should not be hindered by an unduly restrictive taxation and regulatory framework as is currently the case.

Currently, 'income-tax exempt' trusts and foundations are required to pursue their objectives and incur their expenditure principally in Australia. In practice, this means that a majority of their grant-making must be within Australia, which is problematic if a trust or foundation wishes to focus their efforts on international philanthropy.

In the case of trusts and foundations with 'deductible gift recipient' status, such as private or public ancillary funds, the restrictions are even more problematic. These must be established and operated only within Australia.

In practice, this means that the only way in which a private or public ancillary fund can support charitable causes overseas is by distributing through another organisation in Australia which operates an approved overseas aid fund.

Using such an arrangement involves paying a fee, in the range of 7-10% of the amount distributed, to the organisation operating the approved overseas aid fund. Therefore, this red tape results in less funds being available to support charitable causes.

The Council on Foundations, which is a major philanthropic peak body in the United States that represents 1,700 grant makers, corporations, and philanthropic service providers, commissioned a paper[8] on the legal framework for global philanthropy as a contribution to the Global Philanthropy Leadership Initiative.

In that paper, the framework applying in Australia was specifically cited as an example of one that is particularly restrictive.

The Implications of a Restrictive Approach to International Philanthropy

Australia's taxation and regulatory framework for international philanthropy limits the ability of Australian philanthropy to make an impact beyond our borders in a number of ways.

Firstly, it means that fewer funds are available to support important charitable causes in countries within our region and beyond. Australian philanthropy is therefore less able to

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[8] Moore, D and Rutzen, D; Legal Framework for Global Philanthropy: Barriers and Opportunities; *International Journal of Not-for-Profit Law;* vol. 13, nos. 1-2, April 2011. Available here: http://www.icnl.org/research/journal/vol13iss1/special_1.htm

support economic and social development in these countries in order to bring people out of poverty.

In the area of international development, there are a vast number of innovative and effective organisations which have no presence in Australia.

At present it is very difficult for Australian philanthropy to support these organisations, and in the case of a private or public ancillary fund, the only way to way to do so would be through another organisation in Australia which operates an approved overseas aid fund. As pointed out above, this involves a relatively large fee, which means less funds are then available for international development activities.

In a time of Budget constraint where the Australian Government's overseas aid contribution has been reduced, and in an environment where the Australian Government is seeking to promote private sector initiatives which support international development, there should be much more flexibility and scope for Australian philanthropy to make more of a contribution.

However the opposite is currently the case.

Secondly, it means that Australian philanthropy is less able to support the achievement of Australia's foreign policy objectives. Through using private wealth to support economic and social development, philanthropy can foster positive relationships between Australia and countries within our region and beyond.

This can help promote Australia's values as a liberal democracy, and translate into improved relationships and cooperation between peoples and Governments. The current framework limits the ability of Australian philanthropy to foster such positive engagement.

Legislation to 'Restate and Centralise the Special Conditions for Tax Concession Entities'

In addition to the restrictions outlined above, the Australian Government has also proposed introducing legislation which will seek to 'restate and centralise the special conditions for tax concession entities' by:

- 're-stating' the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community (with some exceptions), and
- 'codifying' the 'in Australia' special conditions for deductible gift recipients ensuring that they must generally operate solely in Australia, and pursue their purposes solely in Australia (with some exceptions, such as overseas aid funds, some environmental organisations, some touring arts organisations and medical research institutes).

Philanthropy Australia believes that this proposed legislation would affirm Australia's unduly restrictive and inflexible regulatory and taxation framework for international philanthropy, and further inhibit the wider contribution that Australian philanthropy could make beyond our borders.

Implementing an Enhanced and Simplified Framework for International Philanthropy

Philanthropy Australia acknowledges that in the current Budget environment, new proposals with a large cost to government, in terms of taxation revenue forgone, are likely to be more difficult to implement. However, this provides an opportunity to closely examine proposals for enhancing and simplifying the existing taxation framework.

Philanthropy Australia believes that enhancing and simplifying the taxation and regulatory framework for international philanthropy would have a relatively small cost to government, in terms of taxation revenue forgone, but could grow the funds available to support important charitable causes in countries within our region and beyond, promote private sector initiatives which support international development and also help support the achievement of Australia's foreign policy objectives.

This enhanced and simplified framework should provide certainty and support rather than restrict the contribution which Australian philanthropy can make beyond our borders, whilst maintaining appropriate safeguards to ensure funds distributed overseas are used for the charitable purposes for which they are intended.

Philanthropy Australia believes that this enhanced and simplified framework could be implemented in three components.

Firstly, the proposed legislation 'to 'restate and centralise the special conditions for tax concession entities' should be permanently withdrawn. Although Philanthropy Australia acknowledges that the Australian Government has indicated that progressing this legislation is a low priority, we believe that whilst the proposed legislation remains Government policy there will be ongoing uncertainty. Addressing this uncertainty would be a very positive step in itself.

Secondly, coinciding with the withdrawal of the proposed legislation 'to 'restate and centralise the special conditions for tax concession entities', it would be beneficial to ask the Commissioner of Taxation to provide guidance as to the activities and operations Australian charities can undertake internationally. This guidance should also cover the activities and operations of 'income-tax exempt' trusts and foundations.

There is a view that in the absence of the proposed legislation to 'restate and centralise the special conditions for tax concession entities', the scope for Australian charities to undertake activities and operations internationally will be quite broad and this will enable philanthropy to support these international activities and operations.

Thirdly, as private or public ancillary funds must be established and operated only within Australia, there is a need to provide a more flexible approach which enables them to directly make grants overseas. This could be achieved by enabling private and public ancillary funds to make grants to charitable organisations overseas, provided these organisations would have been eligible to receive a grant had they been established and operated as a charity in Australia.

The existing private and public ancillary fund reporting framework, whereby private and public ancillary funds must submit a detailed annual return to the ATO, would ensure that there is appropriate accountability regarding the making of these grants and manage the risk of funds being misused.

Recommendation 3

That the Australian Government introduce an enhanced and simplified taxation and regulatory framework for international philanthropy, which provides certainty and supports rather than restricts the contribution which Australian philanthropy can make beyond our borders.

4. New Taxation Arrangements to Support the Growth of Philanthropy

There are a number of new taxation arrangements which Philanthropy Australia believes would support the growth of philanthropy. These can be divided into a number of categories.

Firstly, there are reforms which would address deficiencies with the *demand-side* framework for philanthropy and enable more charities to access philanthropy. Secondly, there are reforms which would address the fact that so called 'philanthropic infrastructure entities', organisations which promote and facilitate philanthropy, often cannot themselves fully access philanthropy. Thirdly, there are new structures and incentives which would support further growth of philanthropy.

Reforms to the Demand-side Framework for Philanthropy

The taxation framework for philanthropy can be seen as having two sides – the supply-side are the ways donors can give, for example through individual donations, through workplace giving or using structures like private or public ancillary funds.

The demand-side on the other hand, is how charities access such philanthropic support. For most charities, having deductible gift recipient (DGR) status is critical to accessing philanthropic funds especially from the growing number of private and public ancillary funds or through workplace giving.

The DGR framework set out in Division 30 of the *Income Tax Assessment Act 1997 (Cth)* underpins much of Australia's philanthropy by determining which types of entities are eligible for DGR status and can therefore receive tax deductible gifts.

The ability to make tax deductible donations is a critical part of supporting philanthropy in Australia. Therefore Philanthropy Australia does not support any narrowing of the DGR framework. Rather Philanthropy Australia believes that structural reform is necessary to broaden and simplify this framework.

Division 30 has evolved in an ad hoc manner, resulting in a DGR framework which is complex, cumbersome and a source of red tape. The lack of comprehensive reform of our DGR framework is a particular problem which continues to impede the ability of many charities to access philanthropy.

Australia has just under 60,000 charities. And based on 2014 data, there are only around 28,000 entities with DGR status.[9] Not all of these are charities, but the overwhelmingly majority are. The practical implication of this is that more than half of Australia's charities can't accept tax deductible donations or a grant from a private or public ancillary fund.

The rather arbitrary approach to determining eligibility for DGR status under Division 30 is evident in the types of charities which 'fall between the cracks' and whose only option is to seek a 'specific listing' in the tax laws – a long and complicated process, requiring a legislative amendment and with only a remote possibility of success.

[9] Above No.2

For example, an institution whose principal activity is to promote the prevention or the control of *diseases* in human beings is eligible for DGR status under the category of a 'Health Promotion Charity'. However, because of the way disease is defined, an institution whose principal activity is to promote the prevention of *injuries* of human beings (such as through accidents) is not eligible for DGR status.

Neighbourhood houses and community centres are in a similar situation. If a neighbourhood house or community centre provides welfare as its main activity, it may be eligible for DGR status. But if its main activity is to focus on social inclusion and community development, it may not be eligible for DGR status.

Somewhat ironically, 'philanthropic infrastructure entities', whose purpose is to support and grow philanthropy, are not eligible for DGR status in their own right and therefore cannot themselves access philanthropy in the form of grants from private or public ancillary funds.

These 'philanthropic infrastructure entities' include community foundations, who despite operating a public ancillary fund, can only use this fund to accept donations and distribute grants. This limits their potential impact, particularly in rural and regional areas where there are fewer charities for them to provide grants to.

Also included in this category are workplace giving service providers established to engage with employers and provide platforms to simplify the administration of workplace giving programs. This limits their capacity to expand their service offering and develop new platforms to grow workplace giving.

These types of charities provide just a few examples of organisations that currently miss out on DGR status, but there are other examples, such as organisations seeking to *prevent* rather than *relieve* poverty and some charitable peak bodies.

Further, if a charity is engaged in activities covered by more than one DGR category, it may need multiple DGR endorsements or have to restrict its activities. This adds even more complexity, and is a particular issue for indigenous charities whose activities often cut across a number of areas such as environmental protection, promotion of culture, relief of poverty and promotion of health. This complexity is acknowledged on p.127 of the Discussion Paper.

Clearly, reform of the DGR framework is necessary.

In its final report, the former Not-for-profit Sector Tax Concession Working Group built on the previous recommendation of the Productivity Commission in its 2010 report 'Contribution of the Not-for-Profit Sector',[10] and recommended that DGR status should be extended to all registered charities.[11]

Such a change would move Australia closer to the situation in jurisdictions such as the United States, Canada and the United Kingdom.

The Working Group recommended limits on the activities DGR funds can be used for. For example, charities whose purposes are the advancement of religion, or education through

[10] 'Contribution of the Not-for-Profit Sector', Productivity Commission, February 2010. Available here: http://www.pc.gov.au/inquiries/completed/not-for-profit

[11] Final Report, Not-for-profit Sector Tax Concession Working Group, Australian Government, May 2013. Available here: http://www.treasury.gov.au/~/media/Treasury/Access%20to%20Information/Disclosure%20Log/2014/1447/Downloads/PDF/NFP%20Sector%20WG%20Final%20Report.ashx

child care or primary and secondary education, would only be able to apply DGR funds towards activities falling within other charitable purposes.

This would have the effect of limiting the cost of the reform, which would otherwise be prohibitive. The Working Group's recommendation was estimated to cost $120 million per year.

Such a change would broaden access to DGR status to about 42,000 charities, an increase of about 14,000, simplifying the DGR framework and enabling more charities to access philanthropy.

Recommendation 4

That the Australian Government reforms the deductible gift recipient framework to broaden and simplify access to deductible gift recipient status. This reform should be modelled on the recommendations of the Not-for-profit Sector Tax Concession Working Group.

Philanthropic Infrastructure Entities

Philanthropy Australia's preference is that there be structural reform of our DGR framework to broaden and simplify access to deductible gift recipient status. However if Recommendation 4 is not proceeded with, Philanthropy Australia believes that at a minimum, a new category should be created within the existing DGR framework for 'philanthropic infrastructure entities' whose purpose is to support and grow philanthropy.

This would address the somewhat ironic situation described above, whereby entities established to grow philanthropy, such as community foundations or workplace giving service providers, cannot themselves access philanthropy in the form of grants from private or public ancillary funds.

This limits their capacity to contribute in practical ways to growing Australia's culture of philanthropy. The Australian Government has a stated desire to grow our culture of philanthropy, and the introduction of such a category would assist in achieving this objective.

It is likely that the introduction of such a category within the existing DGR framework would cost considerably less than more comprehensive reform, and would involve a relatively simple amendment to the *Income Tax Assessment Act 1997 (Cth)*. Whilst it would not address the broader issues with the existing DGR framework, it would certainly still be a very beneficial change.

Recommendation 5

In the event that the Australian Government does not proceed with Recommendation 4, a new category should be created within the existing DGR framework for 'philanthropic infrastructure entities' whose purpose is to support and grow philanthropy.

New Structures and Incentives Which Would Support Further Growth of Philanthropy

Tax effective giving structures such as private and public ancillary funds provide a good basis for structured giving, and the availability of pre-tax workplace giving arrangements provides a simple way employees can give through their pay.

New and innovative developments such as giving circles are emerging, which use existing structures such as public ancillary funds as a way of democratising philanthropy through pooling the contributions of many donors to make a number of high impact grants.

However there are a number of new structures and incentives which would further support growth in philanthropy. Philanthropy Australia will focus on two within this submission – charitable remainder trusts/charitable gift annuities and a corporate tax incentive for matching employee donations through workplace giving.

Charitable Remainder Trusts and Charitable Gift Annuities

Charitable Remainder Trusts (CRT) are a tax effective giving structure available in the United States. The structure allows individuals to:

- Irrevocably contribute property to a trust for the deferred benefit of a charity, but retain the income derived from that property for the donor's use during their lifetime
- Obtain an immediate income tax deduction for the contribution's net present value
- Avoid capital gains tax when the property is transferred to the trust
- Avoid income tax on the income earned within the trust, although the donor would be liable for income tax on any income they receive from the trust

An example would involve the placing of an apartment block within a CRT, for the benefit of a particular charity. Whilst the donor is still alive, they can receive the rent from the apartments, and when they pass away, the ownership of the apartments passes from the CRT to the charity.

The arrangement has a number of benefits, as it:

- Provides more much certainty for a charity, as unlike a will, the establishment of a trust is irrevocable and more difficult for family members to challenge
- Provides an opportunity for the donor to make a large gift, whilst still having the comfort of knowing that they will be able to access an income stream to provide for their own needs during their life time

Given these benefits Philanthropy Australia believes there would be merit in exploring the introduction of a CRT type structure in Australia, in order to grow planned giving.

If a CRT type structure were introduced in Australia, it would be advisable to diverge slightly from the model adopted in the United States. That model allows a donor to obtain an immediate income tax deduction for the contribution's net present value, which is based on estimating the value of the contribution once the future income to the donor is deducted – which is effectively what its value will be when it passes from the CRT to the charity upon the donor's death.

This is a complicated arrangement, and it may be advisable to instead provide a fixed income tax deduction, representing a certain percentage of the asset's value when it is placed into a CRT.

In addition, in order to provide for the integrity of the CRT structure, a similar regulatory framework to the one which applies to private and public ancillary funds would be warranted. This would involve certain trustee obligations and annual reporting to the ATO.

A Charitable Gift Annuity (CGA) is another form of tax effective giving structure, similar to a CRT in a number of ways. A CGA is a contract rather than a trust, under which a donor transfers assets to a charity and in return the charity agrees to pay a fixed amount of money (annuity) to one or more individuals for their lifetime.

The contributed assets are given irrevocably and become part of the charity's assets, and can be used by the charity to fulfil its charitable purposes as well as pay the annuity.

The donor is entitled to a tax deduction at the time of transferring the assets, the amount of which depends on the number of individuals which are paid the annuity and the age of the donor at the time of the gift.

Once again, determining the value of the tax deduction applicable is a complicated arrangement, and it may be advisable to instead provide a fixed deduction representing a certain percentage of an asset's value when it is placed into a CGA.

As in the case of a CRT, in order to provide for the integrity of the CGA structure, a similar regulatory framework to the one which applies to private and public ancillary funds would be warranted. This would involve certain trustee obligations and annual reporting to the ATO.

The CRT and CGA structures have the potential to grow planned giving in Australia, particularly from high net worth individuals.

Philanthropy Australia therefore believes that the CRT and CGA structures merit further detailed examination.

Recommendation 6

That the Australian Government examine the introduction of Charitable Remainder Trust and Charitable Gift Annuity structures in Australia, in order to grow planned giving.

Tax Incentive for Matching Employee Donations through Workplace Giving

The Howard Government introduced pre-tax workplace giving in order to make workplace giving simpler and easier. Despite these positive changes, the potential of workplace giving in Australia is yet to be realised. Based on 2012-13 data, fewer than 5 per cent of employees who can access a workplace giving program actually donated through one,[12] although there are number of employers which have over 50 per cent of their employees participating in workplace giving.

There is evidence to suggest that employer matching of employee donations through workplace giving can increase workplace giving[13], ultimately benefiting the charitable causes in the community to which those funds are directed.

However there is no tax incentive (above and beyond the norm) for companies to match employee donations through workplace giving programs.

Charities Aid Foundation Australia and the Australian Charities Fund have proposed that the Australian Government provide an additional incentive for companies to match employee workplace giving donations. This could be done through a tax incentive entitling companies to claim 150 percent of the cost of their donations which match employee donations through workplace giving programs, as an expense against taxable income. This would be similar to the existing R&D Tax Incentive.

The incentive could be introduced for a set period of 5 years, and the scheme could then be reviewed to determine its impact.

[12] Above No.2
[13] 'Engagement: Recognising the Value of Workplace Giving', Australian Charities Fund and the Centre for Social Impact, 2013. Available here: http://australiancharitiesfund.org.au/wp-content/uploads/2013/05/130624-ACFCSI-Research-Report.pdf

Given that take up of workplace giving is particularly low in small to medium sized enterprises (SMEs), access to the incentive could be limited to SMEs with turnover under a specified amount.

This proposal would involve a cost to government, however it would incentivise companies to set up workplace giving programs and promote a culture of giving within their workplaces. This would have the potential of growing philanthropy considerably amongst a broad segment of the population.

Given these benefits Philanthropy Australia believes there would be merit in exploring the introduction of a tax incentive for companies to match employee workplace giving donations.

Recommendation 7

That the Australian Government examine the introduction of a tax incentive for companies to match employee workplace giving donations.

5. Conclusion

Philanthropy Australia thanks the Treasury for the opportunity to make this submission in response to the Tax Discussion Paper, and looks forward to participating further in the Tax White Paper process.