SEEDLING GIVING

Pure hearts, positive impact & kind souls

Productivity Commission Review of Philanthropy

Friday 5 May 2023

Ms Karen Godfrey
Administrative Officer
Philanthropy Inquiry
Productivity Commission

Dear Ms Godfrey,

We are delighted to put forward a submission for the Productivity Commission's Review of Philanthropy.

By way of a brief background Seedling Giving is a charity matching service providing personalised, vetted and trustworthy recommendations for individuals and businesses. We make the process of giving simpler and safer.

Our experienced philanthropic advisors learn about our donors values, giving goals and objectives, then do the research to find three high performing charities they can trust and support with their full heart.

We conduct rigorous due diligence on all charities we shortlist, and only recommend those that meet our high quality standard.

We have developed a service that addresses the challenges to giving and believe it will have a signifiant impact in reaching the governments goal of doubling philanthropic giving by 2030. Since launching just 12 months ago we have placed $406K in charitable gifts.

Our service is independent of the financial sector, which as you will see in this submission, dramatically improves the the systemic challenges that face the Australian philanthropic sector.

If you have any questions about this submission, or seek further information on our research or modelling, please contact me.

Warm Regards,
Jessica Bowman
Co-Founder and Charity Analyst

Key Points

Philanthropy should achieve the following goals:

- Donations made to charities are signifcantly more than tax dollars forgone by the government in incentivising philanthropy
- Donations benefit the public at large
- Donations are diverse and support a thriving ecosystem of charities in Australia.

The Reality:

- To date, there is limited evidence to show that donations received through philanthropic structures are significantly more than taxation revenue forgone
- It is impossible to determine if donations are benefiting the public at large, or if they are used to futher the interests of the philanthropists, without transparency on who is making major gifts to charities
- Philanthropic advisors are increasingly concentrated to align with the financial services industry; there are few advisors outside this network.

The Solution:

- Increase the annual % distribution requirements of PAF and PuAFs.
- Require that PAFs and PuAFs disclose recipients of donations greater than $100,0000. Similarly, require charities to disclose donors of more than $100,000.
- Increase the number and diversity of organisations offering charitable giving advice.

Philanthropy in Australia

Philanthropy in Australia has the power to improve the overall wellbeing of all Australians, increase the value of public assets and preserve democratic institutions. However, this is only true if philanthropic policy is designed thoughtfully. Without careful consideration of costs, benefits and possible ill-intended outcomes, philanthropy will simply be used as a tool by the wealthy to increase their power, at the cost of ordinary Australians. This paper aims to demonstrate the various risks that Australians face with the current philanthropic policies and possible mitigating options to inform any reform.

Summary of recommendations:

- Increase the annual distribution requirement of Private Ancillary Funds (PAFs) and Public Ancillary Funds (PuAFs) to 10% of the capital value of the fund
- Instigate requirements for PAFs and PuAFs to disclose recipients of donations greater than $100,0000
- Instigate requirements for DGR recipients to disclose donors of gifts greater than $100,000
- Increase the number and diversity of organisations offering charitable giving advice through incentives.

Context

Right now, there are increasing threats to the healthy functioning of Australia's society. The cost of living is dramatically rising.[1] The wellbeing of Australians has been declining since 2009.[2] There is increasing polarisation within the community and a dramatic reduction in the trust of both NGO's, public and private Australian institutions.[3] Finally, there is persistent wealth inequality. The richest 10 per cent of households in Australia have almost half of all wealth.[4]

In addition, the trajectory for an active, vocal and independent civil society in Australia is not positive. Between 2010 and 2019, the proportion of people involved in social, community support and civic/political groups decreased from 36.2% to 28.8%.[5] There are fewer people giving.[6] Simultaneously, charities are seeing an increased dependence on government funding, with an increased proportion of their revenue coming from government over time.[7]

Many political scholars warn that an increase in concentration of wealth and a simultaneous reduction in civic life provide the conditions for a change of the power dynamics: from one where ordinary people have the ability to influence political systems, to one where the ordinary merely follow the directions of the powerful.

It is possible that there are well-meaning philanthropists. However, if philanthropic policies don't directly address these two factors – wealth inequality and the fostering of an independent, active civic society, Australia will head in a direction whereby the interests of the philanthropists are put above those of ordinary Australians, to the cost of ordinary Australians.

The stakes are high.

Three key objectives of the review

When embarking on any policy analysis, three steps should be undertaken. First, the key objectives of philanthropy policy should be defined. Then, the current state of philanthropy against those policies should be reviewed. Lastly, options for what can be done to improve the situation should be explored on a cost-benefit basis.

Throughout this document, we will explore these steps for what we believe to be the key objectives of philanthropic policy, namely:

- Objective 1: that donations that are made to charities are more than tax dollars forgone by the government in incentivising philanthropy
- Objective 2: that donations benefit the public at large
- Objective 3: that donations are diverse and support a thriving ecosystem of charities in Australia.

Objective 1: donations made to charities are more than tax dollars foregone in incentivising philanthropy.

Philanthropy is a tax-effective tool for wealthy individuals to distribute funds to projects or organisations that deliver a public benefit. In return for their gift, philanthropists reduce their taxable income.

This first most simple objective for any government examining philanthropy is: that any tax forgone by the government in incentivising philanthropy is more than adequately surpassed by funds delivered to organisations serving the public interest.

Right now, there are two commonly used philanthropic tools:

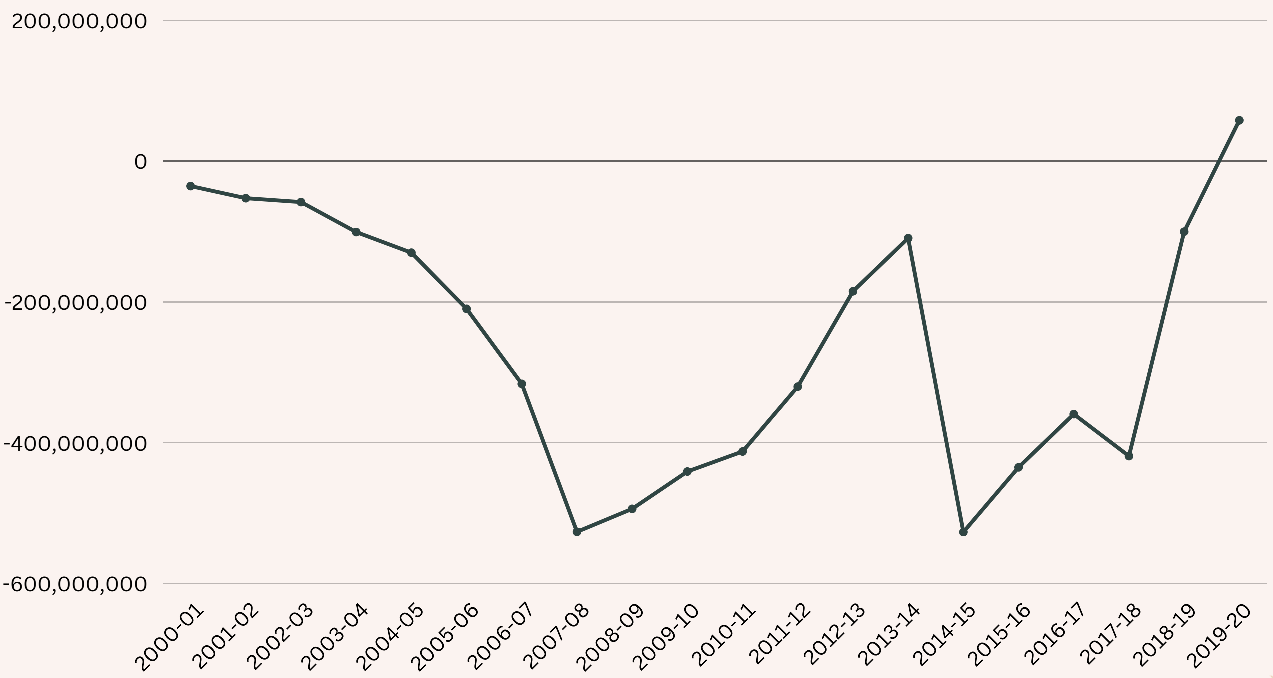
- Private ancillary funds (PAFs) - 5% of the total value of the trust, with the first distribution not being required in the first year.
- Public ancillary funds (PuAFs) - 4% of the total value of the trust, with the first distribution not being required during the first three years of operation. (Note that increases in distributions made during COVID have led to reductions in distributions required at later dates).

An individual can achieve a 100% deduction for any funds placed in a PAF or PuAF.

The implications of this is that the government is forgoing tax income today, with an expectation that the PAF or PuAF will deliver more funds to the charities sector over time. For instance, for a $1,000,000 donation to a PAF, the government is forgoing up to $450,000 in tax revenue today, expecting that $50,000 will go to charities per year, starting in one years' time. For a $1,000,000 donation to a PuAF, the government is forgoing up to $450,000 in tax revenue today, for $40,000 to go to charities per year, starting in four years' time.

By simply examining the reported PAF data, it is obvious that the net financial benefit to society with the current PAF distribution guidelines is questionable at best. Between 2000-01 and 2019-20 financial years, there was $10,215 million contributed towards PAF's, and $4,655 million in distributions to charities were made. However, assuming a marginal tax rate of 45%, contributions to the PAFs resulted in $4,597 million in income tax forgone by the government. This means the net benefit to society (distributions minus tax forgone) was just $58 million over 20 years. In fact, it was only in 2019 that there were cumulative net benefits to society from this scheme. Until then, there were significant cumulative losses. In 2007-08 and 2014-15, cumulative losses to the public were over $500 million. The chart below shows this.

PAF charity distributions minus tax deductions, $AUD (cumulative)



There have been clear winners from this scheme, but it isn't charities, the government or the public. It's the private funds managers of PAFs and PuAFs. These funds managers earn commissions from the total philanthropic funds under management. Between 2000-01 and 2019-20 financial years, assuming an average commission of 0.5% of the capital value of PAF funds (a conservative estimate), fund managers can be assumed to have received $510 million in PAF/PuAF funds management fees. This private gain is almost 10x the net public benefit.

It should be noted that there are strong incentives for these funds managers *not* to make distributions to charities. The more money distributed from the PAF/PuAF to charity, the less fund management commissions. There are currently options within the current legislation to delay making payments to charities, thereby further delaying distributions and reducing the cost effectiveness of the program to government.

The justification for the current scheme is that the net present value (NPV) of the ongoing distributions will be more than the tax deductions forgone. However, the reality is that for 20 years the net public benefit has been marginal at best. There are several reasons for this:

- There are no mechanisms in place to prevent from losses in the capital value of the fund. In fact, there is an agency issue in that the owner of the PAF/PuAF doesn't suffer any financial loss from bad investment decisions (their tax deduction has already been realised), increasing the likelihood that the PAF will take on greater risk than necessary. To illustrate this, assuming the discount rate is 11%, it will take more than 15 years for a PAF's tax deduction to be paid back to society. If from year 0-15, the fund fails, or performs badly, there will be less income to the charities than the predicted forgone taxation revenue.
- In today's high-inflationary setting, the implications of the time value of money on future projected distributions have significant effects. Right now, inflation is 7%.[8] Holding this rate constant, a $50,000 donation today is equivalent to just $40,815 in three years time. By year 10, it is half the original value.
- The overall projected benefit of the scheme is directly linked to discount rates. Demonstrated below are the sensitivities of the future projected cash flows using the 15-year target period under different discount rate scenarios. Small variations in discount rates can have substantial implications on the net benefit of the scheme, so any assumption should err on the side of caution to ensure unequivocally that the scheme provides benefit.

Sensitivity analysis to the net public benefits of PAFs

$1,000,000 PAF – $50,000 annual distribution starting year 2, ending in year 15

Discount Rate	Present value	Forgone tax	Net public benefit
3.34% (risk-free) [9]	$ 1,106,960	$ (450,000)	$ 656,960
7% (inflation)	$ 752,990	$(450,000)	$ 302,990
11% (conservative)	$ 513,053	$ (450,000)	$ 63,053

Sensitivity analysis of the net public benefits of PuAFs
$1,000,000 PuAF – $50,000 annual distribution starting year 2, ending in year 15

Discount Rate	Present value	Forgone tax	Net public benefit
3.34% (risk-free)	$ 933,094	$ (450,000)	$ 483,094
7% (inflation)	$ 607,292	$(450,000)	$ 157,292
11% (conservative)	$ 390,530	$ (450,000)	$ (59,470)

- If a discount rate of more than 11% can be argued, then the current scheme cannot be justified. There are several reasons to argue that higher discount rates are appropriate. Firstly, it is broadly agreed that avoiding intervention in social and environmental problems today will make them far more expensive to address in the future. In addition, there is a high degree of uncertainty as to the policy and legislative context for the public issues that charities face in the future.

But, there is a simple solution to these problems.

Recommendation 1: Increase the annual distribution requirement to 10% of the capital value of the fund

There are pressing needs that need to be addressed today, and left unaddressed, the magnitude of the problems and the cost of addressing the problems will increase over time. The PAF/PuAF guidelines need to ensure that there are incentives to get funds into charities today.

By increasing the fund distribution requirements, the risk of society making a net-loss from philanthropic tools is substantially reduced. While there is an increased likelihood that the capital value of the fund will be depleted, this is not an adverse outcome if it leads to an increased likelihood that the scheme provides net public benefit in a shorter time-frame.

Objective 2: that donations benefit the public at large

A philanthropist making donations cannot be assumed to deliver public benefit. Of course, there are philanthropists that have distribution strategies that ensure improvements in public welfare. However, there are equally philanthropists that have little effect, and concerningly, those that reduce the overall welfare of the public at large.

In summary, philanthropy can have the following effects:

- A: Improve the overall welfare of the public at large
- B: Have negligible effect on the welfare of the public at large
- C: Have a negative effect on the welfare of the public at large.

Philanthropy policy must ensure that philanthropists deliver public benefit equivalent in value to tax deductions gained. As well as that, they should do no harm.

Right now, it is not currently possible to understand the extent to which philanthropy is being used to deliver good/harm. While there are requirements to present audited financial accounts, there are no requirements for philanthropists to disclose specifically who they give to or how much they give to each recipient. In addition, there are no requirements for charities to disclose their major philanthropic donors.

Philanthropists can be extraordinarily influential. Philanthropists with a profit-motive can use charities and not-for-profits to elevate the significance of certain social/environmental issues, garner their support to advocate for government reform and ultimately, instigate change, all under the guise of "social benefit". For the profit-motivated philanthropist, whether or not the reform delivers social benefit is secondary to the first intention of making profit.

For illustrative purposes, here is a theoretical example for how a philanthropist may do this. This philanthropist seeks to increase the use of their mental health services. The demand for their services requires more Australians, not less, having mental illness. Charities working in the mental illness space receive funding from this philanthropist to increase the awareness of mental illness, and passionately advocate for reform. They may also advocate the use of a specific technique or medication that is patented by the philanthropist.

Advocacy for policy change that is driven by a charity can hold far more clout than advocacy from an individual or private company. Media often recruit independent experts from the not-for-profit sector to interview but will rarely engage the private sector. This is to ensure they seem impartial. The further the philanthropist can separate themselves from the charity undertaking the advocacy, the better.

A philanthropist working in the shadows is extremely dangerous. While this risk can't be eliminated, it can be controlled.

Recommendation 2: Instigate transparency requirements for large gifts:

- Philanthropists must publicly declare any gift greater than $100,000 over a 12 month period
- Charities must publicly declare any gift greater than $100,000 over a 12 month period

By ensuring high degrees of transparency by philanthropists and charities, it allows for public scrutiny of certain activities, making it easier for the public to understand with greater clarity the true independence of an organisation and its intentions.

Ensuring disclosure by *both* philanthropists and charities also allows the public to trace and review the portfolio of charities that a philanthropist is funding, and monitor the extent to which charities are acting in the interests of their mission, or the interests of the philanthropic donor.

Objective 3: that donations are diverse and support a thriving ecosystem of charities in Australia

The ecosystem of charities in Australia is extensive and complex. There are approaching 60,000 registered charities in Australia. [10] Some are large and undertake a vast array of activities, others are small charities focusing on local issues. Some have goals to change the world and others simply lending a helping hand. Some focus on immediate issues, others on systemic problems.

Maintaining this diversity is necessary for the persistence of the wellbeing of all Australians.

An ecosystem of independent charities that focus on responding to various needs and problems that face our society provides us with stability and resilience. To retain their independence, these groups need access to a variety of funding sources.

Philanthropy can represent the access to funding from individuals, families, businesses and groups that have a wide range of interests and political interests that keeps these independent charities alive in a wide range of circumstances.

However, this will only be true so far as there is limited coordination within the philanthropic network. Once philanthropic interests start to align, rather than acting as a diverse set of interests that distribute funds across a vast array of different organisations, they start to homogenise. When their interests align, philanthropy no longer represents the diverse income source that it can be. With this kind of coordination, aligned interests have the power to drive where non-for-profit activity is focused and which areas are neglected.

There is clear evidence of this in recent activist campaigns where philanthropists have coordinated their funding.[11]

Not only are the individuals themselves concentrated, philanthropic advisors are concentrated in a handful of financial firms. The most successful business model for philanthropic advisors is one closely tied to PAF/PuAF funds management. This is seen as the only way to ensure a regular income and their ongoing viability. Without their first role as a funds manager, providing philanthropic services wouldn't be viable.

The consequence of this is that the interests of philanthropic advisors are closely tied to the interests of the financial sector.

Recognising this is particularly important now, as there are many seeking to increase the cooperation and coordination of philanthropy, without due recognition to the critical risks that will result from this.

To be clear, cooperation and coordination within philanthropy is extremely dangerous as it can concentrate funds distribution in a way that provides political advantage to those that are already wealthy and powerful.

Recommendation 3: Promote advisors that are independent of the financial sector

To ensure that there is a diversity of perspectives and approaches in philanthropy, there needs to be a variety of voices in the sector, particularly in the advisory capacity. Specifically, there need to be advisors that are independent of the financial sector. From a policy perspective, there are several ways for this to be achieved:

- Direct subsidies to philanthropic advisors that are independent of PAF/PuAF funds management. This may include supporting online advisory platforms that can reach a large volume of people at low cost (like Seedling Giving), or funding independent professionals (like accountants or family lawyers) to further their skills to provide philanthropic advice.
- Provide tax incentives to PAF/PuAF's that use the services of philanthropic advisors that are independent of the financial sector. For example, ensuring that advice from these firms is considered tax-deductible. This will directly increase the level of competition in the philanthropic advisory sector.
- Provide incentives for PAF/PuAF's to distribute 100% of funds within a short timeframe (e.g. 5 years). Without an ongoing guaranteed funds-management income, it will make it easier for independent advisory firms to compete with financial firms.

Conclusion

It is an admirable goal that the government seeks to achieve such an enormous increase in philanthropic giving in Australia. However, if the goal doesn't take into consideration the potential risks that philanthropy can pose to ordinary society, it may lead to overall harm. This paper aims to demonstrate the various risks that Australians face with the current philanthropic policies. Outlined are possible mitigating options that ensure that philanthropy serves society. This includes reforming the PAF and PuAF distribution requirements, increasing transparency of PAFs and PuAF's and incentivising a diverse network of organisations and individuals providing philanthropic advice.

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About Us

Seedling Giving is founded by experts in the Australian charity sector. We are passionate about improving the way Australians give to charity. We know how to identify and engage high performing charities, and we see the bigger picture to identify opportunities for collaboration. Importantly, we aren't just "talk", we have a track record of turning ideas into reality.

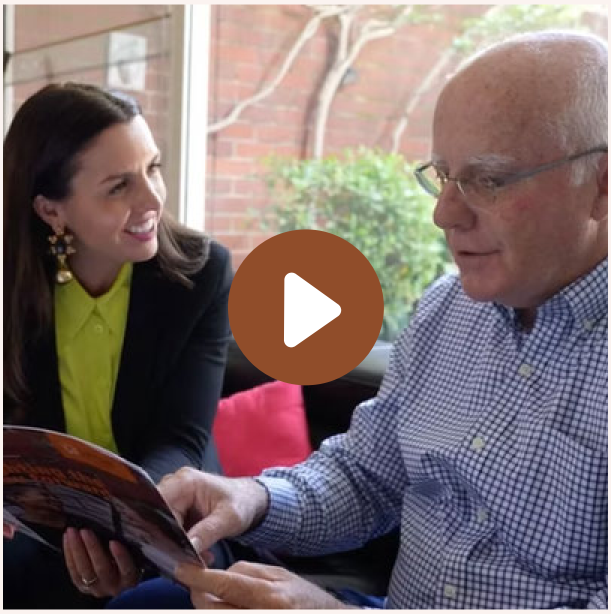
JESS BOWMAN

Jess Bowman is an experienced analyst with a passion for finding great charities. In 2015, she founded The Good Cause Co., the first website in Australia to provide comprehensive, independent reviews of Australian charities. The Good Cause Co. also provided donor services, advising over $15 million dollars of philanthropic funding.

Jess is a former Director of Social Impact Management Network Australia (SIMNA), was a FYA Young Social Pioneer (2016) and an Australian Government Youth Ambassador for Development (2010). She has a Masters of Science majoring in Environmental Science and Bachelors of Finance majoring in Economics. She has over 10 years experience advising government and multilateral agencies, including the UN and the World Bank. Her expertise centers around identifying the economic, financial, environmental and social impact of large government projects.

Kylie Wallace has over 12 years of experience in the not-for-profit and Corporate Social Responsibility space as a Fundraising and Marketing expert. She is experienced in startup environments, building innovative campaigns with $0 budget and evolving them into successful global movements. A great demonstration of this was her work launching and growing the Polished Man campaign. Kylie has been recognised as one of Australia's leaders in the space and was awarded as the '2019 Mover and Shaker' by the Fundraising and Philanthropy Magazine.

KYLIE WALLACE



Learn more about us

Seedling Giving
Jessica Bowman
Co-Founder and Charity Analyst

A: 21/114 William St, Melbourne VIC 3000
W: www.seedlinggiving.com.au