THE UNIVERSITY OF SYDNEY

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Ms Karen Godfrey
Productivity Commission
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By email: philanthropy@pc.gov.au

Productivity Commission: Review of Philanthropy

Dear Ms Godfrey,

Thank you for the opportunity to provide a second submission to the Productivity Commission's Review of Philanthropy. In this submission, I will focus on providing feedback and information on a number of issues raised in the Commission's draft report, *Future Foundations for Giving* ('Draft Report').

Principles for determining whether activities should be within the DGR system

Principles 1 and 2 outlined in the Draft Report provide a subsidy rationale for the DGR concessions, which could be combined as follows:

> There is a rationale for Australian Government support because entities with DGR status provide goods and services that have community benefits which would otherwise be undersupplied.

Another rationale that could be adopted by the Commission is that tax concessions promote the important social value of philanthropic giving, which contributes to a more diverse and pluralistic society.

The third principle seems misplaced given there is often 'a close nexus between donors and beneficiaries.' It also is not clear what is meant by 'the material risk of substitution between fees and donations.' For example, in the case of optional contributions to school building funds donations are not made in place of fees. Instead, the subsidy rationale for tax concessions could be used to explain why some charitable subtypes should be excluded from DGR status. For example, if more government grants were provided for school buildings based on equitable principles, arguably there would not be an undersupply.

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School Building Funds

The justification provided in the Draft Report for removing DGR status for school building funds raises legal and normative issues. The report states that 'this exclusion is based on a concern that where the main activities of a subtype of charities is charging fees to provide services to beneficiaries, there are material risks that donors would convert a tax deductible donation into a *substantial private benefit*.'[1]

The Commission notes that the potential for private benefit is more likely in primary and secondary education, particularly at fee-paying schools, as the 'donors are most likely to be people directly involved with the school and benefit directly from donations, such as students, their parents or alumni.'[2] This is then contrasted with higher education institutions which also charge fees on the basis that 'there is less likelihood of donations being used in a way that provide scope for a substantive private benefit to the doner … because student populations are larger.'[3] Yet donations to universities often specify how the university is to apply the donation, allowing donors to direct their gifts for a specific use.[4] For example, a donor who is an alumnus of the Law School, with a child at the Law School could make a restricted charitable gift specifying that the gift be used for a building at the Law School.

The justification provided in the Draft Report for removing DGR status for school building funds also does not consider developments in the law relating to the definition of a 'gift' for tax purposes. In determining what is a 'gift' for income tax purposes, the common law test and related ATO tax ruling (TR 2005/13)[5] have made it clear that a gift must have the following characteristics: there is a transfer of the beneficial interest in property; the transfer is made voluntarily; the transfer arises by way of benefaction; and (importantly) no *material benefit* or advantage is received by the giver by way of return.[6]

The common law test was first articulated by the High Court of Australia in *Federal Commissioner of Taxation v McPhail*.[7] In that case, a father of a student at a private school claimed a tax deduction for a contribution made to a school building fund together with him being charged lower school fees. In determining whether this was a 'gift', Owen J stated:

> [T]o constitute a "gift", it must appear that the property transferred was transferred voluntarily and not as the result of a contractual obligation to transfer it and that

[1] Draft Report, 190-1. Emphasis added.
[2] Ibid.
[3] Ibid.
[4] See generally, Natalie Silver, 'The Contractualisation of Philanthropy' (2022) 38 (2/3) *Journal of Contract Law* 248.
[5] Australian Taxation Office, *Tax Deductible Gifts – What is a Gift*? TR 2005/13, July 2005. <https://www.ato.gov.au/law/view/document?DocID=TXR/TR200513/NAT/ATO/00001>.
[6] See Natalie Silver, 'The Tax Treatment of Donor-restricted Gifts' (2021) 36 *Australian Tax Forum* 103, 106-114.
[7] (1968) 117 CLR 111.

> no advantage of a material character was received by the transferor by way of return.[8]

His Honour found that neither of these conditions were met, concluding:

> The payment … was not a voluntary payment … it was a payment made pursuant to a contract between the taxpayer and the School Council. … If, however, the payment should be regarded as a voluntary payment, the taxpayer made it in the expectation that in return he would receive, and he did in fact receive, a substantial concession in the fees charged for the education of his son.[9]

In other words, there was a quid pro quo giving rise to a contract, with the parent receiving a material benefit in the form of a reduction in school fees in exchange for his contribution to the school building fund. The situation in *McPhail* can be contrasted to a non-compulsory donation to a school building fund. This amounts to a voluntary gift, which does not give rise to a contractual obligation, and no material benefit or advantage is received by the donor by way of return. Indeed, TR 2005/13 provides specific examples of situations where a material benefit is received in exchange for a donation, including *compulsory* payments to a school building fund where the donor's child is attending the school.[10]

Superannuation Charitable Bequests

Since my first submission, my colleague at the University of Sydney Law School, Dr Ben Chen, and I received an Australian Research Council (ARC) Discovery Project grant to examine the legal issues surrounding superannuation as inheritance, including charitable bequests.[11] This successful ARC grant highlights that research on the use of excess superannuation for inheritance is a high priority for the Australian Government and is not inconsistent with the objective of superannuation 'to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.'[12] In our ARC grant application,[13] Dr Chen and I raised the two issues addressed in the Draft Report that currently exist for making bequests to charity through superannuation death benefits.

The first is the exclusion of bequests being made directly to a charity through superannuation death benefit nominations because charities are not considered a 'dependent' under the superannuation laws.[14] As a result, to make a superannuation bequest to a charity, members must nominate the legal personal representative of their

[8] Ibid 116.
[9] Ibid.
[10] TR 2005/13 (n 5) [99], [102]. Emphasis added.
[11] *Superannuation as Inheritance: Law, Practice and Reform* (DP240102076), summary available at https://rms.arc.gov.au/RMS/Report/Download/Report/a3f6be6e-33f7-4fb5-98a6-7526aaa184cf/259.
[12] As stated in the Superannuation (Objective) Bill 2023 (Cth).
[13] On file with author.
[14] *Superannuation Industry (Supervision) Act 1993* (Cth) Div 2, s 10; *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 6.17A.

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estate in a binding death benefit nomination and include the charity in their will. The Commission seeking to reduce the unnecessary complexity involved in this process is a welcome development. This would require legislative change in the form of an amendment to the *Superannuation Industry (Supervision) Act 1993* (Cth) to carve out a special category for charities as death benefit nominees, in addition to 'dependants' and the member's personal legal representative. It would also require superannuation funds (and SMSFs) to amend their trust deeds (and governing rules), and related forms accordingly.

Should this legislative change be made, there are some practical consequences to consider. Because it was not originally conceived that superannuation would be used as a tool for inheritance, the laws relating to death benefit nominations are very rudimentary. Unlike a will, there can be only one nominee to receive benefits upon death of the member. If that nominee is a charity, it would mean that *all* of the excess superannuation would go to the charity and none would be available for 'dependants', such as close family members. This could result in a family provision claim in NSW under the *Succession Act 2006*, which allows property that does not form part of the deceased's actual estate (eg, superannuation) to be designated as part of the deceased's notional estate. As NSW is the only state in Australia that allows for notional estate claims against deceased estates, a family provision claim in relation to superannuation would not arise in other state jurisdictions. However, this means that in states other than NSW there is a risk that a 'dependant' may not be adequately provided for if the deceased's only significant asset is superannuation.

The second issue addressed in the Draft Report (and my ARC application) is the tax consequences of a superannuation bequest to charity. Where a superannuation death benefit nomination is made indirectly to a charity through the member's legal personal representative, any funds distributed to the charity are subject to a 15% tax plus the 2% medicare levy because the charity is not a 'dependant' under the tax laws.[15] In the Draft Report, the Commission notes that it 'does not consider that a case has been made as to why donations to charities should receive preferential treatment compared to transfers to non dependants.'[16] The reasoning provided is that '[s]uperannuation is concessionally taxed throughout its life cycle, so adding further concessions at the time of death may be a relatively costly way (in terms of any increase in giving per dollar of revenue forgone) for the Australian Government to incentivise giving.'[17]

While this position makes sense from an economic perspective, it does not take into account the rationale for why our legal system confers special tax treatment on charities and other not-for-profits: to support activities that are expected to provide community benefits and would otherwise be undersupplied by the market. Yet the Commission adopts this subsidy rationale in its principles-based framework to justify an overhaul of the DGR system.[18] Application of the subsidy rationale also makes sense in the superannuation context when one considers that a retiree who takes money out of their superannuation to

[15] *Income Tax Assessment Act 1997* (Cth), s 302.195.
[16] Draft Report, 28, 273.
[17] Ibid.
[18] Ibid 17.

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donate to a charity with DGR status while they are alive would receive a tax deduction. As a result, it is arguable that a charity, while not a 'dependant' under the tax law, such as a young or disabled child in need of support, is also not the equivalent of a 'non-dependant', such as an adult child who can support themselves, and should instead be treated as a special category under the tax legislation.

Allowing Australians to make superannuation bequests directly to charities without adverse tax implications to a member's estate will encourage philanthropic giving using superannuation inheritances. This represents additional tangible reforms the Government can adopt in order to meet its commitment to double philanthropic giving by 2030.

Removal of the 'in Australia' condition and addressing specific listing under the 'International Affairs' category

The Productivity Commission's recommended removal of the 'in Australia' condition under the *Income Tax Assessment Act 1997* (Cth) ('*ITAA*') is a welcome development, and is consistent with a recommendation Professor Myles McGregor-Lowndes and I made in article published in 2016 in the *Sydney Law Review*.[19] This will provide Australian donors with greater flexibility in making tax effective contributions to support the wider global community by funding organisations overseas involved in the production of global public goods and the development of solutions for global challenges. Given that entities that come within the statutory definition of charity are not eligible for tax concessions unless they are registered with the ACNC, and that to be registered with the ACNC they must have an ABN and comply with the Governance Standards and External Conduct Standards, there are sufficient regulatory safeguards in place to support this legislative change.

This recommendation will also address the issues associated with the specific listing process for DGRs noted by the Productivity Commission for the exclusive group of organisations listed by name under the 'International Affairs' category.[20] It will also address issues specific to this category. For example, while DGRs listed by name in the *ITAA* remain subject to the 'in Australia' condition, those listed as DGRs under the category of 'international affairs' in s 30-80(2) are exempt from the conditions requiring that their purposes and beneficiaries be in Australia.[21] There is also evidence that DGRs specifically listed under international affairs engage in auspicing to assist other Australian charities without DGR status channel tax-deductible donations overseas.[22]

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[19] Natalie Silver, Myles McGregor-Lowndes and Julie-Ann Tarr, 'Should tax incentives for charitable giving stop at Australia's borders?' (2016) 38(1) *Sydney Law Review* 85, 119.
[20] See ibid 102-3, where these issues are discussed.
[21] See ATO, *Income Tax: Public Funds*, TR 95/27, 2 August 1995 [14(b)].
[22] Silver, McGregor-Lowndes and Tarr (n 19) 102.

Thank you for the opportunity to submit further comments in relation to the Productivity Commission's Review of Philanthropy. I am happy to be contacted to discuss my comments.

Sincerely,

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