Perpetual Private

APPENDIX I

Advancing A Culture of Philanthropy

The case for Community Development Trusts
Discussion paper

1 May 2023

Perpetual Trustee Company Limited
ABN 42 000 001 007
AFSL 236643

Trust is earned.

Perpetual

Contents

Executive Summary

In 2015, Perpetual, through The Prime Minister's Community Business Partnership (PMCBP), recommended a bold and innovative model and structure to support significant growth in philanthropic giving.

At the time, the PMCBP shifted its focus and attention to the provision of early year support for children and as such, philanthropic models and structures were not considered in earnest. As the Productivity Commission renews the Australian Government's interest in growing a culture of philanthropy, it is timely to revisit the concept of the Community Development Trust.

Perpetual has several international philanthropic partners and a great interest on the drivers for giving internationally. Countries which have used a variety of approaches with giving structures have seen further growth in philanthropic giving. This paper has been developed by considering structures, used in countries other than Australia, such as charitable lead annuity trusts, charitable remainder trusts, and the current Australian tax incentives, and looked for a simple structure to boost giving by appealing to a defined market segment.

This paper introduces the concept of a Community Development Trust which is designed to:

- Grow philanthropy in Australia by appealing to a wider range of people than PAFs currently do
- Provide charities with a source of sustainable and reliable revenue over a ten-year period;
- Be efficient for charities to raise and maintain funding sources;
- Provide individuals with an internationally proven incentive to be more philanthropic using tax incentives; and
- Provide charities with an additional structure to engage their high net worth donors.

Perpetual

Introduction

Non-profit community organisations are constantly struggling for sustainable funding sources. Large funding sources include all levels of Government, donations and other community fundraising programs, bequests, grants from philanthropic trusts and foundations, and fee based service delivery.

Each of these sources of funding has strengths and weaknesses, and none by itself could be considered a sustainable funding source for the many and varied problems our communities face.

Source of funding	Strengths and Weaknesses
Government	Large funding available, mostly for the provision of services, often 'tendered' to the non profit sector and the funding is tied to the provision of services under a contract. Tends to be 1-3 years and connected to policy outcomes.
Donations and other community fundraising programs	Can raise 'untied' funding, however is intensive and requires continual effort in asking for donor support, providing feedback to donors and coordinating a range of fundraising events and programs.
Bequests	Can provide significant funding, however these funding sources take many years to mature, are not repeatable from the same person, and established charities that are larger tend to be the primary beneficiaries, leaving gaps in regional communities and under-served population groups.
Philanthropic Grants	While the introduction of Private Ancillary Funds in 2001 have increased grants and incentivised a new era of philanthropy in Australia, giving through these vehicles has not matched wealth growth in Australia. Funding from these vehicles tends to be for 1-3 years to community organisations.
Fee based service delivery	Used to provide compensation, or often only part compensation for the costs associated with the delivery of the community service.

PAFs – a game changer for giving in Australia

Background

In 2001 the Australian Government introduced several initiatives to facilitate higher levels of giving by business and the community. The most significant of these initiatives was the establishment of a new trust structure, initially called Prescribed Private Funds, and now known as Private Ancillary Funds (PAFs).

PAFs are a trust structure like the United States family foundation model. These structures allow individuals, families, and businesses to make tax deductible gifts to establish and grow a named philanthropic fund. The number of PAFs is growing but have seemingly plateaued over the last decade.

Private Ancillary Funds[1]

Table 1 displays the number of PAFs, donations received, distributions made and closing values since 2000–01.

Table 1: Numbers of PAFs, donations received, distributions made and closing values[2]

Year	Number of PAFs approved in the year	Net number of PAFs	Donations received ($m)	Distributions made ($m)	Closing value ($m)
2000–01	22	22	78.66	–	78.62
2001–02	59	81	53.04	6.69	133.71
2002–03	49	130	53.18	18.42	179.33
2003–04	94	224	155.66	27.46	332.02
2004–05	95	319	192.69	57.43	523.25
2005–06	116	435	364.94	84.47	885.42
2006–07	164	599	533.26	133.42	1,484.47
2007–08	169	768	779.33	140.57	2,069.35
2008–09	54	822	272.71	155.34	2,038.19
2009–10	57	879	321.04	197.47	2,266.83
2010–11	28	907	304.39	165.41	2,124.46
2011–12	95	1,002	354.49	251.66	2,933.60
2012–13	84	1,069	316.89	277.97	3,402.97
2013–14	153	1,204	558.83	326.95	4,246.68
2014–15	144	1,315	1,867.44	422.92	5,979.52
2015–16	129	1,426	810.73	456.81	8,307.39
2016–17	139	1,495	837.16	452.27	9,403.88
2017–18	155	1,650	1,009.00	394.43	7,183.14
2018–19	108	1,731	546.39	564.58	7,304.02
2019–20	96	1,819	805.79	520.74	7,636.14

During the 2019–20 financial year, there were 96 new PAFs approved (Chart 1) bringing the total number of PAFs to 1,819 (see Chart 2).[3]

Source: QUT The Australian Centre for Philanthropy and Nonprofit Studies, Ancillary Funds 2000-2020

Why is a new source of funding required?

Despite the growth in donations by individuals and the opportunity for individuals to establish a PAF or an alternate structured giving vehicle, the community need continues to outstrip the available funds. 20 years after the introduction of PAFs there are a little over 2,000 in place. This is despite Frank Knight research suggesting there was more than 20,000 ultra-high net worth ($30m plus wealth) Australians in 2021.

Despite the number of Australian with significant philanthropic capacity, PAF continue to struggle in line with growth of wealth in Australia. This suggests that the structure fails to meet the needs of all individuals and families with capacity to give. Perpetual, through our ongoing conversations with families with capacity to give more, has found one of the reasons those who choose not to give is because the decision to irrevocably give some of their assets in to a PAF structure is a significant barrier. This may be because of concern for the need to access capital for family members or due to a health emergency. We have also heard many clients express concern relating to creating a structure their children do not want, or they do not wish to face difficult conversations with their children or family regarding inheritance loss. While good advisors can guide and support clients with these concerns, a structure that is not perpetuity in nature would be a valuable tool to encourage more giving.

How do we create the right incentives for Australians who can give more, to give more? This paper explores the option of a new structure which incentivises giving in a manner that can lead to longer, sustainable gifts for non-profit organisations, largely without additional foregone tax burdens on the government. This new structure would have the potential to lead to the creation of more traditional PAFs over the longer term.

Community Development Trusts

Summary

This paper proposes the introduction of the new structure that aims to:

- Grow philanthropy in Australia by appealing to a wider range of people than PAFs currently do
- Provide charities with a source of sustainable and reliable revenue over a ten year period;
- Be efficient for charities to raise and maintain funding sources;
- Provide individuals with an internationally proven incentive to be more philanthropic using tax incentives; and
- Provide charities with an additional structure to engage their high net worth donors.

The proposed structure is referred to as a Community Development Trust.

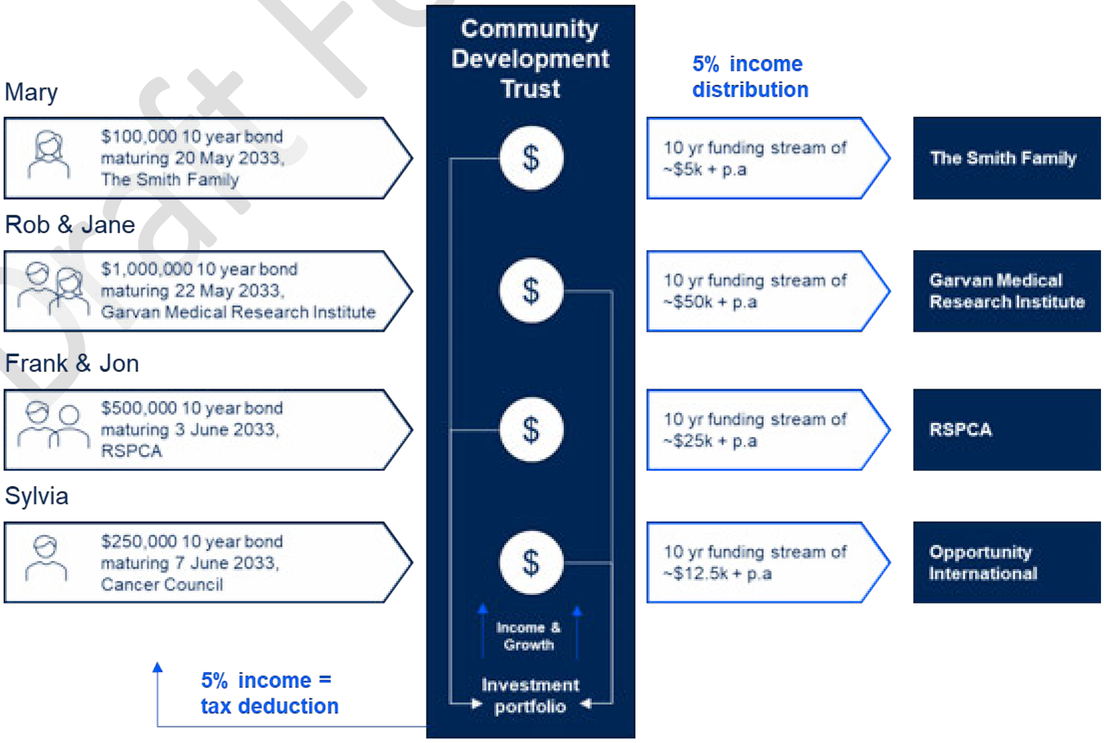
How a Community Development Trust operates

A Community Development Trust is a structure that provides an opportunity for individuals to make a 10 year investment, where an annual distribution will be made to a nominated charity, and the option to have the capital returned to the individual after the 10 year period.

Terms used :

Community Development Trust – the structure used by investors

Community Development Bond – issued by the trust to the individual recording the amount of the investment, the commencement date, maturity date, nominated charitable beneficiary and the investor's details.



Perpetual

A Community Development Trust allows individuals to make an 'investment' to the trust. Each trust may comprise a number of individual 'investments'. Each investment or bond must be for a period of 10 years in duration and must provide a minimum annual distribution rate of 5% to the charitable Item 1 Deductible Gift Recipient.

The trust is established by the ATO/ACNC as a tax-exempt entity. The trust is also established by the ATO to be able to provide to 'investors' or 'bond holders' in the trust, a tax-deductible receipt in the year the 'investment' that equal to the minimum amount the charitable recipient will receive over the fixed ten year period of the 'investment'. The individual can elect to utilise the tax deduction in the year the gift is made or spread the tax deduction over up to 5 years, as is the case for tax deductible donations currently for individuals ie. An individual can choose to give year to year in this manner without any guarantees to the charity.

A Community Development Bond (each individual 'investment') has a fixed life of 10 years however the Community Development Trust can roll the bond for a subsequent 10 years or transition into a perpetuity trust structure.

The Community Development Trust has the following distribution criteria - the trust does not need to make a distribution from an 'investment' or 'bond' in the year the 'investment' is established (note: it is expected that most 'investments' will commence in the late stages of the financial year as is the current practice for other tax motivated giving structures). Each year thereafter, the trust must distribute the higher of (a) 5% of the original value of the 'investment' or (b) 5% of the value of the 'investment' as at 30 June of the previous financial year.

Each individual Community Development Bond is invested by the Trust, generating both an income return and a capital growth return. The total return of the trust is exempt from income and capital gains tax for the 10 year period whilst the trust maintains compliance with the rules for Community Development Trusts.

At the end of the 10 year period, the capital in the trust (after making the required distributions for 10 years) can be returned to the individual. Any movement between the capital when the original 'investment' was made (ie when the 'bond' was issued) and the maturity 10 years later, could be exempt from income and capital gains tax to the individual to further incentivise the structure, or alternatively could require the founder(s) to pay CGT. The later option would mean this is a tax neutral structure, the former would incur a minor tax implication.

How a Community Development Trust operates – a worked example.

Mary would like to make a long-term commitment to The Smith Family to enable annual education assistance. The Smith Family, like all charitable Item 1 Deductible Gift Recipients (DGRs) is looking for both additional funding and certainty of funding.

Mary has a taxable income of $300,000 and is therefore in the highest marginal tax rate. Mary is happy to make annual contributions to The Smith Family, and even prepay annual contributions if asked, however is not comfortable to utilise either a private or public ancillary fund as she is concerned about making a large irrevocable gift.

Mary could look to utilise the proposed Community Development Trust to achieve her wishes by making an 'investment' of $100,000 and provide certainty to The Smith Family of future annual cash flow, for a specific period, equivalent to 5% of the value of this investment.

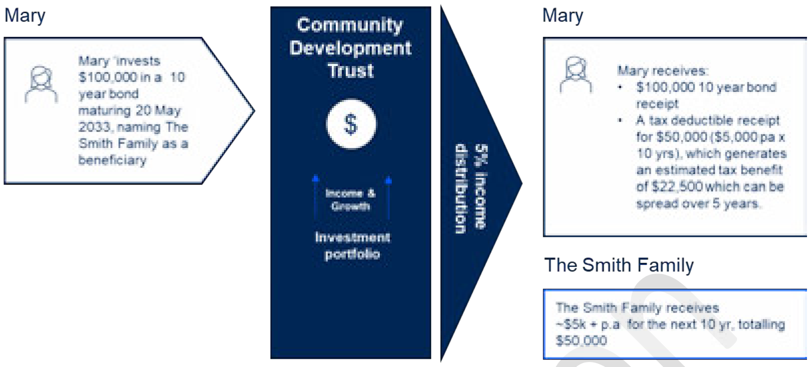
The Community Development Trust example has the following assumptions:

- Annual income expectation 4.5%
- Annual capital growth expectation 3.3%
- Total annual return expectation 7.8%
- Mary's highest marginal tax rate 45%

Perpetual

Establishment

Mary makes an 'investment' of $100,000 on 20 May 2023. Mary is entitled to claim a tax deduction in the 2023 fiscal year of $50,000 (being the minimum distribution amount which this 'investment' will distribute to The Smith Family over the following 10-year period). Based on Mary's marginal tax rate, Mary would receive a tax refund based on this deduction of $22,500 which can be claimed in one lump sum or spread over 5 years.



Years 1 to 10

Mary is not entitled to claim any further tax deduction over the life of this 'investment'. Mary does not receive any income herself from the trust annually and therefore no income from the trust is included in Mary's annual taxable income. Over the 10 years the investment will continue to grow, and the distribution amount would grow in line with the value of the investment.

Bond Termination

Based on the example, over the ten-year period, The Smith Family would receive $56,794. At maturity, in May 2033, Mary would receive $131,805 of which, in an optimal incentivised structure, no part would be eligible for income or capital gains tax. At this point Mary would have a choice to:

- Roll over the bond for a further 10 years
- Roll over the bond into a "in perpetuity" structure (ie PuAF or PAF)
- Redeem the money.

Nominal Portfolio Projection

Date	Investment'	Investment return	5% Distribution	Ending Capital - Nominal
2023	$100,000	$7,800	$5,000	$102,800
2024	$102,800	$8,018	$5,140	$105,678
2025	$105,678	$8,243	$5,284	$108,637
2026	$108,637	$8,474	$5,432	$111,679
2027	$111,679	$8,711	$5,584	$114,806
2028	$114,806	$8,955	$5,740	$118,021
2029	$118,021	$9,206	$5,901	$121,325
2030	$121,325	$9,463	$6,066	$124,723
2031	$124,723	$9,728	$6,236	$128,215
2032	$128,215	$10,001	$6,411	$131,805
Total			**$56,794**	

Based on Perpetual Privates capital market assumptions and investment in a charitable risk profile.

This example is intentionally basic and has several assumptions including that:

- The costs associated with administration, trusteeship, and investments have been deducted prior to the income and capital return assumptions,
- Distributions to The Smith Family are made annually at the end of the fiscal year
- Income and capital returns are consistent each year

This example is entirely scalable and therefore an investment of $1 million would provide The Smith Family with $581,060 over the following 10-year period, providing a truly reliable and low-cost funding source.

Perpetual

What effect would Community Development Trusts have to Tax Revenue?

The effect to tax revenue would need to consider whether an investment in a Community Development Trust would be replacing another transaction that would also have a tax effect.

Tax Revenue Increased   Tax Revenue Broadly Neutral   Tax Revenue Decreased

	Investment	Overview	Outcome
1	Where an investment is made to a Community Development Trust in lieu of a gift to a Private Ancillary Fund	The individual would only receive a tax deduction for the minimum amount equal to the minimum amount the charitable Item 1 Deductible Gift Recipient will receive over the fixed ten year period of the investment. If the individual instead had made a gift to a Private Ancillary Fund the individual would be entitled to claim the full amount as a deduction. In this instance the tax revenue would be double using a Community Development Trust as compared to a Private Ancillary Fund	
2	Where an investment is made to a Community Development Trust in lieu of a gift to a Public Ancillary Fund.	The outcome for this scenario is the same as for a Private Ancillary Fund. In this instance the tax revenue would be double using a Community Development Trust as compared to a Private Ancillary Fund.	
3	Where an investment is made to a Community Development Trust in lieu of making an annual gift direct to the charitable organisation	In this scenario the tax deduction claimed by the individual over the ten year period would be the same figure, however in the case of the Community Development Trust, the tax deduction may be claimed in the first year (or spread the tax deduction over up to 5 years) rather than an amount claimed each year. In this instance the tax revenue would be the same figure over a ten year period, however adjusting for the time value of money, the tax revenue would be slightly less than it would be by making annual gifts direct to the charitable organisation.	
4	Where a gift is made to a Community Development Trust in lieu of a large one-off gift to the charitable organisation.	The tax revenue would be double using a Community Development Trust as compared to a large one-off gift.	
5	Where a gift is made to a Community Development Trust where otherwise no gift would have otherwise been provided.	The tax revenue would be reduced by the deductible amount of the Community Development Trust multiplied by the marginal tax rate of the individual.	

Of the five scenarios highlighted above, based on the current legislation, the Community Development Trust structure provides a stronger tax revenue position to the government in four of the five scenarios. In one scenario there is a tax loss, however a community benefit that otherwise would not exist has been provided for.

Note that current legislation enables individuals to elect to utilise the tax deduction in the year their gift is made or spread the tax deduction over up to 5 years in amounts as nominated in advance.

What would be a mechanism to manage such a structure with confidence?

Like any structure that the community relies upon, there needs to be clear and accountable governance. With these structures there are several key stakeholders with interests including:

- Investors to Community Development Trusts will want to ensure funds are invested appropriately, the charitable organisations receive a growing source of income over the years, and there is a capital sum available for themselves at the end of the ten year period. Investors will also want access to regular reporting and client services to understand the level of their investment and the amount of funds distributed to the community, and how these funds have been utilised in the community.
- Charitable Organisations will want to know the funds are appropriately invested and strong governance is in place to ensure a growing and consistent income stream over the ten years. Charitable organisations will also want to acknowledge the individuals who provide this sustainable long term support their endeavours.
- Treasury / Australian Taxation Office / Australian Charities and Non Profit Commission / ASIC will want to know the investments are at arm's length, are at market value at all times, and the appropriate minimum distribution to charitable organisations is being made.

Accordingly, the role of the trustee is of critical importance, as the trustee is legally liable for the prudent management of a Community Development Trust. The choice of trustees for consideration include:

- Government
- Public Trustees
- Licensed Trustee Companies
- Private Corporate Trustee Vehicles
- Individuals acting as trustee

APPENDIX II

Amplifying the Impact of Philanthropy – Enabling Capital Loan Funds

Discussion paper

11 May 2023

Perpetual Trustee Company Limited
ABN 42 000 001 007
AFSL 236643

Amplifying the Impact of Philanthropy

Perpetual has a proud history supporting its clients to give philanthropically. Perpetual is a member of Philanthropy Australia and supports Philanthropy Australia's strategy to double giving by 2030.

Perpetual's Philanthropy and Not-for-Profit team is one of Australia's largest advisory teams working with philanthropic individuals, families, and for-purpose organisations, helping them have an impact with their giving, investments, and communities. For not-for-profit organisations we provide governance, investment management and spending policy advice.

We work with philanthropists to develop their giving strategies, set up the most appropriate giving approach for their circumstances and help them assess, choose, and support the organisations and causes that matter to them.

We work to bring these two groups together and to support them with thought leadership and analysis that helps them achieve more for their communities.

Philanthropy as a Change Agent

Perpetual's Philanthropy team engages with our clients and the broader for-purpose sector to highlight the potential for effective philanthropy to meaningfully impact on some of society's key social and environmental challenges. The reality is, however, that in Australia and internationally, we are struggling to address key social and environmental challenges.

Working to connect philanthropists with not-for-profit organisations allows us to connect best practice philanthropy with some outstanding not-for-profit organisations. Our technical expertise allows us to consider existing regulatory and policy mechanisms that might benefit community by amplifying the impact of not-for-profit organisations through innovative and effective giving strategies, as we seek to support our leading change-agents to address these complex social and environmental challenges.

Capital Impact Loans

Capital Impact Loans are one such innovation Perpetual believes can be a means of mobilising substantial existing philanthropic balance sheet capacity for the benefit of not-for-profit organisations.

Our best change-makers have the potential to meaningfully impact and benefit so many people and communities in need but are too-often constrained by short-term grant funding cycles, weak balance sheets, distracted leadership focused on fund raising instead of impact, and a weak employee value proposition due to the predominance of short-term employment contracts and an over-reliance on project funding.

Australia's existing philanthropic investment corpus, estimated to exceed $20 billion, is the nation's most important, latent asset for social change. Most of these assets are established in structures that exist in perpetuity. Yet, distributions supporting not-for-profit organisations are linked to an income-based distribution mechanism, while impact investing remains slow to meaningfully mobilise balance sheet capital that benefits social outcomes. Maintaining the status quo is unlikely to shift the dial on some of our nation's most intractable and complex social and environmental issues.

Clause 15(4) of the Taxation Administration (Public Ancillary Fund) Guidelines 2022 provides an existing opportunity to really shift the dial and mobilise substantial capital to directly benefit our leading not-for-profit organisations. At a rate that would dwarf existing impact investments deployed in Australia.

The product

The provision of philanthropic capital, in the form of a zero-rate loan with a 25-year loan term, offered by philanthropic foundations to not-for-profit organisations, will fund an investment portfolio with all the requisite governance and reporting obligations of a corporate trustee and investment manager. The returns from this investment portfolio will provide cash flows for core operating costs of the not-for-profit, plus capital accumulation, and will be a meaningful change for supported not-for-profit organisations.

A form of “investing for impact,” Capital Impact Loans will be accompanied by the distribution of additional annual grants by the philanthropic foundation to establish an independent learning and evaluation framework to inform funders and the organisations themselves of the impact of their activities. An asset that will ultimately be available for supported not-for-profit organisations to leverage alternative sources of funding, as they are better able to demonstrate their impact.

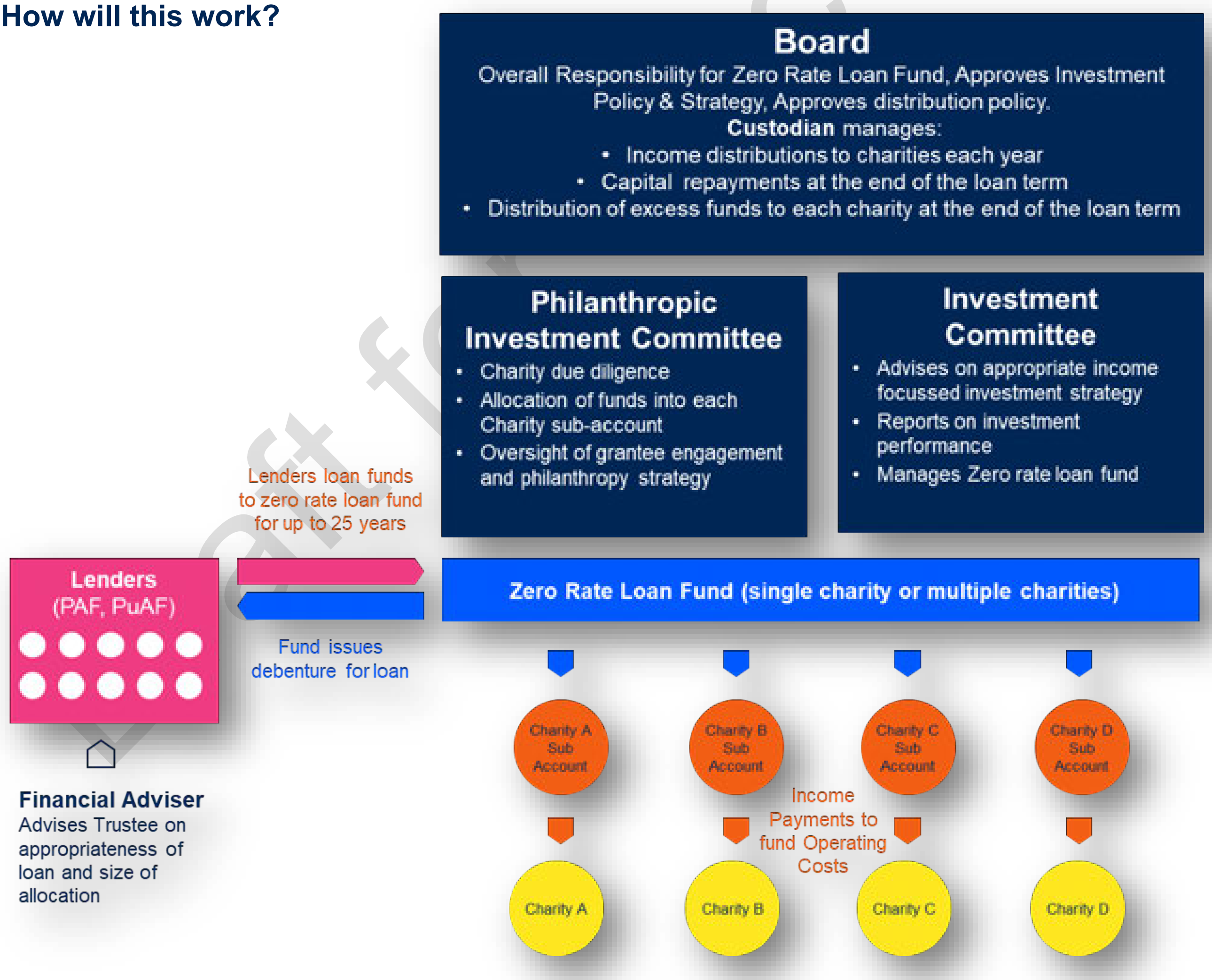
This evaluation framework will ensure formal consideration by the provider of the Capital Impact Loan, of the impact and outcomes achieved every 5-years over the term of the loan. A positive evaluation will release the next 5-years of the loan and associated income, a negative evaluation triggers full principal repayment over the subsequent 5-years.

Capital Impact (zero-rate) Loans will provide a material benefit (the value of the discounted loan) that any PAF (Private Ancillary Fund) or PuAF (Public Ancillary Fund) will be able to include as a non-cash grant distribution in the year in which the benefit is provided, whilst also arming our best change-makers with the capital to amplify their impact.

Each loan recipient receives substantial, untied, and growing income for core operations without any repayments. Not-for-profit organisations will be encouraged to accumulate adequate working capital each year, receive certainty of income for at least 10-years, and possibly 25-years, to fund core operations, free up the time for key executives to think and act strategically, amplifying their potential for impact, whilst providing organisations the confidence to take risks in achieving their mission.

At the end of the 25-year loan term, the principal is repaid to the philanthropic foundation, and all remaining accumulated capital is retained by the not-for-profit organisation, leaving them with a substantial and enduring capital asset available to continue to fund their charitable activities.

How will this work?



Perpetual

Potential for Immediate and Substantial Capital Injections

There is estimated to be more than 2,000 PAFs in Australia now with net assets of $7.6 billion. Mobilising just 1% of this balance sheet capacity in the form of zero-rate Capital Impact Loans would have the potential to unleash at least $76 million in direct support of Australian not-for-profit organisations in a form that is impact-focused and empowering.

We are also confident that a new and innovative product like the Capital Impact Loan will encourage likeminded philanthropic funders and investors to co-investment and mobilise even greater direct financial support of Australian not-for-profit organisations.

Support from Commissioners

There are currently some barriers across PAF and PuAF Guidelines that make implementation of this kind of fund difficult. A special tax ruling could solve the problem but is not guaranteed. Perpetual would welcome the opportunity to discuss this innovative philanthropic product with Commissioners in more detail. The support of the Productivity Commission in advocating for the merits of this idea to Treasury officials and The Australian Taxation Office would assist. It is vital to ensure that this innovative product can be developed in compliance with the funding Guidelines and, if required, propose suitable amendments to those Guidelines to ensure this innovation can support Australian charitable organisations and Australian communities.