Choosing the right program to achieve your philanthropic objectives

Executive Summary

The tax initiatives introduced by the Howard Government in 2001 have provided much greater incentive for individuals, families, and businesses to make a difference in the community through charitable giving. This incentive is greater and more tangible if donations are made during ones lifetime, rather than left as a bequest in ones estate.

For those wishing to make a financial contribution there is now a broader range of options available for donating and making charitable giving tax deductible.

Options vary from making a simple cash donation to a specific charity on the one hand, to making a large contribution of either money or property to a public or private fund on the other. And, tax deductions for significant contributions may now be spread over a period of up to five years.

The appropriate choice of which charitable giving option is best depends on the specific objectives of each individual, family, or business. It will take into account individual attitudes towards the control of capital and choice of recipient (charity), as well as the question of who is to be responsible for the administration and cost effectiveness of the program.

This report provides a map of the broad options available for charitable giving and highlights the key points to consider in deciding the best alternative for each specific situation. The report then outlines the steps to be taken by those wishing to commence a program to realise their philanthropic objectives during their lifetime.

Introduction

Charitable giving in Australia, recent history and trends

Compared with other nations such as the United States (US), the United Kingdom (UK) and Canada, Australia historically has not shown a high level of philanthropy. Recent research by Karen Wright and Goldman Sachs JB Were shows that Australians give 0.5% of their Gross Domestic Product (GDP) to charity. This compares with the US, where citizens give 2.1% of GDP and with the UK, where they give 0.77%.

This apparent difference in attitude is explained in part by the fact that estates in the US and the UK are assessed differently from those in Australia. Capital and property left to an estate in the US and UK are taxed, which encourages the gifting of assets prior to death. In Australia on the other hand, death duties have been abolished and capital gains tax only applies when an asset is sold.

Realising the importance of tax incentives as a way of encouraging greater philanthropy, while at the same time being conscious of the need to transfer the financial responsibility for supporting needy groups in the community away from government and towards individuals and corporations, the Howard Government introduced new tax legislation in 2001. This legislation included a raft of tax incentives to encourage greater philanthropy in Australia.

Time will tell whether these initiatives will give rise to a radical shift in attitudes, but current indications suggest that they are indeed likely to be successful. The number of registered prescribed private funds, for example, has increased over the past four years from 22 in 2000/01 to 223 in 2003/04. (Prescribed private funds or PPFs are defined and discussed below.)

According to a Federal Government report published in October 2005, “a number of data sources have confirmed growing rates or proportions of money”. It goes on to say: “Since 1997, giving of money by individuals has increased in absolute terms by about 88%, or 12.5% per annum. In real terms, adjusted for inflation, giving rose by 58% over those seven years”.

Three key factors have given rise to the overall increase in giving:

- the increasing proportion of adults in the Australian population, due to increasing longevity;
- sustained economic prosperity; and
- greater and more positive publicity for giving.

Interestingly, the report also notes that those with a greater financial capacity are giving proportionately more than they used to, while those with less capacity to do so are giving less, mirroring the research carried out in the US. While taxation incentives appear to encourage planned giving, it seems that “only about one in four dollars donated is claimed for tax purposes.” It is wealthier members of our community, evidently, who are responding better to the tax-related incentives that have been introduced. 64% of Australians with taxable incomes of $1 million or more make a claim for philanthropic giving. Not only is this the highest proportion of any income bracket but their average donation is also higher than that of any other bracket.

Despite the increase in interest in philanthropy, recent media attention has focused on the lack of transparency, the high cost of administration of some charitable organisations, as well as the misuse of funds intended for worthy causes overseas.

The broad range of complex factors to be considered highlights the need for individuals, families and companies to seek advice from people well qualified to counsel on the options for charitable giving.

Recent tax initiatives

In 2001, the Howard Government introduced a number of initiatives to encourage individuals, families, and businesses to make a greater financial contribution to qualified beneficiaries. These initiatives apply to donations made to organisations that, having been accredited with deductible gift recipient (DGR) status, are eligible to receive tax deductible donations.

Taxation measures relating to individuals, families, and business include:

Workplace giving

The workplace giving initiative encourages employers to offer a program providing employees with the ability to make regular donations through their pay in a simple and convenient manner. Because their PAYG tax is adjusted, employees receive the tax benefit immediately and do not have to wait until the end of the financial year to claim a deduction. The employer then has the opportunity to benefit from increased employee morale and loyalty, as well as enhanced reputation and profile.

Prescribed private funds

Individuals, families, and businesses can establish their own prescribed private fund (PPF) to which tax deductible donations can be made. Prescribed private funds allow substantial sums to be invested for future distribution to charities and organisations with deductible gift recipient status. PPFs are not required to seek donations from the public.

Tax deductions for cash donations

Tax deductions for donations in cash may be spread over a period of up to five years, significantly increasing the benefit of the donation to a tax payer on the highest marginal tax rate. Previously, the tax deductibility of a large donation would have been wasted if the donation exceeded the donor's taxable income. Now the tax benefit can be carried forward for an additional four years.

Gifts of property

Donors may receive a tax deduction for gifts of property (land, buildings, artwork, collectibles, and so on) if the property has been owned by the donor for more than 12 months and has a value greater than $5,000. This includes environmental and heritage property donated to approved environmental organisations.

Tax deductions for such donations of property may also be spread over a period of up to five years.

An example:

A grazier with no children donated half of his property to a university. He had owned the property for 40 years and could no longer manage the whole area. His main aim was to assist the university by providing land for agricultural research. In addition, this gift, valued at $500,000, reduced his taxable income by $100,000 each year for five years – an unforseen and very welcome benefit.

Exemption from capital gains tax

A bequest of property and gifts of cultural property made through the cultural gifts program is exempt from capital gains tax, thereby maximising the value of such gifts for tax deduction purposes.

(For more information on such programs and the types of tax incentives they provide, visit the Australian Tax Office's "Non Profit" section on their website [www.ato.gov.au/nonprofit/]. Here you can download a fact sheet on the Charitable Gifts Program and on the types of gifts for which a tax deduction can be claimed.)

Options for giving

There are, then, several options now available to individuals wishing to exercise their philanthropic conscience.

Most Australians are familiar with the direct marketing approaches of major charities, seeking individual or corporate donations. In most instances these approaches cater for “unplanned” giving by individuals or companies. Few are familiar with the other, more deliberate options we have been discussing. Each of these options is outlined below, from the simplest – a cash donation – to the most involved: a private foundation.

Donations

Recent research confirms what most of us already know – that Australians do not appreciate some of the methods employed by charities in raising money to support their otherwise worthwhile causes. The intrusive phone call at 7.30 in the evening requesting a donation is not generally appreciated after a busy day. Yet, with the reduction of government assistance and an increase in demand for the services that charities provide, charities and community groups have a greater need for support than ever before. There is also more competition between charities and community groups to take advantage of the public’s generosity.

The monetary donation prompted by direct marketing or personal association, therefore, is still the simplest option for charitable giving. If the charity or cause has received accreditation from the Tax Office as a deductible gift recipient (DGR), then the donation will be tax deductible to the donor.

While some individuals donate to a specific group of charities each year, for most people the donation of cash is automatic rather than a premeditated response to direct marketing. The receipt of a tax deduction is not, generally speaking, the primary motivation for individuals making this kind of donation, though it does enhance the motivation especially for more wealthy donors for whom tax deductions are of material benefit.

It is a relatively simple exercise to respond to a charity’s request, make a donation, then record the receipt for inclusion with an annual tax return. If people have a connection with the charities they wish to support, their method of giving need be no more complex than making regular or ad hoc donations.

Many people however, are reluctant to donate without feeling confident that their funds will reach the intended cause and seek greater control over their choice of beneficiary. They may also be unsure as to which causes within the community have the greatest need and hence are undecided about committing their donation. While many major charities have developed a high profile and successful business model, some prospective donors question whether equally deserving social and community causes have not been overlooked in the competition for financial support.

Private foundations

The most flexible structure through which to make donations is a private foundation. This structure is generally only used by the very affluent because the trade off for the greater level of control and flexibility that comes with this form of giving is a lack of tax deductibility, as well as a high degree of responsibility, management and ongoing reporting requirements.

A private foundation would generally only be used where a donor (or donor family) wanted to set aside several million dollars to support causes of their choosing, including some beneficiaries who may not have deductible gift recipient status. (An example would be the support of a specific arts project.)

Contributions might be in the form of money or, alternatively, property, shares, artwork, and collectibles can be transferred into the foundation.

Prior to 2001, a private foundation was the only available option for wealthy families or organisations to build a pool of capital and create an ongoing legacy to support their preferred causes.

Prescribed private funds

The prescribed private fund (PPF) is a more recent structure arising directly from the introduction of new legislation by the Howard government in 2001 to prompt charitable giving (see the previous sections).

A prescribed private fund *must* make donations to organisations that have deductible gift recipient status, making all contributions to a prescribed private fund tax deductible.

As with a private foundation, contributions may include property and shares as well as cash.

A prescribed private fund is not as flexible for the beneficiary as a private foundation and it has to comply with strict legislative guidelines to retain its tax concessional status. In addition to annual reporting to the Australian Tax Office, the trustee company of a prescribed private fund must include an external director to ensure the fund meets it statutory obligations.

Generally speaking, a prescribed private fund would not be established unless the capital to be contributed exceeded $500,000. Annual running costs for a prescribed private fund would be in the order of $3,000 to $5,000.

That said, the rise in popularity of prescribed private funds since their introduction in 2001/02 indicates both the growing determination of individuals, families and companies to exercise their social conscience and their willingness to take on the responsibility of managing a fund in order to exercise control over the donations they make to preferred beneficiaries.

The challenge then arises of selecting which causes to support, since the founders of a prescribed private fund would not generally have access to research on community needs.

Community foundations

Community foundations have been popular overseas for many years, but have only recently begun to gain more recognition in Australia.

As the name implies, a community foundation is established to receive donations that will benefit the social needs of a given community or area. Examples include the Sydney Community Foundation, the Melbourne Community Foundation, and the Hunter Valley Community Foundation.

Compared with a PPF or a private foundation, the individual or corporate donor does not have responsibility for all the administration, accounting, and legal issues, nor are they responsible for the investment of capital within the fund.

The disadvantage is that they do not have the same degree of control over donating to preferred beneficiaries. However, with a community foundation the donor can suggest where their contribution might be directed, and the trustee will generally honour that request.

From the donor's perspective, the community foundation provides simplicity and choice, with the community foundation generally carrying out its own research to identify likely deserving causes within a given community as part of its charter. Community foundations also provide the opportunity for donors to play a more active role, with some degree of involvement in their preferred social cause, if they so desire.

As with PPFs, contributions to a community foundation may be tax deductible as grants may only be made to causes with deductible gift recipient status.

An important feature of the Community Foundation is their ability to create a **“sub fund”** to exclusively address a donor’s specific interests and needs. This “sub fund” can generally be established with as little as $50,000 and named after the donor of their family.

Donors may also give capital in the form of an endowment, whereby the income earned from their contribution continues to support a worthy cause beyond their own lifetime.

Public charitable trusts

A public charitable trust is generally established in perpetuity to allow individuals and companies to establish a program of giving that offers flexibility and ease of administration. (One such example is the Perpetual Charitable Gift Fund.)

It is very similar to a community foundation. Like the donor to a community foundation, the donor to a public charitable trust may nominate which charities he or she would prefer to benefit from the donation, and this is then considered by the trustee. The advantage here is an enhanced sense of control (though the chosen causes will always remain subject to trustee approval).

When comparing a public charitable trust with a community foundation, several key differences should be considered:

- a public charitable trust is generally managed by a professional trustee company;
- the trustee of a public charitable trust is responsible for the management of the investment capital donated to the trust;
- not being restricted to the one community, a public charitable trust provides a wider range of charitable organisations from which a donor can choose;
- a public charitable trust will not usually invest time in researching the needs of a particular community, which is an essential component of a community foundation;
- unlike a community foundation, a public charitable trust does not provide the donor with an opportunity for direct involvement in a specific cause.

When to give; now or via estate?

Many people are very willing to support worthy causes with gifts of money or property but are unsure when is the right time to make such a donation. Typical questions include:

- What happens if I give now and then run low on money in the future?
- Are there any tax benefits in giving now, compared to leaving a bequest in my estate?
- How can I see the benefits of my donation if I leave a bequest in my Will?
- Can I become involved with my chosen organisations as well as make a donation?
- How can I involve my children to create a culture of charitable giving in our family?

The key advantage of making a bequest, (making donations via ones estate) is the certainty this provides that the donor will not run out of money during their lifetime. Yet there are many advantages of making a significant donation during ones lifetime, which include:

Fulfilment

The major motivation for philanthropy is to make a difference and it is far more satisfying to see, first hand, the tangible benefits of ones giving.

Involvement

Many donors not only want to donate part of their wealth, they also like to contribute time to their chosen cause as a way of giving back to their community. Many charities and foundations provide donors with the opportunity to become actively involved.

Family culture

Having made the decision to support a wealthy cause, many parents are keen for their children to learn from their example. By donating during their lifetime parents have the opportunity to not only establish a family culture of philanthropy, but also pass on their social conscience to the next generation.

Tax

It may be more tax effective to make a donation during ones lifetime rather than via a bequest nominated in ones estate. As this is a complex area requiring specialist tax advice it is strongly recommended that one consults their accountant prior to making a decision.

Affordability

An important in fact vital, issue is to ensure that potential donors are comfortable to give without significantly impacting their own lifestyle in the future. This can be readily overcome through discussions and analysis with your financial adviser. They have the skills and the analytical tools to assess whether you have surplus capital and how best to match your cash flow in the future.

Case study

George and Margaret retired from their business last year. Both were reluctant to remain idle and wished to continue using their business skills to give back to the community in one form or another. After receiving professional advice, they established a Prescribed Private Fund (PPF). The immediate benefit was the tax deduction they were able to receive to offset the capital gains they had made from the sale of their business. More importantly, the PPF allows them to remain actively involved in the giving process, as well as control the investment of capital.

They have been enjoying managing their PPF. Engaged in finding good causes, George's compassion for the sick has seen him direct distributions to support projects in the field of medicine and science, while Margaret is keen to support charities focussed on helping women and youth in their local community. Bill and Margaret find that their PPF has also provided a valuable tool to instil philanthropic values in their children and grandchildren. Their adult children are also on the board of directors of the trustee company and as such, every six months the family gets together to discuss successful stories, programs and charity groups. Even their grandchildren (under 18) are involved, as their views are sought on particular causes and they are invited to visit different charity programs and projects.

Whist not the driving force for their decision, the ability to be able to claim a tax deduction for their donation to the PPF and to be able to spread this deduction over a five year period was certainly an attraction.

We note that if they had made the donation as a bequest through their estate, none of the above benefits would have been possible.

Deciding what is best for you

With such a wide variety of options available to individuals, families and companies (donor) to achieve their philanthropic objectives, how does one decide which path to follow?

The answer should be relatively straight forward, but should not be attempted until other key questions have also been answered:

First, what will be the impact of making such a donation on the donor's financial future and what amount of capital is the donor willing to contribute over time?

Secondly, does the individual, family or company (donor) want to determine where their donations are to be made?

Thirdly, what level of resources and expertise – particularly time and a knowledge of the charitable alternatives – does the donor have available to select their preferred cause. And what experience and skills must they commit to accounting and investment, as well as the ongoing management and administration of the giving program?

Finally, to what extent does the donor (and their family) wish to be involved with the ultimate recipient beneficiary of his or her charitable giving?

The answers to these questions will generally lead to a clear decision on which option is best suited.

(A summary table is included in the appendix to provide a brief overview of the characteristics of each option in order to enable people readily to compare each option's capacity to meet donor objectives.)

Where to form here?

So what is the next step if you want to do something more purposeful than responding to the annual doorknock appeal or unsolicited evening phone call. The first step for each of the four major options is outlined below.

Prescribed private funds & private foundations

Individuals, families and companies considering establishing their own Private Foundations or Prescribed Private Funds (PPFs) should in the first instance talk to their accountant or financial adviser, who will outline the specific considerations relevant to their circumstances and explain the responsibilities that apply to establishing and operating a private foundation or a prescribed private fund on an ongoing basis.

Generally speaking, an accountant and financial planner will also know a solicitor who can establish the Trust to ensure that it complies with current legislation. Depending on the capital to be contributed, the accountant may also have a relationship with a financial adviser to assist with the investment of capital and to plan cash flows for donations to match the donor's objectives.

In many instances the donor will have a clear idea on which worthy causes they intend to support. If this is not the case and the donor wants assistance in reaching a decision, there are several places to go to obtain research in a specific area. Such research organisations include: Enrich, Philanthropy Australia, as well as the appropriate community foundation for a specific region.

Community foundations

People who do not want the responsibility of managing their own private foundation or prescribed private fund but wish to do something beyond an unplanned donation to a specific charity may elect to involve a community foundation, who will provide a range of worthy causes they have researched in their local community.

One example is *The Sydney Community Foundation*, which has recently supported such worthy causes as *Midnight Basketball, Young Black & Deadly,* and *Project Greenhouse.*

Again, your accountant and/or financial adviser will be aware of the local community foundation and how you might progress consideration of this option.

To enquire about the particular causes supported by community foundations and to obtain more information, you can visit their websites.

Public charitable trusts

People who wish to donate to eligible charities not restricted to a specific community and who know which charities they wish to support may want to consider the public charitable trust as an option.

To make an application to these trusts, the information brochure and the product disclosure statement for investment of capital can be downloaded from their respected websites. Alternatively, you might prefer to contact them directly and request an information brochure and product disclosure statement to be mailed out.

The professional adviser’s role

Our experience is that most people or organisations feel more comfortable consulting an informed, independent adviser to assist them with short listing those options for charitable giving which best suit their need. Such advisers would include an experienced accountant, solicitor, or financial adviser who understands their philanthropic objectives.