Law Council
OF AUSTRALIA

Legal Practice Section

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Director, Not-for-profits Unit
Personal and Indirect Tax and Charities Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: charitiesconsultation@treasury.gov.au

Dear Sir/Madam

Giving fund reforms: distribution rate and smoothing

1. This submission has been prepared by the Charities and Not-for-profits Committee of the Law Council of Australia's Legal Practice Section (the **Committee**). The Committee welcomes the opportunity to make a submission to Treasury in relation to the recent consultation paper on *Giving Fund Reforms: distribution rate and smoothing* (**Consultation Paper**).

2. Many members of the Committee act for and advise both public and private ancillary funds and their founders in relation to the establishment and ongoing operation of Giving Funds (**Funds**). The observations below draw upon the experience of these professional advisers.

3. In general, the Committee does not support the reforms proposed in the Consultation Paper. In the Committee's view, the proposed reforms are likely to decrease choice for donors and those choosing Funds as their philanthropic vehicle and, therefore, potentially reduce philanthropy.

4. In circumstances where deductible gift recipient (**DGR**) reform has been largely stagnant, the Committee submits that there are significant issues in the policy and law surrounding DGRs generally that require attention as a priority over the proposed changes for Funds.

5. The *Future Foundations for Giving* report issued by the Productivity Commission (the **Commission**) in 2024 concluded that the DGR system is not fit for purpose and requires reform in order to achieve the Government's philanthropy targets. We contrast this with the observations made by the Commission about minimum distribution rates, which identified the lack of clear policy or a principles-based framework for minimum distribution rates and was 'inconclusive' in determining what the minimum distribution rate should be.[1]

[1] Productivity Commission, *Future foundations for giving* (Inquiry Report No 104, 10 May 2024) 288 <https://www.pc.gov.au/inquiries/completed/philanthropy/report>.

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6. Funds are an essential, well understood and widely adopted vehicle for philanthropy. As currently regulated, they provide flexibility to donors to give over a set number of years of their choosing or to create a lasting legacy through an endowment fund.

7. Historically many philanthropic foundations have existed—and have been understood by both donors and charity recipients—as endowments. Of course, others are established to have a limited life and be spent down more quickly. Much of the charity and trust law has developed on the basis that trustees of charitable trusts must balance the needs of the charities now and in the future. The investment powers in the state and territory Trustee Acts,[2] and in the Ancillary Fund guidelines,[3] are based on this balancing exercise. Most charitable trusts set up under Wills require the capital or corpus to be preserved and only income distributed annually. Most of the well-known philanthropic foundations which have been in existence for several generations operate on this basis. Philanthropists and potential philanthropists understand this, and many, possibly most, come to establish or contribute to foundations on the basis that it can exist in perpetuity. For some, it is a family philanthropic endeavour where the founder's relatives can be engaged through their contributions of their own funds to a Fund established to have legacy or in the stewarding the Funds by becoming responsible persons.

8. Funds currently provide donors a choice of a lasting endowment model or a 'flow through' or limited life option. In our view and collective experience, more donors choose the endowment option as they want to know their generosity will continue to support the community for future generations as well as addressing today's needs.

9. Given the government's stated intention to double philanthropic giving by 2030, any changes to Funds which may discourage philanthropy, by removing the main choice of donors setting up giving funds, should be avoided.

Minimum annual distribution rates

Question 1—Are these considerations appropriate in setting the minimum annual distribution rate?

10. The Consultation Paper is heavily focused on economic considerations, which must be balanced against other considerations—in particular, encouraging philanthropy, and the psychology, understandings, expectations and motivations of donors.

11. In addition, the analysis does not consider the significant variations in giving funds and how they operate or why they were established. It assumes the funds are all able to support any item 1 DGR whereas many are set up to support the future of one charity only or research for one disease. Some giving funds are established with a one-off significant capital gift and some start with $10 and are aimed at growing through many gifts from the public and conservative investments.

12. The first principle listed on page 3 of the Consultation Paper acknowledges the charitable purpose of Funds, but fails to recognise that investment returns are necessary to support the purposes of the Fund both at present and into the future. Investments are made within Funds for the purpose of generating income in the

[2] Trustee Act 1925 (ACT), s 14; Trustee Act 1983 (NT), s 5; Trustee Act 1925 (NSW), s 14; Trusts Act 1973 (Qld), s 21; Trustee Act 1936 (SA), s 6; Trustee Act 1898 (Tas), s 6; Trustee Act 1958 (Vic), s 5; Trustees Act 1962 (WA), s 17.

[3] Taxation Administration (Public Ancillary Fund) Guidelines 2023 (Cth), s 20; Taxation Administration (Private Ancillary Fund) Guidelines 2019 (Cth), s 20.

present, while preserving capital to enable generation of income into the future so that there are funds for charitable purposes long term. It is unhelpful to suggest that the purpose of investments is simply to maximise returns, when those returns must as a matter of law be applied to charitable ends. Maximisation of returns is not an 'evil'—rather it is a duty of trustees to focus on this in investing. The aim is that investments fund the work of the charitable trust or foundation, by generating money:

> *… the purpose of the trust will be best served by the trustees seeking to obtain [from the investments] the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence. That is the starting point for all charity trustees when considering the exercise of their investment powers. Most charities need money, and the more of it there is available, the more the trustees can seek to accomplish.*[4]

13. There are many different ways and reasons giving funds are established. Much will depend on these circumstances as to how and when donations may be made. Indeed, Funds may be established with a donation from a sale of a significant asset or an inheritance where there is no prospect of further donations—it is not, and has never been, an ongoing requirement for all Funds to continually receive donations.

14. The Committee supports the Consultation Paper's observation that Funds exist to encourage philanthropy, and in setting the minimum annual distribution rate, the Government must strike a balance between maximising benefits to DGRs and encouraging new Funds. Encouraging new Funds will require a greater attention to, and understanding of, the preferences and motivations of donors than what we see foreshadowed in the Consultation Paper.

Question 2—Should the five-year transition period apply only to giving funds that exist at the time the distribution rate changes, or to all giving funds?

15. If the government favours an increase to the minimum annual distribution rate, it must ensure a sufficient transition time for existing Funds. The Committee defers to the views of the investment community for recommendations as to timeframes for the transition period but is broadly supportive of a five-year transition period for all Funds (not solely those that exist at the time of any rate change).

16. We are aware that certain Funds have already structured their investments for the long term based on the current minimum distribution rate. Any change to this rate necessitating change to the investment approach already implemented is likely to not just be inconvenient but expensive. An example of this is as follows:

> A founder/donor has given a large one-off sum to his Fund. The founder can no longer make any substantial donations as he has retired. As its long-term and safe investment strategy, the Fund has purchased a commercial property and has entered into a long-term (20 years) lease with a tenant. Under the lease, the annual rent is to be calculated at slightly over 5 per cent of the market value of the property. Rental income is wholly used to make distributions to DGRs and there is compliance with the current minimum distribution rate. In this example, the retired founder would be forced to make additional donations if the minimum distribution

[4] *Harries v Church Commissioners for England* [1992] 1 WLR 1241, 1247 (Nicholls V-C).

rate is increased, or to terminate the lease (which will be expensive) or divest the property (also expensive).

17. There are also Funds which have made commitments to support particular DGRs for the long term or indefinitely. For example:

> A DGR (established by a community) operated at a loss of $1m per annum and the community used to support the DGR1 to make up the loss in each financial year.
>
> In order to protect the longevity of the DGR's work and enable it to pursue its charitable purposes more securely, the community established a public Fund and over time has built up assets of $25m in this Fund. The Fund has committed to—and implemented—an investment strategy which generates at least 4 per cent returns annually. Under the Fund's trust deed, it is specifically required to make an annual distribution of 4 per cent ($1m) to the DGR and this has had to effect of providing financial stability for the DGR.
>
> In this example, if the minimum distribution rate is changed the Fund would be forced to do any or all of the following (among other things) in order to be able to secure the longevity of the DGR's work:
>
> - raise more funds for the Funds in order to meet the new higher minimum distribution rate, which the supporting community may not have the capacity or inclination to respond to;
> - change investment strategy (expensive and a possible risk to the Fund); and
> - amend the trust deed, which would be a challenging task in the circumstances of the Fund.

Question 3—What other considerations, if any, should the government consider in setting the minimum annual distribution rate?

18. The Committee submits that the motivations and preferences of donors in establishing and contributing to Funds should be prioritised, in order to encourage and preserve this valuable form of philanthropy and support the Government achieving its stated philanthropy targets.

19. The Committee notes that the *recent Taxation Administration (Community Charity) Guidelines 2025* provides for a minimum distribution rate of 4 per cent.[5] While the Committee does not express a view about whether this minimum distribution rate is appropriate, we do observe that consistency across the various DGR-endorsed funds that operate in a similar manner would be preferable. This may include aligning the minimum distribution rates between Private Giving Funds (**PGFs**) and Public Giving Funds (**PuGFs**). However, in considering any such change, it must be remembered that the lower rate of PuGFs was provided in acknowledgement of the greater costs of administering and operating a PuGF and there has been no change to this reality.

[5] *Taxation Administration (Community Charity) Guidelines 2025* (Cth) s 13.

Question 4—In setting the minimum annual distribution rate, is it appropriate to consider the time preferences of DGRs and the community?

20. The preferences of DGRs and the community are not irrelevant. However, as the Consultation Paper acknowledges, these preferences will vary greatly. The Consultation Paper does not outline any evidence obtained in relation to the preferences of DGRs, which the Committee would encourage be obtained through proper research prior to any change to the minimum distribution rate. Changes should not be based on unsubstantiated assumptions.

21. In our view, it is the preferences of donors that should be prioritised if the Government's target of doubling philanthropy by 2030 is to be achieved. In particular, the flexibility of choice for donors to elect whether they seek for the Fund to operate in perpetuity.

Question 5—Is your preference for DGRs to receive distributions sooner, later or no preference?

22. The Committee does not express a preference. However, if DGRs require funding sooner rather than later, those DGRs are able to conduct their own public fundraising and utilise their own DGR status to attract individual donors and they can also approach Funds (as many do) to make the case for earlier distributions as it is also possible for them to propose higher than the minimum distributions be made by Funds that are relevant to them.

23. Further, the needs of the charity sector will vary greatly—some parts of the sector require immediate funding for immediate needs,[6] whereas others will need to maintain funds for planned or anticipated long-term needs.[7] It cannot be assumed that immediate access to funds will be in the best long-term interests of all charities and their diverse purposes and programs addressing needs with various time ranges.

24. As outlined above, the Committee's preference is to maintain the flexibility of choice for donors, which will enable donors to consider whether a perpetual Fund aligns with their (and in many cases, their families') intentions and motivations in establishing the Fund and the charities it intends to support. Where the intention of donors is to provide for more immediate needs of charities, this is already accommodated within the current model.

Question 6—To what extent should the wishes of donors to operate a fund in perpetuity be balanced against the preferences of DGRs?

25. The premise of this question suggests that there is a conflict between the desire of donors and the preferences of DGRs. In the Committee's view, there is insufficient evidence to support this.

26. We reiterate that the Future Foundations for Giving report noted that 'the minimum distribution rate should be set to facilitate the desire of some ancillary funds to operate

[6] For example, DGRs addressing Australia's present housing needs, those responding to emergencies because of natural disasters and those addressing particularly acute present social needs of particular demographics in Australia (such as those experiencing family violence and those needing aged care).
[7] For example, those DGRs with long term community development projects in Australia or overseas aimed at generational (cradle to end of life) transformation, 'expensive' issues (such as human trafficking) and those strategically maintaining funds for emergency preparedness purposes (such as pre-positioning to be able to respond immediately and urgently to emergencies including 'climate disasters').

in perpetuity without guaranteeing that all ancillary funds do so or incentivising that particular outcome'.[8] There is presently no guarantee or incentive for Funds to exist for perpetuity. In our view, it is appropriate that founders and those who operate Funds determine the longevity of Funds.

27. The Committee would defer to the views of the accounting and investment community on an appropriate minimum distribution rate which enables funds to be operated in perpetuity. However, we highlight the comment in the relation to Chart 2 of the Consultation Paper that 'the 5 per cent distribution rate is also the only scenario in which the real value of the initial $1 million gift is retained, if perpetual operation of a fund is considered important'. This suggests that, in order to achieve the Commission's recommended outcome of enabling Funds to exist in perpetuity if desired by the donor, no change should be made or is required to the current minimum distribution rates for PGFs.

Question 7—Do you have a view on how increasing the distribution rate would affect the willingness of donors to set up giving funds?

28. The Committee is concerned that increasing the distribution rate would significantly reduce the willingness of donors to establish Funds.

29. The Consultation Paper does not indicate whether any research or data has been obtained in relation to the preferences of donors, but the Committee's anecdotal view, based on the combined experience of Committee members, is that a significant number of donors seek to establish a long-term legacy with their donations to Funds and may intend for those funds to operate in perpetuity.

30. Any change that removes the option for donors to establish a perpetual Fund is likely to deter some donors and reduce philanthropic giving.

31. We are also concerned that any change now will effectively create uncertainty and lack of confidence in the law relating to Funds. This certainty and confidence are necessary for those who have a duty to invest (and to invest well).

Question 8—Given all considerations, do you have a view on what the appropriate minimum annual distribution rate should be?

32. For all of the reasons outlined in this submission, the Committee does not see the need for an increase to the current minimum distribution rates.

Principles for smoothing distributions

33. While the Committee is generally supportive of the principles outlined in the Consultation Paper in relation to smoothing distributions over a three-year period, we make the following additional submissions in relation to 'smoothing':

    (a) The proposal to allow Funds to smooth distributions should be implemented in as simple a manner—and one that allows Funds the greatest flexibility—as possible.

[8] Productivity Commission, *Future foundations for giving* (Inquiry Report No 104, 10 May 2024) 19 <https://www.pc.gov.au/inquiries/completed/philanthropy/report>.

(b) We question whether the Commissioner of Taxation having power to direct a Fund to make the minimum required distribution in each year, is necessary. In our view, the ability for the Commissioner of Taxation to direct a fund to rectify any shortfall in distributions at the conclusion of the three-year period seems to be an appropriate safeguard against Funds failing to distribute the minimum rate across that period.

(c) We further observe that the proposed power of the Commissioner of Taxation to direct funds to make the minimum distribution rather than smooth will create significant uncertainty if that power is discretionary, which will likely be a deterrent to Funds and their advisers.

(d) The requirement for Funds to notify the Commissioner of Taxation of their intention and reasons for smoothing distributions is an administrative burden, which is likely to deter Funds from utilising the option. We suggest that a more appropriate and proportional approach would be the requirement for Funds to advise whether they are smoothing distributions in their annual Ancillary Fund Return or Annual Information Statement (as applicable).

(e) There does not appear to be any clear basis for disallowing a Fund which has never previously made a distribution to access smoothing, and the Committee's view is that the risk of allowing new Funds to smooth distributions is low.

Contact

34. The Committee would welcome the opportunity to discuss this submission with the Department. In the first instance, please contact the Committee Chair, Bridgid Cowling [redacted]

Yours sincerely

Greg McIntyre
Section Chair