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FINANCIAL PLANNING

Gifting & Philanthropy - *Charitable History & Structures for the Altruistic.*

Working closely with family's since 1992 to achieve their financial goals, we recognise, in many cases, there may also be an altruistic desire. The wish to be selfless, self-sacrificing, philanthropic, considerate, compassionate. This often leads to the discussion surrounding *'how can I best achieve this? and what is the best approach?'.*

Our experience has shown Gifting & Philanthropy, maybe considered by clients for various reasons. So, understanding the history, rationale and appropriate structures works hand-in-hand when providing solutions to meet our client's needs.

Historic Motivation...

The number of people living in extreme poverty (classified as living on less than US$1.90 per day) fell to under 1 billion today in 2020 (around 10% of the global population).

Despite these advances, the need for donations to worthy causes has not diminished. Global inequality continues to grow, with the world's 2,000-odd billionaires holding as much wealth as the poorest 60% of the world (Oxfam 2020), and growth in wealth is increasingly concentrated to the world's most wealthy. While growing wealth across the board is a good thing, there are many social issues that arise from inequality, such as poor health outcomes and crime.

Furthermore, there are countless natural disasters and other calamities (both large and small) that adversely affect millions of people every year. And there are numerous other social and environmental issues that need to be addressed with some urgency.

Current environment in giving

The past decade has seen key movements and ideas in philanthropy take hold. One of the most publicised is the "The Giving Pledge". This program, spearheaded by billionaires Bill and Melinda Gates and Warren Buffet, is the commitment by the ultra-wealthy to dedicate most of their wealth to philanthropy. As at May 2019, around 10% of the world's billionaires had signed the pledge.

Australian philanthropy

According to a report into Australian charities, in 2017 there were over 57,000 charities, with total annual revenue of $146.1 billion and staff numbers of about 1.3 million staff (ACNC 2019). All in all, charities received almost $10 billion in donations from around 15 million Australians (average of around $700 from about 70% of the adult population), which helped to fund a variety of charitable causes, including international relief efforts, social services, health, religious activities, education, research, housing and the environment. The most popular of these in Australia are charities that focus on children, helping the poor or conducting medical research, as shown in Figure 2.

Figure 2: Destination of Australian donations

Source: CAF 2019.

Compared to other countries, when giving is measured as a percentage of gross domestic product (GDP), Australia does not fare as strongly, with giving at around 0.25% (CAF 2016). Relative amounts given by the likes of New Zealanders and Canadians are more than three times that of Australians, while Americans give over 1.4% of GDP.

Motivation to give

Overall, at the top of the list of philanthropic motivations is altruism. Philanthropy is primarily motivated by feelings of empathy (Muller, Pfarrer & Little 2014), and for the most part, giving by most individuals is altruistic (Morvaridi 2012). This is true for Australians, with 54% of donors stating that they had given to a cause because they cared, and 41% wanting to help those less fortunate (CAF 2019). All this, of course, is no surprise as the endeavour of philanthropy is essentially the sharing of one's own wealth with others.

Budget versus capital

In general, funding of a client's philanthropic endeavours can be framed by either their budget or by their capital:

- **Budget**: A client can designate a portion of surplus income every year as charitable donations. This will show up as an expense line on their annual budgets. This can result in variable levels of giving, based on changing income and expense levels.
- **Capital**: A client can segregate a portion of surplus assets to fund ongoing gifts of money. This can be a physical segregation by way of permanently donating the desired portion of assets to a separate entity (e.g. external or self-managed charitable foundation), or a virtual segregation by way of earmarking the income from certain assets for charitable purposes. In general, philanthropists tend to target donation levels of 5% of designated assets per year (which can be mandated by law in many circumstances). This can also result in variable levels of giving, based on changing asset values.

Tax planning

A client's giving can also be structured so as to maximise tax benefits of donations:

- **Deductible gift recipient (DGR) status:** Many philanthropic structures in Australia require donations be made to entities that have deductible gift recipient (DGR) status in order for the donor to receive a tax deduction. Thus, it can be worthwhile for clients to build a philanthropic plan with a preference to donate to entities with the DGR status.
- **Timing:** The timing of donations can also be an important consideration when planning their giving. Clients and advisers can assess expected tax liabilities arising from normal income, bonuses and realised capital gains in order to determine when donations might best be made. In particular, the years leading up to retirement can be a good time to bring forward charitable donations so as to maximise tax deductions in years when marginal tax rates might be high. Although such considerations are non-altruistic in nature, they can help a client to maximise wealth, the increased surplus of which can be used to fund a greater number of charitable programs.
- **Charitable trust:** Establishing a structured philanthropic entity (charitable trust) can be a good way of managing tax effectiveness. Monies donated to the trust will be tax deductible, while the assets in the trust will not incur tax on their earnings (donations will not be tax deductible, but that is irrelevant as the trust is tax exempt). Furthermore, the use of a charitable trust can help bring forward charitable donations. This is accomplished through a lump sum donation to a charitable foundation, which then has the ability to fund charitable donations over time. The alternative – putting a large donation through to an end charity – requires both high conviction in the chosen charity and the loss of being able to fund future opportunities. Hence, in such situations (which often occur when a client sells a stake in a business or is about to retire), it is usually a better tax and philanthropic outcome to establish a valid grant-making trust (discussed further in the next section).

Investment planning

Where surplus wealth is physically or virtually segregated in order to fund future giving, the underlying assets might be managed separately from those of the client. In this regard, it is important to understand the investment timeframe for this portfolio, along with the investment preferences and parameters.

Common investment objectives of such portfolios are to achieve a return of 4–5% above inflation. If achieved, this will allow for the assets to fund donations worth 4–5% of the portfolio value, in real terms (i.e. after inflation), indefinitely. Common investment approaches in this regard are to have a high exposure to equities, greater preference for less liquid alternative assets, and a preference for socially responsible investments.

Non-financial objectives might also be tabled, such as establishing a desired reputation or legacy, building a family environment of giving and exploring the extent to which the client might wish to be involved in charitable programs (volunteering, management etc).

There are numerous resources available for donors to help them meet their various goals and objectives. These include charity research houses, guides and tools for establishing a philanthropy plan from industry and government bodies, and public entities to which most of the decision making might be outsourced. In providing advice to clients on managing their charitable giving, it is important that financial advisers understand the full breadth of resources available, both locally and internationally.

The most common Charitable Trust structures are:

1/Private ancillary Funds (PaF)

This is similar to a client establishing their own self-managed superannuation fund (SMSF) and involves the transfer of money to a self-managed charitable trust known as a “private ancillary fund” (PaF).

One major difference is that contributions to a PaF are irrevocable, whereas SMSF funds can be accessed where conditions of release are met. As PaFs are established with the sole purpose of funding charitable endeavours, they are exempt from tax on earnings of assets or contributions (similar to SMSF assets in pension phase).

PaFs are a very common structure for establishing a charitable trust and are used to create individual/family foundations, as well as corporate foundations (charitable arms of companies). In general, the features and requirements of a PaF are as follows (Funding Centre n.d.):

- PaFs need to be established as a charitable trust with a corporate trustee. The trust directors must include a “responsible person” who has a degree of responsibility over the general community and who cannot be the founder or other major donor (or an associate of these).
- Every year, PaFs must distribute at least 5% of the fund’s net assets or $11,000, whichever is greater, to DGRs, except in the year of establishment. A fund can distribute only 5% (even if this is less than $11,000) if it meets its running costs from outside the fund.
- PaFs cannot seek donations from the public but must retain its private character.
- Financial statements of the PaF must be audited every year.
- PaFs must have a formal investment strategy.
- Generally, PaFs cannot borrow money, must maintain investments on an arm’s-length basis, and must not provide assistance to related parties or acquire assets from them (other than by way of a gift).

2/Public ancillary fund account

This is similar to being a member of a public/retail superannuation fund in which donors contribute to a larger charitable trust which has been established to be able to accept donations from the public. Public ancillary funds (PuAFs) might be large grant-making community foundations or can be a trust set up by a charitable organisation, wealth manager or trustee company. These can allow for a degree of control of donated funds by way of establishing accounts or “sub-funds”. These can be in the name of the donor and can accept recommendations from them on which DGRs they might wish for their account to fund. In general, PuAFs and sub-funds are required to donate 4% of the fund’s assets every year to a DGR. As with PaFs, earnings and contributions are exempt from tax.

3/Testamentary charitable trust: Individuals might establish a testamentary trust through their wills for the sole purpose of funding charitable programs. Unlike the other aforementioned charitable trusts, donations to the trust are not tax deductible (as they generally come by way of the wind-up of an estate), but in the same way, testamentary trusts are not required to meet some of the restrictions imposed on PaFs or PuAFs (such as minimum spending or the need to only fund DGRs). Tax on earnings in the trust and contributions are, however, exempt from tax.

Article Source – Kaplan Professional 2020

Ref:
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