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Submission – Treasury Consultation on Distribution Guidelines for Ancillary Funds 2022

I make this submission in my capacity as an Associate Professor at the University of Western Australia Law School, where I research at the intersection of charity law, taxation law and corporate governance. However, the views expressed are my own and do not necessarily reflect those of the University of Western Australia.

As a general comment on the proposed loosening of rules around accumulation and fund-to-fund transfers, Canada and the United States appear to be moving in the opposite direction at present with various proposals to tighten rules. For instance, Canada's 2022 budget called for a graduated lifting of the disbursement quota up to a top rate of 5% for charities holding investment assets of over C$1 million.[1] In the United States, a bipartisan Bill, Senate Bill 1981 (the Accelerating Charitable Efforts Act), has been introduced capping the time for distributing contributions to a newly popular type of philanthropic intermediary – donor advised funds.[2] A corresponding Bill was introduced in the House of Representatives in February 2022: House Bill 6595. Donor advised funds are essentially management accounts within public charities, where the donor retains advisory privileges, so somewhat akin to management accounts (sub funds) within public ancillary funds in the Australian context. Further, the recent United States budget has flagged measures to restrict distributions from private ancillary funds to donor advised funds by way of excluding such distributions from counting toward the private foundation payout requirement.[3]

Australia's ancillary fund rules are, in many ways, currently stricter than those in place in Canada and the United States.[4] Accordingly, the proposed changes in Australia, Canada and the United States may reflect each country moving toward more similar regulatory approaches in the middle of the spectrum.

However, three overarching matters should be kept in mind:

- First, the consultation paper makes only implicit reference to any normative basis underpinning the proposed changes. I have argued elsewhere that intergenerational justice is such a basis and I strongly endorse consideration of intergenerational justice. The notion is starting to gain traction in Canada[5] and there have also been suggestions by United States commentators too.[6]
- Revenue authorities are the primary charity regulators in Canada (Canada Revenue Agency) and the United States (Internal Revenue Service). That is not the case in Australia, where

[1] https://budget.gc.ca/2022/report-rapport/chap8-en.html

[2] Capped at 15 or 50 years, with more generous tax treatment for donors opting into the 15 year model. Exceptions are provided for community foundations.

[3] For an explanation, see Department of the Treasury (US), *General Explanation of the Administration's Fiscal Year 2023 Revenue Proposals* (March 2022) 58-59 <https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf>.

[4] See, eg, Ian Murray, 'Donor Advised Funds: What Can North America Learn from the Australian Approach?' (2020) 6(1) *Canadian Journal of Comparative and Contemporary Law* 260-304.

[5] See, eg, the peak body, Imagine Canada's submission to the Canadian Treasury, 'Policy Position: A Scaled Disbursement Quota to Release New Funds (2021) <https://www.imaginecanada.ca/en/360/imagine-canada-policy-position-scaled-disbursement-quota-release-new-funds>.

[6] C Cordelli and R Reich 'Philanthropy and Intergenerational Justice', in I Gonzalez-Ricoy and A Gosseries (eds) *Institutions for Future Generations* (Oxford University Press, 2016); R Reich, *Just Giving: Why Philanthropy Is Failing Democracy and How It Can do Better* (Princeton University Press, 2018). Cordelli and Reich adopt a more restrictive notion of intergenerational justice, whereas I would argue that various versions are open.

the Australian Charities and Not-for-profits Commission (ACNC) is the primary regulator of most charities. It is true that the Australian Taxation Office does also have a material regulatory role in relation to ancillary funds. However, care should be taken in enlarging the regulatory role of the ATO (rather than the ACNC) modelled on approaches in Canada and the United States. That is because the risks of regulatory duplication and confusion are greater in Australia with an active ACNC.

- Australian regulatory settings are incredibly permissive of accumulation by charities, with the marked exception of the ancillary fund mandatory distribution requirements.[7] Any changes made should occur in conjunction with new integrity mechanisms to ensure that ancillary fund assets are distributed at an appropriate rate and not just warehoused. Consciousness of this issue is a very commendable aspect of the consultation paper.

Questions 1 to 3

It is hard to answer the question of whether private ancillary funds and public ancillary funds should be able to accumulate funds (or whether particular limits should be imposed) without some agreed basis for making that decision. Most research and commentary on this question fails to identify any agreed basis, other than the partial impact of agency costs (of the additional intermediary) or to treasury efficiency (in essence looking at whether accumulation defers for too long the point at which the cost of donation and income tax concessions is balanced by the public benefit from ancillary fund distributions). I think that this question is primarily concerned with fairness as between members of the current and future generations, having due regard to efficiency.[8] That is, how should ancillary funds allocate benefits over time as between current and future generations so as to enhance the fairness and efficiency of the public benefit thus achieved?

The consultation paper implicitly adopts a position of 'generational neutrality', which was the position adopted when the minimum distribution rates were first set. Essentially, permitting an ancillary fund to maintain its real value in perpetuity thus treating current generations in the same way as future generations. However, this picture of generational neutrality is incorrect as it entirely fails to take account of key matters such as ongoing donations to ancillary funds, which are increasing in size, not remaining constant in real value terms. It also fails to take account of whether future generations will be better off than some members of the current generation, and so less in need of charitable assistance.

More explicitly recognising that generational neutrality is an attempt at following principles of 'intergenerational justice' would enable a better answer to the question because it would help highlight the relevant matters and help identify decision-making tools that could be employed. 'Intergenerational justice' is a normative theory that sets out the obligations owed by the present generation in relation to people in the past and the future. For instance, in the United States context, Reich and Cordelli use a particular interpretation of intergenerational justice to evaluate private foundations, focusing on their role in maintaining social capital and permitting long term approaches to problems.[9] Broader principles of intergenerational justice also exist that relate to meeting the basic social and economic needs of members of society over time, such as 'prioritarianism' and 'sufficientarianism'. A 'sufficientarian' approach, for instance, would demand that the current generation avoid the pursuit of benefits that would impose costs on future

[7] Ian Murray, *Charity Law and Accumulation: Maintaining an Intergenerational Balance.* (Cambridge University Press, 2021).
[8] Ibid.
[9] See n 6.

generations, where this would result in the world being handed on in a state that fails to meet a 'sufficientarian' threshold standard for members of future generations.[10] The threshold could be articulated in terms of a level of resources to meet basic needs, which could include sufficient resources to support civil society and its role in maintaining social capital, as well as to undertake long-term approaches to societal problems. If the threshold is low and relates to fundamental needs, then this approach does not demand that current generations materially sacrifice their own wellbeing to benefit future generations, nor require future generations to level themselves down to the position of earlier generations, since the sufficientarian threshold simply sets a minimum. Sufficientarianism might, for instance, oblige ancillary funds to distribute heavily to fund charities within their purposes, in order to help currently disadvantaged people. However, any distribution requirement would need to be tempered by ensuring that ancillary funds, or other bodies, could remain able to fund charitable purposes for future generations and to fund civil society bodies that will enable the reproduction of social capital and to fund long-term and risky approaches to societal issues.

The benefit of explicitly framing the question using an intergenerational justice lens is that this will help to ensure that decision-makers are conscious of matters that are routinely raised in applications of these principles, such as the potential for future contributions and the potentially improved welfare level of future generations. In particular, tools such as social welfare functions, have already been used to apply intergenerational justice principles in decision-making in areas such as environmental regulation and energy policy.[11]

Question 4

The greater the number of matters to which the Commissioner of Taxation may have regard in determining whether to approve accumulation, the greater the discretion afforded to the Commissioner of Taxation. That discretion translates – at some level - to permitting the Commissioner of Taxation to make choices about how benefits should be distributed between current and future generations. As a tax authority with an institutional focus on administering revenue laws and collecting tax, the ATO is not ideally placed to make decisions about how benefits should be fairly distributed between different generations. The ACNC would be far better placed to make such choices, with its institutional focus on the charity sector.

Further, as the measures involve giving greater choice to a regulator, we should acknowledge that some decision-making ability is being given to the executive, not Parliament and not ancillary fund trustee directors. This has the potential to impinge on charity independence.[12] Ideally, any delegated decision-making powers should be as narrowly confined as possible to achieve the objectives and should be subject to appropriate administrative review.

Questions 7 to 14

Churning between private foundations and donor advised funds so as to meet minimum distribution requirements appears to be a major issue in the United States and has caused concern in Canada, despite anti-avoidance rules.[13] Accordingly, I recommend that rules permitting ancillary fund

[10] L Meyer, 'Intergenerational Justice' in E Zalta (ed) *Stanford Encyclopedia of Philosophy* (Stanford University, 2021). Available at: < https://plato.stanford.edu/archives/sum2021/entries/justice-intergenerational/>; P Laslett, 'Is There a Generational Contract?' in P Laslett and J Fishkin (eds) *Philosophy, Politics, and Society*, *Vol 6: Justice Between Age Groups and Generations* (Yale University Press, 1992) 29-30, 44-45.
[11] See, eg, Murray, *Charity Law and Accumulation*, n 7, 208.
[12] Ibid Ch 7.
[13] See, eg, Murray, 'Donor Advised Funds' n 4, 271-2.

transfers should be as clear and narrow as possible. Not counting transfers towards the minimum distribution requirement would have the advantage of removing much of the tax-avoidance rationale for an ancillary fund-to-ancillary fund transfer.

Question 15

The consultation paper proposes several integrity measures based on legislative rules or the allocation of discretion to a regulator (the ATO) to effectively determine appropriate accumulation and distribution. However, another approach is also open and could be implemented in conjunction with one or both of the first two approaches. That is, better articulating and then requiring better reporting and justification against existing fiduciary duties of ancillary fund trustees for any decisions to defer distributions or distribute to another ancillary fund. Trustees have a duty to give genuine consideration when exercising powers to accumulate or distribute assets.[14] To ensure that ancillary fund trustee companies give genuine consideration when exercising these powers, reporting obligations could be bolstered. For instance, requiring ancillary fund trustee companies to formulate distribution and reserves policies and to report on compliance with these policies, which is somewhat analogous to reserves policy reporting in England and Wales.[15]

In thinking about reporting, consideration should also be given to requiring public ancillary funds to report on the number of sub-fund management accounts and distributions from sub-fund management accounts, so that the ATO has information on sub-fund distributions. Canada's 2022 Budget has proposed a similar information gathering measure for Canadian donor advised funds.[16]

Finally, the consultation paper mentions the possibility of lowering the distribution rate on page 4. As noted above, the minimum distribution rules are one of the few legal restrictions on charity accumulation. The minimum distribution rules already appear less demanding than some interpretations of intergenerational justice. Accordingly, if the rate is to be lowered, consideration should be given to other measures that might encourage ancillary fund trustees to make distributions. For instance, strengthening the understanding and application of the duty to give genuine consideration as identified above.

[14] See, eg, Murray, *Charity Law and Accumulation*, n 7, 109-116.
[15] Charity Commission for England and Wales, *Charity Reserves: Guidance CC19* (London, 2016). Available at: <www.gov.uk/government/publications/charities-and-reserves-cc19>.
[16] https://budget.gc.ca/2022/report-rapport/chap8-en.html