Submission on Interim Report – Philanthropy Productivity Commission Inquiry

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Thank you for the opportunity to contribute to the Productivity Commission's Review of Philanthropy in response to the Interim Report.

I am a charity law academic with a research interest in the regulation of charities: https://research-repository.uwa.edu.au/en/persons/ian-murray-2. I write in that capacity and note that this submission reflects my personal views and not those of the University of Western Australia.

As a general comment, I also thank the Commission for the thoughtful, contextualised and very helpful consultation paper and Interim Report. I have made comments on several matters below, but these should not be seen as detracting from support for the Commission's overarching approaches of:

- Reforming the DGR system to be a principles-based one that leaves donors with significant choice about what communal projects should be supported and how they should be carried out.
- Improving coordination amongst regulators and the possibilities for coordinated action, including by way of expanding abilities and powers to obtain information and undertake coordinated enforcement action (eg ACNC standing to make applications in state or territory Supreme Courts).
- Enabling charities to better obtain certainty via test case funding for litigation, or rulings.
- Proposing reforms that deal with systemic barriers in existing institutions that facilitate and incentivise philanthropy, rather than attempting bright and shiny measures such as deductions of more than 100% or giving a deduction and CGT exemption for appreciated property (effectively also a deduction of more than 100%).

There is one overarching theme that I question. There are suggestions in Chapter 7 that the ACNC may not be sufficiently employing its enforcement powers (especially at page 222). A number of the recommendations for increased information gathering and enforcement powers also carry the implication that greater enforcement is required. However, there is a risk here. As noted in Chapter 3 of the Interim Report, volunteering is declining in Australia. That includes volunteering as responsible persons of charities.[2] This is partly due to increased governance requirements.[3] Care

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[2] In relation to directors of not-for-profit companies, see AICD, *Not-for-profit Governance and Performance Study 2023* (Sydney: AICD) 16.

[3] John Chelliah, Martijn Boersma and Alice Klettner, 'Governance Challenges for Not-for-profit Organisations: Empirical Evidence in Support of a Contingency Approach' (2016) 12(1) *Contemporary Management Research* 3, 12-13; Ian Murray, Joe Fardin and James O'Hara, *Co-designing Benefits Management Structures* (UWA Centre for Mining, Energy and Natural Resources Law, 2019) 79-80; Christel Lorraine Mex, 'Stepping Up or Stepping Out? Recruitment and Retention of Volunteer Leaders in Grassroots Associations' (2018) 24(1) *Third Sector Review* 82-84. See also Marion Cornish, 'Exploring Social Networks of Non-executive Directors in Australian Third Sector Organisations' (2013) 19(1) *Third Sector Review* 51, 68-69.

should be taken to ensure that strengthened regulation does not result in governance expectations that effectively mandate professionalisation of charities, causing loss of board and volunteer diversity and member participation. Increased governance expectations that are too focused on financial matters might also cause mission drift, with too much time spent on compliance and too little spent on pursuing the charity's mission.[4]

1. Draft Recommendation 6.1 – DGR Reform

Few would disagree that the current DGR system is complex and inconsistent and that it has arisen via ad hoc political processes without the rigorous application of eligibility principles. The Commission is to be commended for calling this out and seeking to put principles in place.

1.1. The principles

I have two main comments about these principles. First, they are expressed in terms of "charitable activities" which tends to suggest the direct production of goods or services. For instance, step 1 on page 182 refers in both dot points to goods or services. However, charities do not just produce goods or services, the very way that they operate can produce process benefits.[5] For instance, aspects of charity law such as the non-distribution constraint and prohibition on private benefit arguably foster altruistic modes of acting that are different to market-based modes of acting focussed on maximisation of individual well-being.[6] Some political science perspectives highlight the voluntary association elements of charities as enabling collective and political action.[7] At a more meta-level still, there are also potentially pluralism benefits for society as a result of providing a sufficiently wide range of communal projects from which people can select so that they have a role in directing government support to organisations that pursue a range of projects and do so in a range of different ways.[8]

Ideally, the principles should be framed so that process benefits can also be explicitly captured under the three steps. This could also help inform the framing of the three steps and help identify classes of charities that should/should not receive DGR status. That is because the process benefits are likely to be stronger for some classes of charities than others. For instance, welfare and rights organisations where there is a clear distinction between donors and benefit recipients are likely to better accentuate

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[4] Jeanne Nel de Koker has just completed a PhD thesis at La Trobe University looking at the duty of care and considering whether the regulatory arrangements for volunteer directors support both pursuit of mission and accountability. I recommend that the Commissioners seek input from Jeanne.

[5] See, eg Ann O'Connell, 'Taxation and the Not-for-Profit Sector Globally: Common Issues, Different Solutions', in M Harding (ed), *Research Handbook on Not-For-Profit Law* (Cheltenham: Edward Elgar, 2018) 388, 395; Chia, J., M. Harding, A. O'Connell and M. Stewart. *Taxing Not-for-Profits: A Literature Review: Not-for-Profit Project* (Melbourne: Melbourne Law School, 2011) 17-20.

[6] See, eg, Rob Atkinson, 'Theories of the Federal Tax Exemption for Charities: Thesis, Antithesis,, and Syntheses' (1997) 27(2) *Stetson Law Review* 395, 403.

[7] Elizabeth Clemens, 'The Constitution of Citizens: Political Theories of Nonprofit Organizations' in W. Powell and R. Steinberg (eds), *The Nonprofit Sector: A Research Handbook*. New Haven: Yale University Press, 2nd ed, 2006) 207; Miriam Galston, 'Civic Renewal and the Regulation of Nonprofits' (2004) 13(2) *Cornell Journal of Law and Public Policy* 289, 294-356.

[8] OECD, *Taxation and Philanthropy: OECD Tax Policy Studies No. 27*. (Paris: OECD Publishing, 2020) ch 2.

altruistic modes of acting than instances of close identity between groups, such as primary or secondary education providers that seek donations from parents, or professional associations that provide benefits to members, or agricultural cooperatives that provide in-kind benefits to members. Likewise, associational elements will be weaker for non-member charities, such as charitable trusts (though a distinction could be drawn for philanthropic intermediaries, such as ancillary funds, that are required to on-donate to DGRs), or perhaps in areas of activities where many charities adopt strongly hierarchical structures.

Second, the principles appear based on the subsidy rationale for providing tax concessions to not-for-profits.[9] As the most commonly-accepted explanation for the existence of philanthropic tax concessions, this makes sense. However, there is a distinction between state facilitation of an activity and state incentivisation of that activity. That is, reasons for enabling the existence of charities such as under-provision of public goods due to government failure,[10] or under-provision of goods by the market due to information asymmetries,[11] do not automatically mean that the state must also actively incentivise production. Arguably, a further justification is required for the state to incentivise that responds to the reasons why philanthropic organisations do not spontaneously form and address the government and market failures.[12] For instance, Hansmann argues that in information asymmetry settings where the non-distribution constraint is critical, philanthropic organisations have greater difficulty raising capital (because they cannot pay dividends to equity providers), such that tax concessions can act as a rough and ready way to address this difficulty.[13] Alternatively, Atkinson has suggested that process benefits such as altruism are simply so important to society that there is no need for an economic efficiency ground for the state to incentivise charities.[14]

Despite some of the framing in efficiency terms, step 2 appears to potentially already take account of, and include within the concept of net benefit, broader process benefits. Step 1 could, however, potentially be tightened a bit by making it clearer that government and market failures in a certain area do not automatically mean that a good or service is likely to be undersupplied. This could potentially open up consideration of whether some classes of charities have ready access to equity capital and so there may not be a rationale for government support. For instance, while Australian universities are not in the same league, consider Ivy league universities in the United States, such as Harvard University with a US$50bn endowment. Likewise,

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[9] OECD, *Taxation and Philanthropy: OECD Tax Policy Studies No. 27*. (Paris: OECD Publishing, 2020) ch 2. The subsidy rationale can apply also to donation concessions in that the donations encourage greater production by charities in areas where there would otherwise be less production than is optimal: Roger Colinvaux, 'Ways the Charitable Deduction Has Shaped the US Charitable Sector' in M. Harding (ed), *Research Handbook on Not-For-Profit Law* (Cheltenham: Edward Elgar, 2018) 444, 445.

[10] Burton Weisbrod, *The Nonprofit Economy* (Cambridge, MA: Harvard University Press, 1988).

[11] Henry Hansmann, 'The Role of Non-profit Enterprise' (1980) 89(5) *Yale Law Journal* 835, 843-5.

[12] Henry Hansmann, 'The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation' (1981) 91 *Yale Law Journal* 54, 66; John Colombo and Mark Hall, *The Charitable Tax Exemption* (Westview Press, 1995) 77. While the articles focus on income tax exemption, see n 9 for extension of the subsidy rational from income tax exemption to donation concessions.

[13] Henry Hansmann, 'The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation' (1981) 91 *Yale Law Journal* 54, 71-75.

[14] Rob Atkinson, 'Theories of the Federal Tax Exemption for Charities: Thesis, Antithesis,, and Syntheses' (1997) 27(2) *Stetson Law Review* 395, 423-4.

some membership or quasi-membership based organisations both hold wealth and have ready access to member contributions – such as some religious organisations and professional associations.

1.2. Purposes and activities

The interim report acknowledges on page 158 that charities are defined primarily by reference to their purposes and that the DGR categories are based on a mix or purpose and/or activity definitions. Therefore, some caution needs to be exercised when using the term "charitable activities". The overlap between purposes and activities has caused much confusion over the years, albeit there is clearly a place for reference to both in some contexts of charity regulation.[15] If the Commission proceeds to broaden the DGR concessions, yet wishes to exclude some classes of charities or some activities of charities, the risk of confusion arises. The approach that appears to be proposed in Chapter 6 of the interim report is that charities would be endorsed for DGR tax concessions based on their purposes. Some classes of activities would then be classified as 'excluded', with a charity having to quarantine donations for permitted activities.

The benefit of this approach is that by enabling charities to obtain DGR endorsement based on their charitable purposes, the reformed DGR rules would interact appropriately with the ACNC regime. Attempts to exclude donation concessions for donations made for certain excluded activities could work, but attention should be addressed to keeping the purposes/activities distinction clearly in mind when drafting the relevant provisions. The proposed approach on page 187 of the interim report of excluding groups of activities by categories of DGR is a good one in many ways, as it has the potential to avoid tricky questions that might otherwise arise around, for instance, informal education activities of harm prevention or health promotion charities.

However, there is likely to be a key difficulty arising from charities that are registered under more than one subtype. For instance PBI and advancing religion, or advancing religion and health. Page 192 of the interim report notes that 3% of registered charities have a subtype of advancing religion along with at least one further subtype. Other combinations of subtypes exist also. I understand that it has not been easy to obtain registration under multiple subtypes in the past. However, this may change. The recent ACNC *Commissioner's Interpretation Statement: Public Benevolent Institutions* explicitly acknowledges that PBIs can potentially register with multiple subtypes.[16] Fowler has also shown that a charity can have one organisational purpose, albeit that one purpose can be characterised in several ways, eg advancing religion and advancing social welfare.[17] Are activities that advance that purpose religious activities? Or social welfare activities? Or both? Or would the social

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[15] See, eg, Adam Parachin, 'What Does it Mean to "Act Charitably"?: Revisiting the Purposes and Activities Distinction in Charity Law' in Daniel Halliday and Matthew Harding (eds), *Charity Law: Exploring the Concept of Public Benefit* (Abingdon, Oxon: Routledge) 15; Ian Murray, 'Characterising and Changing Charitable Purposes: Theories of Organisational Purpose', *Modern Law Review* (2024) <https://onlinelibrary.wiley.com/doi/full/10.1111/1468-2230.12871>.

[16] Paragraphs 81 to 87.

[17] Mark Fowler, 'Can a Faith-Based Public Benevolent Institution Have a Purpose of "Advancing Religion"? (2023) 29(1) *Third Sector Review* 65.

welfare dimension perhaps mean that the activities have an equity dimension (page 196 of the interim report) such that donation concessions could still apply?

2. Draft Recommendation 6.2 – Legislative Definition of PBI

A legislative definition of PBI could potentially address perceived stigma associated with the terminology of a 'community compassion' or of a 'benevolent institution', arising from settler colonial history and notions of passive welfare. However, this could be largely achieved by renaming the donation concession category without doing more.

The case for a legislative definition is unclear. First, if there is intended to be no change, then any definition that seeks to maintain the status quo and capture almost 100 years of case law will inevitably be complex and risks locking in a currently accepted meaning, losing the benefit of the common law approach which has permitted gradual change in meaning over time.[18]

Second, there is no agreed definition of the meaning of PBI. Instead there is significant contestation and uncertainty around matters such as the extent to which a PBI can engage in advocacy or use preventative measures. A legislated definition will involve policy choices about where to draw these boundaries; it is not going to be possible to avoid such choices.

Third, it is unlikely to be possible to legislate a definition without causing any change to meaning. Even if it were possible to capture the current case law concept in statutory language, the process of statutory interpretation is a different one to common law reasoning by analogy to earlier authorities and considerations of legal coherence and policy. As has been noted in relation to the statutory definition of charity, courts will instead approach the definition of PBI by reference to the text, context and statutory purpose.[19] This will inevitably cause a divergence in meaning over time.

3. Information Request 7.1 – Dormant Charities

Repurposing charitable assets held by dormant charities often involves changing the purposes of those charities. In Australia, that is not an easy thing to achieve and, other than for small charities in certain circumstances in some jurisdictions, requires an application to the relevant Supreme Court, with all the costs and complications that brings. In contrast, as a result of reforms in 2022, England and Wales has greatly liberalised the circumstances in which charities (including trustees of charitable trusts) can choose to change their charitable purposes (due to altered social and economic conditions) and empowered a sector administrator – the Charity Commission for England and Wales – to approve changes of purpose.[20] If the Productivity Commission intends to recommend methods to deal with dormant

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[18] As to the ambulatory meaning, see *Commissioner of Taxation v Hunger Project Australia* [2014] FCAFC 69 (13 June 2014) [38]–[39] (Edmonds, Pagone and Wigney JJ).

[19] See, eg, Ian Murray, 'Regulating Charity in a Federated State: The Australian Perspective' (2018) 9(4) *Nonprofit Policy Forum* 1; Matthew Harding, 'Equity and Statute in Charity Law' (2015) 9 *Journal of Equity* 167.

[20] Ian Murray and John Picton, 'The Reform of Charitable Constitutional Purposes: Should Australia Follow England's Path in Aligning Charitable Trusts and Corporations?' (2024) *Kings Law Journal* (forthcoming).

charities, these self-help changes from England and Wales should be seriously considered.

4. Draft Recommendation 7.3 – Increasing Certainty

I strongly support the entirety of this recommendation. Test-case funding and binding rulings were available to charities prior to the establishment of the ACNC. There was no policy reason for removing these supports. The only reason appears to be that there was a change in regulator that determined charity status. One of the three objects of the ACNC legislative framework is to 'support and sustain a robust, vibrant, independent and innovative Australian not-for-profit sector'.[21] The proposed reforms would materially advance this object.

5. Draft Recommendation 7.4 – Regulatory Architecture

I strongly support this recommendation. It retains the benefit of a federal system of government, while attempting to bolster collaboration and coordination between regulators. There is support for this approach in the literature.[22]

6. Information Request 8.1 – Minimum Distribution Rates for Ancillary Funds

I have argued elsewhere that principles of intergenerational justice should be used in determining how to regulate the timeliness of distributions from philanthropic intermediaries such as ancillary funds.[23] From a sufficientarian perspective, those principles support the building up of a level of capital and capability in philanthropic intermediaries that can be handed onto future generations so that there is a degree of assured funding for civil society (to support the *maintenance of social capital*), and some organisational capacity to undertake *long-term* and/or *innovative* approaches to communal projects (in contrast to shorter-term and more cautious government pursuit of communal projects).[24] I suggest that those thresholds are a better measure of the effectiveness of ancillary funds (as a whole) than the opportunity cost analysis on pages 255 to 258 of the interim report. Yes, opportunity costs are important, but they should really be considered after an ethical decision has been made about what resources should be handed onto future generations, when the issues relate to selecting the most efficient way of handing those resources on.

There seems to be great promise in adopting a minimum distribution rate as a backstop and requiring active consideration of distribution levels by trustees. That said, current minimum distribution rates seem to be set at levels that would roughly permit an ancillary fund to maintain its real value over time. **But**, they completely disregard the potential for further donations to the ancillary fund (so that assets increase rather than just maintaining their real value) and the fact that distributions today are likely to be spent on a mix of current and longer term activities (for instance

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[21] *Australian Charities and Not-for-profits Commission Act 2012* (Cth), s15-5(1)(b).
[22] Ian Murray, 'Regulating Charity in a Federated State: The Australian Perspective' (2018) 9(4) *Nonprofit Policy Forum* 1.
[23] Ian Murray, 'Donor Advised Funds & Delay: An Intergenerational Justice Solution?' (2023) 14(1) *Nonprofit Policy Forum* 51.
[24] Ibid. This approach draws from C Cordelli & R Reich (2016) "Philanthropy and Intergenerational Justice." In *Institutions for Future Generations*, edited by I. Gonzalez-Ricoy and A. Gosseries. Oxford: Oxford University Press.

a distribution that is used to build a university lecture theatre that will be used for another 100 years). Accordingly, there seems a reasonable argument that minimum distribution rates should be increased a little.

In the case of ancillary funds that involve sub-funds, there are a range of models from the United States context that suggest there is real promise that the processes for active consideration can be captured in distribution policies. I am working on further research with several United States researchers that involves examining the distribution policies of around 150 donor advised fund sponsor organisations to review the extent to which they reflect principles of intergenerational justice. We have a paper that I hope to be able to share very shortly that finds a relatively high level of integration of intergenerational justice norms, as well as concrete avenues for dealing with distribution levels. For instance, by way of inactive account policies that set out processes for the sponsor organisation to become involved and initiate distributions if distributions fall below a certain level over a period of time.