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(Submitted online)

Submission to Treasury in relation to Minimum Tax on Discretionary Trusts

Justice Connect welcomes the opportunity to provide our views on the Government's implementation of a minimum tax on discretionary trusts, in particular in relation to the treatment of distributions from discretionary trusts to tax-exempt entities.

About Justice Connect and our expertise

In the face of huge unmet legal need, Justice Connect's vision is a world in which legal support is within everyone's reach. We have been serving the community for more than 25 years. We are a registered charity and accredited community legal center.

Our specialist, national Not-for-profit Law program provides free and low-cost legal assistance to a diverse range of not-for-profit organisations. Of the more than 1,800 enquiries we receive annually, many relate to accessing critical tax concessions.

Providing integrity and fairness through tax-deductible distributions to DGR endorsed charities and DGR system reform

Justice Connect welcomes and supports the Government's proposed minimum tax on discretionary trusts as an important measure to bring more fairness and equity to the tax system.

The consultation paper asks for feedback on the treatment of distributions by discretionary trusts to charities and other tax-exempt entities. We confine our recommendations and comments below to this issue, and specifically, the opportunity presented for reform of the Deductible Gift Recipient (**DGR**) system to ensure a continued incentive for giving while implementing the 30 per cent minimum tax.

We submit that the most equitable solution to this issue is to reform the DGR system and provide that no tax is paid on distributions made as gifts to DGR endorsed charities.

RECOMMENDATION: Broaden and simplify the DGR system to include the majority of registered charities, as recommended by the Productivity Commission in its *Future Foundations for Giving report*; and provide that distributions from discretionary trusts to DGR endorsed charities are deductible from the assessable income of the trust.

Discretionary trust distributions to DGR endorsed charities should be tax deductible

The Productivity Commission found in its inquiry into philanthropy that tax concessions work to incentivise philanthropic giving. The Government is on the record about wanting to increase philanthropic giving. At present, distributions from discretionary trusts to tax-exempt entities are tax-free and as such, provide an incentive for giving. The imposition of a 30 per cent minimum tax will reduce that incentive.

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The design of the 30 per cent minimum tax on discretionary trusts has the trustee paying the tax on the taxable income of the trust prior to distributions being made. As noted in the consultation paper, the proposed minimum tax will generate a non-refundable tax offset to be received by individual beneficiaries but tax-exempt beneficiaries such as registered charities can't receive a tax offset, given they pay no income tax.

We believe it is important to maintain a tax incentive for giving within the framework of applying a minimum tax to discretionary trusts while also ensuring the broader integrity of the system of the tax deductibility of donations to charities.

We propose that the simplest and fairest way of continuing to incentivise giving is to provide that distributions from discretionary trusts in the form of a gift to DGR endorsed charities are tax deductible, that is, they can be deducted from the taxable income of the trust to reduce the trust's tax liability. This would broadly align with how donations to DGR endorsed charities from individual workers are treated.

The consultation paper notes a key rationale for the minimum tax on discretionary trusts is to better align the tax paid on trust income with that paid by workers. When an individual worker makes a donation to a DGR endorsed charity, that donation can be deducted from their taxable income.

Making distributions to DGR endorsed charities tax deductible *must* be accompanied by DGR system reform

The Government must not bypass this critical opportunity to introduce a balanced set of tax reforms by also fixing the broken DGR system along the lines proposed by the Productivity Commission in its *Future Foundations for Giving* report. Without taking the opportunity to reform the DGR system, the Government will be embedding an unfair and inequitable system affecting all philanthropic giving.

The very fact we are being asked the question of how to treat distributions from discretionary trusts to tax-exempt entities demonstrates why we need a fit-for-purpose DGR system. The present system does not provide for an appropriately fair, equitable and accountable framework for the tax deductibility of donations regardless of their source. A reformed DGR system would provide that framework and ensure the integrity and equity of government support to registered charities via tax-deductible donations.

By broadening and simplifying the DGR system as recommended by the Productivity Commission, discretionary trusts as well as individuals and philanthropic giving funds would have an incentive to give to a much larger group of registered charities. The Productivity Commission's recommendation for reform is based on three principles: whether the activity being supported is in the public interest; whether government support via a tax concession is appropriate; and whether there is minimal risk of a private benefit to the donor. In applying those principles to the list of charitable activities covered by charities registered with the Australian Charities and Not-for-profits Commission (**ACNC**), the Productivity Commission concluded that the majority of charitable activities should be supported by DGR status, with some key exceptions. Implementing the reforms as proposed would see around a further 15,000 charities access DGR status. Without DGR reform, tax incentives for donations will continue to be restricted to a minority of registered charities.

In considering the implementation of this proposal we submit there should be no further administrative burden placed on registered charities receiving the donations, given the majority are extra small, small or medium and it would be unfair to burden them with more red tape.

DGR system reform is essential for the integrity of our tax system

If discretionary trusts were able to continue to reduce their tax liabilities by making distributions to any tax-exempt entity, this would take the tax treatment of such trusts further away from that of individual workers and would undermine the integrity of the broader system of tax deductibility of donations. Indeed, it could risk undermining the rationale for the minimum tax on discretionary trusts in the first place. The benefit of a reformed DGR system is that tax-deductible gifts would still be limited to charities registered with the ACNC, providing for accountability through that registration process and ongoing compliance and reporting requirements.

Allowing discretionary trusts to give tax-free to any registered charity, without broader DGR reform, would again embed inequity in the system, with only discretionary trusts being able to give to any charities and receive a tax benefit, while individuals and giving funds are restricted in their tax-deductible giving to a minority of charities.

Reform of the DGR system offers the solution to all these problems and will provide a consistent, fit-for-purpose system for the treatment of tax-deductible donations that retains integrity through the regulation of registered charities by the ACNC. The ACNC has demonstrated it is a robust regulator and already determines the DGR eligibility for two of the biggest DGR categories, Public Benevolent Institutions and Health Promotion Charities.

Rationale for DGR system reform

The rationale for DGR system reform is outlined in great detail in the Productivity Commission's *Future Foundations for Giving* report. The current DGR system is poorly designed, overly complex and has no coherent policy rationale, creating inefficient, inconsistent and unfair outcomes for charities, donors and the community.

The majority of charities registered with the ACNC are ineligible for DGR endorsement. Examples of the types of charities that are currently unable to access tax-deductible donations or grants from philanthropic giving funds include:

- neighbourhood houses and other place-based charities providing a range of services and supports to their local communities
- charities looking to build community resilience and disaster preparedness in the face of climate change
- charities working on social connection, addressing social isolation, and promoting reconciliation
- human rights organisations and those promoting the value of our democratic institutions, including public interest journalism

- charities focusing on prevention, whether preventing injuries or inequality, and
- charities addressing complex social issues with multiple causes.

The current DGR system is exacerbating existing inequalities across the charity sector. The majority of charities locked out of DGR status are extra small, small and medium charities. While smaller charities are more reliant on donations, the larger charities, most of which have DGR status, receive the vast bulk of all donations and bequests.[1]

Current DGR categories are also out of step with community expectations and hold charities back from taking contemporary approaches to address complex social and environmental problems. The rigid nature of the DGR categories can see charities that work across categories often denied DGR status. For some charities, they face a choice of giving up programs and services that our communities desperately need or giving up on accessing DGR status and the potential of philanthropic support and more donations.

Streamlining the DGR endorsement process will also create much greater efficiency. The complexity of the current system is resulting in a vast waste of time and resources for charities, the Australian Tax Office, the ACNC and giving funds. Justice Connect estimates that legal support for DGR applications can often cost a charity upwards of $10,000, diverting much needed funds away from their purpose and impact. For many charities, such costs are prohibitive and mean they miss out on the benefits of DGR status.

The charity sector is also under increasing financial strain managing both increased demand and their own rising costs.[2] Financial sustainability for the sector is a growing problem and access to DGR status would help many charities navigate these difficult times.

While we appreciate there is a budgetary cost to DGR system reform, the benefits will far outweigh the cost. The Productivity Commission's modelling indicates a cost of between $70-$170 million per year. The value of the charity sector's contribution to the Australian economy and our collective wellbeing is far greater. The sector employs 11 per cent of Australia's workforce and engages more than twice as many people as volunteers. Along with its significant economic contribution, the sector's contribution to Australia's social fabric, our democracy, and prosperity is incalculable. We also note that implementing the minimum tax on trusts will result in a significant increase in revenue for the Government.

The Government has recognised the significance of the charity sector and the importance of donations with its election commitment to double philanthropy by 2030. Reform of the DGR system is necessary to achieve this goal and support a more equitable, sustainable and vibrant charity sector.

For additional information on the need for DGR system reform, please see our submission to the Productivity Commission inquiry into philanthropy.

[1] Australian Charities Report - 12th Edition | ACNC
[2] Australian Charities Report - 12th Edition | ACNC

There is not much data on which types of entities are receiving distributions from discretionary trusts, and charities themselves may not even know if a donation has come from a discretionary trust. We support the Community Council of Australia's submission in respect of addressing the data and research gaps in the charity and not-for-profit sector.

Conclusion

We urge the Government to take this opportunity to implement a fit-for-purpose DGR system that will provide consistency and equity for the tax deductibility of donations to charities, regardless of their source. Reform of the DGR system is painfully long overdue. The charity sector deserves better than the issue being ignored once again.

Justice Connect could not support a solution to the issue of how to treat distributions from discretionary trusts to registered charities without accompanying reform of the DGR system. Without DGR reform, we are missing out on a critical opportunity to increase the charity sector's productivity, economic resilience, and impact for the benefit of all Australians, as well as enhancing the fairness and integrity of the tax system.

For further information or to discuss this submission, please contact Geraldine Menere, Head of Not-for-profit Law, at Geraldine.Menere@justiceconnect.org.au.

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