



The Art of Giving

The Tax Angles

The role of philanthropy in wealth management

Richard Friend
Balena Tassa Pty Ltd
0423 678 971

Overview

For the very wealthy, philanthropy can and should play a major part in their wealth management

- Why philanthropy?
 - Carnegie's "Gospel of Wealth" 1889
- The role of advisors
- Use of Private Foundations (PPFs)
- The tax angles

Carnegie: The gospel of wealth

- Carnegie believed that progress is good and while some get richer, and there is a growing gap between rich and poor ..
“much better this great irregularity than universal squalor”
- But then the question arises as to what is the proper mode of administering the wealth that has been thrown into “the hands of the few”
- Not talking about “moderate sums saved by many years of effort, the returns from which are required for the comfortable maintenance and education of families. This is not wealth, but competence, which it should be the aim of all to acquire”

Carnegie: Modes of disposal

- Three modes by which surplus wealth can be disposed of:
 - Left to the families of the decedents
 - Bequeathed for public purposes
 - Administered by its possessors during their lives

Leaving to family

- Per Carnegie, this is “the most injudicious” method
- “If done through affection, is it not misguided affection?”
- “There are instances of millionaires’ sons unspoiled by wealth, who, being rich, still perform great services to the community. Such are the very salt of the earth, as valuable as, unfortunately, they are rare”
- “A thoughtful man must say “I would as soon leave to my son a curse as the almighty dollar,” and admit that it is not the welfare of the children, but family pride, which inspires these legacies”

Family inheritance

- AFR Magazine article spoke of *the burdens of inheritance*
- Rodney Adler on Radio National:
 - “Clearly, sitting here today facing a jail sentence, I obviously haven’t handled my inheritance properly”
- Pitfalls include:
 - not being exposed to people from other walks of life,
 - affecting ability to relate to others;
 - coping with resentment and jealousy;
 - need to work out whether people love them or the wealth they have

Bequeath to community?

- Carnegie: “This is only a means for disposal of wealth, provided a man is content to wait until he is dead before he becomes of much good to the world”
- Too often real wishes are thwarted
- “Men who leave vast sums in this way may fairly be thought men who would not have left it at all had they been able to take it with them”
- Estate taxes are the wisest form of taxation: “By taxing estates heavily at death the State marks its condemnation of the selfish millionaire’s unworthy life”

Administer wealth during life

- Carnegie: Thus there remains only one mode of using great fortunes: “but in this we have the true antidote for the temporary unequal distribution of wealth, the reconciliation of the rich and the poor”
- The surplus wealth of the few becomes the property of many, administered for the common good
- Carengie: After providing “moderately” for the legitimate wants of those dependant on him, the duty of the man of wealth is to administer the surplus in the manner in which is best calculated to produce the most beneficial results for the community

Private philanthropy

- AFR Magazine: “Catherine found her way out of the troublesome inheritance through philanthropy”
 - “Philanthropy isn’t just giving money away, it is a process of finding creative ways to use it for the benefit of others”
 - “It is basically a way of making passive wealth active again”
- Psychiatrist Louise Newman: “Philanthropy is a very protective thing for the rich because it gives them meaningful values outside of wealth and they tend not to lose a sense of perspective. Wealthy families who focus on philanthropy tend to be very well-adjusted people”

Role of advisors

- 2002 QUT CPNS Study:
 - 75% of advisers said it was not their policy to ask about any interest in charitable giving or philanthropy, but 75% had discussed with over 10% of clients
 - 85.9% do not develop strategies for helping clients develop a focus for charitable giving, but 47% will refer to others
 - When giving was discussed, the main reason (75%) for giving was *personal or family satisfaction* followed by reducing taxes

How to?

To administer wealth during life, can:

- Have plan for regular donations to third party
- Lump sum (and/or regular) to Community Foundation which allows you to “direct” the funds
- Establish a charitable fund
 - Can be *public* or *private*
 - If *public*, fund must have majority of independent trustees and raise money from the public, but can establish your own “good works”
 - Prescribe *Private* Foundations (PPFs) established to simplify this and encourage private philanthropy

Private foundations

- What is a PPF?
 - A private trust which is a Deductible Gift Recipient (DGR)
- Concessions – only need one Responsible Person Trustee and no need to accept donations from public, but can only give to other DGRs
- Use to generate deduction today (or over 5 years) for NPV of future donations
 - more beneficial (for tax purposes) to donate money while you are alive than when you are dead (bequests)

Private foundations

- Need to establish trust deed – based on ATO approved deed
- Need to establish a plan
 - How much do you intend to accumulate?
 - Who is to benefit?
 - Investment plan
 - Must plan to give away (at least) all earnings, other than sufficient retention to preserve capital value
 - Can plan to only accumulate until reach target capital, provided not “too long”
- Can NOT get the money back – ever!

Tax deductions

- Gifts of cash or property to your PPF are deductible
 - Note: If deduction creates a tax loss, loss is not able to be carried forward
 - Election available to claim deduction over period up to 5 years
 - Your choice as to how much each year
- Extra benefits when a donation is able to offset concessionally taxed income such as franked dividends and capital gains

Deductions and franked dividends

- Extra benefit if using donation to offset tax on franked dividends - whether from share portfolio or from private companies
- When you combine 100% deduction with effect of franking credits, then if you *donate 50.7c in the dollar of cash amount of dividends, balance cash is tax free*
- Useful way to clean up old family companies with significant retained earnings and franking credits, but where shareholders are all on the top tax bracket (and so would lose 23.6% of dividend in tax)

Example: Donations and franking

Mary receives \$300,000 pa franked dividends from her portfolio. She wishes to use donation to reduce tax to nil.

Mary donates \$152,073 to Foundation leaving her with balance \$147,927 tax-free cash in her name.

	\$
Dividend	300,000
Gross-up for franking	128,571
Donation	(152,073)

Taxable Income	276,498
Tax @ 46.5%	128,571
Credit	(128,571)

Tax payable	Nil

Example: Donations and franking

Bob has \$500,000 retained profits in a private company which he wants to access part of to set up a Foundation.

He wishes to reduce the tax on his \$500,000 dividend to nil.

Bob donates \$253,455 to Foundation leaving him with balance \$246,545 tax-free cash in his name.

	\$
Dividend	500,000
Gross-up for franking	214,286
Donation	(253,455)

Taxable Income	460,381
Tax @ 46.5%	214,286
Credit	(214,286)

Tax payable	Nil

Franking credits can *create* wealth

- Previous examples used minimum amount of donation to reduce tax on franked dividends to nil, leaving donor with just under 50% of cash amount of dividend.
- If donate an amount greater than the minimum, can generate tax refund, so still have cash in hand for other purposes
- If donate 100% of the cash amount of the dividend, will generate refund of 23% of the amount of the dividend
- So if donate \$1m of franked dividends, receive \$230,000 refund of tax paid in prior years – so you are creating wealth

Example: Donation and franking

Bruce has \$1,000,000 in accumulated profits in his private company. Company could donate the \$1m to Foundation – and waste franking credits

Or company can pay franked dividend to Bruce who then donates the \$1,000,000 to Foundation.

Bruce then receives \$230,0000 cash from Government

	\$
Dividend	1,000,000
Gross-up for franking	428,571
Donation	(1,000,000)

Taxable Income	428,571
Tax @ 46.5%	199,286
Credit	(428,571)

Tax refundable	(229,285)

Giftting property

- If donate assets, will still trigger a capital gain, based on the market value of the asset at the time
 - But if asset held for at least 12 months, only 50% taxable
 - And disposal of certain business assets could be eligible for CGT Small Business concessions to reduce tax to nil
- But donor generates a deduction for full *value* of asset being gifted
- So can eliminate gain through gifting and still generate a net deduction, to use against other income

Example: Gifting property

Sally has a share portfolio that cost \$200,000 and now has a value of \$1M.

Sally wishes to donate these shares to her Foundation

	\$
Capital gain	800,000
Less 50% Discount	(400,000)
Value of Donation	(1,000,000)

Net Deduction	(\$600,000)

Gifting property and super

- If gift property eligible for the CGT SB concessions, you can eliminate tax on gain, and also generate ability to make non-concessional contributions which come within the CGT cap
- Example: Ian is former lawyer who still owns premises from which he used to operate, but which are now leased to third party.
 - Cost \$400,000 Value \$1,000,000
 - Donates property and generates \$1m deduction and no CGT because of concessions
 - Has ability to contribute at least \$350,000 to super

Composite example

- Ross is founding shareholder of one public company and owns shares in this company worth \$15m, but which have nil cost base
- Ross also owns \$8m of shares in another public company, also with a negligible cost base
- Ross also controls a number of private companies, one of which, Rossco Pty Ltd, has \$8m of retained earnings. Much of this has been lent to Ross (who enjoys a lavish lifestyle), which creates major Division 7A problems – he pays non-deductible interest to his company each year

Composite example

- Ross wants to establish Private Foundation with \$20m shares and gift \$1m of shares to each of three trusts to be established for his three grandchildren
- Ross donates \$20m of the shares to Foundation and gifts \$3m to the new trusts (all of these transfers trigger a CGT liability)
- In the same year, Rossco Pty Ltd pays Ross a \$8m fully franked dividend to offset his loan account (no cash)

Outcome for Ross

Capital gain on shares	\$23,000,000
Less 50% discount	<u>\$11,500,000</u>
Net taxable gain	\$11,500,000
Deduction for donation	(\$20,000,000)
Franked dividend	\$8,000,000
Gross up	<u>\$3,428,571</u>
Taxable income	<u>\$2,928,571</u>
Notional tax payable	\$1,361,785
Less franking credit	<u>(\$3,428,571)</u>
Tax REFUND	<u>\$2,066,786</u>

Outcome for Ross

- Has established a \$20m foundation to operate in perpetuity
- Still has control of the \$23m of shares (through trusteeship)
- Has gifted \$3m of shares to grandchildren with no tax cost
- Has cleaned out his old private company, and so can now simplify his tax and accounting structure
- Has received back from the Government over \$2,000,000 of tax payments made in prior years

Summary

- Philanthropy should play a role in the wealth management for the very wealthy
- The ability to create a PPF is a welcome addition to the range of options available to those who are philanthropically minded
- While tax is not a reason to establish a PPF, the interaction of the deduction rules with the concessional tax treatment of dividends and capital gains opens opportunities for the creation of a PPF to be part of a holistic wealth management strategy,
 - Is part of tax structuring, investment planning and estate planning



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