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Philanthropy: the best way to give back

Philanthropy is an important way to show appreciation, support and a 'giving back' to the community. You, your family or your business may be considering increasing charitable donations or reviewing the way you make those donations.

But what is the most effective way to give back?

Many of us don't stop to consider this question – yet there are several different ways to give, and each option has unique benefits. For example, you may choose to make a donation – a simple and cost-effective method of giving. But what if you want to give to a broader range of recipients? Or, how do you structure your donations if you want to support an ongoing project?

First, let's look at the key terms the Australian Tax Office (ATO) uses to classify eligible beneficiaries of charitable funds:

Deductible gift recipient (DGR) – a fund or organisation that can receive tax-deductible gifts. Examples are standard charities that benefit a particular cause.

Tax concession charity (TCC) – a fund or organisation that can receive tax-deductible gifts. Examples are standard charities that benefit a particular cause.

Income tax exempt fund (ITEF) – a non-charitable, ATO-endorsed fund that is permitted to access income-tax exemptions. These organisations are usually established to provide money or property benefits to DGRs, and include examples such as the Australian Communities Foundation and private ancillary funds (explained below).

You can, of course, simply make tax-deductible charitable contributions to any DGR on their own basis. This straightforward form of giving does not require an established structure to manage donations, reporting or compliance obligations – so it's clearly the most cost-effective option. This option is convenient for many of us who wish to donate to multiple charities and employers with workplace giving programs.

The next step is an 'old-style' charitable trust. This type of charitable trust has been around for many years and, as with all valid trusts, it requires a trust deed and trustees to be established, which incurs legal costs. In addition, a TCC application must be filed with the ATO. Expect a set-up period of around two months by the time ATO approval is obtained.

Once set up, the charitable trust can distribute to a range of beneficiaries as determined by the trust deed – but commonly, beneficiaries can be most DGRs and organisations with TCC (or ITEF) status. In terms of the trust's funds, most charitable funds cannot accumulate funds, and all receipts and income must be distributed. The trust requires a separate bank account, clear accounting procedures and annual financial statements. Neither individuals nor entities can claim tax deductions for gifts to the trust.

So what are the advantages of this structure?

Charitable trusts allow for benefits to be gifted to entities without DGR status – that is, entities such as hospitals, museums or cultural institutions, which have solely TCC or ITEF status. (It's worth noting that the ATO has new requirements for TCC and ITEF entities to be 'in Australia'.) So charitable trusts expand the range of beneficiaries, plus they are eligible for a refund of franking credits.

Private ancillary funds (PAFs) are what they sound like – a structure to privately fund a beneficiary (as opposed to public ancillary funds, which are used for public fundraising). As PAFs are classed as a DGR themselves, the sole purpose of a PAF must be to benefit other DGRs. PAFs cannot carry on a business or provide funds to another PAF, public fund or political party. Many people establish a PAF when they sell their business or capital assets and realise a significant capital gain. The contribution to the capital fund of the PAF is a tax deduction and, in a year where taxable income is unusually high, this can be a very effective tax strategy. It is also a time where people have liquid assets that can be easily accessed.

Like a charitable trust, a PAF requires an established trust deed and trustees, plus ATO approval for DGR and TCC or ITEF status. Expect the set-up and approval process to take up to three months. In addition, PAFs established after 1 October 2009 must have a management structure in place that consists of a corporate trustee and at least one responsible person as a director. Often, PAF trustees are family members from different generations.

Once up and running, a PAF can receive tax-deductible gifts from both individuals and entities and can also solicit public donations of up to 20 per cent annually of the fund's market value. Other benefits include the ability to accumulate funds within the PAF, flexibility to change projects/beneficiaries, tax-exempt status and eligibility for refunds of franking credits.

PAFs may be a good option for you if you wish to:

- accumulate a capital base to fund future philanthropy;
- establish a predictable flow of funding to a certain project or beneficiary;
- encourage family involvement in philanthropy and perpetuate a family name.

In summary, different structures will suit different outcomes. Talk to your advisers to ensure that, when you're giving back, everyone benefits.

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