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LAWYERS

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Philanthropic gifts to universities

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A summary of key aspects, including 'tips and traps', for universities seeking philanthropic contributions.

Key points

- Philanthropic gifts are an increasing source of funds for universities. The deductible gift recipient status enjoyed by universities is a most valuable tool in fundraising.
- Frequently, however, universities will have to moderate the requirements or expectations of donors. Care is needed not to create perpetual and cumbersome obligations when negotiating a gift.
- The question of whether an amount is or is not a true (and tax deductible) gift always has to be resolved at some point. This dichotomy has important tax and GST implications.
- With the boomer generation now possessed of enormous wealth in real property, universities have been turning their attention to seeking donations of property and even trying to assure, in advance of death, the donor's promise to leave it in his or her will.
- The university foundation structured as a public ancillary fund is on the wane due to compliance burdens and the movement of donor money into private ancillary funds which cannot give to such funds.

University tax concessions

Universities are usually registered as charities with the ACNC and then endorsed by the ATO as tax exempt[1] entities and as tax deductible gift recipients (**DGR**).

Tax exemption means that the university pays no income tax or capital gains tax on any of its income or gains. There are GST concessions available too, which are beyond the scope of this brief paper.

1 Division 50 of the *Income Tax Assessment Act 1997* (Cth).

DGR status means that:

- Any gift to the University of more than $2 is tax deductible to the donor[2].
- There is no need for the gift to be restricted to any particular purpose in the case of a university.
- There is no upper limit to the deduction for a monetary gift.
- There is no limit to the deduction value of most other kinds of property worth more than $5,000.
- There are some maximum and minimum parameters of value around certain kinds of property including a maximum value for donated shares in a publicly listed company.

Donor entity

For private individuals, the university's DGR status is normally essential to the donor obtaining a deduction for a payment to the university. There is typically no basis otherwise for a private individual to claim a tax deduction for a gift.

For businesses (whether companies or individuals), this is not necessarily the case. They may be entitled to a deduction under the normal principles for deduction of business expenses. For example, an expense incurred in obtaining positive publicity will typically be deductible to a business. However, this alternative basis of deduction where there is a quid pro quo typically has implications for the university, and this is discussed below.

True gifts (made with no expectation of anything material in return) typically tend to be made by individuals who normally can make the best use of the tax deduction. The deduction has the value of the amount of marginal rate tax that is avoided due to the reduction in donor taxable income. For a donor on the highest marginal tax rate, the benefit is almost half the value of the gift.

For a company, on the other hand, a deduction is valued at the lower company tax rate. Also, where a company pays reduced tax because of deductions it has claimed, it will normally be less able to frank its dividends and its shareholders are less likely to receive tax credits.

2 Division 30 of the *Income Tax Assessment Act 1997* (Cth).

Gifts with binding conditions – possible charitable trust

Agreeing that a gift will be applied to particular purposes has potential pitfalls. Where a charitable body, such as a university, makes a binding promise to use a gift in a way that is narrower than its general purposes, eg for particular research or to build a particular building, a Court will quite readily find that a charitable trust is created for that specific purpose. The duties of a charitable trustee are not to be taken on lightly.

A good example of this was recently reported[3]. A university student residence for international students was built with money from a public appeal in the 1960's. The money was donated after the university gave an undertaking to the appeal trustees in 1967 to build the residence and then have it managed in a particular way. The university accepted that the building, having been built with the appeal proceeds, was subject to a trust[4] even though it stood on the university's land. The main issue in the case was that an entity established at the time of the gift, but not controlled by the university, asserted that it was entitled to manage the student residence 'in perpetuity' to the exclusion of the university. This argument was rejected by the Court, which found that management in perpetuity by that entity was not part of the trust. However the point to be made is that the threshold for creating a charitable trust, by giving assurances to a donor, is not difficult to cross. The trust terms themselves were opaque and flexible to say the least and the whole arrangement was a product of an era when international students were quite rare on Australian campuses.

It is worth noting that university legislation typically permits the trust money to be mixed with the money of other trusts, or with the university's own money, in one or more common funds[5]. Were it not for that kind of provision such mixing would be impermissible as a matter of trust law. Some university Acts[6] also provide for a streamlined process for varying such trusts if they are under a prescribed monetary threshold, but the process is still cumbersome.

Charitable trusts attract the supervisory jurisdiction of the State Attorneys-General. It may not always follow that the A-G will see the interests of the trust as aligned with the interests of the university. For example the trust may allow the possibility of institutions other than the university gaining benefit. Or the focus of the trust may not align entirely with the university's plans.

3 *University of New South Wales International House Ltd v University of New South Wales* [2016] NSWSC 1709.

4 This follows from the High Court's decision *in Attorney General for the State of Queensland (at the relation of Nye & Ors) v The Corporation of the Lesser Chapter of The Cathedral Church of Brisbane* (1977) 136 CLR 353.

5 For example see the provisions about common funds in Schedule 2 to the *University of Sydney Act 1989* NSW.

6 For example see Division 3 of Part 4 of the *University of Sydney Act 1989* NSW.

Charitable trusts can also be problematic and expensive to amend if they are not drafted with care. From the university's perspective, the ideal gift is probably one that is not subject to any legally binding conditions at all and certainly one that does not impose the obligations of a charitable trustee on the university.

A further problem is that if a gift creates a separate charitable trust, that trust may need to be separately registered as a charity at the ACNC and separately endorsed by the ATO as tax exempt, even if the university is trustee. This is because the tax exemption provisions in the Federal tax legislation focus on 'entities' - a term which includes trusts, even though trusts have, of course, no separate legal personality. This is certainly the ATO view of it. See for example the guidance given by the ATO in private binding ruling 1051357496002. The unfortunate consequence is that even though the university itself is a charity regulated at ACNC there will be a further layer of regulation at trust 'entity' level. Universities may be able to argue, as in that ruling, that income arising from the investment of trust funds is actually income of the university, not of the trust, if their legislation make express provision for this[7].

In summary, if there is a proposal to offer promises to the donor, careful consideration and drafting is called for. Some universities have been successful in expressly avoiding giving legally binding promises to donors. This does not seem to deter donors as much as may initially be feared. But in the case of a very large gift such as to fund a building it is more likely that there will be formality, and promises on both sides will be made, and the issues above will need to be worked through. Whether or not the agreement with a donor is binding there are reputational risks in poorly worded or extravagant promises to donors.

A true gift must be made out of 'disinterested generosity'

The deductions generated by DGR status apply to 'gifts'. This word hides unexpected complexities of its own. For there to be a tax-deductible 'gift', there must be no material benefit received by the donor in return.

Giving must be an act of 'disinterested generosity' – a phrase referred to in a lengthy tax ruling TR2005/13 which sets out the Federal Commissioner of Taxation's views about the legal requirements for a tax-deductible gift. The donor cannot retain control of the gift or any interest in it. However the receipt of a promise from a university to spend a gift on a particular purpose of the university is not in my view, if correctly framed, a material benefit to a donor or an interest retained, although it may raise the issues above as to potential creation of a charitable trust.

Typically, tokens of recognition, including naming of a prize or scholarship after a private individual donor, are not a problem as they are not material. It is also permissible for the University to agree to report to a donor about the way money has been spent and still receive that money as a gift.

The Commissioner takes the view that it is not open to the recipient DGR to value the amount of any material value given back to the donor as less than the total payment, and for the donor to claim the balance as being the 'gift portion'. There are however some limited and specific cases in which this can be done, notably fund raising events[8].

TR2005/13 is a good resource and safe harbour as to the Commissioner's views if there is any doubt about the position where a donor appears to be acting out of something other than complete 'disinterested generosity'.

7 For example see clause 3(5) of Schedule 2 to the *Macquarie University Act 1989* NSW
8 See Item 7 of the table in section 30-15 of the *Income Tax Assessment Act 1997* (Cth).

GST issues

If there is something of material value passing to the donor, then the transaction is also likely to be a taxable supply by the university for GST purposes. Universities have no general exemption from GST on this kind of supply.

For example, if the donor is a business, and the name of the business is agreed to be featured on a building that has been built with the donated funds, the Commissioner would see this as a sponsorship supply and not a gift.

The University will then be taken to have made a GST taxable supply in exchange for the payment and will have to remit 10% GST to the ATO. To address this, the solution is typically to ensure that the payment to the University is 'grossed up' by adding the 10% GST which the University will have to pay to the ATO. The business will usually get a GST input tax credit (from the ATO) for this as part of its GST accounting (assuming it is an Australian GST payer) so there is no net loss to either side.

Universities need to be clear under which paradigm (gift or sponsorship) the proposed payment fits. Of course, once the transaction is in the realm of sponsorship, and not gift, it is best documented carefully as any commercial agreement should be.

Giving tax advice

Deductibility of the gift is essentially the donor's tax issue as it is the donor who claims the deduction. The DGR status of a university is discoverable to anyone online by a search of the Australian Business Register and is usually all that the donor or his or her advisers need to know to work out the donor's tax position.

Tax laws are very complex and in general it is best to avoid trying to advise the donor about the benefits of income tax deductibility or other tax attributes of any amount paid to the University. This is all the more so when the donor is not Australian. It is likely we will continue to see an increase in gifts from foreign alumni donors in particular.

However universities do need to have personnel who understand the tax issues and can raise and deal with them adeptly as part of the negotiation of a gift, which can sometimes be prolonged.

Assuring receipt of the gift

Issues can arise when the University has made plans or incurred detriment assuming the gift will arrive, and this then fails to happen. It is usually possible to structure a binding gift agreement, but careful drafting is needed.

Making the gift binding does not mean that it is not made out of 'disinterested generosity'. There might also even sometimes be cases where it could be appropriate to take security for a gift.

Testamentary gifts

A testamentary gift of money generally does not generate a deduction. However universities frequently receive testamentary gifts, often of property. The tax rule is that a testamentary gift of property that would have been deductible to the testator whilst alive, is exempt from capital gains tax that might otherwise arise when the property is transferred to the university under the will.

A common scenario is a donor who is willing to give a property (perhaps their home) when they die but wants the right to live in it until then. In the USA a concept developed of a charitable remainder trust, whereby the property would be separated into a life estate and a remainder and the remainder would be donated. However the ATO in Australia appears not to regard this as generating a deduction to the donor for the gift of the remainder.

There are moves by some charities to bind donors to make wills in a particular way so that the charity can bring forward spending knowing it will obtain the bequest eventually. The law does recognise, as binding, a contract to make a will, but the main issue that arises is the potential for family provision claims by relatives or dependents of the donor to override the agreed gift by depleting the estate[9]. Whilst the potential risk of claims seems unavoidable, a university might be able to conduct enough due diligence to satisfy itself that the risk is low. As a very broad generalisation, family provision claims are needs-based and will typically not absorb the bulk of a substantial estate.

Other means may be available to shore up the university's position as donee, for example by taking security from the donor's affiliated entities.

Public ancillary funds or 'university foundations'

A number of universities have established public ancillary funds, often called 'university foundations'. The public ancillary fund structure has been available for many years. Many large companies have established these as part of their corporate social responsibility activities.

A public ancillary fund is a DGR that provides benefits only to other DGRs. However, an ancillary fund cannot provide benefits to other ancillary funds – the idea being that they are kind of transition or feeder funds where money is temporarily accumulated before being given to 'operating' DGRs.

In the university context, these funds are essentially DGR trusts typically controlled by a university using a separate controlled entity as trustee. The trustee solicits gifts which can only be applied by the fund to the university. The board of the trustee typically includes high profile figures who can engage with the donor community.

These structures are falling somewhat out of favour in recent years for several reasons. They attract recently introduced compliance obligations[10] as well as minimum annual distribution requirements. They pose no real tax advantage from the donor's perspective as a gift to the university as a DGR is just as deductible as a gift to its DGR ancillary fund. Moreover, recent years have seen a proliferation of private ancillary funds (which we briefly discuss below) amongst the wealthy. An ancillary fund (private or public) cannot give to another ancillary fund, and so a lot of philanthropic money is out of reach to public ancillary funds and can only be donated directly to the universities.

Another pitfall with the university ancillary fund arises when the foundation trustee gives a binding assurance to the donor that the donated money will be used in a certain way by the university.

9 See the principles set down in the High Court's decision in *Barns v Barns* (2003) 196 ALR 65.

10 See the *Public Ancillary Fund Guidelines* made under section 426-103 in Schedule 1 to the *Taxation Administration Act 1953* (Cth) and the provisions of that Act.

The Commissioner's view is that a gift on such a binding condition cannot be a tax-deductible gift to the university foundation (DGR trust), because the acceptance of the gift on a separate binding condition creates a new and separate fund. If that new and separate fund is not itself endorsed as a DGR no deduction will be available[11].

Private ancillary funds – private foundations

An initiative of the Howard Government, private ancillary funds are private foundations typically set up by wealthy individuals who can make deductible gifts to the foundation they control. They choose how and when to give money to their fund and then choose how and when to allocate the money out of the fund and amongst DGRs. There is a requirement to distribute to DGRs a small percentage of the fund money each year.

The essential difference between a public ancillary fund and a private ancillary fund is that private ancillary fund only takes donations from an individual or family group.

As a university is a DGR, it can receive gifts from a private ancillary fund. These funds are obviously a good target for fundraisers especially as their numbers (and their coffers) swell. However there is probably no real advantage one way or the other to be gained by the university from having a donor establish one of these funds. Where the donor is foreign there may also be issues in terms of the requirements for such funds to be controlled from Australia.

If you would like to discuss any of the above in more detail or would like to subscribe to further bulletins please contact Oliver Shtein at Bartier Perry.

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11 This is the position stated in Taxation Determination 2004/23.

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