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Tax history and philanthropy: a tribute to John Taylor

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Abstract

The Productivity Commission's philanthropy inquiry highlights that Australia's current tax regime for philanthropic tax concessions is sorely lacking guiding principles. This is an area that calls out for tax history analysis, in the vein of John Taylor, to properly lay bare the social context of philanthropic tax concessions. Building on the Productivity Commission's approach and previous work by Fiona Martin, this article investigates the history of donation concessions for appreciated property and of donation integrity measures as applied to refundable imputation credits.

Keywords: tax history, philanthropy, charity, appreciated property, refundable franking credits, integrity measures

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1. INTRODUCTION

When the federal Labor government came to power in 2022, one of the election commitments it had made was to 'double philanthropic giving by 2030'.[1] The Productivity Commission (Commission) was subsequently tasked with undertaking the heavy lifting to determine how philanthropy might be incentivised.[2] The Commission was asked to gain an understanding of the underlying drivers and trends into philanthropic giving in Australia.[3] The terms of reference for the inquiry included making recommendations to government to 'address barriers to giving and harness opportunities to grow it further'.[4] Included within the terms of reference, the inquiry was also to examine the tax expenditure framework and in particular, 'assess the effectiveness and fairness of the deductible gift recipient framework'.[5] Importantly, the Commission was to further investigate how the deductible gift framework aligns with the public policy objectives and priorities of the broader community.[6]

The Commission has delivered a report calling for major reform of the deductible gift recipient system and corresponding adjustments to integrity measures.[7] The breadth of the terms of reference and the high aspirations of the inquiry mean that many major reforms are being proposed and considered. An understanding of the history of philanthropic tax measures is of major significance to this process in order to help identify potential costs and benefits from changes. Such an approach is very much in keeping with the emphasis placed by John Taylor on the role of tax history in informing a proper interpretation of tax law. In this tribute to John, it is also fitting that we build on the work of one of John's colleagues, Fiona Martin, who has explored the broader history of the deductible gift recipient system, demonstrating the ad hoc way in which the system developed.[8]

In this article, we focus on the interaction between the deductible gift recipient system and capital gains tax (CGT), as well as on deductible gift recipient integrity measures – in the context of refundable franking credits. Both the areas of capital gains taxation and taxation of business enterprises (especially franking credits) were subjects dear to John and neither the issue of appreciated property, nor the refundable franking credit integrity measures have received a tax history analysis. Both are relevant to the reforms proposed by the Productivity Commission.

The article is structured as follows. Section 2 provides context, both in relation to John Taylor's work and in relation to the deductible gift recipient system and integrity measures and CGT. Section 3 analyses the history of the tax treatment of gifts of appreciated property. Section 4 examines the tax history of integrity measures for refundable franking credits for charities. Section 5 concludes.

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[1] Andrew Leigh MP, 'Labor to Double Philanthropic Giving by 2030' (Media Release, 7 April 2022).
[2] Productivity Commission, *Future Foundations for Giving: Inquiry Report* (May 2024) iv-v ('Final Report').
[3] Ibid (setting out the terms of reference).
[4] Ibid.
[5] Ibid.
[6] Ibid.
[7] Ibid.
[8] Fiona Martin, 'The Socio-Political and Legal History of the Tax Deduction for Donations to Charities in Australia and How the "Public Benevolent Institution" Developed' (2017) 38(1) *Adelaide Law Review* 195.

2. CONTEXT

We chart out below John Taylor's interest in tax history research and the importance of such an approach to properly understanding the meaning of tax law. This is followed by an outline of the interaction between gift deductibility and the CGT regime and its treatment by the Commission, along with a sketch of the role of integrity measures, including in relation to the imputation system.

2.1 Tax history research and John Taylor

Christopher John Taylor was an accomplished tax scholar, despite his early request of his superior, when starting at University of New South Wales, that he not be required to teach the subject. He acknowledged later that by ignoring this request his head of department had done him a wonderful favour.

In his long and illustrious career, John was always prepared to engage in detailed examination of provisions of the tax law and to analyse them deeply. But another great passion of his as an academic was an understanding of history, and happily he was able to marry the two areas of interest. On many occasions, he did so with thoroughness, enthusiasm, and insight. Indeed, John's University of Sydney doctoral thesis (awarded 2016) was entitled 'A Critical Assessment of the Origins and Continued Validity of Variations in Australian Tax Treaties from the OECD Model'. Much of the work undertaken in writing it involved archival (literally) research, poring over the diaries, memoranda and correspondence of officials (such as Prime Minister Sir Robert Menzies) to reach an understanding of the terms included in the Australia–United Kingdom Double Tax Agreement and the reasons for their inclusion. John even gave presentations to colleagues, sharing the practical insights he had accumulated about the various archives he had worked in and about how those archives functioned.[9]

John's love of the history of taxation was plain enough. His curriculum vitae at the time of his retirement at the end of 2020 revealed that he had (aside from his other technical writings) at least 14 publications of chapters, articles and papers on tax history – many of them focused on tax treaty negotiations[10] – such as those affecting the Double Tax

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[9] C John Taylor, 'Archival Research as an Aid to the Interpretation of Tax Legislation' (Conference Paper, Tax Research Network Conference, University of Roehampton, 5-7 September 2012) ('Archival Research').

[10] C John Taylor, 'The Negotiation and Drafting of the First Australia–United States Double Taxation Treaty of 1953' in Peter Harris and Dominic De Cogan (eds), *Studies in the History of Tax Law, Vol 7* (Hart Publishing, 2015) 213; C John Taylor, 'The Negotiation and Drafting of the 1967 United Kingdom–Australia Double Taxation Treaty' in John Tiley (ed), *Studies in the History of Tax Law, Vol 5* (Hart Publishing, 2012) 427; C John Taylor, '"I Suppose I Must Have More Discussion on This Dreary Subject": The Negotiation and Drafting of the UK–Australia Double Taxation Treaty of 1946' in John Tiley (ed), *Studies in the History of Tax Law, Vol 4* (Hart Publishing, 2010) 213 ('"I Suppose I Must Have More Discussion on This Dreary Subject"'); C John Taylor, 'The History of Australia's Double Tax Conventions' in Michael Lang and Ekkehart Reimer (eds), *The History of Double Taxation Conventions in the Pre-BEPS Era* (IBFD Publications, 2020) 623; C John Taylor, '"Send a Strong Man to England – Capacity to Put Up a Fight More Important Than Intimate Knowledge of Income Tax Acts and Practice": Australia and the Development of the Dominion Income Tax Relief System of 1920' (2014) 12(1) *eJournal of Tax Research* 32 ('"Send a Strong Man to England"'); C John Taylor, 'The Negotiation and Drafting of the First Australia–Canada Taxation Treaty (1957)' (2013) 61(4) *Canadian Tax Journal* 915; C John Taylor, 'Factors Influencing Australian Taxation Treaty Practice 1946–1976' (2012) 27(3) *Australian Tax Forum* 571; C John Taylor, 'Some Distinctive Features of Australian Tax Treaty Practice: An Examination of Their Origins and Interpretation' (2011) 9(3) *eJournal of Tax Research* 294 ('Some Distinctive Features'); C John Taylor, 'Twilight of the Neanderthals, or Are Bilateral Double Taxation Treaty Networks

Treaties Australia has with the United Kingdom, the United States of America and Canada.

It was not only individual treaties that intrigued John but, of course, themes could be identified and thus learnings derived from the mass of the literature John had read.[11]

Sometimes the words of the historical figures involved were quoted to give extra life and allure to John's topic. Take for example titles such as:

> '"I Suppose I Must Have More Discussion on This Dreary Subject": The Negotiation and Drafting of the UK–Australia Double Taxation Treaty of 1946';[12] and
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> '"Send a Strong Man to England – Capacity to Put Up a Fight More Important Than Intimate Knowledge of Income Tax Acts and Practice": Australia and the Development of the Dominion Income Tax Relief System of 1920'.[13]

Such titles would have been a delight to John's wry sense of humour and a drawcard for his readers and conference audiences.

The result of John's work was a rounded, human, appreciation of the relevant tax law and the explanation for its form – in a manner that the written word of the law cannot yield. Thus, John became the expert on such things, and he was generous in sharing his knowledge of the subject matter but also of the techniques he had learned.

It therefore seems highly appropriate to approach the topic of this article from an historical perspective as we do here and John, as a capital gains tax and business entities expert[14] as well as a tax historian, would have approved of the idea of a review of the history of the tax treatment of appreciated property in Australia and of refundable franking credits.

2.2 Deductible gift recipient system and capital gains tax

The current tax-deductible gift system provides incentives for both individuals and corporations to make donations and receive a tax deduction in return. For individuals who derive taxable income and who give more than AUD 2 to a charity or other entity that has deductible gift recipient (DGR) status, the individual can claim a 100 per cent tax deduction. The Commission found that a tax deduction is likely to provide an 'effective mechanism for encouraging donations of money and does not need to substantively change'.[15] Despite the obvious benefit provided by the deductible gift system, the Commission was of the view that further reform was warranted to the DGR framework. This was especially the case with the entities that are designated as DGRs.

Sustainable?' (2010) 34(1) *Melbourne University Law Review* 268 ('Twilight of the Neanderthals'); C John Taylor, 'The Negotiation and Drafting of the UK-Australia Double Taxation Treaty of 1946' [2009] (2) *British Tax Review* 201; C John Taylor and Andrew MC Smith, 'Trans-Tasman Taxation of Companies and Their Shareholders 1945–2005' (Conference Paper, 4th International Accounting History Conference, Braga, Portugal, 8-9 September 2005); Taylor, 'Archival Research', above n 9.

[11] Taylor, 'Some Distinctive Features', above n 10; Taylor, 'Twilight of the Neanderthals', above n 10.

[12] Taylor, '"I Suppose I Must Have More Discussion on This Dreary Subject"', above n 10.

[13] Taylor, '"Send a Strong Man to England"', above n 10.

[14] CJ Taylor, *Capital Gains Tax: Business Assets and Entities* (Law Book Company, 1994).

[15] Productivity Commission, *Future Foundations for Giving: Draft Report* (November 2023), 11 ('Draft Report'). See also Productivity Commission, 'Final Report', above n 2, 6.

The Commission was of the view that the definition and access status of entities and charities that have been designated as DGRs has been 'poorly designed' and become 'overly complex' with 'little or no coherent policy rationale'.[16]

The Commission also engaged in preliminary econometric modelling to identify any changes in behaviour by individual taxpayers in response to tax incentives. The Commission provided an estimate of the *price elasticity of giving*.[17] The price elasticity was modelled on a person's individual marginal tax rate. The Commission also looked at the *income elasticity of giving* as a measure for philanthropy by the individual taxpayer.[18] The preliminary estimates by the Commission regarding the elasticity of giving and income elasticity associated with philanthropy were, for a taxpayer giving AUD 100 and with disposable income of AUD 50,000[19] that:

- 'a 1% decrease in the price of giving increases giving between 48 cents and $1.67';[20]
- 'a 1% increase in disposable income increases giving between 86 cents and $1.17'.[21]

The Commission found that the above price elasticities for both giving and disposable income along with the relationship of philanthropy were consistent with findings from overseas jurisdictions, including the United States,[22] Canada[23] and the UK.[24]

In terms of philanthropy, the Commission considered the CGT implications of donating CGT assets to a charity. Where assets or property that are subject to CGT are donated, the donor would ordinarily bear the CGT liability upon disposal. This liability would be offset by the donor claiming the market value of the gifted property against assessable income and thus realise a tax deduction in the same way as a monetary donation.[25] The Commission considered whether further incentives should be provided to incentivise the donation of capital in the form of assets and property to encourage further philanthropy. One suggestion was to provide a CGT exemption for donated property, at the same time as allowing a deduction for the market value of the donated property. This would apply not only where the donated asset was not used to claim a tax deduction

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[16] Productivity Commission, 'Final Report', above n 2, 6.
[17] Ibid 128-136, 422-439. The Commission estimated on the basis that if an individual marginal tax rate were to decrease by 1 per cent, would they give less because they would receive a lower tax deduction for each dollar of donation.
[18] Ibid. The Commission modelled income elasticity of 'giving' by estimating how individuals change their behaviour in response to changes in the individual's income.
[19] Other factors that may be relevant include the taxpayer's demographics, such as age and gender, the charitable cause and the design of the tax incentive: Productivity Commission, 'Final Report', above n 2, 129.
[20] Ibid 7.
[21] Ibid.
[22] John Peloza and Piers Steel, 'The Price Elasticities of Charitable Contributions: A Meta-Analysis' (2005) 24(2) *Journal of Public Policy and Marketing* 260.
[23] Ross Hickey, Brad Minaker, A Abigail Payne, Joanne Roberts and Justin Smith, 'The Effect of Tax Price on Donations: Evidence from Canada' (Melbourne Institute of Applied Economic and Social Research Working Paper No 02/23, January 2023).
[24] Miguel Almunia, Irem Guceri, Ben Lockwood and Kimberley Scharf, 'More Giving or More Givers? The Effects of Tax Incentives on Charitable Donations in the UK' (2020) 183 *Journal of Public Economics* 104114.
[25] Productivity Commission, 'Final Report', above n 2, 149.

against assessable income, but more broadly. This would effectively allow a donor of a CGT asset to not incur a tax liability upon disposal, yet still receive a full deduction. The Commission was not persuaded to recommend such a change based on a very brief analysis of the policy implications.[26]

2.3 Integrity measures

The Commission's report highlights the need for any changes to tax concessions such as the DGR system to be made in such a way that they 'maintain integrity and direct government subsidised donations toward entities that provide the greatest community-wide benefits'.[27] The report recommends strengthening some DGR integrity measures and removing others, due to their disincentivising effect.[28] In this article we examine the history of integrity measures that apply to franked dividends received by charities, that were modelled on DGR system integrity rules. That history highlights the legislative decision to design integrity measures for the imputation system using concepts emerging from judicial analysis of the nature of a 'gift'. The common law indicia of a 'gift' will often be instructive in a law design project concerning charities. However, as always, care must be taken when constructing targeted integrity measures lest they impede the core purpose of a legislative regime – eg, a regime intended to support and promote the charity sector. Integrity rules relying on the indicia of a 'gift' have the capacity to cover a broad spectrum of potential activity and, accordingly, ought to be designed with appropriate consultation and careful thought about necessary carve-outs.

3. GIFTS OF APPRECIATED PROPERTY

As noted above, the Commission's philanthropy inquiry has involved consideration of whether to increase the tax concessions available to donors of appreciated property, that is, gifts of property where the donor has a small cost base compared with the current market value of the property, for instance, shares in a company founded by the donor or real estate purchased long ago.[29] Australia is far less generous than jurisdictions such as the United States, Canada and the United Kingdom in its treatment of gifts of appreciated property. Increasing the level of generosity might result in greater levels of donation, thus helping toward the goal of doubling philanthropy by 2030. However, as noted by the Productivity Commission, the potential application of the CGT discount (50 per cent for individuals) for property acquired at least 12 months before the donation already results in a concession and there is the risk of unintended consequences such as the difficulties of liquidating property – especially unlisted shares – and the introduction of greater inequity from favouring donations of capital assets over salary income.[30] It is

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[26] Ibid 149-150. See also Productivity Commission, 'Draft Report', above n 15, 154-155.
[27] Productivity Commission, 'Final Report', above n 2, 211.
[28] Ibid 211-214.
[29] The practice is common in the United States with prominent examples including Malcolm and Emily Fairbairn's donation of Energous shares (they were early investors rather than founders) to Fidelity Charitable, *Fairbairn v Fidelity Investments Charitable Gift Fund*, 2018 WL 6199684 (ND Cal 2018) ('*Fairbairn*'), and Charles Johnson's donation of his own mansion at a very high market valuation: Jeff Ernsthausen, 'How the Ultrawealthy Use Private Foundations to Bank Millions in Tax Deductions While Giving the Public Little in Return' *ProPublica* (26 July 2023) <https://www.propublica.org/article/how-private-nonprofits-ultrawealthy-tax-deductions-museums-foundation-art>.
[30] Productivity Commission, 'Final Report', above n 2, 149-150.

therefore useful to look at the context and history of the less generous Australian treatment.

3.1 Deduction and market value CGT exemption

A recent OECD report on taxation and philanthropy indicates that most countries provide donation concessions for gifts to philanthropic organisations (such as charities) of cash and property.[31] Some countries provide donation concessions only for monetary gifts, not property.[32] Others impose numerous restrictions on the type or value of property that can be donated.[33] Historically, Australia was quite restrictive about gifts of property. Prior to 1 January 1978, a deduction was available only for property acquired within 12 months of making a gift, but from 1 January 1978, cultural property was added.[34] Some further additions were made over the intervening years, but it was not until 1 July 1999 that Australia permitted deductions for most items of property that had been purchased 12 months or more before the donation.[35] However, disposing of property by way of gift to a deductible gift recipient is a CGT Event and so raises the risk that CGT – based on market value at the time of the gift[36] – might apply to eliminate or reduce the benefit of the deduction.[37] Other than cultural property donated under the Cultural Gifts Program[38] and main residence gifts,[39] no other property types are granted both an exemption from CGT on disposal and a deduction.[40]

The United States broadly excludes charity-donated property from CGT (provided in the US that it has been held for at least one year), as well as permitting a market value deduction.[41] The United Kingdom provides both an income or corporation tax deduction and a capital gains tax exemption for gifts of listed shares or securities, shares or securities dealt with on the AIM (Alternative Investment Market) or PLUS–Quoted Market, units in authorised unit trusts, certain other shares, and land and buildings.[42] In

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[31] OECD, *Taxation and Philanthropy*, OECD Tax Policy Studies No 27 (OECD Publishing, 2020) [4.2].
[32] Ibid, listing New Zealand as an example.
[33] Ibid.
[34] Hon John Howard (Treasurer), 'Taxation Incentives for the Arts Scheme' (Press Release, 14 October 1981); Peter Clayton, 'The Taxation Incentives for the Arts Scheme' (1988) 37(1) *Australian Library Journal* 5, 6.
[35] *Taxation Laws Amendment Act (No 2) 2000* (Cth) Sch 6. For a discussion, see Myles McGregor-Lowndes, 'The Australian Charitable Contribution Deduction' (Paper presented at the National Centre on Philanthropy and the Law, Reforming the Charitable Contribution Deduction 13th Annual Conference, New York, 2001) 14 <https://ncpl.law.nyu.edu/wp-content/uploads/pdfs/2001/Conf2001_McGregor-Lowndes_Final.pdf>.
[36] *Income Tax Assessment Act 1997* (Cth) s 116(1) or s 116(2) (ITAA 1997) would typically deem the market value of the gifted property to be capital proceeds received by the donor.
[37] A gift of property that is deductible would be expected to result in a change in beneficial ownership and so result in CGT Event A1 under ITAA 1997, above n 36, s 104-10.
[38] ITAA 1997, above n 36, ss 30-15(2) (table items 4 and 5) and 118-60(2).
[39] The CGT main residence exemption can potentially apply to gifts of a main residence: ITAA 1997, above n 36, sub-div 118-B. This could potentially include heritage gifts of a main residence to which ITAA 1997 s 30-15(2) (table item 6) applies.
[40] Albeit that other CGT concessions may apply if, for instance, the gifted property was a war medal or a collectable such as jewellery or artwork acquired for AUD 500 or less: ITAA 1997, above n 36, ss 118-5(b), 118-10. For discussion of potential CGT concessions, see Ann O'Connell, *Taxation of Charities and Not-for-Profits* (LexisNexis, 2021) 405-408.
[41] OECD, above n 31, [4.2.7].
[42] HM Revenue and Customs, 'Detailed Guidance Notes on How the Tax System Operates for Charities' (updated 27 March 2024) Ch 5 <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-5-giving-land-buildings-shares-and-securities-to-charity>.

Canada, from very shortly after the introduction of capital gains taxation in 1972, charitable gifts of property generally gave rise to an income tax concession.[43] While the Canadian Parliament was not persuaded by attempts from the inception of the capital gains tax to exempt all forms of property donations from CGT,[44] Canada exempts a range of property donations (eg, public company listed shares, cultural property and ecologically sensitive land) from capital gains tax.[45] Interestingly, the Canadian classes of exempt property only included cultural property (the exemption was introduced in 1977) on the basis that Canadian museums and other cultural institutions were otherwise competing on an uneven playing field with US institutions, given that US donors could claim a market value deduction and ignore any realised capital gain.[46] Canada subsequently expanded the CGT exemption to publicly traded securities (providing a 50 per cent exemption in 1997) and ecologically sensitive land (providing a 50 per cent exemption in 2001).[47] Then, in 2006, Canada provided full exemption for both publicly traded securities and ecologically sensitive land, with the US approach of full disregard of CGT being provided as a rationale for achieving greater support for capital transfers to Canadian charities.[48]

Further (setting aside listed public company shares worth AUD 5,000 or less, property purchased within 12 months of a deduction and cultural, heritage or environmental property), in Australia, the amount that can be deducted is based on a valuation carried out by the Commissioner of Taxation.[49] In contrast, in jurisdictions such as Canada and the United States, the market value that can be deducted is generally determined by the philanthropic recipient or donor (often with a requirement that they obtain an appraisal), not the revenue authority.[50] Special rules apply to cultural and heritage or environmental property in each jurisdiction.[51]

3.2 Historical explanation for the limited availability of a deduction and exemption in Australia

Martin's analysis of the historical development of income tax deductions in Australia explains that they were fashioned from concessions for charities in income and land tax legislation of the Australian colonies, based on earlier English practice.[52] This occurred without any 'real discussion of the policy behind' the earlier concessions.[53] While theoretical explanations for charity deductions now abound,[54] in earlier times, deduction

[43] First a deduction and then a credit: David G Duff, 'The Tax Treatment of Charitable Contributions in a Personal Income Tax: Lessons from Theory and the Canadian Experience' in Matthew Harding, Ann O'Connell and Miranda Stewart (eds), *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge University Press, 2014) 199, 224.
[44] As to suggestions of a broad exemption from commencement of the CGT, see ibid.
[45] OECD, above n 31, [4.2.7].
[46] Duff, above n 43, 224-225.
[47] Ibid 225.
[48] Ibid.
[49] O'Connell, above n 40, 387-389, 402-403. A deduction can also be claimed for donations of trading stock, but a disposal of trading stock outside the ordinary course of business generates a corresponding amount of assessable income: at 388-392.
[50] OECD, above n 31, [4.2.7].
[51] Ibid.
[52] Martin, above n 8.
[53] Ibid 220.
[54] See, eg, OECD, above n 31; Duff, above n 43; Roger Colinvaux, 'Ways the Charitable Deduction Has Shaped the US Charitable Sector' in Matthew Harding (ed), *Research Handbook on Not-For-Profit Law* (Edward Elgar, 2018) 444.

concessions seem to have been largely justified based on the desirability of incentivising more donations so as to enable charities to achieve more public benefit, albeit that this needed to be balanced against the revenue forgone by government.[55]

In this context, it is perhaps unsurprising that the Asprey Review, which discussed the introduction of an Australian CGT and devoted an entire chapter to charities, did not discuss the issue of whether charitable gifts of property should be made exempt from CGT, as well as deductible.[56] Indeed, in 1975 when the Asprey Review was handed down, the only property for which an income tax deduction could be claimed was property acquired within 12 months of making a gift, for which one might expect the price paid to roughly equal the market value such that capital appreciation was not a major issue. Instead, the Asprey Review recommended that gifts (including non-charitable gifts) should result in a deemed disposal of the gifted property at market value.[57] This was despite the Asprey Review noting the existence of a general view that gifts to charities and other public bodies ought to be encouraged so as to help subsidise the welfare services provided by those bodies and that might otherwise have to be provided by government.[58]

When the Taxation Incentives for the Arts scheme was introduced in 1978, lifetime gifts of cultural property accepted by public galleries, museums and the like institutions were made deductible.[59] There was some recognition that this might encourage gifts of appreciated property, with the government's stated rationale being that '[i]n liberalising the gift deduction provisions in this way, the Government's intention was to encourage the donation for public display of significant works of art, and other cultural property, that had been inherited or that had been held for an extended period of time over which its value had considerably appreciated'.[60] However, there does not appear to be discussion of the potential CGT consequences, likely because Australia had not yet introduced a comprehensive CGT.

In June 1985, the government released a Draft White Paper on taxation reform containing detailed proposals for an Australian CGT.[61] The Draft White Paper contained no discussion about charitable donation concessions in its discussion of CGT, instead adopting a general position similar to that outlined in the Asprey Review. That is, a gift (or bequest upon death) should act as a realisation point for recognising any capital gains, in order to avoid excessive deferral of the realisation time.[62] The resulting CGT provisions that were introduced by the *Income Tax Assessment Amendment (Capital Gains) Act 1986* (Cth) are consistent with this sentiment, applying the provisions to disposals of assets and deeming bequests to tax-exempt persons to result in a disposal.[63] A CGT exemption was included for medals awarded for valour or brave conduct,[64] but

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[55] Martin, above n 8, 221. The revenue saved could presumably have been used directly by government to achieve public benefit.
[56] Taxation Review Committee (Justice Kenneth Asprey, chair), *Full Report* (31 January 1975) chs 23 (capital gains tax) and 25 (charities) (Asprey Review).
[57] Ibid [23.51].
[58] Ibid [25.3]-[25.6], [25.20]-[25.21].
[59] Howard, above n 34.
[60] Ibid.
[61] Australian Treasury, *Reform of the Australian Tax System: Draft White Paper* (June 1985).
[62] Ibid [7.11].
[63] Then ss 160L and 160Y of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936).
[64] Then s 160L(6) of the ITAA 1936, above n 63.

the Explanatory Memorandum and the Second Reading Speech to the Bill for this Act do not explain why this exemption was included, or why no exemption was included for gifts to charities.

It was not until 1994 that a CGT exemption was provided for charitable gifts. That exemption was in the form of the Cultural Bequests Program. The Program was conceived as an addition to the Taxation Incentives for the Arts scheme.[65] The Budget announcement recognises the issue of capital appreciation and identifies achievement of 'cultural significance to the nation' as the rationale for providing a concession:

> [T]ax concessions will be made available for bequests of selected major items of cultural significance to the nation. The tax concessions will be available after the donor's death, to be offset against income in the donor's final tax return and income of the donor's estate, and will consist of a tax deduction equal to the value of the testamentary gift at the time the donor agreed to make the gift, and a capital gains tax exemption. The capital gains tax exemption will relate to the unrealised capital gain at the time a donor agreed to make the bequest, and the subsequent capital gain prior to the donor's death. The program will operate as a supplement to the existing Taxation Incentives for the Arts Scheme. A selection process will assess proposed bequests on the basis of historical and cultural significance, with approvals each year capped at a notional revenue cost of $2m per year.[66]

In line with the Budget announcement, *Taxation Laws Amendment Act (No 3) 1994* (Cth) introduced both a deduction (because bequests were testamentary gifts, for which deductions were not generally available) and a CGT exemption.[67] The Program was devised to focus on a particular type of property – items of material cultural significance – and to minimise the risk of lost revenue. That was achieved by requiring that proposed bequests not only be accepted by the relevant recipient public institution, but also approved in advance by the Minister for the Arts, with the value of the deduction also approved by the Minister.[68] Further, the Minister was required to determine an annual cap on deductions under the scheme before the start of each year, such that no deduction could be claimed once cultural bequests had already been approved up to the cap. The Cultural Bequests Program CGT exemption was rewritten into section 118-60 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) as part of the Tax Law Improvement Project.[69] The Cultural Bequests Program provisions were removed by the *Tax Laws Amendment (2011 Measures No 9) Act 2012* (Cth) on the basis that the program had by then become inoperative.[70]

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[65] Explanatory Memorandum to the Taxation Laws Amendment Bill (No 3) 1994, [8.5].
[66] Australian Treasury, *Budget Statements 1993-94: Budget Paper No 1* (1993). The Explanatory Memorandum to the Taxation Laws Amendment Bill (No 3) 1994, above n 65, [8.3]-[8.4] is consistent with this.
[67] Division 9 of the Act introduced amendments to section 78 of the ITAA 1936, above n 63, (the deduction provision) and introduced section 160L(9) to exempt from CGT disposals of assets under the cultural bequests program.
[68] *Taxation Laws Amendment Act (No 3) 1994* (Cth) s 81. See also McGregor-Lowndes, above n 35, 20.
[69] *Tax Law Improvement Act (No 1) 1998* (Cth). The deduction for cultural bequest program gifts under section 78 of the ITAA 1936, above n 63, had already been rewritten into Sub-div 30-D of the ITAA 1997, above n 36, by the *Tax Law Improvement Act 1997* (Cth).
[70] Explanatory Memorandum to the Tax Laws Amendment (2011 Measures No 9) Bill 2011, [8.7].

Effective from 1999, the CGT exemption for Cultural Bequests Program bequests was extended to cultural gifts under the Cultural Gifts Program, being the new name for the Taxation Incentives for the Arts scheme.[71] The *Taxation Laws Amendment Act (No 2) 2000* (Cth) added the CGT exemption, at the same time as broadening the CGT exemption for bequests to all testamentary gifts that would be deductible but for being testamentary bequests.[72] The only rationale provided in the explanatory materials was that this would 'encourage greater corporate and personal philanthropy in Australia'.[73] A press release by the Prime Minister, Treasurer and Minister for Family and Community Services indicated that the CGT changes were intended to 'boost' donations and 'cut through the red tape that has discouraged many businesses, individuals and families who want to give more to their communities'.[74] At the same time, the deduction for property was broadened to cover most items of property, though no corresponding CGT exemption was included and no additional explanation provided in the explanatory materials as to why a different approach was taken to general property versus cultural property.

In its report the Productivity Commission draws on Martin's research and refers to the lack of a clear policy basis for the development of donation concessions:

> Since a tax deduction for donations was introduced in 1915, the scope of activities eligible for deductible donations has evolved in an ad hoc way. This means that the DGR system does not have a clear overarching policy rationale that explains why certain types of charitable activity receive DGR status and other charitable activities do not. Charities that undertake similar activities and/or have similar purposes can be treated differently, creating anomalous outcomes. This can create uncertainty for charities about their eligibility for DGR status, and complexity in obtaining it … The system also lacks clarity for donors (who claim the tax deduction) because of the anomalous treatment of similar charities.[75]

However, the Productivity Commission does not draw further on the history outlined above, other than an implicit reference to the 'cultural significance' of cultural property as justifying the current CGT exemption for cultural gifts.[76]

3.3 What can we learn?

What can we draw from this review of the history of the tax treatment of appreciated property in Australia? It is clear that, as Martin found for donation concessions generally, there has historically been no sustained policy consideration of the issue. At

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[71] The initiatives were the result of a philanthropy report produced in 1999 by the Prime Minister's Community and Business Working Group chaired by David Gonski. The report does not appear to have been released publicly. As to discussion of business/corporate philanthropy more broadly, see, eg, Tony Ciro and Bulend Terzioglu, 'Corporate Philanthropy in Australia: Evidence from Australia's Top 100 Listed Firms' (2017) 32(1) *Australian Journal of Corporate Law* 27.

[72] *Taxation Laws Amendment Act (No 2) 2000* (Cth) ss 26, 28.

[73] Explanatory Memorandum to the Taxation Laws Amendment Bill (No 8) 1999, [5.4] (this Bill became the *Taxation Laws Amendment Act (No 2) 2000*).

[74] Hon John Howard (Prime Minister), Hon Peter Costello (Treasurer) and Hon Jocelyn Newman (Minister for Family and Community Services), 'Joint Press Release' (1 July 1999) <https://pmtranscripts.pmc.gov.au/release/transcript-11225>.

[75] Productivity Commission, 'Final Report', above n 2, 162-163.

[76] Ibid 149-150.

best, what we can glean is that decisions have been made at various times over the last 40 years to not provide a general CGT exemption in respect of all appreciated property for which a charitable deduction can be claimed. For instance, there have been occasions, such as in 2000, when major changes have been made to the breadth of property for which a deduction can be claimed and yet the CGT exemption has been doled out sparingly to particular types of property. It is clear that the special nature of cultural property – its socio-cultural significance to the nation – is part of the rationale for limiting additional concessions to such property and this is consistent with the Productivity Commission's conclusions in its report.[77] Additionally, the inclusion of restrictive mechanisms as to acceptance and approval for the limited instances of CGT exemption for cultural property suggest a desire to strongly protect the revenue.

The several paragraphs added by the Productivity Commission in its philanthropy inquiry draft and final reports are a major advance on the existing situation and represent an opportunity to reconsider the issue. First, the Productivity Commission refers to the potential preference of donors to leave the management and potential liquidation of donated property to the charity recipient (which can bring difficulties), as opposed to gifts of money. This can be linked to the tax history theme of the use of restrictive acceptance and approval mechanisms, largely due to floodgates and valuation concerns. It is potentially very difficult to value and to sell property such as unlisted shares. This would likely materially increase the transaction costs of giving (and potentially disincentivise giving of illiquid property), which the Productivity Commission found were relatively low under the current regulatory settings.[78]

In the United States, the ability to donate illiquid property and claim a (top of the range) deduction without the donor having to worry about the actual sale of the property is one reason for the spectacular rise of a particular type of philanthropic intermediary/structured giving vehicle: donor advised funds.[79] Donor advised funds are essentially management accounts within a public charity that permit advisory privileges to donors, such that donors obtain extensive concessions for their donations, but in practice retain decision-making privileges about the charity recipients to whom the donated property is ultimately distributed. There are concerns that such philanthropic intermediaries have an in-built tendency to prioritise donor interests so as to ensure further donations, without adequately considering the pursuit of their own charitable purposes, since many are essentially flow-through vehicles with donors determining the charitable recipients.[80] Many professional donor advised fund sponsor organisations also market their supposedly superior ability to deal with illiquid assets and reduce transaction costs.[81] However, practice has sometimes materially diverged from the rhetoric, with *Fairbairn v Fidelity Investments Charitable Gift Fund*[82] being a well-known US example whereby donors sued their donor advised fund sponsor organisation

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[77] See n 76, above, and accompanying text.
[78] Productivity Commission, 'Final Report', above n 2, 387.
[79] Roger Colinvaux, 'Donor Advised Funds: Charitable Spending Vehicles for 21st Century Philanthropy' (2017) 92(1) *Washington Law Review* 39, 71-81 ('Donor Advised Funds'); Mary C Hester, 'Donor-Advised Funds: When Are They the Best Choice for Charitably Minded Clients?' (2008) 108(6) *Journal of Taxation* 330, 333.
[80] See, eg, Colinvaux, 'Donor Advised Funds', above n 79, 73-74.
[81] Ibid 76-81; Hester, above n 79, 330, 333.
[82] *Fairbairn*, above n 29.

for alleged negligence in relation to selling *listed* shares in a large block and thereby significantly depressing the amount realised for the charitable giving account.

The US experience suggests that philanthropic intermediaries similar to donor advised funds might disproportionately attract illiquid property donations (because ordinary gift recipients find liquidation too difficult) potentially reducing the transaction costs of realising illiquid property. However, philanthropic intermediaries like donor advised funds might combine this with a tendency to prioritise donor interests so leading to maximal asset valuations at the point of donation and posing a real risk that the ultimate benefit to the community from gifts of appreciated property is less than the tax forgone.[83] This is a separate issue to the question of delay in the distribution of funds held in structured giving vehicles, a matter considered by the Productivity Commission in its report and in relation to which Australia has an advantage over the US in that one of the main forms of structured giving vehicles used to provide sub-funds or donor advised funds, the Public Ancillary Fund, is already subject to an annual minimum distribution rate of 4 per cent (and with the Productivity Commission recommending a slight increase).[84]

Second, the Productivity Commission refers to potential inequity between taxpayers if gifts of capital assets are further privileged.[85] The Productivity Commission apparently refers to horizontal equity concerns by contrasting capital gain income with salary income. This is undoubtedly correct. However, as noted elsewhere by the Productivity Commission, Australian giving trends already suggest that higher income and wealthier taxpayers are increasingly giving a greater proportion of donations.[86] That is why the Productivity Commission's finding 3.1 is that 'Rising income and wealth are the major reasons behind rising tax-deductible donations'[87] and why the Productivity Commission's finding 4.1 includes the statement that 'those on a higher income [are] more likely to give'.[88] It is these very same Australians who are likely to hold a disproportionate share of capital assets and so gain greater benefit from additional concessions for gifts of capital assets. Accordingly, there is the potential to also materially detract from vertical equity.

The historical context suggests that a cautious and limited approach to concessions for gifts of appreciated property is justified to protect the revenue, and also that a special reason, such as protecting the nation's cultural heritage, is likely to be required to warrant inequitable treatment of gifts from capital receipts and revenue (salary) receipts. A rejection of calls for a broad-based appreciated property CGT exemption which draws on the historical context as well as a more expansive understanding of the Productivity Commission reasons relating to liquidity and inequity could help politicians and others when responding to the inevitable attempts by interest groups to call for Australia to adopt the more generous treatment granted by jurisdictions such as the US, Canada and the UK.

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[83] For a useful analysis of the extent of the transaction costs and valuation difficulties, resulting in revenue leakage, see, eg, Roger Colinvaux. 'Charitable Contributions of Property: A Broken System Reimagined' (2013) 50(2) *Harvard Journal on Legislation* 263.
[84] See, eg, Productivity Commission, 'Final Report', above n 2, 271-272, 275-289.
[85] See n 30, above and accompanying text.
[86] Productivity Commission, 'Final Report', above n 2, 86-89.
[87] Ibid 93.
[88] Ibid 136.

4. INTEGRITY MEASURES: DEDUCTIBLE GIFTS AND REFUNDABLE FRANKING CREDITS

4.1 Overview

The history of deductible gifts also traces into a more modern element of Australian taxation law – namely, Subdivision 207-E of the ITAA 1997, which includes integrity rules concerning the refundability of franking credits received by tax-exempt entities. The language used for the integrity rules in Subdivision 207-E derives from section 78A of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936). Section 78A was introduced as part of anti-avoidance legislation that was designed, in part, to put an end to 'gift schemes' that were commonplace through the 1970s.[89] Subdivision 207-E[90] is a rewrite of former Division 7 of Pt IIIAA of the ITAA 1936,[91] which was introduced as part of large-scale tax reforms responsive to recommendations in the Review of Business Taxation chaired by John Ralph in Australia.[92] Among those recommendations was a proposal to allow for refunds of excess imputation credits to taxpayers whose income was taxed at a rate below the company tax rate.

To the knowledge of the authors, neither former Division 7 of Pt IIIAA of the ITAA 1936 nor Subdivision 207-E received significant attention in the years after they were enacted. More recently, Subdivision 207-E has been brought into frame following the publication by the Australian Taxation Office on 8 December 2023 of Taxpayer Alert TA 2023/3, 'Franking credit refunds – income tax exempt entities receiving franked distributions in the form of property other than money', which concerns distributions of property other than money to tax-exempt entities and, in particular, the application of section 207-122(b)(i) of the ITAA 1997.

4.2 Allowing a refund of franking credits to charities – some observations

While the focus of the Productivity Commission's report is philanthropic giving, one of its underlying themes is the way Australian governments support charities. The primary forms of Australian government support are the allowance of income tax deductions for donations and direct funding by way of grants and contracts.[93] Charities also receive government support through various federal, State, Territory and local government tax concessions.[94]

Refundability of franking credits received by charities is regarded as a form of tax concession.[95] Charities might receive franking credits because of direct investment, for example by holding shares in an Australian company, or by means of gift, for example where a private trust estate that holds shares in an Australian company distributes

[89] Section 78A of the ITAA 1936, above n 63, was enacted by the *Income Tax Assessment Amendment Act 1978* (Cth).

[90] Subdivision 207-E of the ITAA 1997, above n 36, was enacted by the *Tax Laws Amendment (2004 Measures No 6) Act 2005* (Cth).

[91] Former Division 7 of Part IIIAA of the ITAA 1936, above n 36, was enacted by the *New Business Tax System (Miscellaneous) Act (No 1) 2000* (Cth).

[92] Review of Business Taxation (John Ralph, chair), *A Tax System Redesigned: More Certain, Equitable and Durable* (1999) (Ralph Review).

[93] Productivity Commission, 'Final Report', above n 2, 4-5; Productivity Commission, 'Draft Report', above n 15, 9.

[94] Productivity Commission, 'Draft Report', above n 15, 176.

[95] Productivity Commission, *Contribution of the Not-for-Profit Sector* (Research Report, 2010) 163, E.2 and E.8; Ann O'Connell, 'Stretching the Concept of Charity in the Tax Context: Membership-Based Entities as Charities' (2021) 50(2) *Australian Tax Review* 121, 122.

franked dividends to a charity. The extent of support afforded by the refundability of franking credits is substantial, but appears to be in decline, with the latest figures recording refunds to tax-exempt philanthropic entities of AUD 2,095 million in 2019-20, AUD 1,040 million in 2020-21 and AUD 900 million in 2021-22.[96]

The Productivity Commission report does not directly interrogate the role refunds of franking credits can play with respect to philanthropic giving. Refunds of franking credits are mentioned as potentially increasing income for ancillary funds and dividend imputation is mentioned in the context of assessing the cost of giving for an Australian resident shareholder in an Australian company,[97] but otherwise franking credits do not feature.

In our view, the refundability of franking credits received by charities is a topic that warrants consideration in an analysis of philanthropic giving. The absence of consideration by the Productivity Commission may be explained by its characterisation of tax concessions for charities as a means of indirectly reducing 'their operating costs'.[98] In view of the history discussed in section 4.4, that characterisation with respect to the refundability of franking credits might be qualified in at least two respects. First, the refundability of franking credits does not reduce a cost that would otherwise be incurred by a charity; rather, a refund of franking credits is accretive to charities; refunds reverse the payment of tax on corporate income, such tax being an operating cost of the underlying taxable entity that has generated franking credits from (presumably) non-charitable activities. In that sense, the policy of refunding franking credits to charities constitutes a direct contribution by the Australian government (potentially through the actions of an intermediary, such as a private trust), because a refund of franking credits increases a charity's cash flow; it does not avoid a reduction in cash flow that would otherwise arise by the imposition of tax.

Second, one might compare the refundability of franking credits with the income tax deduction for gifts, the latter of which involves the government 'effectively subsidising the gift *by a donor*'.[99] A gift deduction incentivises the donor directly.[100] By contrast, the incentive effect of franking credit refundability operates differently. As noted in section 4.4, the legislative decision to allow a refund of franking credits to charities was explained as removing a potential 'tax-driven distortion' that disincentivised tax-exempt entities from investing in Australian companies,[101] arguably indicating a policy of encouraging charities to partially self-support their activities through investment. However, that policy can also be viewed through the lens of philanthropic giving: allowing a refund of franking credits to charities would, in theory, encourage giving through intermediary trust estates from which charitable objects may receive franked distributions because the cash benefit of a franked distribution for a charity is increased by the government's 'co-contribution', being a refund of tax paid at the company level.

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[96] Australian Treasury, *Tax Expenditures and Insights Statement* (January 2024) 108.
[97] Productivity Commission, 'Final Report', above n 2, 124-125, 282-283.
[98] Ibid 174.
[99] Ann O'Connell, 'The Tax Position of Charities in Australia – Why Does It Have To Be So Complicated?' (2008) 37(1) *Australian Tax Review* 17, 27 (emphasis added).
[100] See Productivity Commission, 'Final Report', above n 2, 120-127.
[101] Supplementary Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill 1999, [1.2].

The Productivity Commission touches on the topic of tax credits in the context of considering the effectiveness of the personal income tax deduction, finding that:[102]

1. 'The current design of the personal income tax deduction is likely to be the most cost-effective way for the Australian Government to encourage giving';
2. 'A flat tax credit would likely incentivise more people to give, but the total amount given overall would likely fall if people who have a high income faced a higher price of giving than they currently do';
3. 'Adjustments to a tax credit to account for the likely fall in overall giving, including a hybrid approach – a tax deduction for some income cohorts and a tax credit for others – would add complexity and the effect on total donations would be uncertain'; and
4. The use of tax credits 'would likely increase tax integrity risks and compliance costs given volunteer work and expenses are often undocumented or informal'.

Those conclusions might be contrasted with the nuances discussed above regarding the tax concession afforded to charities in the form of a refund of franking credits:

1. A personal deduction or tax credit predominantly incentivises supply-side (donor) behaviour. By contrast, imputation credits can target specific behaviours on the supply side and demand side, namely by: (a) encouraging charities to self-support their activities through investment in Australian companies, and (b) potentially, encouraging philanthropists to direct franked distributions to charities.

2. Unlike the flat tax credit (which may reduce overall giving because high-income donors would face a higher price of giving), the refundable franking credit does not differentiate based on a donor's tax rate; instead, it provides a flat credit rate (the corporate tax rate) regardless of donors' personal circumstances.

3. The refunding of franking credits might be characterised as akin to a 'co-contribution' model, whereby the Australian government contributes directly in an accretive way to the cash flow of charities (otherwise than through grants and contracts) by refunding corporate taxes. Participation in the 'co-contribution' program is at the election of charities (by investing in Australian companies) or philanthropists (by directing franked distributions to charities), without substantial and complex regulation.

4. Finally, as explored below, integrity risks associated with the refunding of franking credits are a matter of concern and require careful management. However, those risks are of a different nature to those identified by the Productivity Commission (regarding undocumented

[102] Productivity Commission, 'Final Report', above n 2, 25.

> and informal volunteer work and expenses), because the imputation system already operates through a rigorous legislative regime, including with respect to credits and debits to a company's franking account.[103]

In sections 4.3 and 4.4, we consider this topic further through a historical lens, specifically by looking at connections between, first, integrity measures in section 78A of the ITAA 1936, which were designed to counter 'gift schemes' and, second, similar measures incorporated in former Division 7 of Pt IIIAA of the ITAA 1936 and Subdivision 207-E of the ITAA 1997.

4.3 Section 78A

The schemes at which section 78A was directed occurred in an environment in which tax avoidance activities ran rife throughout Australia.[104] Those activities, which included the well-known '*Curran* scheme',[105] were the subject of various anti-avoidance measures enacted in the *Income Tax Assessment Amendment Act 1978* (Cth).[106]

Then Treasurer John Howard's[107] second reading speech for the Income Tax Assessment Amendment Bill 1978 (1978 Bill) was emphatic as to the focus of the new legislation. Mr Howard spoke of the government's 'program to strike down tax avoidance arrangements' perpetuated by a 'flourishing tax avoidance industry in all corners of the world'.[108] The government accepted the reasonableness of tax minimisation, but drew a line in the case of 'some techniques of tax avoidance [that] are so blatant, contrived and artificial as to go beyond the bounds of reasonableness'.[109] Later, in 1981, Mr Howard used the same expression when describing the 'blatant, artificial and contrived schemes' to which the proposed Part IVA of the ITAA 1936 (which contains Australia's general anti-avoidance rule) would apply.[110]

Section 78A revolved around a 'common feature' of gift schemes of the time: 'the donor seeking a deduction for a gift … does not, when the reality of the situation is laid bare, really make a gift of anything like the amount or value for which a deduction is claimed'.[111] This feature permeates the four paragraphs of section 78A(2), being the

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[103] See, for example, Div 205 of the ITAA 1997, above n 36.
[104] A history of the tax avoidance activities throughout the relevant period can be found in Trevor Boucher, *Blatant, Artificial and Contrived: Tax Schemes of the 70s and 80s* (Australian Taxation Office, 2010).
[105] *Curran v Federal Commissioner of Taxation* (1974) 131 CLR 409, overruled in *John v Federal Commissioner of Taxation* (1989) 166 CLR 417.
[106] The Act created rules targeted at 'the creation of tax losses through the issue and subsequent sale of bonus shares, abuse of the gift provisions, creation of artificial share trading losses, dividend stripping, artificial acquisition of "primary producer" status for averaging purposes and steps to avoid tax on undistributed income and tax on dividends': Commonwealth, *Parliamentary Debates*, House of Representatives, 7 April 1978, 1245 (John Howard, Treasurer).
[107] The wider context of the 1978 Bill includes the fact that Mr Howard took the role of Treasurer following the forced resignation on 19 November 1977 of Phillip Lynch, who had fallen into the spotlight following revelations that he had been using family trust arrangements for tax minimisation purposes.
[108] Commonwealth, *Parliamentary Debates*, House of Representatives, 7 April 1978, 1244 (John Howard, Treasurer).
[109] Ibid.
[110] Commonwealth, *Parliamentary Debates*, House of Representatives, 27 May 1981, 2685, 2687 (John Howard, Treasurer); Income Tax Laws Amendment Bill (No 2) 1981 (Cth). See also Explanatory Memorandum to the Income Tax Laws Amendment Bill (No 2) 1981, 2.
[111] Commonwealth, *Parliamentary Debates*, House of Representatives, 7 April 1978, 1245 (John Howard, Treasurer).

operative provision. In summary, section 78A(2) denies a gift deduction where a relevant arrangement connected to the gift results in:

1. the value of the gifted property being less than its value at the time it was gifted: section 78A(2)(a);

2. the donee being liable to transfer property, or incurring some other detriment, disadvantage, liability or obligation: section 78A(2)(b);

3. the donor (or an associate) obtaining some benefit, advantage, right or privilege (other than the tax deduction): section 78A(2)(c); or

4. the donee (or another entity) acquiring some property from the donor (or an associate): section 78A(2)(d).

Section 78A(3) added that, without limitation, section 78A(2)(c) would be deemed to apply where:

> the terms and conditions on which a gift of property other than money is made are such that the fund, authority or institution to which the gift is made does not receive immediate custody and control of the property, does not have the unconditional right to retain custody and control of the property in perpetuity to the exclusion of the donor or an associate of the donor or does not obtain an immediate, indefeasible and unencumbered legal and equitable title to the property…

It may be observed that the circumstances contemplated by section 78A(2) appear to have been identified with reference to the common law indicia of a 'gift'.[112]

The necessity of section 78A has been questioned in light of the decision of the Full Federal Court in *Leary v Commissioner of Taxation*,[113] which was handed down just two years after the 1978 Bill was enacted. The scheme in *Leary* was described in Mr Howard's second reading speech and the Supplementary Explanatory Memorandum to the 1978 Bill. The scheme involved the Order of St John receiving $120 from a purported donation of $10,000, the latter amount being the deduction claimed by Mr Leary:

> Under one gift scheme the donor seeks a deduction for a $10,000 gift that is made to an institution, $1,500 of the amount coming out of his or her own funds and the balance of $8,500 being lent by the promoters of the scheme. The institution, pursuant to an overall arrangement, pays the promoters a procuration fee of 98.8 per cent of the gift, leaving it with $120 out of the $10,000. The procuration fee puts the promoters in funds not only for their $8,500 loan to the donor but provides them with a substantial fee. In practical terms, the donor does not have to repay the $8,500 loan.[114]

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[112] See, eg, Australian Taxation Office, 'Income Tax: Tax Deductible Gifts – What Is a Gift', Taxation Ruling TR 2005/13 (20 July 2005) [13].
[113] *Leary v Federal Commissioner of Taxation* (1980) 11 ATR 145 ('*Leary*').
[114] Commonwealth, *Parliamentary Debates*, House of Representatives, 7 April 1978, 1245-1246 (John Howard, Treasurer).

The Court denied Mr Leary's deduction, primarily because of an absence of benefaction.[115] That conclusion may have applied to many schemes of the time, causing one commentator to note that:

> [i]n the light of the courts' approach in *Leary*'s case, the amendment may not have been necessary, but who was to know at the time?[116]

Evidently the government was not content to rely on the judiciary alone to end the gift schemes, and perhaps with good reason. In *Commissioner of Taxation v Clendon Investments Pty Ltd*,[117] the Supreme Court of Victoria held that a company was entitled to deduct the value of an artwork gifted to the National Gallery of Victoria despite the terms of the gift providing that the managing director of the company was entitled to retain control of the artwork during his lifetime. Later, in *Commissioner of Taxation v Coppleson*,[118] the Full Federal Court distinguished *Leary*, observing that:

> [t]he fact that the donor in circumstances such as these is, to some extent, motivated by a desire to achieve a tax deduction under s 78(1)(a), cannot itself disentitle him to that deduction.[119]

4.4 Refunding franking credits received by tax-exempt entities

The integrity model developed and enacted under section 78A provided a framework for a later integrity regime designed to protect against potential abuse of rules allowing for refundability of franking credits received by tax-exempt entities.

In August 1998, the government (then led by Prime Minister John Howard) released a White Paper which, among many things, proposed to reform Australia's imputation system by providing for full refundability of excess franking credits. Central to that proposal was a policy of ensuring that 'overall tax paid on profit distributed by a company or trust to low income resident individuals would reflect their marginal tax rates'.[120] The Paper contemplated that '[s]pecial arrangements would apply to *registered charitable organisations*',[121] namely that '[r]egistered organisations would … be allowed to claim refunds of excess imputation credits for tax paid at the trust level on donations to them by way of trust distributions'.[122] In the Ralph Review's final response to the government's White Paper, and following an extensive consultation process, the Review recommended the government's proposal.[123]

Curiously, when the New Business Tax System (Miscellaneous) Bill 1999 (Cth) (1999 Bill) was first introduced, nothing was included to provide for the refund of franking credits to tax-exempt entities. The 1999 Bill clearly included provision 'to enable taxpayers whose tax rates are below the company tax rate … to receive a refund of

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[115] *Leary*, above n 113, 155 (Bowen CJ), 161 (Brennan J), 166 (Deane J).
[116] Boucher, above n 104, 74.
[117] (1977) 7 ATR 493.
[118] (1981) 12 ATR 358.
[119] Ibid 360.
[120] Australian Treasury, *Tax Reform: Not a New Tax, a New Tax System* (August 1998) 115.
[121] Ibid 113.
[122] Ibid 114 to 115. The reference to 'trust distributions' arose because the extracted comments were made in the context of a proposal that trusts would be taxed like companies.
[123] Ralph Review, above n 92, 423-424.

excess imputation credits',[124] but omitted to extend the rules to the tax-exempt community. Subsequently, on 14 April 2000, then Treasurer Peter Costello announced that the government had 'decided that it will legislate to refund excess imputation credits to registered charitable and gift deductible organisations', touting the proposal as a means to 'provide a significant financial boost (around $50 million annually) to charities' who would 'therefore be in a position to provide more services and assistance to their beneficiaries'.[125]

Following Mr Costello's announcement, the 1999 Bill was amended while it remained before the Senate. The Supplementary Explanatory Memorandum explained the proposed amendments by reference to a potential 'tax-driven distortion' under the existing law, being that investments in companies were unattractive to tax-exempt entities because franking credits were non-refundable.[126] Alongside the refundable imputation credits, the Bill introduced 'anti-avoidance rules' (despite, perhaps, the expression 'integrity rules' being more apt) tied to the 'object of the amendments' of 'ensur[ing] that ordinary investment income received by an eligible institution is not subject to underlying taxation simply because it is received through a company as a franked dividend'.[127]

Notably, the new 'anti-avoidance rules' bore close resemblance to section 78A(2), denying the refundability of franking credits where:

1. a 'related transaction'[128] results in:
   - (a) the value of the distribution being less than its value at the time it was paid: section 160ARDAC(2), ITAA 1936;
   - (b) the tax-exempt entity being liable to make a payment or transfer property, or incurring some other detriment, disadvantage, liability or obligation: section 160ARDAC(4), ITAA 1936; or
   - (c) the distributing entity (or an associate) obtaining some benefit, advantage, right or privilege: section 160ARDAC(5), ITAA 1936;
2. for a distribution that to any extent takes the form of property other than money – the terms and conditions on which the dividend is paid are such that the tax-exempt entity does not receive immediate custody and control of the property, does not have the unconditional right to retain custody and control of the property in perpetuity to the exclusion of the distributing entity (or an associate), or does not obtain an immediate indefeasible and unencumbered legal and equitable title to the property: sections 160ARDAC(6) and (9), ITAA 1936;

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[124] Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill 1999 (Cth), 3.
[125] Hon Peter Costello (Treasurer), 'Refunding Excess Imputation Credits to Charities' (Press Release No 24, 14 April 2000).
[126] Supplementary Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill 1999, above n 101, [1.2].
[127] Ibid [1.23].
[128] 'Related transaction' was defined very broadly in former s 160ARDAA(1) of the ITAA 1936, above n 63.

3. in the case of trust distributions only – the total value of transfers of money and property from the relevant trust to the tax-exempt entity in a year is less than the amount of 'notional trust amounts'[129] for the year: section 160ARDAC(7), ITAA 1936; or

4. an arrangement is entered into in relation to a distribution and, because of the arrangement, the tax-exempt entity (or another entity) acquires property other than the property comprising the distribution: section 160ARDAC(10), ITAA 1936.

Subdivision 207-E was introduced to replace former Division 7 of Pt IIIAA of the ITAA 1936 in connection with the enactment of the simplified imputation system.[130] In relation to the 'anti-avoidance rules', the Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No 6) Bill 2004 simply stated that '[t]hese anti-avoidance rules, included in new Subdivision 207-E, will replicate the outcomes provided for under the former rules'.[131]

Having regard to the unique and multifaceted role that the imputation system can play in its interaction with charities (discussed in section 4.2), it might be queried whether the concepts in section 78A(2), which (as already noted) appear to derive from the common law indicia of a 'gift', were suitably adapted for application to franked distributions paid by an investee to an investor. The practicality of repurposing the drafting in section 78A to the refundable franking credit rules is self-evident. But the distinction between, first, the making of a 'gift' (which includes matters such as voluntariness and benefaction) and second, the payment of a distribution on invested capital is not insignificant. At a minimum, it would be expected that the complexities of commerce and business would more likely accompany franked distributions, rather than gifts, thereby adding a layer that may not have been in the minds of the drafters of section 78A.

That distinction has been accommodated in some respects. For example, but for section 207-128(1) of the ITAA 1997, section 207-120(2)(a)(i) would deny a tax-exempt entity from obtaining a refund of franking credits where the entity has elected into a dividend reinvestment plan (DRP) and the franking credits attach to a dividend to which the DRP applies. In particular, section 207-120(2)(a)(i) applies where, because of a 'distribution event',[132] a tax-exempt entity (or another entity) 'makes, becomes liable to make, or may reasonably be expected to make or to become liable to make, a payment to any entity'. If the conditions of section 207-128(1) are satisfied, it will provide a 'carve-out' from section 207-120(2)(a) to ensure that a refund of franking credits is not denied in the case of genuine participation in a DRP.

It might be assumed that the absence of a more extensive set of 'carve-outs' indicates the distinction between gifts and distributions has been sufficiently accommodated in Subdivision 207-E's integrity rules. However, the scope of the concepts derived from

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[129] 'Notional trust amount' was defined in former s 160ARDAA(1) of the ITAA 1936, above n 63, and, broadly, refers to an amount that would be included in the taxable income of an exempt entity if the entity was not exempt from income tax.

[130] See *New Business Tax System (Imputation) Act 2002* (Cth) and *Tax Laws Amendment (2004 Measures No 6) Act 2005*, above n 90.

[131] Explanatory Memorandum to the Tax Laws Amendment (2004 Measures No 6) Bill 2004, [3.24].

[132] 'Distribution event' is defined very broadly in s 207-120(5) of the ITAA 1997, above n 36.

section 78A and adopted in Subdivision 207-E must create some risk of circumstances arising where a tax-exempt entity might be denied a refund of franking credits notwithstanding an absence of the kind of mischief at which the integrity rules are directed. To the extent those circumstances arise in practice, consideration of further carve-outs might be appropriate.

The history discussed above invites a question as to whether the integrity model adopted in Subdivision 207-E reflects a carefully tailored legislative regime or an expedient solution designed without consideration of the unique role that franking credit refunds play as a means of supporting charities. That is not to say that the integrity rules in Subdivision 207-E lack a 'coherent policy rationale' (being the conclusion reached by the Productivity Commission regarding the DGR system).[133] However, it might be regarded as evidencing another patchwork element of the legislative scheme surrounding philanthropic giving. The Productivity Commission recommended strengthening some DGR integrity measures and removing others, due to their disincentivising effect.[134] The history outlined above suggests that a similar reconsideration of the integrity rules in Subdivision 207-E may also be a worthy exercise.

4.5 Concluding observations regarding franking credit refunds

The observations in section 4.2 highlight unique qualities of the tax concession comprising the policy to refund franking credits to charities. It appears that, at the introduction of that policy, those qualities were not front of mind, such that the relevant legislative amendments were expected to be of 'limited cost to the revenue'.[135] In circumstances where the government has committed to doubling philanthropic giving by 2030, it may be time to consider further the role that franking credit refunds can play to support charities.

As indicated in section 4.4, one potential avenue of enquiry might be a re-examination of the appropriateness of applying concepts designed to counter 'gift schemes' to refunds of imputation benefits. Another might be to contrast the potential role of tax credits offered to donors (which the Productivity Commission regards as less preferable than the personal income tax deduction) with the role that franking credits play as a means of: (a) government support, and (b) potential incentive for specific behaviour for both charities and philanthropists. With respect to the latter, in a context where 'Australia is on the cusp of a significant intergenerational transfer of wealth',[136] it might be expected that policy settings that potentially encourage philanthropists to direct franked distributions to charities (such as the implicit government 'co-contribution' program discussed in section 4.2) have the capacity to play a significant role in supporting charities over the coming decades.

5. CONCLUSION

In keeping with John Taylor's passion for tax history research as a means of exposing the broader and more social context in which tax law is developed, this article has shed

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[133] Productivity Commission, 'Final Report', above n 2, 25.
[134] Ibid 211-214.
[135] Supplementary Explanatory Memorandum to the New Business Tax System (Miscellaneous) Bill 1999, above n 102, [1.3].
[136] Productivity Commission, 'Final Report', above n 2, 300.

light on the history of two aspects of philanthropic tax concessions, with the aim of enhancing the debate now the Productivity Commission's final report of its review of philanthropy has been released.

Doubling philanthropic giving by 2030 is a very ambitious target, for which it might be tempting to import quick fixes from other jurisdictions, such as providing a CGT exemption and market value deduction for donations of a range of appreciated property. However, a tax history analysis supports the Productivity Commission's cautious approach to this issue. There is a real risk to the revenue due to the difficulties of valuing some appreciated property, as well as the linked issue of potentially greater reliance on philanthropic intermediaries to deal with property that is difficult to value or liquidate, but in a context where those intermediaries prioritise donor interests, rather than having a strong independent mission. As noted by the Productivity Commission, philanthropic intermediaries, or structured giving vehicles, have many potential benefits, including the potential for enhancing social capital,[137] yet they also pose risks. In particular, the Productivity Commission noted the risk of delayed distribution and the desirability of further investigation into the risks of trustee companies as professional managers of structured giving vehicles, including behavioural impacts of the ways that management and investment services might be remunerated and provided by affiliated entities.[138] The concerns underlying the discussion of these risks mirror concerns in the US context about donor advised fund sponsors being motivated by fee income and therefore aligning with donors' interests rather than focusing on community benefit.[139] A clear justification would also be needed to warrant inequitable treatment of gifts from capital receipts and revenue receipts and for the harm that would likely be done to vertical equity from advantaging donations of capital assets. Historically, a justification for these detriments and risks has been found primarily in respect of appreciated cultural property that is of unique national cultural significance. If the classes of appreciated property for which a CGT exemption is provided are broadened, significant attention will need to be given to the treatment of structured giving vehicles to maintain tax system integrity, with that broader issue being a matter that the Productivity Commission has grappled with to an extent in Chapter 8 of the report.

The history of the gift deduction integrity measures introduced in section 78A of the ITAA 1936 is also relevant to the Commission's task of reforming DGR integrity measures in line with its proposed broad reforms to the DGR system and its larger task of removing barriers to philanthropy. Three key points can be made. First, clear statutory measures provide greater robustness rather than seeking to rely too heavily on the courts to appropriately apply flexible tests such as whether a donation qualifies as a 'gift'. Second, the history of refundable franking credits for tax-exempt entities demonstrates the danger of seeking to lift integrity tests from one context and automatically apply them to another. Not only does this call for greater consideration of carve-outs for Subdivision 207-E, but more broadly in terms of changed context, the Commission's approach of excluding classes of activities (from being funded by deductible donations) for organisations categorised by reference to purposes will require close attention to the slippery divide between activities and purposes. Third, further consideration is warranted of the differences between the role of tax credits offered to donors and the role that franking credits play as a means of both government support

[137] Ibid 270-271.
[138] Ibid 271-272, 295-300.
[139] See n 83, above.

and potential incentives for specific behaviour on the part of charities and philanthropists.