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## Nudging Charities to Balance the Needs of the Present against Those of the Future

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### I. Introduction

This chapter explains the need for some temporal rules in charity law. It raises the underexamined issue of the point in time at which charities are expected to produce a public benefit from resources that they hold. Timing is critical to identifying which persons will benefit. Will they be members of the present generation that have provided resources or collectively granted concessions to the charity? Will future generations benefit instead?

The temporal issue will impact in different ways depending upon a charity's purpose and the means it uses to achieve that purpose. The considerations that apply to a bushfire disaster relief charity will diverge from those relevant to a university intended to last in perpetuity.

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Nevertheless, to remain relevant to as broad a group of charities as possible, this chapter looks in general terms at the gaps in existing constraints and proposes reforms that would better promote an intergenerational balance.

## II. The Need for an Intergenerational Balance

There is a theoretical and practical need for temporal rules. Turning to theory, key charity law goals are to facilitate the pursuit of charitable purposes independently from the state and to incentivise the production of goods for the benefit of the public in pursuing those purposes. This appears from economic theories that explain the production of public and quasi-public goods by the not-for-profit sector (including charities) in place of government production.<sup>2</sup> These goals are also supported by examination of the justification for charity tax concessions<sup>3</sup> and on a doctrinal analysis of charity law's functions.<sup>4</sup> An additional goal is to generate trust and confidence, on the part of those giving to and receiving benefits from charities, that funds received by the charity will be applied to the charitable purpose. This goal is drawn from analysis of the expressive function of charity law<sup>5</sup> and from economic and legal theories that seek to explain why goods are produced by the not-for-profit sector rather than the private sector.<sup>6</sup> Implicit in the goal of incentivising the production of goods is the need for goods to be produced before the end of time. Arguably, the trust and confidence goal also bolsters this conclusion. However, these goals provide limited guidance about the appropriate time.

From a practical perspective, grappling with the issue is critical. While hoarding by Australian charities does not appear systemic at present, there is some potential for accumulation and evidence of significant

2 Burton Weisbrod, *The Nonprofit Economy* (Harvard University Press, 1988); Estelle James and Susan Rose-Ackerman, *The Nonprofit Enterprise in Market Economics* (Harwood Academic Publishers, 1986) 20, 27–31.

3 Gino Dal Pont, 'Conceptualising "Charity" in State Taxation' (2015) 44(1) *Australian Tax Review* 48, 50; Evelyn Brody, 'Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption' (1998) 23(4) *Journal of Corporation Law* 585.

4 Matthew Harding, *Charity Law and the Liberal State* (Cambridge University Press, 2014) 38–41, 44; Dal Pont, above n 3, 50.

5 Harding, above n 4, 38–41, 44.

6 By reference to information asymmetries: Henry Hansmann, 'The Role of Non-profit Enterprise' (1980) 89(5) *Yale Law Journal* 835, 843–45. The theories supplement the subsidisation of public goods rationale above.

variation in savings rates across the not-for-profit sector.<sup>7</sup> Further, the level of Australian philanthropy is increasing, as are public expectations of charities. Moreover, concerns have been mooted in Australia and abroad.<sup>8</sup> In addition, research by the Charity Commission for England and Wales indicates that many charities may not have any formal policy for the retention and maintenance of reserved assets, including a significant proportion of charities that hold reserves.<sup>9</sup> This suggests some charity controllers may not be considering the question.

### III. Gaps in Existing Constraints

There are various legal rules that apply to restrain the accumulation of assets by charities. These rules provide a mechanism for dealing, at least partially, with governance fears that accumulated funds may be lost or improperly applied. They also enable some limits on the perpetuation of a charity creator's control. However, they are materially deficient in addressing the timing issue.

#### A. Tax rules

I have discussed elsewhere the tax rules that potentially restrict asset retention by charities.<sup>10</sup> The key rules comprise:

- A minimum annual distribution requirement, generally of 5 per cent or 4 per cent of the market value of a fund's net assets for certain deductible gift recipient charitable ancillary funds.
- To be exempt from income tax a charity must, amongst other requirements, 'apply its income and assets solely for the purpose for which [it] is established'.

7 See, for example, Australian Bureau of Statistics, 'Australian National Accounts: Non-Profit Institutions Satellite Account 2012–13' (Cat No 5256, 28 August 2015).

8 'The Native Title Divide', *The West Australian* (Perth), 27 March 2010, 32; Charles Mitchell, 'Saving for a Rainy Day: Charity Reserves' (2002) 8(1) *Charity Law & Practice Review* 35, 41 (fundraising organisations); James Fishman and Stephen Schwarz, *Nonprofit Organizations: Cases and Materials* (Foundation Press, 4<sup>th</sup> edn, 2010) 7 (US hospitals, universities, museums and religious organisations).

9 Charity Commission, 'Tell it Like it Is: The Extent of Charity Reserves and Reserve Policies' (Research Report No RS13, November 2006) 8–9, 11.

10 Ian Murray, 'Charity Accumulation: Interrogating the Conventional View on Tax Restraints' (2015) 37(4) *Sydney Law Review* 541.

Assuming that recipient organisations use the funds within a reasonable time, the minimum distribution rule promotes some spending for the present. While the income tax exemption rule may discourage material retention of resources in practice, the better view is that the rule does not permit the Australian Taxation Office (ATO) to monitor accumulation beyond ensuring compliance with the charity's governing rules and the law. In this way, the rule acts as a fall-back to trustee and director duties, rather than an additional constraint.

## B. Perpetuities rules and general charity supervisory mechanisms

The need to select from sanctioned categories of 'charitable purpose' imposes some constraints upon donor control.<sup>11</sup> Further, the rules against remoteness of vesting and against accumulation potentially apply where there is accumulation in the narrow sense of taking some of the income from a capital sum held by a charity and adding that income to the capital. In contrast, the rule against indestructible trusts does not apply to charities, which may be perpetual. Accordingly, one might have expected that the rules against remoteness and accumulation, which are targeted specifically at balancing current and future generations' interests in the freedom of disposition of property, would partially address the timing issue by limiting mandated accumulation to the perpetuity period. However,<sup>12</sup> the rules against remoteness and accumulation have been abolished for charities in South Australia and potentially Tasmania and the Northern Territory.<sup>13</sup> Further, even in jurisdictions where they apply, the rules do not effect a constraint on accumulation in circumstances where property is expressed to be given on trust for charitable purposes, pursuant to the terms of which the trustees are required (or permitted) to accumulate income.<sup>14</sup>

11 See, for example, Rob Atkinson, 'Reforming Cy Pres Reform' (1993) 44(5) *Hastings Law Journal* 1111, 1114–15.

12 Unless an accumulation provision stops a trust from being characterised as having a charitable purpose.

13 Ian Murray, 'Accumulation in Charitable Trusts: Australian Common Law Perpetuities Rules' (2015) 9(1) *Journal of Equity* 30.

14 Ibid; Ian Murray, 'Accumulation in Charitable Trusts: Australian Statutory Perpetuities Rules' (2014) 8(2) *Journal of Equity* 163.

Mechanisms, such as administrative schemes, *cy-près* schemes, winding-up processes and trustee expediency provisions do permit some degree of change.<sup>15</sup> They therefore limit the charity creator's control over charity property. However, their scope, particularly when applied at the instigation of a regulator, is relatively confined.

### C. Governance duties

Charity controllers, be they trustees, company directors or committee members, are subject to a range of common law and statutory duties of care, skill and diligence and of loyalty and good faith. Duties that apply to the exercise of fiduciary powers would require controllers to act upon genuine consideration in exercising powers to retain or accumulate assets.<sup>16</sup> This means that charity controllers must take account of (material) relevant considerations and should not take account of irrelevant considerations.<sup>17</sup> This imposes procedural constraints on accumulation, as charity controllers are likely obliged to conduct a broad survey of the persons who might benefit from pursuit of the relevant charitable purpose, along with the likely relative financial circumstances of these persons in the present and the future.<sup>18</sup> However, as the procedural requirements are not clearly articulated and as judicial review is focused on maintaining the integrity of the process rather than the merits of the ultimate decision, there is significant flexibility. Additionally, the Charity Commission for England and Wales research on reserves policies discussed above suggests that many controllers may not be aware of the duties.

## IV. Reform

The timing of charity benefits involves, by definition, matters of distribution. The extent to which charity controllers should be subject to obligations in retaining or distributing charity assets, so as to distribute benefits to different generations, is essentially a matter of ethics.

<sup>15</sup> *Ibid.*

<sup>16</sup> See, for example, *Karger v Paul* [1984] VR 161, 163–66 (McGarvie J); Rosemary Teele Langford, 'Solving the Fiduciary Puzzle: The Bona Fide and Proper Purposes Duties of Company Directors' (2013) 41(3) *Australian Business Law Review* 127, 130–31, 134.

<sup>17</sup> *Scott v National Trust* [1998] 2 All ER 705, 718 (Robert Walker J).

<sup>18</sup> *Cf Re Hay's Settlement Trusts* [1982] 1 WLR 202, 209–10 (Megarry VC).

## A. Is there a relevant ethical basis?

There are a range of philosophical theories that attempt to articulate what obligations are owed by the present generation in relation to past and future people. While the content and concept of ‘intergenerational justice’ remain debated, it is often used for such theories, as they typically apply notions of ‘justice’ from political philosophy to relations between non-contemporaneous persons.<sup>19</sup>

For instance, intergenerational justice may mean that the current generation owes a duty grounded in ‘distributive justice’ to redistribute resources, to some extent, to persons, whether in the same or in future generations, based on the degree to which this would satisfy their fundamental social and economic needs.<sup>20</sup> The notion of distributive justice inevitably requires attention to Rawls’s ‘difference principle’,<sup>21</sup> being the second condition of the following principle:<sup>22</sup>

Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second [the difference principle], they are to be to the greatest benefit of the least advantaged members of society.

The difference principle permits differences in socioeconomic status of individuals, but only to the extent that such differences improve the absolute position of the most disadvantaged members of society, for instance because they incentivise greater productivity and hence greater wealth for society. If they do not, then resources should be redistributed to those disadvantaged persons. However, Rawls applied the difference principle to contemporaneous persons, not non-contemporaneous persons. In the intergenerational context, Rawls conceived of intergenerational savings obligations to preserve capital so as to enable the establishment and then

19 See, for example, Axel Gosseries and Lukas Meyer (eds), *Intergenerational Justice* (Oxford University Press, 2009) 1–4; Joerg Tremmel (ed), *Handbook of Intergenerational Justice* (Edward Elgar, 2006).

20 See, for example, Frederic Gaspard and Axel Gosseries, ‘Are Generational Savings Unjust?’ (2007) 6(2) *Politics, Philosophy and Economics* 193, 201–4, 209, 211–12; Dieter Birnbacher, ‘Responsibility for Future Generations’ in Tremmel, above n 19, 34. Welfare economics adopts this basis when using certain social welfare functions: cf Robin Broadway and Michael Keen, ‘Redistribution’ in Anthony Atkinson and François Bourguignon (eds), *Handbook of Income Distribution* (North Holland, Vol 1, 2000) 677, 680–83.

21 Many other philosophers also embrace notions of distributive justice based upon a reallocation of resources to satisfy basic social and economic needs.

22 John Rawls, *Justice as Fairness: A Restatement* (Harvard University Press, 2001) 42–43. See also John Rawls, *A Theory of Justice* (Clarendon Press, 1972) 76–83, 302–3.

maintenance of just institutions.<sup>23</sup> These savings obligations acted as a substitute for and constraint on (rather than application of) the difference principle. Subsequent philosophers have, however, demonstrated that distributive principles can be applied to some extent between generations, that cooperation can take place between generations and that it is possible to transfer resources between generations, even if there are difficulties.<sup>24</sup>

Of course, in applying distributive principles across generations, one has to contend with the issue of choosing between those in need in one's own generation and those in need in future generations – who may potentially be better off, overall. In this context, some writers have demonstrated that the principles can discourage both intergenerational 'dissaving' and saving.<sup>25</sup> Therefore, some theorists have favoured Benthamite-type utilitarian approaches to maximising social welfare across generations, which take less account of distributive justice and encourage greater saving.<sup>26</sup>

Intergenerational justice has also been interpreted as requiring that the current generation avoid the pursuit of benefits that would impose costs on future generations, where to do so would result in the world being handed on in a lesser state to future generations, or in a state that fails to meet 'sufficientarian' standards for members of future generations.<sup>27</sup> Such approaches may be based on distributive justice or on notions of sustainability. However, sustainability principles can themselves be conceived of in distributional terms, or otherwise incorporate distributional matters.<sup>28</sup>

Finally, conceptions of intergenerational justice that derive from Rawlsian notions of justice are concerned with the rules for society's basic structure and hence do not directly apply to actions taken by societal associations such as charities. Accordingly, if guidance was to be obtained from

23 John Rawls, *A Theory of Justice* (Clarendon Press, 1972) 285, 291–93.

24 Janna Thompson, *Intergenerational Justice: Rights and Responsibilities in an Intergenerational Polity* (Routledge, 2009) 117; Tremmel, above n 19.

25 Gaspart and Gosseries, above n 20, 203–4, 209, 211–12 (once society has accumulated sufficient capital to establish just institutions). Cf Birnbacher, above n 20, 34.

26 See, for example, Birnbacher, above n 20, 32–33.

27 See, for example, Lukas Meyer, 'Intergenerational Justice', in Edward Zalta (ed), *Stanford Encyclopedia of Philosophy* (Summer 2016 edn), plato.stanford.edu/archives/sum2016/entries/justice-intergenerational/ (sufficientarianism relates to whether persons are below a threshold of harm); Peter Laslett, 'Is There a Generational Contract?' in Peter Laslett and James S Fishkin (eds), *Justice Between Age Groups and Generations* (Yale University Press, 1992) 24, 29–30, 44–45.

28 Tremmel, above n 19, 7–9, Chs 1–2.

a Rawlsian notion of justice, then its requirements may need to shape charity law itself—viewed as part of the basic structure.<sup>29</sup> Alternatively, they may inform the principles of ‘local justice’<sup>30</sup> that ought to be considered by charity controllers. Certainly, intergenerational justice has been used as a moral guide to the actions of private and governmental actors under a basic structure as well as to the formation of that structure.<sup>31</sup>

## B. Implementing obligations

There are significant practical and theoretical impediments to implementing obligations based on theories of intergenerational justice. The practical difficulties include the potential need for charity controllers to take account of other systems for achieving distributive justice, the most significant being the state’s role in collecting and redistributing assets. Would intergenerational justice demand that charities be compelled to conserve assets so as to counterbalance insufficient governmental regard for future generations? How would charity controllers determine this?

Equally, charity controllers would have to consider whether future generations might be wealthier and so potentially less deserving of resources, although they must also consider whether the particular benefits they bestow will become comparatively more expensive with time. Charity controllers would also need to compare the costs and benefits, over time, of the alternative courses of action being considered. There are tools that can assist. In particular, while it has limits, welfare economics can provide insights into how to maximise social welfare in pursuit of an intergenerational equity distributional preference. It does so by using a social welfare function that applies to the aggregate utilities of individuals across generations.<sup>32</sup> For instance, this can help account for economic growth by discounting future utilities on the assumption that individuals will derive lower marginal utility from additional consumption enabled by the transfer.

29 Cf John Rawls, *Justice as Fairness: A Restatement* (Harvard University Press, 2001) 10–12.

30 See, for example, Jon Elster, ‘Local Justice’ (1991) 35(2–3) *European Economic Review* 273.

31 See, for example, Thompson, above n 24, 125–27, 150–59; Birnbacher, above n 20, 26; Michael Klausner, ‘When Time Isn’t Money: Foundation Payout Rates and the Time Value of Money’ (2003) 1(1) *Stanford Social Innovation Review* 51.

32 See, for example, Broadway and Keen, above n 20, 680–83.

There is also a key theoretical difficulty. As discussed above, notions of what intergenerational justice requires may legitimately differ. However, there are some commonalities to the theories, such as the implication that neither current nor future persons have a moral priority over the other and the notion that intergenerational justice is concerned with meeting basic social and economic needs of members of society.

In light of the above factors, and cognisant of the charity law goal of pursuing charitable objects independently of government,<sup>33</sup> it seems inappropriate for the state to deal with intergenerational justice by mandating minimum distribution or savings rates. A limit on the duration of charities would also involve state intervention and would operate, at least in the lead up to the termination date, analogously to a minimum distribution requirement. Equally, the state should not delegate the temporal question of how much a particular charity ought to spend or save to a regulator like the ATO. Broadening the circumstances in which *cy-près* is available to encompass breaches of intergenerational justice would not only be a drastic alteration to those principles, but, because of the breadth of intergenerational justice and of the relevant factors, intergenerational decision-making would likewise be delegated to another arm of government – the courts.

Nevertheless, ensuring that charity controllers consider issues of intergenerational justice, as reasonably understood by the controllers, is consistent with the aims of charity law and with the theories and tools available. This could be achieved by interpreting the existing governance duty to give genuine consideration as requiring this step. Alternatively, the duty could be explicitly incorporated in legislation, perhaps similarly to s 172 of the *Companies Act 2006* (UK) which requires a director to have regard to a range of specified matters in ‘act[ing] in the way he considers, in good faith, would be most likely to promote the success of the company’. Either method could be twinned with a requirement to report on the levels of, and reasons for, retained assets, as in England and Wales where most registered charities that prepare accruals-based accounts need to report on reserves and reserves policies.<sup>34</sup>

33 This aim would be trumped by principles of justice that delineate the basic structure, if that is how the moral theory is implemented.

34 Charity Commission, *Charity Reserves*, Guidance CC19, January 2016, 9–10.

A further step could be adopted if disclosure proves inadequate in conjunction with the duty identified above. It may prove inadequate if the costs involved in applying principles of intergenerational justice are too high for charity controllers and the regulator. If so, there may be grounds for ‘nudging’<sup>35</sup> charity controllers by setting a default rule from which the charity controllers could choose to opt out. For instance, the default rule could involve a safe harbour default minimum distribution rate, such as one that is roughly consistent with generational neutrality for the relevant charity, in that it neither provides for saving nor dissaving. The current ancillary fund minimum distribution rates are likely close to such neutrality.

## V. Conclusion

This chapter has highlighted the practical and theoretical need for guidance on the time at which charities are expected to produce a public benefit from resources that they presently hold. In essence, the question is the extent to which the present generation should forego benefits in favour of future generations. Intergenerational justice has been identified as a possible theoretical base upon which decisions can be made, albeit there are impediments, including the range of theories of intergenerational justice.

Accordingly, the reform advocated is a process-focused approach which requires charity controllers to actively consider the interests of current and future generations, applying any reasonably open conception of intergenerational justice. Coupled with disclosure requirements, this reform could be adopted by incorporating it within the duty to exercise powers with genuine consideration, or by explicitly legislating such a duty for charity controllers. If the approach proves inadequate, for instance because it is too costly for charity controllers and regulators, then it could be implemented in conjunction with a safe harbour, such as a default minimum distribution rate.

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35 Richard Thaler and Cass Sunstein, *Nudge* (Penguin, revised edn, 2009).

This text is taken from *New Directions for Law in Australia: Essays in Contemporary Law Reform*, edited by Ron Levy, Molly O'Brien, Simon Rice, Pauline Ridge and Margaret Thornton, published 2017 by ANU Press, The Australian National University, Canberra, Australia.

[dx.doi.org/10.22459/NDLA.09.2017.32](https://doi.org/10.22459/NDLA.09.2017.32)