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Dear Tax White Paper Task Force

Re:think — Tax discussion paper Not-for-profit sector

Governance Institute of Australia is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance advisers and risk managers are second to none.

Our members are all involved in governance, risk management and corporate administration. Furthermore, many of our members serve as officers of charities, or work for, or are involved with charities, many of which are companies limited by guarantee and some of which are entitled to tax concessions. As a result, they are also involved in the governance of charities and compliance with the Australian Charities and Not-for-profits Commission (ACNC) regulations.

Governance Institute of Australia (Governance Institute) is itself a charity operating in the legal form of a company limited by guarantee, established to promote and advance the efficient governance, management and administration of commerce, industry and public affairs and the development of secretaryship of organisations through education and the dissemination of information. Our members therefore possess extensive knowledge of administration, governance and regulatory frameworks in the charity sector to support our comments in this submission.

General comments

The Federal Government's discussion paper on tax reform specifically targets the not-for-profit (NFP) sector, asking if the current tax arrangements are appropriate. It raises issues in relation to the ongoing availability of Fringe Benefits Tax (FBT) concessions and other forgone tax revenue. It points out that while existing tax concessions help increase the level of activity in the NFP sector, the value of revenue forgone from the concessions is significant and growing steadily.

Governance Institute strongly supports the important and intrinsic role that the NFP sector plays in Australian society. Our members are also of the opinion that tax concessions for the NFP sector are integral to the continuation of the provision of these substantial social and economic benefits.

The discussion paper notes that 'tax concessions *arguably* help to improve both societal outcomes and ensure that the overall level of activity in the NFP sector is closer to optimal' [our

italics]. Governance Institute is of the view that this is not an arguable issue. We are firmly of the view that tax concessions do assist the sector not only to improve societal outcomes but also economic outcomes.

A measurement of the benefits of the NFP sector to the economy was undertaken when Curtin University partnered with the ACNC to analyse data from the Annual Information Statements (AISs) of more than 38,000 registered charities in their first year of reporting to the ACNC. The *Curtin Charities 2013 Report* was the first comprehensive, evidence-based research of the Australian charity sector of its kind and found that:

- charities employ nearly one million people across Australia, equating to eight per cent of Australia's workforce
- they manage around two million volunteers, equating to 36 per cent of Australia's adult population
- the sector has a combined total income of more than \$100 billion
- the sector has grown by two per cent annually since 1990.

Its contribution to Australia's economy, as well as its social cohesion, is demonstrated by the fact that the agriculture, forestry and fishing industries have a combined total income of \$75 billion and employ 500,000 people; the mining industry has a combined total income of \$217 billion and employs 50,000. In further evidence of how the sector is a 'lifter', not a 'leaner', the ABS Satellite Account analysis also showed that the charities and NFP sector continues to outperform most other parts of the economy with above eight per cent growth.

The NFP sector is considerably larger than just the charities sector. *The Productivity Commission Research Report: Contribution of the Not-for-Profit Sector* sets out the extent of the sector (around 600,000 organisations, contributing \$43 billion to Australia's GDP and eight per cent of employment in 2006-07)¹ and its social impact compellingly:

Community (not-for-profit) organisations play an important role in combating social exclusion and enhancing the economic, social, cultural and environmental wellbeing of society.²

Many do not operate in the market (or economic) sector, and only a relatively small number (around 20 000), mainly in the human services area, rely heavily on government as their main source of funding. NFPs deliver services to their members, to their clients or to the community more broadly, such as welfare, education, sports, arts, worship, culture and emergency services. Some NFPs build or maintain community endowments such as biodiversity, cultural heritage and artistic creations. Some engage in educative, advocacy and political activities, while for others the focus is on activities that create fellowship. Many offer their participants opportunities to build a sense of self worth and for connection and influence that form an important part of the foundations of an active civil society.³

Our members are of the view that the NFP sector is well overdue for tax reform⁴. We welcome the Government's commitment to simplify and streamline burdensome regulation and increase productivity as a whole-of-government approach to the reduction of red tape. However, as always, the public good should guide the public policy position – public good outcomes should be the basis on which reform proceeds. It is our view that there is a concentration on tax

¹ *Productivity Commission Research Report: Contribution of the Not-for-Profit Sector*, January 2010, pxxiii

² *Ibid*, p iv

³, *Ibid*, p xxv

⁴ Senator Arthur Sinodinos, 'Integrity restored to Australia's taxation system', Media Release, No. 8, 14 December 2013

arrangements, when the focus needs to expand to include Australian Government funding arrangements, as these too need to be simplified. Any change to public policy of tax concessions for NFPs also needs to take account of the fact that the structure of government funding is changing — the proposals to change the heavily funded model need to be reviewed in terms of implications for tax arrangements.

Are the current tax arrangements for the NFP sector appropriate? Why or why not?

Governance Institute strongly supports appropriate tax concessions for the sector that effectively assist the sector to fulfil its role. We are not opposed to either simplification or change to the public policy concerning tax concessions, but **recommend strongly** that any simplification or change must be made on the basis of:

- supporting the sector to achieve its outcomes, which are of benefit socially and economically to society
- not hindering the sector to achieve its outcomes, with a commensurate decline in benefit to society
- making the policy and procedures attached to the policy more equitable and efficient.

Our support for the tax concessions is based on the fact that, as shown in the Productivity Commission report, many NFPs do not operate in the market (or economic) sector, because:

- they provide much-needed services that the for-profit sector is unwilling to undertake, as they are unlikely to provide any financial return on investment
- they provide much-needed services more cheaply and efficiently than the government is able to provide.

Should NFPs not receive tax concessions, there would be a greatly increased call on the government's budget to provide the services for combating social exclusion and enhancing the economic, social, cultural and environmental wellbeing of society. Currently the Australian Government subcontracts a great many services to the disadvantaged to the NFP sector, and it does so as the sector is able to produce outcomes more cheaply than can the government. This reduces the cost to government, with the additional benefit of outcomes being achieved more efficiently and quickly, which is of benefit to society as a whole.

The focus should always be on ensuring that any tax concessions produce better outcomes. Currently, the tax arrangements in relation to concessions for the sector are piecemeal and unduly complicated. It is for this reason that we recommend that the focus be on simplifying and streamlining the tax concessions. A simplified policy and process would bring greater certainty to the sector, with a commensurate benefit to outcomes. Where there are loopholes in the current tax arrangements that are being abused, those loopholes should be addressed rather than removing tax concessions for the NFP sector as a whole. Governance Institute is of the belief that it is short-sighted to reduce tax concessions to the NFP sector, the majority of which are well managed and provide substantial benefits to the community, in order to penalise those few that might have misused the system to their advantage.

Governance Institute is concerned that, while the discussion paper provides quantification of the revenue forgone as a result of tax concessions to the sector, it provides no quantification of the impact on the sector and outcomes should the tax concessions to the sector cease. Nor does it place any estimate on the aggregate value of contribution to the economy by volunteers and other support provided by the sector. We are of the opinion that government funding to replace the services currently provided by the sector would not necessarily increase, and therefore there would be significant social and economic impact. This should be quantified before any move is made to remove tax concessions.

Importantly, the Productivity Commission report notes that less than 10 per cent of NFP organisations access tax concessions:

On a rough estimate, there are some 600 000 NFPs (excluding body corporates such as for strata titles). The majority, some 440 000, are small unincorporated organisations (such as neighbourhood tennis, babysitting, or card clubs). Of the remainder, the ABS classifies 58 779 as ‘having an active tax role’ (on the basis that they employ staff or access tax concessions). These ‘economically significant’ NFPs employed 889 900 staff, around 8 per cent of employment, and contributed just under \$43 billion to Australia’s GDP in 2006-07.⁵

This needs to be borne in mind — the majority of NFPs are self-funding and not accessing tax concessions.

We are also cognisant of the fact that any changes to tax concessions would impact the sector’s capacity to serve the community in future years, and this also needs to be considered in the formulation of public policy.

To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared with the tax arrangements for for-profit organisations?

Governance Institute is strongly of the view that it is not valid to suggest that there is a competitive advantage for the NFP sector when in receipt of tax concessions, compared to the tax arrangements for for-profit organisations. We do not agree with the assumption that there should be reform based on a need to ‘level the playing field’. We contend that this argument is flawed, given that for-profit organisations are free to distribute their profits as they see fit, whereas NFP organisations are not. In NFPs, the profit is returned to the provision of services, unlike in for-profit organisations where it is returned to the providers of financial capital — the benefit is the wealth maximisation of investors.

To base reform of the NFP sector on a misapprehension that the private and NFP sectors can and should be treated in similar fashion defeats the objectives of providing a regulatory framework for the NFP sector that takes into account its specific characteristics and needs.

We also note that the NFP sector is not the only sector to receive tax concessions. For example, benefits are made available to the for-profit sector, in the form of subsidies to mining companies; state government tax concessions on payroll tax and stamp duties to attract business to the state; or the funding by government of apprenticeships to support the labour force in the for-profit sector. This raises questions as to whether there can be any competitive advantage provided to NFP organisations, given that tax concessions are also available to the for-profit sector.

Moreover, many of the larger NFPs receive grants from the government, but frequently the grants are insufficient to deliver services. It is entirely appropriate that such organisations be able to access tax concessions.

Specifically on the FBT tax concessions, it is worth revisiting the public policy rationale for introducing them. They were introduced as NFP organisations could not afford to recruit and retain employees at the same level as for-profit organisations. They were offered the tax concession as a means of attracting a competent labour force. This issue has not abated. The Productivity Commission report noted that:

⁵ *Productivity Commission Research Report: Contribution of the Not-for-Profit Sector*, January 2010, p xxv1

For NFPs, less than full cost funding of many services has resulted in substantial wage gaps for NFP staff. The challenges in retaining staff threaten the sustainability and quality of services.⁶

The rationale of attracting people with the right skills and qualifications to work for NFP organisations continues to justify the FBT concession. The focus on good governance in the NFP sector further emphasises the need to attract suitably skilled employees.

However, tax concessions are most usually only available to the employees on higher levels of income in an organisation. Due to the processes involved, they are generally not accessed by employees on lower levels of income. Governance Institute is of the view that the tax concessions should operate equitably for all employees. Our view is that it would be preferable to introduce an annual limit that would stop the purported abuse by the handful of high income earners as noted in the discussion paper, to close any loopholes, rather than to restrict access to the concessions by all employees, with commensurate impact on recruitment, retention and remuneration strategies of NFP organisations.

We note that, following the release of the Federal Budget, the previously uncapped exemption to the fringe benefits tax (FBT) of meals and entertainment expenses for employees in NFP organisations will now be subject to a cap of \$5,000 per annum from 1 July 2016. On this front, we are very disappointed to see that the Federal Budget introduced specific tax reforms aimed at the NFP sector that are covered in the tax discussion paper, which our members reviewed and to which they have developed a response in good faith on the basis that the government announced that no changes or reforms would be introduced until after the consultation period on the paper had concluded. We are of the view that it is poor governance and poor public policy formulation to issue a discussion paper seeking input from stakeholders and then to introduce tax reform on one of the topics set out in the paper before the consultation has concluded.

We would therefore recommend that a preferable option to explore in order to ensure that tax concessions operate equitably for all employees could include reviewing the capping of the concessions, at a reasonable level, closing the loophole of being able to claim the same FBT and meal benefits from more than one employer, and undertaking audits to identify misuse of the system.

What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs.

Deductible gift recipient (DGR) status is highly desirable for NFP organisations seeking to fund their purposes (fully or partially) through receipt of donations. The benefit is the tax deductible nature of the value of the donation to the donor.

The current policy and administrative processes in relation to obtaining DGR status are unduly complicated.

While the ATO is the sole determiner of DGR status it does not administer all of the categories. There are at present in excess of 40 categories of eligibility for DGR status. These categories are administered by a range of different government departments or statutory bodies, each of which has its own requirements for determining DGR eligibility. Furthermore, there is the option for a NFP organisation to seek an individual listing in the taxation legislation if there is not a clear category in which the NFP organisation can apply.

⁶ xxiv

Under the current system the onus is on the NFP organisation to select the correct category. Only once category selection occurs can the NFP organisation work out which body they should apply to and what forms are required. Often selecting the correct category requires more than a rudimentary understanding of tax law. In support of this point we refer to the comment on the website of the Funding centre under the heading 'DGR Status' which states:

OUR TIP: The laws governing deductible gift recipient status are really complicated. Equip yourself with the basic information you need using the ATO's GiftPack, but then see if you can find yourself a (preferably pro bono) lawyer to guide your organisation through the process.

Failure by a NFP organisation to select the correct category will result in failure of the application.

The applications themselves require detailed information about the NFP organisation, its structure, activities and purposes (for registered charities this information is now available on the ACNC website) and how this applies to the DGR endorsement category under which endorsement is sought. This can require the need to include references to applicable legislation, case law, taxation rulings, ATO and other relevant government department guides and policies.

The complex nature of the current DGR endorsement system limits accessibility to those NFP organisations that either have the time and skills to go through the lengthy and complex process or financial resources available to purchase access to the required skill set. We suggest it would be a much fairer system if policy was more clearly articulated and made accessible to all NFP organisations — not just the large and well-funded ones.

Streamlining is required for both:

- the policy for granting DGR status and
- the process by which it is administered.

There is a great opportunity to clarify the basis on which DGR status is granted and re-state the basis for eligibility in a form that is clear, readily accessible to all interested parties and located in one central source.

In considering the basis on which DGR status is granted, the following suggestions are made:

- provide a link between the type of charities that are eligible and the definition of charity in the *Charity Act*, as this will provide clarity on which organisation is worthy, and
- provide a broader way to express and grant status that is more in line with other jurisdictions — Australia has a very limited view compared to other jurisdictions.

Once the policy issues are determined, simplification of the administrative process can occur and at the very least there can be the objective of designating one department to manage all DGR endorsements.

Making the process more accessible, and bringing greater clarity to eligibility and status will make donations more attractive, which will encourage donations, thus increasing the pool of funds available for a wide range of socially desirable activities. In turn, this will decrease the call on government funding. This brings clear benefits to both the charities and the government.

Conclusion

We welcome the Australian Government's commitment to simplifying and streamlining burdensome regulation and increasing productivity as a whole-of-government approach to the reduction of red tape. However, as always, the public good should guide the public policy position — public good outcomes should be the basis on which reform proceeds. We strongly

recommend targeted consultation with the NFP sector in relation to any proposed reforms — stakeholder roundtables will assist in securing all the views to ensure any unintended consequences have been considered and avoided.

We further recommend that, following stakeholder consultation in the form of roundtables, any proposals be released as consultation papers, to provide the opportunity for the sector to consider how each proposal would be implemented. At no point should any reform proceed directly to an exposure draft of legislation prior to such consultation.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style with a large initial 'T' and 'S'.

Tim Sheehy
Chief Executive