

# **Submission to the Rethink Tax Discussion Consultation**

## **Tax and the Not-For-Profit Sector**

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## 1. EXECUTIVE SUMMARY

This submission addresses the discussion questions raised in Chapter 7 of the Rethink Tax Discussion Paper of 30 March 2015, concerning the taxation of the Not-For-Profit (NFP) sector.

The current tax exemptions and concessions available for the NFP sector assist organisations to effectively return a benefit to the community. Effective taxation legislation, particularly in relation to the NFP sector, should be used to achieve policy objectives, as opposed to as a method of raising revenue.

It is inappropriate to approach the fringe benefit tax (FBT) exemption for public benevolent institutions (PBI) and deductions for gifts made to endorsed deductible gift recipients (DGR) as 'foregone revenue'. These tax concessions and exemptions incentivise the community to contribute to the growth of the NFP sector, encouraging taxpayers to invest in programs or organisations that will ultimately in turn return a benefit to the community.

Concerns regarding 'foregone revenue' would be better addressed through thorough regulation, to ensure these tax advantages only benefit appropriate NFPs.

The 'competitive advantages' NFPs receive as a consequence of their charitable status do not raise significant policy concerns. This issue has been considered previously in other reports, all of which have concluded that 'competitive neutrality' concerns lack substance. It is our view that these findings continue to apply to the sector.

The Australian Charities and Not-for-profit Commission (ACNC) has made progress in reducing the number of organisations benefiting from the tax arrangements of the NFP sector. The NFP sector has adapted to the administrative arrangements established by the ACNC. In order to minimise compliance costs and simplify administrative arrangements, the current structure and requirements should be maintained.

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## 2. TAX ARRANGEMENTS FOR THE NFP SECTOR

In relation to the current tax arrangements, this submission will focus upon the appropriateness of the fringe benefit tax exemption for public benevolent institutions (PBI) and the income tax deductions for gifts to deductible gift recipients (DGR).

The current tax arrangements of the NFP sector should not be approached from the perspective of the 'revenue' that is 'foregone' as a consequence of the provisions. In the Australia's Future Tax System Review (Henry Review), emphasis was placed on the use of the tax system in order to effectively achieve policy objectives, rather than as a tool to raise revenue.<sup>1</sup>

CRH Law supports the approach outlined in the Henry Review. Tax concessions for the NFP sector should reflect community needs and values, and encourage activities that provide broad public benefits.<sup>2</sup>

Viewing the tax advantages enjoyed by the NFP sector from a 'foregone revenue' perspective fails to consider the connection between the tax concessions and exemptions, and the policy objectives and community benefits achieved by the NFP sector as a result.

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<sup>1</sup> Australia's Future Tax System Review Panel, *Report to the Treasurer*, 2009 (Henry Review).

<sup>2</sup> Australia's Future Tax System Review Panel, *Report to the Treasurer: Part Two Detailed Analysis*, 2009, vol 1, p 206 (Henry Review).

## 2.1 Fringe Benefit Tax Exemption

The fringe benefit tax concession available for public benevolent institutions provides a way for the sector to attract and retain skilled employees. For the sector to effectively provide a benefit to the public, it will be crucial for NFPs to be able to hire and retain sufficiently skilled staff.

The FBT tax concession currently provides a small added incentive for skilled employees to work in the sector. The current caps of \$17,000 and \$30,000 on the FBT exemption ensure this advantage is not abused.

The FBT exemption for public benevolent institutions provides an advantage for NFP organisations which operate in the same areas as for-profit competitors. In these instances, the availability of the FBT exemption provides public benevolent institutions with an advantage in attracting and hiring staff at a more affordable wage.<sup>3</sup> In the Henry Review, this was identified as problematic, due to suggestions that the current FBT concessions may be contributing to wage inflation across the sector.<sup>4</sup>

However, the Henry Review ultimately noted that the impact of the FBT concessions is less clear where there is no direct competition between the NFP sector and the for-profit sector, concluding,<sup>5</sup>

'The removal of FBT concessions in these cases may make it difficult for NFP organisations to attract appropriately qualified staff, which may result in the downsizing or closure of programs.'

CRH Law broadly supports the findings of the Henry Review. The FBT concessions for public benevolent institutions enable the NFP sector to attract employees, and facilitate the achievement of policy objectives that for-profit organisations may be less inclined to address.

## 2.2 Deductions for Gifts to Deductible Gift Recipients

The deductions available for gifts made to DGRs encourage the community to donate to the NFP sector. This, in turn, assists the NFP sector to effectively provide a benefit to the community.

As the benefit provided by the deduction will ultimately be returned to the community, the deduction should be reviewed as a means of achieving policy objectives, rather than a source of 'foregone revenue'. In this sense, the deductions encourage the community to direct government expenditures to their preferred causes.<sup>6</sup>

CRH Law supports the recommendations of the Henry Review; the deductions available for gifts made to DGRs are appropriate.<sup>7</sup>

Despite some complexity, the DGR system provides a broad range of categories under which an NFP may become endorsed. Through these categories, organisations can identify the specific requirements for DGR endorsement and comply accordingly.

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<sup>3</sup> Ibid p 210.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid page 211.

<sup>6</sup> Ibid page 60.

<sup>7</sup> Ibid.

Given the valuable benefits provided by DGR endorsement, it would be inappropriate to overly simplify these arrangements. Ultimately, it is our opinion that the current costs of complying with the DGR endorsement system are unlikely to be reduced by an overhaul of the legislation.

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### 3. COMPETITIVE ADVANTAGES OF THE NFP SECTOR

Following the 2008 decision of the High Court in *Word Investments*,<sup>8</sup> there has been considerable discussion concerning whether the tax advantages available to the NFP sector provide it with a 'competitive advantage' over the for-profit sector. This topic has been considered extensively in previous consultations and commissions. Previously, this concept has been referred to as 'competitive neutrality'.

In 1995, the Industry Commission considered 'competitive neutrality' concerns in its *Charitable Organisations in Australia Report*. While the report acknowledged the tax advantages the NFP sector may have when compared to the for-profit sector, the report ultimately concluded that 'such exemptions were unlikely to provide an unfair advantage to NFPs'.<sup>9</sup>

Similarly, in 2009 the Australia's Future Tax System Review ("the Henry Review") considered the tax arrangements of the NFP sector, particularly in relation to income tax, GST and FBT concessions. The Henry Review ultimately found that the concessions 'generally do not appear to violate the principle of competitive neutrality where NFP organisations operate in commercial markets'.<sup>10</sup>

Most recently, in 2010 the Productivity Commission considered the impact of the tax arrangements of the NFP sector in its *Contribution of the Not-for-Profit Sector* report. The Commission found that, despite the tax advantages available for the NFP sector, 'on balance, income tax exemptions are not significantly distortionary'.<sup>11</sup>

In CRH Law's view, the conclusions drawn by these reports remain valid. Through these reports, the tax advantages of the NFP sector have been considered extensively, all of which have resulted in similar conclusions concerning the unfounded nature of 'competitive neutrality' concerns.

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### 4. ADMINISTRATIVE ARRANGEMENTS AND COMPLIANCE COSTS

According to its 2013 – 2014 annual report, the ACNC reports at least 80% support from charities for the ACNC and its regulatory role.<sup>12</sup> Similarly, the ACNC reports 93% overall satisfaction with the process for registering a charity.<sup>13</sup>

The NFP sector has adapted to the reporting obligation and compliance framework established by the ACNC. As an independent regulator, the ACNC has been met with widespread approval of the sector, and has continued to operate effectively.

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<sup>8</sup> *Commissioner of Taxation of the Commonwealth of Australia v Word Investments Limited* [2008] HCA 55.

<sup>9</sup> Industry Commission, *Charitable organisations in Australia*, report no. 45, 1995, App K.

<sup>10</sup> Australia's Future Tax System Review Panel, *Report to the Treasurer: Part Two detailed analysis*, 2009, vol 1, p 209 (Henry Review, *Report*).

<sup>11</sup> Productivity Commission, *Contribution of the not-for-profit sector: research report*, 2010, p 197.

<sup>12</sup> Australian Charities and Not-for-profits Commission, *Annual Report 2013-2014*, page 3.

<sup>13</sup> *Ibid* page 29.

It is our opinion that returning the regulation of the NFP sector to the Australian Taxation Office will require the NFP sector to once again adapt to new administrative arrangements, which will in turn result in unnecessary compliance costs.

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## **5. CONCLUSION**

The current tax arrangements of the NFP sector are appropriate. The tax advantages available to NFPs facilitate the continued community benefits the sector provides, and consequentially should not be considered 'foregone revenue'.

Reports addressing the tax advantages available to the NFP sector have repeatedly concluded that the current arrangements do not raise legitimate 'competitive advantage' concerns, in relation to the for-profit sector.

We consider that, in order to reduce compliance costs imposed upon the NFP sector, the ACNC should continue to act as the regulator of charities and not-for-profit organisations.

**CRH Law**

**26 May 2015**

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