



## **Communicare Submission to the Re:think Discussion White Paper: Not- for-Profit Tax Concession Reforms**

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## About Communicare

Communicare is a registered charity with Public Benevolent Institution endorsement. For nearly four decades, Communicare has delivered positive outcomes for highly disadvantaged and vulnerable people through its core service portfolios comprised of Children and Family Services, Cultural and Community Services, Employment Services, Accommodation and Therapeutic Services, and Education and Training Services.

Communicare currently has a workforce of over 300 employees delivering ninety diverse programmes and services to over a quarter of a million Australians each year in Western Australia and New South Wales.

## Discussion Paper

The Treasury has released a discussion white paper under the Australian Government's 'Better tax system, better Australia' tax reform agenda. Communicare supports a taxation system that will lead to taxes becoming more transparent, fairer and simpler, and welcomes this opportunity to submit a response to the discussion paper.

Communicare's interest in and response to the discussion paper concerns not-for-profit tax concessions. The key points raised in the discussion paper on not-for-profit tax concessions concern the diversity of the sector, complexity in applying concessions, foregone revenue, and competitive advantage. These key points are addressed in Communicare's submission hereunder.

## Submission

Communicare's submission draws from a previous submission of the Western Australia Council of Social Service (WACOSS) made to the Not-for-profit Sector Tax Concession Working Group 2012 Discussion Paper. The 2012 WACOSS submission was based on consultations with a cross-section of its members and the points made herein by Communicare on tax concessions largely reflects the findings made from WACOSS's consultations.

The key points of the discussion paper are addressed in Communicare's response to each of the discussion paper questions below.

### **47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?**

The work of charitable and not-for-profit organisations as providers of services for the public good has historically been recognised through the provision of tax concessions. The principal function of NFP tax concessions is to support and enhance charitable purposes by not levying taxes on non-commercial charitable and not-for-profit activities.

## □ Tax concessions as ‘forgone tax revenue’

On the above point, the tax discussion paper makes a narrow interpretation of tax concessions as ‘forgone tax revenue.’ Premising tax concessions as purely ‘forgone tax revenue’ without also quantifying the social value or public benefit gained from tax concessions is questionable and has the potential to draw false conclusions.

The notion of tax concessions as ‘foregone tax revenue’ ignores the considerable contribution made by the not-for-profit sector to the social and economic fabric of Australian society, for instance, a \$43 billion or 4.1% contribution to the GDP in 2006-07 and 4.6 million volunteers working in the sector for the public benefit that saves governments millions of dollars each year from having to otherwise fund services.<sup>1</sup>

Not-for-profits depend heavily on tax concessions to maintain service levels and quality in service delivery. A diminution of tax concessions to offset ‘foregone tax revenue’ would adversely affect the sustainability of services with a corresponding reduction in public good outcomes. Without not-for-profit tax concessions, it would cost governments and taxpayers many millions of dollars more each year just to maintain existing levels of services let alone keep up with increasing demand for services.

Juxtaposed against \$1 billion in tax concessions (2008-2009), the socio-economic contribution of the not-for-profit sector far outweighs considerations of ‘foregone tax revenue.’ On the point of the \$1 billion tax concession, this figure is a Treasury estimate and a claim apparently made in the absence of modelling the social value of tax concessions including the additional cost to governments of compensating for reductions in service levels and quality if the tax concessions were to be reduced or removed.

The emphasis on tax concessions as ‘foregone tax revenue’ without quantifying the public benefit plainly does not consider the full picture of tax concessions. This narrow view of tax concessions limits the capacity of the Australian government to deliver reforms that recognise the true cost benefits of tax concessions.

*Communicare recommends that considerations of not-for-profit tax concessions reform should be modelled on the basis of efficiency and effectiveness, social and economic value, and the simplicity and equity of access to concessions, and further that the current tax concession arrangements on which the not-for-profit sector heavily depends are not in any way diminished.*

## □ Meals and Entertainment allowance

In relation to tax concessions pertaining to the Meals and Entertainment allowance, the Australian Government’s move to curtail misuse of the allowance was clearly needed.

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<sup>1</sup> Productivity Commission Research Report: Contribution of the Not-for-Profit Sector (Jan 2010)

Misuse of the Meals and Entertainment allowance, as recently highlighted in the media, is contrary to the intent of the allowance of supporting philanthropic activity. In the main, misuse of the allowance would be uncommon among community or religious based organisations where usage of the allowance tends to be modest, responsible and applied to genuine purposes such as entertainment of donors for fund-raising purposes.

Unfortunately, the Australian Government's 2015 Budget measure to cap the allowance at \$5,000 pre-empted the Re:think better tax review and was made without sector consultation. It is not clear apart from tax revenue considerations why and how the Treasury arrived at what appears to be an arbitrary cap of \$5,000 and this is a concern.

Further, measures to curtail the misuse of the Meals and Entertainment allowance need to include a more definitive regulation of the allowance, that is, restricting usage of the allowance only to genuine fund-raising activity and not be used in any way for personal gain or purposes not directly related to philanthropy.

*Communicare supports the Australian Government's aim to curtail misuse of the Meals and Entertainment Allowance, but registers its concern about the lack of due process and consultation in arbitrarily setting the allowance cap at \$5,000. Communicare further recommends that the allowance be restricted only to support genuine philanthropic activity and not be used for extraneous or private purposes.*

#### **48. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?**

##### **□ Competitive advantage / neutrality**

The question contains an assumption that tax concessions afford not-for-profits a competitive advantage over the for-profit sector and create distortions of equity in areas of competition. The premise of competitive advantage or neutrality is only relevant to commercial activities and fails to recognise that not-for-profit tax concessions were founded on the principle that tax concessions add social value to the public investment made in not-for-profit activities. The historic intent of tax concessions by various governments has been to assist underfunded and under-resourced not-for-profits to better discharge their mission and purpose. In this context, the premise of competitive advantage is neither valid nor relevant.

The supposition of a competitive advantage gained by not-for-profits over the for-profit sector sidesteps the reality that the two sectors generally do not compete with each other for government funding or in service delivery or provide equivalent job roles; they have a different mission and purpose. This is not a matter of a level playing field, but different playing fields. A postulation of competitive advantage in this context is ill-conceived.

Only a small segment of not-for-profits operate in the same community services market as for-profits. In markets where both sectors operate, such as in aged care or employment services, not-for-profits frequently find that they do not have the resources available to for-profits to compete on equal terms, whether tendering for contracts, providing services, or recruiting staff.

Despite the benefit of tax concessions, annual surveys undertaken by the Australian Council of Social Service about 'sector issues' have repeatedly confirmed that 'the capacity of community service organisations to attract and retain staff is one of the single greatest issues that they face.' This situation arises from perpetual underfunding of community services, which is confirmed in the Productivity Commissions study into the contribution of the not-for-profit sector that 'government funding routinely covers only 70% of the full cost of service, with organisations seeking costs from service users [most community service organisations do not charge service fees] and contributing from their own funds to make up the short-fall.'

The effect of not funding the true cost of services is that not-for-profits struggle to sustain an adequate level of service delivery and by default have to subsidise funding shortfalls from tax concessions. Without the benefit of tax concessions, many services would be in terminal decline. Under these operating conditions, the premise of competitive advantage lacks validity.

A further point on the public benefit derived from tax concessions in relation to inter-sector 'competition,' for-profits are a business enterprise and pocket their takings whereas not-for-profits plough their 'gains' back into community services. For-profits minimise their costs and maximise their profits while not-for-profits maximise their service output from any gains they make. Any possibility of competitive advantage would be offset by the commitment to service and public benefit that not-for-profits deliver to the Australian community: governments and taxpayers get better value for money from their 'investment' in not-for-profits.

#### **□ Fringe benefits tax exemption and wage parity**

PBI charities often struggle to attract and retain staff due to lower wages compared to other sectors as a result of endemic underfunding and the insecure nature of employment within the sector. Even though FBT concessions enable charities to compensate for lower wages with the option of salary packaging, they are still way behind the private and public sectors on wage parity, as demonstrated hereunder.

The closest measure for making wage comparisons in relation to competitive advantage would be between PBI charities and the public sector (including local government). These sectors share some degree of job similarity and are frequently used as a benchmark for determining inter-sector wage parity.

A prevailing wage disparity between charities and the public sector weighs heavily in favour of the public sector. This assertion is supported in the 2012 Fair Work Australia Equal Remuneration Order (ERO), which established that ‘employees in the not-for profit sector were grossly underpaid compared to their public sector counterparts.’ Furthermore, the aforesaid Productivity Commission Study found that, ‘The wage gap between social workers employed by NFP and government providers in similar positions was estimated to be up to 25 per cent (after adjusting for Fringe Benefit Tax concessions).’

The ERO only partially addressed the wage disparity by limiting wage increases exclusively to not-for-profit employees employed under Commonwealth funded contracts, leaving out a considerable number of community service organisations and employees from the reach of the ERO. Furthermore, the supplementary wages awarded to contracted organisations only scratched the surface. In Western Australia, for instance, there have been numerous accounts of organisations rejecting offers of supplementary wage payments from the Commonwealth Government because the amount of paperwork involved for only small supplementary payments rendered acceptance of offers not worth the administrative effort.

The ERO has delivered only a marginal gain if any over the 25% wage disparity with the public sector, and only for a limited proportion of not-for-profit employees. And that is just for wages and not all the other and better conditions attached to working in the public sector. There is certainly no evidence of public servants queuing to work in the not-for-profit sector since the ERO was made.

Wage parity between the public and private sectors presents a different picture. According to the National Office of Statistics<sup>2</sup>, ‘in 2011, public sector employees were paid on average between 7.7% and 8.7% more than private sector employees.....but, if you have a degree, you will get paid better in the private sector - and, for five out of eleven years of data the private sector got better pay increases.’

An aggregation of the above figures indicates a probable wage disparity of a minimum 17% favouring the for-profit sector over the not-for-profit sector. This figure assumes that public sector wages are ascendant over private sector wages, but may be the reverse according to the National Office of Statistics report which suggests that there has been higher levels of wage increases in the private sector. The wage disparity between the not-for-profit and for-profits sectors therefore is likely to be higher than the 17% figure and removal or reduction of the FBT concession will further widen the wage disparity.

Furthermore, a cap on salary packaging has remained unchanged since first introduced 13 years ago because the cap is not indexed; for example, to the Consumer Price Index. Consequently, the value of the FBT concession has significantly declined and would continue

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<sup>2</sup> Estimating Differences in Public and Private Sector Pay, 2012

to devalue until eventually rendered worthless, and meanwhile inter-sector wage disparities continue to widen.

*Communicare's position is that perpetual wage disparities and subsidisation of funding shortfalls contradict the premise that tax concessions give not-for-profits a competitive advantage over for-profits. Furthermore, Communicare does not accept the framing of not-for-profit tax concessions as a budget cost of 'foregone tax revenue.' Accordingly, Communicare recommends that considerations of competitive advantage or neutrality be modelled in terms of the socio-economic investment and public benefit pertaining to tax concessions, and further that the cap on salary packaging be index linked to maintain value and nullify further wage disparity.*

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

There have been a number of issues raised about the FBT concession as being at times unevenly and unfairly distributed. For example, some not-for-profit entities qualify for the capped FBT exemption while other entities are only eligible for the tax concession rebate, or employees on higher salaries gain a greater level of benefit out of salary packaging (a difference of about \$400 between, for example, salaries of \$50,000 and \$80,000).

The Not-for-profit Sector Tax Concession Working Group Final Report (May 2013) has floated a number of options to address anomalies in salary packaging, including making it more accessible and evenly distributed, and to remove the administrative impost on employers. The two key options promulgated by the aforesaid report are addressed hereunder.

The first option of making the system more equitable and shifting the onus of administrative responsibility from the employer to the employee was to replace the FBT exemption on salary packaging with an alternative payment through the tax system, for instance, giving tax offsets directly to employees of PBI endorsed charities.

The other key option centred on the replacement of the current FBT exemption with compensatory grants paid directly to the employer for distribution among employees.

Both of the 'tax offset' or 'grants-based' propositions lack solidity as viable options. The full implication of subsuming the FBT exemption under grants or tax offsets has the potential to create a less transparent and independent process, erode the value of the FBT exemption, and reverse the original aim of the FBT exemption to support and enhance charitable activities and remedy wage disparities.

Grant-based payments are especially problematic; they rely on the employer to evenly and fairly distribute grant monies among its employees, and not to use grants to, for example,

supplement services or administrative operations. This option also would increase rather than reduce the administrative burden on employers.

Inevitably, grant based payments would be subsumed by budget deliberations and cost-cutting exercises and thereby degrade the value and intent of the superseded FBT exemption. Moreover, grants-based payments would create the effect of excluding charitable and religious PBI entities that by choice are not government funded. Under a grants-based system, these entities would entirely lose their FBT entitlements, resulting in no compensation and inequitable treatment.

A further proposition circulating around the issue of tax and funding is that if not-for-profits received the true cost of service delivery from governments there would be no need to rely upon tax concessions and therefore no need for tax concessions. On the surface, this seems to be a reasonable proposition until the reality of budget constraints intrude upon and erode funding levels. Moreover, not all not-for-profits receive government funding and a loss of or erosion of tax concessions would have severe financial consequences for these organisations and restrict their ability to effectively perform their mission and purpose.

*Communicare recognises that reform of the FBT exemption to obtain better value and more equitable distribution of the benefits of the exemption would be a complex exercise in a highly diverse not-for-profit sector. Communicare recommends that any reform of the FBT exemption must be based on the principles laid out by the Australian Council of Social Service that any tax concession reform should not:*

- a) Leave clients of social services worse off;*
- b) Leave not-for-profit community organisations worse off; and*
- c) Leave employees of not-for-profit community organisations worse off.*

## **50. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?**

### **Deductible Gift Recipient and Public Benevolent Institution endorsement**

The current application process to achieve DGR or PBI endorsement from the Australian Taxation Office needs to be made fairer, simpler and more transparent. The present system is fraught with inconsistencies and delays. Too often, charities are receiving adverse DGR or PBI eligibility determinations from the ATO despite having a mission and primary purpose similar to other entities that have obtained PBI or DGR status.

The ATO regulatory framework contains no apparent measures to account for reasons and inconsistencies in PBI or DGR eligibility determinations. This conundrum has led to confusion

over what regulations exist and how they apply, and the perception that the endorsement process is arbitrary and too dependent on the assessments of individual ATO officers.

The inconsistencies in decision-making appears to spread across different ATO offices. For example, there are reported instances of one ATO office making a favourable determination and another office making a contrary determination for two separate charities with the same mission and primary purpose and similar constitutions.

Furthermore, reports from charitable entities indicate that within the ATO there is a backlog of applications for DGR or PBI endorsement, and long delays in making eligibility determinations. The reasons for these delays are unclear, but regulation of the application process clearly requires streamlining and transparency.

*Communicare recommends that the tax concession regulatory framework is overhauled to achieve a simpler, fairer, consistent and more transparent system of determining DGR or PBI eligibility and administering tax concessions.*

Further, not-for-profits which successfully apply for charitable status through the Australian Charities and Not-for-profits Commission do not automatically qualify for DGR status. These charities have to separately apply to the ATO for DGR status, which unnecessarily increases red tape and frustrates philanthropic activity.

The Not-for-profit Sector Tax Concession Working Group Final Report found that ‘the current system for granting DGR status was cumbersome, inequitable and anomalous.’ Further, the report found that the framework was not well placed to handle organisations that carry out a range of purposes that fit within a number of DGR categories and states that, ‘Reforming the framework would increase certainty, reduce red tape for eligible entities and should further increase philanthropy.’

*Communicare’s position on the current process of DGR regulation is supported by the findings of the Not-for-profit Sector Tax Concession Working Group Report and recommends that all not-for-profits that are endorsed for charitable status by the ACNC are automatically granted DGR status through a streamlined process that reduces red tape, increases certainty, and encourages philanthropic activity.*

***Communicare’s recommendation is in accord with the Commonwealth Government’s May 2015 announcement on cutting red tape to boost philanthropy in Australia.***