

Tax White Paper Task Force
The Treasury
Langton Crescent
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Dear Task Force

Re:think tax discussion paper

Not-for-profit Law (NFP Law) is a program of Justice Connect, providing free and low cost legal assistance to small to medium not-for-profit (NFP) community organisations, particularly those working across Victoria and New South Wales.

NFP Law 'helps the helpers' by providing tailored legal information, advice and training to NFP community organisations. By relieving the burden of legal issues, organisations can better focus their time and energy on achieving their mission. We are committed to improving access to legal help for NFP community organisations, and on improving the legal landscape in which they operate. Our policy and law reform work is focused on effective and appropriate regulation of the NFP sector, helping NFPs be more efficient and better run, and ensuring that reform takes into account impacts on the sector.

We welcome the opportunity to make a submission to the Discussion Paper. Our comments are made only in response to Chapter 7 (Questions 47 to 50) regarding the current tax treatment of the NFP sector. Rather than starting from first principles, we instead highlight the extensive and expert work already undertaken in previous inquiries and reviews (which we also contributed to) as we respond to the below questions.

Question 47. Are the current tax arrangements for the NFP sector appropriate?

Reflecting the concerns and experience of our clients, our service has a strong and long standing interest in a simplification of existing tax concessions for the NFP sector. The inappropriateness of the tax concession framework is well-documented, and its complexity is evident from the high numbers of questions we receive on the issue.

We note the Guiding Principles established by the Not-for-profit Sector Tax Concession Working Group in its 2013 Report¹, and endorse these principles to the current review. In particular, we highlight Principle 5 which focusses on simplicity and neatly encapsulates our view of what a key outcome for the *Re:think* consultation process should be for the NFP sector:

“The concessions should be easy to understand and simple to apply. A simple and transparent system makes it easier for people to understand their obligations and entitlements. Organisations will be more likely to make the most beneficial choices for themselves and respond to intended policy signals. A simple and transparent system may also involve lower compliance and administration costs. However, it is acknowledged that there may be trade-offs between the principles of fairness and simplicity.”

¹ Not-for-profit Sector Tax Concession Working Group: *Fairer, simpler and more effective tax concessions for the not-for-profit sector*.

In the interests of providing Treasury with working examples of complexity in the system, the following illustration is a common situation faced by organisations grappling with the application of tax concessions and DGR, and reflects our experiences working with many small-to-medium NFPs.

COMPLEXITY AND DUPLICATION: AN EXAMPLE

A volunteer-run environmental organisation in regional Victoria has established itself as an incorporated association. After a small amount of time operating, the group seeks clarity on available tax concessions.

The organisation is informed that they may be eligible for registration as a charity with the Australian Charities and Not-for-profits Commission (ACNC), as the Charities Act lists 'advancing the natural environment' as a charitable purpose, allowing the group to access certain tax concessions at the Commonwealth level. Upon registration, and after ATO consideration of special conditions, the group received income tax exemption under the Income Tax Assessment Act (ITAA) and other related tax concessions.

Soon after, the group takes on its first employee and discovers that in order to access payroll tax exemptions as a charitable institution, it must apply to a state-based regulator (the State Revenue Office) and again demonstrate its charitable purposes, this time pursuant to the Payroll Tax Act which relies on the common law definition of charity. Similarly, when attempting to access other state-based concessions (eg, land tax exemption) it is again required to demonstrate that it is a 'charitable institution' pursuant to the Land Tax Act.

The group's work attracts the attention of a foundation and is offered a small amount of philanthropic funding however is informed that it must be endorsed as a Deductible Gift Recipient (DGR) in order to receive the grant. The group obtains advice that it may well be eligible to be endorsed as a DGR as an environmental organisation. To obtain endorsement however, the group must meet a further definition contained in the ITAA focussed on the group's principal purpose being the protection and enhancement of (or education and research into) the natural environment. The group must also establish a public fund and seek endorsement through the Register of Environmental Organisations (REO) administered by the Department of Environment.

The organisation takes steps to amend their Rules to add clauses regarding the establishment and maintenance of a public fund. This requires a general meeting of members, passing of a special resolution, and lodging changes with two regulators (in this case, the ACNC and Consumer Affairs Victoria).

Despite establishing the public fund, the group finds it extremely difficult to locate a majority of 'Responsible Persons' to administer the fund (as required by the ITAA) given their regional location and qualifications required for this title. The group also struggles to recruit the minimum 50 individual members, or 5 organisational members, required to be eligible for REO.

At this point, many groups do not proceed with their application for DGR endorsement, having formed the view that the process requires too heavy an investment of their limited resources – this applies as much to other subsectors as it does to environmental organisations. As a result, many smaller organisations lose the opportunity to access philanthropic funds (despite their purposes meeting the eligibility criteria for DGR status) and are left to rely on membership fees, local donation drives and small grants.

Clarity on the availability and application of charitable tax concessions is consistently one of the most requested areas of our legal service, particularly in relation to seeking DGR endorsement. This trend reflects the recent findings of the National Pro Bono Resource Centre, which identified DGR applications as being one of the largest areas of pro bono legal contribution, as well as one of the most refused areas due to the high level of demand.²

It is unfortunate that one of the most complex of tax regimes applies to a sector that is often the least equipped to apply it given the resource constraints and reliance on volunteers experienced by many in the not-for-profit sector.

² National Pro Bono Resource Centre: Fourth National Law Firm Pro Bono Survey: Final Report, pages 33-35

The complexity of the existing tax regime for NFP entities is well documented. In 2010, the Productivity Commission found that “the current system of NFP tax concessions is complex, inefficient and inequitable, imposing substantial administrative costs on both NFPs and governments.”³ In the same year, the Commonwealth Government’s Report into Australia’s Future Tax System noted that “the system of concessions is complex and does not appropriately reflect current community values about the merit and social worth of activities.”⁴

Despite these identified complexities, it is significant that since the abovementioned reports were published, the ACNC has been established and continues to function. This development gives rise to opportunities to improve and simplify the determination of eligibility for existing charity tax concessions and potentially other NFP tax concessions. We discuss this further in response to Questions 49 and 50 below.

We recommend the NFP tax concession framework should have regard to the Guiding Principles developed by the Not-for-profit Sector Tax Concession Working Group, in particular the emphasis on removing the existing complexities in the system which in our view lead to inefficiencies for NFPs as mission driven entities.

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

The question of competitive neutrality and NFP tax concessions has been considered extensively in previous inquiries, the findings of which should form the basis for the current review. In this regard, we highlight the following earlier findings:

- On balance, income tax exemptions do not generally violate the principle of competitive neutrality where NFP organisations operate in commercial markets.⁵
- Input tax exemptions such as FBT tax concessions have the potential to provide recipient organisations with a competitive advantage in labour markets, by enabling them to pay the market wage at a lower cost.⁶

As highlighted in previous reports, the potential for competitive advantage arises primarily from the FBT concession, particularly in relation to NFP hospitals. We note the recent 2015-16 Budget proposes a \$5,000 cap on meals and entertainment expenses. While we support this move, it does not address the inherent issues over inconsistencies and complexity in the FBT framework. Importantly, we would also seek to ensure that any savings generated from this shift in policy be reinvested into the NFP community sector rather than absorbed into consolidated revenue.

Notably, despite well-documented exploitation of the FBT concession framework by some employees of larger NFP entities, the policy intent behind the system is still very much relevant. For many Public Benevolent Institutions and Health Promotion Charities, the FBT concession is critical to the ability to attract and retain employees, and should not be removed without proper consideration given to an alternative framework that can fulfil the same objectives. As the Productivity Commission observed in 2010, there are undoubtedly better ways than the FBT exemption to deliver government support, however the system is well entrenched so any change needs very careful consideration and an appropriate transition period.⁷

³ Productivity Commission Research Report: *Contribution of the Not-for-Profit Sector*, page 155

⁴ Australia’s Future Tax System (2010), chapter 5

⁵ Australia’s Future Tax System (2010) ch 5.4, and Productivity Commission (2010) p.203

⁶ Australia’s Future Tax System (2010) ch 5.4, and Productivity Commission (2010) p.206

⁷ At page 208

In our view, the salary packaging arrangements within the current FBT framework is better replaced with an alternative financial support mechanism to eligible organisations. We note Recommendation 12 of the Not-for-profit Sector Tax Concession Working Group's Final Report, which opts for a system that is spread more evenly across the charitable sector, rather than through exemptions and rebates that are applied selectively. In our view this is a sensible approach worthy of further consideration by the Task Force.

We recommend that salary packaging arrangements within the current FBT framework be replaced with an alternative financial support mechanism to eligible organisations. However, any change should be treated with caution to ensure the policy intent of the FBT concessions is not lost as a result, with an assurance that savings acquired as a result of a policy shift are returned to the NFP sector.

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

Based on our experiences working with the sector, particularly with small organisations that are often reliant on volunteers to interpret and apply the tax concession framework, we have selected two issues as being critical to the simplification of tax concessions for NFPs. We have drawn these from the findings of Not-for-profit Sector Tax Concession Working Group and refer the Task Force to its Final Report for an extensive list of recommendations that focus primarily on the improved effectiveness and simplification of the NFP tax concession landscape.

(i) DGR should be extended to all charities

From our experience handling many thousands of enquiries over several years, access to DGR endorsement is the most misunderstood and resource intensive areas of the tax concession system for NFPs.

The present categories of DGR are ad hoc and do not always reflect community expectations. The presence of the ACNC in the regulatory landscape presents significant opportunities for reducing complexity and red tape from the current tax concession regime, particularly in relation to streamlining the administration of DGR categories.

In our view, the ideal outcome is that DGR endorsement is extended to all charities registered with the ACNC without restriction. However, we recognise that there may need to be some carve outs depending on the fiscal implications of implementing this policy balanced against savings made from other tax reforms. If carve outs are required, we endorse the earlier proposal of the NFP Tax Concession Working Group as it seems to strike a reasonable balance between simplicity and necessary exceptions. Under this proposal, registered charities could only use donated funds for purposes not solely for the advancement of religion or education except where sufficiently connected to a charitable purpose.

We recommend that DGR status should extend to all charities registered with the ACNC, although the use of donated funds should be restricted to purposes and activities that are not solely for the advancement of religion or education, except where the activity is sufficiently related to advancing another charitable purpose.⁸

⁸ This view is in line with Recommendation 6 of the Not-for-profit Sector Tax Concession Working Group Report 2013

(ii) Access to charitable tax concessions should be harmonised across jurisdictions

Currently organisations seeking tax concessions at state and territory level are required to meet varying and inconsistent definitions of charity, based on a mix of legislation and common law and without reference to each other. This is inefficient and confusing. It is also unnecessary with the introduction of the *Charities Act 2013* (Cth).

We submit that inconsistencies between state, territory and federal tax concessions should be addressed through harmonisation or mutual recognition. We, along with many others in the sector, have consistently supported the Productivity Commission's 2010 recommendation that state and territory governments should "seek to harmonise tax concessional status definitions or classifications with the Commonwealth over time."⁹

We believe there is scope for greater recognition of ACNC registration at the state and territory level, which would allow charities registered with the ACNC to use this endorsement when accessing charitable tax concessions across all levels of government.

We recommend the definition of charitable purposes set out in the Charities Act 2013 (Cth) be adopted by all states, territories and local councils to reduce the potential for inconsistent endorsements and entitlements across jurisdictions. If there is a state/territory/local council policy reason for a variation (for example, the intention is for a concession to be given to 'charities except religious bodies' or to 'charities and sporting clubs'), this can still occur with the core definition of charity/charitable purposes applying consistently.

We appreciate this recommendation is not one that can be imposed by the Commonwealth on other levels of government. However, the Task Force could recommend that the Minister (ideally in conjunction with the ACNC under its red tape reduction mandate) request meetings with state, territory and local government Ministers to progress this efficiency, even if it ultimately means making minor amendments to the Charities Act.

Question 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?

In our experience, the establishment of the ACNC and introduction of a statutory definition of charity has already led to efficiencies for the charitable sector, and provides a strong foundation from which to build upon.

The ACNC has a legislative requirement to promote the reduction of unnecessary regulatory obligations on the Australian NFP sector.¹⁰ There is already strong working relationships between the ACNC and other government agencies such as the ATO, however with improved collaboration with states and territories, the ACNC and its register could assist with other significant streamlining of regulatory requirements (including administration of tax concessions) for the sector. In this regard, the ACNC's register of charities provides a credible and freely accessible means for a charity to establish its charitable status, at least for Commonwealth purposes. This register could become a 'one-stop shop' for state, territory and local government purposes, providing a significant reduction in the paperwork burden for NFPs and government. It would save precious volunteer time and free up resources within state and territory agencies

The role of the ACNC in not only regulating, but also educating charities, has in our view improved accessibility to and understanding of the legal definition of charity and charitable purposes as well as the related tax concessions. However, in our experience, a significant number of NFPs are confused about why all relevant tax concessions do

⁹ Recommendation 7.2

¹⁰ ACNC Act s.15-5(c)

not flow from federal endorsement as a charity, and how this interacts with the various other agencies and registers involved in the tax concession landscape.

For these reasons, we submit that the ACNC should be central to reform of the NFP tax concession framework, as it should also be with other areas of reform such as charitable fundraising regulation. For example, it could take on the determination of DGR status and registration and reporting to the ACNC could serve as a licence for charities to fundraise across Australia, further reducing the complexity and duplication that is apparent in the current system.

We recommend that Treasury work with the Australian Taxation Office and the ACNC with the view to simplifying the administration of charity and other NFP tax concessions, both current and reformed.

We thank you for the opportunity to make a submission to this consultation. Please contact us if we can assist any further information about these important issues.

Yours sincerely



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