Submission to Treasury, *Re:Think Tax* Discussion Paper (March 2015)

The Not-for-Profit Project, University of Melbourne Law School

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INTRODUCTION

The University of Melbourne Law School's Not-for-Profit Project is a research project funded by the Australian Research Council which began in 2010. This project is the first comprehensive Australian analysis of the legal definition, taxation, and regulation of not-for-profit (NFP) organisations. Our research and related resources are available on our website, http://tax.law.unimelb.edu.au/notforprofit.

We note that the Government's objective in releasing the *Re:Think Tax - Discussion Paper* (Discussion Paper) is to "have an open and constructive conversation with the community on how [to] create a better tax system that delivers taxes that are lower, simpler, fairer". The Executive Summary also notes that "tax concessions need to be well justified to ensure the fairness of the tax system".

This submission deals with the issues raised in Chapter 7 of the Discussion Paper concerning the Not-for-Profit Sector. In particular we wish to address the issue raised in **Discussion Question 47: Are the current tax arrangements for the NFP sector appropriate? Why or why not?**

We start by noting that the NFP sector has been the subject of a number of inquiries, reports and significant change over the past fifteen years. In particular, an important sub-set of NFP organisations, 'charities', has been the subject of legislative and judicially mandated change in relation to definition and regulation. The legislative changes have not enjoyed bipartisan support and considerable time and effort has been expended on the debate surrounding the appropriate character of these entities as well as the nature of their rights and obligations.

The NFP sector comprises approximately 600,000 organisations. The PC noted that about 10% were economically significant. We also know that there are approximately 60,000 registered charities. ATO data suggests that based on the categorisation now adopted for reporting to the ACNC ie the small (< $250,000 annual turnover); medium (> $250,000 but less than $1 million) and large (> $1 million), the overwhelming majority of charities are small (78%) with 110% being medium and 11% being large.

The tax treatment of the NFP sector was considered by a Working Group comprising NFP sector representatives, advisers and academics in 2012. Recommendations made by that Working Group were the subject of wide consultations but were not implemented before the 2013 election. This submission will draw on work undertaken by the NFP Tax Concessions Working Group (of which Professor Ann O'Connell was a member) which delivered its final report to the then Assistant Treasurer in December 2012 ('TCWG Report').

This submission also draws on work undertaken by the NFP Project, including a Literature Review, *Taxing Not-for-Profits: A Literature Review* (2011) (Literature Review), dealing with taxation of NFPs. One of the tasks undertaken in that Literature Review was to consider support to the NFP sector through the tax system in various countries.

In our Literature Review, we noted that a number of common features globally. For example, we noted that concessions available for NFP entities were fairly similar in most jurisdictions around the world (p 3). In relation to several concessions, such as the exemption from tax, we also noted that almost universally there has been "little or no examination of the rationale for such exemptions, and …. usually no or very little discussion of the exemptions when legislation was passed".(p 8)

The TCWG Discussion Paper set out a number of rationales for providing (and alternatively limiting) tax concessions. The rationales for providing concessions were:

- Concessions are a form of assistance to worthy causes;
- Concessions are a form of payment for the delivery of goods or services that are of public benefit; and
- Charities and other NFPs, unlike for profit entities, are formed and operate for public purposes rather than individuals and so should not be within the taxing net.

The first and second of the rationales suggest that the entities eligible for support from government are providing public benefits, either that government is unable to provide or as a substitute for government provision of goods and services.

The rationales for placing limitations on tax concessions provided to the NFP sector were:

- Tax concessions to one group or sector means a higher tax burden for the rest of the community;
- Tax concessions may rise issues of competitive neutrality; and

- Given the large number and diversity of entities that are entitled to concessions, the public benefit is not always evident.

Although it is possible to identify a number of reasons why government might support the sector, it is also clear that the eligibility for various concessions has mushroomed and that it is now not possible to identify one underlying principle for the concessions. How do we identify those organisations that deserve support and those that do not? We return to this issue below.

The structure of this submission is as follows:

1. What tax concessions are currently available to the NFP sector and what is the estimated cost of those concessions?
2. What are the problems with the current tax concession framework?
3. What principles should be applied to determine the most appropriate tax treatment for the NFP sector?
4. What are the potential obstacles to achieving a fairer and simpler tax regime for NFPs?

CURRENT TAX CONCESSIONS FOR CHARITIES AND OTHER NOT-FOR-PROFITS

The tax treatment of not-for-profit ('NFP') entities in Australia is complex, haphazard and often incoherent. Several Reports, including those from the Industry Commission (1995), the Sheppard Inquiry (2000) and the Productivity Commission (2010) make the same point. The Productivity Commission Report described the concessions as 'complex, confusing and administratively costly' (163-5). The Henry Review (2010) labelled the concessions 'complex, anachronistic and administratively costly'(B3-2). In addition to the Federal concessions, different concessions with different qualifying criteria apply at State and Territory and local government level.

The enactment in 2013 of the *Charities Act (Cth)* which defines the terms 'charity' and 'charitable purpose', has created the possibility of further divergence as the States and Territories appear likely to continue with the common law meaning of those terms. At the Federal level, there is a clear case for an examination of existing concessions and a consideration of whether they are 'appropriate'. We take this reference to 'appropriate' in the Discussion Paper Question 47 to mean that the continuation of the concessions is justified on policy grounds and that the concessions are effective in achieving the stated policy objective.

CURRENT CONCESSIONS

The main concessions that might be available to different types of NFP entities are:

- Exemption from income tax (Div 50 *Income Tax Assessment Act 1997*);
- Refundable franking credits (Divs 67 and 207 ITAA 1997);

- Eligibility for deductible gifts (Div 30 ITAA 1997);
- Exemption from fringe benefits tax (FBT) (s 57A, *Fringe Benefits Tax Assessment Act 1986*);
- FBT rebate (s 65J FBTAA 1986);
- GST concessions (*A New Tax System (Goods and Services Tax) Act 1999*); and
- The common law principle of mutuality.

For simplicity we will deal with:

- Income tax exemption;
- Gift deductibility status; and
- FBT concessions.

ELIGIBILITY FOR CONCESSIONS

Income tax exemption

The *Income Tax Assessment Act 1997* identifies 8 categories of entity that are eligible to be income tax exempt. These entities are not required to submit a tax return. This alone is a considerable benefit but it means that we do not know how much tax is not being collected as a result of the exemption.

One category that is eligible for exemption is 'charity, education and science'. This includes a registered charity; a scientific institution, a public educational institution, a fund established to enable scientific research to be conducted by or in conjunction with a public university or public hospital, a society association or club established for the encouragement of science and (between 2009 and 2013) Global Carbon Capture and Storage Institute Ltd.

Other categories of eligible entities in Div 50 ITAA 1997 include:

- Entities established for community service purposes (except political or lobbying purposes);
- Employer associations;
- Trade unions;
- Local and municipal government bodies and public authorities (see also Div 1AB, Part III of the *Income Tax Assessment Act 1936*);
- Public hospitals;
- NFP hospitals carried on by a society or association;
- NFP health insurers;
- Various associations established for the promotion of primary and secondary resources and tourism;
- A society, association of club established for musical purposes or for the encouragement of animal racing, art, a game or sport, literature, or music.

In total there are 23 separate items of eligibility for income tax exempt status and only one of them is for a 'charity'. There is also overlap between categories, for example, NFP hospitals are likely to be charities as are many scientific research entities. Most other jurisdictions provide exemption for 'charities' only.

Deductible gift recipient status

The *Income Tax Assessment Act 1997* identifies 14 categories of entity that are eligible to become DGRs. Each category has a general section and a specific section with numerous 'named entities'. Within the 14 categories there are 45 types of entities under the general section and more than 200 named entities. Each type of entity within the general sections many have numerous individual entities. For example, a Senate Committee looking into the DGR status of environmental organisations noted that there are over 600 such organisations.

It is important to note that being a charity is neither necessary nor sufficient for eligibility. There is a category for 'Welfare and Rights' but the types of entities included Public Benevolent Institutions (PBIs) which are a subset of charities.

In the past the desirability of having DGR status was linked to the ability to access public money by fundraising. DGR status enabled the entity to encourage charitable giving on the basis that a tax deduction would be available to the donor. Since not all income tax exempt entities are eligible for DGR status, and in many cases need to satisfy different criteria the process of becoming a DGR is more difficult. The justification being presumably the additional cost to government of granting that status but perhaps also the recognition that members of the public will be giving money. In more recent times, entities have another reason to become a DGR and that is to apply for grants from Private and Public Ancillary Funds (PAFs and PuAFs). It may now be the case that a large number of DGRs do not undertake public fundraising but rather rely on support from Funds that have already claimed a deduction.

The current categories for DGR status in Div 30 ITAA 1997 are:

- Public and NFP hospitals, an authority or institution engaged in research into the causes, prevention or cure of disease, a health promotion charity, a public ambulance services (and 14 named entities);
- Public universities, public funds established to provide religious education; school building funds (and 42 named entities);
- Scientific research entities (and 13 named entities);
- Public benevolent institutions; necessitous circumstances funds; harm prevention charities, disaster relief funds, charities that provide care to sick or injured animals and charities that are PBIs but also promote disease prevention or control of abusive behaviour (and 42 named entities);

- Certain defence organisations (3 types of entities);
- Environmental organisations on the Register of Environmental Organisations (and 23 named entities);
- Industry, trade and design (2 entities);
- The family, including marriage education organisations (which must be approved) (and 10 named entities);
- Developing country relief funds and developed country disaster relief funds (and 25 named entities);
- Some specific sports and recreation entities (8 entities);
- Some philanthropic trusts (9 entities);
- Cultural organisations on the Register of Cultural Organisations, a public library, public museum, public art gallery (and 3 named entities);
- Fire and emergency services (3 types of entities); and
- Other recipients (13 named entities).

In many cases the entity or gift must satisfy conditions and entities that are charities must be registered with the Australian Charities and Not-for-Profits Commission and endorsed by the Commissioner of Taxation. In most other jurisdictions, eligibility is confined to 'charities' (which would include many, but not all, of the entities/organisations set out in the Division).

Fringe Benefits Tax concessions

The Fringe Benefits Tax concessions are some of the most inequitable, complex and inefficient of the tax concessions for the NFP sector. The benefits of the concessions are unevenly spread through the sector, there is significant rorting and double dipping and attempts at limiting the worst excesses have been ineffective. The operation of the FBT concessions casts a shadow over the sector.

FBT Exemption

The exemption from liability to pay fringe benefits tax is available to:

- Public benevolent institutions;
- Health promotion charities;
- Public hospitals;
- NFP hospitals; and
- Public ambulance services.

The exemption is subject to a cap on the grossed up amount of benefit that can be provided: $30,000 for a PBI and $17,000 for other entities. These caps have not included 'meal and entertainment' fringe benefits and this type of benefit has been subject to significant rorting, being used for holidays, weddings and other celebrations as well as dining and shopping benefits being accessed with no tax payable. The 2015 Budget announced a measure to impose a cap of $10,000 on these types of benefits (the TCWG

recommended that these benefits be included in the existing caps). Another rort has been the double dipping, especially within the hospital sector. Since the caps are determined on a per employer basis, individuals who hold positions with a number of employers are able to access the concessions multiple times.

FBT Rebate

The FBT rebate is available to most, but not all, NFP income tax exempt entities other than PBIs and other FBT-exempt entities. It is available to a 'registered charity'. The effect of the 49 per cent rebate is that although the entity is subject to FBT, the entity will be entitled to a rebate of about half of the tax otherwise payable. One consequence is that these entities must comply with the FBT legislation and complete all of the complex paper work to report various benefits. This is discussed further below.

ESTIMATING THE COST OF NFP TAX CONCESSIONS

The provision of tax concessions to NFP entities involves a cost in terms of revenue foregone. The TCWG Discussion Paper noted that the total value of income tax concessions to the NFP sector cannot be reliably estimated, due to gaps in data on activities undertaken by the sector. For example, because NFP entities that are income tax exempt and so do not have to lodge a tax return, there is no reliable way of knowing how much tax revenue is not being collected. By contrast, in the United States, all income tax exempt entities must lodge a tax return.

Income Tax Exemption

According to the TCWG Discussion Paper, based on the limited data available, total income tax exemptions provided to the NFP sector in 2011-12 were likely in the order of $3 billion. The exemption for charitable, religious, scientific and community service entities was estimated to exceed $1 billion (Treasury Tax Expenditure Statement 2011-12).

Gift deductibility

The TCWG Discussion Paper noted that in 2009-10 around 4.4 million individual taxpayers claimed a deduction for gifts to DGRs, and donated $2 billion dollars. The DGR tax concession had an estimated cost to government revenue of around $910 million in the 2011-12 financial year (Treasury Tax Expenditure Statement 2011-12).

Fringe Benefits Tax concessions

The TCWG Discussion Paper noted again that it was difficult to quantify the total amount of revenue foregone as a result of the FBT concessions provided to the NFP sector as a result of limited reporting. However, Treasury estimated the cost to be in the order of $2.5 billion in 2011-12. The largest concession, by total revenue foregone by the Commonwealth, is the exemption for PBIs, other than public and NFP hospitals and health promotion charities, which can provide up to a grossed-up value of $30,000 in fringe benefits to each employee without paying FBT. This concession was estimated at $1.3 billion for 2011-12. Another

significant concession is for public and NFP hospitals and ambulance services, which can provide a grossed-up value of up to $17,000 per employee and an estimated cost of $1.0 billion. The provision of a rebate of FBT for certain NFP entities was estimated to be in the order of $35 million in 2011-12. Importantly, certain benefits have not been included within the caps and so provision of those benefits is likely to increase the cost to government. This is discussed further below.

WHAT ARE THE PROBLEMS WITH THE CURRENT TAX CONCESSION FRAMEWORK?

There appear to be at least three problems with the current tax concession framework – the lack of a clear unifying principle for the concessions; the one unifying characteristic, that is, the 'not for profit' requirement does not preclude private benefits and disquiet that many of the entities that benefit from the concessions do not provide any significant 'public benefit'.

No clear unifying principle

An examination of the tax concessions available for NFP entities reveals that there was no clear principle underlying the tax provisions but rather the concessions have grown as a result of ad hoc decision making. That is, the tax provisions that apply to NFPs were not enacted as a result of carefully thought out tax policy or even more broadly framed public policy. Provisions have been introduced over time and modified as a result of case law or political considerations. Two examples illustrate this approach – the DGR provisions and the FBT concessions. The rules that provide a deduction for contributions of $2 or more to DGRs contain lists of specific or named recipients. The process for being named in the legislation is not immediately transparent but involves applying to the Minister[1] and the list can be seen to reflect the leanings of the government of the day.

The original Bill introducing FBT did not provide an exemption for public benevolent institutions. There was an exemption for religious practitioners (s 57 *FBTAA 1986*) and when the legislation was before the Senate a question was raised as to why an exemption was not also available for charities.[2] The Senate determined that not all charities should be eligible for an exemption and so "public benevolent institutions" were included as exempt. Health promotion charities were exempted in 2001. The exemption for NFP hospitals was included in 2000 and for public hospitals (whether or not PBIs) in 2003. Ambulance services were added in 2004 as a result of a case that held they were not PBIs.

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[1] The ATO website states: "For an organisation to become a DGR listed by name, Parliament must amend the Income Tax Assessment Act 1997 to include the organisation individually by name as a DGR. The ATO does not process an inquiry for listing by name. The organisation will need to seek assistance from Parliament to do this". See http://www.ato.gov.au/nonprofit/content.aspx?menuid=0&doc=/content/34485.htm&page=2&H2>

2 A O'Connell and J Chia, 'Advancement (or Retreat?) of Religion as a Head of Charity: A Historical Perspective' in John Tiley (ed), Studies in the History of Tax Law, Volume 6 (Hart Publishing, 2013).

These examples suggest that the provisions lack coherence as a result of the way they have developed and that a reworking of the provisions should be based on a holistic approach rather than just an acceptance of what is currently provided.

'NFP' does not preclude private benefits

The one common feature that applies to all entities under consideration is that they must be 'not for profit'. That term is not defined. It does not mean that the entity cannot make a profit, although a dominant purpose of profit making would generally be inconsistent with the notion of having a charitable purpose. The general view is the not for profit requirement precludes distributions to members or related parties, either while the entity is operating or on winding up. The ATO notes that this does not preclude the payment of 'reasonable remuneration' to such persons (TR 2011/4, fn 207). However, there is not guidance about what constitutes 'reasonable remuneration' or any mechanism to check whether the amount of remuneration paid is reasonable. Even charities that have reporting obligations to the ACNC are not obliged to disclose, much less justify, the amount paid to officers or employees. Given the broad nature of concessions, which include for example, professional sporting associations, it seems likely that many officers of income tax exempt entities would be receiving substantial remuneration. We note that in Canada there is a directive from the revenue authority about what constitutes reasonable remuneration.

Concern about the 'public benefit'

The exemption from income tax and the gift deduction have been present in the income tax legislation since it was introduced in 1915 (and before that in several other taxing statutes). The notion of 'charity' is said to have its origins in the Preamble to the Statute of Elizabeth 1601. In 1891 a UK case held that charitable purposes included relief of poverty, advancement of education, advancement of religion and other purposes beneficial to the community and within the spirit and intendment of the Statute of Elizabeth. When the colonies and later the Federal government introduced legislation, it was of course open to them to adopt the ordinary meaning of 'charity' and there is some indication that they attempted to do so. The Privy Council decided in 1925 that when the term 'charity' appeared in legislation it had the legal meaning, that is the meaning adopted in the UK. That notion of charity was referred to as the common law meaning. In 2013 the Federal government enacted a statutory definition of 'charity' which broadly adopted the common law meaning, although it 'modernised' the definition by including additional purposes recognised by the courts of Australia and removed the requirement that 'other purposes' should be within the spirit and intendment of the Statute of Elizabeth. The common law and statutory definitions require the entity's purpose to be for the 'public benefit'. This involves consideration of any benefits provided to the public (or a section of the public) as well as any detriments. However, for many purposes there is a presumption that certain purposes are for the public benefit. This means that the issue of whether, for example, a private school or a religious organisation is for the 'public benefit' is never considered as a matter of practice. There may be sections of the community who take the view that many of the

entities that are currently recognised as charities do not provide public benefits. Alternatively, it may be that the nature of the benefit being provided in 2015 is different to the benefit that may have been perceived in 1915.

As we have noted, the NFP sector comprises a great number of entities that are not charities but are able to access tax concessions and in relation to those other entities, there may be even greater concern about the nature of an public benefits.

Fringe Benefit Tax

The *Fringe Benefits Tax (Assessment) Act 1986* was introduced because employees were not disclosing benefits received in addition to salary and wages for tax purposes. The imposition of the tax on employers was thought to be administratively simpler. The operation of the Act has been an administrative burden for employers because it potentially applies to all benefits provided to an employee or an associate of an employee by an employer, an associate of an employer or a third party under an arrangement. The Act applies to what might be termed 'salary packaged benefits' ie benefits such as cars, goods or services or expense payments as part of the employees' remuneration. However, the legislation also applies to any other benefits provided such as any workplace facilities or food or drink provided to employees at any time even during working hours, subject to some exceptions. It was because of the recording burden associated with these types of benefits that the exemption for PBIs was originally introduced. Over time, other entities were included in the exemption – public and not for profit hospitals, health promotion charities and NFP ambulance services. In 2000 a cap was imposed to limit the amount of 'salary packaged benefits' that could be provided. A change in the way the FBT was calculated resulted in income tax entities having to increase the value of the benefit and so the amount of tax they had to pay. For-profit employers could claim a deduction for the cost of the benefit and the tax payable, but of course an income tax exempt entity does not pay tax so a rebate was introduced (this entitled the income tax exempt employer to a rebate of about half the amount of the FBT).

The TCWG noted several problems with these concessions that impacted on 'fairness':

- Those entities within the NFP sector that are exempt are seen as having a considerable advantage over other entities within the sector as well as entities providing similar services in the for-profit sector;
- There is no real coherence in the types of entities that are entitled to the exemption or the rebate – although the granting of the exemption to PBIs was considered in detail when introduced, the lists have simply grown in an ad hoc fashion;
- Despite the caps, some benefits were not included in the caps and so these benefits could be provided and the entity would either pay no FBT (exempt entities) or 50% of the FBT (rebateable entities). The benefits that could be provided were 'meal entertainment and leisure facility benefits', so some employees were able to receive

often significant benefits in the form of meals, holidays etc with no tax liability for the employer or employee. We note that the Government has now imposed an additional cap of $10,000 on these types of benefits. Although this is to be commended, it still provides a significant benefit to employees of eligible entities that is not available to others. Moreover, if a for-profit employer provides these types of benefits or if an individual business taxpayer incurs these types of expenses they will not be entitled to a deduction;

- As the benefits are subject to caps per each employer, those who have more than one employment are able to access multiple caps. This is fairly common with medical professionals who have appointments at a number of hospitals;
- The list of rebateable employers does not cover all income tax entities. For example, it does not include public museums, public libraries or art galleries or universities. Although these entities are unlikely to provide salary packaged benefits, they are obliged to record and pay FBT on any other benefits provided. For example, if a University department holds a book launch or academic seminar and serves food or drink, there will be an FBT liability for the employees (and their associates) who attend. The worst aspect of this liability is the record keeping required. We append a copy of the form that has to be completed every time a University department services food or drink (Appendix B); and
- The record keeping and form filling that has been referred to also apply to rebateable employers. This is another situation in which exempt employers have a considerable advantage as they will not need to keep record except to the extent necessary to ensure benefits are within the caps and other obligations, such as recording of benefits on payment slips, are satisfied.

In conclusion, we note that the FBT concessions are complex, inequitable, subject to abuse and often impose an administrative burden on the majority of NFP sector entities. The TCWG heard that those entities that are eligible for the exemption believe it allows them to recruit and retain staff as they are generally unable to offer the same salaries as for-profit entities. Even if there was evidence that this was the case, only a minority of NFP entities are eligible and rorting has been a big problem.

WHAT PRINCIPLES SHOULD BE APPLIED TO DETERMINE THE MOST APPROPRIATE TAX TREATMENT FOR THE NFP SECTOR?

Fairness, simplicity and efficiency

The tax concession framework for the NFP sector is complex, inequitable and inefficient. Minor tinkering with the current provisions will not fix the underlying problems. The same principles that apply to all taxing provisions should be adopted: fairness, simplicity and efficiency should be the guiding principles in any reform of the NFP provisions. The first principle suggests that there should be a clear basis for providing government support

through the tax system. The second principle suggests that the provisions be re-written in a more straightforward style. The third principle suggests that if the reason for providing tax concessions is the provision of public benefits, there should be some accountability and transparency about the way these tax-preferred entities operate.

Clear principles for eligibility (charity)

As noted in the TCWG Report, identifying a principle for the granting of tax concessions will ensure a more coherent system of relief. Rather than the ad hoc addition of types of entities, it is suggested that being a charity should be the basic criterion for eligibility for tax support. Other jurisdictions such as the UK, Canada, New Zealand and the US adopt this approach. Entities that currently enjoy support, such as income tax exemption, should be considered to see if they fall within the current meaning of charity and if not should be denied exempt status. In this regard, it is noted that NFP companies and associations that are not income tax exempt are eligible for a tax free threshold not available to other companies or associations. The amount of the threshold is $416 having been set many decades ago. A more realistic threshold of say $10,000 or $18,000 would mean that a great many smaller entities would not be liable to pay income tax.

It may also be desirable to have two tiers of charities as suggested by the Sheppard Committee in 2000. The suggestion was that there be a type of charity, a 'benevolent charity' (something closer to the ordinary meaning of charity and similar to a PBI) that would perhaps be eligible for concessions that would not be available to other charities.

It is also suggested that all NFP entities, unless they fell below the threshold mentioned above, should be obliged to lodge a tax return. This is the case in other jurisdictions and would ensure greater transparency and accountability than at present.

Greater alignment between ITE and DGR

The TCWG recommended a greater alignment between entities eligible for income tax exemption and deductible gift status. However, rather than extending gift deductibility to all currently exempt entities, it was suggested that it apply to charities excluding charities that had as their purpose advancement of religion and certain educational entities (fee-paying primary and secondary schools). The reason given for the exclusions were pragmatic – the cost to revenue would be too great and school fees to private schools could be made to look like donations.

More rigorous monitoring of private benefits and penalties for abuse

The ability of NFP entities to provide benefits to members and related parties, through the provision of excessive salaries and otherwise should be monitored. This could be part of the function of the ACNC as it determines eligibility for registration as a charity and included in the annual reporting requirements. This would also require consideration and guidance about what is reasonable remuneration.

Where private benefits are being provided there should be penalties.

Radical overhaul of FBT

The FBT regime requires a radical overhaul. It has been suggested by many reports that the burden on employers is so great that the FBT should be abolished and the benefits provided to employees should be assessable in their hands. Employers are now familiar with calculating the value of common benefits and this could be recorded for each employee on their payment summaries with liability for tax resting with them. This would also mean that benefits would be taxed at the employee's marginal rate rather than at the top marginal tax rate.

Another suggested change is to limit the taxation of benefits to 'salary packaged benefits'. This is the position in New Zealand. If an employer provides a car or an expense account or pays an employee's accounts then tax should be payable as if the employee received salary or wages. Other benefits such as food provided at work events should be ignored. This would also mean there would be no need for any exemption or rebate for NFP entities as there would only be liability for tax is 'salary packaged benefits' were provided.

What are the potential obstacles to achieving a fairer and simpler tax regime for NFPs?

Vested interests

Any change to existing concessions will face resistance from those entities that may have their concessions reduced or removed. In relation to income tax exemption, given the large number of small entities, a more realistic threshold should mean that there is no tax liability, although potentially a liability to complete a tax return. This can be justified on the basis of fairness and transparency.

In relation to gift deductibility, there is likely to be an expansion of eligible entities, although some entities that do not qualify as charities may lose this status. The gift deduction is the only deduction in the income tax legislation that is not related to the earning of assessable income. It is a major expense to government, equivalent to direct payments from government, yet government has no say in how the benefit is distributed. In the case of DGR status and income tax exempt status, there is clearly a basis for reviewing the lists that in some cases refer to entities that had their tax preferred status determined a century ago.

The most sustained resistance is likely to come in relation to FBT. Although the benefits provided are subject to caps which are not indexed, the value of the benefit will decline over time. However, on equity grounds there is a strong argument for saying that the concessions should be reviewed. The TCWG heard that exempt entities relied on the concessions to attract and maintain staff. This is unlikely to be true in fact. Many people seek employment with a particular entity for reasons other than the receipt of exempt

benefits. Moreover, if the FBT was revised so that it only related to 'salary packaged benefits' entities within the NFP sector would not be obliged to go through the onerous form filling and record keeping that may be required. NFP entities, like other taxpaying entities, would then have a choice as to whether to provide such benefits (and pay FBT) or to pay a cash salary. This will not be a good result for salary packaging business but will ultimately be good for the tax system and help to maintain the integrity of the sector. In this regard it is important to note that Australia and New Zealand are the only countries that treat employee benefits in this way and the New Zealand system is much more straightforward.

Transitional issues

There will, of course, be transitional issues as a result of any change to the concessions. It seems likely that changes to the income tax exemption as suggested and the expansion of the DGR framework, will not impact heavily on the sector.

The greatest challenge will be in relation to FBT. It is submitted that the current practices in relation to FBT cast a blight on the sector and must be addressed. It may be thought appropriate to provide direct support to the sector in the short-term to assist the transition to the new framework. Direct payments will mean that the government has more control over who receives the payments and how long they are provided for.

Increased administrative burden

Any change to the tax treatment of NFP entities will involve entities coming to terms with the new framework and adjusting processes. The TCWG was tasked with devising reforms to the tax arrangements for the sector that were revenue neutral. In suggesting similar reforms here (except in relation to FBT reform) we believe that the tax treatment of the NFP sector will be fairer, simpler and more effective. Appendix A contains some suggested redrafted provisions that rely on the central concept of charity to determine eligibility for income tax exemption and DGR status.

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Matthew is a Professor at the Melbourne Law School. He holds a PhD from Oxford University. His published work deals with issues in moral philosophy, fiduciary law, equitable property, land title registration, and the law of charity. Matthew has also worked as a solicitor for Arthur Robinson & Hedderwicks (now Allens).

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More information on the project can be found on the website at http://tax.law.unimelb.edu.au/notforprofit.

APPENDIX A

Possible re-written provisions:

INCOME TAX ASSESSMENT ACT 1997 - SECT 50.1

Entities whose ordinary income and statutory income is exempt

(1) The total *ordinary income and *statutory income of the entities listed below is exempt from income tax. The exemption is subject to special conditions.

Entity	Special Conditions
A Registered Charity	'in Australia' Endorsed by Commissioner

(2) All entities that are exempt from income tax must lodge a tax return as required by the Commissioner under s 161 of the *Income Tax Assessment Act 1936*.

(3) The total *ordinary income and *statutory income of all *not-for-profit entities that are not made income tax exempt by this section are subject to tax but the entities may be eligible for an income tax free threshold ($10,000 or $18,000).

(4) All entities that are exempt from income tax must lodge a tax return as required by the Commissioner under s 161 of the *Income Tax Assessment Act 1936*.

(5) The total *ordinary income and *statutory income of all *not-for-profit entities that are not made income tax exempt by this section are subject to tax but the entities may be eligible for an income tax free threshold ($10,000 or $18,000).

INCOME TAX ASSESSMENT ACT 1997 - SECT 30.15

Gifts or contributions that you can deduct

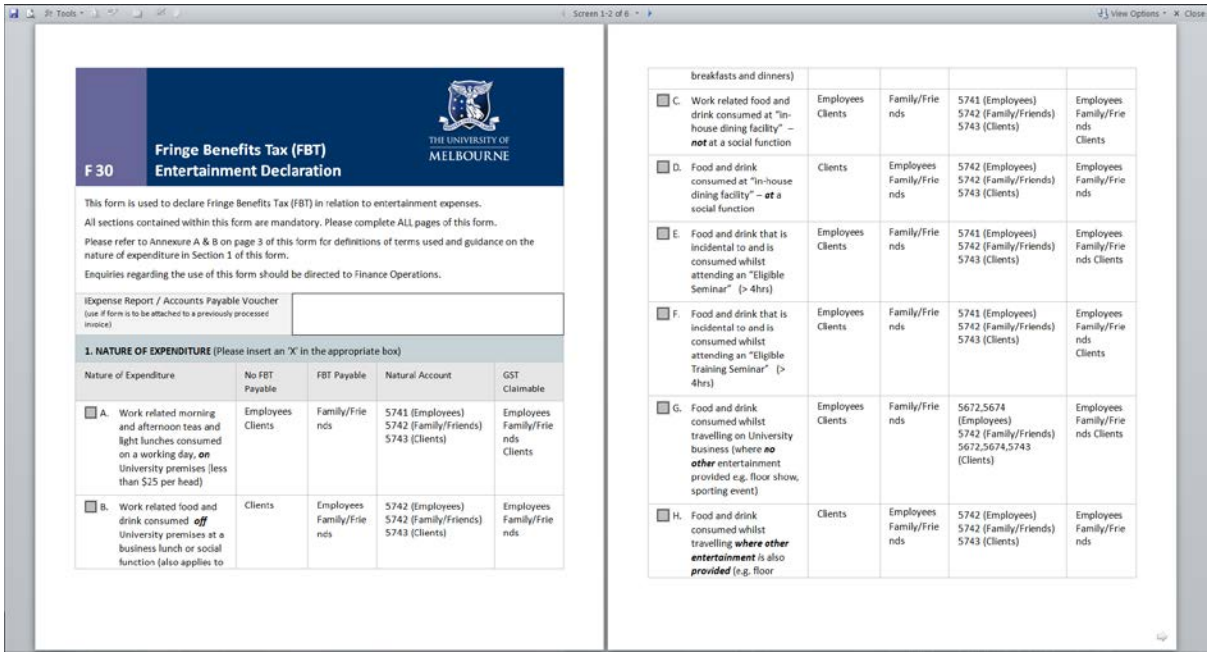
(1) A taxpayer can deduct certain gifts or contributions to the entities listed below. In some cases, the deduction is subject to special conditions.

Eligible recipient	Type of gift	Special Conditions
A Registered Charity (subject to the restriction on activities set out below)	Money or property (which has been independently valued)	'In Australia' Endorsed by Commissioner

(2) A testamentary gift or contribution is not deductible under this section.

Note: Testamentary gifts or contributions may be eligible for CGT relief.

APPENDIX B



F 30 **Fringe Benefits Tax (FBT) Entertainment Declaration**

THE UNIVERSITY OF MELBOURNE

This form is used to declare Fringe Benefits Tax (FBT) in relation to entertainment expenses.

All sections contained within this form are mandatory. Please complete ALL pages of this form.

Please refer to Annexure A & B on page 3 of this form for definitions of terms used and guidance on the nature of expenditure in Section 1 of this form.

Enquiries regarding the use of this form should be directed to Finance Operations.

Expense Report / Accounts Payable Voucher (use if form is to be attached to a previously processed invoice)	

1. NATURE OF EXPENDITURE (Please insert an 'X' in the appropriate box)

Nature of Expenditure	No FBT Payable	FBT Payable	Natural Account	GST Claimable
☐ A. Work related morning and afternoon teas and light lunches consumed on a working day, ***on*** University premises (less than $25 per head)	Employees Clients	Family/Friends	5741 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends Clients
☐ B. Work related food and drink consumed ***off*** University premises at a business lunch or social function (also applies to breakfasts and dinners)	Clients	Employees Family/Friends	5742 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends
☐ C. Work related food and drink consumed at "in-house dining facility" – ***not*** at a social function	Employees Clients	Family/Friends	5741 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends Clients
☐ D. Food and drink consumed at "in-house dining facility" – ***at*** a social function	Clients	Employees Family/Friends	5742 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends
☐ E. Food and drink that is incidental to and is consumed whilst attending an "Eligible Seminar" (> 4hrs)	Employees Clients	Family/Friends	5741 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends Clients
☐ F. Food and drink that is incidental to and is consumed whilst attending an "Eligible Training Seminar" (> 4hrs)	Employees Clients	Family/Friends	5741 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends Clients
☐ G. Food and drink consumed whilst travelling on University business (where ***no other*** entertainment provided e.g. floor show, sporting event)	Employees Clients	Family/Friends	5672,5674 (Employees) 5742 (Family/Friends) 5672,5674,5743 (Clients)	Employees Family/Friends Clients
☐ H. Food and drink consumed whilst travelling ***where other entertainment*** is also ***provided*** (e.g. floor show, sporting event)	Clients	Employees Family/Friends	5742 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends
☐ I. Food and drink at a social function (e.g. Staff farewell, Christmas party, et cetera)	Clients	Employees Family/Friends	5742 (Employees) 5742 (Family/Friends) 5743 (Clients)	Employees Family/Friends

2. PURPOSE OF EXPENDITURE

Venue		Date	
Purpose †			

† Where expenditure is business related, please include enough detail to clearly establish a business connection. (Existing documents, including agenda can be attached).

Note: To simply say "Prof. Jones was visiting" would be insufficient. Stating the purpose of the visit is necessary i.e. Meeting to discuss progress on NHMRC Bird Flu Vaccine Project.

3. PERSONS IN ATTENDANCE

Number of Attendees	Clients	Employees	Family/Friends	TOTAL

Please list names of all people attending the function (or attach documentation) including whether they are an employee, associate or client. Note: Students are generally classified as clients.

Name	Employee	Family/Friend	Client
	☐	☐	☐
	☐	☐	☐

	☐	☐	☐
	☐	☐	☐
	☐	☐	☐

4. APPORTIONMENT OF COSTS

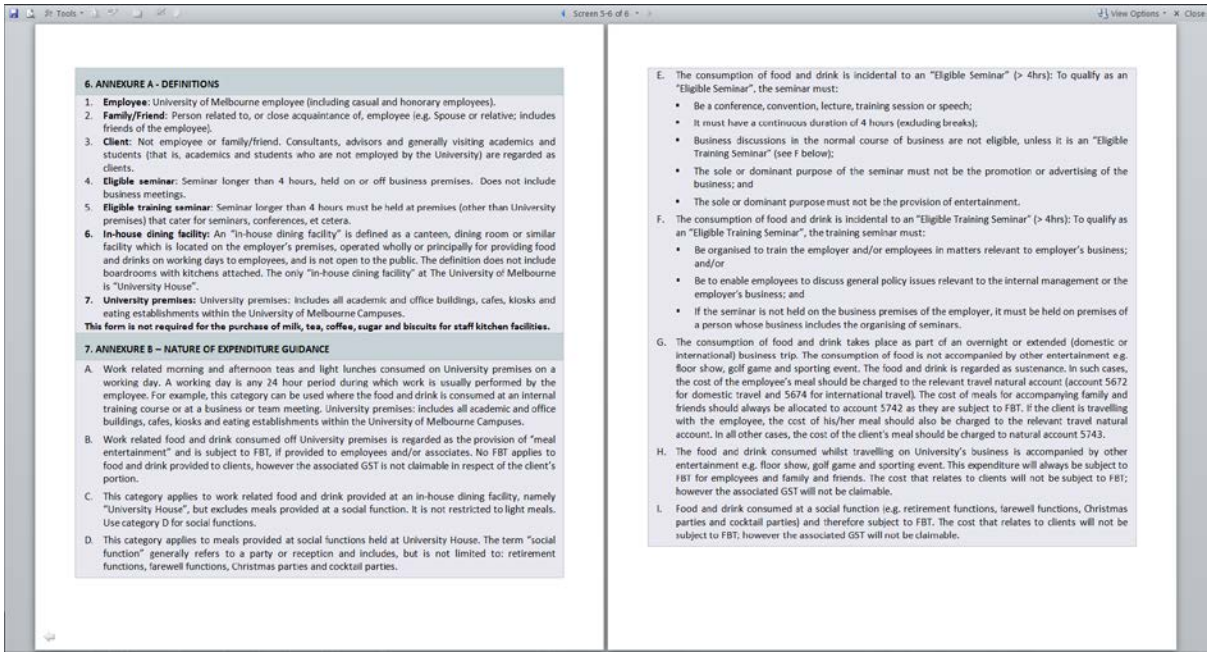
Natural Account **5741** (No FBT / GST claimable - employees)	(GST included)	
Natural Account **5742** (FBT / GST claimable – employees/family/friends)	(GST included)	
Natural Account **5743** (No FBT / GST not claimable in some instances – clients ‡)	(GST included)	
Natural Account **5672** (Domestic Travel - No FBT/GST claimable – employees)	(GST included)	
Natural Account **5674** (International Travel - No FBT/GST-Free – employees)	(inclusive of taxes)	
TOTAL (should equal invoice amount)	(GST included)	

‡ GST incurred on entertainment (restaurant meal or social function – entertainment type B, D, H & I in Section 1 on this form) provided to clients cannot be claimed by the University – expensed to budget units. Use tax code: "INPUT TAX – GST" at the item line in Themis Accounts Payable.

5. CERTIFICATION

I certify that the information contained on this form is true and correct.

Name			
Signature		Date	



6. ANNEXURE A - DEFINITIONS

1. **Employee**: University of Melbourne employee (including casual and honorary employees).
2. **Family/Friend**: Person related to, or close acquaintance of, employee (e.g. Spouse or relative; includes friends of the employee).
3. **Client**: Not employee or family/friend. Consultants, advisors and generally visiting academics and students (that is, academics and students who are not employed by the University) are regarded as clients.
4. **Eligible seminar**: Seminar longer than 4 hours, held on or off business premises. Does not include business meetings.
5. **Eligible training seminar**: Seminar longer than 4 hours must be held at premises (other than University premises) that cater for seminars, conferences, et cetera.
6. **In-house dining facility:** An "in-house dining facility" is defined as a canteen, dining room or similar facility which is located on the employer's premises, operated wholly or principally for providing food and drinks on working days to employees, and is not open to the public. The definition does not include boardrooms with kitchens attached. The only "in-house dining facility" at The University of Melbourne is "University House".
7. **University premises:** University premises: includes all academic and office buildings, cafes, kiosks and eating establishments within the University of Melbourne Campuses.

This form is not required for the purchase of milk, tea, coffee, sugar and biscuits for staff kitchen facilities.

7. ANNEXURE B – NATURE OF EXPENDITURE GUIDANCE

A. Work related morning and afternoon teas and light lunches consumed on University premises on a working day. A working day is any 24 hour period during which work is usually performed by the employee. For example, this category can be used where the food and drink is consumed at an internal training course or at a business or team meeting. University premises: includes all academic and office buildings, cafes, kiosks and eating establishments within the University of Melbourne Campuses.

B. Work related food and drink consumed off University premises is regarded as the provision of "meal entertainment" and is subject to FBT, if provided to employees and/or associates. No FBT applies to food and drink provided to clients, however the associated GST is not claimable in respect of the client's portion.

C. This category applies to work related food and drink provided at an in-house dining facility, namely "University House", but excludes meals provided at a social function. It is not restricted to light meals. Use category D for social functions.

D. This category applies to meals provided at social functions held at University House. The term "social function" generally refers to a party or reception and includes, but is not limited to: retirement functions, farewell functions, Christmas parties and cocktail parties.

E. The consumption of food and drink is incidental to an "Eligible Seminar" (> 4hrs): To qualify as an "Eligible Seminar", the seminar must:
   - Be a conference, convention, lecture, training session or speech;
   - It must have a continuous duration of 4 hours (excluding breaks);
   - Business discussions in the normal course of business are not eligible, unless it is an "Eligible Training Seminar" (see F below);
   - The sole or dominant purpose of the seminar must not be the promotion or advertising of the business; and
   - The sole or dominant purpose must not be the provision of entertainment.

F. The consumption of food and drink is incidental to an "Eligible Training Seminar" (> 4hrs): To qualify as an "Eligible Training Seminar", the training seminar must:
   - Be organised to train the employer and/or employees in matters relevant to employer's business; and/or
   - Be to enable employees to discuss general policy issues relevant to the internal management or the employer's business; and
   - If the seminar is not held on the business premises of the employer, it must be held on premises of a person whose business includes the organising of seminars.

G. The consumption of food and drink takes place as part of an overnight or extended (domestic or international) business trip. The consumption of food is not accompanied by other entertainment e.g. floor show, golf game and sporting event. The food and drink is regarded as sustenance. In such cases, the cost of the employee's meal should be charged to the relevant travel natural account (account 5672 for domestic travel and 5674 for international travel). The cost of meals for accompanying family and friends should always be allocated to account 5742 as they are subject to FBT. If the client is travelling with the employee, the cost of his/her meal should also be charged to the relevant travel natural account. In all other cases, the cost of the client's meal should be charged to natural account 5743.

H. The food and drink consumed whilst travelling on University's business is accompanied by other entertainment e.g. floor show, golf game and sporting event. This expenditure will always be subject to FBT for employees and family and friends. The cost that relates to clients will not be subject to FBT; however the associated GST will not be claimable.

I. Food and drink consumed at a social function (e.g. retirement functions, farewell functions, Christmas parties and cocktail parties) and therefore subject to FBT. The cost that relates to clients will not be subject to FBT; however the associated GST will not be claimable.