Not-For-Profit Sector – it needs to be brought into the tax paying base. Q 47-50

Brief submission summary:

The not-for-profit sector generates revenue of about $107billion per year and employs almost 1.1 million people. This is hugely significant and the current distortions in resource allocation to this sector are a drain on Australia's economy and a burden to other taxpaying organisations and individuals who must make up the difference for tax lost.

The not-for-profit sector can be brought into the company tax system simply and efficiently. Two examples: CBH and Sanitarium.

Chapter 7 Not-for-profit sector Questions 47-50 **– This sector needs to be brought into the company tax paying base**.

The not-for-profit sector generates revenue of about $107billion per year and employs almost 1.1 million people (P 122 tax discussion paper). This is hugely significant and the current distortions in resource allocation to this sector are a drain on Australia's economy and a burden to other taxpaying organisations and individuals who must make up the difference for tax lost.

The not-for-profit sector can be brought into the company tax system simply and efficiently as all but the smallest members this sector are fully enmeshed in the tax system via the GST (BAS) process. Two glaring examples of inequity and sub optimal economic outcomes are:

- large agricultural cooperatives; and
- non-profits operating major food manufacturing businesses.

Agricultural Co-operative example - CBH Group

CBH does not pay income tax on its substantial commercial Australian operations. It operates in direct competition with companies that do.

CBH is based in Western Australia and is "owned" by 4200 Western Australian grain farmers. It operates across the country and part owns manufacturing and distribution businesses in Indonesia. It recently opened an office in US to trade grain from US and Canadian farmers to Asian customers. (P14 CBH 2014 annual report). CBH recently invested in a consortium constructing a new agricultural export terminal in Newcastle in NSW. Its governance structure of equal votes for members regardless of use of the CBH system appears to have led to a sub-optimal grain transport and storage system including sub-optimal pricing of its services. It recently moved into train ownership costing $175million.

The imperative to operate efficiently does not fully exist as CBH has an effective monopoly on WA grain infrastructure. This monopoly includes port storage and loading facilities and inland grain storage and transport infrastructure. This infrastructure includes 195 grain storage sites, four ports, and $175million recently purchased train sets. CBH's internal control structures favour decisions based on member numbers and not on the commercial basis of the value of grain moved/traded. This control structure probably leads to sub optimal outcomes for the larger users/members.

The below table clearly illustrates this is a substantial business with an average revenue of around $3billion, assets of $2billion (a severely discounted historic cost basis) with 3,000 employees.

CBH Group Finiancial & Operational Summary				
	2012	2013	2014	average
Financial	$million	$million	$million	$million
Revenue	2,230	2,712	3,939	2,960
Profit	162	132	149	148
Assets purchased	192	145	115	151
Asset value	2155 or 2062	1,989	1,980	1,985
Equity	1,243	1,370	1,516	1,376
Operational				
employees Permanent	1,000	1,000	1,000	1,000
employees Temporary	2,000	2,000	2,000	2,000
Tonnes Moved	15,100,000	9,100,000	15,900,000	13,333,333
Grain growers	4,300	4,200	4,200	4,233

CBH's actual income tax position is complicated with a little income tax being paid. On 21 March 2014 the ATO retrospectively conferred CBH with charity status from 1 July 2000:

> (i) Income tax
>
> CBH was retrospectively endorsed by the Australian Taxation Office on 21 March 2014 as a charitable institution by virtue of section 50-5 of the Income Tax Assessment Act 1997 ("ITAA 1997"), with effect from 1 July 2000. This endorsement did not change the income tax position for CBH as it was already tax-exempt under section 50-40 of the ITAA 1997. However, endorsement as a charity is recognition that section 50-5 is considered to be the more appropriate tax characterisation. (Page 79 CBH 2014 annual report)

Church Owned Charity Business - Sanitarium.

Its most well-known product is Weet-Bix which is prominent on all Supermarket shelves and I suspect in most home pantries. In September 2010 Josette Dunn of Australian Food news stated Sanatirium was one of Australia's largest food businesses employing over 1500 staff with a turnover of over $550 million. IBISWorld Pty Ltd (31/5/2015) estimated 2014 revenue at $406 million. Little other financial information is readily available. It is clearly a substantial business yet pays no company income tax *"As an organisation that operates as a charity, Sanitarium is exempt from company income tax."* (http://www.sanitarium.com.au/about-us/our-promise/sanitarium-charitable-purposes) whereas others in the food manufacturing business do pay company tax.

A simple effective and fair tax solution for this company income tax leakage.

The not-for-profit sector pays almost no company income tax on the $107billion of revenue it generates.

I suggest all not-for-profit organisations big enough to be captured by the Business Activity Statement (BAS) are required to either join the standard company income tax system or pay a "substituted company tax" of 5% of revenue. This 5% tax could be calculated on the standard BAS form as follows: Total sales (G1); + Export sales (G2); + and other GST free sales (G3) times 5% and entered on a modified BAS form. This can be easily implemented by adding a couple of lines to the BAS for and requiring quarterly or monthly payment along with other BAS payments.

I propose a phasing in of this substituted income tax over 5 years with the rate 1% for year one increasing by 1% per annum until the 5% level is reached. This additional amount of tax would not appear on tax invoices and is not considered GST. It is not claimable by those buying goods or services from the not-for-profit income tax exempt entities. Not-for-profit organisations can choose to join the company income tax system at any time but not later revert to paying the substituted company income tax. The gradual implementation would allow time for the organisations and their customers to assess the impact and adapt, and maybe change their business structures and pricing.

This substituted company tax of 5% of revenue is close to revenue raising method historicly applied to State Government Trading Enterprises (GTE's) in Western Australia. This changed in the 80's and 90's with competitive neutrality reforms and the implementation of National tax equivalent regime for these GTE's (https://www.ato.gov.au/Business/Bus/National-tax-equivalent-regime-manual/). This earlier 5% levy regime worked well for revenue raising and was simple to administer by both the Government and the GTE. It did produce distortions particularly for capital intensive GTE's and it was one of the reasons it was considered more economically efficient for these GTE's to join the National tax equivalent regime.

A 5% substituted company tax on $107 billion is $5.35 billion, about half of the cost of the Pharmaceutical Benefits scheme (PBS) and current Superannuation taxes. It is highly unlikely this would be the amount raised as entities with low "profit" levels would choose to join the company income tax system. However; it is an indication of the magnitude of revenue forgone and distortions in the economy.

The impact of such a substituted company tax on the two examples I discussed above, CBH and Sanitarium would be:

CBH – an average of $148 million per year collected in substituted company tax if they did not choose to join the company tax system. This new tax would encourage them to join the company tax system It is probably the most significant barrier to changing the organisation to a profit motivated company and produce the ensuing operational efficiencies. Funds or at least tradable shares would probably end up in the hand of the current "owners" farmers. A win all round.

Sanitarium – approximately $20 million per year would be raised in Revenue. From the limited information available and my completely uninformed view I suspect they would remain with the current not-for-profit structure and pay this tax.