UNIVERSITIES AUSTRALIA

DISCOVER LEARN LEAD

Submission responding to the Re:think tax discussion paper

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Executive Summary

Australia's university system is a crucial part of the nation's knowledge infrastructure, educating our workforce, underpinning our research and innovation capacity. An adequately funded and resourced university sector plays an important role in driving Australia's international competitiveness and productive capability. Australian universities are also the major providers of education services to international students, earning more than $16 billion annually in national income.

Despite strong public support for a well-funded university system, public investment in Australian universities remains inadequate and low compared with OECD countries. Successive governments have sought to further reduce public investment in our universities, primarily in response to current fiscal circumstances. There is a range of proposals to reduce Government subsidies for university places that have not been resolved by the Parliament, but the Government has claimed these savings in its Budget forecasts. The Government is also continuing to reduce funding for research and these decisions can be implemented without Parliamentary consideration.

In this environment, the immediate imperative for Australian universities is how to achieve a predictable and sustainable operating environment. The funding and policy arrangements for our universities should reflect long term higher education goals, rather than the short term political imperatives which in recent years have driven frequent and disruptive change.

Universities Australia supports the objective of the Tax Discussion Paper to create an efficient, simpler and fairer tax system that encourages productivity and workforce participation, and responds to the challenges raised by new technologies and an increasingly globalised economy. It would not support a package of tax reforms which effectively reduced the overall level of public investment in our universities.

The Government has requested that submissions focus on how revenue is raised, not just how much. However, the two questions are not easily divorced. The removal of tax concessions currently available to universities could reduce the resources available to universities or increase their cost structures. While additional Government resources might result from changes to how much revenue is raised, it is not clear that any compensation to universities for losses from how revenue is raised would continue to be provided to universities into the medium term. Higher education funding is too unstable and too subject to short term political imperatives for universities to be confident that this would occur.

Despite this, Universities Australia is open to considering proposals for tax reform which might enable Governments to increase their support for education and research, provide greater certainty in the continued delivery of that support or reduce the regulatory burden of taxation arrangements without reducing the level of public investment in higher education.

In this submission, Universities Australia identifies the main elements of our current tax system which affect our universities. Where appropriate, it outlines why those benefits are important and why universities would generally support their retention. It also identifies a number of areas for potential improvement to taxation arrangements. In summary, Universities Australia argues that:

i. Australian not-for-profit universities should continue to be income tax exempt and eligible for deductible gift recipient status.
ii. Work should be undertaken to remove inconsistencies and complexity in FBT concessions and to clarify the relationship between these concessions and access to the public funding framework for higher education.
iii. Under dividend imputation arrangements, franking credit refunds should continue for universities.

iv. Any broadening of the GST base should be accompanied by an adequate and appropriately structured compensation package for low income people and households and adverse impacts on access to higher education for low income people should be minimised.
v. In the short-term, payroll tax arrangements should be simplified and harmonised across the states and territories. Payroll tax from universities exceeds the amount of revenue received from State and Territory governments. In the longer term, the sector should be exempted from payroll tax.
vi. Any redesign of the R&D Tax Incentive should consider how it can better leverage public and private investment in research and development and encourage business to conduct research that would not otherwise occur.

Overview of Australia's higher education sector

Australian universities[1] are a critical part of our national economic infrastructure. Through teaching, scholarship and research, they contribute to Australia's economic future by supporting innovation, facilitating the development of knowledge based industries and improving the capability of the workforce. They promote productivity growth and international competitiveness.

Australian universities contribute $24 billion to the Australian economy, employing almost 120,000 academic, professional and administrative staff and earning more than $16 billion annually in export revenue through the provision of education services to international students. In 2013, Australian universities' total operating revenues were just over $26 billion, with 42 per cent of the revenue from the Australian Government and a further 3 per cent of the revenue from the state and local governments. A further 19 per cent of revenue was derived from domestic student contributions (i.e. HECS-HELP, FEE-HELP, SA-HELP and upfront student contributions), the value of which is wholly regulated by the Australian Government.

Australian universities are large and complex not-for-profit (NFP) organisations governed by more than 100 different pieces of Federal and State legislation. They are engaged in a diverse range of activities directed towards public good objectives. In recognition of their contribution to the Australian community, it has been a longstanding policy of successive governments to provide support for their activities through tax concessions.

Australian universities are income tax exempt, able to obtain deductible gift recipient (DGR) status, receive refunds of franking credits on investments and are able to access GST concessions. In addition, education-related services or supplies provided by the university are GST-free.

Concessional tax arrangements for not-for-profit organisations

Income tax exemption

Universities Australia supports the current income tax exemption available to Australian universities.

The Tax Discussion Paper states that there is no clear rationale underlying the income tax exemption of NFP organisations (p.126). UA does not accept that there is no clear rationale underlying the income tax exemption of Australian universities.

[1] In 2013, there were 43 universities in Australia. Of these, 39 are members of Universities Australia and references in this submission to 'Australian universities' and 'universities' are only references to these not-for-profit universities.

As indicated above the majority of their revenue is either provided or regulated by the Australian Government. Taxing these revenues will directly reduce their effective value by returning revenues made available by the Government back to the Government. This recycling of revenues would appear to be inefficient.

University surpluses are reinvested in future operations, in particular for capital development. If universities were taxed, they would need to recover the resulting loss of revenue to ensure that their future operations were not adversely affected If the full value of university surpluses in 2013 was taxed at a 30 per cent rate, the university sector would have a tax liability of around $600 million. This loss of revenue would need to be delivered through increases to Government grants and/or student contributions.

Most Australian universities are not-for-profit institutions. They are either established under Commonwealth, State or Territory legislation to pursue public good objectives or have otherwise been created to serve public interests. In addition to core activities in learning, teaching and research, public universities may have objectives requiring them to serve a particular regional area. Surpluses generated from university operations are re-invested to support these objectives.

Tax concessions provided to universities do not necessarily violate the principles of competitive neutrality. They are a significant part of the current funding arrangements and help to sustain activities universities are required to undertake in the public interest (examples include courses in particular fields that have low student demand; partially funded research activities; and community engagement).

Deductible gift recipient status

Universities Australia supports Australian universities continuing to be eligible for DGR status.

Universities are under constant pressure to enhance and diversify their income streams. The clearest example of this is in the area of research funding. Research funding is being increasingly concentrated in competitive grant research programmes and these grants do not support the full cost of research. Universities are required to find alternative sources of revenue to support principal researchers and the indirect costs of research. There are very significant costs in increasingly sophisticated research infrastructure. While Governments have made commitments to assist with these costs, promised support has been withdrawn to assist with fiscal objectives.

DGR status assists universities to encourage philanthropic donations. These donations have increased over time, with the donations rising from $161 million in 2005 to $295 million in 2013, an increase of 83 per cent over the period. Nonetheless, revenue from philanthropic donations as a percentage of total university revenue remains small at around one per cent.

Withdrawal of DGR status from universities would have an adverse impact on the level of philanthropic donations to the sector. Both the Bradley Review of Higher Education and the Base Funding Review recommended that the Australian Government should introduce reforms to enhance philanthropy targeted at the higher education sector.

Fringe benefit tax concessions

Universities Australia supports further work being undertaken to remove inconsistencies and complexity in the availability of the FBT concessions and to clarify the relationship between these concessions and access to the public funding framework for higher education.

The fringe benefits tax arrangements are important to ensuring equity in taxation arrangements. The exemptions and rebates that may be available to certain not-for-profit entities are effectively a subsidy which enables that organisation to attract skilled labour at a more affordable rate than otherwise would be the case. Access to such a subsidy should be equitable and based on both the public purposes of an organisation and how that subsidy relates to other sources of public support for that organisation.

There are currently a number of apparent inconsistencies in the application of FBT concessions which warrant further investigation with a view to improving equity of access to the arrangement and the effectiveness of Government subsidies as a whole in support of the public purpose to which those subsidies are directed.

Australian universities that are a statutory authority of the Commonwealth, States or territories are currently not eligible for the FBT rebate. Other not-for-profit universities (the Australian Catholic University and Bond University) are eligible for the FBT rebate and this applies irrespective of the university's level of access to the public funding framework for higher education. The inconsistency in this arrangement is likely to be exacerbated by the extension of the public funding framework to a wider range of providers, including charitable and for profit higher education providers.

A medical research institute (MRI) or hospital may be eligible for an FBT exemption, but universities are generally not eligible for any FBT concession, notwithstanding the researchers employed by these different organisations may work in the same physical location. It is not clear that the current arrangement is equitable across the employing agencies or the employees. Whether the differences in access to FBT concessions are equitable is further complicated by differences in access to other sources of funding support for research across these institutional types.

These inconsistencies may be best solved by Government delivering a transparent direct subsidy to those entities which are delivering the public goods, such as research outputs and educational services, sought by Government. It is vital that Australia's higher education and research institutions have the resources to attract the best academic, research and professional staff from the pool of expertise available to Australia.

GST concessions

Universities Australia supports universities receiving the GST concession which applies to 'non-commercial activities' and which is generally available to charities, MRIs, hospitals and some other NFP entities.

Universities currently receive this GST concession for a range of services that would not otherwise be covered by 'education' being exempt from the GST. In particular, the supply of accommodation receives this concessional GST treatment where the amount charged is less than 75 per cent of either the cost of providing the accommodation or the GST-inclusive market value of the accommodation.

The GST concession makes these accommodation and other student services GST-free, as opposed to being fully subject to the GST or GST input taxed only. Universities can claim GST input tax credits for the GST paid on those acquisitions (inputs) associated with making the supply or service available.

The removal of GST concessions would result in either an increase in the price of student accommodation and affected services or universities bearing the additional costs associated with the GST. It would negatively impact universities' ability to provide affordable student accommodation to students in the future, particularly students from low SES background and remote and regional areas.

Dividend imputation and franking credit refunds

Universities Australia supports universities being able to claim a full refund of franking credits associated with their share investments.

Under dividend imputation arrangements, Australian shareholders receive a tax credit for the tax paid by a company that issues them with share dividends, to ensure that these returns to shareholders are only taxed once. Individuals, superannuation funds and some tax-exempt entities, including not-for-profit universities, are entitled to a refund of this tax credit if it exceeds their tax liability. As discussed above, Australian universities are income tax exempt and thus are entitled to a refund of any excess tax credit. These arrangements mean that the final tax on company profits reflects each shareholder's tax rate.

If dividend imputation is retained, it would be inequitable to remove the right to a refund for excess franking credits to shareholders whose taxation liability is less than their franking credit, in particular for shareholders that are exempted from paying income tax.

Any changes to the dividend imputation arrangements which limit universities' ability to obtain refunds for franking credits would have implications for universities' investment strategies. It would make Australian shares a less attractive asset class than is currently the case. It would negatively affect the funding available for core university activities, such as teaching, research and the provision of scholarships and bursaries.

Goods and Services Tax (GST) and State taxes

GST

Universities Australia recognises that changes to GST arrangements might result in a more efficient set of taxation arrangements and more predictable and adequate revenue to state and territory governments for the services and functions expected of them. Complexity and compliance costs for goods and services providers, particularly small businesses could be reduced if a single rate of GST was applied to the broadest range of goods and services, with minimal exclusions.

Proposals for reform to GST arrangements need to be considered in detail and their implications for different sectors of the economy and the community understood. This particularly applies in respect of the implications of such proposals for low income people and households and for the major public services, such as education and health, which are integral to the standard of living of Australians.

An adequate and appropriately structured compensation package would be needed for low income people and households. This would be likely to significantly increase the cost of income support for people undertaking higher education study, particularly for young people.

In the case of the university sector, broadening the GST to include education services could negatively impact on access to higher education, particularly for current and prospective students from low socioeconomic backgrounds. These impacts should be minimised as far as possible.

Extending the GST to cover education-related services, including university fees, is likely to:

- result in students paying more for their education courses which may act as a disincentive for some aspiring students considering undertaking tertiary education and for some mature-aged students pursuing further retraining or upskilling; and
- increase the amount borrowed under the HELP income contingent loan scheme and consequently increase the cost to Government of the scheme through increasing both the time taken to repay debt and the amount of debt not repaid.

Payroll tax

Payroll tax is one of the significant costs of university operations. The university sector paid $669 million in tax in 2013. This was equivalent to 3 per cent of the sector's total operating expenses and exceeded the amount of revenue received from state and local governments ($650 million) over the same period. In the long term, the sector should be exempted from payroll tax. If universities were exempt from payroll tax, these funds could be directed to better support university's core activities in teaching, research and community engagement.

However, Universities Australia recognises that payroll tax is the largest of the state and territory tax revenues. The current array of payroll tax arrangements is inefficient and complex. It places significant compliance costs on employers due to the variety of tax-free thresholds and other exemptions, often introduced to reduce the tax paid by certain groups of employers such as small businesses. These exemptions may relate to the size of payrolls, entity type and types of wage costs included.

In the short term, Universities Australia would welcome reforms to improve the consistency and reduce the complexity of payroll tax across the states and territories. It recommends that consideration be given to standardised tax-free thresholds, tax rates, special exemptions and calculation methods. Harmonisation of payroll tax would significantly reduce the administrative costs and compliance burdens which are currently imposed on universities who employ staff in different jurisdictions.

R&D Tax Incentive

Universities Australia welcomes the Government's commitment to increasing the level of R&D undertaken by businesses in Australia, and acknowledges that the review of the R&D Tax Incentive is part of broader work to consider the effectiveness of incentives for innovation, industry-funded research and collaboration with public research institutions.

The R&D Tax Incentive is the Government's most significant policy instrument to encourage business innovation. It is estimated that in 2014–15 the Australian Government will invest $2.4 billion in R&D through the Tax Incentive, which amounts to over a quarter of the Australian Government's support for science, research and innovation.

Despite the increase in Government support through the incentive, Australia's Business Expenditure on Research Development (BERD) as a percentage of GDP (1.2 per cent) remains below the OECD average of 1.6 per cent. The incentive has also been subject to a number of changes over recent years, some retrospective and with limited consultation, which is problematic when seeking long-term cultural change in Australian industry.

The recent *Boosting the Commercial Returns from Research Discussion Paper* highlights that one of the reasons Australia has difficulty in capitalising on its public investment in research is insufficient collaboration between businesses and researchers. Australia ranks second last of 17 OECD countries on new-to-the-world innovation, which is partly attributed to Australian businesses' preference to adopt or modify existing technologies and practices.

Australia ranks 29th out of 30 OECD countries on the proportion of large businesses collaborating with higher education and public research institutions on innovation. In the case of small to medium enterprises (SMEs), it ranks 30th out of 30 OECD countries on this measure.

While the R&D Tax Incentive is an important part of Australian Government support for innovation in Australia, it needs to be seen as part of an interdependent system which includes direct support to business, research funding to public institutions and investment in institutional and research infrastructure. Direct investment that assists businesses, especially SMEs, to innovate is a policy feature in many countries with high-wage, high-growth sectors.

The OECD Scoreboard ranks Australia equal second last for the amount of direct government funding as a proportion of GDP for business research and development, and 17 out of 35 countries for total public funding of business research and development (i.e. including indirect public funding such as the R&D Tax Incentive).[2] Continuing investment in public research is also vital to ensure Australia remains at the forefront of new knowledge generation and adoption.

Any redesign of the R&D Tax Incentive should consider how it can better leverage public and private investment in research and development and encourage businesses to conduct research that would not otherwise occur. The design of the R&D tax incentive needs to ensure that the tax incentive is not primarily being used by businesses to reduce the costs of activities that they would have conducted as part of their normal business operations.

The role of R&D Tax Incentive in supporting research–industry collaboration could be improved, for example, if a premium rebate was introduced for research conducted with a university, other public research institution and/or utilising publically funded research infrastructure. Consideration should also be given to providing quarterly tax credits under the R&D Tax Incentive to SMEs. The current approach of yearly returns can create a significant cash flow difficulties for an early-stage start-up and it is exactly these type of firms that Australia needs to foster if we are to diversify our economy. A premium rebate for SMEs is an additional approach that could be considered.

The sector welcomes the reform to the tax treatment of employee share schemes announced in October 2014 which ensures that employees will generally not be taxed on employee share options until they have converted them into shares. Employees of eligible start-ups are also to be given additional concessions. These changes would boost support for innovative start-up companies and encourage entrepreneurship and should be maintained.

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[2] OECD 2013, *OECD Science, Technology and Industry Scoreboard*, p.106.