World Vision Australia Response to Tax Discussion Paper
Re:Think – better tax, better Australia

June 2015

Introduction

This paper sets out the submission of World Vision Australia (**WVA**) in response to the tax discussion paper entitled '*Re:Think – better tax, better Australia*' (**2015 Tax Discussion Paper**). This submission primarily addresses matters that are important and relevant to WVA as well as noting other matters which we consider would be of concern to the not-for-profit (**NFP**) sector generally.

Background

World Vision Australia

WVA is a Christian relief, development and advocacy organisation dedicated to working with children, families and communities to overcome poverty and injustice. It is part of the World Vision International Partnership, which operates in more than 90 countries. WVA is Australia's largest overseas aid and development organisation, operating primarily to assist overseas communities living in poverty. It also carries out development work in Australia with Indigenous communities, working collaboratively with both government and non-government organisations in Australia.

What is WVA's charity and tax status?

WVA is a public benevolent institution (**PBI**) and is registered as a charity with the Australian Charities and Not-for-Profits Commission (**ACNC**).

As a registered charity, WVA is endorsed to access the income tax exemption and GST concession. As a PBI, it is also endorsed to access the FBT exemption and is endorsed as a whole as a deductible gift recipient (**DGR**). In addition to this, WVA is endorsed for the operation of the following DGR funds:

- World Vision of Australia Overseas Aid Fund; and
- World Vision of Australia Necessitous Persons Fund.

Summary of World Vision's position

We welcome the broad and unlimited discussion regarding NFP sector tax reform initiated by the 2015 Tax Discussion Paper and support the stated goal of ensuring that tax concessions continue to meet intended policy objectives, and do not result in unintended consequences such as high compliance costs or uncompetitive advantage.

As a PBI and Australia's largest overseas aid charity with a growing domestic program, our access to existing tax concessions enables us to more effectively perform vital functions both domestically and overseas, and to have greater impact and more effectively achieve our mission. Specifically, our ability to provide tax deductible receipts in crucial to encouraging and sustaining public donations to support our work, our income tax exemption 'frees up' funds raised to be applied towards our charitable purposes, and our FBT concessions assist us in attracting and retaining high performing staff dedicated to our cause.

For the reasons set out below, we consider that reforms are both necessary and desirable to remove administrative burden, cost and complexity. Our key recommendations include:

- Reforming and modernising the definition of PBIs, to enable PBIs to carry out relief and poverty alleviation projects both in Australia and internationally in accordance with development best practice principles. This will enable us to have one DGR category to cover all of our work in Australia and overseas, and thereby reduce the administrative burden and cost resulting from having multiple DGR categories.
- Reforming the FBT concession to reduce administrative burden and cost, but only in circumstances where an alternative structural mechanism is introduced to maintain the existing level of support for charities and PBIs. One model may be to provide concessions directly to employees of eligible organisations in the form of a refundable rebate capped at an appropriate level, or an increase in the tax-free threshold for employees. This is likely to be more equitable and transparent, and easier and less costly to administer.

In reforming the existing tax concession, we consider that any changes should:

- continue to recognise the valuable role that all charities, and in particular PBIs, perform; and
- not directly or indirectly result in outcomes for charities which would place them in a worse-off position than under the existing regime.

The below section specifically address the questions posed in chapter 7 of the 2015 Tax Discussion Paper relating to the NFP sector, and focuses on reforms to enable registered charities, and in particular PBIs, to deliver benefits to the Australian public more efficiently and effectively.

Responding to questions

1. Are the current tax arrangements for the NFP sector appropriate?

- We consider the level of overall support afforded to the NFP sector by government, via the myriad tax concessions and endorsements, to be appropriate. This support has been made available in recognition that charities perform valuable work and play an important and intrinsic role in Australian society. This recognition is both historic and contemporary.
- This support is vital in enabling registered charities to have a greater impact and to more effectively achieve their mission. For example, in regard to WVA:
    - the income tax exemption strengthens our capacity as it frees up funds raised to be applied to charitable purposes rather than to general tax revenue;
    - the FBT exemption enables us to attract and retain talented employees that we could otherwise not afford; and
    - having DGR status helps us to fundraise from the public and develop relationships with donors – this is a significant factor in our ability to sustain donation income over the long term.
- While the level of support is appropriate and based on a sound rationale, we do believe that reform of the myriad different concessions and exemptions, which have resulted in the current complex and unwieldy tax regime, is both necessary and desirable and would promote efficiency and effectiveness.

2. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage over for-profit organisations?

- The charity tax arrangements available to overseas aid charities do not give rise to any significant concerns of competitive advantage over for-profit organisations.
- Competitive neutrality was examined in detail in the 2010 Productivity Commission Report which concluded that, on balance, income tax exemptions are not significantly distortionary as NFPs have an incentive to maximise the returns on their commercial activities that they then put towards achieving their charitable purpose.[1]
- However, the 2010 Productivity Commission Report did find that input taxes, in particular payroll tax and FBT concessions, can confer a significant advantage to eligible organisations by reducing their employment costs. It noted that, *'in principle, concessions are distortionary whenever eligible organisation is **in competition** with a for-profit provider, or an NFP not eligible for the concessions. In practice, only a few areas pose a concern'* (emphasis added). This report noted that the key areas of concern were NFP hospitals and public hospitals.[2]
- In our sector, competitive advantage is not of concern as overseas aid charities do not compete directly with for-profit businesses. On the contrary, charities and for-profit organisations often have complementary roles, with overseas aid charities such as WVA filling gaps and providing services that for-profit organisations do not. For example, we have partnered with for-profit organisations in submitting funding proposals for development projects, and in these cases, each party brings complementary skills, capacity and reach.

[1] At page 197.

[2] At page 197.

- Moreover, the vast proportion of funds of overseas aid charities like WVA comes from donations from the Australian public, with only a very small proportion derived from government funding. By contrast, for-profit providers operating in the overseas aid sector do not receive donations but derive their income largely from investment or from fee for service (i.e. delivering services on behalf of government).

In our sector, charity tax concessions, including the FBT exemption, provide organisations such as WVA with an important and reliable source of support, especially to attract and retain staff, and underpin the financial viability of overseas aid charities which are unable to access capital investment to fund and grow activities, and are under considerable pressure to minimise overheads and maximise outputs.

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

- WVA is endorsed as a DGR as a whole, and is also endorsed for the operation of two DGR funds, each with its own set of rules.
- The need to have multiple DGR categories gives rise to unhelpful administrative constraints and compliance burdens. There would be benefit in simplifying and aggregating DGR categories, such as by clarifying the status and role of PBIs. See below at 4(i)-(iii).
- In addition, we incur significant costs associated with administering and complying with the complex FBT exemption. While this form of concession is vital to WVA attracting and retaining staff, significant reform in this area is desirable to reduce cost and administrative burden. See below at 4(iv).

4. 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?

We set out below our view on reforms that may reduce complexity and/or administrative burdens and thereby enable registered charities to delivery benefits more efficiently and effectively.

(i) Simplify and aggregate DGR categories

- We currently hold three DGR endorsements, as set out above. Each of these endorsements has its own requirements and rules that must be complied with.
- The existing system is complicated, inconsistent and cumbersome. For example:
    - Overseas aid organisations must demonstrate a 1-2 year track-record of sound development work and demonstrate compliance with lengthy guidelines administered by the Department of Foreign Affairs and Trading in order to be (and continue to be) eligible for endorsement as a DGR under the Overseas Aid and Gift Deduction Scheme (**OAGDS**). We operate an Overseas Aid Fund endorsed as a DGR under the OAGDS, and we must comply with the OAGDS guidelines for our development work funded by our Overseas Aid Fund.

      By contrast, PBIs endorsed as DGRs have relatively few restrictions on the type of work that they carry out, provided that the work is focused on assisting persons in need of benevolent relief. Following the *Hunger Project*[3] decision, and the relaxation of the long-held 'directness' requirement, PBIs (including those who do not meet the OAGDS guidelines) may now pursue their objects of benevolence overseas and need not limit their beneficiaries to persons located in Australia.

      This variation in compliance burden and regulatory oversight means that overseas aid organisations endorsed as DGRs under the OAGDS are significantly disadvantaged as compared to PBI DGRs, which are not subject to the OAGDS guidelines or equivalent regulatory regime.

      Furthermore, some uncertainty remains as while it appears that the ATO is revising its position on PBIs and the 'in Australia' requirements (set out at paragraphs 128-130 of Taxation Ruling TR 2003/5), almost 12 months after the *Hunger Project* decision, it has not yet withdrawn or published a revised taxation ruling.

[3] Commissioner of Taxation v Hunger Project Australia [2014] FCAFC 69 (13 June 2014).

- In relation to disaster relief in developed countries, under the existing tax regime, it is necessary to establish a separate DGR fund for each new disaster under section 30-86 of the ITAA. For example, in 2011, we were unable to establish one DGR fund that could cover disaster relief work in Japan and Christchurch following the tsunami and earthquake in those places that year.

  The requirement to establish separate DGRs funds for disasters in developed countries inhibits our ability to act quickly in galvanising public support and providing emergency relief. It also increases our administrative burden and restricts use of funds as between natural disasters, and as between our work in developed and developing countries. We are unable, for example, to deploy designated emergency preparedness funds in our Overseas Aid Fund for emergency relief in a developed country, even if the need is great.

- Our different DGR categories also mean that fundraising and administration is fragmented. For example, we have to run separate appeals for overseas aid, developed country disaster relief and domestic work in Australia, and ensure that our receipting and banking is delineated. This adds to the administrative and costs burden.

- In light of the above, we support a simplification of DGR categories so that a single endorsement can cover our work in Australia, in developing countries and in developed countries requiring disaster relief. This would significantly reduce the complexity and administrative burden that arises from having multiple DGR endorsements. This could be achieved by modernising the definition of PBIs to incorporate sound development principles and confirming that such charities may use deductible funds both in Australia and internationally and need only hold one DGR endorsement.

(ii) 'In Australia' reforms affecting PBIs and the OAGDS

- We are broadly supportive of clarification, but not tightening, of the 'in Australia' special conditions for DGRs in Division 30 of the ITAA 1997.

- We understand that following the decision in the *Hunger Project*, there is no legal impediment to PBIs using DGR funds to support overseas projects - a charity that is registered as a PBI with the ACNC may now be endorsed as a DGR, even if it operates outside Australia and is not an approved organisation under the OAGDS.

- We welcome this development as it reduces the complexity and administrative burden that arises from PBIs having to obtain an additional DGR endorsement under the OAGDS in order to carry out work overseas. However, we are concerned to ensure that the quality of, and accountability for, overseas development projects, supported by tax deductible donations, is maintained.

- Quality assurance and accountability to the Australian public has been provided through the OAGDS; the OAGDS guidelines requiring that overseas development projects focus on capacity building and empowerment rather than welfare, and that development projects are carried out in partnership with local communities and with a clear exit strategy. These guidelines have been developed from 40 years of learnings in the development field.

- There are currently no equivalent guidelines or mechanism like the OAGDS guidelines to ensure PBIs abide by sound development principles, either for their projects in Australia or overseas. On the contrary, the definition of PBIs focuses on a passive welfare model of providing relief (as discussed below).

- Given this, while we do not support the tightening of the 'in Australia' special conditions, we welcome reforms which provide some mechanism to ensure that tax deductible donations are accountable to the Australian public and are only used to support overseas projects which are aligned with sound development principles. This may be achieved by modernising the concept of PBIs as discussed below.

(iii) Modernising concept of PBIs

- We support a redefinition of the concept of a PBI to bring this category into line with modern expectations and good practice in relation to poverty alleviation and assistance to the disadvantaged.
- The concept of a PBI, as developed by the common law, focuses on an institution which provides relief to persons in need of benevolent assistance as arouses compassion in the community. This suggests a passive welfare approach, whereby funds are to be used to provide relief by direct hand-outs, rather than by means of capacity-building and empowerment (through education and life skills, health, economic development, for example)
- In this regard, Taxation Ruling TR 2003/5 provides the following guidance as to the ATO's view of what constitutes a PBI:

> *7. A public benevolent institution is a non-profit institution organised for the direct relief of such poverty, sickness, suffering, distress, misfortune, disability, destitution, or helplessness* ***as arouses compassion*** *in the community....*
>
> *10. The condition or misfortune that is relieved by a public benevolent institution will be* ***such as to arouse pity or compassion*** *in the community. Needs might be caused by poverty or lack of financial resources. Disability or sickness can also give rise to misfortune or helplessness.* ***On the other hand, needs that are to be met by education, training or the promotion of cultural or social objectives will not normally arouse community compassion*** *and call forth the giving of benevolent relief. However, they might do so where the needs arise from poverty or helplessness.*
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> *30.* ***While the essence of what is a public benevolent institution has not changed since the Perpetual Trustee case was decided in 1931****, 'the ways in which many public benevolent institutions go about achieving their objectives today are different from the ways in which the typical public benevolent institutions operated in 1931' (per McGarvie J in Commr of Pay-roll Tax (Vic) v. Cairnmillar Institute 90 ATC 4752 at 4757; (1990) 21 ATR 665 at 671). (emphasis added)*

- Modern expectations and good practice promote a model of poverty alleviation that involves helping people to help themselves, building capacity and treating the development process as a catalyst for change; not only teaching a person to fish instead of handing out food, but also addressing the causes of lack of fish. This best practice development model is reflected in the OAGDS guidelines which distinguish between 'development' and 'welfare' and prevents deductible funds being used for welfare purposes overseas.
- It is incongruous that a charity under the OAGDS scheme cannot use tax deductible funds for welfare projects, whereas a PBI charity wishing to carry out development work in Australia is circumscribed by an outdated concept of welfare-type assistance inherent in the concept of a PBI. The practical outworking of this is that our work as a PBI with Indigenous communities in Australia is unhelpfully constrained.
- Given this, we consider that the PBI category should be modernised to enable PBI charities to carry out poverty alleviation projects both in Australia and internationally in accordance with modern best practice principles.

(iv) FBT concessions

- Like many other PBIs, we rely on the FBT exemption as part of salary packaging to attract and retain staff – this exemption a key component of our ability to provide competitive remuneration packages.
- While this tax concession is vital to our functioning, it is complex and costly to administer, and results in a significant administrative and costs burden. We therefore welcome reform of the FBT exemption, but only in circumstances where an alternative mechanism is introduced in order to maintain the existing level of support provided to PBIs.

- We consider that any reform of the FBT concession/exemption should be by way of structural change to the tax system. We do not support a model which replaces the exemption with government grants; grants are a poor and regressive (and likely unreliable) way to compensate for loss of a tax exemption. Further, grants would need to be periodically made as the loss of the benefits of the exemption would not be a once-off consequence, and such grants would not result in a reduction in the administrative burden and costs for charities (having to apply for the grants) or on government (having to administer the grants).
- One option may be to replace the FBT concession with a concession provided to employees via the income tax system. Such concessions could be in the form of a refundable rebate (akin to the low income tax offset or spouse rebate) capped at an appropriate level, or an increase in the tax-free threshold for employees of eligible organisations such as registered charities.
- The above could be administered via a two-tiered structure, according to whether an employee is employed by a registered charity or other charity type entitled to a more generous level of support (ie. PBI, health promotion charity, public hospital etc.). This would preserve the current levels of support which differentiate between different types of charities. The appropriate concessional treatment to be applied could be flagged through the individual payment summaries of employees.
- We would be supportive of these options as they are likely to be:
    - significantly simpler and more equitable than the existing FBT concessions;
    - easily accessed by all employees of registered charities (include lower paid employees);
    - recognised as a tax concession because of who you work for; and
    - more transparent than the existing FBT concessions.

(v) FBT meal and entertainment facility leasing benefits

- We welcome introducing a limit to salary sacrificed meal entertainment and entertainment facility leasing expenses (meal entertainment benefits) for employees of not-for-profits, as announced in the 2015 May Budget. This aligns with our current policy of limiting meal and entertainment expenses for our employees.
- However, we consider that the proposed grossed-up cap of $5,000 is too low, and suggests that the appropriate limit is a grossed-up cap of $10,000 (or a net cap of $5,000).
- Moreover, if the current FBT exemption regime is maintained, we would welcome including the meal entertainment and entertainment facility benefits within the existing caps, provided that the caps are increased accordingly, for example by $10,000. This would reduce administrative burden.

(vi) Income tax exemption and refund of franking credits for not-for-profits

- We consider that the current income tax exemption for registered charities is appropriate and should be retained. This exemption is based on a sound rationale - as charities exist for the public benefit, rather than the private benefit of individuals, they should not fall within the ambit of the income tax regime.
- Consistent with this, the provision for charities to apply for a refund of franking credits for franked dividends received from companies should also be retained. This enables charities to recoup income tax paid on their behalf by the companies, recognising that charities do not, and should not, pay tax on income.
- Access to this refund is critical for charities, which have, or wish to establish, endowment funds to provide a sustainable revenue stream to cover ongoing operational and program costs. These types of revenue streams are increasingly important for charities such as ourselves, particularly as traditional models of fundraising are on the decline and less reliable.

(vii) Fundraising and valuation rules

- The current rules around tax-deductible contributions for DGR fundraising events such as fetes, balls, gala shows, dinners and charity auctions are extremely complex and difficult to navigate.
- Under the current regime, a DGR is responsible for determining the value of a minor (token) benefit given to a person in return for a contribution. The person may then claim a deduction for that part of the contribution that is in excess of the minor benefit received by the contributor.
- The valuation rules used to determine the value of a benefit are complicated and difficult to administer – particularly if the event is unusual, not generally available to the public, or the market value is not easily determined.
- We welcome reforms to simply the process, as the costs in complying with these rules are not warranted, and valuation rules are unduly complex.

Next steps

These detailed submissions are provided in relation to the principal tax concessions which affect WVA's operations.

If you have any queries regarding our submission, please contact either:

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