



**Submission to Not-for-Profit Sector Tax Concession Working Group
Discussion Paper**

***Fairer, simpler and more effective tax concessions
for the not-for-profit sector***

17 December 2012

Professor Brendan Crabb
President
Association of Australian Medical Research Institutes
PO Box 2097, Royal Melbourne Hospital VIC 3050
e:aamri@wesleyresearch.com.au

Introduction

About Australia's not-for-profit medical research sector

The Association of Australian Medical Research Institutes (AAMRI) welcomes the opportunity to provide feedback on the discussion paper, *Fairer, simpler and more effective tax concessions for the not-for-profit sector*.

AAMRI is the peak body for Australia's independent medical research institutes (MRIs), i.e. medical research institutes that are independent of a university or hospital. Our 41 member organisations are internationally recognised leaders in health and medical research, with a collective research income of around \$700 million. Together they account for over 8,000 staff and students, varying in size from as few as 6 staff and students to over 700 staff and students.

Of AAMRI's 41 member institutes, 37 are independently registered charities and a further two are part of larger registered charities. The remaining two are part of state government entities. The majority of medical research institutes (MRIs) are companies limited by guarantee, with the remainder being statutory bodies or other incorporated entities.

Contribution of Australia's medical research institutes (MRIs) to the community

MRIs provide an important service to the community through their research on a broad spectrum of human health conditions, from mental health and Indigenous health, to diabetes and heart disease. Australia's long-term health and prosperity relies on this research to provide advances in disease prevention, diagnosis and treatments. Health and medical research also safeguards the community from future health risks, and helps improve the quality and efficiency of health service delivery in Australia. Being based on hospital campuses, MRIs provide a direct interface between laboratory-based research and improved clinical practice. Through affiliations with universities, they also help train the next generation of Australian researchers. Because of their mission-based nature in areas of genuine community need, MRIs attract philanthropy to medical research that other parts of Australia's medical research sector cannot.

Reliance of MRIs on tax concessions to provide services to the community

The majority of charitable MRIs are registered as 'health promotion charities', with the remainder being 'charitable institutions' or 'public benevolent institutions'. All charitable MRIs are endorsed to access the income tax exemption, refundable franking credits, GST concessions, and the FBT exemption or rebate. All but one (who receives donations through an affiliated foundation) are Deductible Gift Recipients.

Typically MRIs receive at least half of their income from Federal Government grants, primarily through competitive grants from the National Health and Medical Research Council (NHMRC). They also rely on income from State/Territory Governments, community donations and bequests, foundations and trusts, and industry. Importantly, funding provided by Government research grants and schemes is rarely sufficient to complete the research program set out grants or to cover the 'indirect costs of research' (i.e. costs not directly attributable to a specific research project, including overheads, administration, IT and laboratory equipment). Further, salary levels provided by the NHMRC, the main Government funding body for health and medical research, are well below the salaries paid to researchers in the private and public sector and in universities, who receive income streams not available to MRIs (e.g. Federal Government funding for Higher Education Providers that can be used to subsidise research, and student fees).

Consequently, MRIs rely on tax concessions to remain viable and to provide the community with advances in disease prevention and treatment. They also rely heavily on FBT exemptions to be able to provide remuneration packages that are competitive with universities, the public sector and with research organisations overseas. Without FBT exemptions, remuneration packages of MRIs would be significantly less, reducing their ability to attract and retain the best and brightest from Australia and abroad to the innovation-intensive medical research sector. This would diminish our national capacity to deal with emerging diseases and to reduce the burden of disease on our health system. Already, due to inadequate Government funding for the indirect costs of research, MRIs are under significant financial stress, leading to the loss of highly skilled research staff to other sectors and countries. This is a significant cost to the Government and community on our substantial investment in these highly trained members of the workforce.

Finally, MRIs attract philanthropic giving to health and medical research more so than universities and government agencies. They rely on donations and bequests to achieve their purpose and to remain viable. Their Deductible Gift Recipient status is crucial in order to continue to encourage philanthropy into the sector.

Responses to consultation questions

The below responses focus on those measures that would significantly impact Australia's not-for-profit medical research institutes and that are within scope of AAMRI's capability areas as a peak body.

Chapter 1 – Income tax exemption and refundable franking credits

Q6. Should the ability of tax exempt charities and DGRs to receive refunds for franking credits be limited?

No, there should be no limitation to tax exempt charities and DGRs receiving refunds for franking credits. Entities/individuals eligible for refunds for franking credits include resident individuals; complying superannuation funds and approved deposit funds; life insurance companies; pooled superannuation trusts; and endorsed income tax exempt charities and DGRs. Most entities that receive large franked dividend streams are structured in such a way that they can take advantage of refunds of excess franking credits (e.g. corporate tax entities might set up as trusts that can pass franking credits through to resident individuals; partnerships can pass franking credits through to individual partners to claim). To specifically limit the refund for franking credits for tax exempt charities and DGRs would impose a restriction that is not imposed on these other eligible tax payers and would introduce a level of 'unfairness' to income tax exempt and DGR status entities.

Currently MRIs are eligible to receive refunds for franking credits due to their income tax exempt and DGR status, and many have investment portfolios to optimise the returns on endowment funds. This income is often used to fund the core activities of MRIs, including activities for which it is difficult to attract funding from other sources (e.g. administration costs and overheads). Others re-invest the refunds from franking credits in long-term endowment funds set up to ensure the long-term survival of MRIs in times of future funding cuts or shortages.

Chapter 2 – Deductible Gift Recipients

Q11. Should all charities be DGRs? Should some entities that are charities (for example, those for the advancement of religion, charitable child care services, and primary and secondary education) be excluded?

The final decision on DGR status should aim to simplify the system, yet ensure the activities of eligible entities are for public (not private) benefit. While, in principle, the extension of DGR status

to all charities might be appealing, it is likely the devil will be in the detail. For example, the current draft of the 'in Australia' Tax Laws Amendment Bill (2012 Measure No 4) excludes charities (other than organisations with special provisions) with activities outside Australia that are more than 'merely incidental' or 'minor in extent and importance' from having DGR status.

Q13. Would DGR endorsement at the entity level with restrictions based on activity address the behavioural distortions in Australia's DGR framework? Could unintended consequences follow from this approach?

While AAMRI acknowledges difficulties experienced by some entities with the current DGR categories, we argue that an activities-based system would be difficult and onerous to administer. Additional Government resources would need to be expended to categorise the many and varied activities of DGRs and for subsequent governance. Reporting on the part of DGRs would also presumably be substantial, as records would have to be kept for each activity and the direction of DGR funds and non-DGR funds to activities would need to be traced. This would impose additional administrative costs on DGRs.

Q15. Would a fixed tax offset deliver fairer outcomes? Would a fixed tax offset be more complex than the current system? Would a fixed tax offset be as effective as the current system in terms of recognising giving?

In principle, AAMRI supports a fixed tax offset system to provide donors with a tax incentive. As outlined in the consultation paper, such a system would be fairer for low and middle income earners, who currently receive a lower tax benefit than high income earners for no reason other than they earn less income. A fairer system might also encourage a national culture of giving, currently weak in Australia compared with other similar countries. A tax offset system would retain the transparency and simplicity of the current system.

However, prior to implementing any such change, much more research is required on the implications of various tax offset systems (e.g. single- versus two-tiered, and various tax offset levels and tier thresholds) on the level of giving by donors in various income brackets, and the consequences of this on total donations. (While the discussion paper provides information on the level of giving by people in various income brackets, it does not consider how much of the population is within each bracket, and thus the consequences of changes in any one bracket on total giving.) An inappropriate tax offset rate or framework would be very damaging to the income streams of the NFP sector.

Q18. Should testamentary giving be encouraged through tax concessions and what mechanisms could be considered to address simplicity, integrity and effectiveness issues?

No, AAMRI does not support testamentary giving through tax concessions. As outlined in the consultation paper, a system that would provide tax concessions prior to the donation being received would have the potential to result in tax avoidance schemes, would be high risk, and would be very complicated in terms of estimating the value of the testamentary gift. There would also be issues around subsequent changes to wills and testamentary gifts being subject to family provision claims by the testator's offspring.

Q19. Would a clearing house linked to the ACN Register be beneficial for the sector and public?

AAMRI does not support Government investment in the establishment and maintenance of a clearing house linked to the ACNC Register because the benefits of such a clearing house are likely to be limited. A clearing house reduces the concept of philanthropy (however large or small a gift) to an accounting procedure that fails to appreciate how and why donors give, or the importance of a strong relationship between DGRs and donors. Donors give to a cause in which they are interested or concerned, or which affects their lives. DGRs invest significant time and resources in engaging the community and building strong relationships with their donors, to inform

them of issues and achievements, to thank them personally for donations, and to encourage future giving. A significant portion of donations to MRIs stem from long-term relationships with families, corporate organisations and individuals.

Also, while this might change in the future, much donor giving occurs through mediums outside the internet, such as telephone calls, door knocking, appeals and fundraising events. An internet-based clearing house with credit card facilities also requires internet-savvy donors, while many regular donors are of a generation that still prefers to donate cash or by cheque.

Q21. Do valuation requirements and costs restrict the donation of property? What could be done to improve the requirements?

Yes, AAMRI would welcome the simplification of rules and increased certainty of the tax deductions for donors of property. Any action that makes donating easier and more attractive for donors would benefit DGRs.

Q26. Should the threshold for deductible gifts be increased from \$2 to \$25 (or to some other amount?)

Increasing the threshold for deductible gifts to \$25 has the potential to reduce the administrative burden for deductible gifts on DGRs. However, increasing the threshold too much has the potential to discourage giving, by removing financial (and recognition-based) incentives to donate small amounts; this can in turn affect future giving by individuals or the overall culture of giving. On the other hand, an appropriately increased threshold for deductible gifts could potentially encourage giving of greater amounts by some individuals in order to reach the threshold.

As with several other measures considered by the discussion paper, there is a paucity of information on the consequences of the initiative or the appropriate level of change. AAMRI suggests that before setting a new threshold, information be obtained on what individual donation amounts donors deem too small to bother to claim a tax deduction, as well as community sentiment regarding an increased threshold for deductible gifts and how it might affect (positively or negatively) their level of giving.

Chapter 3 – Fringe benefits tax concessions

Q31. Should salary sacrificed meal entertainment and entertainment facility leasing benefits be brought within the existing caps on FBT concessions?

No, AAMRI does not support salary sacrificed meal entertainment and entertainment facility benefits being brought within the existing caps on FBT concessions. As the consultation paper states, FBT concessions were introduced to reduce the gap in employee remuneration between NFP organisations and for-profit competitors in order to attract and retain employees in the NFP sector. If meal entertainment and entertainment facility leasing benefits were to be brought into the current caps, the ability of MRIs to compete for employees with the private, public and university sector, whom provide significantly higher salaries, would be materially reduced.

Analysis of employee salary sacrificing data by Smartsalary showed that employees with a salary of around \$100,000 claimed an average of \$4,820 and \$3,640 in meal entertainment and entertainment facility benefits, respectively, equivalent to an average increase in effective salary of \$4,541. MRIs rely on these increases in effective salary to attract and retain staff, and there is serious concern that removal or reduction of meal entertainment and entertainment facility leasing benefits could result in the loss of staff to the public, private and university sectors.

Q35. Should the rate for FBT rebates be re-aligned with the FBT tax rate? Is there any reason for not aligning the rates?

AAMRI supports re-aligning the rate for FBT rebates with the FBT tax rate.

Q36. Should the limitation on tax exempt bodies in the minor benefits exemption be removed? Is there any reason why the limitation should not be removed?

Yes, AAMRI supports removing the limitation on tax exempt bodies.

Q37. Is the provision of FBT concessions to current eligible entities appropriate? Should the concessions be available to more NFP entities?

The FBT exemption cap of \$30,000 for 'health promotion charities', which include most MRIs, reduces the gap in the remuneration packages that can be offered by MRIs and those that can be offered by organisations with greater financial resources that receive no or lower caps of FBT exemptions, including universities, the private sector and government organisations. It is important that any changes in the eligibility for FBT concessions does not compromise the ability of MRIs to compete with these other sectors for employees.

Q38. Should FBT concessions (that is, the exemption and rebate) be phased out?

AAMRI believes the current concessions, particularly capped concessions, form an essential source of the remuneration equity between NPF and for-profit organisations. Removal of FBT concessions, without replacement with a scheme of equivalent benefit, would have a profoundly negative impact on employees, the ability of NFPs to retain employees, and the viability of the NFP sector.

The level of the threat to the viability of the NFP sector of removing or reducing FBT concessions is starkly illustrated in a recent survey by Systems Knowledge Concepts Pty Ltd (SDC). Of 102 NFP employers surveyed (representing over 60,000 employees), 85% believed that salary packaging was important or critical in attracting and retaining employees. Further, 78% of employers estimated that they would lose more than 10% of their staff if current FBT concessions were materially reduced.

A survey of over 3,200 NFP employees found that 75% thought that salary packaging was very important and 20% thought it was quite important in influencing whether they remained in the NFP sector. Should FBT concessions be discontinued without any compensating changes, 41% indicated that they would not stay in the NFP sector.

Q39. Should FBT concessions be replaced with direct support for entities that benefit from the application of these concessions?

AAMRI strongly opposes replacing FBT concessions with direct support for entities through Government grants. In the SKC survey mentioned above, 79% of NFP employers indicated that a grant funding system in place of FBT concessions would be detrimental to their organisation. Applying for grants would be onerous for NFP organisations (many with limited resources and skills in successfully applying for grants), while quantifying grants to each eligible entity would prove costly in time and effort for the Government. A grants system would also be dangerously vulnerable to Government budget cuts. Replacing FBT concessions with direct support via grants would reduce eligible organisations' revenue certainty, increase organisational risk, and negatively impact forward planning.

Further, the suggestion that FBT concessions be replaced with direct funding for 'specific projects' or for 'assistance with the costs of recruiting specialist staff' would mean that some NFPs would not be eligible, reducing fairness of the system.

Q40. Should FBT concessions be replaced with tax based support for entities that are eligible for example, by refundable tax offsets to employers; a direct tax offset to the employees or a tax free allowance for employees?

The current system of FBT concessions/rebates provides direct benefits to employees (through higher net remuneration) and indirect benefits to the employer (as a recruitment and retention tool to remain competitive with organisations with greater financial resources). In order to avoid

negative consequences on NFPs and their employees, any alternative system must directly benefit the employees by maintaining their net remuneration at current levels, thus indirectly benefiting the NFP employer.

While the current FBT concession system does not appear overly onerous on employers, it can be onerous and confusing for employees. There is sub-optimal uptake of salary packaging by employees (estimated for Smartsalary clients at 60-70% of employees for the threshold cap, 40-50% of employees for the meal entertainment benefit and 10-16% of employees for entertainment facility benefits). This is in part because of the onerous and confusing nature of salary sacrificing, but it also due to other issues, such as end of tax-year issues for employees with HECS and HELP debts, and a lack of uptake by certain sections of the workforce such as casual and foreign staff. This results in a lack of equality and fairness for employees.

A tax offset or tax free allowance system would overcome these issues, increasing simplicity and fairness for employees. A tax offset or allowance to employees is a preferable option than a benefit to the employers, as it would ensure that the benefits would be passed on to the employee.

However, there are several negative consequences of a tax offset / tax free allowance system that must be considered. Such a system would result in a greater number of employees receiving the benefit (since not all employees currently opt in to salary packaging). This would either be at an increased cost to Government or would dilute the benefit to individual employees of the NFP sector. If the latter, this would reduce the competitiveness of remuneration packages offered by the NFP sector, and potentially affect the ability of NFPs to attract and retain employees. Also, those employees currently taking advantage of salary sacrificed meal entertainment and entertainment facility leasing benefits (which are not capped) would be further disadvantaged by this system unless these benefits were still an optional component on top of a tax offset or tax free allowance system, or the total benefit was increased.

Q41. Should FBT concessions be limited to non-remuneration benefits?

No, AAMRI opposes FBT concessions being limited to non-remuneration benefits (i.e. benefits incidental to employment such as staff car parking, in-house meals or incidental use of cars). This would significantly reduce benefits to NFP employees, compromising the competitiveness of NFPs in attracting and retaining staff.

Q42. If FBT concessions are to be phased out or if concessions were to be limited to non-remuneration benefits, which entity types should be eligible to receive support to replace these concessions?

All those entities currently receiving FBT concessions should be eligible for any replacement concession system at an equivalent level of current concessions in order to remain competitive with the for-profit sector (and each other) in attracting and retaining staff. (Also see Question 37.)

Chapter 4 – Goods and services tax concessions

Q44. Would a principles-based definition of the types of fundraising activities that are input-taxed reduce the compliance burden for entities that engage in fundraising?

Yes, AAMRI agrees that a principles-based approach could simplify and reduce the burden of compliance.

Q45. Should current GST concessions continue to apply for eligible NFP entities?

Yes, GST concessions are important to the continued competitiveness and viability of the NFP sector.

AAMRI members

