

ACOSS response to Discussion Paper

Context of this Discussion Paper

The Not-for-profit Sector Tax Concession Working Group emerged out of the 2011 Tax Forum. ACOSS was a strong supporter and participant of the 2011 Forum, where we continued our sustained advocacy for a fair, adequate and equitable taxation system in Australia. In particular, we advocate the principle that income in different forms should be taxed consistently according to ability to pay. In line with this principle, we have argued that a broad tax base is generally fairer and more efficient than a narrow one, unless exemptions can be justified on specific grounds. One such ground is charitable purpose.

The establishment of the NFP Sector Tax Concession Working Group was an important step towards addressing the transparency and equity of tax arrangements in our own sector; and we welcome the Discussion Paper for its contribution towards this end. The scope and detail in the Paper reflect the range and complexity of the issues at stake and as such we have not sought to respond to each and every one. Our submission focuses on the most significant tax arrangements for charities engaged in social service; and on our recommendations for policy to improve these in line with our key policies on taxation as outlined above.

NFP Tax Concessions: Framing the discussion

There are a number of assumptions that frame the Discussion Paper that are important to address at the outset. The first is the requirement within its terms of reference that the Working Group 'identify budget savings from within the NFP sector for any proposals that have a budget cost' (p.4). We question the appropriateness of such a principle applied to a sector that is both independent of government and is, by definition, using its resources for public good rather than profit.

It becomes evident later in the Paper that the budget offsets intended lie within the tax base underpinning NFP concessions. While the Paper makes clear that the total value of NFP tax concessions cannot be reliably estimated, it also presents a Treasury estimate of the NFP sector's tax arrangements as costing \$3 billion (p.11). The implication is that this is lost revenue from the tax base. It is an assertion made without modeling of the complete value of the existing tax concessions; nor any assessment of the taxes that would be paid by NFP organisations in the absence of such concessions.

Beyond the questionable basis of the estimate itself, there is a more fundamental problem with the framing of the sector's tax concessions in terms of cost rather than value. The Paper's Introduction sets out three rationales for providing tax concessions: incentivising NFP activity for 'worthy causes'; subsidising the public benefit that comes from the sector; and exempting such purposes of public benefit from the income tax system. Despite this rationale, the quantification of the sector's tax concessions is not presented in terms of investment or overall economic (as well as social) benefit, but is

assumed to be a cost to revenue. We do not accept this framing of the value of NFP tax concessions; nor the direction it sets by requiring any recommendations that might add to the value of NFP tax concessions to be somehow 'offset' within the existing concessions framework.

The Discussion Paper also puts forward the view that limiting tax concessions enables lower taxes overall (p.10). This is an overly simplistic interpretation of the interaction between not-for-profit tax concessions and the tax system more broadly. It ignores the fact that Australia's ranks as the 8th lowest taxing country in the OECD, with tax revenues in Australia at \$60 billion below the average level.¹ Moreover, the implication that lower taxes are a policy objective in their own right undermines the importance of tax revenue to fund essential health and community services, among many other things.

Another assumption reflected throughout the Paper is that the principles of competitive neutrality apply equally in the NFP sector as they do commercially. On the contrary, the principles of competitive neutrality should not apply to activities that have a predominantly *charitable* purpose. We address this further in our discussion of Chapter 3 below.

Finally, it is important to draw a distinction between the value of tax concessions in showing society's support for the work of charities and NFPs; and the role of adequate funding for funded services. The Productivity Commission's landmark study into the contribution of the sector found that only 70% of the cost of delivering funded services was being covered by existing funding arrangements.² The effect of this underfunding is evident in the inability of organisations to sustain effective services for the people and communities that rely upon them. It is also evident in structural impacts such as pay inequity, with the landmark equal remuneration case before Fair Work Australia finding that the sector does not have equal remuneration compared to state and local government employees; and that this is significantly due to the gendered nature of the sector's workforce.³ Where charities are engaged in delivering funded services, funders need to provide adequate funding for the cost of delivering those services; or be explicit about what proportion of a service they are funding.

However government funding is only one part of the support for charitable and NFP service activity. Many organisations do not seek government funding to support their work; indeed some see independence from government funding as critical to their independence overall.

¹ ACOSS (2009) 'Progressive tax reform: Reform of the personal income tax system', ACOSS Paper 158, Australian Council of Social Service, November,

http://acoss.org.au/images/uploads/Personal_Income_Tax_Reform_-_final_09.pdf.

² PC (2010) *Study into the contribution of the not-for-profit sector*, Productivity Commission, <http://www.pc.gov.au/projects/study/not-for-profit/report>.

³ FWA (2012) *Equal Remuneration Case*, Australian Municipal, Administrative, Clerical and Services Union and others, (C2010/3131), [2012] FWAFB 1000, <http://www.fwa.gov.au/sites/remuneration/decisions/2012fwafb1000.htm>.

For other parts of the not-for-profit sector, tax concessions can encourage key forms of private funding into their activities. For example, the community housing sector relies on tax concessions to encourage developers to partner with them on affordable housing projects and is one way to get more private investment into this market. Encouraging private investment is one of the Government's objectives in affordable housing and tax incentives help to do that.

As a key driver of a charity's ability to access non-government sources of funding, tax concessions provide direct value in terms of additional resources beyond those of government. They also support the added value of a strong, independent and diverse charitable and not-for-profit sector. This value needs to be at the forefront of any reforms to the administration of tax concessions for charities and NFPs; and needs to guard against any diminution of the independence of the sector and its capacity to access sustainable and diverse sources of funding for its important work.

Chapter 1: Income tax exemption and refundable franking credits

1.5.1 Refunds of franking credits

If a charity is income tax exempt, it receives no benefit from franking credits. This means there is a reduced benefit in franking dividends for these charities, compared with other shareholders paying income tax. Pensioners are in a similar position in terms of their contribution to the tax base, yet they receive franking credits as refunds of equivalent cash payments. Thus there is precedent for extending the benefits of franking credits to charities, notwithstanding their income tax exempt status.

Chapter 2: Deductible gift recipients

Recommendation: Extend DGR status to those charities whose dominant purpose is altruistic and for the public benefit.

ACOSS supports streamlining and simplifying the process for obtaining DGR status with a focus on expanding the equitability and consistency of how the concession is applied. A clear framework for this was set out in the landmark Charities Definition Inquiry in 2001. In seeking to distinguish 'altruistic entities from other not-for-profit entities', the CDI recommended retaining,

'the wide definition of charity to provide recognition of the extensive range of purposes that provide benefit to the public. However, we have also identified a subset of charity that can attract more favourable treatment to be known as Benevolent Charity'.⁴

The recommendations of this Inquiry had strong support at the time and remain a definitive approach to resolving the complexity and inconsistency of charitable concessions relating to DGR status. This approach was narrow enough to constrain

⁴ CDI (2001) Chapter 29: Benevolent Charities, Report of the Inquiry into the Definition of Charities and Related Organisations (Charities Definition Inquiry), June, <http://www.cdi.gov.au/html/report.htm>.

excessive distribution of tax concessions, while avoiding the current blurring of tax concessions that occurs through the exercise of Public Benevolent Institution (PBI) status.

The current complexity and inconsistency surrounding NFP tax concessions limits many deserving charities from benefitting from the most significant tax concessions. Reform needs to set clearer boundaries for improved tax concessions, so that those who deserve the benefits of tax concessions can benefit from them consistently and equitably.

Chapter 3: Fringe Benefits Tax Concessions

Recommendation: Any reform to the FBT concession should ensure that it does not leave clients or employees of social services or the organisations themselves worse off.

The Discussion Paper rightly points out that salary packaging options available under the FBT concession are used by employers to attract workers to a sector that struggles to offer wages competitive with other sectors. For charities delivering social services, this struggle to attract the workforce vital to delivering services is underpinned by the structural impacts of inadequate funding for community services. While FBT is relied upon by many charities, it is not an appropriate tool to deal with structural problems of inadequate funding for community services.

A number of other concerns relate to this tax concession and how it operates.

- The fact that it is not indexed means that its value has been declining in real terms.
- There is concern that the advantages that organisations and individuals receive from the exemption are not evenly spread, with the lowest paid workers in the sector sometimes benefitting the least from the concession. Therefore, not only is it not a viable option for addressing the structural problems of inadequate funding and pay inequity overall; it may actually serve to exacerbate them.
- There has been reputational damage to the FBT concession arising from a number of high profile cases where it has been abused or used inappropriately. The impact of these stories and subsequent media attention has been negative across the sector, regardless of whether such examples reflect wider practice by organisations or individuals.

Many of these concerns about the FBT concession are shared across the not-for-profit sector. But from ACOSS consultations in 2009 and 2010, we are aware of widely divergent views about its reform. Some organisations have assessed the impact that the exemption's removal would have on their operations as disastrous and argue strongly for it to remain. Others see it as a distorting and unsustainable tax whose erosion is inevitable. A number of organisations within the ACOSS network choose not to exercise their right to access it. Others who use the benefit do not use it to the extent

they would be permitted under existing rules. Many more charities are simply not entitled to access its benefits because of their tax status.

In 2009, the ACOSS Board agreed on a set of principles upon which any reform to the FBT exemption must be based. Chief among these were that FBT reform should not:

- i. leave clients of social services worse off;
- ii. leave not-for-profit community organisations worse off;
- iii. leave employees of community organisations worse off.

The role of competitive neutrality within the NFP sector

The principle of competitive neutrality is appropriate in so far as commercial activities are at issue. It should not be applied to activities with a predominantly charitable purpose. This is in keeping with the recommendation of the Charities Definition Inquiry 2001, which found that ‘commercial purposes should not deny charitable status where such purposes further, or are in aid of, the dominant charitable purposes or where they are incidental or ancillary to the dominant charitable purposes’.⁵

While this can be a difficult principle to apply, particularly when some charities argue that any activity they undertake has a charitable purpose inherently, it is an important element of good tax policy. For example, the provision of employment services is a charitable purpose. The fact that for-profit providers work in this space does not automatically introduce principles of competitive neutrality and charities should have a competitive advantage in this area precisely because they are driven by their charitable purpose. This principle applies equally to social housing organisations whose tenants are people on low incomes. The determining factor should not be whether the private sector is involved, but whether the purpose of the activity is charitable or commercial.

In the same way, the principle of mutuality in relation to clubs and societies is complicated by the layers of tax concession involved. The same core principles as apply to competitive neutrality ought to be applied in this area, namely that tax concessions should be kept to a minimum except in so far as there is a socially-recognised charitable purpose.

⁵ CDI (2001) Recommendation 18 (Chapter 27), *Report of the Inquiry into the Definition of Charities and Related Organisations (Charities Definition Inquiry)*, June, <http://www.cdi.gov.au/html/report.htm>.

Chapter 6: Next Steps

ACOSS supports developing a system of tax concessions based on the concept of 'charity', so long as this policy is developed in line with a broadened definition of charity. This is a key issue in terms of the sequencing of the reforms and would considerably improve the clarity and consistency that would be applied to tax concession for charitable organisations. Many of the most fraught issues canvassed in the Discussion Paper would diminish significantly if charities were able to access tax concessions on a more equitable and transparent basis.

The most important area of tax concessions in this respect is access to Deductible Gift Recipient status. While this is often discussed in the context of individual giving, it is at least as important for the capacity of charities to seek non-government forms of funding such as through philanthropy. For instance, the perception that a charity should have DGR status to benefit from philanthropy prevents many charities with altruistic purposes from accessing these important sources of funding. ACOSS reiterates our strong support for the immediate extension of DGR to charities with altruistic purposes.

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