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NFP Sector Tax Concession Working Group Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: NFPReform@treasury.gov.au

Dear Sir/Madam

Submission to the Discussion Paper: Not-For-Profit Sector Tax Concession Working Group ('Discussion Paper')

1 About Moore Stephens

We are writing on behalf of the Moore Stephens Australia network of eight independent firms of accountants and advisors. Moore Stephens have a real understanding of the environment in which our clients operate. We currently service a diverse range of entities within the NFP sector and specialise in providing assurance, accounting, tax and advisory services to our NFP clients. We provide a national service offering to a number of key clients operating in the NFP sector, including the following:

- Religious organisations
- Schools
- Charities
- Football clubs and sporting associations
- Membership based organisations; and
- Universities and TAFE colleges.

As a firm, we have had a long standing commitment and involvement for the past 50 years in this sector. We have also been active this year and in recent years in providing submissions to the Government's various committees and consultations to support the sector through this reform phase.

2 General comments

We thank you for the opportunity to submit our response to the discussion paper made by The Not-for-Profit Sector Tax Concession Working Group.

As a sector, NFPs raise, control and distribute millions in funds and make significant contributions to the economy of Australia for example through, employment, charitable projects and the provision of benevolent relief.

Whilst we believe that the current range of tax concessions that are currently afforded to NFP's are appropriate from both a fiscal and social policy perspective, we consider that the plethora of taxes that NFPs (and also non-NFPs) have to grapple with are numerous, inconsistent, and complex. As noted at page 8 of the Discussion Paper, "Existing arrangements are complex and impose compliance burdens on the sector". We agree and consider that there are fairer, simpler and more effective ways of delivering the required support (through tax concessions) to this important sector of our economy.

3 Response to Questions

We submit, in Appendix A of this letter, our views, comments, and suggestions in response to the questions in the Discussion Paper that are of most relevance to our clients.

We note that we broadly agree with the framework established by The Not-for-Profit Sector Tax Concession Working Group for assessing policies and agree that the criteria of fairness, simplicity and effectiveness are the correct principles for the examination of tax concessions provided to the NFP sector.

Our key comments are:

1. The 'in Australia' special conditions should not restrict a tax exempt entity, as a whole, to carry out all of its activities in Australia. It should be sufficient for a DGR to clearly demonstrate that the funds received from tax deductible donations are spent in Australia.
2. There should be no limit to the ability of tax exempt charities and DGRs to receive refunds for franking credits. It is of paramount importance that there is no clawback of the existing ability of DGRs and charities to claim refunds of franking credits. Otherwise there would be significant stress on these entities to obtain alternative sources of funding.
3. The restriction on a tax exempt body's ability to access the minor benefits exemption should be removed as it causes too much administrative burden for limited tax revenue. It is not clear why the tax exempt sector is not able to access the same minor benefits exemption as all other employers.

We have set our responses to selected questions in Appendix A.

4 Conclusion

In formulating our response to the discussion paper we have actively sought feedback from a range of organisations within the sector. Our submission incorporates a number of the issues and concerns which have been identified during these discussions.

If you have any queries please contact me or any of the contributors to this submission:

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Yours faithfully

Joe Shannon
Chairman
Not-For-Profit Steering Committee
MOORE STEPHENS AUSTRALIA

Encl

Appendix A

CHAPTER 1 — INCOME TAX EXEMPTION AND REFUNDABLE FRANKING CREDITS

1. What criteria should be used to determine whether an entity is entitled to an income tax exemption?

Our main concern relates to the proposed 'in Australia' special conditions. We appreciate that funds received from tax deductible donations should be spent in Australia. However, for large charities that operate in an ever-increasingly connected world, there is a fundamental requirement to interact with the wider world. Therefore, the 'in Australia' special conditions should not restrict the entity as a whole to carry out all of its activities in Australia. It should be sufficient for a deductible gift recipient to clearly demonstrate that the funds from deductible gifts are spent in Australia.

2. Are the current categories of income tax exempt entity appropriate? If not, what entities should cease to be exempt or what additional entities should be exempt?

In our view, the current categories of income tax exempt entities are appropriate. However, we would recommend that the Working Group give consideration to the treatment of vehicles which have been set up specifically for the purpose of Social Enterprise. These entities which have a mixture of for profit and NFP elements have been established in a number of other jurisdictions such as the UK and are supported in Australia through the establishment of the Social Enterprise Fund by the Federal Government. Potentially, income tax concessions might promote the further development of this type of entity.

3. Should additional special conditions apply to income tax exemptions? For example, should the public benefit test be extended to entities other than charities, or should exemption for some types of NFP be subject to different conditions than at present?

We consider that the presumption of public benefit should remain for charities. However, the expansion of the public benefit test to entities other than charities is a public policy issue and there are parties in a better position to comment on this issue.

4. Does the tax system create particular impediments for large or complex NFPs?

Over the last 20 years there has been significant uncertainty in relation to the status of subsidiary entities of tax exempt entities. In our view, a 100% subsidiary of an income tax exempt entity should automatically qualify for income tax exemption. The proposed definition of a NFP entity contained in the "in-Australia special conditions" bill should alleviate these concerns regarding the eligibility to access income tax exempt status.

5. Should other types of NFPs also be able to claim a refund of franking credits?

We consider that all NFPs should be entitled to a refund of franking credits. We note that under the current system, fairness is not achieved as between NFPs in the sense that not all NFPs can obtain a refund of franking credits. These credits represent tax paid at the corporate level and for a NFP the lack of access to these credits results in an impost on the entity equivalent to the franking credits.

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

There should be no limit on the ability of tax exempt charities and DGRs to receive refunds for franking credits. Any clawback of franking credits or the restriction of the existing system would in our view have a significant impact on the funding capacity of these entities to the extent that they would need to obtain alternative sources of funding.

7. Should the ATO endorsement framework be extended to include NFP entities other than charities seeking tax exemption?

We consider that requiring all NFPs and not just charities to seek endorsement would provide greater certainty to NFPs that must self-assess their entitlements and also act as a revenue protection measure. This recognises that of the estimated 600,000 NFP organisations in Australia, approximately only 60,000 of those are charities. We recommend that the ATO endorsement framework be extended to NFP's with annual turnover greater than $1 million.

A threshold at this level would provide an appropriate balance between certainty of status for NFPs of economic significance and the desire not to impose unnecessary additional compliance costs.

From a practical perspective, we recognise the extension of the endorsement framework would result in additional resourcing requirements. We would therefore recommend the implementation of the endorsement process be considered in conjunction with the announced extension of the recently established ACNC to the regulation of broader NFP sector.

9. Should the threshold for income tax exemptions for taxable NFP clubs, associations and societies be increased? What would a suitable level be for an updated threshold?

We consider that an increase in the tax free threshold from the current threshold of $416 (the same threshold for minors) to the current threshold for resident individuals of $18,200 for taxable NFP clubs, associations and societies is appropriate as it should:

- reduce the compliance burden for small NFP companies;
- reduce the regulatory burden on the ATO; and
- foster a simpler and efficient taxing system.

CHAPTER 2 — DEDUCTIBLE GIFT RECIPIENTS

11. 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 extension of DGR status to all charities would remove a significant compliance and administrative costs and achieve simplification. It would also assist the public in its giving decisions as it would remove complexity and uncertainty for the donor thereby facilitating additional giving.

However this measure is not likely to be revenue neutral. The discussion paper notes that this proposal would have an estimated fiscal cost of at least $1 billion per annum.

Accordingly, if this measure is adopted, we understand that there needs to be careful selection of carve outs.

12. Based on your response to Q11, should charities endorsed as DGRs be allowed to use DGRs funds to provide religious services, charitable child care services, and primary and secondary education?

Given that there are various announcements and legislation at various stages of development, we believe further consultation is required as there will be winners and losers from this approach. We acknowledge that the cost to revenue for expansion of DGR endorsement may be too high for this proposal to be progressed further.

13. 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?

We do not support activity based restrictions on DGR endorsement as it does not promote the principles of fairness and simplicity advocated by the Working Group.

14. If DGR status is extended to all endorsed charities, should this reform be implemented in stages (for example, over a period of years) in line with the PC's recommendations, or should it be implemented in some other way?

Should it be deemed appropriate to extend DGR status to all endorsed charities, we support the PC's recommendations that DGR status be progressively extended.

15. 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?

We see no compelling reason to change the current approach. Most other forms of deductions are regressive as well. We doubt this would encourage additional giving for medium level income earners and could have a detrimental impact on the level of donations made by high income earners.

16. Would having a two-tiered tax offset encourage giving by higher income earners?

We do not support an offset (refer to our responses to questions 14 and 15 above). However if an offset was to be introduced it must not impact on the after tax position of high income earners as given the existing giving pattern in Australia we would suggest that this would have a material impact on the level of donations.

17. What other strategies would encourage giving to DGRs, especially by high income earners?

We recommend that the Working Group give further consideration to the research already undertaken in this area. In particular, we refer to the findings of the QUT – The Australian Centre for Philanthropy and Nonprofit Studies February 2012 research project – Foundations for Giving – why and how Australians structure their philanthropy.

This project was focused on structured giving by high net worth individuals and its findings identified a range of drivers and non-financial considerations that come into play when this section of donors make the decision to donate.

Whilst we recognise that the tax deductions are an element of the giving experience it is also important to note that these are but one of the considerations in the giving decision process. When identifying

strategies to encourage giving, consideration should be given to these other factors and how the Government may be able to support initiatives or activities which support this process.

23. Are there additional barriers relevant to increasing charitable giving by corporations and corporate foundations? Is there anything the Working Group could recommend to help increase charitable giving by corporations and corporate foundations?

Whilst we recognise the value of Private Ancillary funds as being useful tools for the development of family and small private company giving, it has been our experience that the nature of these funds can be overly restrictive when applying these structures to organisations which have a more diverse employee or corporate structure.

A number of organisations would like to directly link their "foundations" to their local community and provide support to a range of entities for which DGR status is not available.

In addition, those companies with foundations in other jurisdictions such as the United States seek to have a comparable structure in their Australian foundations which is not readily accessible in one entity under the current arrangements.

The restrictions of the "in Australia" special conditions in terms of the board composition can also limit the establishment of these funds where there is a desire to have an overseas holding entity strongly represented on the board of the Trustee of the fund.

Furthermore, the ability to link social corporate responsibilities activities directly to the corporate foundation can at times be seen to be restricted. For example, undertaking charitable activities within the local community is not easily achieved where there is only an ancillary fund in existence. We note that a number of entities also establish an Income Tax exempt fund to overcome these issues or alternatively promote through the corporate entity rather than their foundation

24. Are the public fund requirements, currently administered by the ATO, either inadequate or unnecessarily onerous?

There is a prohibition on minor charitable activities by the funds. A small threshold that would allow organisations to promote the foundation and incorporate their corporate social responsibility policies more effectively would be useful.

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

Our initial reaction is that $25 is too high as it would disadvantage those who donate on an ad hoc basis or those from lower socio-economic circumstances. If there is to be an increase in the threshold for deductible gifts, we recommend that it be increased from $2 to $5.

The following are concerns in relation to the increase of the deductible amount from $2 to $25 which were identified through our consultation with those in the Sector who receive a significant proportion of their donations from the general public:

- These charities receive a significant level of donations below $25 particularly around the $10 mark.

- The option provided is unclear as to whether the change in threshold will continue to be per donation or as a total of the donations made throughout the year.

- A significant number of donors contribute on a regular basis of say $10 per month - how would this be impacted?

- Given the existing fundraising requirements for charities raising funds from the public the reduction in compliance costs was not considered significant.

- A significant number of their donors commence their giving through say a $10 donation and then increase frequency or amount over time. To deny deduction at this initial stage in the giving relationship could result in fewer actually developing a giving approach ultimately resulting in a small potential donor pool.

- It was generally considered that this option would actually reduce donations not encourage more donations.

- This option could act as a deterrent for the youth in our community beginning to make a positive contribution to this world through their financial means.

CHAPTER 3 — FRINGE BENEFITS TAX CONCESSIONS

29. Also assuming that the current two-tiered concessions structure remains (see Part B), what criteria should determine an entity's eligibility to provide rebateable benefits to its employees? Should this be restricted to charities? Should it be extended to all NFP entities? Are there any entities currently entitled to the concessions that should not be eligible?

The rebate should recompense the organisation for the "deductibility of fringe benefits tax" and accordingly the rebate should reflect that the entity is not eligible for a tax deduction. Therefore, in our view, any organisation which receives an endorsed income tax exemption should be eligible for the rebate.

30. Should there be a two-tiered approach in relation to eligibility? For example, should all tax exempt entities be eligible for the rebate, but a more limited group be eligible for the exemption?

We are of the view that all tax exempt entities should be eligible for the rebate (refer to our response to question 29 above). However, the issue of whether a more limited group is eligible for the exemption is a public policy concern and there are parties in a better position to determine who should be eligible for the exemption.

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

As identified in the discussion paper, the exclusion on caps on meal entertainment and entertainment facility leasing benefits are being exploited and offending the principles of fairness. Accordingly, we are of the view that it would be reasonable to incorporate salary sacrificed meal entertainment and entertainment leasing benefits into the capping system.

32. Should the caps for FBT concessions be increased if meal entertainment and entertainment facility leasing benefits are brought within the caps? Should there be a separate cap for meal entertainment and entertainment facility leasing benefits? If so, what would be an appropriate amount for such a cap?

We consider that the caps should be increased mainly because they have not been raised for many years. In addition, this would also be a trade-off for bringing the salary sacrificed meal entertainment and entertainment leasing benefits within the capping system.

33. Are there any types of meal entertainment or entertainment facility leasing benefits that should remain exempt/rebatable if these items are otherwise subject to the relevant caps?

Yes all meal entertainment or entertainment facility leasing benefits (other than salary sacrificed amounts) should continue being exempt / rebatable.

34. Should there be a requirement on eligible employers to deny FBT concessions to employees that have claimed a concession from another employer? Would this impose an unacceptable compliance burden on those employers? Are there other ways of restricting access to multiple caps?

We consider that restricting access to multiple caps would not be workable as it would impose excessive compliance burdens on NFPs. Perhaps only where there is common control could access to multiple caps be restricted.

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

We consider that the rate for FBT rebate should be aligned with the FBT tax rate.

36. 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?

The limitation on tax exempt bodies accessing the minor benefits exemption for tax exempt body entertainment is one of the major compliance burdens that annoy tax exempt employers. We recommend that the limitation be removed on the basis that it causes too much of an administrative burden for limited tax revenue. It is not clear why the tax exempt sector is not able to access the same concession as all other employers. The difference in treatment makes it difficult to train staff new to the tax exempt sector to ensure that FBT is paid on minor tax exempt body meal entertainment benefits.

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

We note that our NFP clients generally consider the current rebate and exemption system vital to their ability to attract and retain staff. There is a view of the Charities we have consulted in preparation of this submission that these concessions simply reduce the gap between the remuneration levels an NFP can provide to its employees compared with the remuneration levels that commercial (and in some cases government) organisations are offering. We see no evidence that NFPs are providing an after tax remuneration above or on par with the commercial sector. However, the issue of providing FBT concessions is a public policy concern and there are parties in a better position to determine who should be eligible for the exemption.

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

No they are vital for NFPs to be able to attract staff and consequently deliver their services to the community.

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

There needs to be further consideration given to the benefit and use of direct support and what mechanism would be used to provide it. Our current view is that the FBT concessions for NFPs should be retained. A number of our NFP clients are concerned that a greater administrative burden would be placed on NFPs when trying to access direct support.

40. 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?

We are definitely opposed to the removal of the FBT exemption and rebate caps. We are strongly of the view that the FBT rebate should be extended to all tax exempts. Our main question is at what level the caps should apply. If salary packaging benefits were no longer able to access the exemption or rebate then a lower rebate cap say $10,000 (that is indexed to inflation) could be provided to all tax exempt entities. As an alternative a tax free allowance to all employees of tax exempt employers (or a combination of lower rebate cap and tax free allowance) would be acceptable. This would ensure that NFPs that are competing for staff would be on a level playing field. A tax free allowance would promote the principles of fairness and simplicity advocated by the Working Group.

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

Please refer to the recommendation in our response to question 40 above.

42. 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?

We are of the view that all NFP's should receive FBT concessions (refer to our responses to questions 39 and 40 above).

CHAPTER 4 — GOODS AND SERVICES TAX CONCESSIONS

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

We consider that the current concessions should continue in order to reduce administrative burdens. In particular the GST-free concessions in Subdivision 38-G should be retained.

In addition, turnover thresholds should be regularly increased.

47. Would an opt-in arrangement result in a reduced compliance burden for charities that would otherwise need to apply apportionment rules to supplies made for nominal consideration?

Whilst an opt-in arrangement may be useful in some situations we would not anticipate too many clients taking up this opportunity. We consider the better option to reduce the compliance burden is to treat them all as GST-free supplies.

CHAPTER 5 — MUTUALITY, CLUBS AND SOCIETIES

50. Should the gaming, catering, entertainment and hospitality activities of NFP clubs and societies be subject to a concessional rate of tax, for income greater than a relatively high threshold, instead of being exempt?

The Government has previously announced that the unrelated commercial activities of NFPs are to be taxed from 1 July 2012. We refer you to our previous submissions on this issue. The vast majority of income from unrelated commercial activities of NFPs is applied towards a NFPs core altruistic purpose on an annual basis. Any income not applied on an annual basis is either retained as a buffer for bad years, working capital or accumulated to help fund long term capital works. Therefore, we are opposed to this measure as we believe that it will impose a significant unnecessary administrative burden on the NFP sector, it reduces a NFPs ability to provide improved facilities and it is unlikely to provide a significant net increase in tax for the Government.

We also note that whilst there are community concerns regarding gaming, smoking and alcohol consumption we do not believe that the income tax system is an appropriate instrument to bring about social change. There are many alternative and more effective options. We also note that gaming, smoking and alcohol taxes are already significant.

51. What would be a suitable threshold and rate of tax if such activities were to be subject to tax?

Whilst we are strongly opposed to any income tax on the NFP sector, if any income tax regime is introduced the impact would be felt most significantly by small clubs and societies (who are largely volunteer based). In addition they do not have the resources to administer any tax on their commercial activities.

52. Should the mutuality principle be extended to all NFP member-based organisations?

Whilst the mutuality principle and its related calculations are complex the current common law approach does work. We would definitely support the extension of the mutuality principle on the grounds of simplicity.

53. Should the mutuality principle be legislated to provide that all income from dealings between entities and their members is assessable?

We are opposed to taxing dealings between entities and their members. However, our greatest concern is regarding the tax exempt status of clubs. Determining whether a club or association is tax exempt is an art not a science. Currently, clubs and associations are required to self assess their eligibility and there are many shades of grey when trying to confirm the eligibility for tax exemption. Clubs have generally shied away from applying for private rulings as it is felt that the ATO is either inconsistent in their approach or they generally opt to protect the revenue when in doubt. It may be appropriate to provide clubs with automatic tax exemption where they meet the following criteria:

- Their member income (including income from memberships, gaming, food and beverage), sponsorship and investment income is greater than 50% of their total income; or

- Their total turnover is less than $6m (linked to inflation) (this is consistent with the small business CGT concession threshold).

Clubs that do not meet this threshold should be able to continue to access the mutuality principle.

54. Should a balancing adjustment be allowed for mutual clubs and societies to allow for mutual gains or mutual losses?

We would like to see further detail around this proposal prior to providing our view. It may have merit.

55. Is existing law adequate to address concerns about exploitation of the mutuality principle for tax evasion? Should a specific anti-avoidance rule be introduced to allow more effective action to be taken to address such concerns?

We are opposed to the introduction of an anti-avoidance rule. The current rules are sufficient. The main issues are around enforcement. Mandatory endorsement would overcome most issues. However, due to the size of the sector resourcing would be a significant issue. Therefore, a staged introduction of mandatory endorsement may be the appropriate approach potentially beginning with clubs or societies with more than $20m of turnover.