Tel: +61 7 3237 5999
Fax: +61 7 3221 9227
www.bdo.com.au

Level 18, 300 Queen St
Brisbane QLD 4000
GPO Box 457 Brisbane QLD 4001
Australia

By email: NFPReform@treasury.gov.au

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

17 December 2012

Dear Sir/Madam

DISCUSSION PAPER - NOT-FOR-PROFIT SECTOR TAX CONCESSION WORKING GROUP

BDO welcomes the opportunity to provide a submission on the discussion paper (Discussion Paper) released by the Not-for-profit Tax Concession Working Group for public consultation on 2 November 2012.

As explained and elaborated upon in the Appendix to this letter, we hold the following views in respect of the matters raised in the Discussion Paper:

- There should be no decrease in the entities which are income tax exempt or which have deductible gift recipient (DGR) status.
- Franking credits should continue to be refundable to tax exempt entities.
- The minimum donation for deductibility of donations to DGRs should remain at $2 and not be increased to $25. Most charities do not see the $2 donation threshold as an administrative burden.
- Full deductibility of donations to DGRs should be retained. Such deductibility should not be abandoned in favour of a tax offset at a lower rate than the maximum marginal tax rate.
- The existing Fringe Benefits Tax (FBT) concessions provided to not-for-profit entities should not be replaced with direct grants or alternative tax concessions. Instead, the thresholds for such FBT concessions should be adjusted upward by reference to the effects of inflation since their introduction and thereafter indexed annually for inflation.

Should you have any questions, or wish to discuss any of the comments made in this submission, please do not hesitate to contact Lance Cunningham on 02 9240 9736 or lance.cunningham@bdo.com.au or Matthew Wallace on 02 9240 9760 or matthew.wallace@bdo.com.au

Yours sincerely

Lance Cunningham
BDO National Tax Director

Matthew Wallace
BDO National Tax Counsel

APPENDIX

This document sets out the submissions of BDO in relation to the matters raised in the *Discussion Paper* (Discussion Paper) released for public consultation by the Not-for-profit Tax Concession Working Group on 2 November 2012.

1. Change in classes of entities with exempt status or DGR status

There should be no decrease in the entities which are tax exempt or which have deductible gift recipient (DGR) status.

Rather than further limiting the number of entities eligible for exempt or DGR status, more emphasis should be placed on the responsibility of ACNC to test that those with exempt or DGR status apply funds to relevant projects.

Services supplied by philanthropic institutions replace those that would have to otherwise be supplied by government.

Many activities undertaken by charities / tax exempt entities are not funded by government at any level. These activities can only be funded by the charities / tax exempt entities from accumulated reserves, sponsorships and fundraising.

A NFP can only source capital from borrowings and accumulated reserves. A NFP does not have a shareholder base that it can go to for capital. Whilst it can ask donors for support for a particular project, the lead time for these is usually substantial and the outcome uncertain.

If the tax exempt entity was required to pay income tax, this amount would diminish the amount of reserves retained and would immediately restrict the ability to deliver services. If the tax exempt entity was required to pay income tax, new services will be more difficult to implement and may not occur at all.

Income tax exempt status is obtained at the time of establishment. We understand that it will be part of the role of the ACNC to monitor the ongoing entitlement of an income tax exempt entity to continue to enjoy the income tax exemption.

The introduction of the ACNC will over time provide the regulatory structure for the Federal Government as the controller of the income tax legislation, to be satisfied that those who have access to the income tax exemption remain qualified to receive assess to that tax concession.

This process will protect the integrity of the tax concession.

2. Refunds of franking credits

Franking credits should continue to be refundable to tax exempt entities.

Tax exempt entities will from time to time have funds that are not required for the immediate day to day requirements of that entity. It is our understanding that tax exempt entities will commonly include equity investments in their investment of available funds.

Equity investments provide the opportunity of capital appreciation that is not available with fixed interest facilities.

We understand:

- This investment class is designed to provide a spread of asset class in accordance with advice from professional financial advisers.
- A material part of the return which influences the choice to make such investments is the refund of franking credits.

The refund of imputation credits is treated as part of the return when considering the balance of return and risk of equities compared to fixed interest.

If the right to a refund of the credits was removed, the attractiveness of equity investments vis-à-vis fixed interest investments would diminish and there could be a migration away from equity markets.

If tax exempt entities retain all of their available funds in fixed interest investments only, there is a risk that the purchasing power of those funds will be eroded. This would result in a lesser amount being available to the tax exempt entity to devote to is objects.

In addition, we understand that some tax exempt charities are able to fund their administration costs from returns on equity investments, including franking credit refunds. This allows those charities to use 100% of their donations for charitable works. This is a good promotion point to attract donors i.e. "100% of your donation will be used for the charitable work of the charity".

The Discussion Paper includes the statement that "NFPs that are entitled to refunds of franking credits are likely to be large, well-resourced NFPs". This statement fails to take into account the funds requirements that may be applicable to the particular NFP and its requirements for capital to maintain the services that it delivers. We suggest that the statement contained in the Discussion Paper at paragraph 25 does not take into account the prudent financial management required by NFPs to manage their limited resources and as a consequence is not justification for the withdrawal of access to the imputation credits.

3. Lifting the minimum donation for deductibility purposes from $2 to $25

The minimum donation for deductibility of donations to DGRs should remain at $2 and not be increased to $25.

Lifting the minimum donation from $2 to $25 would have a material detrimental effect on the total quantum of donations to DGRs.

Lifting the deduction threshold would also make a distinction between Division 30 deductions for donations and section 8-1 deductions for sponsorships – Charities may need to rely more on sponsorships.

The arguments in the Discussion Paper for increasing the minimum amount of deductible donations are not persuasive.

Anecdotal evidence indicates that a major factor in encouraging private and corporate donations is the ability to claim a deduction for that donation.

We consider an increase in the threshold of deductibility will provide a disincentive to individuals who cannot donate more than small amounts (as those donors will not be able to access the concession).

The $2 threshold allows contact between the DGR and people including those who are not able to donate large amounts. Many small donors become lifetime donors and go on to provide the DGR with considerable donations at a later date and bequests.

In addition, this connection also results in additional non-monetary support (such as providing support as a volunteer and supporting non-donation based fundraising).

Charities have indicated their concern that increasing the threshold to $25 may result in those people whose donation is below that threshold believing that the smaller donations (and their contributions) are not valued. This may, in turn, adversely affect the level of support (both in monetary and non-monetary terms) that DGRs enjoy from these individuals and communities.

Elsewhere in the Discussion Paper there is a question on how to encourage corporate support. In Queensland the Royal Flying Doctor Service (RFDS) has for many years enjoyed the support of Ergon Energy Limited which is the retail entity that supplies electricity to most of Queensland. Ergon offers its customers the opportunity to donate $5 per power bill to the RFDS. This support from Ergon has raised substantial funds for the RFDS. It is our understanding that the RFDS believes that raising the limit to $25 will place this source of donations at risk. We would submit that such a possible outcome would also apply to other similar arrangements

The discussion paper suggests exempting workplace giving from this limit. This exemption arises because each payslip deduction is a separate donation. However there are many other instances where regular individual donation amounts will be less than the $25 but the annual aggregate greater.

Many charities have invested considerable time and resources to establish regular giving programs where a person gives say $10 per month. These provide a degree of certainty to donation income which historically is fickle.

Each month's payment is a separate donation and below the threshold.

We anticipate that the person who currently donates $10 per month and is no longer able to claim this as a tax deduction will most likely cease the regular giving rather than increase the monthly donation or change to higher quarterly donations. For most people in balancing their personal budgets it is much easier to find of $10 per month than a single amount of $120.

If "regular giving programs" are to be afforded a similar treatment to the workplace giving there needs to be flexibility around what constitutes regular. We suggest that no pattern to the timing or the amount should still qualify for the collective donations from that person to be regular.

We understand most charities welcome the "administrative burden" suggested in the discussion paper as it provides the opportunity to connect with and remain in contact with the donor.

Whether or not the taxpayer chooses to claim the deduction should not be a factor in removing the availability of the deduction.

4. Change from deductibility of donations to tax offsets

Full deductibility of donations to DGRs should be retained. Such deductibility should not be abandoned in favour of a tax offset at a lower rate than the maximum marginal tax rate.

a) Deduction compared to tax offset

The arguments put forward for the replacement of the full deductibility of donations to DGRs and replacement thereof with a tax offset at rates of between 34% and 38%are unpersuasive.

The Discussion Paper acknowledges that those on higher income typically are more likely to donate. This is more likely to be attributable to the greater amounts that such individuals have for discretionary expenditure than the allegedly regressive nature of the applicable tax deduction. It would follow that the provision of tax relief at a lower rate than applicable marginal tax rates has the potential to materially decrease total donations to DGRs.

The DGR system is designed to elicit the largest donations from those with the most financial capacity to give. There is an overall objective of developing a culture of private philanthropy in Australia, particularly from wealthy individuals and companies. The rise of corporate charitable giving programs in the last 5 years, many of which match corporate to employee donations, is an example of the success of this initiative.

Donation and sponsorships – a dichotomy

The proposed replacement of tax deductibility with a tax offset at a lower than maximum marginal rate would also result in a dichotomy favouring sponsorship (deductible) over donations (lower level tax offset).

To be a donation the amount paid must be a gift with nothing in return other than a receipt and gratitude. For donations to be income tax deductible under the specific section of the income tax legislation they must gifts be to a DGR. Untied donations received by the DGR are not taxable supplies for GST purposes.

Businesses will often provide financial support in exchange for recognition of the amount that the business has provided. This is often seen in the form of donated raffle prizes, advertising support and similar. These amounts are not donations as there is an exchange of services.

For a business, these amounts are not claimed as a gift / donation under Division 35 but rather as an outgoing necessarily incurred in carrying on a business, and as such, deductible under Section 8-1. For GST purposes, the services exchanged are taxable supplies for a GST registered entity.

If a tax offset system is introduced it will introduce an inconsistency between the income tax treatment of a donation and that of a sponsorship. Under a fixed tax offset, a person in business who sponsors a DGR will obtain a different tax outcome to that which would apply if they gave a donation.

This does not meet the tests of equity or neutrality. It also introduces additional complexity.

The Discussion Paper in arguing that the current system is regressive assumes the deduction system gives a higher benefit to higher income earners than lower income earners. A better way of looking at this is that both higher and lower income earners receive the same benefit from a tax deduction for gifts i.e. not paying tax on amounts that they have given away. A rebate system with a rate of less than the highest marginal tax rate would disadvantage higher income earners as they would then be paying some tax on amounts that they have given away.

b) Clearing house

We support the concept of a clearing house

It is our understanding that the experience of DGRs from discussions with donors is that the donor selects the DGR through a personal experience and not as a consequence of a clinical search of a list of charities.

Donor management strategies include the goal for the charity to know the donor and to help the donor connect with the charity / DGR and its goals / activities. This process is designed to establish a long term relationship between the DGR and the donor. This is about establishing a donor lifetime value.

5. Fringe Benefits Tax

The existing Fringe Benefits Tax (FBT) concessions provided to not-for-profit entities (NFPs) should not be replaced with direct grants or alternative tax concessions. Instead, the thresholds for such FBT concessions should be adjusted upward by reference to the effects of inflation since their introduction and thereafter indexed annually for inflation.

a) FBT concession - retention in general

The current FBT concessions provided to NFPs facilitate the recruitment and retention of staff by such NFPs, particularly when competing for such staff against other sectors of the economy. Without these concessions the NFPs could not provide the same level of service to the Australian community and/or would require further funding from Government.

In relation to reportable fringe benefits the calculation for the employer, NFP or profit-making, is identical between the two and so produces the same number for an employee irrespective of the tax status of the employer.

The reportable fringe benefits system incorporates a new measure of income, Adjusted Taxable Income, which calculation includes:

- Taxable income
- Investment losses on real estate and investments
- Reportable superannuation contributions
- Reportable fringe benefits

The adjusted taxable income is the income definition used to test a person's entitlement to Centrelink benefits such as Family tax Benefit, Private Health Insurance Rebate, Superannuation higher rates on contribution, Child Support

As a consequence of the use of the extended definition, an employee cannot convert salary to a non-taxable fringe benefit and thereby gain access to entitlements that they would not have otherwise accessed

b) Replacement of FBT concession with direct support

The FBT concessions are available to qualifying charities with a statutory cap. The list of those to whom the concession is available is controlled, ensuring that the concession is only available to those employer organisations that benefit the community.

The FBT concessions are used by those organisations to reduce their cost of employment. The applied saving from the FBT is applied across all of a charity's activities – whether funded under current Federal / State funding agreements or from the accumulated reserves / income generated by the charity.

The message from State and Federal Governments is that there are very limited funds available.

In addition the regular message from government is that the charities should be looking to develop their own funding and not be totally reliant on government support. This suggestion is further weakening this approach and increasing direct reliance.

The replacement of such concessions with direct grants would raise a material risk that such grants would be later withdrawn or otherwise limited.

c) Replacement of FBT concession with an alternative offset

The suggestion raised by Q40 implies introducing a new suite of taxation rules that apply to only to NFP's or those who work for NFP's.

This suggestion raises many questions:

- This would introduce a new set of tax rules that mean that the legislation that applies to for profit entities is different to the NFP; at the moment there is one FBT legislation that calculates the taxable fringe benefits irrespective of the employer; NFP's then apply the per employee threshold to determine the actual FBT payable; the manner of recording the reportable fringe benefits to show on the payment summaries and be used in the determination of the individuals' Adjusted taxable income is the same between the for profit and the NFP sectors.

- This would also introduce complexities for individuals who work on a part time or casual basis for both for profits and NFP's as to how to determine the employee component.

- If a benefit is passed to the employee through the tax system, there would need to be an integrity measure to ensure that the proportion of income through a NFP was commensurate with being entitled to accessing the employee concession.

- If a benefit is passed direct to the employee through the tax system, the employee is obtaining the benefit from the NFP sector rather than from his / her employer which would be unique to the tax system.

To introduce a system of refundable tax offsets to employers, a direct tax offset to the employees or a tax free allowance for employees would create substantial new complexity and administration, none of which is warranted

d) Salary sacrificed meal entertainment

The salary sacrificed meal entertainment and entertainment facility leasing benefits were identified as issues in the October 2011 tax forum.

Both arise through salary sacrifice arrangements, so the employee must forego salary to obtain these benefits.

The issue revolves around the fact that entertainment (as defined in the income tax legislation to include recreation) as such, is not a reportable fringe benefit.

We consider that it is appropriate that <u>salary sacrificed</u> meal entertainment and entertainment facility leasing benefits are brought within the cap and are reportable.

We also submit that it is important to exclude work related entertainment. Employees will incur entertainment expenses as part of their duties and this entertainment should be excluded from the cap and not be reportable. Only that expenditure that is part of the salary sacrifice arrangements should be within the FBT calculations.

Similar rules should apply to other items such as accommodation.

e) FBT Minor benefits

The exemption for minor benefits is designed to assist in the management and the administration of the FBT system and should have the same rules between a for-profit and a NFP.

Otherwise there is confusion and increased complexity by introducing two sets of rules on how to calculate the taxable fringe benefits and the FBT area of taxation law is already very complex.

If such a rule was introduced, it would address neutrality and equity issues, where NFP's are currently penalised.

f) Caps

The current FBT legislation places no limit on the number of times an employee can access the FBT cap available to selected NFPs. This can provide an advantage to some individuals within the NFP sector over others in certain circumstances including:

- An individual employee of one NFP who is at the same time an employee of another NFP and is therefore able to access the limit on more than one occasion;

- An individual employee who leaves the employ of one NFP to take up employment with another NFP in the same FBT year thereby accessing the concession a second time in the same FBT year.

We consider that it would be appropriate that the concession be limited to one per person per annum. This could be achieved by employers with part year employees having to do a pro-rata calculation of the cap for each of these employees for the period they are in their employment. This should not require much additional administrative time to calculate.

We don't support the proposal in the paper to limit the concessional cap to the first employer where the employer has more than one employer in an FBT year, unless the system allowed the maximum available cap for the employers of that person during the course of that year.

By way of example if a person worked for a state hospital for 6 months where the cap is $17,000 and six months for a public benevolent institution (PBI) where the cap is $30,000, the cap adopted should reflect the higher cap that the person has for part of that year.

We can see the limiting of the cap to only one employer would be administratively difficult and therefore our preference is for employers with part year employees to do a pro-rata calculation of the cap for these employees.

Conclusion re FBT

It is conceded that there have been some uses of FBT concessions involving meal cards and entertainment leasing facilities that whilst they are within the current law, may not be within the spirit of the concessions. However these issues can be easily dealt with by minor amendments to the FBT law.

Lack of indexation of the upper limits of the concessions has meant that their positive impact has materially diminished over time. There is, accordingly, an argument for upward adjustment to reflect diminished value compared to when first introduced and indexation thereafter. –