



**Response by EPIC Employment Service Inc
to Not-for-Profit Reform Council Tax
Concession Working Group Discussion Paper**

17 December 2012

EXECUTIVE SUMMARY

EPIC is a leading charity in the area of employment services, which serves the most disadvantaged in our community. Our submission mainly concerns the review of FBT concessions. Charities serve niche needs in our Australian society and economy, and we operate for the public benefit, not corporate nor personal profit. As an independent and altruistically motivated sector charities are both a valuable voice for social wellbeing and social inclusion, and an ideal vehicle for addressing social issues and social concerns.

Historically, governments have recognised this unique contribution through financial support, both direct and indirect. This is both because charities deserve recognition for their good work and because charities alleviate the burden on government to provide for its citizens.

The FBT system was introduced to prevent tax evasion, so abuse of the system has been a problem. In our experience, however, it is not widespread. As the Productivity Commission found in 2010, FBT concessions are also not a competitive neutrality problem outside the hospital sector. FBT concessions allow the sector to compete for the quality staff we need, which we would otherwise struggle to attract due to less flexible access to funds than the for-profit and government sectors. Government bodies should not be eligible for FBT concessions as they lack the altruism characterising the NFP sector. Commercial operators also have no place in NFP tax concession discussions as they are recent entrants to what has been a purely charitable sphere.

Regardless of other decisions about the future of FBT concessions, the concessional caps should be indexed as promised in 2001. EPIC supports bringing the uncapped meal and entertainment benefits under these caps, so long as a commensurate amount is added to the cap to compensate.

Direct funding is not the answer to the ills experienced with FBT. The Henry Review argued FBT concessions should be replaced for competition reasons, in our view these are flawed. Efficiency arguments are also misplaced as indirect support costs less to provide and administer. EPIC does not support direct payments to charities themselves as this will encourage in-house politics rather than freedom of allocation.

A better alternative would be creating an added 'bonus' tax free threshold for the employees of PBIs and income tax exempt charities. Disproportionate benefit to higher-earning employees may result, but this is required in any replacement for FBT concessions if our sector's ability to compete for high quality staff is to be maintained.

If FBT exemptions are to be abolished entirely, EPIC agrees that alternative support would be required in exchange. Loss or reduction of the FBT exemption would severely impact EPIC's ability to maintain current service levels. Without the support to compete with private sector salaries, we will have to reduce salaries or reduce service. Either choice will negatively affect our disadvantaged clients.

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INTRODUCTION

EPIC Employment Service Inc ('EPIC') thanks the Not-for-Profit Sector Tax Concession Working Group ('the Working Group') for its generally inclusive approach to the reforms it is pursuing in the not-for-profit area, and its return to the principles set out in *Australia's Future Tax System* ('the Henry Review').

EPIC Employment Service Inc

EPIC is a leading charity in the area of employment services, growing from a small group started by university staff and students in the 1980s to the largest disability employment services provider in Queensland, with over 9 000 clients assisted in the past financial year. This is our response to the reality that in Australia, "having a disability makes and keeps people poor".¹

EPIC operates 32 regional offices and over 300 staff spread throughout Queensland and northern New South Wales.

Our clients are drawn from groups suffering systemic disadvantage or discrimination: those with physical, psychological or intellectual disabilities; those living in poverty; the poorly educated; the socially isolated; refugees; ethnic minorities; and those recovering from major injury or illness.

EPIC programs include:

- Employment support services, assisting people with disabilities to find and maintain employment in the mainstream labour market;
- Job Services Australia programs;
- Rehabilitation and disability management programs;
- Home based Telecentre enterprise; and
- Group mentoring of disadvantaged youth through schools.

We believe that it is our compassionate care for our staff and our clients that has driven our success. EPIC's commitment to inclusive practices extends to our corporate governance, with a client representative being part of our management committee.

EPIC is a Public Benevolent Institution (PBI) currently endorsed by the Australian Taxation Office as a Deductible Gift Recipient (DGR), income tax exempt charity (ITEC), concessional treatment for Goods and Services Tax (GST) and exemption from Fringe Benefits Tax (FBT).

Further information about EPIC is available from our website, www.epic.org.au.

¹ The Hon Bill Shorten MP, *Opening Address to National Disability and Carers Congress* (2 May 2011), speech delivered at the National Disability and Carers Congress, Etihad Stadium, Melbourne. Transcript available at <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2011/015.htm&pageID=005&min=brs&Year=2011&DocType=1>.

Overview

Charities provide essential social infrastructure and services to our society, often at lower cost than would be possible for government. Charities like EPIC, which exist to empower the most vulnerable Australians, are especially vital to the community.

Central to our ability to provide these services is the ability to employ enough properly qualified and experienced staff. A key element in being able to do so is FBT concessions, which allow us to compete with the private and government sectors.

If FBT concessions are to be abolished entirely, EPIC agrees that alternative support would be required in exchange. Loss or reduction of the FBT exemption would severely impact EPIC's ability to maintain current service levels. Without the support to compete with private sector salaries, we will have to reduce salaries or reduce service.

We will firstly address the core principles behind offering tax concessions to PBIs and charities, and why this has historically been done through the taxation system. We will then discuss the importance of FBT concessions to the sector, and why the concerns raised in the Discussion Paper and earlier government inquiries have been overstated.

EPIC's answers to the short-term reform options follow, along with a few additional suggestions for improving the current regime. We conclude with a discussion of the reasoning behind the common argument that FBT concessions need to be abolished, and our response to this idea.

This submission will focus on the issues surrounding FBT concessions. GST issues and mutuality issues are not relevant to EPIC; the consultation questions of income tax concession and DGR status are not targeted towards organisations like EPIC which serve the most vulnerable members of our community.

RATIONALE FOR PROVIDING TAX CONCESSIONS TO CHARITIES

Before addressing the substantive proposals in the Discussion Paper, EPIC would like to address Guiding Principles 1 and 2 as set out on page 6 of the Paper.

Charities make a unique and irreplaceable contribution to social wellbeing

As recognised in the Preamble to the *Australian Charities and Not-for-Profits Commission Act 2012*, “Not-for-profit entities promote a broad range of community, altruistic and philanthropic purposes. The not-for-profit sector delivers vital services and benefits to communities throughout Australia.”²

Charities have a unique role in the Australian community and economy. Some people are not able, whether for economic or other reasons, to access mainstream services and employment. Private businesses must charge for their services in order to provide an income for their owners, and are not in a position to give ongoing special treatment to the needy. While government exists to provide public goods, its role is a product of law and social contract. Australia’s democratic political system often requires governments to obey majority opinions and serve majority concerns. Those who are most vulnerable, however, are rarely part of this majority. It is well recognised that it falls to charities to care for minority concerns.³

Charitable activity is, by definition, voluntary. It is done to benefit others, not for personal gain. Charities often rely on volunteers, and gifts from the public, to continue delivering their services. As an independent and altruistically motivated sector, charities are both a valuable voice for social wellbeing and social inclusion, and an ideal vehicle for addressing social issues and social concerns.

Under the law of charity in Australia, in order to be classified as a ‘charity’, an organisation must pursue a charitable purpose, and it must also provide benefit to the public, or a section of the public.⁴

Government support for charity is deserved, necessary and good policy

a) Service delivery

² *Australian Charities and Not-for-Profits Commission Act 2012* (Cth).

³ See Estelle James, 'The Public/Private Division of Responsibility for Education: An International Comparison' (1987) 6 *Economics of Education Review*, pp 1-4; Martti Muukkonen, *The Familiar Unknown - Introduction to Third Sector Theories* (Licentiate Thesis, University of Joensuu, 2000) pp 102-103; Burton A Weisbrod, 'Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy' in Burton A Weisbrod (ed), *The Voluntary Nonprofit Sector* (1977) pp 51, 75.

⁴ Australian Taxation Office, *Income tax guide for non-profit organisations* (2007) pp 31-48.

Governments throughout the world have acknowledged, and continue to acknowledge, the contribution of the charitable sector through both direct and indirect financial support.

The efficiencies of providing services through not-for-profits (NFPs), due to their 'unique relationship with the community',⁵ has long been recognised, leading in Australia and elsewhere to unprecedented levels of service delivery through organisations like EPIC.

Currently, EPIC receives \$22 million to deliver three programs on behalf of the Commonwealth Department of Education, Employment and Workplace Relations. In fact, EPIC has continued to attract increasing amounts of responsibility and government funding since its inception in the 1980s. In latter years, this has been in an environment of competition with for-profit providers.

Our expertise and ethic of care enables us to help our clients achieve their employment goals in a more efficient and sensitive manner than would be possible for government directly. We are consistently chosen in tenders for government contracts for our excellence in service delivery, despite offering less lucrative remuneration than our competitors.

b) Provision of public good

As well as providing direct benefit to disadvantaged people by increasing their employability, self-confidence and economic situation, charities like EPIC also indirectly benefit the general public. The increased economic participation of disadvantaged groups and people with disabilities in mainstream employment promotes positive social diversity and reduces welfare dependence.

Australian governments' support for charities' contribution to the public good in alleviating their own responsibilities dates from the earliest days of colonial legislation.⁶ This is in recognition of the role charity plays in supporting social infrastructure and meeting needs that are outside either the financial or legal capacity of government, but nonetheless are complementary to government activity. Victorian MP JM Davies explained this reasoning in his speech introducing Australia's first legislation for tax-deductibility for charitable donations: '...although the State would lose revenue in one direction the encouragement afforded to charitable giving would probably make up the loss.'⁷

Tax concessions as a form of support

Use of the taxation system to recognise and support charities has also been an integral part of the Australian legislative history from the first income tax Acts, which excluded

⁵ Commonwealth Government, *Australia's Future Tax System: Final Report* (2009) Part 2 Vol 2 p 206.

⁶ Ann O'Connell, 'Charitable Treatment? – A (Potted) History Of The Taxation of Charities In Australia' Conference Paper presented at July 2010 Tax History Conference, Centre for Tax Law, University of Cambridge, pp 2-4, 8.

⁷ Victoria, *Parliamentary Debates*, Legislative Council, 2 October 1907, 1356–1357; cited in O'Connell, above n 6.

entities not operating for profit.⁸ As types of taxation have proliferated, so have charities' tax concessions; the rationale, however, for providing exemptions, concessions and deductions, remains the same. Charitable bodies, especially 'benevolent institutions', the forerunners of organisations like EPIC, have enjoyed exemptions from numerous taxes from the beginning of Australian taxation, in recognition of their contribution to public good.⁹

In the last two decades, an additional reason for providing tax concessions is the increasingly common provision of government services by community organisations and PBIs like EPIC. This is because of the well-known 'efficiency dividend' obtained by government when it outsources services to non-government organisations with existing volunteers and community networks created as part of their mission to serve.¹⁰

Disability services in particular, a large part of EPIC's operations, are 'the responsibility of state and territory governments', while the Commonwealth government funds income support and employment services.¹¹ Government funds this area because it is a public responsibility to care for those in our community suffering disadvantage through no fault of their own.

The sector is severely underfunded,¹² which is one reason the Commonwealth Government is pursuing the National Disability Insurance Scheme reforms. The annual shortfall of \$6.5 billion is filled, so far as is possible, by charitable contributions from ordinary Australians, charging fees for services and other 'business' strategies, and wise management of resources.¹³

Avoiding the transaction costs of collecting money from those who will ultimately benefit from its distribution is an old idea which we now call 'churn'. It is more efficient to provide tax concessions than to collect tax in full, only to send it back to the organisation in grants and contracts funding.

Also, similar to the 'dividend' obtained by government when services are provided by a community organisation rather than the state itself, organisations enjoying tax exemptions or concessions are able to multiply the face value of the concession. A concrete example of this is given in the discussion below on long-term reform options.

Reform which is costly in time, resources and compliance adjustments but does not deliver meaningful added value to the community is of negligible benefit. Accordingly, any policy choice to remove tax support for charities must be carefully weighed and carefully costed. We note that, as pointed out by the Productivity Commission in its 2010 report, *Contribution of the Not-for-Profit Sector*, the intangible benefits that charities provide to

⁸ O'Connell, above n 6, pp 2-4, 8.

⁹ Commonwealth Government above n 5, 206; O'Connell, above n 6 pp 2-4, 8; Productivity Commission, *Contribution of the Not-for-profit Sector* (January 2010) Research Report, p 25.

¹⁰ Commonwealth Government above n 5, p 206.

¹¹ Council of Australian Governments *National Disability Insurance Scheme: Consultation Regulation Impact Statement* (December 2012), available at <http://www.coag.gov.au/node/476>, p 14.

¹² Ibid p 26.

¹³ Ibid pp 10-11.

their beneficiaries and also to wider society are difficult to quantify.¹⁴ This should be remembered in assessing Treasury and Australian Taxation Office modelling.

We now turn to the concerns raised about Fringe Benefits Tax (FBT) concessions in the Discussion Paper.

FRINGE BENEFITS TAX CONCESSIONS AND EXEMPTIONS

A. GENERAL ISSUES

In the Discussion Paper, the Working Group raises a number of concerns about FBT concessions which have been circulating for some years: abuse of the benefit, competitive neutrality, inequitable access and the generally complicated nature of the concessions.¹⁵

EPIC agrees that there are elements of the current regime which are flawed and in need of reform. It does not, however, concede to either the extent or the relevance of a number of concerns raised by the Discussion Paper. We will address each concern in the order they appear in the Paper.

It will be helpful though to first address a common misconception in relation to competitive neutrality and the benefits gained by the sector from FBT concessions. Erroneous assumptions about the nature of FBT concessions and benefits conferred to the sector are a key factor in the general public unease in this area.

Importance of FBT exemptions to the sector

The FBT concessions are of vital importance to charities like EPIC in enabling us to provide quality and reliable services to those most in need in Australian society. As stated above, EPIC is currently exempt from paying FBT. This is due to its status as a PBI.

EPIC considers that the public perception of FBT arrangements, particularly for PBIs, is often unfairly negative. It is common for FBT concessions to be viewed as some kind of barely-legal, government sanctioned tax evasion scheme. Even among our employees, it is not unusual for their first questions about salary packaging to involve fears of owing a debt to the ATO. Given the highly complicated nature of the tax and the linked exemptions and concessions, it is not surprising that the average layperson struggles to understand the true nature of FBT.

¹⁴ Productivity Commission above n 9, p 100.

¹⁵ Not-for-Profit Sector Tax Concession Working Group, *Fairer, simpler and more effective tax concessions for the not-for-profit sector* (November 2012) Discussion Paper pp 34-38.

In reality, the FBT system was introduced precisely to *prevent* tax evasion caused by employers and employees agreeing on significant non-salary benefits which were not caught by the existing personal income tax provisions.¹⁶ While EPIC employees and those of other PBIs and charities may enjoy FBT concessions or exemptions, this does not relieve them of the responsibility to monitor, report and pay tax on fringe benefits that do not fall under the exemption or concession. FBT raises more revenue for the government than was ever envisaged by the original policy.¹⁷

These beliefs about the nature of FBT concessions are linked to another set of incorrect assumptions about the real benefit obtained by NFP and charity employees from accessing FBT concessions. At paragraph 139 of the Discussion Paper, the Working Group states that:

Entities entitled to the exemption have a competitive advantage over for-profit organisations in hiring and retaining staff and also over other NFP entities that are not eligible for the exemption.¹⁸

EPIC strongly disagrees with this assessment, especially so far as it applies to PBIs. In EPIC's experience, it is simply not true that FBT arrangements allow charities and NFPs to 'out-bid' for-profit operators. Commercial businesses almost invariably offer higher salaries and more generous packages than the not-for-profit sector, even when FBT exemptions are available.

EPIC considers that this is connected to the freedom of for-profits to access business financing and run business models which maximise profits, and therefore funds available to pay staff. NFPs must assess all actions in light of their mission to benefit the community. This requires us to choose the wellbeing of our clients over higher pay for our staff. Where funds are available, EPIC prefers to invest in our mission: enabling people to access support, counselling, employment and training to achieve social and economic participation in their community.

It is this client and community focus that draws people to work in the NFP sector. Our 'competitive advantage' is not FBT concessions but charities' and NFPs' altruistic motivations and commitment to caring for the person.

This was precisely the conclusion of the Productivity Commission following its investigation of this issue in 2010. The Commission found that workers choose the sector for its emotional rather than financial rewards.¹⁹ Most NFP employees would work more hours if there was money to pay them for their work.²⁰

¹⁶ KPMG, '20 Years of FBT: 20 year anniversary of the Fringe Benefits Tax' (July 2006) p 1, available at <http://www.kpmg.com.au/Portals/0/20FBT.pdf>; Myles McGregor-Lowndes, 'The 1998 tax reform proposal: fringe benefits tax and non-profit organisations' (1998) Working Paper, p 13, available at <http://eprints.qut.edu.au/53424/2/53424.pdf>.

¹⁷ KPMG, above n 16, pp 2-4; Max Newnham, 'Why the fringe benefits tax system needs a haircut' *Sydney Morning Herald* (July 27 2009), available at <http://www.smh.com.au/small-business/managing/why-the-fringe-benefits-tax-system-needs-a-haircut-20090727-dy0e.html>.

¹⁸ Not-for-Profit Sector Tax Concession Working Group above n 15.

¹⁹ Productivity Commission above n 9, p 262.

²⁰ *Ibid* 264.

Importantly, where NFPs and charities compete more equitably on wages with the other sectors, it is FBT exemptions and concessions which allow them to do so. While it does not bridge the gap entirely, the concessions enable EPIC and organisations like it to offer remuneration which is competitive, though still not commensurate. The Productivity Commission stated that “even when FBT exemptions are considered, wages in the community sector are still considerably lower than equivalent positions in the public sector.”²¹

Furthermore, while government contract funding for services includes a sum for staff salaries, it rarely provides the full cost of employing the staff. Even where the initial funding amount does cover staffing costs for the funded services, grants are not indexed as a general rule. This means that over time, with the need to increase staff salaries to maintain their real value in line with inflation, there is an increasing shortfall between funding and salary costs. For example, EPIC currently has government contracts which will run for five years from 2013 to 2018 with no indexation.

In summary, staff choose EPIC and the NFP sector more broadly because they want to join in making a positive contribution to public welfare, not because they will be financially better off. However, they can afford to make this choice in part because of FBT exemptions and concessions which bolster their salaries.

Inconsistency of treatment and eligibility for the concessions

In EPIC’s view, exemptions and concessions available to charities should not have been extended to non-charitable government bodies and public institutions. This is because the core reason for providing tax support for a charity is absent in the case of government.

Whereas charities and NFPs are born of and sustained by the desire to help others, government activities for the public good are backed by the power of the state.²² Government extracts funds from citizens through taxation to deliver its public goods. It does not need to give itself and its constituent arms tax concessions in order to continue in its mission, as it has the power to do as it pleases. FBT concessions should not be available to state-owned bodies and public hospitals.

If government wishes to give itself tax concessions for efficiency reasons, it is able to do so by creating a new category of exemption. EPIC suggests that inclusion of government activity in the existing concession category for charity and not-for-profit was logically inconsistent, and public hospitals and other government activities should be removed.

EPIC also submits that exemptions and concessions should properly be available only to recognised charities. As explained above in relation to the rationale for providing charities

²¹ Ibid.

²² Matthew Turnour, *Beyond Charity: Outline of a Jurisprudence for Civil Society* (2009) PhD Thesis pp 358-59.

with tax concessions, charities have already been required to demonstrate that they exist for public benefit. Given that the purpose of tax concessions to the sector generally is to support provision of public benefit by non-government bodies,²³ organisations which are unable to demonstrate charitable purpose and public benefit to the Australian Charities and Not-for-profits Commission (ACNC) should not be eligible for FBT exemptions and rebates.

While PBIs as a category receive the greatest quantity of FBT concessions, at \$1.3 billion annually,²⁴ this is only proper. Organisations qualifying as PBIs have had to prove that they exist to serve the most vulnerable members of our society.

Concerns about the cost of providing FBT exemption to PBIs cannot be accurately assessed in a vacuum. Reallocating \$1.3+ billion in government 'expenditure' is an attractive proposition only until the collateral cost to Australia's most needy is considered. We direct the Working Group to the recent comments by Commonwealth Human Services Minister Kim Carr made at the Menzies Centre for Australian Studies at Kings College in London: "Our obligations to the vulnerable and the disadvantaged do not evaporate when times are hard; they increase."²⁵

Competitive neutrality

a) Non-issue for majority of the sector

The Discussion Paper states at paragraph 139 that FBT exemptions may pose a competitive neutrality problem. For the reasons set out above, EPIC submits that the extent of this issue is vastly overstated.

Accordingly, EPIC cannot agree with the conclusions of the Henry Review when it asserted that NFPs 'can afford to pay the market wage at a lower cost' due to FBT concessions.²⁶

EPIC considers that the Productivity Commission findings on this issue were the product of more focused research, and therefore are a better source of guidance on this policy issue.²⁷ The Commission found that FBT concessions were not a competitive neutrality issue with regard to the sector as a whole. The notable exception to this was the same area singled out for attention by the Henry Review: public and NFP hospitals.²⁸ These

²³ Commonwealth Government above n 5, p 206.

²⁴ This is the figure quoted by the Discussion Paper at [127].

²⁵ The Hon Kim Carr MP, *The Politics of Austerity* (4 December 2012), speech delivered at the Menzies Centre for Australian Studies, Kings College London. Transcript available at http://www.mhs.gov.au/media/speeches_and_transcripts/2012/12/4_dec_2012_-_the_politics_of_austerity.php.

²⁶ Commonwealth Government above n 5, p 210.

²⁷ The Henry Review does not cite any evidence in support of its short conclusions on FBT – this in the 'Detailed Analysis'.

²⁸ Commonwealth Government above n 5, pp 210 - 11; Productivity Commission above n 9, p xxxi.

hospitals provide the same services under the same funding structure as commercial hospitals, but have access to significant FBT benefits.²⁹

We reiterate our concern at government bodies being able to access the benefits intended for voluntary organisations. It would seem that extension to public hospitals in particular has not proved to be a profitable experiment.

EPIC supports removing the FBT concessions for public hospitals, and for all other non-charitable bodies. The question of NFP hospitals is more complex, and it may be that there are good reasons for their retaining the concession. EPIC does not comment any further on that question. We wish to emphasise though that the vast majority of the sector is not a site of market distortion through using FBT concessions.

Periodic calls for reform can be traced to the core issue of NFPs having access to sufficient resources to carry out their work. For example, in 1995 the Industry Commission called for FBT exemptions to be abolished entirely, as packaging by NFPs was considered to have gone 'too far' in terms of the level of fringe benefits provided.³⁰ This behaviour was "largely driven by non-profit organisations finding that their funds from government [were] decreasing and their mission increasing through government withdrawal of public services."³¹ This is why the Industry Commission also recommended that government grants be increased to make up the shortfall.³²

It follows that if there is to be change to the FBT arrangements to limit 'roorting', the reform should be targeted at the locus of the problem, not the charity or PBI sector.

EPIC would also point out that FBT was originally linked to employers, rather than employees as in other countries,³³ due to a government desire for ease of enforcement. There being less employers than employees, it was decided that employers would be simpler to tax.³⁴ According to Professor Myles McGregor-Lowndes:

It is important to note that the policy that drove FBT to a technically impure option was the efficiency of tax collection, if this option had not been chosen, then no corrective exemptions or rebates would have been necessary for nonprofit organisations.³⁵

b) 'Market' model not applicable to PBIs

In any event, even if it were found that FBT concessions were 'distorting' the 'market' for charitable NFP services, EPIC would argue that this is not relevant in the case of PBIs. This is because, by definition, there is no 'market' for the provision of charitable services by PBIs. As recognised by the Council of Australian Governments Regulatory Impact

²⁹ Productivity Commission above n 9, pp xxxi, 197, 212, 216.

³⁰ McGregor Lowndes above n 16, p 15.

³¹ Ibid.

³² Ibid.

³³ Neil Warren, *Fringe benefit tax design: decision time* (March 2006), policy paper prepared for the Institute of Chartered Accountants in Australia, p 5.

³⁴ McGregor-Lowndes above n 16 p 1.

³⁵ McGregor-Lowndes above n 16, p 2.

Statement for the National Disability Insurance Scheme, high input costs can make it impossible to sustainably provide disability services;³⁶ our clients usually cannot afford to pay even half of a 'fair' price for what they receive.

Charities operate for the good of the community, not for profit. Charities did so before government funding of the sector, and before making money from providing government-funded services was a commercially viable proposition. Charities will continue to do so long after a for-profit business would abandon the field. That is why about 86% of non-government disability service providers, as an example, are charities.³⁷

Therefore, complaints about 'unfair advantages' from commercial operators are not only usually false, they are entirely inappropriate.

We again point to the findings of the Productivity Commission:

...concessions are an important and reliable source of support for many NFPs, especially to attract and retain staff. Most of these NFPs do not compete directly with for-profit businesses, and for the few that do, they tend to be delivering government services.³⁸

Put bluntly, disability services is a charity space, which for-profits have only thought to enter in more recent years, hoping to secure a slice of government funding. The FBT and other concessions existed before commercial operators entered the sector. They cannot now protest that the rules of the game are unfair.

Use of concessions outside initial policy intent

Any system, regardless of its design, will be vulnerable to those who seek to exploit any available loophole for personal profit. As a charity dedicated to the ethical and effective use of resources for the maximum benefit of our clients, EPIC considers abuses of the FBT system to be wrong. In fact, EPIC voluntarily imposes a limit of \$450 per fortnight per staff member in meal entertainment and entertainment facility benefits.

Again, EPIC would suggest that our practices are more representative of the sector, and especially PBIs, than the incidents described at paragraph 147 in the Discussion Paper and in the *Contribution of the Not-for-Profit Sector* report.³⁹ Stories such as these are memorable for their egregiousness, but in our submission are limited to the uncapped allowances for meal entertainment and entertainment facilities.

The most common use of fringe benefits in our sector is for a car.⁴⁰ This is also the case in our organisation. In line with the EPIC philosophy of ethics, a staff member must require a vehicle to carry out their work before EPIC will consider the staff member eligible to

³⁶ Council of Australian Governments above n 11, p 38.

³⁷ Ibid p 10.

³⁸ Productivity Commission above n 9, p xxxi.

³⁹ Productivity Commission above n 9, p 215.

⁴⁰ Diane Kraal, P.W. Senarath Yapa, Dianne Harvey 'The impact of Australia's Fringe Benefits Tax for cars on petrol consumption and greenhouse emissions' (2008) 23 *Australian Tax Forum* pp 191 – 223, p 193.

access a company car. EPIC cars are only available to staff who need to visit or transport clients, or drive between regional offices.

Only one model of car is available to staff who choose to access an EPIC vehicle, other than ten senior managers. These senior managers are restricted to a choice of three cars, none of which are luxury vehicles. EPIC prefers to conserve the money spent in this area so that the maximum amount of resources can be devoted to client services.

Vehicles are vital to good client service, so EPIC pays the running, servicing and fuel costs of our cars, but employees must contribute a fixed amount of their after-tax income to these costs. Access to this basic company car is also highly beneficial to our staff. Company cars are especially valuable to our lower paid employees, who comprise the majority of our staff, and might find it difficult to access reasonably priced finance privately.

EPIC values its ability to access the FBT exemption and provide its staff with up to \$30 000 in tax-free fringe benefits. We consider the quality of our staff to be very important in providing excellent service to our clients. In a business environment where we now compete with for-profit entrants to the field, the ability to provide a comparable salary and benefits package is a key factor in recruiting and retaining the quality staff that our clients deserve.

Tax concessions are a more flexible way to achieve this outcome than updating award rates, though the need for better funding of staff salaries has been recognised at both a federal and state level in recent years.⁴¹

If FBT exemptions are to be abolished entirely, EPIC agrees that alternative support would be required in exchange. Loss or reduction of the FBT exemption would severely impact EPIC's ability to maintain current service levels. Without the support to compete with private sector salaries, we will have to reduce salaries or reduce service. Either choice will negatively affect our disadvantaged clients.

Administrative burden

It has not been EPIC's experience that administering the FBT concessions is overwhelmingly difficult. We acknowledge that this is now because we outsource FBT packaging to an external provider. If employees wish to access FBT benefits, they pay a nominal sum to cover the cost of the third party's services.

In our view, this arrangement works well. Compliance costs are therefore not a compelling reason for changing the current system.

⁴¹ *Queensland Services, Industrial Union of Employees and Queensland Chamber of Commerce and Industry Limited, Industrial Organisation of Employers and Others (A/2008/5)* Decision of the Queensland Industrial Commission; *Equal Remuneration Case [2012] FWA FB 1000*.

Inequitable access

It is suggested at paragraphs 141 and 142 of the Discussion Paper that access to FBT packaging is inequitable for staff, both in terms of who accesses it and the benefits available for different staff.

We estimate that about 50% of EPIC staff access a salary packaging option, but at the management level this is closer to 90-100%. Our assessment would be that 2/3 of staff in the sector generally would be accessing salary packaging.

In EPIC's view, this phenomenon is not due to disproportionately favourable results for staff on higher incomes. FBT is complex and difficult to understand. In EPIC's experience, few staff feel able to accurately assess for themselves the advantages and disadvantages of accessing FBT packaging. We find that many of our staff are concerned about misunderstanding the FBT rules and inadvertently committing a costly error. EPIC always recommends that staff seek independent financial advice before making a choice about FBT exemption options. In practice, many staff do not do so.

Senior staff are typically more confident in this area due to their added experience, expertise and existing connections to independent financial advice. We believe this accounts for the higher levels of takeup by higher income earners.

EPIC cannot be expected to exhaustively explain FBT to each individual staff member in a way tailored to their personal circumstances. We would consider it irresponsible to do so, as it is not an area of expertise for us, and would consume valuable staff time which could be spent on client work. We do provide an overview of FBT at induction, and at the end of initial probation. We also arrange for our external FBT administration provider to visit regularly to provide more detailed information and advice to any interested staff.

SHORT TERM REFORM OPTIONS

Additional suggested changes

There are issues with the existing FBT concession structure which were not raised in Part A of the consultation questions. EPIC addresses these below.

a) Indexation of the cap

Regardless of whether meal entertainment and entertainment facility leasing are brought within the main FBT concession cap, the present cap should be indexed as promised in 2001 as part of the *Tax Reform: Not a New Tax, A New Tax System* reforms.

This indexation has never occurred. As observed by the Productivity Commission, this is more than an administrative oversight or minor inconvenience for the sector – it is eroding

the ability of NFPs and charities to provide services, as the FBT concessions are directly linked with the ability to attract appropriate staff.⁴²

EPIC estimates that indexation would bring the current \$30 000 cap up to around \$43 000.⁴³ Adding the entertainment amount to this cap would result in a new cap of \$54 700.

Indexation should continue each year hereafter. The measure of indexation which is used is a matter for Treasury advice. Consumer Price Index calculations can be distorted, as the value of consumer goods varies considerably between different areas of the country.

b) Education support from Australian Taxation Office

As explored above, understanding how FBT and FBT concessions apply to your own personal financial situation can be very difficult.

The existing ATO publications on this issue are not particularly user-friendly. More guidance from the ATO, especially in how to adequately explain FBT benefits to staff, would assist with this knowledge problem and address the fairness issue identified by the Working Group.

Answers to consultation questions

The substantive reasoning informing EPIC's answers to the consultation questions on short-term reform has been adequately explored above. We therefore set out our answers to Questions 28 – 37 below.

Q 28 Assuming that the current two tiered concessions structure remains (see Part B), what criteria should determine an entity's eligibility to provide exempt benefits to its employees?

Only charitable entities, as that term is defined in Australian law, should be eligible. PBIs should be considered a priority, as they provide 'charity' as first defined by English law and as popularly understood.

In practice, this would mean only those entities assessed as having charitable status by the ACNC should be entitled to FBT concessions.

Q 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?

⁴² Productivity Commission above n 9, pp 213, 267.

⁴³ Calculated for 12 years of avg 3% inflation.

For the reasons outlined above, government entities and government-owned bodies should not be entitled to FBT exemptions and rebates. Removal of their exemption would be in accord with Guiding Principles 2, 6, 8 and 9.

In line with our answer to Q 28 above, all and any kind of FBT concessions, including rebates, should be restricted to charities.

Q 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?

See Q 28 above.

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

EPIC supports this proposal as a way of allaying community concern on the issue of FBT concession abuse. We would note that the majority of PBI employees are on the lower end of the payscale. Table E at page 37 of the Discussion Paper is a good illustration of a typical employee. Even if this typical PBI employee wished to pay for weddings, expensive restaurant meals and other luxuries using the unlimited meal and entertainment benefits, they are unlikely to have the financial resources to outlay large amounts of money in anticipation of a refund.

Our support is however conditional upon the existing cap being increased by a modest amount to accommodate the current usage of these exempt items: see Q 32 below.

Q 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?

EPIC's support for bringing the entertainment benefits within the existing concession caps is conditional upon the caps being increased. EPIC already imposes a voluntary limit on these benefits out of a concern for ethical use of the FBT exemption. We suggest that this amount of \$450 per fortnight, or \$11 700 per year, would be a reasonable starting point.

A separate cap for entertainment benefits would merely duplicate administrative problems and restrict freedom of choice for employees. All benefits should remain under the same cap.

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

No.

Q 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?

EPIC is in favour of preventing employees from simultaneously claiming the concession from more than one employer. It may be more beneficial to employees in the sector, many of whom work casually, to have more flexibility in which employer they are claiming the concession from; for example, a relief carer who works more hours with Employer A than Employer B in January, but the reverse in February.

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

Re-alignment is a fair and logical step; there are no compelling reasons not to do so.

Q 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?

No comment.

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

Concessions should not be available to more entities; concessions for government-owned bodies should be removed – see answer to Q 28 and 29 above.

LONG TERM REFORM OPTIONS

Before we turn to the various options for major reform canvassed in the Discussion Paper, there are several philosophical points to be made first.

Phasing out FBT concessions

All but one of the options for long-term reform put forward by the Discussion Paper involve abolishing FBT concessions. It is not clear to EPIC that the case for removing the concessions has been made out.

At paragraph 160, the Discussion Paper refers to the Henry Review's recommendation that the concessions be phased out and substituted with direct government funding. The primary reason given by the Henry Review for doing so was the need for a 'more neutral form of assistance';⁴⁴ that is, a more competitively neutral form of assistance.

For reasons explored already in this submission, this reason is based on false premises. It is therefore not an adequate ground for removing FBT concessions.

⁴⁴ Commonwealth Government above n 5, p 212.

The Productivity Commission, whose findings EPIC prefers, made a similar recommendation but in terms less strong, and specifically related to hospital employees:

...the FBT concessions produce a number of significant distortions, affecting resource allocation and changing employee behaviour, the Commission concludes that there is no compelling reason to increase the cap [for hospital employees, to account for inflation]. Indeed, it would be preferable to phase out the concessions. As discussed, the Commission recognises that this could impose hardship and would need an appropriate phasing out period and a means of providing intended support to those NFPs not competing in the market.⁴⁵

The Commission did not go further to recommend a particular method of support.

An alternative argument for replacing FBT concessions with a different form of support could also be made in terms of 'efficiency'. Given the supposed burden on employers of administering FBT benefits, direct grants in particular could surely relieve a great deal of compliance costs. It would also allow government to support 'worthy' projects rather than wasteful extravagances for a select few employees; in short, more support for the same price, and in a fairer distribution.

In addition, the reality is that the ongoing cost of a \$1 FBT concession in real terms to the government is less than \$1. At the same time, \$1 in FBT concessions is worth more than \$1 to the employee. A concrete example is EPIC's own company car arrangements. A company vehicle 'costs' an EPIC employee \$4 000 of their \$30 000 cap. We estimate that a similar car, sourced privately, would cost at least double this amount – between \$8 000 and \$10 000. The lower cost is not creative accounting – it stems from the EPIC's ability to access fleet prices, and arrange insurance, maintenance and so forth at corporate rates.

EPIC also rejects the notion that an alternative form of support would necessarily be less costly for government and for organisations. Whilst the Australian Treasury will have access to modelling on the cost of raising revenue in Australia, we note that the most recent US research in this area suggests that the cost of raising revenues to 'fund provision of public goods' could be 'roughly double' what was formerly thought, if different methods of assessment are adopted.⁴⁶ We submit that in this context, where concessions are clearly less expensive than grants and raising revenue to fund public goods comes at a substantial cost that is difficult to quantify, the case for concessions over grants remains compelling. Providing truly equivalent support would therefore cost more than the current tax expenditures figure.

EPIC also considers it unlikely that grants administration in particular would be any less onerous than FBT concession compliance. It is likely to increase for government in particular.

⁴⁵ Productivity Commission above n 9, p 213.

⁴⁶ Will Martin and James E. Anderson, *Costs of Taxation and the Benefits of Public Goods: The Role of Income Effects* (September 2005) World Bank Policy Research Working Paper No. 3700, available at <http://elibrary.worldbank.org/content/workingpaper/10.1596/1813-9450-3700>.

In summary, it is inefficient to insist upon reform for principle's sake that does not deliver increased resources to charitable work.

De facto phase out?

When FBT was first introduced in 1986, the taxation rate for fringe benefits was deliberately set at the highest marginal tax rate.⁴⁷ The hope was that employers would 'cash out' fringe benefits into employees' salaries in response to the punitively high tax associated with fringe benefits,⁴⁸ and that fringe benefits would eventually die off. Salaries are much easier to tax and measure, and FBT was to neatly solve the tax evasion problem.⁴⁹

It appears that the same reasoning may be in play in the failure to index the FBT concession caps introduced in 2001. Perhaps it was hoped that the concessions fringe would decrease in relevance for the sector over time, as the value of the concessions became less and less. Ultimately, they would be so meaningless that they could be abolished painlessly.

Much like the result of the FBT – fringe benefits diminished, but have continued as a significant part of remuneration for many Australians – this approach cannot produce the desired result. This is because the sector cannot afford to simply replace the deteriorating value of FBT concessions with funds from other sources. Government grants and alternative concessions have not been increased to maintain the ability to offer competitive salaries in the absence of FBT concessions. Some funds can be procured through increased fundraising, commercialisation of services, and reduction of spending on core business – all of which will affect the quality and quantity of services available to our clients. If FBT concessions are to be abolished, alternative concessions are required.

Consultation questions

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

FBT concessions should not be replaced with direct support. EPIC would support substituting another form of tax concession for the FBT benefits. EPIC supports the suggestion set out in 'Tax free allowance for employees', below.

⁴⁷ The Hon. Paul Keating MP, Treasurer, Second Reading Speech on the *Fringe Benefits Tax Assessment Bill 1986*, available at <http://law.ato.gov.au/atolaw/print.htm?DocID=srs%2F19860039h%2F00001&PiT=99991231235958&Life=10010101000001-99991231235959>.

⁴⁸ There was specific provision for this in the Act: see Clause 67, *Explanatory Memorandum, Fringe Benefits Tax Assessment Bill 1986*, available at <http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=06%3AEXT%3AExplanatory%20Memorandum%20and%20SRS%3A1986%3AFringe%20Benefits%20Tax%20Assessment%20Act%201986%3AExplanatory%20Memorandum%20-%20REPS%3A%2300004%23FRINGE%20BENEFITS%20TAX%20ASSESSMENT%20BILL%201986%3B>.

⁴⁹ Ibid.

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

EPIC is strongly opposed to replacing FBT concessions with direct grants. It is clear from the Henry Review that the primary attraction for government in doing so would be greater control over entities' use of concession funds.⁵⁰ This both an undesirable outcome from the charity perspective and also inconsistent with the government's stated intention to preserve the independence of the sector, as expressed in the National Compact between the federal Government and the not-for-profit sector,⁵¹ and the Objects of the *Australian Charities and Not-for-profits Commission Act 2012*.⁵²

Given the general government preference for accountability from recipients of direct government funding, EPIC expects that direct grants would also require reporting from recipient organisations. It is the Gillard government's expressed intention to reduce the compliance burden for charities and not-for-profits, facilitated primarily through the Australian Charities and Not-for-Profits Commission.⁵³ Reporting to government on the use of direct grants would not be preferable to the current FBT arrangements and would substantially increase red tape.

FBT exemption allows charities the freedom to provide salary packages necessary to attract the required skilled staff without government intrusion, and allows employees to choose the benefits most relevant to them without having to prove why they should be able to do so.

Government administration of the suggested direct grants option would also consume resources. This would either be an added cost on top of the cost of grants themselves, or would be taken from the available pool of grant money, reducing the amount available to organisations.

It is EPIC's experience that funding initiatives for the not-for-profit sector are rarely indexed to retain their full value. Applied to direct grants, this general trend would further erode the support given to not-for-profit organisations.

Grants would also cause division and unhelpful conflict within organisations. While technically 'free' to choose how to spend the money, in reality employers would be receiving the funds in compensation for the loss of FBT exemption. Any decision to

⁵⁰ Commonwealth Government above n 5, pp 205, 211, 213.

⁵¹ Commonwealth Government Department of the Prime Minister and Cabinet, *National Compact: Working Together* (2011), available at http://www.nationalcompact.gov.au/sites/www.nationalcompact.gov.au/files/files/final_national_compact_web.pdf.

⁵² See s 15-5 of the Act.

⁵³ For example, see The Hon. David Bradbury MP, Assistant Treasurer and The Hon. Mark Butler MP, Minister for Social Inclusion, *New Era for Charities Sector Begins* (10 December 2012), Media release No. 163, available at <http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/163.htm&pageID=003&min=djba&Year=&DocType=>.

allocate funds away from staff salaries would be controversial; any decision to allocate funds to particular staff even more so.

EPIC notes that the Working Group also has reservations about the efficacy of replacing FBT exemption with direct grants.⁵⁴

Overall, it is fair to say that the direct grant option is not consistent with Guiding Principle 8: consistency with the Government's overall aim of providing support to the NFP sector.

Q 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?

Refundable tax offset paid to eligible entities

While EPIC prefers an indirect, tax-based benefit to direct grants, this option is not greatly different to direct grants.

As above, while technically 'free' to choose how to spend the money, in reality employers would be receiving the funds in compensation for the loss of FBT exemption. Any decision to allocate funds away from staff salaries would be controversial; any decision to allocate funds to particular staff even more so.

The ability to 'allocate the funding to where [we] believe it would do the most good'⁵⁵ is illusory.

Direct tax offset to employees of eligible entities

EPIC prefers this option to paying an offset to employers, as it benefits employees directly and avoids the internal politics issue inherent in the previous option. EPIC does not consider that this option is adequate, as it does not allow for differential benefits to employees on different pay scales.

While EPIC recognises that this could be considered a fairness issue, we submit that failing to provide meaningful benefits to higher-paid employees would create problems for PBI and other charitable employers seeking to attract quality senior staff. As matters stand, FBT concessions play a valuable role in enabling us to do so.

Horizontal equity and vertical equity are both important, and are not to be conflated.

Tax free allowance for employees of eligible entities

⁵⁴ Not-for-profit Sector Tax Concession Working Group above n 15, p 42.

⁵⁵ Ibid [164].

EPIC considers that this is the most desirable of the consultation options. We do not believe that differential caps are necessary; however, eligibility should be restricted to PBIs and charities.

EPIC suggests that an extra tier be added to the existing personal income tax free threshold (currently \$18 200 for the 2012-2013 financial year) for employees of PBIs and income-tax exempt charities (ITECs). Eligibility for the 'bonus' tax free threshold would be tied to employment by a PBI or registered charity, with pro rata eligibility for part-year employment.

This arrangement has the advantage of simplicity, efficiency, and fairness. There would be less administrative cost for organisations than the current arrangement, no added burden for employees, and no additional processing for government, unlike the direct grants option.

The benefit is clearly linked to support for the sector, with simple criteria for eligibility. All PBI and ITEC employees would have equal access to the benefit, with no knowledge barrier to inhibit takeup. The public would also understand and accept this much better than the past ten years of FBT complexity and confusion.

A tax offset or tax free threshold would alleviate the abuses issues noted earlier, and would be linked to a natural person, rather than a workplace, so there would be no need to monitor use of multiple caps at multiple workplaces. Similar to the current tax free threshold, an employee would only be allowed to claim the threshold from one PBI or ITEC employer.

As to the amount of the additional threshold, EPIC suggests the grossed down value of the current cap, but indexed as outlined above. We estimate this would be approximately \$24 000 for the current financial year.

This means that charity employees would be liable to pay FBT through their employer for any fringe benefits that their employer provides, as most Australians do. At the same time, the additional tax-free threshold would provide charity employees with around the same level of benefits as currently enjoyed, but without restrictions as to what the concession can be spent on. It is likely that fringe benefits, attracting the full premium tax, would decline in popularity in the sector as a result. Thus, the original purpose of FBT – to minimise tax evasion – would be fulfilled. Our solution would lower compliance costs for employers and government, while achieving the same goal: supporting vulnerable Australians by supporting the charitable sector.

In regard to the 'fairness' issue raised at paragraph 169, the current tax free threshold does not fluctuate according to annual taxable income. EPIC considers disproportionate benefit to higher-earning PBI or ITEC staff to be necessary. As explored above, the primary reason for providing FBT support to the sector is to enable organisations like EPIC to compete for quality staff. Different arrangements in lieu of FBT must accomplish the same outcome.

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

No. This would negate the benefit of the FBT concession, which is the ability of charitable bodies to offer competitive salary packages and attract suitably qualified staff. If FBT concessions were to be limited in this way, alternative support would be required to replace this lost benefit.

Q 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?

Consistent with EPIC's previous responses to similar questions, only PBIs and recognised charities should be eligible.

INCOME TAX, DGR, GST AND MUTUALITY

EPIC does not propose to comment in detail on income tax concessions, DGR and GST endorsement, or mutuality benefits.

While EPIC is endorsed as a DGR and for income tax concessions, EPIC considers that charities existing for the purpose of serving the poor and disadvantaged are the most deserving of tax support.

Entities in this category are at the heart of charity as traditionally understood, and our understanding of the Discussion Paper is that income tax concessions and DGR status for this group are not controversial.

EPIC does, however, make the following brief observations:

- EPIC supports an increase in the donation amount required before tax-deductibility is available. As a general principle, this should be an increase from coins to notes, in the order of \$5 - \$10. \$25 is too high a limit and will exclude low income donors from the benefits of tax deductibility.
- All benefits enjoyed by income tax exempt charities are subject to rigorous independent and government, ATO and/or ACNC auditing. This limits the ability of any charity to abuse or misuse their valued tax incentives and exemptions.