



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

Sent via email: NFPReform@treasury.gov.au

17 December 2012

Dear Sir / Madam

**Not-For-Profit Sector Tax Concession Working Group
Discussion Paper – November 2012**

We are pleased to have the opportunity to provide our response to the Not-For-Profit Sector Tax Concession Working Group's discussion paper issued in November 2012, addressing reforms to create fairer, simpler and more effective tax concessions for the not-for-profit sector.

Given the discussion paper covered a broad range of tax issues facing a wide variety of Not-For-Profit organisations, we have focussed our attention on five key income tax questions as well as those questions relating to FBT below:

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

We do not believe the current categories of income tax exempt entities per Division 50 of the Income Tax Assessment Act 1997 ("ITAA97") are sufficiently broad to capture the current range of altruistic activities being undertaken, given the change in the nature of Australia's community and business landscape. The existing categories of income tax exempt entities reflect the industry sectors Australian businesses have traditionally operated within (e.g. mining, agriculture and primary resources). However, over time, Australia's economic focus has broadened to new industry sectors and a growing services base. As such, we believe entities whose purpose is to promote these industries (which we have outlined below) should also be eligible for income tax exemption.

- **Commerce and Financial Services** – entities which exist to support the development and growth of commerce, financial services and the banking sector within Australia, including promotion of foreign investments into and out of Australia.

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- **Environment** – entities which support research and development relating to a sustainable future, clean energy, climate change and protection and conservation of the natural environment.
- **Innovation** – entities which support research and development and innovation within Australia.
- **Biosciences and bio-technology** – entities which support the development of the bio-technology and biosciences sector (particularly those that may fall outside the definition of a scientific institution).
- Entities which promote the **development of and export of Australian goods and services**.

We also recommend broadening the definition of exempt entities within the existing categories eligible for income tax exemption. For example, items 6.1 to 6.3 of Division 50 ITAA97 under the category of health is narrow in its definition of health institutions which may be eligible for income tax exemption, limiting this to hospitals and private health insurers, but not general not-for-profit organisations promoting health and well-being (and not simply the relief of sickness).

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

The ATO endorsement framework should be extended to include NFP entities as well as charities with respect to income tax exemption, FBT rebateable status and GST concessions.

By requiring NFP entities to obtain ATO endorsement, this will ensure they have certainty with respect to their tax concession status. Given the application of the tax legislation with respect to a Not-For-Profit entity's tax status can be particularly subjective and unclear, having an endorsement framework will enable NFP entities to have clarity on their tax exempt status.

The requirement to apply to the ATO in order to be eligible for the tax concessions also provides NFP entities with the opportunity to be made aware of technical issues that may adversely impact their tax exempt status. Otherwise, the NFP entity may find itself in a particularly detrimental tax position in the circumstance of ATO review or audit of their tax exempt status, that they are not eligible for the tax concessions due to a technical error which could have been easily rectified (if the NFP entity had been made aware of it at the very beginning). Given the complexity of the tax legislation relating to the eligibility of NFP's to tax concessions as well the fact that NFP's often have limited access to resources to deal with technical issues such as their tax exempt status, this can be a particular risk for NFPs.



Question 11: Should all charities be DGR? 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?

Yes, we agree that all charities should be DGRs. We believe that it is inequitable for some charities to not qualify because their charitable activities extend across several DGR categories (operating for broad public benefit), or as a result of undertaking activities which are unique or exceptional and may not fall within the narrow DGR categories, even though they are undertaken for the public benefit and are considered “charitable” for the purposes of common law.

By not extending the definition of DGRs to cover all charities, this may result in distorting the behaviours of charities in order to obtain DGR status, or increase their compliance and administrative costs should a charity be required to isolate each stream of its activities and structure them in separate entities to obtain DGR status.

The inclusion of all charities as DGRs would also bring Australia’s tax regime more in line with overseas tax regimes (such as the UK) in relation to the tax deductibility of donations. As a result, this could encourage further charities to establish entities in Australia, rather than registering entities in more traditional jurisdictions such as the UK or US.

Even though some charities’ activities are directed towards certain sectors of the community (such as charitable child care service and primary and secondary education), these charities should still be included as DGRs given the overarching benefits these charities provide to the community as a whole. The role of primary and secondary education and child care service entities in the community is growing, and they are becoming increasingly reliant on the community in order to fund their activities for the altruistic purpose of contributing to the development and education of young people. As such, having DGR status will be critical for making it easier for such organisations to raise funds in order to finance these projects.

Question 19: Would a clearing house linked to the ACN Register be beneficial for the sector and public?

We agree that a clearing house linked to the ACN register would be very beneficial to the Not-For-Profit sector and the public and would promote and encourage charitable giving, particularly to those smaller charities which do not have online fundraising facilities. However, we note that given that such a clearing house is likely to collate significant sensitive information (such as personal details of donors and banking details) that it will be important that safeguards are implemented to ensure that the information collected is kept confidential and not at risk of exposure. This may require additional funding to ensure the ACN Register systems and processes are secure.



Question 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?

We consider the existing criteria to be appropriate for the determination and limitation of the availability of the exemption. The FBT exemption has become a critical part of the Human Resources (HR) and internal administration strategies of these organisations, as well as representing an important tool for them to remain competitive with the private sector in being able to attract, retain and reward staff. Organisations receiving the exemption have become reliant upon it. As such, we consider that the criteria for assessing the exemption should remain as is.

Question 29: Also assuming that the current two tiered concession 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?

We consider the concession should be available to all genuine not for profit entities.

Question 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?

With the exception of the extended eligibility noted above, we consider that the current eligibility criteria for both the FBT exemption and the FBT rebate should be maintained.

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

No. Practically, this results in the removal of the concession for meal entertainment and entertainment facility leasing benefits.

Employees at organisations that access the relevant FBT concessions are typically already using the full amount of the concession caps available to them. As such, moving these additional benefits under the ambit of the existing caps (without an increase in the level of the caps) would simply and effectively remove the concessions available for these benefits.

These benefits are currently treated differently to other benefits because of administration-related reasons, including the reportable fringe benefit implications. This relief needs to be retained for the NFP sector.

We understand that the reason behind the proposal to review this benefit is the perceived 'abuse' of the existing concessions, with employees receiving benefits outside of the original policy intent. We disagree with the view that there is consistent abuse of the existing concessions.

In our experience, NFP entities are extremely conservative with respect to their policies around such benefits and rigorous in the internal audit of such arrangements due to the 'perception' associated with such exaggerated reporting of abuse. Examples have been raised of instances of abuse, but this abuse



is limited to isolated actions of an individual (in some cases necessitating the creation of fraud), rather than the exploitation of a systematic fault with the guiding legislation, necessitating a change.

NFPs, as a general rule, do not offer excessive pay scales and indeed the FBT concessional caps are a way for them to attract and retain employees on a net pay basis, despite offering gross wages that are lower than commercial market rates for a given position. However, we acknowledge that there are certain (but very limited) employees within the NFP sector that have the remuneration levels and opportunity to access these concessional benefits in a manner which is not consistent with the apparent intention of the concession. Accordingly, we can see merit in introducing a cap for salary sacrificed meal entertainment and entertainment facility leasing expenses, subject to our responses in Q.32 and Q.33 regarding salary sacrificed benefits.

A relevant question to ask which was not raised for discussion is whether the existing concession caps for NFP entities should be increased, given the caps have not been increased for over a decade. When the Treasurer, Peter Costello, introduced the FBT capping measure in 2000, he stated that:

“The Government has further agreed to review the level of the cap from time to time in the light of general salary movements.”¹

The level of the cap has not changed since, despite increases in general salary levels. This represents a decrease in the ‘real value’ of Government funding for the NFP sector over this time. It is also important to recognise that the introduction of the concessional caps represented a decrease in the level of funding by Government for the NFP sector.

Question 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 do not support the inclusion of meal entertainment and entertainment facility leasing benefits in the existing concessional caps, but if this was to occur, then yes, the concessional caps should be increased. As stated in previous question responses:

- The inclusion of these items within the existing concessional caps (without an increase in the caps) effectively removes the concession currently available for them;
- These benefits have, over time, formed part of NFP employee’s remuneration entitlements, in some cases being inserted into enterprise agreement and contractual entitlements. The removal of such concessions represents an effective pay-decrease for employees; and
- The existing concessional caps should be adjusted upwards regardless to compensate for the failure to do so over the past decade (resulting in the effective real value of the concession).

If a cap is brought in for salary sacrificed meal entertainment and entertainment facility leasing expenses, as per our previous response, we propose concessional caps of \$10,000 (grossed-up taxable value) each, for meal entertainment and entertainment facility leasing benefits.

¹ 2000 Media Release No 022 from Treasurer Peter Costello



Question 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?

One of the key reasons behind exempting certain benefits over and above the concessional caps for NFPs was to help out NFPs with the administrative burden imposed on them as a result of FBT compliance. As such, our position is that salary sacrificed meal entertainment and entertainment facility leasing benefits could be considered for capping, however all non-salary sacrificed benefits of these types should be excluded from capping. This will ensure that record keeping is kept to a minimum and the apparent intention of the legislation at implementation is upheld.

A charity or NFP can currently allow an employee to salary sacrifice for non capped benefits such as meal entertainment and entertainment facility leasing expenses if they so choose, incurring the resulting administrative overhead. This is an appropriate and acceptable outcome in the circumstances.

Question 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?

In principle, we agree with this reform, as it effectively prevents employees with multiple employers benefiting from concessions to a greater extent than 'single employer employees'. However, to prevent this is administratively problematic as FBT is a tax on employers. We do not consider that one employer should be penalised in its ability to provide for its staff or in terms of the administrative burden placed on it simply because it employs a person who is or was employed by another organisation with access to the caps in the same FBT year. Further, we consider that there are a limited number of NFP employees accessing multiple caps in any given FBT year. As such, the administrative burden of preventing this occurrence would outweigh any of the benefits it may provide the government.

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

Yes. There is no compelling reason not to align the FBT rebate rate with the FBT tax rate.

Question 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 provision of minor benefits by Charitable and NFP organisations is not substantial and removing it would simplify an otherwise complex taxation rule. Simplification though is the only policy reason for changing the existing treatment.

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

The current list of entities entitled to access the FBT concessions is appropriate. The organisations that currently benefit from the cap represent the majority of organisations providing positive charitable or

other socially and publically beneficial outcomes to the community.

Further, it is likely that any expansion of the scope of the concessions would necessitate a reduction in the scope of the concessions in order to keep the outcome largely revenue neutral. Given that we consider that the current concession levels are appropriate considering the circumstances of the organisations that receive them, we do not consider any conduct that may result in reductions to them to be appropriate. If additional funding is available, then an extension of concessions to further NFP entities noted earlier in our submission should be considered.

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

No. The Charitable and NFP sectors both rely on the concessions available to them in order to attract and retain staff in the face of substantial competition from commercial organisations that have the financial capacity to pay higher remuneration to their employees. Human resource costs are a significant component of the cost of running NFP entities. It is logical that Government support be in the form of a remuneration based assistance package and clearly FBT, a tax on remuneration, is an obvious concession to provide.

Also, importantly, the removal of FBT concessions would create significant administrative burden on NFPs, given the integration of such arrangements through their remuneration policies and practices, enterprise agreements and contractual documentation. There would also be significant employee communication obligations for the employer. The NFP sector is the least-prepared and resourced sector to cope with such significant administrative change.

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

No. We are not convinced that the proposed alternate government support mechanisms outlined in the Discussion Paper are viable alternatives. Most importantly, each would represent significant additional costs to government, unless government intends to reduce the benefit currently available per employee. This is a critical consideration given the government's intent that any changes be revenue neutral.

The current system of FBT concessions available to NFPs is already a system of 'direct support' for those organisations. Further, it represents the lowest low cost alternative for government, as it is provided only 'on demand'. The concessions are only activated when employees of NFPs are provided with fringe benefits, or exercise salary packaging arrangements. In our experience, many NFPs and their employees do not access the full value of the concessions available to them. Based on our experience, we estimate the take-up rate of the concessions to be less than 50%. As such, if a direct support payment, such as a grant, was provided to charities, presumably to be transferred to employees in the form of a wage increase, this would need to be provided to 100% of their employees and therefore would represent significant additional funding. Failure to do so would inevitably lead to considerable adverse human resource implications.

If the government introduces such a significant area of reform, one which is stated as being 'revenue neutral', then consideration also needs to be given to up-front financial assistance that needs to be provided to NFPs to cope with such change. The question to be asked is "is the alternate government



support program so superior that it warrants placing the NFP sector under such stress and administrative strain?”.

Our view is that considerable overall tax reform is required to the Australian taxation system. NFP sector tax reform should only occur as part of a broader reform package, one which makes available additional financial support for the sector that compensates for the efficiency of the 50% take-up of the existing government support provided through FBT concessions.

Question 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?

No. With respect to a direct tax offset for employers, it is unclear what payments of tax such an offset would be directed towards. The vast majority of organisations accessing the concessions are exempt from Income Tax and most State or Territory Taxes.

With respect to a direct tax offset to employees, this approach would represent a simple alternative, however it would represent a significant cost to government as outlined in Q 39 above and create timing delays for the employees concerned, or administrative burden to rectify this, presumably by a tax instalment variation process.

Finally, with respect to a tax-free allowance to employees, given at present not all employees of organisations accessing the concessions in fact claim the full benefit of those concessions, the provision of an allowance to employees would result in a multi-billion dollar additional liability for government, unless the value of that allowance was reduced in comparison to the concession amounts currently provided for under FBT legislation.

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

No. It is logical that the concessions are provided for remuneration-related arrangements and such FBT concessions largely relate to remuneration arrangements. If such concessions were restricted to non-remuneration benefits, this would present significant problems for the NFP sector, as:

- It would effectively mean a significant reduction in the level of government support; and
- It would mean significant administrative change, including human resource management implications.

Question 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 suggest that any entity that has NFP income tax status should get a rebate, unless they are already entitled to the PBI exemption.



Question 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?

Whilst the provision of gaming, catering, entertainment and hospitality activities of NFP clubs and societies may not fall within the original core objectives upon which the NFP club or society was initially established, we believe that in order for the club or society to continue to provide benefits for its members and the community, its activities have had to evolve over time to include activities which the community currently values.

We perceive three key concerns of the retention of an income tax exemption status for NFP clubs and societies:

- 1) The competitive advantage the NFP club or society gains over its direct, for-profit competitors who receive no income tax concessions; and
- 2) If the untaxed surplus generated by the NFP club / society from carrying on these activities is used in a way which is considered wasteful as a result of trying to reduce surpluses or minimise tax.
- 3) The changing nature of membership of clubs and societies which has meant that it is significantly easier to become a member of a club or society, which may result in distortions in the mix of member/non-member contributions to the revenue of the club or society.

We believe any surplus generated from these catering, entertainment and hospitality activities should be exempt from tax if they are used directly and in line with achieving the club / society's core altruistic purpose. Even though the NFP club or society may be viewed to have a competitive advantage over for-profit taxable entities as a result of their tax exempt status, provided the surpluses generated are then applied to further the NFP entities' altruistic purposes, we believe these surpluses should be exempt from tax as they are then used to provide significant services and benefits to its members and the broader community which may not otherwise be possible.

Realistically however, a NFP club / society may not have particular plans for ways in which they can utilise these surpluses to fund activities or projects which align with their core altruistic purposes in their foreseeable future. In this circumstance, rather than encouraging wasteful spending by clubs/societies to avoid the income tax consequences of accumulating surpluses for which they have no particular altruistic plan, we believe it would be more beneficial for the wider Australian community if NFP clubs / societies were encouraged to invest any surplus funds in a low risk investment, e.g. government promoted investment such as NSW Waratah bonds, which provides a low-risk, stable income stream and simultaneously supports the growth of the wider



Australian community. Returns generated from these investments could be exempt or subject to a concessional rate of tax. The surplus could be subsequently withdrawn from the investment when the NFP entity/club has a particular project or plan which meets their altruistic purposes for which funding was required.

Therefore, we request you consider how income generated by NFP clubs and societies through gaming, catering, entertainment and hospitality activities is used to further their altruistic objectives, as opposed to removing the income tax exemption and applying a concessional rate of tax on income generated from these activities. If surpluses derived by the NFP club or society are reinvested to further their core altruistic purposes for the benefits of its members and the broader community, then this income tax exemption should be maintained.

We appreciate that in the life cycle of NFP entities, there are certain times where they may not have firm plans for ways in which they will reinvest their surpluses into projects for the purposes of furthering their altruistic purposes. Therefore, we believe that the provision of an investment fund, which enables not-for-profit organisation to invest their surpluses in a low risk environment without endangering their tax exempt status, as well as enabling the future development of community infrastructure, is a suitable mechanism which addresses a number of issues facing the NFP sector.

We welcome the opportunity to further discuss our views. Please do not hesitate to contact me on (02) 8266 2261, Greg Kent on (03) 8603 3149 or Michelle Le Roux on (02) 8266 2602.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Craig McIlveen'.

Craig McIlveen
Partner
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A handwritten signature in blue ink, appearing to read 'Greg Kent'.

Greg Kent
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