NOT-FOR-PROFIT SECTOR TAX CONCESSION WORKING GROUP

Fairer, simpler and more effective tax concessions for the not-for-profit sector

Discussion Paper

November 2012

© Commonwealth of Australia 2012

ISBN 978-0-642-74862-1

This publication is available for your use under a Creative Commons BY Attribution 3.0 Australia licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures and where otherwise stated. The full licence terms are available from http://creativecommons.org/licenses/by/3.0/au/legalcode.

Use of Treasury material under a Creative Commons BY Attribution 3.0 Australia licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

Treasury material used 'as supplied'

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics — then Treasury prefers the following attribution:

Source: The Australian Government the Treasury

Derivative material

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

Based on The Australian Government the Treasury data

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are set out on the It's an Honour website (see www.itsanhonour.gov.au)

Other Uses

Inquiries regarding this licence and any other use of this document are welcome at:

Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

CHAIR'S FOREWORD

Tax concessions for the not-for-profit sector are a longstanding and critical part of the Australian Government's support for the important work of the sector. Reviewing these concessions to ensure that support is provided in the most effective possible way is important given the significant contribution that the sector makes to the lives of all Australians.

The terms of reference for the review are broad and provide a significant opportunity for the Not-for-profit (NFP) Sector Tax Concession Working Group (the Working Group) to consider the entire range of tax concessions provided to the sector by the Australian Government with a view to identifying reform options that could improve their effectiveness in supporting the work of the sector.

A number of earlier reviews and forums have provided the not-for-profit sector with an opportunity to make their views known about the existing framework for tax concessions. These have included the 2010 Productivity Commission report on the Contribution of the Not-for-profit Sector, the Australia's Future Tax System Review and the Tax Forum. These reviews and forums provide a strong foundation upon which further consideration of tax concessions can be built.

In this paper, the Working Group considers the history and current status of tax concessions for the not-for-profit sector and seeks the views of the not-for-profit sector and the broader community on a number of reform options. The reform options canvassed in the discussion paper have been put forward merely to gather information that will assist the Working Group to evaluate each option.

Over the next 6 months, the Working Group will consider submissions made in response to this discussion paper and conduct targeted consultation with interested stakeholders. These consultation activities will assist to shape the Working Group's final report to the Government in March 2013.

Linda Lavarch
Chair
Not-for-profit Sector Tax Concession Working Group

TABLE OF CONTENTS

CHAPTER 1 — INCOME TAX EXEMPTION AND REFUNDABLE FRANKING CREDITS 11
1.1 History of income tax concessions for NFP entities 11
1.2 Current income tax exemption — types of exempt entities 12
1.3 Concerns about income tax exemption 13
1.4 Reform options 14
1.5 Refunds of franking credits 14
1.6 Other Issues and Reform Options 15

CHAPTER 2 — DEDUCTIBLE GIFT RECIPIENTS 18
2.1 History of tax concessions for tax deductible gifts 18
2.2 Current state of tax concessions — categories of deductible gift recipients 19
2.3 Concerns with the DGR framework 21
2.4 Reform Options 22

CHAPTER 3 — FRINGE BENEFITS TAX CONCESSIONS 34
3.1 History of fringe benefits tax concessions 34
3.2 Current fringe benefits tax concessions 36
3.3 Concerns with the current FBT concessions 37
3.4 Reform Options 38

CHAPTER 4 — GOODS AND SERVICES TAX CONCESSIONS 48
4.1 History of the concessions 48
4.2 Current concessions 48
4.3 Input tax credits for volunteer reimbursements 50
4.4 Concerns with the current GST concessions 50

CHAPTER 5 — MUTUALITY, CLUBS AND SOCIETIES 53
5.1 History and scope of the principle of mutuality 53
5.2 Concerns about the principle of mutuality 54

CHAPTER 6 — NEXT STEPS 59
6.1 Delivering reform within the current envelope of support 59
6.2 Other reform proposals 59
6.3 Is there scope to streamline income tax, FBT, GST and DGR concessions? 59

APPENDIX A — EXAMPLES OF HOW NFP ENTITIES CURRENTLY BENEFIT FROM TAX CONCESSIONS 61

APPENDIX B — RECOMMENDATIONS FROM EARLIER REVIEWS 63

APPENDIX C — OVERVIEW OF OTHER NFP REFORMS 65

APPENDIX D — TAX CONCESSIONS FOR NFPS — 2011 TAX EXPENDITURE STATEMENT 68

APPENDIX E — CONSULTATION QUESTIONS 70

RESPONDING TO THE DISCUSSION PAPER

Responses to this discussion paper will inform the preparation of a final report (including recommendations) which the Working Group plans to provide to Government by March 2013.

MAKING A SUBMISSION

Written submissions in response to this discussion paper are requested by 10am on **Monday 17 December 2012**.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

Submissions should be provided to:

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

Email: NFPReform@treasury.gov.au

Phone: (02) 6263 3980

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information, marked as such, in a separate attachment. Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

DISCLAIMER

This is a discussion paper whose purpose is to stimulate discussion, debate and feedback to the Not-for-profit Sector Tax Concession Working Group. It is not a position paper and the options canvassed are not recommendations.

ACRONYMS

ACNC	Australian Charities and Not-for-profits Commission
AFTS	*Australia's future tax system report*
ATO	Australian Taxation Office
CDI	*Charities definition inquiry report*
CGT	capital gains tax
DGR	deductible gift recipient
FBT	fringe benefits tax
GST	goods and services tax
ITAA 1997	*Income Tax Assessment Act 1997*
ITAA 1936	*Income Tax Assessment Act 1936*
NFP	not-for-profit
PAF	private ancillary fund
PAYG	pay-as-you-go
PBI	public benevolent institution
PC	Productivity Commission
RBT	Review of Business Taxation

THE NOT-FOR-PROFIT SECTOR TAX CONCESSION WORKING GROUP

The Tax Concession Working Group was established in February 2012 by the then Assistant Treasurer, the Hon Mark Arbib, with terms of reference requiring it to consider ideas for better delivering the support currently provided through tax concessions to the not-for-profit (NFP) sector.

The Working Group is supported by representatives from the Department of the Treasury (Secretariat), the Department of the Prime Minister and Cabinet and the Australian Taxation Office.

LINDA LAVARCH (CHAIR)

Linda Lavarch is the Chair of the Federal Government's Not-for-profit Sector Reform Council having been appointed in December 2010 and a Research Fellow at the Australian Centre for Philanthropy and Nonprofit Studies at the Queensland University of Technology (QUT). Prior to these positions Linda served in the Queensland Parliament from 1997 to 2009. During her Parliamentary career she held many positions including serving as the Queensland Attorney-General in 2005/06. Linda is also Chair of the Board of Directors of Coast2Bay Housing Group, a nonprofit social and affordable housing company and serves as a Director on the Board of the Australian Cervical Cancer Foundation.

JOHN EMERSON AM

John Emerson is recognised Australia wide as an expert in the tax laws applicable to charities. He joined the law firm of Freehills in 1971, was admitted to partnership in 1976, and became a consultant with the global firm of Herbert Smith Freehills in 2012. John has been appointed as a Member of the Order of Australia (AM) 'for services to law and to the community, particularly through the provision of advice to charities and not-for-profit organisations and the development of public administration reform to encourage philanthropy in Australia'. He is the Herbert Smith Freehills Melbourne office Pro Bono Partner and is a member of the Board of Taxation and of a number of legal and public sector committees active in the charity tax and pro bono areas.

BRIAN LUCAS

Brian Lucas is a Catholic priest of the Archdiocese of Sydney. He is presently the General Secretary of the Australian Catholic Bishops Conference in Canberra. Prior to that appointment he was for twelve years the Financial Administrator and Secretary of the Archdiocese of Sydney. He has academic qualifications in law, general studies and theology. He is an adjunct professor of the Australian Catholic University, and a member of the Australian Taxation Office Charities Consultative Committee. He has served on numerous Boards and Advisory Bodies for Church and other not-for-profit organisations. He is a co-author of the *Church Administration Handbook*.

Elizabeth Lucas

Elizabeth Lucas is a Tax Partner with Grant Thornton Australia. Elizabeth was appointed as a member of the ATO's National Tax Liaison Group — FBT Subcommittee on 11 September 1997 and she chairs the Taxation Institute's FBT sub-committee. Elizabeth has a wealth of experience and knowledge on fringe benefits tax and other taxes gained over more than 20 years consulting in this area. Elizabeth has particular experience in the NFP sector, having advised a broad spectrum of many NFP clients.

Greg Mackie OAM

Greg Mackie is currently Executive Director of Ageing in SA Health and has previously held the positions of Deputy Chief Executive in the Department of the Premier and Cabinet South Australia and Executive Director of Art SA. He has also been an elected member of the Adelaide City Council and was a founding director of Imprints Booksellers in Adelaide. He was awarded the Medal of the Order of Australia in 2002 for his services to the arts, in particular as founder of the Adelaide Festival of Ideas. He has served widely in the community and arts sectors.

Tim Morris-Smith

Tim Morris-Smith joined Mission Australia as CFO in 2008. He is a UK Chartered Accountant with 20 years experience providing strategic financial leadership and controllership in US, European and Australian companies, including special-purpose entities, superannuation funds and trusts. At Mission Australia, Tim provides oversight for ethics, risk management, compliance and corporate governance, ensuring compliance with government obligations and regulatory requirements.

Heather Neil

Heather Neil has spent most of her career in the non-profit sector, working in sustainability, environment, city planning, health and most recently the animal welfare sector. Across all of these roles, Heather has been involved in informing, engaging and supporting community and individual action and influencing public policy and private sector practices. She has worked closely with Boards, members and volunteers as well as governments and other stakeholders. Heather has been CEO of RSPCA Australia for six years, and in a voluntary capacity, is a Director of Rowing Australia and a Director of the Community Council for Australia.

Ann O'Connell

Ann O'Connell is a professor of law at the University of Melbourne. She holds degrees in arts (economics) and law and a master of laws by thesis from the University of Melbourne. Ann carries out research in corporate law and taxation, including in relation to the not-for-profit sector. She is also Special Counsel at Allens-Linklaters, a member of the Advisory Panel to the Australian Board of Taxation, a Visiting Fellow at the Centre of Tax Law, Cambridge University, and a member of the Australian Taxation Office's Public Rulings Panel.

Anne Robinson

Admitted as a solicitor in 1980, Anne worked in two major Sydney law firms in commercial law, including resource development, finance and banking. Since then a significant part of Anne's compliance and preventative law work has been with NFP and educational institutions, covering a wide range of charities and education law issues. It was a logical step therefore in 2001 to establish Prolegis to act only for charities and other not-for-profit organisations. In 2009 Anne established the Australian Charity Law Association, a body which exists to support the work of the charity and NFP sector in Australia by providing education for practitioners in this field, and support for charity law reform. In addition to her legal work, Anne has also been involved in governance of NFP organisations for 25 years, including serving on the boards of two large Sydney independent schools for 16 years, and also as a director and Chairman of the Board of World Vision Australia for 12 years until 2012.

Miranda Stewart

Miranda Stewart is Professor and Director of Taxation Studies at Melbourne Law School, University of Melbourne. She is an International Fellow of the Centre of Business Taxation at Oxford University and previously worked for the Australian Government in tax policy and legislation and in private practice at Arthur Robinson & Hedderwicks. She has taught at New York University School of Law, Osgoode Hall Law School, York University, Toronto, Canada and the University of Florida Law School. Miranda has many years experience in comparative tax law and policy research and is co-author of many books and articles including *Death and Taxes: Tax-effective Estate Planning* (4th ed, 2012 with Michael Flynn) and *Tax Law and Political Institutions* (ed, 2006), as well as acting as a consultant to governments and non-government organisations on tax reform.

Joe Zabar

Joe Zabar is UnitingCare Australia’s Director of Services Sustainability responsible for identifying and advocating reforms to policy and processes that enhance the viability and sustainability of social services. Prior to joining UnitingCare Australia, Joe was a senior executive with the international development and humanitarian response organisation, CARE Australia. Joe has spent most of his working career in the area of international development in both the non-government and government sectors.

TERMS OF REFERENCE

OBJECTIVE

1. The Working Group will consider whether there are better ways of delivering the current envelope of support provided through tax concessions to the NFP sector by the Australian Government.

SCOPE

2. The Working Group will examine the current range of tax concessions provided to the NFP sector in terms of their fairness, simplicity and effectiveness.

3. The Working Group will identify whether there are fairer, simpler and more effective ways of delivering the current envelope of support provided through tax concessions to the NFP sector.

4. The Working Group will identify offsetting budget savings from within the NFP sector for any proposals that have a budget cost.

4.1. All proposals and offsetting budget savings examined by the Working Group will be costed by Treasury in accordance with the budget rules.

5. The Working Group will have regard to the Productivity Commission's 2010 report *Contribution of the Not-for-profit Sector*, the *Australia's Future Tax System Review*, and relevant international experience and expertise, in developing its recommendations.

6. The Working Group will have regard to the Government's broader NFP reform agenda in developing its recommendations.

TIMING

7. The Working Group is expected to complete its work by December 2012.[1]

CONSULTATION

8. The Working Group, with assistance from Treasury, will consult widely with the NFP sector, state and territory governments, and the broader community.

9. The Working Group will provide the NFP Sector Reform Council with regular updates on its progress.

10. The meetings of the Working Group will be attended by a representative of Treasury and a representative of the Office for the Not-for-Profit Sector.

1 Since the terms of reference were settled, the Treasurer has agreed to a delayed timeframe for the final report from the Working Group. The final report is due by March 2013.

SUPPORT

11. The Working Group will be supported by a Secretariat within Treasury.

    11.1. The Secretariat will provide the Working Group with technical and legal advice as required.

GUIDING PRINCIPLES FOR THIS REVIEW

The Working Group agreed upon the following guiding principles for this review of NFP tax concessions. The Working Group considers that adherence to these principles when reviewing and designing NFP tax concessions would maximise the public benefit generated by these concessions.

1. Understanding the envelope of support and underlying assumptions of the existing concessions

1.1 By understanding what the existing concessions are and their original intent and current scope of application, the Working Group will be better able to assess the appropriateness of the existing concessions.

2. Maximise the social good

2.1 Ensure that the concessions are used in a way that provides the maximum social benefit by enabling the NFP sector to achieve their community and altruistic purposes.

3. Recognise giving in Australia

3.1 The concessions should provide a supportive environment in which the community can support the NFP sector. The Working Group seeks to highlight the benefits of 'giving', and considers that this concept is broader than the term 'philanthropy'.

4. Fairness

4.1 The concessions should be fair. The aim should be to treat like with like unless there is good rationale for differing treatments. Fairness can mean that different levels of support can be provided, where justified, in different circumstances. Concessions should be available having regard to purposes and activities rather than arbitrary legislative requirements.

5. Simplicity

5.1 The concessions should be easy to understand and simple to apply. A simple and transparent system makes it easier for people to understand their obligations and entitlements. Organisations will be more likely to make the most beneficial choices for themselves and respond to intended policy signals. A simple and transparent system may also involve lower compliance and administration costs. However, it is acknowledged that there may be trade-offs between the principles of fairness and simplicity.

6. Effectiveness

6.1 The concessions should enable effective policy outcomes that maximise the social good.

7. Efficiency

7.1 The concessions should have the least possible cost to economic efficiency and with the lowest possible compliance and administration costs. So far as possible they should not distort decisions by NFPs.

8. Structural coherence

8.1 The concessions should be consistent with the Government's overall aims of providing support to the NFP sector.

9. Transparency

9.1 There should be a clear explanation of the rationale for the concessions to enable the sector and the broader public to understand why the tax concessions apply as they do.

Introduction

The Australian Government hosted a Tax Forum in October 2011 to help identify further tax reforms to make the most of the opportunities and challenges ahead. The Tax Forum continued the conversation the Government started with the release of the *Australia's Future Tax System Report* (AFTS) in 2010.

One of the matters raised at the Tax Forum related to concerns that certain fringe benefits tax (FBT) concessions were not providing support for activities of the sector in the way intended. In particular, the use of FBT exemptions for restaurant meals and the hire of entertainment facilities for private purposes by relatively high income professionals were considered unlikely to be supporting the sector in a meaningful way. The Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, in his closing remarks to the Tax Forum, announced that a Working Group would be set up to look at how the Government can strengthen the effectiveness and fairness of support it provides to the sector.

In February 2012 the then Assistant Treasurer, the Hon Mark Arbib and the Hon Mark Butler, announced the membership and terms of reference for the Not-for-profit Sector Tax Concession Working Group (the Working Group) to:

> examine the current range of tax concessions and whether there are fairer, simpler and more effective ways of delivering the current envelope of support.

The terms of reference require the Working Group to identify offsetting savings for any proposals that would have a budget cost.

The Australian Government has estimated that in 2011-12 it provided around $4 billion of quantifiable support to the NFP sector by way of tax concessions. Unquantifiable support by way of tax concessions is likely to add several billion dollars to this total. The most significant support is through income tax, goods and services tax (GST) and FBT exemptions and tax deductibility of gifts. This compares to an estimate of over $100 billion for all concessions related to taxes levied by the Australian Government.[2]

As well as considering ways to effectively direct Australian Government support for the sector, this review also provides an opportunity to consider whether support for the sector can be delivered in a simpler way. Existing arrangements are complex and impose compliance burdens on the sector. Proposals to simplify the tax concessions would reduce this compliance burden.

The terms of reference for the Working Group require it to consult widely with the not-for-profit (NFP) sector, State and Territory governments and the broader community. Accordingly, the Working Group has developed this discussion paper as a basis for engagement with the community and the NFP sector.

---

2 These are measured as tax expenditures. The Australian Government uses the revenue foregone approach to estimate tax expenditures, which takes account of the difference in tax paid by taxpayers who receive a particular concession, relative to similar taxpayers who do not receive the concession. It compares the current or prospective treatment to the 'benchmark' treatment of the tax, assuming that taxpayer behaviour is unchanged. Aggregate estimates of tax expenditures may not be reliable indicators of revenue cost because of overlapping and possible interactions between the behavioural responses to the removal of different tax expenditures. See *Tax Expenditure Statement* 2011; *Australia's Future Tax System, Architecture Report*, (AFTS) Box 2.7 at www.taxreview.treasury.gov.au.

Understanding the envelope of support for the NFP sector provided through the tax system

The following chapters consider each of the tax concessions, its history, its current status, potential concerns and possible options for reform. Table A summarises the main tax concessions.

Table A: Tax concessions for the main types of NFP entity

	Charities[1]	Public Benevolent Institutions (PBIs) and health promotion charities	NFP public hospitals and NFP public ambulance services	Deductible gift recipients	Clubs and other NFP entities
Income tax exemption	Yes	Yes	Yes	No[2]	Yes
Refundable franking credits	Yes	Yes	Yes	Yes	No
FBT exemption ($17,000 cap)	No	No	Yes	No	No
FBT exemption ($30,000 cap)	No	Yes	No	No	No
FBT rebate	Charitable institutions only	No	No	No	Some non-clubs only
Other FBT concessions	Yes	Yes	Yes	No	No
GST concessions	Yes	Yes	Charities only	Yes	No
Deductible gifts	No	Yes	No	Yes	No

[1] Charities that are endorsed as deductible gift recipients or specifically listed in the *Income Tax Assessment Act 1997* can receive deductible gifts.
[2] Deductible gift recipients are generally charities that also have income tax exemptions, but an income tax exemption does not automatically flow from an entity having DGR status.

Rationales for providing tax concessions

Three rationales have been identified in the literature for providing tax concessions to the NFP sector.

First, concessions are a form of government assistance to worthy causes. In economic terms, the work of the NFP sector generates positive externalities or 'spill over effects' not fully accounted for by private benefits derived from participation in the sector. Without incentives, such as tax concessions, the overall level of activity in the NFP sector may be sub-optimal.

Second, and closely related, concessions are a form of payment or subsidy for delivery of public benefit by the NFP sector. Some commentators label this a 'fiscal' rationale for tax concessions, in that activities undertaken by the NFP sector save governments from making outlays for similar activities. The benefit may be services that government would otherwise provide (for example, health, education or welfare) or they may be services that government would not usually provide but which are viewed as having benefit.

Third, and only relevant to the income tax exemption, income tax is only borne by individuals in a society and is imposed on entities as proxies for individuals. As charities and other NFPs are formed for purposes of public benefit, rather than the private benefit of individuals, it is argued that they should not be within the income tax regime.

Reasons for limiting tax concessions

Accepting that there are rationales that support tax concessions for the NFP sector, three reasons for placing limits on such tax concessions have been identified in the literature.

First, a former UK Chancellor of the Exchequer pointed out that tax concessions for one group within the community inevitably put a greater tax burden on others, if a particular amount of taxation revenue is to be collected.[3] A tax system with fewer concessions tends to enable lower taxes to be levied on the larger number of entities from which the same level of tax revenue may be collected.

Second, tax concessions may affect competitive neutrality. Businesses that pay tax and compete with entities that benefit from tax concessions do not always do so on a level playing field. For example, NFPs able to provide FBT-exempt benefits to compete for staff with for-profit entities and NFPs that are not eligible for the FBT concession.

Finally, some have questioned the nature and scope of the public benefit provided by some entities that benefit from tax concessions, given the breadth of the current system.

3 This comment was made by William Gladstone in 1863 in the context of an attempt to remove the income tax exemption for charities.

1. INCOME TAX EXEMPTION AND REFUNDABLE FRANKING CREDITS

1. Income tax law provides an exemption from income tax for various NFP entities, including charities, scientific and religious organisations, public and NFP hospitals, and entities that promote animal racing, art, games, sport literature or music.[4] Certain income tax exempt entities may also benefit from a refund of franking credits on dividends from Australian companies.

2. In the absence of an exemption, charities and other NFPs would be subject to tax on their incomes, usually as companies[5] or trusts. This would include income from businesses, income from investments (for example, rent, interest and dividends) and capital gains, but usually not gifts.

3. The Commissioner of Taxation can require an exempt entity to lodge a tax return, but generally does not do so for exempt NFPs. NFP Australian resident companies that are not exempt, but have taxable income that does not exceed $416, are also not required to lodge an income tax return.

4. The total value of income tax concessions to the NFP sector cannot be reliably estimated, due to gaps in data on activities undertaken by the sector. Based on the limited data available, total income tax exemptions provided to the NFP sector in 2011-12 were likely in the order of $3 billion.[6] The exemption for charitable, religious, scientific and community service entities was estimated to exceed $1 billion. The next largest exemptions are for industry-specific NFPs that promote the development of Australian resources and for sport and other cultural activities.[7]

5. Entities that are endorsed as income tax exempt charities or income tax exempt deductible gift recipients (DGRs) are generally able to claim a refund of franking credits on distributions from Australian companies. These concessions were estimated to exceed $520 million in 2010-11.[8]

6. The Australian Government is pursuing a number of reforms related to income tax concessions. These include better targeting of NFP tax concessions, developing a statutory definition of charity and restating and standardising the special conditions for tax concession entities. Further details of these reforms are at Appendix C. The Working Group's terms of reference do not extend to revisiting these reforms.

1.1 HISTORY OF INCOME TAX CONCESSIONS FOR NFP ENTITIES

7. Income tax exemptions for entities that benefit the community have a long history: English hospitals created to treat leprosy patients were one of the earliest known beneficiaries of an

---

4 See Division 50 of the ITAA 1997.

5 The term 'company' is defined in the ITAA 1997 to mean: (a) a body corporate; or (b) any other unincorporated association or body of persons.

6 Treasury, *Tax Expenditure Statement*, 2011, Items B63, B68, B69, B70.

7 The value of these concessions is difficult to estimate. The 2011 *Tax Expenditure Statement* estimated each of them at $100 million to $1 billion in 2010-11.

8 Treasury, *Tax Expenditure Statement*, 2011, Item B71.

exemption from papal taxation in 1274.[9] Exemptions from the earliest British income tax legislation continued in the earliest income taxes introduced in the colonies (and later States) and Commonwealth income tax legislation.

8. The first Australian law to tax income, the *Land and Income Assessment Act 1895* (NSW), exempted 'benevolent institutions' and lands occupied for 'public charitable purposes' from land tax. It also exempted 'companies or societies not carrying on a business for the purpose of profit or gain' and 'ecclesiastical, charitable and educational institutions of a public character' from income tax. Similarly, the Victorian *Income Tax Act 1895* exempted 'trusts, societies, associations, institutions and public bodies not carrying on any trade or not being engaged in any trade for the purposes of gain' and bodies 'formed solely for the promotion of religion'.

9. The first federal income tax law, the *Income Tax Assessment Act 1915*, exempted friendly societies, trade unions and 'religious, scientific, charitable or public education institutions'.

10. Between 1915 and 1956, Australian income tax exemptions were expanded to include:

- charitable trusts and bequests (1916);
- associations for agricultural and industrial purposes (1918);
- associations for artistic and scientific purposes (1922);
- scientific research (1932);
- educational scholarships (1951);
- public and NFP hospitals (1952);
- sporting associations (1952); and
- NFP medical and hospital benefits organisations (1956).

11. In 1996, societies, associations or clubs established for community service purposes (except political or lobbying purposes) were made exempt from income tax.

1.2 Current income tax exemption — types of exempt entities

12. The current tax law provides an income tax exemption to entities that primarily undertake purposes that are broadly beneficial to the community, such as charitable, religious, scientific and public educational institutions. The exemption applies to both ordinary income and statutory income such as capital gains tax (CGT).

13. A charity is a NFP that has a sole purpose that is charitable. At common law, as modified by Commonwealth legislation for Commonwealth purposes only, charitable purposes are:

- the relief of poverty or sickness or the needs of the aged;

9 W.E. Lunt, 'A Papal Tenth Levied in the British Isles from 1274 to 1280' (1917) 32 (125) *English Historical Review* 49-89, 86.

- the advancement of religion;
- the advancement of education;
- the provisions of child care services; and
- other purposes beneficial to the community.

14. Some other types of entities are also exempt from income tax. For example, certain:

- organisations established for community service purposes (other than political lobbying);
- employee associations, employer associations and trade unions;
- governmental bodies;
- public hospitals, hospitals operated by a NFP society or association, collecting institutions (for example, public museums) and NFP private health insurers;
- resource development organisations;
- scientific organisations; and
- animal racing, art, games, sport, literature and music organisations.

15. Various conditions must be satisfied to obtain the exemption. All entities must be NFP. An entity is NFP where its constituent or governing documents or the operation of law prevent it from distributing profits or assets for the benefit of its members — both while it is operating and when it is wound up. Any surplus made by an entity must be directed towards carrying out the entity's purposes.

16. For an entity to be classified as a charity, it must be NFP, its sole purpose must be charitable, and it must exist for the public benefit or for the relief of poverty. Accordingly, entities that limit the benefits that they provide to particular segments of the community may, in certain circumstances, not be considered charities. Examples provided on the Australian Taxation Office (ATO) website are limiting benefits on the basis of family ties, employment with a particular employer or membership of a particular association.

17. Other types of entities are not required to satisfy the public benefit test that charities must meet in order to access certain tax concessions (including employee and employer associations, public authorities and local government). However, other types of entity may have special conditions that must be met to be exempt.

18. Income tax exempt entities must generally meet the 'in Australia' special conditions by operating and pursuing their purposes principally in Australia.

1.3 Concerns about income tax exemption

19. The types of entity that are exempt from income tax have developed over the past century as successive governments made decisions about the types of entity that should be provided

with this concession. Application of the guiding principles for this review provides a means of assessing whether the current categories of exempt entity are appropriate.

20. The principles that are most relevant to income tax concessions are fairness, simplicity, and effectiveness. Income tax exemptions are likely to rate highly on simplicity, as an exemption effectively eliminates a significant compliance issue for exempt entities. Some entity types that do not qualify for income tax exemptions may question the fairness of this concession, particularly for entities that fall just outside the boundaries of the exempt categories.

21. The current categories of income tax exemptions may also raise questions about effectiveness in achieving the maximum possible social good.

1.4 Reform options

1.4.1 Eligibility

Option 1.1: Who should be eligible for exemption from income tax?

22. If the categories of exempt entity extend beyond that which can be justified by the types of rationales identified in the introduction to this discussion paper, it is likely that a net gain in social benefit could be achieved by limiting these concessions and redistributing the benefits elsewhere. This involves considering what types of entities should be entitled to income tax exemption. It also involves considering whether any special conditions should be attached to eligibility and whether these should be uniform or different for different entity types.

Consultation questions

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

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

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

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

1.5 Refunds of franking credits

23. Entities endorsed as income tax exempt charities or that are income tax exempt DGRs, can claim a refund of franking credits on franked distributions from Australian companies. This refund was introduced in 2000. This change was made so that the tax treatment of dividends in the hands of these tax-exempt entities is the same as that for individuals with no basic income tax liability. Allowing franking credits ensures that the effective tax rate on dividends, after taking into account the tax paid by the company, is equal to the marginal tax rate of the individual, or for individuals with no income tax liability, a cash refund is received.

1.5.1 Concerns about refunds of franking credits

24. The growth in this tax expenditure, averaging approximately 12 per cent per year, far exceeds the average growth in Australian Government revenue over the period of 3.6 per cent (Table B). Growth in the tax expenditure on refundable franking credits may, in part, be explained by increasing use of off-market share buybacks by Australian companies.

Table B: Growth in tax expenditure on refundable franking credits for tax exempt charities and DGRs

Fiscal year	Growth in tax expenditure on refundable franking credits	Growth in Australian Government revenue[1]
2005-06 to 2006-07	5.9 per cent	6.6 per cent
2006-07 to 2007-08	51.7 per cent	9.1 per cent
2007-08 to 2008-09	8.0 per cent	-1.6 per cent
2008-09 to 2009-10	14.0 per cent	-2.1 per cent
2009-10 to 2010-11	-17.7 per cent	5.8 per cent

[1] Source: Final Budget Outcome 2011-12 – Appendix B – Table B6: Australian Government general government sector accrual taxation revenue, non-taxation revenue and total revenue

Option 1.2: Who should be eligible for refunds of franking credits?

25. Refunds of franking credits are only available to a limited number of NFPs. One possibility would be to extend the concession to a greater range of NFPs, although this would have revenue implications. It might also be argued that NFPs that are entitled to refunds of franking credits are likely to be large, well-resourced NFPs and that perhaps the tax expenditure could be used in a way that benefits a broader range of entities.

Consultation questions

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

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

1.6 Other issues and reform options

26. The Working Group will consider whether income tax exemptions and refunds of franking credits are providing fair, simple and effective support to the NFP sector. Some other issues to be considered include the requirement to be endorsed, the complexity of the rules for State, Territory and local government bodies and whether the threshold for taxable NFP entities should be raised. A brief discussion of these issues and some options for reform are outlined below.

Option 1.3: Extending the ATO endorsement framework

27. Under existing arrangements for charities, income tax exemption and certain other tax concessions (for example, FBT concessions) are available only if the Commissioner of Taxation endorses an entity as a charity. Other types of entity can also be income tax exempt. These include, broadly, non-charitable scientific and public education institutions, community

service organisations, employee and employer associations, public authorities and local government and certain societies that promote aviation, tourism or the development of Australian resources. These other entities do not need to be endorsed and can self-assess their eligibility for the exemption. They can also apply to the Commissioner of Taxation asking him to rule that the entity is entitled to be exempt.

28. One change that could be made would be to require all NFP entities that seek income tax exemption, FBT rebateable status or GST concessions to be endorsed by the Commissioner. This endorsement would provide greater certainty for these organisations and prevent entities incorrectly self-assessing themselves as entitled to the concessions.

29. This reform option could be linked to the extension of the Australian Charities and Not-for-profits Commission (ACNC) regulatory framework beyond charities to other NFP entities (that is, other entities could be required to seek registration). However, a possible linking is outside of the remit of this Working Group. The Australian Government has announced that it will consider extension of the ACNC regulatory framework to entities other than charities after 1 July 2014.

Consultation question

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

Option 1.4: Rewrite and consolidate rules for State, Territory and local government bodies

30. Provisions that deal with income tax exemptions for State, Territory and local government bodies are in Division 1AB of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).

31. These provisions ensure that the profits of some cultural and similar bodies established by a State, Territory or local government are exempt from taxation. The exemption was extended to local governments in 2001 to encourage local governments to operate bodies in separate entities.

32. These exemptions for government-owned bodies could be simplified and consolidated into the ITAA 1997.

Consultation question

Q 8 Should the income tax exemptions for State, Territory and local government bodies be simplified and consolidated into the ITAA 1997? Which entities should be included?

Option 1.5: Increasing the tax free threshold for taxable NFPs

33. Taxable NFP companies (which could include clubs, associations and societies) must lodge a tax return if their annual income exceeds $416. No tax is applied to the first $416 of income. A

rate of 55 per cent applies to income of between $417 and $915 and 30 per cent tax applies to income of more than $916.

34. A higher threshold would reduce the compliance burden for small NFP companies and the regulatory burden on the ATO. However, a higher threshold could create a compliance issue if it creates an incentive to create multiple entities to benefit from multiple tax-free thresholds.

Consultation question

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

1.6.1 General

Consultation question

Q 10 Please outline any other suggestions you have to improve the fairness, simplicity and effectiveness of the income tax exemption regime, having regard to the terms of reference.

Reform options	Assessment against the Working Group's guiding principles
Option 1.1: Who should be eligible for exemption for income tax?	The option allows issues of fairness and maximising the social good to be addressed.
Option 1.2: Who should be eligible for refunds of franking credits?	The option allows issues of fairness and maximising the social good to be addressed.
Option 1.3: Extend ATO endorsement framework All entities that are potentially eligible for an income tax exemption would need to apply for endorsement by the ATO. At present only charities require endorsement to be exempt from income tax.	The option scores highly for fairness as there is no clear rationale for requiring charities to apply for endorsement but not applying the same requirement to other NFP entities. The option does not score as highly for efficiency, as a requirement to apply for endorsement would increase compliance burdens for NFP entities that do not currently need to be endorsed.
Option 1.4: Rewrite and consolidate rules for State, Territory and Local Government bodies Income tax exemption rules for State, Territory and Local Government bodies are complex and remain in the ITAA 1936. A rewrite and consolidation into the ITAA 1997 would make the provisions more accessible.	The option scores highly in terms of efficiency as compliance burdens could be reduced by simplifying the relevant provisions.
Reform options	**Assessment against the Working Group's guiding principles**
Option 1.5: Increase the tax free threshold for taxable NFP clubs, associations and societies The current tax free threshold is $416 and has not been updated for several decades.	The option scores highly on maximising social good and simplicity. Increasing the tax free threshold would reduce the compliance burden for those entities that no longer need to lodge tax returns or pay tax.

2. DEDUCTIBLE GIFT RECIPIENTS

35. The Australian Government provides DGR status as the primary tax concession that promotes giving to particular entities.

36. In 2009-10 around 4.4 million individual taxpayers claimed a deduction for gifts to DGRs, and donated $2 billion dollars.[10] The DGR tax concession had an estimated cost to government revenue of around $910 million in the 2011-12 financial year.[11]

37. This chapter assesses Australia's current DGR framework, and looks at reform options and strategies available to help ensure concessions provide more effective, fairer and simpler support to the NFP sector.

2.1 HISTORY OF TAX CONCESSIONS FOR TAX DEDUCTIBLE GIFTS

38. The tax deductibility of gifts in Australia began in an amendment to the *Income Tax Act 1907* (VIC). The records of the Victorian Parliamentary Debates reveal the motivation for its inclusion in the amendments:

> … in one or two cases, gentlemen had stated that they would not give to charities the large amounts that they would otherwise give because the Government were charging income tax upon them.

39. Section 3 of the *Income Tax Act 1907* (Vic) ultimately allowed a deduction for donations of more than 20 pounds to free public libraries, free public museums, public institutions for the promotion of science and art, mens' colleges, schools of mines, public universities, public hospitals, public benevolent asylums, public dispensaries, womens' refuges, ladies' benevolent societies and miners' benevolent funds. The Victorian gift provisions also required that an institution be located in Victoria to entitle the donor to a deduction.

40. At the Commonwealth level, the *Income Tax Assessment Act 1915* included a provision allowing taxpayers to claim tax deductions for donations of more than 20 pounds to 'public charitable institutions'. This was the first piece of Commonwealth legislation which enabled gifts to charities to be deductible.

41. The deductibility of gifts was expanded in 1924 to include gifts to organisations that conducted research into disease. In 1927, it was expanded further to include gifts to universities and colleges and the threshold for deductibility was reduced to 1 pound (this threshold has not been changed since).

42. Deductions for war and military-related purposes (for example, war memorials) were added to the list shortly after both World Wars. This was followed by a period from the late 1940s during which a number of individual entities were named in the tax legislation as allowable recipients of tax deductible donations. These included the United Nations Appeal for

10 Australian Taxation Office, *Taxation Statistics 2009-10*.
11 Treasury, *Tax Expenditure Statement*, 2011.

Children (1948), Queen Elizabeth II Coronation Fund (1954) and various medical colleges and scientific foundations.

43. The current system for deductibility of gifts had its genesis in the 1993 tax simplification project, which established categories for deductibility, accompanied by registers for some types of entity and provision for specific listing of entities in exceptional circumstances.

2.2 CURRENT STATE OF TAX CONCESSIONS — CATEGORIES OF DEDUCTIBLE GIFT RECIPIENTS

44. Taxpayers can claim an income tax deduction for gifts of $2 or more to entities with DGR status. To be tax deductible, gifts to DGRs must generally be cash, or property valued by the ATO at more than $5,000. Additionally, the donor must not receive, or expect to receive, a material benefit in return for the gift.

45. Australia's DGR framework has evolved over time, with the number of entities eligible expanding in an ad hoc manner. As a general rule all entities wishing to be endorsed as DGRs must formally apply for endorsement, with endorsement generally being 'entity based' rather than activities based. There are a total of 27,783 endorsed DGRs as at October 2010.[12] There are also about 200 entities that are specifically listed in the ITAA 1997 as DGRs. Such entities do not require endorsement. Further, there are some DGRs that must be approved by a Minister for entry onto one of four DGR registers.

2.2.1 General DGR categories and endorsement

46. There are around 50 general DGR categories set out in Division 30 of the ITAA 1997, grouped into 14 overarching categories including:

- health;
- tertiary education and residential education institutions;
- research;
- ancillary funds;
- welfare and rights;
- environmental organisations;
- cultural organisations; and
- international affairs.

47. Perhaps the most significant single entity type is for public benevolent institutions (PBIs) (within the 'welfare and rights' category). The term PBI has been interpreted strictly by the Courts and requires direct provision of services by an institution for the relief of needs that require benevolence.

12 Australian Taxation Office, *Taxation Statistics 2009-10*.

48. To be endorsed an entity must fit into one of the categories specified in Division 30 and satisfy any special conditions associated with the category under which they are seeking endorsement.

2.2.2 Specific DGR listing

49. Entities can also become DGRs by requesting specific DGR listing in Division 30. Around 200 entities have specific DGR listing. This process is resource intensive as entities must satisfy the Government they:

- do not fit within one of the general DGR categories;
- operate for the broad public benefit; and
- are unique and exceptional, that is, there are no other, or a limited number of entities that undertake the same activities.

50. The process is usually lengthy as it requires a legislative change to Division 30. Entities must satisfy Government agencies that they meet the requirements. The agencies then investigate whether information provided is accurate and recommend whether the entity should be specifically listed by the Parliament.

2.2.3 DGR registers

51. Ministerial approval is required for entities to be entered on four types of DGR registers before they can be endorsed as a DGR by the Commissioner of Taxation. The four DGR registers are the:

- Register of Environmental Organisations;
- Register of Harm Prevention Charities;
- Register of Cultural Organisations; and
- Overseas Aid Gift Deductibility Scheme.

52. Obtaining a listing on a register involves entities applying directly to Australian Government agencies that administer the DGR registers. This can be a lengthy process. It was announced in the 2009-10 Budget, that the Government will review the DGR registers to recommend how to simplify and streamline the application and endorsement processes.

2.3 Concerns with the DGR framework

2.3.1 Eligibility

53. Many entities that are eligible for income tax exemption are not eligible for DGR status. As noted, the most significant category in relation to 'welfare and rights' is for PBIs.[13] The second type of entity under the 'welfare and rights' category is a 'necessitous circumstances fund' (most likely intended to be a fund established for the same purposes as a PBI).[14]

Overlapping categories of entity type

54. The requirement to fit within a general DGR category presents problems for entities that undertake activities that fit within, or are covered by, more than one general DGR category. For example, an entity may engage in activities that are covered by one of the health general DGR categories, and one of the education general categories.

55. To be granted DGR status, an entity engaged in activities covered by more than one general DGR category may have to restrict its purposes and activities to fit within one general DGR category, or set up other funds, authorities or institutions to carry on activities that fall within a single category.

56. This behavioural distortion arises because endorsement for DGR status is at the entity level and is not activities based. This distortion typically generates increased compliance and administration costs.

57. For example, organisations that operate for the public benefit to advance the condition and welfare of Indigenous Australians may meet the eligibility criteria for a number of the general DGR categories. Examples include operating Indigenous health promotion bodies, women's shelters, rehabilitation services, indigenous cultural organisations, family support services, environmental organisations, harm prevention charities, and research organisations.

58. Some Indigenous organisations have difficulty seeking endorsement as DGRs as their activities do not fall within a single DGR category. These organisations tend to engage in a range of charitable activities encompassing social, cultural, environmental and educational objectives.

59. Treasury's consultation paper, *Native Title, Indigenous Economic Development and Tax*, identified these concerns, and concluded there may be a case for creating a new general DGR category to include Indigenous organisations that carry out activities across multiple DGR categories if broader DGR reform is not pursued.

---

13 The term 'public benevolent institution' is not defined in the legislation. It was considered for the first time in *Perpetual Trustee Co Ltd v FCT* (1931) 4S CLR 224, where the High Court held that the term was limited to organisations that are established for the relief of poverty, sickness, destitution or helplessness. The Charities Definition Inquiry (CDI) in 2001 noted that a significant restriction is that services provided must be direct and would not include an organisation that simply promotes or is concerned with social welfare in the community generally. The CDI accepted that it may be appropriate to have some sort of subset of charities that are eligible for certain tax reliefs, as opposed to allowing all charities equal access, but there was doubt about the continuing relevance of the term 'public benevolent institution' itself. The CDI Report concluded that the interpretation of the term was outdated and unnecessarily restrictive.

14 Again, the courts have interpreted the term narrowly. For example, in *Ballarat Trustees Executors and Agency Co Ltd v FCT* (1950) 80 CLR 350 at 355, Kitto J said that 'necessitous circumstances' refers to an "inability to afford what may fairly be regarded as necessities for persons living in Australia", distinguishing such necessities from things that are merely desirable advantages.

60. An additional source of complexity, created by the endorsement of DGRs based on entity type (rather than activity), relates to the status of funds under the ITAA 1997. Some larger NFP entities may operate several DGR funds or institutions. The definition of an 'entity' under the ITAA 1997 includes a trust but does not include a fund. Funds can be established either as separate entities, such as a trust or a company limited by guarantee, or the entity may seek endorsement itself as a DGR for the operation of a particular fund or institution.

61. The Productivity Commission (PC) Report in 2010, *Contribution of the Not-for-Profit Sector*, noted that fewer than half of all charities endorsed as income tax exempt are endorsed as DGRs. The report also noted that charities operate for the public benefit and promote charitable purposes, which the public would generally consider worthy of tax concession support. The PC concluded that this may be inappropriately distorting donations towards DGRs and away from other charities that operate for the public benefit and have a charitable purpose.

62. The PC recommended extending DGR status to all tax endorsed charities in the interest of fairness and simplicity.[15] It noted the revenue implications and recommended an approach whereby DGR status is progressively expanded to separately incorporate each head of charity.

2.3.2 Mechanism for encouraging charitable giving

63. Australia's DGR framework currently allows taxpayers to claim a tax deduction for gifts to DGRs. The benefit received by individual taxpayers from the income tax deduction is equivalent to their marginal tax rate. This allows high income earners to receive a greater benefit, in terms of reduction in payable income tax, than lower income individuals. For example, an individual earning $200,000 (in 2012-13) can reduce their tax liability by 46.5 per cent of their gifts to DGRs, while an individual earning $30,000 can reduce their tax liability by 20.5 per cent of their gifts.[16]

64. A tax offset (or tax rebate) system would remove the regressive nature of the current tax deduction system. AFTS considered this possibility and concluded that shifting from a deduction to an offset system could raise integrity issues and that further consideration should be given to understanding the effect the shift would have on the overall level of donations to DGRs. There may also be other measures related to encouraging charitable giving that have worked in other jurisdictions. Further consideration could also be given to promoting payroll giving and addressing any barriers to payroll giving.

2.4 Reform Options

65. The Working Group will consider options to address concerns about the DGR framework including eligibility for DGR status and the mechanism to provide encouragement of charitable giving and to assist the Government to provide more effective, fairer and simpler support to the NFP sector.

66. The various options, discussed in more detail below, relate to:

---

15 Productivity Commission, 2010, *Contribution of the Not-For-Profit Sector*, Recommendation 7.3, p. 184.

16 Assuming that the taxpayer earning $30,000 is not eligible for the senior Australians tax offset or the pensioner tax offset.

- the scope of entities that are eligible to be endorsed as DGRs and the range of activities these entities can fund through the use of DGR funds;

- the mechanisms used to provide individual taxpayers with a tax incentive to donate; and

- encouraging charitable giving and reduce transactions costs associated with charitable giving, and strengthen public confidence that DGR funds will be used in line with the purposes for which they were donated.

67. The table at the end of this chapter summarises the various options discussed in this chapter, and provides a brief indication of the extent to which the options meet the Working Group's guiding principles.

2.4.1 Identifying entities that qualify for DGR status

Option 2.1: Extending DGR status to all charities

68. Currently only gifts to DGRs attract a deduction. Fewer than half of all charities that are endorsed as income tax exempt are endorsed as DGRs. A possible reform option is to expand DGR status to all endorsed charities, as recommended in the PC report, *Contribution of the Not-for-Profit Sector*.

69. The current system is complex. A few entities in the general DGR categories are not charities and some general DGR categories overlap (particularly in relation to PBIs). Other general DGR categories overlap with entities that are usually excluded from being eligible for DGR status.

70. This reform option could significantly improve the fairness of Australia's DGR framework, by making all charities operating for the public benefit eligible to be endorsed as DGRs. It would encourage charitable giving as it would expand the scope of DGR entities. Currently around 28,000 entities have DGR status. Under this reform option, the number of entities entitled to be endorsed as DGRs would be at least 56,000 entities (setting aside charity-like government entities for the moment).

71. This option would simplify the system significantly by ensuring that all charities are eligible to be endorsed as DGRs. Entities would not need to fit within one of the DGR general categories or be specifically listed in Division 30, provided that they qualify as charities. All charities would need to comply with the DGR 'in Australia' special conditions, except those entities specifically permitted to operate overseas without complying with those conditions.

72. Another issue relates to certain government bodies that currently have DGR endorsement. They are not eligible for registration as charities because of the degree of their connection with government, typically, the ability of government to direct their board of management. These bodies include some public art galleries, public museums, public libraries and public hospitals. Extending eligibility to all charities should not impact on these types of entities retaining their DGR status.

Issues with expanding DGR status to all charities

73. The general DGR categories and DGR endorsement process ensure that, generally, tax deductible gifts directly fund activities which generate a broad public or community benefit. The framework helps ensure public funds are not used in an inappropriate manner to provide a private gain or benefit.

74. Some charities provide significant private benefits to certain individuals that access their services. For example, a NFP non-government school is eligible for endorsement as a charity on the basis that it is established for the advancement of education, however, it provides significant private benefits to those who attend the school. Granting DGR status to these schools is likely to give rise to integrity issues as it would be difficult to distinguish between the payment of fees and voluntary donations. This is also likely to result in a significant increase in the revenue costs associated with the DGR concession.

75. Nevertheless differentiating the public benefit of charities from the benefits they deliver to their beneficiaries is an issue in relation to many other DGR categories — although typically in circumstances where the private benefits are more indirect or remote, for example, the benefits provided to a donor to a music organisation by the reduction of the cost of tickets.

76. While many DGRs provide private benefits, the integrity issues appear to be more apparent in relation to providers of educational, child care and religious services. The recently released *Review of Funding for Schooling: Final Report* (Gonski Review) recommended that the Australian Government create a fund to provide national leadership in philanthropy in schooling, and to support schools in need of assistance including by providing schools with funding for buildings or scholarships. The Gonski Review recommends that the fund should operate under DGR status and that donors should be able to influence where funds are directed. The Government has initiated a separate process to respond to the recommendations in the Gonski Review, including the recommendation to set up a philanthropic fund.

77. Extending DGR status to all charities would have a significant cost. If DGR status was extended to all charities including primary and secondary education providers; charitable child care providers and entities established for the advancement of religion, and this would have an estimated fiscal cost of at least $1 billion per annum. In the current fiscal environment this cost is high and it would need to be offset from savings in (that is, removal of) existing sector concessions.

Option 2.2: Extending DGR status to most charities

78. To help address the shortcomings of option 2.1, another option could be to exclude charities that provide significant private benefits such as primary and secondary education providers; charitable child care providers and entities established for the advancement of religion, from endorsement as a DGR. This would reduce integrity concerns and the fiscal cost.

79. However, these exclusions would maintain some of the complexity and perpetuate behavioural distortions in the existing DGR framework.

80. This would be inconsistent with the approach of the Australian Charities and Not-for-profits Commission Bill 2012. Under that Bill, an entity can be registered as a charity and have multiple sub-type registrations. For example, an entity could be registered as a charity and potentially have a number of sub-types (for example, the advancement of education and also the relief of poverty, sickness or the needs of the aged). Under this option, a charity established for the advancement of education as well as other purposes would have to split its operations into different entities to be able to claim DGR endorsement in respect of its eligible activities, adding to compliance and administration costs.

Option 2.3: Establishing endorsement conditions relating to the scope of charitable activities

81. Alternatively, DGR endorsement could remain at the entity level and endorsement conditions could be established to limit the scope of activities for which an entity can use its DGR funds.

82. Under this option, all charities would remain eligible for endorsement as a DGR but could not use DGR funds for the advancement of religion, charitable child care services, and primary and secondary education.

83. However, the scope of activities that may be excluded may not always be clear. For example, many charities established for religious purposes also provide incidental and related services, such as caring for the elderly and the less fortunate in society as a stated part of their religious mission. A principles-based solution could be envisaged where all activities that *directly* further the religious purpose of the entity would fit under the term 'religious services', with broader activities excluded from the restriction. In addition, this option would still allow charities, such as schools, that are not otherwise undertaking DGR supported activities to operate school building funds for supported activities.

84. Treasury estimates this option would provide 42,000 charities in total with access to DGR funds, an increase of about 14,000. This option would have a cost to revenue of approximately $120 million per annum[17].

Consultation questions

Q 11 Should all charities be DGRs? Should some entities that are charities (for example, those for the advancement of religion, charitable child care services, and primary and secondary education) be excluded?

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

Q 13 Would DGR endorsement at the entity level with restrictions based on activity address the behavioural distortions in Australia's DGR framework? Could unintended consequences follow from this approach?

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

2.4.2 Mechanisms to provide donors with a tax incentive

85. The Government encourages charitable giving by allowing a tax deduction for donations to DGRs. Deductions cannot be used to create losses and therefore deductions are capped at total taxable income, although certain gift deductions can be spread over 5 years. The tax

17 This estimate, and all others in this document, are preliminary estimates and should not be considered official costings.

incentive individual taxpayers receive is equivalent to their marginal tax rate in the year of the deduction.

86. While this mechanism is simple, transparent and effective, the tax deduction mechanism is regressive. Income earners with higher marginal tax rates receive a larger tax benefit for every dollar donated to a DGR. However, the deduction mechanism provides greater incentives for higher income earners to donate, and these income earners have higher levels of disposal income from which to make donations. Accordingly, it appears to have resulted in higher aggregate gifts to DGRs.

87. The empirical data generally supports this conclusion. However, it could also be explained by other external factors. According to the ATO's *Taxation statistics 2009-10,* individuals earning between $180,000 and $250,000 donated an average of $1,882 in 2009-10, while individuals earning between $50,000 and $55,000 donated an average of $320. Broadly, the data shows that higher levels of income are associated with higher average levels of donations (Table C).

Table C: Average donation levels

Taxable income level ($)	Average donations ($)	Percentage of individuals that donate
Less than 6,001	662	6.3
6,001 to 20,000	228	24.7
20,001 to 40,000	258	35.3
40,001 to 60,000	287	44.9
60,001 to 100,000	386	50.2
100,001 and over	1,460	53.8

Source: ATO, Taxation Statistics 2009-10

Option 2.4: Implementing a tax offset mechanism for gifts

88. A mechanism used overseas to provide a tax incentive for donations is a fixed tax offset (or rebate). A system of tax offsets has been in place in Canada since 1988. In Canada, the first $200 of donations is offset at the same percentage as the lowest marginal income tax rate, and donations in excess of $200 receive a tax offset at the highest marginal tax rate.

89. This mechanism allows taxpayers to reduce their tax liability by a fixed percentage of their donations to DGR entities. It is simple, produces minor administrative costs for the Government and taxpayers, and is effective to encourage donations to DGRs. It is also fair, as it ensures that all individual taxpayers receive identical tax benefits from donations to DGRs.

90. The potential incentive (and revenue) effects of shifting from a tax deduction to a fixed tax offset on total charitable donations will depend on the level of the fixed offset rate. For higher income earners, the tax incentive or benefit derived from donations to DGRs will be reduced unless the fixed offset rate is the same as their marginal tax rate. Low income earners on the other hand are likely to receive a greater tax incentive from donating to DGRs and are therefore likely to increase their donations.

91. The Treasury has performed preliminary analysis of shifting to a two-tiered offset with a 34 per cent offset for donations of up to $1,000 per year, and a 38 per cent offset for donations of more than $1,000 per year. It is estimated that this would produce revenue savings of around $135 million per year. A $1,000 threshold provides an incentive for high income earners to maintain their current level of donations. Under these thresholds, it is estimated that donations to DGRs would decline by around 5 per cent due to the behavioural

response of high income earners, which would outweigh the response of low income earners in total dollar terms.

92. The PC predicted a small overall decline in the level of giving to DGRs if Australia changed its DGR mechanism from a tax deduction to a fixed tax offset set at 38 per cent.[18] It estimated a fixed tax offset rate of 38 per cent would be revenue-neutral from the Government's perspective.

93. A multiple tax offset system could be designed to elicit a higher level of average donations, by increasing average donation levels of middle income individuals, and limiting the fall in tax incentives faced by high income individuals. Canada takes this approach with the lower offset rate set at the lowest marginal tax rate and the high rate set at the highest marginal tax rate. The costs of setting the offset rates at these levels, or at any other levels, have to be considered.

Option 2.5: Hybrid system for donations to private ancillary funds

94. Another possibility is to retain deductions in some cases and allow offsets in others. For example, individuals with high incomes may wish to establish and make deductible gifts to private ancillary funds (PAFs), a privately controlled DGR fund established for the sole purpose of distributing funds to other DGRs.

95. In a hybrid system, donations to PAFs could attract a tax deduction under the current deduction mechanism, and donations made directly to DGRs could be offset under a single or multiple tax offset system.

96. This would not reduce tax incentives for high income individuals giving to PAFs so these individuals would not reduce their overall level of donations to DGRs. However, donations from individuals who do not establish PAFs, may reduce under this option. The overall effectiveness of this option depends on the level of the high tax offset rate.

97. One concern is that under this option, high income individuals with PAFs would receive a tax benefit not available to other taxpayers. It may also have implications for the integrity of the tax system. These issues need to be weighed up against the benefit of potentially eliciting higher levels of total donations.

2.4.3 Encouraging charitable giving and reducing transaction costs

Option 2.6: Tax incentives to encourage testamentary giving

98. Current law only provides a tax deduction for gifts made during the donor's lifetime. However, there is some relief for testamentary gifts under the capital gains tax provisions. A testamentary gift of property that would have been deductible under the gift deduction if made during the person's lifetime, is disregarded for capital gains tax purposes.

99. The Mitchell Review of *Private Sector Support for the Arts* (March 2012) (Mitchell Review) recommended that the Government introduce the capacity for private donors to make testamentary gifts in their wills to DGR arts organisations, and receive an immediate tax deduction equal to the present value of the gift. This seeks to encourage giving and to remove

18 Productivity Commission, 2010, *Contribution of the Not-for-profit Sector*, Appendix G.

the distinction between the tax treatment of gifts made during a person's life and those made in a will. This option proposes that the deduction would be allowed at the time the gift is included in the will and not at the time of death.

100. This option scores poorly against principles of simplicity and effectiveness. For example, if a gift of artwork is made in this way, the donor can continue to privately benefit from the 'gift' for an indeterminate time during their own lifetime, while the public would not have the same opportunity. Further, in overseas jurisdictions, such a concession has been found to generate tax avoidance schemes that allow a person to claim deductions during periods where revenue or income flows are low and 'pay back' these deductions when the economic situation improves, resulting in the Government taking on financial market risk for donors and donees. Simplicity would also be lacking as the donor and the ATO would need to estimate the present value of a testamentary gift, which would include an assessment of the life expectancy of the donor.

101. The Mitchell Review also looked at the use of charitable remainder trusts and charitable lead trusts which, in the United States of America (USA), provide a tax incentive for testamentary giving. The Mitchell Review concluded that these programs attract private sector support for the arts, partly because tax incentives minimise the impact of inheritance tax, which do not apply in Australia.

102. The effectiveness of this reform option in increasing the level and value of donations is likely to be low. Experience in overseas jurisdictions and in similar past Government programs suggest that such initiatives are likely to come at a significant cost to revenue, result in substantial tax avoidance opportunities, and have a limited impact on testamentary giving. This was evident in Australia's own experience with the Cultural Bequests programme, which was suspended in the 1999-2000 financial year as it failed to achieve intended outcomes.

103. As mentioned above under the current law, one barrier to testamentary giving has been removed by the exemption from CGT of certain testamentary gifts of property to DGRs. Testators previously faced barriers to gifting property to DGRs because their estate could incur CGT on the gift. Advancing the Mitchell review recommendation would require the exemption from CGT to be repealed to prevent testators from benefiting from multiple tax benefits in relation to the same testamentary disposition.

Consultation questions

Q 15 Would a fixed tax offset deliver fairer outcomes? Would a fixed tax offset be more complex than the current system? Would a fixed tax offset be as effective as the current system in terms of recognising giving?

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

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

Q 18 Should testamentary giving be encouraged through tax concessions and what mechanisms could be considered to address simplicity, integrity and effectiveness issues?

Option 2.7: Creating a clearing house for donations to DGRs

104. The ACNC is likely to begin operations in late 2012. It will register charities and maintain the Australian Charities and Not-for-profits Register (ACN register). The ACN register may contain standard information set for all registered entities including a description of their purposes, activities and, typically, at a minimum, high level financial information.

105. A clearing house for gifts to DGR entities which is linked to the ACN register could promote and encourage charitable giving. Individual taxpayers could use the register to search for particular types of DGR to support. Individuals could donate to these DGRs through the clearing house website.

106. An advantage of this option is that individual taxpayers would be able to use one website to access information on all registered charities, helping them make informed choices. Currently, information on purposes and activities of DGRs is scattered across different sources, and in some cases, may not be available, particularly for smaller charities. The clearing house would simplify making cash gifts to DGRs and would provide a reliable mechanism for individual taxpayers to make credit card donations to one or more DGRs in a single secure transaction.

107. Cash donations would be deposited into the bank accounts of charities by the ATO which would maintain the clearing house. The clearing house could automatically create electronic donation receipts and if desired, pre-fill electronic tax returns. Taxpayers could access the clearing house website for details of their deductible cash gifts during a financial year. This would reduce the compliance and administrative costs of DGRs as, subject to any applicable State and Territory law requirements, they would no longer have to issue donation receipts.

108. Smaller charities are likely to have limited or no online fundraising facilities, and are therefore likely to benefit from this option.

109. Establishing a clearing house has an estimated once-off capital cost of around $25 million. This does not include ongoing costs, such as credit card charges, which it may be possible to eliminate through support from financial institutions.

110. A further benefit of a clearing house is that it may assist increased donations through workplace giving. This option would facilitate workplace giving by providing employees and employers with a central website to donate to DGRs. Workplace giving allows better planning of giving by more closely aligning donations and cash flow patterns, and allows individuals to donate in a more considered manner.

111. The PC noted that around 0.6 per cent of all adults in Australia participated in workplace giving, compared to 1.3 per cent in the UK, and 5.6 per cent in Canada.[19]

112. A clearing house linked to the ACN register would help to reassure donors that all monies donated through the clearing house will go to registered charities. It would also provide donors with a comprehensive list of potential DGR entities they would be able to confidently donate to.

19 Productivity Commission, 2010, *Contribution of the Not-for-Profit Sector*, pp. 180.

Consultation questions

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

Q 20 Are there any barriers which could prohibit the wider adoption of workplace giving programs in Australia? Is there anything the Working Group could recommend to help increase workplace giving in Australia?

Option 2.8: Simplify property donation rules and anti-avoidance rules

113. To reduce transaction costs associated with gifts, property donation and anti-avoidance rules could be revised and simplified. Property donation rules specify the types of donated property eligible for tax deductions and valuation methods to determine appropriate tax deductible amounts.

114. The current property donation rules are complex and may be confusing. The valuation methods for obtaining a tax deductible amount for specific property types may be costly. For example, property donated must be valued by the Australian Valuation Office, a part of the ATO, currently attracting a non-refundable application fee of $174. Different rules apply to trading stock, shares listed on a stock exchange, and other types of property held for different periods of time by the donor.

115. The gift rules are complemented by integrity provisions — see, for example, section 78A of ITAA 1936. This provision outlines situations where donations may not be tax deductible. This includes where donors (or their associates) receive something in return for the donation and so are denied the deduction. Section 78A is complex and only applies in limited situations.

116. The current tax law enables individual donors to receive a minor benefit for contributions made to a DGR and claim a deduction for the difference between the value of the contribution and the minor benefit received in return for a contribution. The value of the minor benefit received cannot exceed $150 or 20 per cent of the value of the contribution, whichever is less. This is aimed at corporate fundraising type events. The Working Group will consider whether these rules are working appropriately.

117. Reforms could simplify the valuation rules and simplify and strengthen the integrity rules for gifts, so donors have more certainty and safeguards continue to protect the integrity of Australia’s tax system.

Consultation questions

Q 21 Do valuation requirements and costs restrict the donation of property? What could be done to improve the requirements?

Q 22 Is there a need to review and simplify the integrity rules?

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

Option 2.9: Eliminate public fund requirements for charities registered by the ACNC

118. Ensuring DGR entities operate under appropriate frameworks and use funds in line with the purposes for which they were donated would also help to promote and encourage charitable giving. As noted above, all charities that have been registered by the ACNC would be required to comply with a specific set of regulatory requirements, including governance and reporting requirements.

119. Currently, before endorsing some types of entity as a DGR, the ATO checks that the public fund requirements have been met.

120. The public fund requirements are mainly contained in *Taxation Ruling TR 95/27 Income Tax: public funds*. The requirement to have a public fund is in part intended to ensure that moneys and property donated to the fund, which attract a tax concession, are used for the purpose for which the fund has been granted DGR status.

121. There may be less need to have public fund requirements where an entity is registered by the ACNC and operating under appropriate governance standards. Under these conditions, it is more likely that donated funds will be used for the purpose for which the entity has been granted DGR status.

Consultation questions

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

Q 25 Are there any possible unintended consequences from eliminating the public fund requirements for entities that have been registered by the ACNC?

Option 2.10: Increase the threshold for a deductible gift from $2 to $25

122. AFTS recommended that the tax deduction for gifts be maintained, but that the threshold for deductible donations be increased from $2 to $25 per gift. A different or higher threshold could also be considered. The main purpose of any change would be to simplify administration for DGRs and for donors. It is likely that many donors of small sums do not claim a tax deduction so any change to the threshold may have a minimal impact on donor behaviour.

123. Such a reform might also encourage donors to consider making larger individual donations, instead of making smaller donations across multiple organisations. This could also reduce administrative burdens for DGRs.

124. Increasing the threshold would reduce the compliance burden associated with providing receipts for donations of $2 or more. There may be concerns that increasing the limit would have implications for workplace giving. This could be reduced by creating an exception.

Consultation question

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

General

Consultation question

Q 27 Outline any other suggestions you have to improve the fairness, simplicity and effectiveness of the DGR regime, having regard to the terms of reference.

Reform options	Assessment against the Working Group's guiding principles
Option 2.1: extending DGR status to all charities All charities would be eligible for endorsement as a DGR entity.	This option scores highly in recognising giving in Australia, as the public will be able to donate to all charities on a tax deductible basis; simplicity as the general DGR categories and Registers will be eliminated; and transparency as eligibility conditions will be simplified and easy to understand.
Option 2.2: extending DGR status to most charities All charities, except for charities that are primary and secondary education providers; charitable child care providers and entities established for the advancement of religion, would be eligible for endorsement as a DGR entity.	This option scores highly in terms of structural coherence as the option helps safeguard Australia's DGR framework from inappropriate use, have less cost to revenue than reform option 2.1. The other benefits identified for reform option 1 apply to this option.
Option 2.3: establishing endorsement conditions relating to the scope of charitable activities All charities will be endorsed with restrictions on the scope of activities an entity can use DGR funds to finance.	The option scores highly in terms of efficiency as it reduces behavioural distortions which characterise Australia's current DGR framework. The other benefits identified for reform option 2.1 and reform option 2.2 apply under this option.
Option 2.4: implementing a tax offset mechanism for gifts Donors would receive a tax offset (tax rebate) at a rate to be determined for gifts to DGR entities.	This option scores highly in terms of fairness as all taxpayers would receive a similar tax benefit. It also scores highly on transparency and efficiency as it will be easy to understand and use.
Option 2.5: hybrid system for donations to private ancillary funds (PAFs) Donations to PAFs will continue to be tax deductible, and donations to all other DGR would be offset at a fixed rate to be determined.	This option scores highly in terms of recognising giving in Australia as it would ensure that the tax benefit for high net worth individuals is not reduced. The other benefits identified for option 2.4 apply to this option, but to a lesser extent (particularly related to fairness).
Option 2.6: tax incentive to encourage testamentary giving Donors would receive a tax deduction for testamentary gifts made to DGRs.	This option may help to encourage giving by reducing the difference which exists between the tax treatment of gifts made during a person's life and those provided in a will.

Reform options	Assessment against the Working Group's guiding principles
	The effectiveness of this reform option is likely to be low. Overseas experiences and similar past Government programs suggest that such initiatives are likely to have a significant cost to revenue, result in substantial tax avoidance opportunities, and have only a very limited impact on testamentary giving. This option creates distortions as different DGRs will effectively operate under differing DGR frameworks which would undermine reforms to simplify the framework.
Option 2.7: creating a clearing house for donations to DGRs The ATO would establish and maintain a clearing house for donations to DGR entities which is linked to the Australian Charities Not-for-profits Register (ACN Register).	This option scores highly in recognising giving in Australia as it reduces transaction costs associating with giving, provides simplicity for both donors and DGR entities, and is transparent as all entities would have information on their operations included on the ACN Register. Donors would also be readily able to track their gifts for claim purposes. It is estimated that a significant percentage of gifts to DGRs are not currently claimed.
Option 2.8: simplification of property donation rules and anti-avoidance rules Property donation rules and integrity rules would be streamlined and simplified.	This option scores highly in terms of efficiency as rules would be streamlined and simplified reducing compliance costs, transparency, as it would foster a sounder understanding of the rules, and recognising giving as it will be easier to make property gifts which would likely increase property donations.
Option 2.9: eliminate public fund requirements for charities registered by the ACNC Where an entity is registered by the ACNC it would not have to comply with the public fund requirements.	This option scores highly in terms of efficiency as charities which are registered by the ACNC would not have to simultaneously prove that they meet governance standards and public fund requirements. However, this would not ensure suitably qualified persons controlled the DGR so as to help prevent inappropriate decisions being made by it in breach of its constitution or the law.
Option 2.10: increase the threshold for a deductible gift from $2 to $25	This option scores highly in terms of efficiency as the threshold has not been updated for many decades and the requirement to issue receipts for relatively small donations can be a compliance burden for some deductible gift recipient and for some types of fundraising activity. This option is likely to score less well on recognising giving, as gifts of less than $25 would no longer be tax deductible, unless an exception applies (for example, for workplace giving).

3. FRINGE BENEFITS TAX CONCESSIONS

125. A range of NFP entities are exempt from paying tax on fringe benefits provided to employees, generally up to a monetary limit per employee. NFP entities that benefit from this exemption include public benevolent institutions (PBIs), public and NFP hospitals and religious institutions in relation to religious practitioners.

126. Entities that are endorsed by the ATO as income tax exempt, but not entitled to the FBT exemption, may qualify for an FBT rebate up to a monetary limit per employee. Employers entitled to the rebate are entitled to have their liability to pay FBT reduced by a rebate equal to 48 per cent of the gross FBT payable. Entities that qualify for the rebate include religious, certain educational, charitable, or scientific institutions, trade unions and employer associations, certain community organisations, and organisations established to promote the development of certain Australian resources.

127. Total quantifiable Commonwealth tax expenditures on FBT concessions provided to the NFP sector were estimated to be in the order of $2.5 billion. Unquantifiable FBT concessions (see Table D) are likely to add several hundred million to this total. The largest concession, by total revenue foregone by the Commonwealth, is the exemption for PBIs, other than public and NFP hospitals and health promotion charities, which can provide up to a grossed-up value of $30,000 in fringe benefits to each employee without paying FBT. This concession was estimated at $1.3 billion for 2011-12.[20] Another significant concession is for public and NFP hospitals and ambulance services, which can provide a grossed-up value of up to $17,000 per employee and an estimated cost of $1.0 billion.[21] Importantly, the rules for calculating the caps exclude various benefits, including meal entertainment and entertainment facility leasing benefits.

128. The FBT exemption provides significant benefits to employees of eligible entities (and to the entities themselves), with the ability to engage in salary packaging worth up to around $4,300 per annum to an employee with a taxable income of $45,000 and up to around $6,100 per annum to an employee with a taxable income of $100,000. Anecdotal evidence suggests that salary sacrificing is utilised by eligible employers as a method of attracting employees by offering packages that compete with those offered by the commercial sector. Meal entertainment and entertainment facility leasing benefits can be provided with no limit.

3.1 HISTORY OF FRINGE BENEFITS TAX CONCESSIONS

129. Concessional treatment for certain NFP organisations has been a feature of the FBT system since its introduction in 1986. Prior to this, benefits (generally non-cash benefits) provided to employees were taxed in the hands of individual employees. Concessional FBT treatment was initially provided to exempt benefits provided by PBIs to their employees. The exemption was later extended to employees of government bodies where the duties of employment are performed exclusively in, or in connection with, a public hospital that was a PBI.

20 Treasury, *Tax Expenditure Statement*, 2011, Item D14.
21 Treasury, *Tax Expenditure Statement*, 2011, Item D11.

130. The method of calculation of an employer's FBT liability was changed from 1 April 1994 to use a tax-inclusive amount, or a 'gross-up method'. As a result of this structural change, a rebate of FBT payable was introduced to ensure that the FBT liability of certain income tax exempt employers did not substantially change. The rebate was provided to some, but not all, income tax exempt entities. Employers entitled to the rebate are listed in the legislation. They include religious institutions; certain charitable institutions and certain other income tax exempt NFPs.

131. As a result of the different forms of concessional treatment provided to eligible entities (exemption or rebate), inconsistencies arose between public and NFP hospitals. NFP hospitals were entitled to a rebate while benefits provided by public hospitals were exempt benefits. To ensure that public and NFP hospitals were treated consistently, NFP hospitals were provided with an exemption. The FBT exemption provided to PBIs was extended from 1 April 1998 to charitable institutions whose principle activity was promoting the prevention or control of diseases in humans (health promotion charities).

132. From 1 April 2001, caps were introduced to limit the concessional tax treatment provided by way of exemption and rebate to PBIs and other eligible organisations. The caps were set at $17,000 per employee for hospitals and ambulance services and $30,000 per employee for PBIs and health promotion charities. As noted in the AFTS consultation paper, the caps were introduced to prevent over-use of these concessions and limit the impact on competitive neutrality.[22] From 1 April 2003 the requirement that public hospitals must be PBIs to access concessional treatment was removed. This change was made to ensure that public hospitals could continue to provide exempt benefits to employees when organisational restructures meant they no longer met the requirements to be PBIs. Public ambulance services were able to provide exempt benefits to employees (with a cap of $17,000) from 1 April 2004.

133. From 1 July 2005, entities that are charities (including PBIs and health promotion charities) were required to be endorsed to access the FBT concessions.

22 AFTS, 2008, *Consultation Paper*, section 7.

3.2 CURRENT FRINGE BENEFITS TAX CONCESSIONS

134. Table D provides details of the main FBT concessions. The table at Appendix D provides details of all FBT concessions.

Table D: Main Fringe Benefits Tax concessions for the NFP sector (Treasury estimates)

Concession	Limitations	Estimated value in 2011-12	Estimated number of employees within the relevant sector
Exemption for public benevolent institutions (other than public and NFP hospitals)	$30,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	$1.3 billion	485,000
Exemption for public and NFP hospitals and public ambulance services	$17,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	$1.0 billion	450,000
Exemption for certain fringe benefits provided to live-in employees of religious institutions	No limit	**	**
Exemption for charities promoting the prevention or control of disease in human beings	$30,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	$90 million	24,000
Exemption for practice, study, teaching or propagation of religious beliefs by religious practitioner	No Limit	$85 million	**
Parking for employees of scientific, religious, charitable or other public education institutions	No Limit	**	**
Rebate of FBT for certain NFP entities	$30,000 of grossed-up taxable value per employee (rebate on meal entertainment and entertainment facility leasing is uncapped)	$35 million	440,000

** The relevant value is difficult to estimate with precision, as there is limited reporting on this area of activity.

135. Anecdotal evidence suggests that fringe benefits that are typically provided under the capped FBT exemptions include cars, mortgage repayments, rent, and school fees. Employees often receive a ‘salary package’ which involves a ‘salary sacrifice’ so that benefits are provided out of pre-tax income. This can result in a significant tax saving. Table E provides a simplified example of the benefit available to a PBI through salary packaging of benefits for an employee. Salary packaging arrangements are often complicated by interactions with various other transfer payments provided by the Australian Government, such as Family Tax Benefits and parenting payments. The PC noted that FBT concessions are sometimes used in ways that are not consistent with the initial policy intent.[23]

23 Productivity Commission, 2010, *Contribution of the Not-for-profit Sector*, Chapter 8.

136. Each package, in the example in Table E, provides the employee with the same net income after tax, but salary sacrificing provides the PBI with a saving of over $8,000. This saving could be provided in its entirety to the employee by way of higher remuneration, or some or all of the saving could be retained by the PBI.

Table E: Simplified example of benefit for a PBI from salary packaging

	With salary sacrificing	Without salary sacrificing
Taxable Income (A)	$45,000	$69,810
Salary sacrificed benefits (B)	$16,050	-
Tax on taxable income (including Medicare levy) (2012/13 rates) (C)	$6,522	$15,282
Net income after tax (A+B-C)	$54,528	$54,528
Cost to PBI (A+B)	$61,050	$69,810

137. Meal entertainment, entertainment facility leasing and car parking expenses are excluded from the benefit caps placed on some of the FBT concessions. Accordingly, employees of the relevant categories of eligible entities can receive unlimited amounts of these benefits from pre-tax income. The PC indicated, in their 2010 Report, that the only practical limitation on these benefits is the taxable income of the relevant employee. Nevertheless, it appears that some eligible entities voluntarily limit the quantum of these benefits available to employees.

3.3 Concerns with the current fringe benefits tax concessions

3.3.1 Inconsistency of treatment

138. Some stakeholders may question whether eligibility for the exemption or rebate is appropriate in all cases. The only entities entitled to the exemption are PBIs, public and NFP hospitals, health promotion charities, ambulance services and religious entities. Some, but not all, income tax exempt entities are entitled to the rebate. Some of those not eligible for the rebate include entities that can access the exemption or those that are funds, rather than institutions.

3.3.2 Competitive neutrality

139. Issues of competitive neutrality arise where eligible entities compete directly with businesses that do not benefit from FBT concessions. Examples include private for-profit hospitals that compete with NFP and public hospitals, and restaurants and bars that compete with rebateable clubs.[24] 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. On the other hand, an entity's status might be considered a valid reason for provision of the concession. The concession might also be seen as a form of assistance to compensate for other disadvantages, such as impediments to NFPs raising external finance.

24 These concerns were discussed in detail by the PC Report in 2010 and also highlighted in the AFTS Report.

3.3.3 Use of concessions outside of initial policy intent

140. There is considerable anecdotal evidence to indicate that some relatively high income individuals receive significant benefits from the use of uncapped meal entertainment and entertainment facility leasing concessions. The PC, in its 2010 report, noted examples of high income professionals paying for restaurant meals and hire of wedding venues from pre-tax income under these concessions.

3.3.4 Administrative burdens

141. The perceived need to offer fringe benefits imposes considerable compliance burdens on eligible entities. This includes the requirement to organise and offer salary packaging and the recording and reporting requirements for fringe benefits. These costs might be met internally or through engaging an external provider. However, anecdotally, the take up rate is often not commensurate with the effort exerted in offering salary packaging arrangements. Take-up rates tend to be higher for more highly paid employees than for lower paid employees, apparently due to the higher tax savings.

3.4 Reform Options

142. FBT concessions allow some entities in the NFP sector to offer attractive remuneration benefits to employees. However, the FBT concessions are complex, impose significant compliance burdens and raise concerns about fairness. Inequality arises because there are inconsistencies related to who is eligible for the concessions and also because fringe benefits tend to be provided to employees with higher disposable incomes.

3.4.1 Eligibility

Option 3.1: Should the list of entities eligible for the exemption or rebate be revised?

143. At present a limited number of entities are eligible for the exemption. Some, but not all, tax exempt entities are eligible for the rebate and some of the entities that are eligible for concessions are not charities (for example, employees of public hospitals are eligible for the exemption and employees of NFP music or sport societies are eligible for the rebate).

Consultation questions

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?

Q 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?

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?

3.4.2 Other issues

144. The Working Group has identified a number of options relating to the operation of FBT concessions. These options have been divided into two parts. Part A sets out reform proposals that could be pursued in the short term. Part B includes options for reform that could be pursued over the longer term, as they involve considerable change to existing arrangements and would need to be progressed with in-depth consultation processes and lengthy transitional periods.

145. Consistent with the terms of reference for the Working Group, any reduction in support to the sector from changes to the FBT should continue to be available to support the NFP sector as part of the overall envelope of government support for the sector. This is also consistent with the Government response to AFTS, which stated that it would not make 'any changes to the tax system that harm the NFP sector'.

3.4.3 Part A — Short-term reform options

Option 3.2: Include meal entertainment and entertainment facility leasing benefits within the relevant caps

146. The PC, in its 2010 Report, raised particular concerns about the uncapped meal entertainment and entertainment facility leasing concessions. The concessions allow employees of eligible entities to have an unlimited amount of restaurant meals and hiring of entertainment facilities paid for from pre-tax income, thereby avoiding income tax on that portion of their incomes. Some salary packaging firms offer credit cards that can be used at restaurants to facilitate this form of expenditure from pre-tax income.

147. The PC provided an example of an employee of an eligible entity paying $2,200 for a restaurant meal with 10 colleagues, for a total cost of $1,177, with a tax concession of $1,023 resulting from the ability to pay for the dinner using an employer credit card to access pre-tax income. The PC provided an additional example of an employee on an income of $90,000 salary sacrificing a $40,000 wedding to reduce tax payable in that year by $13,950. The way that these concessions are being used would appear to offend principles of fairness

and the value of these concessions could be better directed to achieve the community and altruistic purposes of the NFP sector generally.

148. Under option 3.2, these benefits would continue to be exempt from FBT or rebatable but the value of benefits would need to fit within the relevant FBT caps. Employers would continue to have access to uncapped FBT concessions for benefits that cannot easily be attributable to a single individual, such as the provision of venue hire and meal entertainment associated with a staff Christmas party.

149. Treasury has estimated that making salary sacrificed meal entertainment and facility leasing fringe benefits reportable would result in a saving of approximately $100 million per year in the tax expenditure on this concession.

Consultation questions

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

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?

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?

Option 3.3: Require employment declarations to include information about FBT concessions to avoid employees from benefiting from multiple caps

150. FBT is levied upon individual employers and the relevant concessional benefit caps apply per employee for each employer. This creates the possibility that employees with several employers could receive fringe benefits from several employers and, if each of those employers is a PBI or health promotion charity or a public or NFP hospital or ambulance service, those benefits would be exempt from FBT up to the relevant cap for each employer. For example, a doctor employed by 3 different NFP hospitals could receive a total grossed up benefit of $51,000 without any FBT liability accruing for any of the hospitals.

151. The potential for individuals to benefit from multiple FBT caps could be addressed by eliminating the concessional treatment of benefits from second and successive employers if an employee already receives concessional benefits from another employer. Second and subsequent employers would require notice that this is the case. One way of providing such notice, that is effective for calculating employee's pay-as-you-go withholding taking into account the tax-free threshold, would be to require employees to indicate whether they are receiving concessional FBT benefits from another employer on their employment declarations.

152. One complication that would need to be addressed in implementing this reform option involves how to deal with employees that wish to claim fringe benefits from several employers within the limits of a single concessional cap. A simple approach might be to deny

concessional treatment for any second and subsequent employers. An alternative approach would be to allow an employee to benefit from a proportion of the capped amount from each employer. For example, one-half of the cap could apply to each employer if a person obtains fringe benefits from two employers.

153. It is not known exactly how many employees receive fringe benefits from multiple NFP employers. The size of this issue is somewhat limited by the relatively small number of employees with multiple employers.

154. One disadvantage of this option is that it would likely create an additional compliance burden for some eligible entities, albeit a small one, given that a similar system is already in place for taking account of tax-free thresholds under pay-as-you-go withholding schedules.

155. Treasury has estimated that this reform would generate revenue savings of approximately $10 million per annum.

Consultation question

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?

Option 3.4: Align the rate for fringe benefits tax rebates with the fringe benefits tax rate of 46.5 per cent

156. Certain tax exempt entities are eligible for a 48 per cent rebate of the FBT that would otherwise be payable on up to $30,000 of the grossed-up taxable value of fringe benefits per employee. As the FBT rebate was introduced to preserve the existing liabilities of these exempt entities, it has traditionally been aligned with the FBT tax rate because the FBT tax rate forms part of the formula for grossing up of fringe benefits. That is, as the FBT tax rate increases there is a need to increase the FBT rebate rate to preserve existing liabilities, and as the FBT tax rate falls there is a need to decrease the FBT rebate rate to ensure that affected bodies are not over compensated.

157. The FBT tax rate is currently 46.5 per cent, which is the sum of the top marginal tax income tax rate (45 per cent) plus the Medicare Levy (1.5 per cent). The FBT rebate rate was not realigned with the FBT tax rate when the top marginal tax rate was reduced in the 2005-06 Budget. Treasury has estimated that this reform would generate revenue savings of approximately $3 million per annum.

Consultation question

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?

Option 3.5: Align the minor benefit exemption with the commercial sector

158. Some minor fringe benefits are not subject to FBT. Benefits of up to $300 can be provided to employees without FBT being payable. This is subject to a number of conditions, including that similar or identical benefits are not provided frequently or regularly to the employee and the benefit is not part of a salary packaging arrangement. Examples of benefits that would generally be regarded as minor benefits include a gift of flowers to an employee on the birth of a child, a birthday present of movie tickets and a staff Christmas party. Examples of benefits that would not be exempt minor benefits include a regular lunch provided by an employer or ongoing subsidised rent of a home.

159. Tax exempt bodies are currently restricted in the application of this exemption in relation to meal entertainment benefits. This is particularly relevant to rebatable employers. To address this apparent inequity, application of the minor benefit exemption could be extended to tax exempt bodies on the same basis as it applies for other entities.

Consultation question

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?

3.4.4 Part B — Long-term reform options

Option 3.6: Phase out capped FBT concessions and replace with alternative government support

160. AFTS recommended that the capped FBT concessions be phased out entirely over 10 years and replaced with direct government funding. AFTS suggested that this direct funding might be provided by application to the ACNC or relevant Commonwealth Government agencies for funding for specific projects or for assistance with the costs of recruiting specialist staff. The major benefit of this approach would be a significant reduction in the compliance burden for tax-exempt NFP entities that are currently required to provide salary sacrificing and FBT reporting services to their staff. However, applications for direct grants and reporting on those grants to government agencies can also involve significant compliance costs that would, to some extent, replace those tax compliance burdens.

161. This option may also raise concerns for some in the NFP sector about its effect on their autonomy and independence from government. It may also expose the sector to the risk of sudden reductions in funding as a result of budget decisions.

Consultation questions

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

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

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

Option 3.7: Phase out fringe benefits tax concession and replace with alternative tax-based support mechanisms for eligible not-for-profit entities

162. The Working Group will consider whether there might be better ways of providing assistance to the sector if FBT concessions are to be phased out. Three main questions arise for consideration: what mechanism should be used to provide assistance? what should be the scope of such assistance? and who should be eligible?

Refundable tax offsets payable to eligible entities

163. Instead of moving to a system of grants to be allocated by application and approval process, the current system of FBT concessions could be replaced by a system of refundable tax offsets for eligible entities. Such an employer offset could be applied on a per employee basis and could be directed to the eligible employer. It would operate as a more transparent incentive to be employed in the NFP sector.

164. As an example, the FBT exemption for PBIs has an estimated cost of approximately $1.4 billion in 2012-13. Assuming that there are around 500,000 employees of PBIs, the FBT exemption alone amounts to approximately $2,800 per employee. A direct payment of an amount, per employee, to each PBI to replace FBT concessions would eliminate a significant compliance burden, be more transparent, equitable and simple. It would also allow eligible entities to allocate the funding to where they believe it would do the most good in achieving their purposes, which might include in remunerating all or certain employees.

A direct tax offset for employees of eligible entities

165. A second alternative is to provide an income tax offset to employees of eligible entities that would directly reduce the income tax on an employee's salary. This would be an alternative to directing support to the employer entity. It could be supported through the PAYG withholding system by allowing assistance throughout the year. The purpose of this offset would be to replace the value currently derived from FBT concessions in remuneration packaging for employees of eligible entities.

166. This offset could be modelled on existing tax offsets, such as the offset for workers in remote regions of Australia and the mature age workers tax offset. An employee of an eligible entity would indicate that they are employed by an eligible entity to qualify for a tax offset. The compliance burden associated with such a declaration could be minimal, as the identity of a person's employer is disclosed to the ATO on their payment summary. The eligible employer entity could reduce the amount of tax deducted from an employee's pay throughout the year

to allow for the offset amount, to provide the employee with increased take-home pay on a regular basis.

167. Employers that currently retain part of the tax savings from salary packaging arrangements would need to reset their employees' remuneration having regard to the employees' eligibility for the offset. The offset amount might need to take into account the flow on effect of a reduced reportable income for employees in relation to family tax benefit and other government benefits and levies. The tax offset would also need to be designed to take account of multiple eligible employers. The offset should only be available with respect to one employment.

Tax free allowances for employees of eligible entities

168. Another way to provide direct support to employees of eligible entities would be to allow employers to provide capped tax-free allowances to employees. A different cap could be set for different types of employers (for example, using the current distinction between exempt and rebatable employers). This option differs from the tax offset option above in the potential amount of benefit for the employee. The tax offset option provides the same tax benefit to all employees, while a tax-free allowance effectively provides a higher tax benefit to higher income earners. The compliance burden would again be minimal, as the employee's payment summary will disclose the identity of their employer.

169. Reportable income flow on effects would again need consideration as this reduces an employee's income which may have significant flow on consequences for government payments as well as for other matters, such as child support payments. This may indicate that fairness of this mechanism would be lower than for a tax offset.

Consultation question

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?

Option 3.8: Limit concessions to benefits that are incidental to employment

170. If the FBT concessional framework were to be retained, the Working Group will consider the alternative of limiting concessional fringe benefits to 'non-remuneration benefits' (for example, benefits that are incidental to employment such as use of a staff car park at no cost in the CBD). This approach would eliminate concessional treatment for salary packaged benefits, but the sector would retain the ability to provide incidental benefits to employees, such as in-house meals or incidental use of cars, without FBT being payable, or with application of the rebate. The concessional treatment of these incidental benefits would not require capping due to the specific requirement that these benefits not be part of the employee's remuneration.

171. This option has the potential to address fairness concerns that arise under the current system, whereby the ability to benefit from FBT concessions is greater for those on higher incomes and for those with a better understanding of the tax system. This option would also reduce

compliance burdens for eligible entities, and for employees of eligible entities, as it would limit the need to engage, and account for, salary sacrificing arrangements.

Consultation questions

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

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?

Reform options	Assessment against the Working Group's guiding principles
Option 3.1: Should the list of entities eligible for the exemption or rebate be revised?	The option allows issues of fairness and maximising the social good to be addressed.
Short Term Reforms	
Option 3.2: Include meal entertainment and entertainment facility leasing benefits within the relevant caps Existing caps of $17,000 and $30,000 (grossed-up) apply to fringe benefits provided by some NFP entities. Meal entertainment and entertainment facility leasing benefits are unlimited as they are currently exempt from these caps. The option would require these types of benefits to be counted towards the respective caps.	The option scores highly on maximising the social good, fairness and simplicity. Limiting the ability of a small number of individuals to access these benefits and redistributing this money within the NFP sector addresses fairness concerns about some individuals receiving disproportionate benefits from the uncapped concession. Bringing meal entertainment and entertainment facility leasing within the relevant caps would be relatively simple, as eligible entities already have systems in place for dealing with the existing caps. This option may reduce the social good that some entities can contribute if it reduces their ability to attract and retain employees.
Option 3.3: Require employment declarations to include information about FBT concessions to avoid employees from benefiting from multiple caps FBT caps are applied to employers, rather than employees. Accordingly, an employer with several employers can access the full value of an additional cap for each employer. The option would limit the ability of employees to access multiple caps.	The option scores highly on maximising the social good (as above) and fairness. The ability of employee to access multiple caps merely as a result of having several employers raises fairness concerns that would be addressed by limiting access to multiple caps.
Option 3.4: Aligning FBT rate and the FBT rebate rate of 46.5 per cent The FBT rebate rate is currently 48 per cent, whereas the FBT rate is 46.5 per cent. This overcompensates eligible NFP entities for the effect of FBT.	The option scores highly on structural coherence. The FBT rebate rate is intended to compensate for the grossing-up of FBT benefits. The current lack of alignment does not accurately compensate for the effect of the grossing-up of FBT benefits.
Option 3.5: Align the minor benefit exemption with the commercial sector NFP sector employers would, subject to certain condition, be able to provide tax free benefits of up to $300 to employees.	The option scores highly on fairness, as the rationale for distinguishing between NFP and for-profit businesses for the provision of minor benefits is not clear. It also scores highly for simplicity, as minor benefits would be exempt from FBT.
Longer-term reforms	
Option 3.6: Phase out capped FBT concessions and replace with alternative government support Capped FBT concessions would be phased out and the savings redirected by direct funding for specific projects or funding to assist with the recruitment of specialist staff.	The option scores highly on maximising the social good (as above) and fairness. Redirecting support from a subset of employees that structure their affairs to receive FBT concessions to eligible entities would likely enhance their ability to pursue activities that contribute to the wellbeing of Australians.
Option 3.7: Phase out FBT concession and replace with alternative tax-based support mechanisms for eligible NFP entities Capped FBT concessions would be phased out and replaced with a payment to NFP sector entities or employees.	The option scores highly on maximising the social good (as above). Making payments to NFP sector employees directly scores less well on fairness, as the rationale for discriminating between employees of eligible entities and other employees may not be obvious in some cases.

Reform options	Assessment against the Working Group's guiding principles
Option 3.8: Limit concessions to benefits that are incidental to employment Capped FBT concessions would be retained, but the benefits that are allowable under the caps would be limited to benefits that are incidental to employment 'non-remuneration benefits'.	The option scores highly on maximising the social good (as above), fairness and structural coherence. The option would more closely align the treatment of fringe benefits for employees of eligible entities with the treatment for other employees, whilst retaining concessional treatment for benefits that are incidental to employment.

4. GOODS AND SERVICES TAX CONCESSIONS

4.1 HISTORY OF THE CONCESSIONS

172. The GST was introduced in 2000 as a broad based tax to apply to most goods and services, with a limited number of exemptions.

173. However, it was recognised that charities, PBIs, community groups and religious organisations operate differently from businesses as they often supply goods of services for nominal or no charge, and a large proportion of their inputs and funding are generally provided in the form of donations.

174. As a result, a number of charitable activities and non-commercial supplies of goods and services by these entities have been exempt from GST. In order to avoid unfair competition, the activities of charities are generally treated the same as other entities under the GST Act.

4.2 CURRENT CONCESSIONS

175. The GST concessions that are available to NFP entities vary depending on the type of body. Some GST concessions are available to all NFP entities. Others are limited to the following specified NFP entities (referred to hereafter as 'certain NFP entities'):

- endorsed charitable institutions;
- endorsed trustees of charitable funds;
- gift-deductible entities that are NFP entities; and
- government schools.

176. Further, limited concessions are available to NFP entities that are exempt from income tax under certain parts of Division 50 of the ITAA 1997.

4.2.1 Administrative concessions

177. A number of administrative concessions are available for NFP entities that help to simplify their reporting and accounting obligations.

4.2.2 Registration threshold

178. All NFP bodies have a higher GST registration turnover threshold of $150,000, compared to $75,000 for other entities. This means that NFP entities with smaller turnovers can choose to stay out of the GST system and as a result, avoid having to report and account for GST on the supplies they make.

179. As only registered entities may claim input tax credits for the GST paid on their inputs, NFP bodies that do not meet the registration threshold may still choose to register for GST. This

allows them to claim input tax credits but also means they will be required to include GST on any taxable supplies they make.

Accounting on a cash basis

180. Certain NFP entities may choose to account on a cash basis regardless of their annual turnover, which means that GST liabilities and input tax credits are attributed to the tax period in which they are paid for the supplies they make, or pay for the things they acquire.

NFP sub-entities

181. The same bodies may also choose to split some of their separately identifiable operations into branches called 'NFP sub-entities' for GST purposes. These NFP sub-entities are considered separate entities for GST purposes, as long as the parent entity remains registered for GST. One of the benefits of splitting the operations into NFP sub-entities is that each NFP sub-entity will only need to register for GST it exceeds the registration threshold for NFP entities. NFP sub-entities are also able to access the same GST concessions available to their parent entities.

GST religious groups

182. Further, registered entities that are endorsed as exempt from income tax under Subdivision 50-B of the ITAA 1997 and part of the same religious organisations may form a GST religious group that allows transactions between members of the group to be ignored for GST purposes. While this concession does not have revenue implications it simplifies compliance and assists cash-flow management.

GST-free supplies

183. A number of supplies made by certain NFP entities are GST-free. Treating a supply as GST-free means that no GST is payable on the supplies made but allows the entity to claim input tax credits for any GST paid on the cost of their inputs.

184. Supplies that are GST-free include:

- supplies of raffle tickets, bingo games and specified gambling supplies provided that the holding of the raffle or bingo event does not contravene a State or Territory law;
- supplies of accommodation for less than 75 per cent of the GST-inclusive market value of the supply, or less than 75 per cent of the cost to the supplier of providing the accommodation;
- non-commercial supplies other than accommodation for less than 50 per cent of the GST inclusive market value, or less than 75 per cent of the amount the supplier paid to acquire the thing (for example,food handouts); and
- supplies of donated second-hand goods.

185. Further, supplies of retirement village accommodation and related services by endorsed charitable institutions and endorsed trustees of charitable funds that operate retirement villages are GST-free.

Option to treat certain supplies as input taxed

186. Certain NFP entities may choose to treat all supplies it makes in connection with certain fundraising events as input taxed. NFP entities that operate in schools also have the ability to treat supplies of food at school tuckshops and canteens as input-taxed.

187. Treating a supply as input taxed has the same practical effect of taking that supply out of the GST system. This means that entities which choose to treat the supplies as input taxed are not required to remit GST on the supplies they make and are also not entitled to claim any input tax credits on their acquisitions.

4.3 Input tax credits for volunteer reimbursements

188. Under the normal GST rules, input tax credits are generally only available for acquisitions that relate to the activities of a GST registered entity. In addition, certain NFP entities may claim input tax credits for reimbursements made to volunteers for expenses incurred that directly relate to their activities as a volunteer of that NFP body.

4.4 Concerns with the current GST concessions

189. There are relatively few concerns that have been raised with the current GST concessions, other than minor issues with compliance burdens around fundraising and non-commercial supplies.

4.4.1 Reform options

190. Any reforms in the GST regime will need to take into account the fact that all GST revenue is paid to the States and Territories. As such, any savings made from reforms in this area will generally not be able to be reinvested in the NFP sector without agreement from the States and Territories. Any additional revenue will need to be paid to the States and Territories, unless they agree otherwise.

191. Further, under the *Intergovernmental Agreement on Federal Financial Relations*, any change to the rate or base of the GST requires the unanimous agreement of the State and Territory governments.

192. In view of these requirements, any recommendations of the Working Group and support of them by the Commonwealth will ultimately need to be accepted by the States and Territories.

Option 4.1: Adopt a principles-based approach to the fundraising concession

193. There has been some uncertainty as to the scope of events which the Tax Commissioner would consider to be within the scope of the fundraising concession. Currently, the concession is available in respect of fetes, balls, gala shows, dinners, performances and event where all goods are sold for $20 or less outside the ordinary course of the NFP body's business. In addition to this, the Tax Commissioner may approve other events as fundraising events that may be treated as input taxed.

194. The rules governing fundraising events could be amended to adopt a principles-based test under which certain NFP entities self-assess whether the event satisfies the requirements.

Consultation questions

Q 43 Does the existing fundraising concession create uncertainty, or additional compliance burdens, for NFP entities that wish to engage in fundraising activities that fall outside of the scope of the concession?

Q 44 Would a principles-based definition of the types of fundraising activities that are input taxed reduce the compliance burden for entities that engage in fundraising?

Option 4.2: Provide an opt-in arrangement for GST treatment of non-commercial supplies

195. Whilst the GST-free treatment of non-commercial supplies is beneficial to NFP bodies, it can give rise to complexities in accounting and apportionment where they make a number of supplies relating to one event, some of which are for low consideration and others are not.

196. One example is where a NFP body sells tickets of varying prices to an event where the total amount of the ticket sales is less than 75 per cent of the cost incurred by the body in organising the event. However, when the organising costs are apportioned across the ticket sales, some tickets are sold for more than nominal consideration, whilst others are not. This scenario requires the NFP body to distinguish between the tickets, and account for GST on the proportion of the tickets that are sold for more than nominal value.

197. A simple reform would be to provide an option to allow these NFP bodies to treat all of the supplies as either taxable or input taxed. This would mean that the same GST-treatment applies to all tickets sold in relation to the event.

Consultation questions

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

Q 46 Are there any other issues or concerns with the operation of the GST concessions in their current form?

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

Q 48 If an opt in arrangement is favoured, would the preference be to treat the supplies as taxable or input taxed? Why?

Q 49 Is there an alternative way of reducing the compliance burden associated with apportionment for supplies made for nominal consideration?

Reform options	Assessment against the Working Group's guiding principles
Option 4.1: Adopt a principles-based approach to the fundraising concession The current concession for fetes, balls, gala shows, dinners, performances and event where all goods are sold for $20 or less outside the ordinary course of the NFP body's business would be replaced with a principles-based concession.	The option scores highly on simplicity and efficiency. The existing fundraising concessions distort decisions about fundraising activities and impose avoidable compliance burdens on the sector.
Option 4.2: Provide an opt-in arrangement for GST treatment of non-commercial supplies The GST-free treatment of non-commercial supplies increases compliance costs in some cases if only a small number of supplies are non-commercial. An opt-in mechanism could reduce these compliance costs.	The option scores highly on simplicity and efficiency. The existing system imposes disproportionate compliance burdens on entities when a small proportion of supplies are non-commercial. An opt-in arrangement would reduce the compliance burden whilst having a small positive impact on Government revenue.

5. MUTUALITY, CLUBS AND SOCIETIES

5.1 HISTORY AND SCOPE OF THE PRINCIPLE OF MUTUALITY

198. The mutuality principle is a common law principle that is a feature of the concept of 'ordinary income' in the ITAA 1997. Surplus or gains of a club from some of its dealings with its members are not ordinary income. Under the common law exception, where a group of people contribute to a common fund created and controlled by them for a common purpose, any surplus created in the fund is not considered income for tax purposes.

199. The mutuality principle was developed by the Courts in the late 1800s when mutual organisations developed to provide sickness and death benefits to their members. These organisations provided members with a primitive form of insurance, whereby all members would contribute to a common fund and would be entitled to receive payments in the event of sickness or death.

200. The principle is derived from English common law, and was discussed in respect of Australia's first federal income tax law by the High Court in *Bohemians Club v. Acting FCT* (1918) 24 CLR 334. It was decided in this case that the receipt by a social club of annual subscriptions from its members was not income of the club. The High Court stated:

> A man is not the source of his own income, though in another sense his exertions may be so described. A man's income consists of moneys derived from sources outside of himself ...

201. The mutuality principle requires identity between the contributors of funds to the organisation and the participators in the surplus (in line with the principle that the surplus must be derived by contributions of the members and hence be essentially their own funds): *The Social Credit Savings and Loans Society Ltd.* v. *F.C. of* T. 71 ATC 4232 per Gibbs J. It has also been held that there must be 'a reasonable relationship' between what a member contributes and what he may be expected or entitled to receive from the fund.[25] Various other conditions such as a common purpose are ascribed in a range of cases.

202. The ATO explains the application of the principle of mutuality to a club in the context of income tax as follows:[26]

> A licensed club is only assessable on trading income which relates to non-members and on income received from sources outside its general trading activities. This is due to the principle of mutuality that recognises that any surplus arising from contributions to a common fund created and controlled by people for a common purpose is not income.

203. In principle, the proportion of a club's surplus from members is tax-free while that derived from non-members (for example, guests) is subject to tax. However, not all receipts from members benefit from the exclusion. Interest on loans from a cooperative to members, which

25 *Fletcher v. Income Tax Commissioner* [1972] A.C. 414.
26 *Taxation Determination 93/194*, para [1].

was paid to the cooperative was held to be taxable and not to be eligible for the mutuality principle in *Sydney Water Board Employees' Credit Union Limited v. Federal Commissioner of Taxation* (1973) 73 ATC 4129 in which the full High Court, while acknowledging the history and scope of the principle, was clear that it has limits at common law.

204. A consequence of the principle of mutuality applying is that expenses related to members' income are non-deductible. In *Taxation Determination TD 93/194*, the ATO provides a formula to assist in the calculation of the proportion of a club's trading surplus attributable to members and non-members. The formula allows a proportion of a club's general expenses to be allowed as a deduction and a portion is non-allowable against non-assessable income.

205. Some mutuals are not eligible for tax exemptions based on the mutuality principle. These include life insurance companies, friendly societies, mutual insurance companies and credit unions.

206. Clubs eligible under Division 50 of the ITAA 1997 (primarily section 50-45) receive a tax exemption for all income, irrespective of whether their activities are mutual or non-mutual. This encompasses:

> A society, association or club established for the encouragement of: (a) animal racing; (b) art; (c) a game or sport; (d) literature; or (e) music.

207. These entities are not exempt if they are carried on for the purpose of profit or gain of their individual members.[27]

208. Other taxes may still apply to the mutual society. For example, wine equalisation tax will apply to sales of wine by a wine club to its members even though the club benefits from the principle of mutuality.[28] Similarly, GST applies as it relates to taxable supplies and not to member transactions.

209. Mutual associations and clubs are also assessable on statutory income, such as capital gains, under specific provisions of the ITAA 1997.

5.2 Concerns about the principle of mutuality

210. The main concerns which have been expressed about operation of the mutuality principle are:

- uncertainty and complexity in operation in some cases, for example, tracking mutual and non-mutual receipts;
- competitive neutrality concerns where clubs carry out trading activities with members in competition with non-exempt businesses;
- social policy concerns especially given revenue foregone, for example, because much revenue of wealthier clubs is derived from gambling and hospitality (alcohol) services to members; and

27 Section 50-70 of ITAA 1997.
28 ATO ID 2010/152.

- a concern about clubs issuing temporary memberships to the wider public — is income from those individuals mutual income? If so, should it be mutual income?

211. Unlike other NFPs which must spend their income or surplus for specified charitable or other specified purposes, clubs (not exempt under section 50-45) that have a tax-free surplus as a result of the mutuality principle 'are free to spend their mutual receipts as they wish (subject to their objects that typically do not involve philanthropic purposes)'.[29] The PC observed that clubs that have surpluses may use them in a variety of ways:[30]

> Clubs could use surpluses to reduce membership charges or lower the prices charged for services to their members, make donations to charities or for other community purposes, or to purchase new assets or enhance existing assets. Many clubs do a combination of all of these.

212. Larger clubs that are not income tax exempt, but that benefit from the mutuality principle and have significant untaxed surpluses as a result, may engage in substantial building or capital works activities for the benefit of members. The ability to accumulate an untaxed surplus for what might be perceived as private benefit, especially where the link between members and the club is weakened or 'temporary' or 'instant' memberships are the norm, in some large clubs, may be of concern.

213. AFTS, while acknowledging that many small clubs and associations benefit from the principle of mutuality, found that the link between members and the organization (and its surplus) were weakened in many very large clubs providing significant entertainment and gaming:

> The principle also benefits a number of very large NFP clubs with many members and high levels of turnover, which engage in trading activities in direct competition with the hotel and restaurant industries. Any mutual receipts these clubs receive, including membership fees and restaurant, bar and gambling revenues (which account for most of the total income of hospitality clubs), are tax exempt. By contrast, hotels and restaurants are assessed on all of the income they receive.
>
> In the case of clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality, a practice has emerged to establish wide membership at a nominal charge for patrons whose only substantive activities at the club are as customers of the trading activity (whether personally or by bringing 'guests'). It is not clear that the wider community should entirely forgo tax on all of these profits, although some concession could be retained, particularly to support smaller clubs.

214. Earlier concerns were expressed by the Review of Business Taxation (RBT) which focused on the ability to claim excessive deductions for operating expenses (against some trading income) while benefiting from the mutuality principle for member income.

5.2.1 Reform options

215. The issue of reform of the principle of mutuality has been raised from time to time. After *Coleambally Irrigation Mutual Co-operative Ltd v Commissioner of Taxation* [2004] FCAC 250, the government enacted reforms that ensured that the mutuality principle as it was previously

29 AFTS, Final Report p. 209.
30 PC, p. 221.

thought to apply, was reinstated. However, it has never been generally ‘reformed’ or legislated.

Option 5.1: Gaming, catering, entertainment and hospitality trading activities

216. Recommendation 44 of AFTS proposed changes to the treatment of mutuals for income tax purposes. AFTS recommended that trading activities arising from gaming, catering, entertainment and hospitality activities of mutuals should be subject to a concessional rate of tax on net income earned above a relatively high threshold. This recommendation appears to be motivated by concerns, held by some, that some activities in these fields do not offer the same type of public benefit as other activities of NFPs. In some cases, it could be argued that the negative societal impact of activities in the areas of gambling and alcohol consumption outweigh any benefits that are derived from directing income from these activities to charitable causes.

217. Arguments for retention of income tax exemptions for gaming, catering, entertainment and hospitality include the possible benefits that are provided by NFP clubs and societies. These include support for local sporting clubs, promotion of a healthy lifestyle and contribution to a sense of community for people with shared interests or backgrounds.

Consultation questions

Q 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?

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

Option 5.2: Extend the mutuality principle

218. While much of the focus on income or surplus of clubs has focused on restricting the tax concession (as suggested in the options below), AFTS noted in its Consultation Paper that a number of submissions argued for extension of the common law principle of mutuality by legislation:

> Several submissions call for the extension of mutuality to provide a full tax exemption for NFP member-based organisations. Such an extension would enhance any competitive advantage these organisations hold relative to fully taxable businesses offering similar services.
>
> Submissions also call for mutuality to be legislated (like other features of the concept of 'income', reliance is currently placed on the common law and ATO rulings). While legislating mutuality may provide increased certainty for NFP member-based organisations, it would add to the complexity of the tax law.

Consultation question

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

Option 5.3: Repeal the common law principle and legislate a narrower principle

219. The RBT recommended that the mutuality principle be legislated as an exception from the general principle that all income from dealings between an entity and its members should be included in taxable income of the entity.[31] The RBT highlighted what it termed an anomaly in the law as it stood then (which is similar to current law) which it stated effectively allows a disproportionate deduction of expenses for clubs that benefit from the mutuality principle. It stated:

> There is, however, an anomaly in the interaction between the common law rule and the operation of the present law in relation to the allowance of deductions. Absent an appropriate rule, the present law (which was never designed to deal with the significant commercial activities undertaken under mutual principles) effectively allows a disproportionate share of deductions against assessable income, thus minimising taxable income.[32]

220. A narrower legislated principle of mutuality thus could incorporate limits on deduction of expenses. The RBT proposed to legislate a balancing adjustment for mutual clubs and societies to be made at the end of each income year equal to the entity's mutual gains for the year. A corresponding balancing adjustment for mutual losses is also required. This will allow equitable apportionment of expenditures and liabilities as well as receipts and assets in applying the mutual exception.

221. New Zealand, USA and Canada have legislated to restrict the application of the mutuality principle. For example, in the USA and Canada, more than 75 per cent of a club's total gross receipts must be derived from members or through investment income in order to qualify for income tax concessions.

Consultation questions

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

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

Option 5.4: Enact anti-avoidance rules, or enforce the principle more strictly

222. It may be possible to increase compliance activity, under existing law, to address concerns about certain conduct that exploits mutuality to evade tax. Examples include mutual entities

31 *Review of Business Taxation*, 1999, Recommendation 5.6.
32 *Review of Business Taxation*, 1999, Recommendation 5.6 (b).

issuing temporary or instant memberships. Alternatively, consideration could be given to enacting a specific anti-avoidance rule to address such concerns.

Consultation question

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

Reform options	Assessment against the Working Group's guiding principles
Option 5.1: Gaming, catering, entertainment and hospitality trading activities	The option has impacts on fairness. Those currently benefiting from an exemption from income tax on these activities would argue that the levying of income tax would be less fair than the current exemption and would point to activities funded by tax-free income in support of this argument. Others may argue that an exemption from income tax for these activities is difficult to support on fairness grounds as some for-profit businesses may experience difficulties competing with mutual clubs and societies that do not pay income tax.
Option 5.2: Extend the mutuality principle Tax concessions for mutual entities would be legislated and the types of entity that are not subject to income tax would be expanded.	The option has impacts on fairness (as above).
Option 5.3: Repeal the common law principle and legislative a narrower principle Tax concessions for mutual entities would be legislated and the types of entity that are not subject to income tax would be narrowed.	The option has impacts on fairness (as above).
Option 5.4: Enact anti-avoidance rules, or enforce the principle more strictly Specific anti-avoidance rules could be enacted to deal with circumstances whereby mutual entities avoid tax by reliance on the mutuality principle (for example, by using temporary or instant memberships).	The option has impacts on fairness (as above).

6. Next Steps

223. The publication of this discussion paper is a first step towards finding ways to improve the way in which tax concession support is provided to the NFP sector. The Working Group looks forward to working with the sector to consider options for reform of the tax system that would benefit the sector and the Australian community.

224. By setting out the history and current status of tax concessions that are available to the sector and outlining some reform options, the Working Group wishes to commence a discussion with the sector about how support could be more effectively delivered.

6.1 Delivering reform within the current envelope of support

225. The terms of reference for this review provide that the Working Group is to identify offsetting budget savings for any proposals that have a revenue cost. That is, any reform is to be delivered within the current envelope of support for the sector. Accordingly, the options for reform have been developed with this consideration in mind.

226. Reform options that would have significant revenue impacts include extending DGR status to all charities, and bringing meal entertainment and venue hire fringe benefits within the relevant caps for fringe benefits tax exemptions. By way of example, the offsetting process could be undertaken as follows. Treasury costings indicate that extending DGR status to most charities (see Chapter 2) and bringing meal entertainment and venue hire fringe benefits within the relevant caps (see Chapter 3) would have approximately offsetting impacts on revenue. The cost of extending DGR to most charities has been estimated at approximately $120 million and bringing meal entertainment and venue hire within the relevant caps would generate an additional $100 million of revenue. Accordingly, these reforms could be brought forward as a package to largely fulfil the need to offset the cost of any proposals that have a revenue cost.

6.2 Other reform proposals

227. The consultation questions that have been put forward in this paper relate to issues upon which the Working Group is seeking specific guidance. This approach does not rule out other holistic or innovative reform proposals or ideas for reform that stakeholders may wish to put forward. By way of example, a holistic approach to reform could aim to streamline tax concessions by applying similar rules to income tax, FBT, GST and DGR concessions.

6.3 Is there scope to streamline income tax, FBT, GST and DGR concessions?

228. Income tax exemptions, FBT and GST concessions each have different rules. A unified system could significantly reduce compliance burdens for the sector and regulators, and create more certainty. Charities endorsed by the Commissioner of Taxation are generally eligible for an income tax exemption and GST concessions. They may also qualify for FBT concessions if they

are charitable institutions, PBIs, or operate to prevent or control disease in human beings and they may or may not qualify for DGR status.

229. If a system of tax concessions were to be developed without reference to the status quo, a more effective system might simply decide on categories of organisation that qualify for all of the relevant concessions. The most obvious existing classification upon which such as system could be based is the concept of a 'charity'.

Consultation questions

Q 56 Are there any areas in which greater streamlining of concessions could be achieved?

Q 57 Do you have any ideas for reform of NFP sector tax concessions within the terms of reference that have not been considered in this discussion paper?

Appendix A — Examples of how NFP entities currently benefit from tax concessions

Example 1: PBI that operates a recycled clothing store and provides temporary hostel accommodation and food for the homeless

Income tax

Income tax is not payable by the PBI on any profits derived from charging nominal rents (if any) on housing, receipts from providing meals (if any) or from selling recycled clothing.

Fringe benefits tax

Employees of the charity would be able to receive up to $16,050 (a grossed-up amount of $30,000) in salary or wages from their before-tax incomes without any FBT liability arising for the PBI. This would save the PBI up to $7,400 per employee in expenses for wages and salaries. This saving could either be retained by the PBI or provided to employees by way of higher pay.

Fundraising

The PBI would be eligible to apply to the ATO for endorsement as a deductible gift recipient under the 'welfare and rights' category. Any donations to the PBI would be tax deductible for the donor, providing a benefit for the donor of up to 46.5 cents for each dollar donated.

Goods and services tax

If the PBI has a turnover for less than $150,000 it can choose not to register for GST. In these circumstances, GST does not need to be included in the prices that it charges on goods or services and does not need to be paid to the ATO.

Any recycled clothing sold by the PBI is GST-free as any sales of donated second-hand goods by a charitable institution are GST free.

Prices (if any) charged for hostel accommodation would likely be GST-free as these prices would be less than 75 per cent of the GST-inclusive market value of the accommodation or less than 75 per cent of the cost of providing the accommodation.

Prices (if any) charged for meals would also be GST-free if it is less than 50 per cent of the GST-inclusive market value or less than 75 per cent of the amount paid to purchase the inputs for the meal.

Example 2: A sporting club or an artists' society

Income tax

Income tax is not payable by a society, association or club established to encourage a game, sport or art. Accordingly, any there would be no tax payable on any profits derived from activities of a sporting club or an artists' society.

Fringe benefits tax

Non-profit entities that are established to encourage art or sport are eligible to have their fringe benefits tax liabilities rebated by 48 per cent on benefits up to a grossed-up value of $30,000 per employee.

Fundraising

Sporting club

Sporting clubs are typically not eligible to be endorsed as recipients of tax deductible gifts. This does not prevent sporting clubs from receiving gifts from members or others, but any such gifts do not provide the giver with a tax benefit.

Artists' society

An artists' society would be eligible to apply for listing on the register of cultural organisations (ROCO). Assuming the artists' society meets the conditions for listing on ROCO, it would be able to receive tax deductible donations.

Goods and Services Tax

An NFP sporting club or artists' society can choose not to register for GST if its turnover is less than $150,000 (compared to $75,000 for for-profit entities). This means that GST would not be added to prices charged by the club or society and GST would not be payable to the ATO.

If an NFP sporting club or artists' society has a turnover of more than $150,000 it must register for GST. Some categories of goods and services are GST-free. These include basic food items, some education, child care and health services and some exports.

Certain other GST concessions would also apply to a sporting club or artists' society including an exemption for the sale of donated second-hand goods, certain exemptions for fundraising events and for non-commercial activities.

APPENDIX B — RECOMMENDATIONS FROM EARLIER REVIEWS

THE PRODUCTIVITY COMMISSION: CONTRIBUTION OF THE NOT-FOR-PROFIT SECTOR[33] (2010)

- The Australian Government should adopt a statutory definition of charitable purposes in accordance with the recommendations of the 2001 Inquiry into the *Definition of Charities and Related Organisations* (Recommendation 7.1, pp, 168).

- State and territory governments should recognise the tax concession status endorsement of not-for-profit organisations at the Commonwealth level. Given the disparities between eligibility for tax concessions across jurisdictions, state and territory governments should utilise such Commonwealth endorsements in determining eligibility for their jurisdictional concessions, and seek to harmonise tax concessional status definitions or classifications with the Commonwealth over time (Recommendation 7.2, pp. 168).

- Current DGR arrangements are distortionary and out of date. Progressively expand DGR status to all charitable institutions and funds endorsed by the Registrar (Recommendation 7.3, pp. 184).

AUSTRALIA'S FUTURE TAX SYSTEM — FINAL REPORT[34]

- Gift deductibility should be retained, with the deductibility threshold raised from $2 to $25 (Recommendation 13, pp. 60).

- Consistent with the recommendations of previous inquiries, a national charities commission should be established to monitor, regulate and provide advice to all not-for-profit (NFP) organisations (including private ancillary funds). The charities commission should be tasked with streamlining the NFP tax concessions (including the application process for gift deductibility), and modernising and codifying the definition of a charity (Recommendation 41, pp. 211).

- Categories of NFP organisations that currently receive income tax or GST concessions should retain these concessions. NFP organisations should be permitted to apply their income tax concessions to their commercial activities (Recommendation 42, pp. 211).

- NFP entities' FBT concessions should be reconfigured (Recommendation 43, pp. 211).

- NFP FBT concessions should be reconfigured (Recommendation 43, pp. 211).
  - The capped concessions should be phased out over ten years. In the transition period, the value of the caps would gradually be reduced. Reportable fringe benefits for affected employees (that is, those benefits that are easily valued and attributed) would be exempt from tax up to the relevant cap, and taxed at the employee's

33 PC Report, 2010, Contribution *of the Not-for-profit Sector*, http://www.pc.gov.au/projects/study/not-for-profit/report.

34 Australian Government, 2009, *Australia's* Future *Tax System, Report to the Treasurer, Part 2: Detailed Analysis*, http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm.

marginal tax rate above the cap. The market value of these benefits would be taken into account for transfer payment purposes. Non-reportable fringe benefits would be taxable for NFP employers.

  – The FBT concessions should be replaced with direct government funding, to be administered by relevant Australian government portfolio agencies or the charities commission. All NFP organisations eligible for tax concessions should be able to apply to the relevant body for funding for specific projects or for assistance with the costs of recruiting specialist staff.

- Simple and efficient tax arrangements should be established for clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality. One option is to apply a concessional rate of tax to total net income from these activities above a high threshold. For clubs below the threshold, no tax would be applied to income from these activities (Recommendation 44, pp. 212).

Review of Business Taxation (1999) Final Report (Recommendation 5.6)

- Statutory exclusion for 'mutual gains'
  – The current common law exclusion from the calculation of taxable income of 'mutual gains' — being gains by certain mutual entities and organisations from some dealings with their members — be given explicit effect in the tax law, notwithstanding the general principle that income arising from dealings between entities and their members should be included in the taxable income of those entities.

- Apportioning expenditure between member and non-member income
  – Appropriate provisions should be established for ensuring that all expenditure of mutual entities is equitably apportioned between exempt 'mutual gains' and taxable income.

- The Review of Business Taxation also proposed to legislate a balancing adjustment for mutual clubs/societies to be made at the end of each income year equal to the entity's mutual gains for the year. A corresponding balancing adjustment for mutual losses is also required. This will allow equitable apportionment of expenditures and liabilities as well as receipts and assets in applying the mutual exception.

Appendix C — Overview of other NFP Reforms

Australian Charities and Not-for-profits Commission Bill

The ACNC Bill establishes the ACNC as a Commonwealth statutory office, legislates the ACNC's overarching objective and responsibilities and the relevant powers required by the ACNC to fulfil its role, and sets out the regulatory responsibilities of registered NFP entities.

The ACNC Bill was passed by the Commonwealth Parliament on 1 November 2012.

Better targeting of NFP tax concessions

In the 2011-12 Budget, the Government announced the measure to better target NFP tax concessions. The aim of the measure is to protect the integrity of the NFP sector and the revenue base by ensuring that valuable tax concessions are utilised in direct furtherance of the purposes for which they were provided, rather than to support unrelated businesses operated for the purpose of raising money. The measure is applicable from 1 July 2012 for unrelated commercial activities that commenced after 10 May 2011 and transitional arrangements will apply for pre-existing unrelated commercial activities. The ATO will be responsible for administering the changes.

The measure will affect the way in which the tax system applies to certain NFP entities. It will not, however, alter the ACNC's consideration of whether an entity is a charity or other NFP entity.

Introducing a statutory definition of charity

A statutory definition of charity will be introduced for all Commonwealth purposes, effective from 1 July 2013. It will contain the current key common law principles of charity. The definition will provide a clear framework for both the public and regulatory agencies for recognising entities as charitable, and greater clarity and certainty to the sector. The definition will be administered by the ACNC, which will be responsible for registering charities.

The ATO will accept an ACNC determination of charity status. The ATO will then apply the special tax specific conditions (such as the 'in Australia' conditions) before endorsing a charity for access to tax concessions.

Review of governance arrangements

The Government announced in the 2011-12 Budget a number of reviews of aspects of the regulation of the NFP sector, including a review of the governance obligations appropriate for NFP entities.

The intent of the governance review is to centralise and simplify the existing arrangements in order to reduce red tape and minimise compliance burdens for the sector. The Government is currently consulting on what the core organisational governance principles applying to registered NFPs should be. The outcomes of the governance review will help form the governance requirements for registered entities in the ACNC legislation.

The Government announced on 17 May 2012 that the governance standards will commence on 1 July 2013. The governance standards will be subject to public consultation prior to their inclusion in regulations to be made under the ACNC legislation.

Reducing regulatory duplication review

Commonwealth agencies are currently undertaking a review of all NFP regulation at the Commonwealth level. This review is exploring mechanisms to minimise any duplication of regulatory responsibilities between existing regulators and the soon to be established ACNC, to ensure that the ACNC is created as a 'one-stop shop' regulator for the NFP sector.

Restating and standardising the special conditions for tax concession entities

The Australian Government announced in the 2009-10 Budget that it would amend the 'in Australia' special conditions in Division 50 of the *Income Tax Assessment Act 1997* to ensure that Parliament retains the ability to fully scrutinise those organisations seeking to pass money to overseas charities and other entities.

The Australian Government introduced a Bill to amend the 'in Australia' special conditions into the Commonwealth Parliament on 23 August 2012.

The Bill:

- re-states the 'in Australia' special conditions for income tax exempt entities, ensuring that they generally must be operated principally in Australia and for the broad benefit of the Australian community (with some exceptions);
- standardises the other special conditions entities must meet to be income tax exempt, such as complying with all the substantive requirements in their governing rules and being a 'not-for-profit' entity (with some exceptions);
- standardises the term 'not-for-profit', replacing the defined and undefined uses of 'non profit' throughout the tax laws; and
- codifies the 'in Australia' special conditions for DGRs ensuring that they must generally operate solely in Australia, and pursue their purposes solely in Australia (with some exceptions).

Working with the States and Territories towards national regulation

As part of the 2011-12 Budget, the Government announced that it would begin negotiations with the States and Territories on national regulation and a new national regulator for the sector, as it considers that the greatest reduction in red tape can only be achieved with national coordination. Since then, the Commonwealth and the states and territories have come together to establish the Council of Australian Governments (COAG) NFP Reform Working Group to progress the national NFP reform agenda and consider the harmonisation of regulation for the NFP sector across Australia.

On 13 April 2012, the Prime Minister, Assistant Treasurer and Minister for Social Inclusion announced that COAG has agreed to endorse the Terms of Reference and 2011-12 Work Plan of the COAG NFP Reform Working Group.

The Working Group will regularly report to COAG, through the Standing Council for Federal Financial Relations, about its progress.

ACNC Taskforce: implementation design

In February 2012, the ACNC Discussion Paper was released to seek feedback on the design of administrative systems of the ACNC. The paper discussed the design and implementation of the new reporting framework for charities that will be administered by the ACNC. The reporting framework is a central platform for the Government's vision of 'report once-use often' reporting for the NFP sector. The paper also sought comments on the ACNC's public information portal and the ACNC's educative role. Submissions on the discussion paper closed on 27 February 2012.

In June 2012, the ACNC Taskforce published an implementation report. The implementation report provides information to the sector on the key action areas in the ACNC's regulatory approach.

Consultation paper: Review of fundraising regulation

The Government announced in the 2011-12 Budget that it will undertake negotiations with the States and Territories on national regulation for the NFP sector with the aim of minimising reporting and other regulatory requirements through coordinated national arrangements. One part of these negotiations involves the development of a national approach to charitable fundraising regulation.

A charitable fundraising discussion paper was released on 12 February 2012 canvassing options for a new national approach to charitable fundraising regulation. The closing date for submissions was 5 April 2012.

Consultation paper: Review of companies limited by guarantee

The Government announced in the 2011-12 Budget a number of reviews of aspects of the regulation of the NFP sector, including a review of the company limited by guarantee structure and its continuing appropriateness for NFP entities. This review will assist in determining whether there are any barriers for NFP entities using this structure.

Appendix D — Tax concessions for NFPs — 2011 Tax Expenditure Statement

Exemptions	TES number and legislative reference	2010-11 $m	2011-12 $m	2012-13 $m	2013-14 $m	2014-15 $m
Deduction claimed by donors for gifts to deductible gift recipients	A65, Division 30 of the ITAA 1997	890	910	970	1,050	1,120
Deduction claimed by donors for gifts to private ancillary funds	A66, Item 2 of the table in Section 30-15 of the ITAA 1997	140	140	140	140	140
Income of certain international organisations is exempt from income tax (that is, UN, and WTO)	B5, Section 6 of the *international Organisations (Privileges and Immunities) Act 1963*	*	*	*	*	*
Interest withholding tax and dividend withholding tax exemptions for overseas charitable institutions	B6, paragraph 128B(3)(aa) of the *Income Tax Assessment Act 1936*	*	*	*	*	*
Income tax exemption for NFP private health insurers	B21, Item 6.3 of the table in Section 50-30 of the ITAA 1997	125	125	125	120	120
Tax exemption for incentives provided by governments under the National Rental Affordability Scheme — charities can choose to receive the payment as either refundable tax offset or cash payment.	B31, Division 380 of the ITAA 1997	1	2	5	30	45
Income tax exemption for recreation-type NFP societies (that is, clubs or associations established for the encouragement of sport, music, or community service purposes)	B33, Section 50-10, and 50-45 of the ITAA 1997	20	20	20	20	20
Income tax exemption for industry-specific NFP societies and associations	B63, Section 50-40 of the ITAA 1997	*	*	*	*	*
Income tax exemption for non-charitable public or private ancillary funds	B67 — Section 50-20 of the ITAA 1997	Included in B68				
Income tax exemption for charitable funds (that is, religious or public educational institutions and funds, and clubs for community service purposes)	B68, Sections 50-5, 50-52 and 50-60 of the ITAA 1997	*	*	*	*	*
Income tax exemption for charitable, religious, scientific and community services entities	B69, sections 50-5 and 50-10 of the *Income Tax Assessment Act 1997* (ITAA 1997)	*	*	*	*	*
Income tax exemption for small NFP companies that has taxable income not exceeding $316 in a given income year	B70, Subsection 23(6) of the *Income Tax Rates Act 1986*	*	*	*	*	*

Exemptions	TES number and legislative reference	2010-11 $m	2011-12 $m	2012-13 $m	2013-14 $m	2014-15 $m
Refundable franking credits for charities and DGRs	B71, Subdivision 207-E of the *ITAA 1997*	520	*	*	*	*
Exemption for benefits provided by certain international organisations	D4, Section 55 of the Fringe Benefits Tax Assessment Act 1986	*	*	*	*	*
FBT exemption for charities promoting the prevention or control of disease in human beings	D10, Section 5B and subsection 57A(5) of the *Fringe Benefits Tax Assessment Act 1986*	85	90	100	105	110
FBT exemption for public and NFP hospitals, and public ambulance services	D11, sections 57A(3) and 57(A) of the *Fringe Benefits Tax Assessment Act 1986*	930	1,000	1,100	1,150	1,250
Exemption for accommodation, fuel and meals for live-in employees caring for the elderly or disadvantaged	D13, Sections 58 and 58U of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
Public benevolent institutions are provided with an exemption for FBT up to $30,000	D14, Subsection 57A(1)) of the *Fringe Benefits Tax Assessment Act 1986*	1,110	1,260	1,380	1,490	1,610
Exemption for certain fringe benefits provided to live-in employees providing domestic services to religious institutions and practitioners	D16, Section 58T of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
Exemption for fringe benefits provided to certain employees of religious institutions	D17, sections 57A of the *Fringe Benefits Tax Assessment Act 1986*	80	85	95	100	105
Donations to DGRs made under salary sacrifice arrangements are FBT exempt	D46, Subsection 148(2) of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
FBT rebate for certain NFP, non-government bodies (that is, trade unions, NFP scientific institution)	D50, Section 65J of the *Fringe Benefits Tax Assessment Act 1986*	30	35	40	45	50
Capital gains tax exemption for the disposal of assets under the Cultural Gifts program	E9, Subsection 118-60(2) of the ITAA 1997	*	*	*	*	*
Testamentary gifts (that is, gifts made under a will) to a DGR are exempted from capital gains tax	E31, Subsections 118-60(1) and (1A) of the ITAA 1997	*	*	*	*	*
GST-free treatment Supplies by charitable institutions and non-profit bodies	H4, *A New Tax System (Goods and Services Tax) Act 1999*	*	*	*	*	*
GST exemption for the supply of religious services	H22, *A New Tax System (Goods and Services Tax) Act 1999*	25	25	30	30	30

Note: * represents unquantifiable by the Tax Expenditure Statement 2011

APPENDIX E — CONSULTATION QUESTIONS

CHAPTER 1 — INCOME TAX EXEMPTION AND REFUNDABLE FRANKING CREDITS

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

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

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

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

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

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

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

8. Should the income tax exemptions for State, Territory and local government bodies be simplified and consolidated into the ITAA 1997? Which entities should be included?

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

10. Please outline any other suggestions you have to improve the fairness, simplicity and effectiveness of the income tax exemption regime, having regard to the terms of reference.

CHAPTER 2 — DEDUCTIBLE GIFT RECIPIENTS

11. Should all charities be DGRs? Should some entities that are charities (for example, those for the advancement of religion, charitable child care services, and primary and secondary education) be excluded?

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

13. Would DGR endorsement at the entity level with restrictions based on activity address the behavioural distortions in Australia's DGR framework? Could unintended consequences follow from this approach?

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

15. Would a fixed tax offset deliver fairer outcomes? Would a fixed tax offset be more complex than the current system? Would a fixed tax offset be as effective as the current system in terms of recognising giving?

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

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

18. Should testamentary giving be encouraged through tax concessions and what mechanisms could be considered to address simplicity, integrity and effectiveness issues?

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

20. Are there any barriers which could prohibit the wider adoption of workplace giving programs in Australia? Is there anything the Working Group could recommend to help increase workplace giving in Australia?

21. Do valuation requirements and costs restrict the donation of property? What could be done to improve the requirements?

22. Is there a need to review and simplify the integrity rules?

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

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

25. Are there any possible unintended consequences from eliminating the public fund requirements for entities that have been registered by the ACNC?

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

27. Outline any other suggestions you have to improve the fairness, simplicity and effectiveness of the DGR regime, having regard to the terms of reference.

Chapter 3 — Fringe benefits tax concessions

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?

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?

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?

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

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?

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?

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?

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

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?

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

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

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

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?

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

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?

Chapter 4 — Goods and services tax concessions

43. Does the existing fundraising concession create uncertainty, or additional compliance burdens, for NFP entities that wish to engage in fundraising activities that fall outside of the scope of the concession?

44. Would a principles-based definition of the types of fundraising activities that are input-taxed reduce the compliance burden for entities that engage in fundraising?

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

46. Are there any other issues or concerns with the operation of the GST concessions in their current form?

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

48. If an opt-in arrangement is favoured, would the preference be to treat the supplies as taxable or input taxed? Why?

49. Is there an alternative way of reducing the compliance burden associated with apportionment for supplies made for nominal consideration?

CHAPTER 5 — MUTUALITY, CLUBS AND SOCIETIES

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

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

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

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

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

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

CHAPTER 6 — NEXT STEPS

56. Are there any areas in which greater streamlining of concessions could be achieved?

57. Do you have any ideas for reform of NFP sector tax concessions within the terms of reference that have not been considered in this discussion paper?