

10 June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Email: bettertax@treasury.gov.au

Dear Sir/Madam

Tax reform

The Australian Institute of Company Directors (AICD) is pleased to provide a submission to the Tax White Paper Task Force in response to *Re:Think Tax Discussion paper* (Discussion Paper).

The AICD is Australia's leading organisation for directors, dedicated to making a positive impact on society and the economy by promoting professional director education and excellence in corporate governance. We have a significant and diverse membership of more than 36,000 from across a wide range of industries, commerce, government, the professions, private and not-for-profit sectors.

The main focus of our submission relates to the taxation arrangements in the not-for-profit (NFP) sector. A large proportion of our members serve on the boards of NFP organisations. To assist NFP directors we have chosen to focus our comments predominantly on the issues raised by Chapter 7 of the Discussion Paper. However, we also make some comments about other aspects of Australia's tax regime that are of keen interest or concern to directors. These areas include the need for effective regulation, the importance of employee share schemes and the director liability provision in section 8Y of the Taxation Administration Act 1953 (C'th).

1. Summary

In summary, the key comments of the AICD are as follows:

- (a) A simple, efficient and understandable tax regime will support good governance in the NFP sector;
- (b) The current taxation arrangements, while they support the NFP sector, could be improved;
- (c) Tax concession arrangements could be simplified for charities by removing the existing Fringe Benefits Tax (FBT) concessions and ensuring that there is an alternative benefit immediately in place, supported by appropriate transition arrangements;
- (d) As an alternative to the complex FBT regime, the income tax exempt thresholds could be increased for employees who work for, and gain their main source of income from, an employer that is a charity registered with the Australian Charities and Not-for-profits Commission (ACNC);

- (e) As Deductible Gift Recipient (DGR) status encourages giving it should be retained, however the system could benefit from simplification;
- (f) We do not suggest any changes be made to income tax exemption for NFPs;
- (g) In addition to the simplification of tax concessions, we support the simplification of the regulatory regime for NFPs at a State and Federal level;
- (h) We recommend the Government focus on encouraging competition within the NFP sector, rather than debating whether NFPs have a competitive advantage over for-profit businesses;
- (i) We strongly support the changes proposed to the taxation laws that apply to employee share schemes; and
- (j) Section 8Y of the Taxation Administration Act 1953 should be amended to restore the presumption of innocence for directors.

2. Not-for-profit (NFP) sector

The AICD is dedicated to excellence in corporate governance across all sectors of the economy, including the NFP sector. A simple, efficient and understandable tax regime will support good governance in the NFP sector.

We are of the view that the current taxation arrangements, while they support the sector, could be improved. The Tax Discussion Paper provides an important opportunity for the Government to enhance the effectiveness of the tax regime for NFPs, assisting the efficiency of NFP organisations and in turn, supporting the Government's own long term bottom line.

Our comments on the existing taxation arrangements for the sector are mindful of the fact that the sector comprises a large number of organisations, with a variety of structures and missions, spanning a diverse range of activities.

The NFP sector plays a critical role in the Australian economy as an employer and a contributor to the nation's GDP and, more importantly, to the communities in which we live. NFP organisations commonly tackle the most complex social issues and serve the most vulnerable in our society over the long term. The connection those in the sector make to the communities in which they work is invaluable. As Governments continue to increase their reliance on the NFP sector to fulfil a range of essential community services and support, the sector has become even more important to the fabric of our society. In some cases, if the NFP sector does not do it, it will not be done.

There are currently some hundreds of thousands of NFP directors in Australia. These directors range from experienced non-executive directors to individuals with relatively little or no experience as a director. Regardless of their experience or backgrounds, most NFP directors serve on a voluntary basis. Unfortunately, the complexity of the taxation arrangements for NFPs imposes a burden of time and cost on directors and their organisations alike, and the assistance of legal and tax advisers is commonly necessary to ensure compliance.

We note that if one of the policy drivers for tax reform is efficiency then federal taxation is only one issue to be considered. State taxes and duties also add to the complexity for

the sector. Further, simplification of the overall regulatory regime for NFPs at a State and Federal level is a key factor the Government should consider. The NFP sector will be most effective when red-tape is reduced and when regulatory requirements for charities are streamlined.

The ACNC has been effective in providing regulatory oversight for the charities sector. We believe this could be enhanced if the ACNC framework is extended to capture all NFPs, not just charities, as per its original intent.

Discussion Question 47: Are the current tax arrangements for the NFP sector appropriate? Why or why not?

We broadly consider the current tax arrangements to be appropriate in supporting the NFP sector, except for the FBT concessions applying to charities (discussed below).

Although the rationale for tax concessions for NFPs in Australia is not clearly set out in relevant legislation, the outcomes of leading reports and inquiries¹ into NFPs do offer insight. These reports strongly support the view that tax concessions play a vital role in the existence and ongoing viability of NFPs in their service of the community.

Tax concessions allow NFPs to devote more of their income to their mission in undertaking activities benefiting the public. Without such tax concessions, many NFPs and the critical services they provide would not exist.

Rules to Give By: A Global Philanthropy Legal Environment Index, published in December 2014, explores the tax and regulatory regimes in 193 nations that are recognised by the United Nations. The report provides a global index that ranks nations by the effectiveness of their legal, regulatory and tax environment in enabling charitable giving. The findings of the report reveal great insight into the effect on tax concessions globally, including the following:

- There is a clear link between tax incentives and the likelihood that people will give to charity;
- The percentage of people donating money to charity is 12% higher in nations offering tax incentives to individuals. It also finds that this relationship is equally as strong in countries that are defined by the World Bank as Low Income, as it is in High Income countries;
- There is a growing global consensus around the need for tax incentives for giving with 77% of governments offering tax incentives for corporations and 66% offering tax incentives for individual donors; and
- 94% of countries have a legal form for organisations that provide a public benefit that is exempt from taxation. Furthermore, 80% of governments require some form of reporting from charities, thus ensuring certain governance standards and helping to build public trust.

According to this report, Australia scored 10 out of 11 (11 being the best score), behind countries such as the US, UK, Canada, France and Germany which scored 11. This means Australia can improve the effectiveness of its tax system in relation to

¹ *Not-for-Profit Section Tax Concession Working Group – May 2013, Contribution of the Not-for-Profit Sector: Productivity Commission Research Report - January 2010, Competition Policy Review – March 2015 & Rules to Give By: A Global Philanthropy Legal Environment Index – December 2014*

encouraging philanthropy, and reinforces the importance of maintaining sufficient tax concessions in the NFP sector. If we were to, for instance, reduce concessions available to NFPs, this might reflect negatively on Australia as one of the wealthier OECD countries.

Other noteworthy factors regarding the appropriateness of tax concessions are set out below:

Deductible Gift Recipient status

- DGR status significantly encourages philanthropic giving to charities. This represents an important source of income to these organisations.
- Deductibility of philanthropic gifts is one of the only direct ways that individual taxpayers (including businesses) can allocate government revenue to causes that they themselves would like to see funded.

Income tax exemption

- Income tax exemptions are administratively more efficient than direct funding mechanisms. The costs to both government and organisations in taxing NFPs and then reallocating these taxes back to the same organisations through direct funding mechanisms could be substantial.
- As charities and other NFPs are formed for the purposes of public benefit, not the private benefit of individuals, it is argued that they should not be within the income tax regime. Income tax is therefore only applicable where there is a private benefit.

FBT concessions and rebates

- While the FBT regime benefits many employees in the sector, we agree that reform of the FBT concessions is necessary.
- Administering FBT concessions can be costly which means that the full benefit is eroded or not fully utilised.
- The current FBT concessions can give rise to inequities, they benefit employees on higher salaries, and there are different concessions available to different types of charities.
- As we discuss further below, if FBT concessions are removed, they should be immediately replaced with another alternative and appropriate transitional arrangements put in place.

47. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?

It is our view that the tax concessions available to NFPs do not create a competitive advantage compared to for-profit businesses.²

² In forming this view, we have not considered the impact of the mutuality principle.

Some NFPs conduct commercial activities in direct competition with for-profit providers of goods and services. The remainder operate in areas that are currently of little interest to for-profit business.

Most NFPs are exempt from income tax. The Industry Commission, in the *Charitable Organisations in Australia Report* of June 1995, concluded that such exemptions were unlikely to provide an unfair advantage to NFPs. Whether or not there is an income tax exemption, the output and pricing decisions to maximise a surplus (or profit) are the same. Therefore the income tax exemption does not distort decisions such as to how many people to employ, what price to charge etc., as long as tax is a fixed share of profit.

In terms of FBT concessions, in the situation where charities are competing with for-profit organisations, these concessions may provide an advantage to charities in recruiting and retaining employees. However, FBT concessions play a vital role in allowing these organisations to compete with for-profits in the first place as they offset the disadvantages that charities inherently have, such as offering lower wages and having limited resources and access to capital. The tax concessions therefore assist to bring charities up to a position where they can compete with for-profit businesses for employees. This view is documented in various research and working group reports.³

Where tax concessions are reduced, this places additional reliance on the Government for increased funding from other areas if vital services to the community are to be retained.

We recommend the Government focus on encouraging competition within the NFP sector, rather than debating whether NFPs have a competitive advantage over for-profit businesses.

In our experience, effective competition is fostered when a simplified and efficient regulatory regime exists and provides a level playing field for organisations. This type of regulatory environment allows organisations to turn their mind to generating their own efficiencies as opposed to spending valuable time seeking external advice on, and ensuring compliance with, a complex set of rules and regulations. Streamlining regulatory requirements, reducing red-tape and addressing the complexities within the tax regime for NFPs will therefore encourage competition and improve efficiencies within the sector.

We note that much of the Government's work to date on red-tape reduction has assisted for-profit enterprises, while this is positive, we would encourage the Government to also consider initiatives to reduce the regulatory burden in the NFP sector.

48. What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?

The current system of NFP tax concessions, while it provides support to the sector, has areas where it is complex, inefficient and inequitable, imposing substantial administrative costs on NFPs.

³ Not-for-Profit Sector Tax Concession Working Group – May 2013, Contribution of the Not-for-Profit Sector: Productivity Commission Research Report - January 2010 & Competition Policy Review – March 2015

The majority of NFPs in Australia are small organisations that rely on volunteers, including volunteer directors. Directors within the sector range from experienced non-executive directors to individuals with relatively little or no experience as a director. For directors, regardless of their experience, the complexities of the tax regime are an unnecessary hurdle toward good governance within the sector. The knowledge required to navigate the taxation requirements reduces the number of small entities fully utilising the tax concessions available. This is commonly the case for FBT concessions (and salary packaging) which are inherently complex and costly to administer.

Further, where charities do try to utilise tax concessions and get it wrong (because for example, they do not have sufficient funds to outsource salary packaging programs or seek tax or legal advice) they can become liable to pay expensive FBT, including interest and penalties for inadvertent errors and misinterpretation of the FBT law.

Other complexities, such as determining whether NFPs meet the conditions for an income tax exemption (especially where they are required to self-assess) and satisfying the conditions for DGR endorsement can require costly legal and tax advice.

The administration costs that NFPs need to incur to meet the requirements of the legislation in order to be entitled to tax concessions take away vital funds that could otherwise be used in undertaking their altruistic activities.

It is also our experience that increased administration costs could impede philanthropic giving. That is, individuals are less likely to give to charities (even where they are DGR endorsed) where they know that more than a small part of their funds will be going towards administration costs and not for the ultimate purpose of the charity.

We therefore strongly support simplification of the tax concessions and outline in our response to question 49 how this could be achieved.

49. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

We agree that changes are necessary to effectively and more efficiently deliver benefits to the Australian community via the taxation system. We understand the Government's intention with tax reform is not to save costs, but rather to provide charities with simplified and more transparent tax concessions to support the important activities undertaken by charities in benefiting the public.

Whilst the current tax concessions provide vital support to the NFP sector, in our view they could be improved. These improvements are necessary because the sector is critical to a well-functioning Australian society. The aim of our suggestions is to make the system work more effectively and for these suggestions to be revenue neutral.

Tax concession arrangements could be simplified in the charitable sector by:

- Removing the existing FBT concessions and ensuring that there is an alternative benefit immediately in place, supported by appropriate transition arrangements; and
- Selecting as an alternative to the complex FBT regime, an increase in the income tax exempt thresholds for employees who work for, and gain their main source of income from, an employer that is a charity registered with the

ACNC. Alternatively the Government could consider an equivalent structural measure that provides incentives for employees of registered charities.

We are of the view that by paying less income tax, the employee would receive a similar benefit, whilst the complexities of the FBT regime for the sector would be removed and administration costs significantly reduced. It is our view that this arrangement would provide increased transparency to the Government regarding the cost of forgone revenue, would significantly simplify the tax regime and reduce inequities. Reporting of an employee's eligibility could be quite simple using the payment summary mechanism.

Our further recommendations for NFP tax reform are set out below:

- As DGR status encourages giving to charities it should be retained. However, to improve efficiency in the system the government could consider whether it would be appropriate to make all charities registered with the ACNC eligible for DGR status. This would remove existing inequities in the legislation that allow some categories DGR endorsement and not others;
- We support maintaining the current arrangements between the ACNC and the ATO for registration and endorsement of tax concessions. Since the introduction of the ACNC this process is far more streamlined and has helped charities navigate the complexity previously inherent in this process;
- We do not suggest any changes be made to income tax exemptions for NFPs; and
- As stated above, in addition to the simplification of Federal tax concessions, we believe state-based taxes applicable to charities such as payroll taxes and duties could also be simplified. Similarly, we support efforts to simplify the regulatory regime, beyond tax matters, for NFPs at a State and Federal level.

3. Other comments

Effective Regulation

One of the key pillars of regulatory reform that we identified in our paper *Towards Better Regulation*⁴, was to improve how new regulation is developed. We congratulate the Government for the consultative approach it has taken to tax reform so far. Engaging with business and other stakeholders and undertaking adequate consultation on these issues through the Discussion Paper and the eventual Green Paper that will follow, will help to ensure that any eventual regulation that is introduced works in practice and achieves the intended outcomes.

In the event it is determined that the introduction of black-letter law is the only way to achieve the desired outcomes identified through the consultation, care must be taken to ensure the legislation and regulation be carefully drafted so that it is:

- Simple;
- Targeted at achieving the relevant policy objective;
- Proportional to the problem being addressed;

⁴ Available at www.companydirectors.com.au

- Designed to minimise compliance burdens;
- Not unduly prescriptive or restrictive;
- Transparently and clearly communicated;
- Consistent with existing laws and regulations; and
- Readily enforceable.

It is also important that any new legislation is appropriately monitored and reviewed once it has been implemented. As noted in our paper, we are of the view that all primary legislation that has more than a minor regulatory impact on business should include a requirement to review the regulation, and preferably have a sunset clause (being a clause that provides for the expiry of the regulation at a particular time subject to action being taken by the relevant agency) embedded into the legislation itself to further enhance the likelihood of the review taking place.⁵

Employee share schemes

Generally speaking, the AICD strongly supports the changes proposed to the taxation laws that apply to employee share schemes, as noted in our recent submission⁶ to Treasury in response to the Exposure Draft, “*Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015: improvements to taxation of employee share schemes*” (Exposure Draft).

In particular, we welcome the repeal of the changes introduced by the previous Government in 2009 that altered the taxation laws relating shares and options granted under employee share scheme. The 2009 changes had significantly compromised the commercial value of employee options and the changes proposed under the Exposure Draft address this by effectively eliminating the risk that options can be taxed even where they are “underwater”.

We also support the introduction of tax concessions for the grants of shares and options to the employees of start-up companies (and which should also be available to the non-executive directors of such companies where shares or options are granted in lieu of director fees) subject to certain conditions being met.

As noted in our submission, however, there are a number of ways that the tax treatment of employee share schemes could be further improved, including:

- Addressing the triggering of tax liability in respect of unvested or restricted securities under an employee share scheme on cessation of employment to encourage (or at least not deter) the holding of securities by employees beyond cessation of employment; and
- Allowing for greater flexibility for security grants to employees and directors of start-up companies by loosening some of the conditions that apply under the Exposure Draft (for example, the requirement that the grants be offered to at least 75% of the company’s employees and that the securities must not vest earlier than 3 years).

⁵ See *Towards Better Regulation* at page 26, available at www.companydirectors.com.au

⁶ Available at www.companydirectors.com.au

Section 8Y of the Taxation Administration Act

The AICD continues to be concerned about section 8Y of the Taxation Administration Act 1953 which provides that if a corporation commits a taxation offence, a director of the corporation will be deemed guilty of the same offence. In other words, the provision reverses the fundamental legal principle that a person is innocent until proven guilty. It also fails to recognise that the corporation is a legal entity distinct from its directors by holding the directors liable for the offence, without the need for directors to be involved in the offence.

We are of the view that section 8Y of the Taxation Administration Act should be re-drafted so that it becomes an accessorial liability provision which requires the prosecution to prove a director's involvement as an accessory to a corporation's taxation offence.

Further information about section 8Y of the Taxation Administration Act is set out in an earlier submission to Treasury.⁷

Director Sentiment Index

Twice a year the AICD surveys a representative group of our members to get their views on a range of public policy and economic issues. This survey is known as the *Director Sentiment Index*. A number of findings in the most recent survey (released in May 2015) provide useful background to inform Treasury's thinking on the issue of tax reform. These include:

- Directors identified taxation reform as the second most important issue the Federal Government should address in the short term (infrastructure was the top priority);
- Directors rate the GST as the top priority for reform in any comprehensive review of the taxation system. This is followed by multinational tax arrangements and state based taxes; and
- Almost 80 per cent of directors support a change to the GST system, whether that be by increasing the rate across the board or broadening the base.

An executive summary of the *Director Sentiment Index* is available on our website.⁸

We hope our comments will be of assistance to you. If you would like to discuss any aspect of our views, please contact us on (02) 8248 6600.

Yours sincerely



JOHN BROGDEN
Managing Director & Chief Executive Officer

⁷ See AICD Submission to Federal Treasury "Personal Liability for Corporate Fault Reform Bill 2012 (third tranche)" dated 3 September 2012 available at www.companydirectors.com.au

⁸ www.companydirectors.com.au