

Re:think Tax Discussion Paper - The Not-for-profit View

A joint response from Curtin University and Baptistcare WA

1. Introduction

This paper summarises our responses to the discussion, issues and questions raised in the Re:think Tax Discussion Paper (the Paper) in regard to taxation and the Not-for-Profit sector (the Sector). As such, our focus is on the discussion and questions included in Chapter Seven of the Paper.

Baptistcare WA and the Curtin Not-for-profit Initiative offer these comments in order to enhance understanding of the sector, reshape the discussion by emphasising a more pragmatic viewpoint and to support the discourse. We appreciate the opportunity to submit our response.

2. Summary of Key Points

This section provides a brief summary of the points raised in this submission. We have found significant unsupported assertions and a lack of deep analysis in the discourse presented even though it is an extremely complex and important sector of the Australian economy. We have identified and discussed these shortcomings prior to turning to each question raised in Chapter Seven of the Paper.

2.1 Addressing the Paper's Inadequacies

The ideological—rather than evidenced based—perspective adopted in the paper suggests certain answers are being solicited rather than encouraging a free discussion. Specifically, these assertions and poor analysis lead the reader to assume:

1. There is something wrong with the current tax arrangements pertaining to the Not-for-profit sector and change is therefore required;
2. Not taxing Not-for-profit surpluses or providing tax concessions constitutes 'lost revenue' for the Commonwealth;
3. The Not-for-profit sector is inefficient and ineffective, reinforcing the assertion above relating to lost revenue and implying 'recovered' revenue could be better spent;
4. Changing the tax structure will lead to greater efficiency and better services for end users as well as increased revenue for the Commonwealth;
5. Tax arrangements for Not-for-profits are not fair for For-profit organisations and Not-for-profits and For-profits should be treated more similarly apparently on the basis that their contribution to our community is similar; and

6. The impact of changes to the tax system as it relates to Not-for-profits will not impact the services provided to the most vulnerable people in our community either because they will easily be replaced by the For-profit sector or because the services are optional.

The authors of the Paper treat the sector as an homogeneous group. This is naive and inconsistent with their examination of the For-profit sector. This dichotomy is carried further when the Paper treats tax concessions for Not-for-profits as costs while it treats tax concessions for the For-profit sector as incentives and necessary supports. Finally, the Paper fails to understand or address the importance of the Not-for-profit sector in the supply of critical services to governments, the impact changes to tax arrangements are likely to have on the capacity of governments to implement policy, or the resultant budget and service risks that result if the capacity of the Not-for-profit sector is reduced.

We highlight the fundamental errors inherent in this perspective and comment on the need for more informed and less subjective thinking. In particular, we draw attention to the far-reaching risks to communities and governments if this distorted view of tax in the context of the Not-for-profit sector prevails and the danger of being swayed by media and lobbying by For-profit organisations.

2.2 Overview of Our Response to the Discussion Questions:

In summary our response to the questions raised in the discussion paper are as follows. Please note that our full response is available in the main section below.

Q. 47 Are the current tax arrangements for the NFP sector appropriate? Why or why not?

Yes, the current overarching approach to tax of the Not-for-profit sector is appropriate. Further, neither this paper nor any other reputable, objective review or research has presented evidence to support the need for change. The use of Fringe Benefits Tax exemptions by those on high incomes has long been inconsistent with the intent of the arrangement and change to these regulations, following appropriate modelling, in relation to that sub-group of employees is long overdue and welcome. Other than this, there is no evidence that the fundamental principles of Not-for-profit tax arrangements need to be altered or that such alteration would result in a better outcome for Australians.

Q. 48 To what extent do the tax arrangements for the Not-for-profit sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?

Not-for-profit and For-profit entities are fundamentally different. Asking this question raises concerns about the extent to which the authors understand the differences between these entities and/or are influenced by lobbying by For-profit organisations. The paper presents a poorly developed discourse regarding the myth of competitive advantage favouring the Not-for-profit sector, implies little understanding of the range of services provided and demonstrates a poor understanding of sector heterogeneity.

Q. 49 What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?

We are very supportive of a simplification of the current complex system of varied tax concession entitlements and application procedures with the Charities Act (2012) (Cth) forming the basis of a sound definition. Further, any simplification, and its implementation and ongoing application, should be supported and overseen by a national regulator with supervisory and capacity building powers.

Q. 50 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?

Again, underlying this question is an unsubstantiated assumption. In this case, the assumption is that Not-for-profits are less efficient or effective in the delivery of services than the public or For-profit sectors. Although this is a widely held belief, there is no evidence to support it. In fact, there is a growing body of evidence supporting a view of Not-for-profits as efficient, or more efficient, than their For-profit counterparts.¹ This notion of inefficiency is based on a simplistic understanding of economics, suggesting only competition can drive efficiency and effectiveness. The mission imperative of Not-for-profits combined with rigorous scrutiny applied by funders, philanthropists, members and other stakeholders creates significant pressure on the sector to be both efficient and innovative. Additionally, the sector's capacity to attract philanthropy and to deploy volunteers is highly suggestive of greater efficiency and effectiveness than the prospects for the For-profit sector. There is no similar question asked regarding the tax of For-profit entities, illustrating the subjective opinion and assumptions underpinning the Paper's view of the Not-for-profit sector and the comments and questions raised in this paper. It is clear that market economics are the default position for this paper.

2.3 Final Remarks:

We urge the Commonwealth to:

1. Examine and test the assumptions underpinning this paper, and reset the debate to be based on factual, objective and holistic arguments;
2. Fully consider the size and contribution of the Not-for-profit sector to Australia's communities and economy as well as the impact of change on the sector's sustainability; and
3. Consider the extent to which there is a real need for change and examine who will benefit (and who will lose) by implementing the changes implied in this policy review.

We support a regular review of the tax system, including those aspects relevant to the Not-for-profit and Charitable Sector, but these reviews should be based on a detailed and in-depth understanding of how the Not-for-profit sector really operates, its contribution to the community and the economy and the potential impact of tax change not only on the sector, but, more importantly on those relying on the services the sector provides.

¹For example, see: <http://www.companydirectors.com.au/Director-Resource-Centre/Not-for-profit/NFP-governance-study#NFP%20governance%20study>

3. Detailed Response

This section identifies a number of assertions, apparent assertions and inappropriate assumptions relating to the taxation arrangements of the Not-for-profit sector evident in the Paper and underpinning the Paper's analysis, commentary and questions. It provides the rationale in support of our responses to the individual discussion questions detailed in the section following.

3.1 Australia's Not-for-profit Sector and this Paper:

3.1.1 Our current understanding of the size and contribution of the Not-for-profit sector is limited:

For over ten years, policy makers and researchers have commented that, compared with the public and For-profit sectors, we have very little information regarding the Not-for-profit sector upon which to formulate effective policy. In particular, they draw consistent conclusions which simply put are:²

- 1) We do not know how many Not-for-profit organisations there are in Australia;
- 2) Not-for-profits do not form an homogenous sector, but operate in industries as diverse as health, arts, law, research and sport, and we do not know what they all do;
- 3) We do not know what the real impact of tax concessions is on sector performance, nor the potential impact of changes to tax concessions.

The quality of data available is rapidly improving since the establishment of the Australian Charities and Not-for-profits Commission (ACNC) and its collection of operational and financial data via the Annual Information Statement process. This data has been collected in full for the first time in 2015 and will prove invaluable in future reviews of Not-for-profit tax arrangements. At present, to make far reaching changes to tax when this information is not yet available would seem to represent considerable risk.³ The lack of evidence and impact modelling underlies the direction encompassed within the Paper and its reliance of opinion and ideology.

3.1.2 The evidence we have shows that the Not-for-profit sector is a core contributor to our economic and social well-being:

Australian Bureau of Statistics data shows economically significant Not-for-profits make a substantial and growing contribution to Australia's GDP.⁴ ACNC data demonstrates that the Charitable Sector alone is highly complex, turns over at least \$100 billion (of which government purchased services and grants make up a sub-set only), employs almost 1 million people (or 8% of the Australian workforce), and is supported by over 2 million volunteers.⁵

Indeed, the sub-set of faith-based charities is a case in point. It is a large group making an enormous contribution toward many aspects of social activity. This group of charities is

² For instance, see: <http://www.pc.gov.au/inquiries/completed/not-for-profit>

³ See <http://business.curtin.edu.au/local/docs/Curtin-Australian-Charities-Report-2013.pdf>

⁴ See: <http://www.abs.gov.au/AusStats/ABS@.nsf/Latestproducts/5256.0Main%20Features12012-13?opendocument&tabname=Summary&prodno=5256.0&issue=2012-13&num=&view=>

⁵ See: <http://business.curtin.edu.au/local/docs/Curtin-Australian-Charities-Report-2013.pdf>

involved in social housing, relief of poverty, education, relief of sickness, services to the aged, and the advancement of religion. While Faith-based charities are themselves not a homogenous group, collectively they are significant in terms of their capacity to deploy resources in support of the many social objectives they pursue. This sub-group employs 133,000 people or 14% of people employed by charities and engages hundreds of thousands of volunteers.⁶ Many of these charities have earned colloquial household names, for example Vinnies or the Salvos, and have an extremely long history of contributing to our society supporting our most vulnerable people and those suffering significant disadvantage. The tenor of the Paper seems to suggest that these organisations are occupying a sector of our economy that For-profits can service. Further, these organisations are also caught by the ideological discourse of the Paper with its implications of market economics when these organisations operate because of market failure.

3.1.3 The Not-for-profit sector is critical to all governments' capacity to deliver policy:

It should be noted the Paper has been released during a period of fundamental change in the structure of the Not-for-profit sector.⁷ In particular, governments continue to increase the number of services, including critical human services, purchased from the Not-for-profit and For-profit sectors. During the 2013 financial year, the Commonwealth government alone purchased \$28 billion worth of services from the Sector.⁸ Many of these services are provided to the most disadvantaged and vulnerable people in our community, such as people living with disability, children in child protection, those who are homeless or the aged. Whether or not to access these services is not a choice. They cannot be 'put on hold' should supply fail or the bids received be above budget. Governments will have to pay whatever it costs to provide service, creating budget risk in thin markets. Tampering with the tax system without adequate knowledge of the likely impact will enhance these risks greatly, ultimately to the detriment of governments.

A strong, efficient and effective Not-for-profit sector is a significant asset for governments. Not-for-profit providers offer a higher 'return on investment' to governments and other funders, as they leverage volunteer resources and donations and are not required to distribute profits to shareholders—they reinvest profits in pursuit of their mission. Not-for-profit providers will operate in service delivery areas in which profit margins are between 0% and 5%, whereas For-profits are obligated to leave sectors and shift capital to markets where they can achieve the highest returns. This is a proper response from the For-profit sector and is not objected to here *per se*. However, the same idea of Not-for-profits having mobile capital is inherent in the Paper. Not-for-profits do not have the capacity for shifting capital given their mission focus and accumulated intellectual property and infrastructure. Indeed, they are more constant in their focus on mission and particular areas of service delivery and are less likely to be transitory in a sector thus reducing supply risk. Not-for-profits' continued engagement in service delivery in areas where only marginal profit is available is in many respects contingent on their being able to also provide services in areas where greater profits are available. This cross-subsidisation of services is essential particularly where there is little variation in contract fee regardless of the cost base associated with the location of operations. It is put at risk if poor economic policy results in For-profits selectively providing profitable services and leaving the Not-for-profit sector to provide unsustainable services. Ultimately, Australia's government will pay for this supply side risk.

⁶ See: <http://business.curtin.edu.au/local/docs/faith-based-charities-curtin-report-final.pdf>

⁷ For instance, see: <http://business.curtin.edu.au/local/docs/150227-Sustainable-Funding-and-Contracting-2014-Evaluation.pdf>

⁸ and: <http://business.curtin.edu.au/local/docs/Curtin-Australian-Charities-Report-2013.pdf>

Unfortunately, instead of objectively examining the pros and cons of contracting with Not-for-profits, the Commonwealth government has demonstrated its lack of understanding of the sector, deference to For-profit interests and an intention to reduce the Sector's advocacy capacity.⁹ The impact such undeveloped ideologies will have on Sector capacity and ultimately the social infrastructure which ensures Australian civil society is maintained is not addressed at all in this paper.

3.2 Addressing Treasury's specific misunderstandings and assumptions about the NFP sector and its tax arrangements

3.2.1 The Commonwealth has taken an ideological rather than evidenced based perspective and starts from the premise that tax arrangements for Not-for-profits are unfair and need to change:

In preparing this paper, it is clear the Commonwealth has taken an ideological approach and accepted received wisdoms and assumptions without question. Chapter Seven has been written with the intent of driving the discussion toward a particular outcome. The use of the terms 'tax expense', 'potential savings' and 'competitive advantage' are combined with an unsupported assertion that these things are problems—in fact the phrase used is 'particularly problematic'—needing to be addressed. In this way, the Paper sets up the reader to make a particular response. The recent budget announcements regarding Fringe Benefits Tax arrangements pre-empt the current discussion and seem to support the drive of Chapter Seven.

This ideology has been fuelled by some sections of the media creating a distorted view of the current tax arrangements, implying there has been widespread misuse of allowances.¹⁰ This ill-informed view and the related naïve support of competitive neutrality create a distorted perspective and further confirms the impression that the removal of tax concessions and allowances would provide much needed income for the Commonwealth.¹¹ These propositions are not based on real data nor an empirical examination of the state of the Sector and its impact but, on an ideological disposition. Additionally, the removal of concessions such as those provided for Fringe Benefits Tax will effectively reduce the incomes of low paid workers who spend such savings directly into the economy thus increasing consumption for better overall economic outcomes. As discussed above, there has been and remains a dearth of accurate information about the Sector upon which to make effective policy decisions, including tax policy.

Related to this ideological perspective, there is an assumption inherent in the paper that the tax arrangements for the Not-for-profit sector should be changed. Although not stated, the inherent assertion is that the current structure provides too many advantages for Not-for-profits, reduces taxable income and is, therefore, unfair to For-profits. While the implication is that Not-for-profits are the 'winners', under the current arrangement, there is no identification of who is winning and what winning actually means. Any saving achieved in

⁹ <http://www.probonoaustralia.com.au/news/2015/04/not-profits-grill-assistant-treasurer#>

¹⁰ The focus on some poorly managed organisations in these media reports is disturbing on two counts, firstly there is evidence of like activities in the For-profit and Public Sectors—the Sector is not immune from nefarious activity just like every other part of the Community; and secondly, evidence is now highlighting the fact that the Sector is demonstrating a very high rate of compliance with regulatory requirements. See https://www.acnc.gov.au/ACNC/Publications/Reports/ComplianceRpt2012_2014.aspx

¹¹ For instance, see: <http://www.theaustralian.com.au/opinion/columnists/theresnothingcharitableaboutthesetaxdodges/storyfbkbnk71227081845214>

the Not-for-profit sector is deployed back into purpose, a fact well understood by government purchasers and relied upon by those purchasers in order to reduce the cost of services to the public purse by forcing Not-for-profits to leverage other income streams and resources. Nor is there evidence Australian communities or even the For-profits are losing. The remainder of this section aims to address the incorrect assumptions and conclusions underpinning the paper and present a more balanced perspective.

3.2.2 The Commonwealth is inconsistent in its approach to Not-for-profits and For-profits:

The Paper treats the Not-for-profit and For-profit sectors differently in its description of tax concessions. For example, when discussing the tax concessions available to the Not-for-profit sector, it uses the concept of expense. On the other hand, when discussing concessions provided to the commercial sector it talks in terms of incentives and necessary supports. This dichotomy leads directly to the Commonwealth incorrectly asserting that the Doctrine of Mutuality is in appropriate for the Not-for-profit sector but appropriate in the commercial sector.

Specifically, Chapter Seven questions the appropriateness of applying the Doctrine of Mutuality in various types of Not-for-profit organisations. The Chapter suggests there is “...no clear rationality underlying this exemption” (p. 126). In fact this is erroneous. There is a clear and appropriate rationality for this exemption. The same rationale is also used to apply to companies in the treatment of dividends. Essentially, the Doctrine of Mutuality formalises the relationship between members of a corporation involved in a mutual endeavour who are not required to pay taxes on transfers occurring within that corporation. The same idea is applied to For-profit corporations where investors come together in a mutual endeavour, essentially to make a profit, and as a result are provided with Franking Credits when a dividend is paid and upon which those members enjoy a tax benefit. There is no basis for this inconsistency. If it is considered to be double taxing to remove the franking credit entitlement, it is inconsistent to then remove the reliance on the Doctrine of Mutuality for Not-for-profits.

Additionally, while the Sector concessions are described as expenses and lost revenue, those concessions provided to the mining sector and the farming sector in the form of fuel excise rebates and income-averaging are described as incentives and necessary supports. Further, while the focus of Chapter Seven is heavily weighted toward the recovery of this ‘lost revenue’ from Not-for-profits, the discussion in other chapters examining concessions available to the For-profit sector focuses on improving the efficiency of administrative arrangements. We are left asking why the Not-for-profit Sector is singled out for this treatment while the commercial sector is not. This is an especially important query given that changes to the tax arrangements will invariably negatively impact the Sector’s ability to deliver services and no modelling has been done to examine the extent of the impact of such an impact.

3.2.3 The Commonwealth misunderstands the tax arrangements for Not-for-profits, their purpose and impact:

The Paper implicitly or explicitly shows significant weaknesses in the understanding of tax arrangements for Not-for-profits. Specific assertions and errors are discussed below:

Incorrect assertion that the tax concessions equal lost revenue:

As already highlighted, Chapter Seven frames the discussion pertaining to Not-for-profit organisations in terms of ‘lost revenue’ and ‘cost’ implying the Commonwealth is losing income. For a number of reasons, this misleads the reader as it carries implications that are not supportable in relation to the history and purpose of tax concessions.

Firstly, it assumes tax concessions represent a foregoing of tax that ‘could be’ or ‘was once’ collected. This is not the case. The Sector has had access to taxation exemptions since first settlement and to various levels of Fringe Benefits Tax exemptions and rebates since the tax was introduced.

Secondly, the chapter suggests that, if the concessions were no longer available, somehow the “tax expenses” would be recovered and the Commonwealth’s financial position would be accordingly improved. This is a highly unlikely outcome as organisations are historically and structurally underfunded by governments purchasing services in order to meet their own responsibilities regarding civil society, health, education and other social infrastructure. Any reduction in tax concessions would result in great costs for the government as funding would need to be increased accordingly.

Thirdly, any tax costs associated with charitable organisations would likely reduce philanthropic contributions which Not-for-profits rely on to support their many purpose driven activities and which government service purchasers rely upon in order to reduce the cost of service delivery to the public purse. The positive externalities associated with philanthropy would also be lost.

At best, the discussion of these ideas is premature as we simply do not have the data or modelling necessary to assess the likely impact of these types of ideas.

Incorrect implication that Not-for-profits do not pay any tax:

Not-for-profits are major sources of tax revenue. Indeed, most economically significant Not-for-profits are liable for payment of GST while a vast proportion contribute to the various state-based utilities at rates that, like private households, actually subsidise industry. Only a small number of Not-for-profits are registered as Public Benevolent Institutions or Health Promotion Charities and are exempt from paying FBT, and some charities can apply for FBT rebates up to a threshold. Many non-charitable Not-for-profits pay full FBT. Once again, there is a great need for analysis as those Not-for-profits likely to be most affected by the types of changes discussed in the Paper are those most likely to be supporting the most vulnerable people in our community. Therefore, there is significant risk associated with getting any change wrong.

Incorrect assertion that services provided by the sector are replaceable:

Chapter Seven also focuses on the tax elements in a vacuum as it does not consider the role played by the Sector in Australian civil society or the impact potential changes may have on groups within our community. It seems to be suggesting For-profits would simply step in and provide services and capacity without really understanding the Sector's considerable and irreplaceable infrastructure and intellectual property in these areas.¹² Further, there are many locations and service types that For-profits would not consider serving. For instance, many services provided in rural, regional and remote areas are provided by Not-for-profit organisations because For-profit organisations cannot operate there profitably. Further reducing the capacity of Not-for-profits to provide these services will result in added costs to government.

Incorrect assumption that removal of tax concessions will result in increased revenue for government:

As for all organisations, an increase in costs can only be absorbed if the organisation is achieving above market returns. For those Not-for-profits with little or no operating surplus, costs must be immediately passed on to buyers or members if the organisation is to remain viable. Others may be able to initially absorb the cost increase but as this will result in a reduction of funds reinvested in the Not-for-profits' capacity, these costs will eventually have to be passed on to buyers if the organisation is to remain viable. If organisations cannot pass on costs in either the short- or long-term, then some services or even the Not-for-profit will no longer be viable and supply will decline to the detriment of the community. If the increase in costs were significant and uniform across Not-for-profits, this would have significant implications for the supply of community services and the value these bring to their local communities. In regard to government contracted human services, governments will have to absorb cost increases or risk lack of supply of key services.

3.3 The Commonwealth shows a lack of understanding of the size and contribution of the Not-for-profit sector and governments' reliance on the sector to deliver key policies:

- 1) The success of many policies established by governments is inextricably linked to a healthy Not-for-profit sector;
- 2) Success is enhanced when the Sector and governments work closely together and develop a strong partnership;¹³
- 3) The Sector can leverage 2 million volunteers, very substantial and growing philanthropic contributions, significant infrastructure, and intellectual property in support of government policy objectives and in addition to government funding;

¹² For example, see: <http://business.curtin.edu.au/local/docs/Curtin-Australian-Charities-Report-2013.pdf>

¹³ For example, see the Western Australian government's "Delivering Community Services in Partnership Policy" which focuses on strengthening the relationship between the Not-for-profit sector and government (available at: https://www.finance.wa.gov.au/cms/uploadedFiles/Government_Procurement/Policies/dcspp.pdf?n=1765)

- 4) This infrastructure, intellectual property, philanthropy and volunteerism cannot be readily replaced and so ideas such as the enduring myth of anti-competitive behaviour, of a “market” for human services particularly, and the breaking down of tax concessions will invariably decrease governments’ capacity to achieve their policy objectives and ultimately impact civil society.

3.4 The Commonwealth treats the sector as a mostly homogeneous group and fails to understand that it is as diverse as the For-profit sector (for which it supports a differential approach):

The Paper discusses the taxation arrangements surrounding the Not-for-profit sector at the sector level, failing to appreciate the diversity of a Sector operating in all aspects of the community. While we have clearly pointed out there is insufficient evidence and analysis to support the overt and inherent arguments developed in the Paper, there is a further need for such analysis as different parts of the Sector might validly be treated in different ways. As the current tax arrangements are nuanced for different sub-sectors of the For-profit sector, so too can the tax arrangements for the Not-for-profit sector be nuanced. This cannot be done effectively without additional and substantive evidence and analysis.

3.5 Incorrect assumption that the Not-for-profit sector is inefficient, and less efficient than government or the For-profit sector:

There seems to be an underlying narrative suggesting the For-profit sector can achieve better and more efficient outcomes than the Not-for-profit sector. There is no evidence supporting the received wisdom the Not-for-profit sector is any more or any less efficient or effective than the for-profit sector. Indeed, recent reporting suggests compliance rates of the charitable sector are very high, in turn suggesting efficiency is high in the sector.¹⁴ Treasury misunderstands the concept of competition and prioritises competitive neutrality over all other outcomes, including public sector costs.

3.6 Inconsistent assertion that income tax exemption does not impact competitive neutrality but FBT does:

This inconsistency is extremely hard to reconcile. Obviously DGR status and income tax concessions are critical for the Sector to continue to deliver services and to support civil society in Australia. The concessions particularly relating to DGR status are necessary to ensure philanthropic activities continue to grow and contribute. Indeed, the Paper covertly acknowledges this by referring to the lack of concern regarding income tax concessions and DGR status in the context of competitive advantage. This inconsistency demonstrates the simplistic approach taken in this document. For-profits would be concerned with respect to competitive advantage where they perceive lower input costs are achievable by a Not-for-profit as a result of these concessions. As such, the issue is not the type of tax concession but whether that concession reduces the efficient price and thereby reduces the For-profit’s after-tax return on investment. Given the reliance of many sub-sectors of the Not-for-profit Sector on donations and volunteerism, and given the governments of Australia have traditionally

¹⁴ For instance, see: <https://www.acnc.gov.au/CMDownload.aspx?ContentKey=6af3e137-04ed-4001-a8d3-b13b2e34e2a0&ContentItemKey=398d3b8e-f774-4453-b21b-e4b87840261c> and <http://business.curtin.edu.au/local/docs/DSC-Annual-Funded-Sector-Report-2010-11.pdf>

underfunded service delivery, the likelihood that changes to the current taxation arrangements are going to raise the efficient price.

3.7 The Commonwealth fails to examine the potential impact of tax changes on our communities and those who are most vulnerable:

As already identified, the Paper does not provide any analysis of the potential impact of any changes to the Not-for-profit tax arrangements. While this is a substantial deficiency in the context of the discussion put forward, it is not unexpected given the lack of data available and the premature nature of this discussion. Particularly though, the Paper suggests:

- 1) Those vulnerable people in our country who rely on many elements of the Sector are able to bear the risk associated with the implementation of this one dimensional policy;
- 2) Such risk can be borne because many of the services accessed by vulnerable people are optional and driven by a desire to consume rather than a required service enabling people to live; and
- 5) There is a market for Not-for-profit services based on this consumer preference philosophy and the work of the Not-for-profit sector can be readily replaced by For-profits.

In reality none of these suggestions apply. There is no market for many of the services being funded by governments. Indeed, government funds these services as a result of the market's failure to supply them. If there was a market, Not-for-profit organisations would not be necessary. Many of the services being sought are essential in nature, not optional. Any supply side risk is borne by the recipients of these services who constitute the most vulnerable people in Australia. The Sector's infrastructure, intellectual property, philanthropy and volunteerism cannot be readily replaced and so ideas such as the enduring myth of anti-competitive behaviour, of a "market" for human services particularly, and the breaking down of tax concessions will invariably decrease governments' capacity to achieve their policy objectives and ultimately impact civil society.

4. Responses to Discussion Questions

The following constitute our specific responses to the questions raised in the Discussion Paper:

Q.47 Are the current tax arrangements for the Not-for-profit sector appropriate? Why or why not?

Yes, we believe the overarching premise of the current tax arrangements for the Not-for-profit sector is appropriate. We consider there is likely to be opportunity for enhancements to be made to ensure equity and efficiency in terms of the application of the concessions and the processes required to apply for and retain them. Before such an examination can take place, we consider there is a need for further information and more complex modelling given the simplistic nature of the Discussion Paper and the lack of evaluation being applied. This deficiency is particularly acute in the context of the potential impact of any taxation changes on those vulnerable people who rely on many of Australia's Not-for-profit organisations.

Ultimately, the service recipients bear the risk associated with this discussion. For the reasons outlined in our response above, the following should be retained as tax concessions for the Not-for-profit Sector:

- 1) **Income Tax Concessions:** This concession should be retained for all Not-for-profit organisations as their contribution represents significant value to the Australian community, contributes a number of positive externalities where they operate, and any surpluses have been, and will continue to be, invested in community infrastructure or services benefitting all and subsidising government funding.
- 2) **Fringe Benefits Tax Concessions:** This concession is critical to enabling the Sector to continue to attract and retain staff. It is especially important given those employed in the Not-for-profit Sector are among the lowest paid staff in the economy and any fringe benefits concession is converted to consumption thus enhancing economic outcomes more broadly, in line with Commonwealth government policy. There is a strong argument for restricting the concession to those who fall under a prescribed level of remuneration. Such a change would need to be analysed to ensure the cost of compliance—to the government and the employing entity—would not negate the positive effects of the current arrangement in the context of those workers who are underpaid and the Sector which is seeking to attract and retain good staff.
- 3) **The Doctrine of Mutuality:** The doctrine of mutuality should be retained in order to ensure the social and community aspects of clubs and societies are retained. Notwithstanding the apparent lack of consistency in dealing with this issue in the context of the Not-for-profit and For-profit sectors, only limited analysis of the prospective effects of removing this important feature has been done. The impact remains unknown and the apparent expectation of government income rising as a result of removing the feature is unconvincing.

Q.48 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?

The enduring myth of competitive advantage fundamentally distorts the real issues. This enduring myth has been discussed above and its continued evocation relies heavily on the need for research or analysis to prove or disprove it. We reaffirm the underlying premise of this aspect of the discussion is erroneous because:

- 1) The sector is heterogeneous. Simplistic notions relating to competitive neutrality, even within a sub-sector, are dangerous for those sections of the community supported by the sector;
- 2) The sector does not operate in markets where its services are accessed by recipients on an opt-in basis. They are necessitous requirements and, as such, supply side risk is borne by the recipients;
- 3) The Sector receives the bulk of its funding from governments and so any increase in costs will be borne by governments;

- 4) Funding from governments is structurally and historically insufficient and is supplemented significantly by philanthropy, volunteerism and community support—all resources not generally available to For-profit entities;
- 5) The infrastructure, intellectual property and community support are not able to be transferred quickly and easily to the For-profit sector and so, while ideologically it is attractive to talk in terms of competitive neutrality, in fact the For-profit sector cannot provide many of the services currently provided by the Not-for-profit Sector as efficiently as the Not-for-profit Sector; and
- 6) While the For-profit sector can contribute to some areas of service delivery that might have traditionally been the province of Not-for-profit organisations, three further issues need to be considered:
 - a. Not-for-profit organisations provide services where there is market failure and can often utilise the surplus made in other areas of their operations (together with donations and volunteers) to ensure sustainability of otherwise unsustainable activities. For example, remote, regional and rural communities generally rely on service provision from not-for-profits, which will, in many instances, use their surpluses generated in urban areas to fund a service; or rely heavily on volunteers to make a service viable. For-profits will likely only seek to enter service delivery areas where profits are to be made thus reducing the overall sustainability of the Not-for-profit Sector as the traditionally viable service mix becomes unbalanced. In other words, many Not-for-profits are able to achieve financially viable average returns as a result of maintaining a balanced service mix. If the service mix becomes unbalanced, the Sector will become less viable, shifting more risk to those people who are recipients of services.
 - b. The For-profits will, appropriately, seek profits out of any service delivery they undertake. The distribution of such profits to shareholders will reduce the resource base of the social sector in Australia and cause an increase in funding requirements as the profit component must be funded together with the cost of service delivery, and
 - c. While, ideologically, many will argue the For-profit sector is more efficient than the Not-for-profit Sector, there is absolutely no evidence to this effect and the evidence demonstrating the high compliance rates of Charities for instance suggests otherwise. This idea of a lack of efficiency within the Not-for-profit sector defies logic as the Sector is able to deploy significant volunteer and donative resources not available to the For-profit Sector; by and large enjoys the services of voluntary boards and pays executives much lower remuneration than other sectors within the Australian economy.

Q.49 What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?

We are in support of any simplification of administrative arrangements made in relation to the application for, assessment of, and ongoing retention of tax concessions relative to Not-for-profits. However, we think the following parameters are important:

- 1) There should be a reduction of types of entities and types of concessions. Simplification of this aspect of the current arrangements would increase understanding and reduce the opportunity for inadvertent misapplication of the rules. It would generate savings for government and the Sector.
- 2) Any simplification should be undertaken with the following in mind:
 - a. There should be only three subsets of Not-for-profit organisations; those which are Not-for-profits and enjoy income tax concessions; those which relate to concessions provided to relevant government departments in order to enhance the recruitment and retention of staff, and those which are charities and which enjoy all current concessions (and which are registered with the Australian Charities and Not-for-profits Commission); and
 - b. The test for charitable status should remain as that enshrined in the Charities Act 2012.
- 3) The retention of the Australian Charities and Not-for-profits Commission (ACNC) is critical to ensure adequate regulation and supervision of the Sector and to ensure the activities of registered entities are commensurate with their registration and tax concessions provided. The ACNC's success to date in difficult circumstances and its growing knowledge of the Sector supports this conclusion.
- 4) Any change should be undertaken only after adequate research and analysis has been conducted which will:
 - a. Highlight what is actually happening within the Sector and as a result of the work of the Sector;
 - b. Highlight the economic impacts of current and prospective tax concessions, particularly with the intent of highlighting the consequences which might result from any proposed change; and
 - c. Examine the positive externalities derived from the work of the Sector, its capacity for involving wider community support and commitment, and its significance in community building.

Q.50 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?

Streamlining the Not-for-profit and charity concession arrangements would enhance efficiency in applying for and retaining tax concessions. However, there are some further elements that would enhance the efficiency and effectiveness of Not-for-profit organisations:

- 1) Removing the uncertainty relating to the tax position of Not-for-profits would strengthen their focus on what they do and relieve them of constantly having to consider the taxation ramifications of their activities. While a regular review of the tax arrangements for this sector is both appropriate and useful, the continued uncertainty generated by the current messaging from government ensures the Sector is diverted from its purpose.
- 2) The definitions used under taxation law to define and allocate concessions is complex, expensive and inappropriate. At its core, the Sector should receive concessions based on what it does under adequate supervision from a suitably empowered and tutored agency and in the context of the Charities Act.
- 3) Recognition that services and activities of Not-for-profit organisations are available to all in the community. The definition of Not-for-profit includes the fact that goods and services provided are public goods in the economic sense and are provided by Not-for-profits largely because markets have failed. This aspect of the nature of Not-for-profits is reinforced when it is considered that significant sums from the public purse are used to purchase services from the sector. Therefore, the universality of the availability of Not-for-profit goods and services should also be taken into consideration when considering the nature of Not-for-profits.
- 4) Efficiency, effectiveness and value for money are important for the governments of Australia as well as for the Not-for-profit Sector and those it serves. Governments are much less able to engage with the community, are less capable of appreciating the nature of demand for the services provided by the Sector, and are not well placed to appreciate the nuanced change in demand that takes place within the community over time. This is why, increasingly, governments are placing more services traditionally provided by public sectors in the hands of the Not-for-profit Sector. Any intended or inadvertent reduction in the strength and capacity of the Not-for-profit Sector will reduce the capacity of governments in meeting their obligations and will, ultimately, ensure governments pay more for less nuanced services should supply-side shocks reduce recipient service availability.

5. Concluding Remarks

Overall, it concerns us that the Discussion Paper appears to be constructed in such a way as to solicit certain responses that support the Commonwealth's current position regarding the Not-for-profit Sector. Further, the lack of research and analysis and the unsophisticated discourse concern us greatly as the ultimate risk in all of this is borne by those people who access the myriad of services provided by Not-for-profits. The apparent belief that the Sector and governments are somehow able to be disassociated is erroneous and belies the reliance that all governments in Australia place on the Sector to deliver services fundamental to the needs of an equitable, thriving community.

The periodic review of Not-for-profit sector taxation arrangements is critical to the timely adoption of appropriate change, to ensuring equity within our taxation system and in ensuring our resources are focused where they are likely to have best effect. Such reviews should be undertaken after adequate research and modelling has taken place so the current situation is understood and the potential impacts of change, particularly on those who rely on the services of the Sector, are modelled and understood.

Once again, we appreciate the opportunity to respond to this paper but warn of the unintended consequences and the responses solicited as a result of this Paper's content.

6. About Us

The Curtin Not-for-profit Initiative:

Curtin's School of Accounting established the Curtin Not-for-profit Initiative in 2011 following a refocus of research objectives toward industry-ready research outputs that are readily applicable in practice. As such, the aims of the Initiative are to:

- 1) Develop a body of research focused on practical and implementable outcomes that will enhance the resilience, efficiency and the sustainability of the Not-for-profit Sector Australia-wide;
- 2) Build significant and effective industry engagement in order to identify and prioritise the topics of research, and to facilitate dissemination and discussion of the findings to the best effect for the sector; and
- 3) Build a body of up-to-date, Australia specific knowledge that can be used to inform policy and practice within government, the Not-for-profit Sector and the broader community with a view to enhancing policy outcomes to the greater benefit of all communities in Australia.

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Baptistcare WA

Baptistcare is a faith based community benefit organisation working to provide care and support services across the aged care, disability and mental health sectors in Western Australia.

Our quality care is provided by over 1700 skilled and professional employees and more than 250 volunteers who are all dedicated to transforming and enriching the lives of the people we care for. We operate in regional, rural and metropolitan Perth.

Baptistcare's vision is for people who come into contact with us, to begin to see changes in their lives. We long to see people's lives enriched and made more satisfying, but even more than that, we see the potential for transformation from hopelessness to hope, from fear to confidence, from loneliness to community and from sadness to joy. Providing a personalised approach is at the core of how we operate. We know everyone is different, which is why it's important for us to get to know you.

Our Vision applies as much to our staff, volunteers and supporters, as it does to those we serve, so our goal is to work together to achieve this goal.

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