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

by email bettertax@treasury.gov.au

Dear Secretary

Royal Flying Doctor Service of Australia (RFDS) proposals to enhance Australia's tax system

Australia's tax system operates to enable governments to raise revenue to fund services. A portion of this revenue is applied to fund delivery of health care services. The tax system also operates to enable charities, such as the RFDS, to be exempt from income tax, to receive operating concessions, and to benefit from charitable donations and philanthropy to fund service delivery. The RFDS seeks to maintain and improve the tax system's ability to achieve these two often competing objectives.

To this end, the RFDS proposes in this submission that:

1. Income tax exemptions for charities be maintained;
2. New tax incentives be provided to stimulate charitable giving;
3. Charitable fringe benefit tax concessions be retained and indexed;
4. Revenue savings from capping meal and accommodation fringe benefit tax concessions from 1 April are applied to benefit the charitable sector;
5. Refunding of franking credits for charities be continued.

I below outline these three proposals, in addition to providing a brief summary of the RFDS's role, purpose, and structure. I conclude this submission to the Tax White Paper Taskforce by reaffirming the RFDS's position on GST treatment of health services, and also providing commentary on data presented in the Tax White Paper.

About the RFDS

Residents of remote and outer regional Australia see doctors at half the rate of residents of cities. These same residents die on average two years earlier than city residents, and have higher prevalence of chronic illness. The RFDS's mission is to provide to remote and rural residents and visitors to country Australia excellence in aeromedical and primary health care across Australia.

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National Patron: His Excellency General the Honourable Sir Peter Cosgrove AK MC (Retd)

Royal Flying Doctor Service of Australia ACN 004 213 067 ABN 74 438 059 643



The RFDS is a federation of seven charitable public benevolent institution companies. The RFDS's services include aeromedical retrieval, GP and nurse clinics, tele-health, medicine distribution, patient road transport, dental care, mental health care, and healthy living programs. These services are delivered by 1,100 staff located right around Australia.

In the last financial year, State and Territory Government's provided 48% of total RFDS revenue, the Australian Government provided 27%, fundraising generated 15% of revenues, and private contracting work generated 10% of revenues. The RFDS is an income tax exempt charity, and this income tax exemption is essential to the character of the RFDS. The case for retaining this income tax exemption is made below.

1. Income tax exemptions for charities be maintained

Income tax exemption arises primarily through Division 50 of the *Income Tax Assessment Act 1997*. Under this division, some entities have income tax exemption if they fit the type of activity and satisfy the operating requirements of the legislation. Others must also be registered with the Australian Charities and Not-for-Profit Commission (ACNC) and have obtained an Income Tax Exemption Concession (ITEC) registration with the Australian Tax Office (ATO).

There is a strong rationale underpinning the granting of income tax exemption. Services supplied by charitable institutions or tax exempt entities replace those that would have to otherwise be supplied by government. Many activities undertaken by such entities are not funded by government, or are only partly funded. These activities can only be funded by such entities from accumulated reserves, sponsorships and fundraising.

A charity or tax exempt entity can only source capital from borrowings and accumulated reserves. Such entities do not have a shareholder base that it can go to for capital. Whilst it can ask donors for support for a particular project, the lead time for these is usually substantial and the outcome uncertain. Social enterprise funding is still an unknown source of funds, but one that holds promise.

If the tax exempt entity was required to pay income tax, the tax liability would diminish the amount of reserves retained and would immediately restrict the ability of tax exempt entities to deliver services. If the tax exempt entity was required to pay income tax, new services would be more difficult to implement and may not occur at all.

Rather than further limiting the number of entities eligible for income tax exemption or DGR status, it should be recognised that the overview of those entities with income tax exemption or DGR status has increased by way of recent changes in the law, focus by the ATO, and the scrutiny by the ACNC. Indeed, access to income tax exemption has been refined by:

- More specific requirements within the income tax legislation by way of 2013 amendments;
- Greater focus of the regulation of the entitlements by the ATO, as evidenced by their ruling issued in 2015;
- Monitoring of the charity sector by the ACNC;
- Increased transparency to society through the single location to access charity information on the ACNC website.

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There is no strong evidence that the granting of income tax exemptions, or the provision of other charitable concessions, distorts markets or creates an unreasonable competitive advantage as:

- Income tax exemption cannot be viewed in isolation. It is only available to those entities that satisfy requirements of Division 50. All constraints and requirements of compliance with Division 50, including compliance with the requirements of the ACNC, are part of the price paid to have access to that exemption;
- The exemption is only available to a not-for-profit entity, which introduces additional constraints on access to capital and retention of assets, constraints not applicable to for-profit entities;
- A for-profit entity may have no income tax liability due to losses carried forward or the ability to offset against other business activities;
- A for-profit entity has a greater freedom as to its activities and how it seeks to benefit its shareholders. A not-for-profit utilising a Division 50 exemption must at all times be able to demonstrate how any particular payment or activity is directed to furthering its purpose.

It is accordingly the RFDS's proposal that there should be no change to the definition of entities which are able to be income tax exempted or which have deductible gift recipient (DGR) status as a result of the tax review.

2. New tax incentives to stimulate charitable giving

With the RFDS and other charities reliant on charitable giving and philanthropy to fund services that government does not, the RFDS proposes that the review of the tax system should include a focus on methods that might stimulate growth in donations being made to DGR entities. At the very least, it is the RFDS's proposal that there be no change to the \$2 minimum donation deductibility threshold. The RFDS additionally proposes three new ways in which charitable giving could be incentivised through enhancement of the tax system:

- 2.1 - Increasing the deductibility of gifts to deductible gift recipients;
- 2.2 - Providing a new incentive to stimulate payroll giving;
- 2.3 - Revising incentives for charitable giving at fundraising events.

2.1 - Increasing the deductibility of gifts to deductible gift recipients

Donations made by either an individual or entity to a deductible gift recipient are currently 100% deductible. This rate of deductibility drives donations to charitable causes, and at a minimum must be maintained and should not be reduced as some have argued in recent years.

Increasing the deductible portion of a gift to a deductible gift recipient to a rate greater than 100% (to say 110% or 125%) would result in greater propensity for a donor to give. Increasing the deductible portion would come at a cost to the Federal Budget in lost revenue, but it would be possible to forecast the likely increase in social benefit achieved by greater charitable giving against the anticipated decrease in tax receipts.

It is the RFDS's proposal that financial modelling be conducted in partnership with the charitable sector to inform the cost and benefit of increasing the deductible rate for gifts to deductible gift recipients.

2.2 - Providing a new incentive to stimulate payroll giving

Payroll or workplace giving is a method by which employees make donations to charities directly through their employer at the time of regular wage payment. A portion of the employee's *after tax or net wage* is paid by the employer at the employee's direction to a charitable purpose. Occasionally, the employer matches the employee's donation or also contributes to the charitable purpose.

In 1987 the United Kingdom allowed payroll giving to be paid from an employee's *before tax or gross wage*. It is understood that roughly 2% of all UK employees now participate in this payroll giving incentive scheme. The Australian tax system could be enhanced to offer a similar incentive for payroll giving. Enabling a tax deductible donation from *before tax or gross wages* would come at a cost to the Federal Budget in lost revenue, but again it would be possible to forecast the likely increase in social benefit achieved by greater payroll giving against the anticipated decrease in tax receipts.

It is the RFDS's proposal that financial modelling be conducted in partnership with the charitable sector to inform the cost and benefit of allowing payroll giving from before tax or gross wages.

2.3 - Revising incentives for charitable giving at fundraising events

Payments for tickets to attend fundraising events conducted by deductible gift recipients do not always entitle a payee and donor to claim what is mostly considered a contribution to the charity as a tax deductible gift. Individuals may be able to claim a deduction for a portion of their payment as a tax deductible contribution, but not that portion that provides personal benefit. The arrangement is at least complicated, and at worse a disincentive for attendance at fundraising events.

Similarly, the purchase by a donor of an auction item at fundraising event conducted by the deductible gift recipient also fails to attract a deductible contribution. Auction items are often donated to the deductible gift recipient, and purchase prices often reflect a donor's intent to pay over and above the saleable value of the auction item. Ideally, the difference in the cost of acquisition of the auction item – if any – by the deductible gift recipient and the auction price paid by the donor could be treated as a tax deductible amount.

3. Charitable fringe benefit tax concessions are retained and indexed

The seven main employer companies of the RFDS are public benevolent institutions. They are exempted from paying fringe benefits tax for employees up to the threshold of circa \$30,000. Employees also currently utilise fringe benefits tax exemptions for meal entertainment allowance and accommodation and venue hire.

These exemptions allow public benevolent institutions to use fringe benefits to attract and retain quality employees who may otherwise be enticed by the higher salaries available in the corporate sector. This is particularly important in the health and rural aviation sectors.

The concessions both allow charities to compete for staff, and also offer remuneration options that don't require the charity to obtain revenue to fund them. There is no evidence that the

concessions distort competitive neutrality, rather, they simply allow the charity to employ staff without needing to raise additional revenue from government or donors to cover staff costs.

The RFDS employs around 1,100 staff nation-wide, and is highly dependent on use of the concessions to attract and retain expert staff. Any significant reduction in available concessions would adversely impact the RFDS. Of specific uncertainty is what a significant change in concessions might mean for the RFDS's relationship with its existing employees. The contractual status of the concessions may not be as clear as the Federal Government might think. If, for example, an employee benefit is removed by way of government decision, the RFDS cannot be confident it would not be asked to continue funding the equivalent employee benefit in the absence of the Federal Government continuing to fund that benefit itself.

Having in the 2015 Budget announced a \$5,000 cap on the currently uncapped meal and accommodation allowances, ideally the Tax White Paper Taskforce would affirm ongoing support for remaining concessions. It is the RFDS's proposal that public benevolent institution fringe benefits tax employee concessions continue, and be indexed each year to retain their value.

4. Revenue savings to benefit the charitable sector

The 2015 Budget announcement of a \$5,000 cap on the currently uncapped meal and accommodation allowances has the support of the RFDS. Uncapped tax concessions are inequitable. However, this measure will result in revenue savings. It is the RFDS's proposal that these fringe benefits tax cap savings be directed to benefit the charitable sector, ideally by being applied to first fund indexation of the circa \$30,000 fringe benefit threshold.

5. Refunding of franking credits for charities be continued

Tax exempt entities will from time to time have funds that are not required for their immediate day-to-day requirements. It is common for tax exempt entities to include equity investments in their investment of available funds as a mechanism to generate funds to meet their purpose. Equity investments provide the opportunity of capital appreciation that is not available with fixed interest facilities.

It is understood that:

- This investment class is designed to provide a spread of asset classes in accordance with advice from professional financial advisers; and
- A material part of the return which influences the choice to make such investments is the refund of franking credits.

The refund of imputation credits is treated as part of the return when considering the balance of return and risk of equities compared to fixed interest. If the right to a refund of the credits was removed, the attractiveness of equity investments vis-à-vis fixed interest investments would diminish, triggering migration away from equity markets.

If tax exempt entities retain all of their available funds in fixed interest investments only, there is a risk that the purchasing power of those funds will be eroded. This would result in a lesser amount being available to the tax exempt entity to devote to its objects. It is further understood

some tax exempt charities are able to fund their administration costs from returns on equity investments, including franking credit refunds. This allows those charities to use 100% of their donations for charitable works. This is a good promotion point to attract donors, that is, *"100% of your donation will be used for the charitable work of the charity"*.

Access to the concession is controlled by the ATO, and is subject to the controls through Division 50. It is the RFDS's proposal that franking credits should continue to be refundable to tax exempt entities.

Applicability of GST to health services

To the extent that the Tax White Paper Taskforce will deal with the application of the GST, the RFDS can see no reason to change the current exemption of health services from the GST. The exemption was originally formulated to prevent barriers in access to healthcare. The residents and communities the RFDS serves already visit a doctor at only half the rate of city residents. The imposition of the GST may create yet another barrier in access.

Data presented in the Tax White Paper

The Tax White Paper in the paragraph above Chart 7.3 makes the suggestion that tax concessions available to not-for-profit entities may result in market distortions. RFDS sees little evidence in support of this claim.

The impact of charitable fringe benefit tax concessions on the cost of labour in a competitive market will not in and of itself provide a pricing advantage. The competitive position of a particular not-for-profit entity when compared to a for-profit entity will need to include many factors that potentially carry greater significance such as relative financial strength, access to capital, shareholder support to the for-profit entity and comparable ability to borrow. Critics of charitable fringe benefits tax concessions very often ignore these multiple factors, and it appears the Tax White Paper has also overlooked them.

Chart 7.3 is titled estimated revenue foregone. One inference that may be drawn from the chart is that these concessions could be withdrawn and this foregone income could contribute to consolidated revenue.

All of the tax concessions in chart 7.3 benefit charities, not-for-profit organisations and state governments. If these concessions were removed, all of those organisations and governments would suffer a decline in revenue. Services delivered would either reduce, or the cost of providing those services would have to increase to compensate for the effect of the removal of the tax concession. Most of this cost increase would fall on the Federal Government to pay as additional grants. There is strong anecdotal evidence that charities deliver services at a lower cost per unit of measure than the cost for government to deliver that same service. If government had to step in to replace the withdrawn services, the cost to the taxpayer would be greater than the tax concessions "foregone."

The RFDS submits that not-for-profit tax concessions should be viewed as an investment by government on behalf of society in the delivery of charitable and not for profit activities around Australia. The RFDS also submits that the increased requirements contained in the 2013

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amendments to Division 50, the increased focus by the ATO, and the ongoing scrutiny by the ACNC are all positive in ensuring that the tax concessions included in chart 7.3 are accessed only by those who are entitled to do so on an ongoing basis. It is the RFDS's view that the benefits of the tax concessions that are transferred through to the Australian community are of far greater value than the notional value of the concessions granted.

The RFDS is happy to provide further material in support of the matters raised here. Do contact my office on 02 6269 5500 if I or my staff can be of assistance.

Yours sincerely



Martin Laverty
Federation Chief Executive Officer