

changemakersaustralia

NFP Sector Tax Concession Working Group
Secretariat
NFPReform@treasury.gov.au
14 December 2012

C/O Reichstein Foundation
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Melbourne 3000
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Dear Sir / Madam,

Please find attached a submission in response to the discussion paper on “fairer, simpler and more effective tax concessions for the not-for-profit sector”.

In summary, Changemakers view on tax reform is that:

- The highest priority reform is to extend DGR to a wider group of charities, resourced through removing the current anomalies in the fringe benefits tax concession;
- Further reforms should be staged over time to enable informed discussion and debate within the sector;
- The working group should seek to develop a clearer package of tax concessions which are available to charities as a first priority in streamlining tax concessions.

Please contact Changemakers Executive Officer Esther Abram if you would like to discuss any of the points raised in the submission.

Yours sincerely,



Jill Reichstein
Chair

1. Introduction to Changemakers Australia

Changemakers Australia was established in 2006 to encourage greater philanthropic investment in work which addresses the causes, rather than the symptoms, of social and environmental problems. The organization is led by individuals with decades of experience in Australian philanthropy, with a shared commitment to focusing philanthropy on the common good.

1.1 Charity Law Reform Project

A key priority for Changemakers is the removal of barriers to social change philanthropy, in particular the laws and regulations which restrict charities in their doing or funding of advocacy. We operate the Charity Law Reform Project with support from our partners PILCH and the Human Rights Law Centre.

In 2011 we released a report *Freedom to Speak, Capacity to Act*, which in part highlighted how the tax concession system impedes advocacy. Independent funds from philanthropy are extremely important to charities which seek to do advocacy, but such funds are largely unavailable. This is because many social change focused organisations are ineligible for DGR. Newer philanthropic vehicles – namely private and public ancillary funds – can only fund DGRs. Individual donors are unable to receive a tax deduction if they fund organisations without DGR. Some trusts and foundations which are not legally required to restrict their funding to DGR view DGR as a “stamp of endorsement” by government and restrict their grants to DGR organisations.

2. How to approach tax concession reform

Tax concessions are an important vehicle for government and community support for charities and not for profit organisations. Unlike direct funding through grants, tax concessions provide across the board support to the whole sector, regardless of whether individual organisations or sub sets of the sector enjoy favourable relationships with government or popular support. They provide reliable support as they stem from legislation. Where tax deductibility is available, they encourage community members to get behind organisations, giving individuals a greater say over where government support is directed.

Obviously tax concessions come at a cost to the public purse. However, Changemakers believes strongly that tax concession support for charities should never be framed as only a ‘loss to revenue’ as this severely undervalues the benefits to the community which charities provide. In addition, charities have an amazing capacity to make a significant contribution from a relatively small amount of money. It is likely that if the tax concession system was not in place, government would be required to provide greater levels of support through direct grants to charities.

The discussion paper paints a picture of a very complicated tax concession system. Different sorts of tax concessions apply to different parts of the not for profit sector, beyond charities and voluntary organisations to government entities (such as hospitals) as well. There are clear examples of where the current system needs updating and where this type of reform will have minimal impact upon the not for profit sector. There are anomalies in the system which should be fixed, resulting in savings which could be better utilised elsewhere. There are also bigger reforms where the impact could potentially be wider.

Changemakers believes that the current situation lends itself to a staged reform approach. The top reform priority should be to extend DGR to all charities (not including charitable trusts), with restrictions on use of such funds for activities where there is more private than public benefit. The discussion paper has demonstrated that the resources required for this reform can be achieved through small changes which 'clean up' aspects of the system.

There is also the potential for deeper reforms in future. However, there needs to be much more discussion about tax concession reform within the sector and between government and the sector before these are implemented. Most people involved in the sector have limited understanding of the wider tax concession framework and how different organisations will be impacted differently by reforms. Given the relationship between tax concessions and fundraising, and the difficulty of assessing how the public will respond to changes in the tax system, more thinking has to be done in this area.

In section 6 the discussion paper asks whether there is scope to streamline the different tax concessions. Given that for each tax concession there are different types of organisations which are eligible, and eligibility itself may come through different routes, there is definitely much to be gained by streamlining the system.

It makes good sense to have a clearer package of tax concessions available to not for profit organisations which are *charities*. This is not to suggest that all tax concessions currently available to some charities should be available to all; there are good financial and public benefit reasons against this approach. But, focusing attention more clearly on charities, what they all get as a result of registering, and what they can access for particular purposes or if they are a particular sub group of charities, seems a good place to start.

Regarding this consultation process, Changemakers has responded primarily to those questions that directly relate to our mission of encouraging philanthropic dollars to be directed to achieving positive, long term systemic change.

Section 1 – Income Tax Exemption and Franking Credits

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

Changemakers understands that refunds for franking credits are currently used extensively in the philanthropic sector to extend grant making. Limiting such franking credits could have a negative impact on philanthropy and its ability to support the charitable sector. Changemakers does not support limits on franking credit refunds.

Consultation question 7 – Should the ATO endorsement be extended to include NFP entities other than charities seeking tax exemption?

Changemakers supports extending the ATO endorsement framework to non-charitable NFP entities as it would reduce the prospect of ineligible organisations self assessing as ITE and would protect government revenue.

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

Changemakers supports the raising of the threshold, on the basis that the current threshold appears to be extremely low. We do not have a view on what the suitable level would be.

Section 2 – Deductible Gift Recipients

Changemakers supports extending DGR to more charities. Changemakers' research has identified the limited availability of DGR as a key barrier to charities undertaking and funding advocacy for social change. Many of the organisations which are well positioned to drive positive social change through advocacy are unable to access DGR. This limits their ability to access independent funding for their advocacy and public policy reform work.

The key reason for this is that the 'welfare and rights' category in the Tax Act is very narrowly defined. Charities which advocate to improve conditions for people experiencing poverty, sickness, suffering, distress, misfortune, disability or helplessness are not included in this 'welfare and rights' category. Human rights, indigenous and animal rights organisations are also excluded.

Under the current system, welfare charities are eligible for Public Benevolent Institution status if they provide *direct relief* to individuals experiencing poverty or disadvantage. Those which achieve their charitable purpose through other means, such as campaigning for systemic change or rights, are not PBIs and cannot access DGR. Organisations which focus on prevention, such as Neighbourhood Houses, are also ineligible for DGR.¹

Peak welfare organisations, which play important policy development, advocacy and sector development roles, are generally ineligible for DGR. The exception is for those peak organisations whose members are all PBIs. Peak organisations with a mixed membership have difficulty accessing DGR, unless they undertake direct relief work. Less than half of the welfare and rights peak and network organisations surveyed by Changemakers in 2011 had DGR.²

Other types of charities, such as environmental and cultural, have a specific category which requires the organisation to be included on a register managed by a government department. This has led to a fragmented approach to determining DGR and does not necessarily suit organisations which don't fit neatly into a specific category.

Consultation questions 11 & 12 – Should all charities be DGRs? Should some entities that are charities (for example, those for the advancement of religion, charitable child care services, and primary and secondary education) be excluded? Should charities endorsed as DGRs be allowed to use DGR funds to provide religious services, charitable child care services and primary and secondary education?

1 Association of Neighbourhood Houses and Learning Centres, *Prevention is better than cure...*, 2001, p4

2 Changemakers, *Freedom to Speak, Capacity to Act – Removing the Barriers to advocacy*, April 2011, p50

Changemakers supports the principle that tax concessions should be targeted to activities and functions which provide public benefit and that the system should avoid subsidising activities which have a disproportionate private benefit attached. The extension of DGR will maximise public benefit if it provides resource strapped community organisations with greater ability to access fundraising income and philanthropy.

According to the Productivity Commission, the majority of donations made without claiming a tax deduction were made to religious organisations. Clearly, religious organisations have a longstanding history of generating support from their followers without needing tax benefits. Providing them with the right to provide donors with a tax deductible receipt would create a significant impost on tax revenue, without any clear additional benefit to the public.

Regarding schools and child care centres, there is the potential to increase social inequity through extension of DGR to these entities. Wealthier parents are unlikely to send their children to the schools and child care centres which educate and care for children born into disadvantaged families. Tax deductible donations made to schools of the more affluent members of the community don't have the same public benefit as donations made to schools and childcare centres serving communities of poorer and more disadvantaged households. There is also potential for fee-for-service schools and childcare centres to misuse the system, discounting fees where parents make sizeable donations.

Changemakers also supports Philanthropy Australia's view that DGR status should not be extended to charitable trusts, as there could be unintended consequences for current granting practice.

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

Changemakers supports option 2.3 as a means of providing greater access to DGR for the work of charitable organisations which provide the greatest public benefit. It is simpler than the current system. Guidance would need to be developed for those entities which undertake activities which are considered 'charitable purposes' but cannot be funded using tax deductible donations, to avoid any unintended consequences. .

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

Changemakers does not support the extension to all endorsed charities, without restriction on 'private benefit' activities. It is likely that the PC recommended a staged approach because of the high cost to revenue anticipated from allowing religious organisations to access DGR. If option 2.3 was implemented, the simplest and most beneficial approach would be to establish it across-the-board. The timing should provide for guidance materials to be developed and education initiatives to be run prior to the new system coming in.

Consultation questions 15 – 18 Would a fixed tax offset deliver fairer outcomes? Would a fixed tax offset be more complex than the current system? Would a fixed tax offset be as effective as the current system in terms of recognising giving? Would having a two tiered tax offset encourage giving by higher income earners? What other strategies would encourage giving to DGRs, especially by high income earners? Should testamentary giving be encouraged through tax concessions and what mechanisms could be considered to address simplicity, integrity and effectiveness issues?

This section of discussion paper investigates the other aspect of DGR status; how the incentive works for the individual making the donation. Changemakers is concerned that this issue has a high level of risk attached, given that tax incentives play a role in determining who gives and how much they give. While tax deductible donations have grown significantly over the last few decades, in recent years tax deductible giving has gone down in relation to the size of the donation and the number of people claiming donations.³ On this basis we believe that changes to this aspect of the tax concession system should be approached with caution. We would prefer such reforms to be considered after reforms to extend DGR have been implemented.

Regarding option 2.5, Changemakers does not support a hybrid system which would provide higher tax deductions for donations made to private ancillary funds. This would skew high income earners donations away from alternatives to private ancillary funds, namely public ancillary funds, such as community foundations, and donations made directly to charities.

Regarding testamentary giving, we note that such gifts are attractive when death duties apply, which is not the case in Australia. We are concerned about incentives that can be gorted, such as the art testamentary gift scheme. Such schemes may be popular with some wealthy people, who get to have their cake, eat it and gift it as well, but they reflect badly upon philanthropy.

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

Changemakers supports the idea of a clearing house for donations, as long as it doesn't supplant individual organisations' ability to fundraise and draw up receipts. This proposal would be very beneficial to small organisations which struggle to undertake the administration associated with fundraising. It would also be helpful to members of the public wanting to support particular issues but lacking the full picture on the range of organisations that exist to do such work.

Consultation questions 21 – 22 Do valuation requirements and costs restrict the donation of property? What could be done to improve the requirements? Is there a need to review and simplify the integrity rules?

We support the idea of simplifying property donation rules and anti-avoidance rules, in principle.

Consultation questions 24 & 25 Are the public fund requirements, currently administered by the ATO, either inadequate or unnecessarily onerous? Are there any possible unintended consequences from eliminating the public fund requirements for entities that have been registered by the ACNC?

³ McGregor-Lowndes, Myles & Pelling, Emma, An examination of tax deductible donations made by individual Australian taxpayers in 2009-10 (working paper), QUT, 2012

Changemakers supports the abolition of the requirement for public funds for charities registered with the ACNC, in the context of extending DGR to all charities (with exemptions for charitable trusts and restrictions for private benefit activities as discussed in option 2.3). These funds provide an additional level of red tape for organisations receiving tax deductible donations. Given that charities are now required to comply with organisation-wide governance requirements and provide annual reports to the ACNC, public funds are no longer necessary.

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

Changemakers supports raising the threshold for deductible gifts. The costs involved with issuing a receipt for a \$2 donation outweigh the benefit to the organisation receiving such a donation. We question whether \$25 is too high and might provide a disincentive to low income people to make donations. We have no expertise in how such thresholds are set but suggest \$10 might be a compromise.

Section 3 - Fringe benefits tax concessions

Rather than address the consultation questions, we would like to make the following points regarding FBT.

Changemakers acknowledges that FBT has been relied upon by eligible organisations as a means of boosting salaries for their employees, putting them in a more competitive position in attracting and retaining staff vis-a-vis more well paying jobs in other parts of the public and private sectors. Changemakers believes that employees in the not for profit sector should be paid decent salaries and enjoy good working conditions. It is preferable that this be achieved without complicated tax arrangements.

Changemakers acknowledges that FBT is used by some organisations to extend service delivery or support legitimate functions unrelated to the employee pay arrangements. Any changes to FBT must factor in the impact it could have on service delivery.

There is reputational risk to the not for profit sector when FBT is used for purposes such as funding lavish entertainment or wedding receptions. Changemakers supports the objective of removing such rorting potential and redirecting the funds towards better uses, such as extending DGR.

While there are problems with the FBT system, we do not support the idea of shifting sector support out of the taxation system into the annual budgetary process for government, through direct funding to the NFP sector. It is beneficial to maintain distance between the government and the not for profit sector in relation to funding. Tax concession support which is provided through legislation provides not for profit organisations with the independence and relative certainty to fulfil their goals. Relying upon direct government grants is an undesirable situation for organisations which risk losing funds when they are out of favour with governments, face onerous contracts and reporting requirements etc.

Section 4 – Goods and Services Tax Concessions

Changemakers does not have a view about the issues raised at this time.

Section 5 – Mutuality, Clubs and Societies

Consultation questions 50 & 51 – Should the gaming, catering, entertainment and hospitality activities of NFP clubs and societies be subject to a concessional rate of tax, for income greater than a relatively high threshold, instead of being exempt? What would be a suitable threshold and rate of tax if such activities were to be subject to tax?

Changemakers concurs with the discussion under option 5.1, namely that it is difficult to see much public benefit associated with the activities of clubs which operate large venues for gambling and alcohol consumption. While such clubs argue they make financial contributions to worthy community causes, we believe that it makes better sense for them to pay tax and for that revenue to be redirected to other aspects of the not for profit sector through tax concessions.

We do not have a view on a suitable threshold. However, it should clearly be higher enough to ensure that small member driven clubs are not subject to tax on smaller fundraising activities.

Consultation question 52 – Should the mutuality principle be extended to all NFP member-based organisations?

We do not support extending the mutuality principle as it can clearly be open to abuse.

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

We support the introduction of anti-avoidance rules to address abuses of the mutuality principle, such as temporary or instant memberships.