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17 December 2012

Victorian Healthcare Association

Comments on the *Fairer, simpler and more effective tax concessions for the not-for-profit sector* Discussion Paper

1. Introduction

This submission outlines the Victorian Healthcare Association's (VHA) response to the *Fairer, simpler and more effective tax concessions for the not-for-profit sector* discussion paper.

The VHA agrees to this submission being treated as a public document and the information being cited in the Not-for-Profit Sector Tax Concession Working Group's report.

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1.2 The Victorian Healthcare Association

The VHA is the major peak body representing the public healthcare sector in Victoria. Our members include public hospitals, rural and regional health services, community health services and aged care facilities. Established in 1938, the VHA promotes the improvement of health outcomes for all Victorians, from the perspective of its members.

1.3 Prefacing comments

Like most developed countries, Australia provides support for not-for-profit (NFP) organisations through its tax system. The NFP sector receives a number of tax concessions and this is generally considered as an appropriate use of public funds. While tax concessions exist at both the federal and state levels, the main federal concessions include:

- Exemption from income tax
- Gift deductibility
- Fringe benefit tax (FBT) concessions

One issue of providing tax concessions is the difficulty associated with accurately quantifying the current level of support being provided to the NFP sector. The Federal Government estimates that it provided around $4 billion in 2011-12 in quantifiable support to the NFP sector though tax concessions. However, the unquantifiable support is likely to add significantly to this total.

The FBT ensures that tax is paid on fringe benefits which are provided in place of, or in addition to, salary or wages of employees. Since its introduction in 1986, FBT has attracted debate in regard to a perception of embedded inequities, complexity and economic inefficiencies.[1]

Community health (CH) services, as Public Benevolent Institutions (PBI), and public hospitals in Victoria are considered NFP entities that have access to a range of FBTexemptions and many are endorsed as deductible gift recipients (DGR).

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2. The VHA Response

The VHA accepts that all Australians should pay their fair share of tax and that any abuses of the current tax concessions should be addressed. While the VHA is not opposed to reforming the current tax concessions to make it fairer, simpler and more effective, we do have some reservations.

Of foremost concern is that any significant amendments to the tax concessions may have the potential to severely impact on the capacity of Victorian health services to provide quality services. Thus, the VHA suggests the following recommendations to avoid potential negative outcomes.

The VHA also encourages the Working Group to consider a transition period prior to any substantial reform. Gradually rolling back benefits will allow employees within the Victorian healthcare sector to adjust their financial planning due to the flow on consequences in income. A transition period will also provide adequate time for health services to ensure the correct accounting and administrative systems are in place. [2]

Recommendation:

- Should major reforms to the current tax concessions be recommended, an adequate transitional period must be applied for those employed at the point of implementation.

Victoria's devolved governance model

Unlike other states and territories in Australia, Victoria has a long established model of devolved governance, which is a major strength of the Victorian public healthcare system. The Victorian healthcare governance model provides local leadership across acute health, aged care, CH, social services and sub-acute services. There are 86 government-appointment healthcare boards and a further 38 registered CH service boards (registered companies limited by guarantee) across the state. Each Board of governance brings a local perspective to strategic decisions about health service provision and how to meet local demands with limited resources.

Healthcare providers are facing enormous challenges. The demand for healthcare services in Australia is increasing and changing rapidly. So too are the costs associated with providing these services. Significant financial stress has been placed on Victoria's public healthcare system by the ageing population, the increasing burden of chronic disease, rising costs, and increasing demand for new technology. This demand equation results in significant competition of skilled healthcare professionals.

The expenditure and funding arrangements of health services influence how healthcare is provided and whether the system is capable of adapting to changing community needs. A significant amendment of current tax concessions would adversely impact on service delivery and the ability for health service boards to govern effectively for two reasons. Firstly, it could redirect already limited funding from service delivery into the payment of tax and secondly, it could impact unfavourably on the ability of services to recruit and retain staff.

Before considering any change to the current arrangements, it is imperative to reflect on the original policy intent of the tax concessions and ensure that any change continues to support the NFP sector and the plethora of welfare and goodwill services they provide to the community. For example, Victoria's public primary healthcare services – predominately CH services – are unique and often work with the most vulnerable and disempowered members of their communities. The work of CH services is based on the egalitarian principle that healthcare should be accessible and affordable for all. Their NFP status, local governance model and the breadth of health and human services provided by CH services enables the capacity to respond innovatively to community needs and address equity issues. The programs and services provided by these organisations confirm individuals as the central focus as opposed to profit or corporate gain. This behaviour is

consistent with the stated intention of tax concessions for the NFP sector on their implementation in 1986.

Deductible Gift Recipients

Impact on the financial viability of Victorian health services

The Australian Government provides DGR status as a primary tax concession to promote certain entities within the NFP sector. The policy rationale behind tax deductions for gifts is that it will increase giving and thus produce more public goods such as research, health and education services.[3]

In order to access charity concessions under the goods and services (GST) tax and FBT laws, Victorian public healthcare services are endorsed as registered charities. This charitable status prevents the agency from being taxed as an organisation whose purpose may be the commercial gain of the owners thus reflecting the structure, direction and goals of the service. It enables agencies to direct their expendable finances towards the delivery and quality of their services. A change in tax status may consequently expose them to payroll tax, land tax, debits tax and respective local government rates. If these organisations were subjected to these taxes, their capacity to provide a public benefit would be significantly impaired.

While Victorian public healthcare services are primarily funded by state and Federal government, their NFP status enables them to receive donations to assist in the management of their services. The immense financial community support that some health services receive has become an important funding stream. For some health agencies, it has enabled them to fundraise in order to undertake specific projects.

VHA response to proposed DGR reforms:

Option 2.1: Extending DGR status to all charities

Less than half of all charities in Australia that are endorsed as income tax exempt are endorsed as DGRs. The VHA supports the reform option to expand DGR status to all endorsed charities. This will significantly improve the fairness of Australia's DGR framework and encourage greater charitable giving.

The Australian Charities and Not-for-profits Commission (ACNC), as the independent national regulator of charities, would be responsible for ensuring that tax deductible gifts directly fund activities that provide a benefit to the general public or community and are not used inappropriately i.e. to provide a private gain or benefit. If charities were convicted of breaching the ACNC rules, they could be deregistered from the Commission and thus denied access to government support in the form of tax concessions or exemptions. This is part of the ACNC's broader objective to *maintain, protect and enhance public trust and confidence through increased accountability and transparency*.[4]

Recommendation:

- DGR status should be expanded to all endorsed charities and be regulated by the ACNC to ensure entities are compliant and eligible for tax exemptions.

Option 2.4: Implementing a tax offset mechanism for gifts

Implementing a tax offset mechanism for gifts may come at a risk of providing a disincentive to major benefactors. The original intent of the DGR status was to encourage donations. As income was donated by an individual and 'gifted' to an eligible DGR, it was considered unfair to levy tax on this income not available to the donor. This would be contradicted if a tax offset or rebate was employed.

For example, if the offset rate was set at 38%, as modelled by the Treasury in the discussion paper and the donor was paying the top tax rate of 48.5%, for every $100 donated to the DGR the donor would still have to incur a tax of 10.5% tax.

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Recommendation:

- A tax offset should not be implemented and that the current arrangement for donations to DGRs should be maintained

Option 2.7: Creating a clearing house for donations to DGRs

The ACNC, which was officially launched on 10 December 2012, is supported by the VHA as a national clearing house for donations to DGRs. The ACNC will be responsible for maintaining the Australian Charities and Not-for-profit Register, which is a national database of the 56,000 charities and provides information about the registered charity, their activities, finances and reports.

There are several benefits in creating a clearing house for gifts to DGR entities. Firstly, it will allow the public to make a more informed choice about donating and simplify the process of making a cash gift to their chosen charity. Secondly, the ACNC would remove some of the administrative barriers faced by health agencies so that they may focus their time and resources on providing valuable services.

Recommendation:

- The ACNC should become the national clearing house for donations to DGRs

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

The VHA opposes the suggestion of an increase of the deductible gift threshold from $2 to $25. The VHA accepts that the donor should have the flexibility of whether or not to claim a tax deduction irrespective of the donation amount.

Recommendation:

- The threshold for a deductible donation should not be increased from $2 to $25

Fringe Benefit Tax

Impact on health workforce retention and recruitment

The ability of health agencies to attract and retain staff will become increasingly important as the impact of an ageing workforce and skill shortages emerge.

A range of factors exist that adversely affect the job satisfaction of workers, their productivity and, ultimately, their willingness to remain in or re-enter the workforce. However, the recruitment and retention of employees remains a critical challenge in the health industry as the demand for care far outweighs supply. There is evidence of shortages in various specialty medical areas: dentistry; nursing; and other key allied health areas.[5] Furthermore, there are significant workforce shortages in outer metropolitan, rural and regional areas and in services such as disability, mental health and aged care.[6]

Australia is one of many countries that have strategies in place to increase the number and skills of the paid care workforce in order to improve low wages in the sector.[7] Health professionals working in the public sector have access to exemptions from FBT. For employees of public hospitals and state-funded ambulance services this is capped at $17,000 grossed up value and for employees of CH services this is capped at $30,000 grossed up value. Salary sacrificing, more commonly known as salary packaging, is a strategy employed by the NFP sector in an attempt to increase the net value of wages by providing access to pre-tax earnings for a wide range of benefits.[8]

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The Victorian public healthcare sector currently employs more than 80,000 full-time equivalent staff.[9] This workforce includes doctors, nurses, allied health professionals, executives, cleaners, gardeners, engineers and technicians. The terms and conditions (including wage rate) of employees are determined by enterprise bargaining agreements (EBA). Access to other benefits, for example those listed under the FBT exemption legislation, enable the public healthcare sector to compete for scarce human resources essential to a sustainable public healthcare system.

Case Study 1: Dental Health Services Victoria (DHSV)

The gap between Victoria's oral health demands and the number of clinicians available to meet these demands has contributed to the inequity of access to dental care. Public dental agencies, particularly in rural and regional areas, must compete with the private sector, which allows dentists to determine their own work hours, fees and remuneration within major metropolitan centres.[10]

Table 2.1 indicates the current EBA outcomes for dentists working in the public sector across the country. Victorian dentists are remunerated 40% less compared to other jurisdictions. Furthermore, a graduate dentist entering the private sector in Victoria can expect to earn a minimum of $80,000 and this grows at least three times the rate of a public dentist salary. For DHSV, the leading public oral health agency in Victoria, the FBT concessions serve as an important strategy in enticing dentists to work in the public sector and deliver essential oral health services to disadvantaged Victorians across the state.

		DHSV	SADS (SA)	NSW	QLD	TAS	WA
Dentist	**Level 1**	59,174	91,728 to 112,567	77,361 to 100,903	88,842 to 107,003	96,329 to 102,243	88,932 to 116,048
	Level 2	64,396 to 72,751	119,906 to 132,146	106,789 to 112,674	110,240 to 121,913	113,625	122,818 to 133,398
	Level 3	77,623 to 92,787	143,243 to 148,022	119,090 to 124,981	126,457 to 130,347	117,613 to 149,988	146,157
	Level 4	97,214 to 104,121	163,871	142,690 to 146,799	136,178 to 142,014	153,104 to 160,759	151,811 (Head of Unit)
	Level 5	110,992 to 121,296	174,726			168,413	168,919 (Regional Dental Officer)

Table 2.1. EBA remuneration for dentists across Australia

The VHA recognises that the removal of, or any significant change to the FBT exemption has the potential to introduce market competition, which may be detrimental to some Victorian health services. It will reduce the ability to attract quality staff to address the needs of their community and ultimately reduce the standard of service provision. Changes to current tax concessions will amplify the difficulty associated with achieving a competitive edge.

Salary packaging remains as a considerable factor in attracting and retaining health staff from various disciplines, particularly in rural and regional areas across Australia. It is well known that health outcomes among Australians living in rural and remote areas are considerably worse than their metropolitan counterparts.

The viability of many rural communities strongly correlates to the level of healthcare available within that community. The ability of rural communities to recruit or retain a permanent health workforce has the potential to diminish available services and to place further stress on the remaining workforce.

Changes to workforce attractiveness carry the risk that poorer health outcomes may be further exacerbated. The VHA acknowledges that a variety of Commonwealth programs provide incentives to work in rural areas. However, workforce shortages remain an unfortunate feature in many rural locations, so any diminution of available benefits must be considered with a high degree of caution.

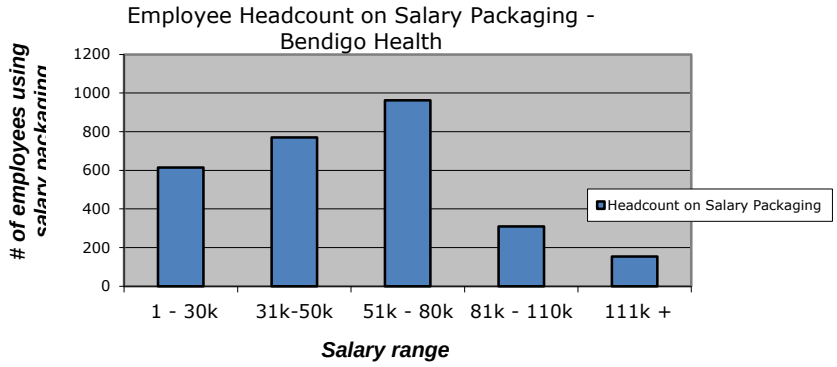
Recommendation:

- Changes to the tax concessions must ensure that they are not counterproductive in addressing the workforce shortages that currently exist in some health services, particularly those located in rural and regional areas.

The VHA is concerned that the discussion paper cultivates the idea of change linked to fairness based on the anecdotal notion that it is 'high income earners' who reap the benefits of the current tax concessions and perhaps, use it excessively. The case study below provides an alternative view.

Case Study 2: Bendigo Health

Bendigo Health is the largest regional health provider in Victoria. The health service currently employs a workforce of approximately 4,000 of which 70% avail themselves of some form of salary packaging. Graph 2.1 confounds the suggestions of the discussion paper and indicates that most salary packaging participants earn less than $80,000 per annum. Bendigo Health employees rely upon both the $17,000 standard salary packaging as well as the meal entertainment and entertainment leasing (MET) benefits to balance their personal budgets.



Graph 2.1. Headcount on salary packaging in Bendigo Health

VHA response to proposed FBT exemption reforms:

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

The VHA strongly supports the retention of FBT concessions in the public healthcare system in Victoria. FBT exemptions currently represent an administrative, financial and employment benefit to health services.

By directing the tax administration at employers rather than employees, the Federal government has simplified the process of taxing employee fringe benefits. In doing so, employers can pool employees together in determining the most appropriate tax treatment. This administrative convenience simplifies the tax audit and review process by reducing the number of audit entities and increasing the opportunity for uniform tax treatment among taxable entities.[11]

For CH services, salary packaging, particularly the personal use of motor vehicles, represents one of the few avenues to increase the remuneration of staff in supervisory roles whilst adhering

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to EBA structures. Removal of FBT concessions would mean agencies would be forced to pay their staff over the award cash payment, which in reality the agency cannot afford.

Recommendation:

- That public health services and community health services in Victoria should remain exempt from the FBT

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

The paper notes that there are agencies in the NFP sector that excessively use the meal and entertainment (MET) fringe benefit, which is currently uncapped, and is in addition to the capped FBT allowance. In particular, some salary packaging companies offer credit cards that can be used at restaurants to facilitate this form of expenditure from pre-tax income. Despite this, the VHA believes that the MET still has some merit in terms of an additional recruitment and retention strategy, but recognises that there needs to be some restrictions.

One possible solution involves providing a capped limit in addition to the relevant FBT exemption cap. One VHA member has already implemented a fair and reasonable internal policy that has a capped MET limit of $5,000 and defines allowable MET expenses. For example, the benefits provided must be for an entertainment nature, not of refreshment or sustenance.

Recommendation:

- MET benefits should not be integrated within the current FBT exemption caps
- Some restrictions should be employed supported by an articulated definition of allowable MET expenses.

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

The VHA is not opposed to a change to FBT rules that seeks, as part of the change, to reduce capacity for benefits to be claimed from a multiple of employers. The VHA is concerned however that the fundamental nature of a fringe benefit is one that passes from employer to employee and questions how, from an implementation perspective, this can be achieved without increasing the burden of reporting that employers already manage.

Health agencies have reported how administratively difficult it is to ensure employees in this type of situation are completely compliant with FBT concessions, particularly when individuals do a proportional split of their salary packaging across multiple employers. One way to rectify this is by having each employee declare a ‘primary employer’ if they have more than one, and it is this employer who is able to facilitate salary packaging. In doing so, employees would be held responsible for declaring single-employer packaging rather than the employer, who has no visibility of their full income.

VHA Recommendation:

- Measures should be implemented to prevent employees from benefitting from multiple FBT concession caps in a way that does not provide additional administrative burden to the employer

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

The VHA does not accept the recommendation to phase out capped FBT concessions entirely over 10 years to be replaced by direct funding via application to the ACNC or relevant Commonwealth Government agency.

In April 2001, caps were introduced to limit the concessional tax treatment to prevent the over-use of these concessions and limit the impact on competitive neutrality. Since its introduction, the capped amount has remained unchanged for both public hospitals and PBIs. The VHA suggests employing an annual indexation to the capped amount to keep pace with yearly wage growth particularly in areas of designated workforce shortage. A higher taxable value of fringe benefits could be made available to employees who were willing to relocate to areas of workforce shortage without the employer incurring additional FBT.[12]

Recommendations:

- Capped FBT concessions should not be phased out and be replaced with alternative government support.
- An annual indexation to the capped amount should be employed in line with yearly wage growth and CPI.

3. Conclusion

The VHA is concerned that the case for change is driven by anecdotal evidence, which neglects to consider the unique situation of organisations that benefit from the tax concessions.

While the VHA is not opposed to reforming tax concessions, it is essential that any changes are reminiscent of the original policy intent, that is, to support the important work of the NFP sector. It is fundamental that reforms ensure that the public health sector in Victoria can maintain viability and that health services can continue to be provided by an adequate and capable workforce.

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