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NFP Sector Tax Concession Paper Working Group Secretariat
The Treasury
Langton Crescent
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To the Secretariat

Submission on the Not-for-profit Sector Tax Concessions Discussion Paper

The Royal Flying Doctor Service ("RFDS") welcomes the opportunity to provide a submission on the Not-for-profit Sector Tax Concessions Discussion Paper ("Discussion Paper").

RFDS has previously made submissions addressing many of the issues being considered by the Working Group. These include:

- a submission in 2009 to the Henry Review on tax concessions available to not-for-profit ("NFP") organisations;
- a submission in June 2009 regarding the Productivity Commission Issues Paper on the Contribution of the Not for Profit Sector;
- a further submission in November 2009 in relation to the issue of competitive neutrality; and,
- a submission in April 2012 regarding a Consultation Paper in relation to Charitable Fundraising Regulation Reform.

The RFDS encourages the Working Group to review the conclusions reached in previous consultations in relation to the matters in the Discussion Paper that have been previously considered.

The reform proposals which have already been announced, and/or implemented, such as the oversight role of the Australian Charities and Not-for-profits Commission, should also be taken into account.

About the Royal Flying Doctor Service

The RFDS provides an aero-medical health service for those who live, work or travel in outback and regional Australia. The RFDS is a not-for-profit organisation, supported by the Commonwealth and State and Territory Governments, fundraising activities and generous donations from the community and corporations. The RFDS also generates additional funds through services provided under competitive tenders and directly to commercial operators.

The RFDS is made up of seven entities, comprising six Sections and the Royal Flying Doctor Service of Australia, which is the national body.

The Royal Flying Doctor Service of Australia holds the funding agreement with the Commonwealth, and manages and distributes Commonwealth Government funds to each of the Operating Sections. It also coordinates national strategies.

The Sections are the operational bodies which own the aircraft and bases, and employ the pilots for the service. They also hold the funding agreements with the various State and Territory governments.

While RFDS services cover regional, rural and remote Australia, our "Traditional Services" focus on remote communities which comprise 0.3% of the Australian population, and are spread across 65% of Australia's land mass, beyond the reach of normal medical infrastructure.

For the 66,500 people who live within this RFDS Traditional Services footprint, life expectancy is significantly lower than for the general community. Death rates from chronic illnesses such as heart disease, stroke, diabetes, chronic respiratory disease and kidney disease are also up to 70% higher than those living in the major cities.

Further information about the RFDS is available at: <http://www.flyingdoctor.net/>

Tax status of the RFDS

The RFDS is endorsed by the ATO as a Public Benevolent Institution ("PBI") and as a Deductible Gift Recipient ("DGR").

The RFDS qualifies for the following tax concessions:

- a) income tax exemption;
- b) Fringe Benefit Tax ("**FBT**") concession; and,
- c) as a charity, certain concessions in the GST legislation relating to sub entities and fundraising activities.

The related entities of the RFDS have similar endorsements.

Summary

This submission does not seek to address all of the matters raised in the Discussion Paper. Rather, in this submission, the RFDS has provided specific comments in relation to particular issues which have material relevance to the RFDS and its activities.

More specific responses in relation to certain questions have also been included at the end of this submission.

If you would like to discuss this submission or require any further information, please do not hesitate to contact me on (02) 8259 8100.

Yours sincerely

Greg Rochford
National Chief Executive Officer

Submission

1. Competitive neutrality

There is a broad review of the NFP sector currently being undertaken by the Government. The reform initiatives include:

- introducing a statutory definition of “charity”;
- restating and standardising of the “in Australia” special conditions for tax concession entities;
- improving and better targeting NFP tax concessions to the altruistic activities of NFP (the “unrelated commercial activities” proposals);
- review of NFP governance arrangements;
- reforming of charitable fundraising regulation; and
- improving the legislative framework for Public Ancillary Funds.

The RFDS submits that the range of matters referenced above should be taken into account by the Working Group in considering any additional reforms.

In particular, a significant proposal which should be carefully considered is the suggestion that certain revenues of “tax exempt” entities be subject to tax.

In this regard, the RFDS strongly disagrees with the proposition that the tax concessions available to NFPs mean that the NFPs compete with for-profit organisations with an unfair advantage and that, in relation to commercial activities; these concessions should be limited or removed.

The RFDS submits that NFP concessions in the commercial sector should not be restricted for the following reasons:

- many of the commercial services that the NFP may provide will often be consistent with the activities of the NFP which are carried out on a charitable basis. It would not be appropriate to seek to delineate whether an activity carried out by the NFP is commercial or charitable by reference to the way it is conducted or the return provided. Further, the profits generated from assets cannot be measured and attributed to commercial or charitable purposes in a single year because often assets that generate revenues for commercial purposes will be medium to long term assets that may be used for both charitable and commercial purposes;
- commercial activities assist in the acquisition of assets and funding for the continued expansion and provision of charitable services. If NFPs are not able to obtain concessional returns for certain activities, the government may need to provide additional funds to ensure that the service is provided. The alternative is that a reduced charitable service will be provided to the community while dependency on, and potentially control by government is increased;
- it has already been accepted by the Government¹, the courts² and the ATO³ that, so long as the profits derived from commercial activities are directed back towards the charitable purposes of the NFP, the income/profits from that commercial enterprise should not be taxed; and

¹ Assistant Treasurer’s Media Release No 077, 10 May 2011

² *Commissioner of Taxation of the Commonwealth v Word Investments Ltd* (2008) 251 ALR 206

³ Paragraphs 38, 61 and 275 of TR 2011/4

- There are a number of other factors that place a NFPs at a disadvantage when compared to for profits entities including:
 - NFPs have more limited opportunities from which to source capital required to fund the NFPs activities; sources are primarily accumulated surpluses. A for profit entity can seek additional share capital from its owners;
 - NFPs have more limited opportunities from which to source borrowings required to fund the NFPs activities – financiers display caution in lending to NFPs as they treat the income streams from donations and from government grants as containing substantial risk; and,
 - NFPs have greater restrictions on how their resources are used. Afor profit entity can choose to apply a profit from one activity against a new loss making activity whereas a NFP that has funding contributions from grant will have restrictions on how those funds are utilised.

In comparison to for-profit entities, the RFDS directs its profits towards funding other charitable services (which are provided free of charge to the public). The RFDS does not return profits to shareholders. Income derived from commercial operations directly affects the ability of the RFDS to provide emergency evacuation and other healthcare services in rural and remote areas.

Applying a tax to income from “commercial activities” would adversely affect the ability of the RFDS to provide those services. The cost to the public health system of having to provide replacement health services in these areas would be significant.

The RFDS notes that there are already many requirements and regulations that apply consistently to both NFPs and commercial organisations. This is particularly true in relation to large NFPs that are subject to the Corporations Act and have contractual agreements with the Commonwealth, State and Territory governments. For example, in addition to reporting requirements, the RFDS is also required to meet specific service and quality standards which are equivalent in the commercial sector. For example, in the aviation and health sectors in which the RFDS operates, the RFDS is subject to the same extensive regulation of pilots, maintenance arrangements and flying operations on the aviation side, and strict standards with regard to the quality and safety health services and the competency of clinicians as all other providers.

Further, the objectives of the NFP reforms are to enhance fairness, simplicity and effectiveness. The RFDS submits that taxing only the commercial activities of a NFP would be contrary to those stated objectives as entities would be required to distinguish between their charitable operations and their commercial operations as well as requiring a substantial amount of additional legislation, guidance and oversight.

2. FBT matters

Eligibility to provide benefits to employees and restrictions

In general, the RFDS does not support any reduction in concessions to NFPs or their ability to provide benefits to their employees other than to address the issues arising from meal entertainment and multiple employers within the NFP sector as discussed below.

The objective of the FBT concession is to better enable NFPs to recruit and retain staff. This is a particular challenge for NFPs in sectors where the highly skilled requirements for employment mean that the commercial sector can often offer higher salaries, for example, aviation and health.

The NFP sector is not easily able to compete with the commercial sector in this regard whilst maximising the amount of money that can be directed to charitable activities. The existing FBT arrangements support a greater public benefit being provided by the NFP sector.

NFPs have limited funds available to offer appealing salaries to potential employees. Moreover, organisations which operate in rural and remote areas are under increased pressure to retain staff. For these reasons, the FBT concessions are critical to the RFDS and to the NFP sector as a whole.

The RFDS employs around 900 full time staff nation-wide⁴. Any reduction in the concession would translate directly into a reduction in the ability of the RFDS to provide an essential service and would be detrimental to the public health system.

If the functions provided by the RFDS were instead provided by a company seeking to maximise profit, Australians living in remote areas may be cut-off from emergency medical support. In such circumstances, the private company would not be able to provide the coverage to the necessary locations, or the patients in need would need to be charged fees to make such operations commercially viable. Alternatively, the public system would need to provide a replacement service at substantial cost and in competition with other public health priorities.

In relation to Questions 31 to 33 (meal and entertainment benefits) and Question 34 (access to FBT concessions through multiple employers) the RFDS considers that clear controls in line with other FBT arrangements would be appropriate.

It is appropriate that salary sacrificed meal entertainment and entertainment facility leasing benefits are brought within the cap and are reportable. However, work related meal entertainment and entertainment expenses incurred by employees as part of their duties should be excluded from the cap.

The RFDS also considers that it would be appropriate to limit access to the FBT concession to one per person per annum; but that the limit be set at the maximum available for that person's employers during the course of a year (for example a nurse working for a state hospital for 6 months where the cap is \$17,000 and six months for the RFDS where the cap is \$30,000, should have access to the higher cap for that year).

The RFDS considers that the FBT reporting system used by employers should already capture the amount of the cap used by each employee and a schedule by employee could be supplied with a FBT return so the ATO can accumulate and test the cap in the income tax return process.

Direct support vs FBT concessions

The RFDS submits that FBT concessions are preferable to direct support from the Government.

There does not appear to be any advantage for the taxpayer, the government or the NFP organisations themselves in making the NFPs more reliant on government funding or reducing the incentive on the private sector to make donations to NFPs. Accordingly, the RFDS does not support this suggestion.

⁴ 2011-2012 RFDS Annual Report, page 7

3. DGR Matters

DGR status for all charities and restrictions

The Discussion Paper highlights the risk that recipients of tax concessions may use “public funds in an inappropriate manner to provide a private benefit or gain”. The RFDS submits that it is unnecessary to limit or remove any concessions available to DGR’s and tax exempt charities. This is especially so if the justification for the change is that one person may not abide by the rules. The already substantial anti-avoidance regime and significant reporting requirements in conjunction with the establishment of the ACNC should be sufficient to prevent any abuse of tax concessions.

The anti-avoidance measures include, inter alia, the rules in section 78A of the Income Tax Assessment Act 1936 (Cth) and the Commissioner’s application of Division 30 in assessing what a “gift” is for tax purposes (see Taxation Ruling 2005/13 “what is a gift”).

Fixed tax offsets

The RFDS does not support the proposal to introduce a fixed tax offset in place of the existing deduction regime.

In the experience of the RFDS, an important issue for the majority of donors is whether the recipient is a DGR. The ability to claim a deduction and the extent of that deduction are both relevant.

The proposal may result in a disincentive for higher income earners to donate.

Top marginal taxpayers provide the majority of donations (assessed on a total funds basis). The NFP sector relies heavily on the contributions of top marginal taxpayers. These taxpayers should continue to be provided with incentives to contribute wealth to the sector. The proposed offset regime would make raising funds from top marginal taxpayers more difficult.

Conversely, the RFDS considers that a potentially higher tax incentive for lower income earners will not necessarily lead to those low income earners donating more than they already do (nor donating enough to counter any reduction in donations from higher income earners) because lower income earners have a lower capacity to donate.

The RFDS is heavily dependent upon community donations and believes that the deductibility of donations is a key driver in encouraging people to donate.

A tax deductible based approach is also more easily implemented as a component of workplace giving regimes.

The regime suggested in the Discussion Paper would require substantial new legislation and guidance and considerable community engagement and education. It is unlikely to be well received or supported.

A fixed tax offset may produce a negative reaction for those whose income is subject to significant fluctuation between years changing the percentage of deduction available. The fixed offset approach would also create an unhelpful inconsistency where an entity claims an amount as a deductible outgoing instead of a donation. In such circumstances, the entity would enjoy a deduction at its marginal tax rate however the same amount, if claimed as a donation would only result in the fixed tax offset.

The RFDS’ experience is that the existing regime which provides for a deduction for donations is important to individual taxpayers. In 2006 the RFDS ran a successful fund raising campaign to assist in replacing two planes in Broken Hill. Every single donor queried the tax deductibility of their donations and required the supporting documentation to substantiate their income tax deduction for their donation. In that case, \$10 million was raised.

Deductibility threshold

The RFDS does not support an increase in the deductibility threshold. The \$2 threshold should remain.

RFDS experience is that both the ability to claim a tax deduction and the extent to which a donation is deductible are major factors in encouraging private and corporate donations.

The RFDS submits that increasing the threshold of deductibility will provide a disincentive to individuals who cannot donate more than small amounts (as those donors will not be able to access the concession). Approximately 25% of the number of donations made to the RFDS fall within the \$2 to \$25 range. The \$2 threshold has facilitated a level of connection between the RFDS and people from rural and remote communities who are not able to donate large amounts. However, many small donors become lifetime donors and go on to provide the RFDS with considerable donations at a later date and bequests. Currently bequests account for more than 30% of the value of all donations to the RFDS.

Just as importantly, this level of broad community connection also translates into additional non-monetary contributions including volunteering and participating in fundraising. For many smaller communities and groups, the social interaction and engagement that accompanies these activities also contributes in a positive way to the general health and wellbeing of community life.

The RFDS is concerned that increasing the threshold to \$25 may result in people believing that the smaller donations (and their contributions) are not valued. This may, in turn, adversely affect the level of support in both monetary and non-monetary terms, that the RFDS enjoys from individuals and communities.

The discussion paper suggests exempting workplace giving from such a limit. However there are many regular giving programs, outside the workplace where regular individual donation amounts are less than \$25 but the annual aggregate greater. Many charities invest considerable time and resources to establish regular giving programs which usually involve amounts below \$25. There is strong evidence to show that donors are far more likely to enrol in a regular giving program than to make a single donation of an equivalent value to the program total. These programs provide a degree of certainty to donation income which historically is fickle.

On successful example is the program operated through Ergon Energy in Queensland where electricity customers are offered the opportunity to donate \$5 per power bill to the RFDS. This support from Ergon has raised over \$5m for the RFDS.

RFDS opposes raising the deductibility threshold which would be at odds with marketing research and the experience of many charities and would almost certainly impinge on donation revenue. RFDS believes that raising the deductibility threshold but exempting workplace and regular giving programs would lead to similar results. The consequent administrative burden on donors, supporters and charities would present a barrier to participation in such programs.

Further, the RFDS submits that the "administrative burden" associated with current arrangements suggested in the consultation paper is minimal. The benefits to RFDS in connecting with and maintaining relationships with its supporter base greatly outweigh the minimal overheads involved.

Whether or not the taxpayer chooses to claim the deduction should not be a factor in removing the availability of the deduction.

Donation clearing house

With respect to the proposal to establish a donation clearing house, the RFDS considers that this will distract potential donors and limit donations.

The experience of the RFDS from discussions with donors is that the donor selects the charity to which they wish to donate through a personal experience for them, a relative or a friend. That is the selection is not as a consequence of a clinical search of a list of charities.

Donor management strategies (for the RFDS and other charities with DGR status) include the goal for the charity to establish regular contact with and get to know the donor and to help the donor connect with the charity / DGR and its goals / activities.

This process is designed to establish a long term relationship between the DGR and the donor referred to as a donor lifetime value.

Donation requirements and donation of property

Donation of property to a DGR is an appropriate opportunity to transfer valuable assets to the DGR so the category of asset donation should be retained.

Where property is donated as a gift to a DGR the key question is the value of that property, and it is to the benefit of all stakeholders that the value used is a properly assessed market value. The stakeholders include the recipient DGR, the donor and the ATO as the gatekeeper of the income tax deduction.

The current system requires that unless there has been a recent arm's length transfer of the asset to the donor, a valuation is required with that valuation to be done by the Australian Valuation Office.

The RFDS considers that this system works reasonably well.

A potential enhancement may be that there could be a panel of valuers for assets in various categories where the ATO could rely on that panel to undertake valuations that will meet the ATO scrutiny. The valuers panel may be similar to how the banks establish panels.

4. Income tax exemption issues

Issues for large NFPs

The RFDS is made up of six legal entities: RFDS Central Operations, RFDS Queensland Section, RFDS South Eastern Section, RFDS Tasmanian Section, RFDS Victorian Section, and RFDS Western Operations.

Each of the six entities has its own Board and Management and operates independently, both financially and operationally. This structure is important to enable better access to Commonwealth, State and Territory funding and to comply with state based regulatory regimes where applicable.

Entities within the RFDS structure have sought endorsement as PBIs wherever possible for Commonwealth taxation purposes. This means that arrangements between RFDS entities need to be carefully monitored to ensure that the relevant payer continues to provide "direct relief" for the purposes of the PBI rules.

More broadly, it is often necessary to enter into a range of commercial agreements between the RFDS entities. The RFDS submits that a regime similar to the income tax consolidation and GST group and GST joint venture regimes would assist in addressing the above compliance issues. In such circumstances, provided that they satisfy certain conditions, a number of entities could form a group with the requisite charitable or public benevolent purpose and all intra-group transactions could be ignored for tax purposes.

Refunds of franking credits

Section 207-115 of the Income Tax Assessment Act 1997 (Cth) currently sets out which exempt institutions are eligible for a refund of imputation credits.

The RFDS submits that the distinction between NFP entities which are and which are not eligible for a refund of franking credits currently distorts the investment decisions of NFPs.

If an NFP is unable to access a refund of the imputation credits, the total return on equity will be reduced. In such circumstances, the NFP may choose to instead invest in fixed interest assets which may return less than the equity asset (if a refund of imputation credits was available).

This distortion may reduce the funding available to the NFPs as investment options are more limited. The RFDS submits that there should be no disincentives for any NFP to invest in shares and that the rules in section 207-115 of the ITAA 1997 should be expanded.

Simplification of income tax exemptions for State, Territory and local government bodies

The RFDS supports the consolidation and simplification of **all** taxation legislation that relates to the NFP sector, not just income tax legislation.

For example, under the *Duties Act 1997* (NSW), stamp duty is not charged in New South Wales on certain transactions involving an “exempt charitable or benevolent body”. To be an “exempt charitable or benevolent body”, the entity generally must either be:

- (a) approved by the Chief Commissioner and, in accordance with its rules or objects, use its resources wholly or predominantly for the relief of poverty in Australia or the promotion of education in Australia; or
- (b) in the opinion of the Chief Commissioner, of a charitable or benevolent nature or have as its primary objective the promotion of interests of Aborigines.

On the other hand, stamp duty will not be charged in Queensland on certain transactions involving “charitable institutions”. To be a “charitable institution”, the entity must satisfy the criteria provided in *The Taxation Administration Act 2001* (Qld).

The above processes are not relevant to obtaining income tax exempt status under Commonwealth legislation. If one standard set of rules relating to NFP registration existed, time and money that currently must be spent on registration and approval from each State and Territory could instead be directed towards the entity’s charitable purpose.

Similarly, in a non-taxation context, fundraising activities are currently regulated by different laws in each State and Territory (each of which imposes different requirements and standards). The disparity between the State and Territory requirements means that if NFPs wish to conduct fundraising activities across numerous States and Territories, resources must be devoted to separate registration and approval.

5. Goods and Services Tax Concessions

GST concessions

The RFDS submits that the current GST concessions should continue to apply to eligible NFP entities. As noted in the consultation paper, any savings made from reforms in this area will generally not be able to be reinvested in the NFP sector without agreement from the States and Territories.

The main GST concessions utilised by the RFDS are:

- the ability to establish sub entities, each of which can separately choose their GST status; and
- the ability to elect to treat a fundraising function as input taxed.

The benefit of each of the above is to increase the income generated as part of the fundraising activities of the RFDS because the GST leakage is minimised.

The RFDS has established a number of sub entities in local communities which remain part of the RFDS organisation for control and insurance purposes. The activities of these sub entities are focused on fundraising, and often use donated goods and services. By the sub entity being able to utilise the first concession and choose not to be registered for GST, the amount of income raised by fundraising activities is maximised.

Similarly, for fund raising functions, the second concession means that the RFDS is able to forego the claim on input tax credits on the costs rather than being required to charge one eleventh of the ticket price (which will often include a donation element). Again, this serves to maximise the amount of funding that can be retained by the RFDS.

However there are several limitations that arise through the requirement to apply for specific treatment of each function.

The RFDS agrees that there would a benefit in moving to a principles based entitlement to access this provision. That is, the legislation and / or the regulations can contain those key criteria that control access to that concession. Charities could self-assess in the same manner as other provisions in the GST Act.

6. Further Specific Responses to Consultation Questions

Please refer to the attached paper.

RFDS Submission on the Not-for-profit Sector Tax Concessions Discussion Paper
Additional responses to consultation questions

Q2

Are the current categories of income tax exempt entity appropriate? If not, what entities should cease to be exempt or what additional entities should be exempt?

Income tax exemption is provided to NFP's under two broad headings-

- Those organisations whose activities are within the specific exemption categories contained in the Income tax legislation.
- Those organisations who are required to apply for income tax exemption (ITEC)

The RFDS has ITEC status.

The RFDS generates income under various headings including:

- Activities funded in full or in part by Federal or State government grants
- Activities where it can generate cost recoveries
- Donations received
- Bequests
- Corporate sponsorships
- Fundraising activities

The RFDS applies all of the funds generated to further the objects of the organisation. To do this it is submitted that this cannot be measured in a single year. In fulfilling its activities the RFDS uses assets that are held for long periods of time such as real estate, assets that are held for medium periods such as aircraft, medical equipment and shorter life assets. In addition it incurs expenditure of an operational basis such as salaries and wages.

The RFDS has been providing support to rural, regional and remote areas of Australia since 1928. During this time technology and many other changes have meant that the manner in which the services are provided has changed and the services themselves have changed in line with changes in demographics, transport and community expectations.

If the RFDS is to continue to embrace these changes into the future it needs to plan and prepare both operationally and financially. Governments will regularly support the delivery of medical services to these regions and the RFDS continues to enjoy government support in the delivery of its services. However, the history of the RFDS contains constant examples of where the RFDS has initiated new services to meet a community need, or to acquire additional resources (fixed assets and people) where the assets funded under the government resourcing are insufficient to meet the needs.

Recent examples of this include:

- RFDS in Queensland purchased two aircraft using accumulated reserves from donations and similar- these aircraft were used full time in an activity that in theory was fully supported by the State Government, but in reality was unable to be fully funded
- Some years ago the RFDS in Queensland used its own accumulated reserves to undertake a three trial of a clinical psychologist – this trial established the evidence to show the need and that the people would embrace this support. There are now more than 30 allied health professionals employed by the RFDS in Queensland alone, and the RFDS continues to provide its own accumulated resources to meet the needs.

- The RFDS in Queensland will launch a new service in February 2013 to deliver dental health services using a road based mobile clinic – whilst the Federal Government provided a grant contributing to the construction of the truck, all of the operational costs will be from RFDS controlled resources.
- The RFDS will be establishing a medical service in Charleville to commence in 2013, to provide that town with a medical service after the retirement of its GP next year. The local council is providing support as well.

All of these services and acquisitions are drawn from the RFDS accumulated reserves. Funding from governments was not available or very limited.

A NFP can only source capital from borrowings and accumulated reserves. A NFP does 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.

If the RFDS was required to pay income tax, this amount would diminish the amount of reserves retained and would immediately restrict the ability to deliver services. If the RFDS was required to pay income tax, new services such as those outlined above will be more difficult to implement and may not occur at all.

Obtaining an ITEC status is at the time of establishment. The RFDS understands that it will be part of the role of the ACNC to monitor the ongoing entitlement of an ITEC to continue to enjoy the income tax exemption.

The introduction of the ACNC will over time provide the regulatory structure for the Federal Government as the controller of the income tax legislation, to be satisfied that those who have access to the income tax exemption remain qualified to receive access to that tax concession.

This process will protect the integrity of the tax concession.

Q6

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

The RFDS has an investment portfolio (a gross investment value of less than 5% of its net assets), including shares that generate imputation credits. This investment portfolio is designed to provide a spread of asset class in accordance with advice from professional financial advisers.

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. Equity investments offer the opportunity of capital appreciation that is not available with fixed interest facilities, so that when the capital is to be applied to acquire an asset such as an aircraft for the RFDS the amount of the capital has advanced over time rather than been depreciated by inflation.

If the RFDS is unable to access the refund of the imputation credits, the total return from equities will be reduced, and the total income available to the RFDS to apply to its objects will be similarly reduced in the short term. The long term assets available to apply to its objects may also be reduced as the lower return on equities discourages investment in that asset class and more is invested in fixed interest.

Q15

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?

Q16

Would having a two tiered tax offset encourage giving by higher income earners?

The current approach of tax deductible donations has been successful in stimulating significant private contributions to charity, as demonstrated by the Queensland University of Technology report "An Examination of Tax Deductible Donations made by Individual Australian Taxpayers in 2005-06". The report states that, using a base year of 1978-79, the average tax-deductible donation is "far exceeding" the inflation-adjusted average donation as measured by the CPI.

The report also concludes that 4.2 million Australian taxpayers made and claimed a donation in 2005-06, which equates to 36.45% of the Australian taxpaying population. This participation percentage has been increasing slightly over the last 11 years, and is at its highest level since 1992-93.

These numbers are reinforced in Table C Average Donation Levels in paragraph 87.

It is submitted that the current system of fully tax deductible donations is producing increased level of donations providing support to the NFP sector.

The ACNC should over time provide the regulatory framework for the Federal Government as the controller of the income tax legislation, to be satisfied that those who receive the tax deductible donations are applying those in a manner consistent with the reason why the entity first received the DGR status.

Tax deduction v offset

The Consultation Paper referred to the tax deduction for donations as regressive.

This refers to the fact that donors who pay higher marginal rates of tax receive a comparatively greater benefit from their deduction than donors in lower income tax brackets. The alternative proposed is a fixed tax offset for donors, in a single rate offset or multiple rate or some other system that effectively ignores the donor's marginal tax rate.

With due respect these proposals appear to miss the point. The DGR system is designed to elicit the largest donations from those with the most financial capacity to give. There is an overall objective of developing a culture of private philanthropy in Australia, particularly from wealthy individuals and companies. The rise of corporate charitable giving programs in the last 5 years, many of which match corporate to employee donations, is an example of the success of this initiative.

To say that wealthy individuals receive a greater tax benefit than others, and that this is somehow objectionable, seems to the RFDS a philosophical objection only. The fact that the deduction obtained by the donor is at their marginal tax rate is at the heart of this system. A change to this would threaten the donation base of all NFPs, and would seem to us to be entirely without benefit.

The future financial viability of the RFDS is dependent upon the receipt of donations. As part of the financial management of the individual RFDS sections, an analysis is made (as best possible) of the profile of the donor and of those who may be targeted as donors. In assessing this profile the RFDS believes that the full deductibility of donations is a key factor in the minds of those who donate.

Two significant value activities in recent years highlight the importance of this.

In 2006 the South East Section initiated a fund raising campaign to assist with the replacement of two ageing aircraft at the Broken Hill base. A well planned campaign over the ensuing years identified a number of key influential people who each influenced colleagues and associates to contribute significant sums to this aircraft replacement campaign. Deductibility for these donations was a question asked by all donors, and all required the supporting documentation to substantiate their income tax deduction for their donation. The outcome was a successful campaign to raise over \$10million dollars to fund these replacement aircraft.

In 2008, the Queensland Section purchased a new King Air aircraft at a cost in excess of \$7.5million where the entire source of funds for this aircraft acquisition was from donations.

Whilst the RFDS does not have access to the detailed taxable income profiles of its donors, there is clear anecdotal evidence that the large donations are received from those who are most likely to be on higher marginal incomes, and that the tax deductible status is a fundamental factor in the decision on whether to make any donation.

It should also be remembered that the donation that is being claimed is the result of a cash payment to a DGR; that is to create the donation the taxpayer has incurred real cost.

Donations v sponsorships

To be a donation the amount paid must be a gift with nothing in return than a receipt and gratitude. For donations to be income tax deductible under the specific section of the income tax act they must gifts be to a DGR. Untied donations received by the DGR are not taxable supplies for GST purposes.

Business will often provide financial support in exchange for recognition of the amount that the business has provided. This is often seen in the form of donated raffle prizes, advertising support and similar. These amounts are not donations as there is an exchange of services.

For a business, these amounts are not claimed as a gift / donation under section TT but rather as an outgoing necessarily incurred in carrying on a business, so deductible under Section 8-1. For GST purposes, the services exchanged are taxable supplies for a GST registered entity.

If the tax offset system is introduced it will introduce an inconsistency between the income tax treatment of a donation and that of a sponsorship. Under a fixed tax offset, a person in business who sponsors a DGR will obtain a different deduction than would apply if they gave a donation.

This does not meet the tests of equitable or fairer. It also introduces additional complexity.

Q 19

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

The observation by RFDS personnel is that many of those who make a donation to the RFDS for the first time do so in response to a patient transfer or after the RFDS provided medical assistance to the person, a relative or friend. The RFDS experience is that members of the public do not go through a Yellow Pages approach to select a charity to support – they do so based on more tangible connections.

The experience of the RFDS from discussions with donors is that the donor selects the RFDS through a personal experience and not as a consequence of a clinical search of a list of charities.

Donor management strategies include the goal for the charity to know the donor and to help the donor connect with the charity / DGR and are goals / activities. This process is designed to establish a long term relationship between the DGR and the donor. This is about establishing a donor lifetime value.

A clearing house concept is very clinical, a factual list where it would be difficult to be recognised. It would encourage charities to seek to establish brand in other ways. The RFDS is honoured to enjoy good brand recognition and public support. The establishment of a clearing house would potentially make it easier to locate the well-known brands; smaller and innovative new charities DGR's would struggle for recognition.

Consequently the RFDS considers the concept of a clearing house to be a negative not anything positive.

Q20

Are there additional barriers relevant to increasing charitable giving by corporations and corporate foundations? Is there anything the Working Group could recommend to help increase charitable giving by corporations and corporate foundations?

Corporate foundations

Corporate foundations are established with a philanthropic objective. Those charged with the responsibility of administering these respective foundations will evaluate particular individual causes, individual charities and NFP's and amounts within the guidelines of the entity that sponsored the foundation. Corporate foundations are usually established with a pool of capital that will allow the foundation to generate an income stream for distribution without damaging the capital base for the future sustainability. The RFDS understands that the trustees of these foundations have to manage the balance between amounts to distribute and managing the investment base when the returns from those investments will fluctuate. Corporate foundations are good for charities in general as they provide opportunities for distributions in times when the entity that established the foundation may have financial challenges.

Corporations

There is a question that directors of corporations must consider and that is, whose responsibility is it to make donations to charities.

At a seminar in Brisbane, after he had resigned from his role at Rio Tinto, former managing director Leigh Clifford provided a good summary on the position of companies in supporting charities.

He explained that donations to charities are a decision for shareholders to make individually from their distributions and it was the responsibility of the company to generate that dividend income to the shareholder. Having said Leigh Clifford stated that companies could and should still choose to assist a charity where that charity is important to the future of the company. He cited the RFDS as an example since under his stewardship Rio Tinto had provided \$1m support to the RFDS in WA. Leigh Clifford explained that the presence of the RFDS in WA provided great comfort for those employees of Rio and their families who worked in the remote regions in which most of the mining activities were located.

Similarly corporations may choose to align themselves with a charity. In Queensland, Ergon Energy an electricity retailer covering much of Queensland, chose to align itself with the RFDS by offering to each of its customers the opportunity to donate the RFDS with each power bill. The support by Ergon to the RFDS is that of sponsorship.

Conclusion

Corporations will always be restricted in the amount of donations and the RFDS believes that corporate support will be best developed when the corporate is able to demonstrate to its shareholders the value received from that support.

Q 21

Do valuation requirements and costs restrict the donation of property? What could be done to improve the requirements?

Donation of property to a DGR is an appropriate opportunity to transfer valuable assets to the DGR so the category of asset donation should be retained.

Where property is donated as a gift to a DGR the key question is the value of that property, and it is to the benefit of all stakeholders that the value used is a properly assessed market value. The stakeholders include the recipient DGR, the donor and the ATO as the gatekeeper of the income tax deduction.

The current system requires that unless there has been a recent arm's length transfer of the asset to the donor, a valuation is required with that valuation to be done by the Australian Valuation Office.

The RFDS considers that this system works well. The only potential enhancement may be that there could be a panel of valuers for assets in various categories where the ATO could rely on that panel to undertake valuations that will meet the ATO scrutiny. The valuers panel may be similar to how the banks establish panels.

Q 31

Should salary sacrificed meal entertainment and entertainment facility leasing benefits be brought within the existing caps on FBT concessions?

The salary sacrificed meal entertainment and entertainment facility leasing benefits were identified as issues in the October 2011 forum.

Both arise through salary sacrifice so the employee must forego salary to obtain these benefits.

The issue revolves around the fact that entertainment (as defined in the income tax legislation to include recreation) as such is not a reportable fringe benefit.

The RFDS considers that it is appropriate that salary sacrificed meal entertainment and entertainment facility leasing benefits are brought within the cap and are reportable.

The RFDS also submits that it is important to exclude work related entertainment. Employees will incur entertainment that is part of their duties and this entertainment should be excluded from the cap and reportable.

Q 34

Should there be a requirement on eligible employers to deny FBT concessions to employees that have claimed a concession from another employer? Would this impose an unacceptable compliance burden on those employers? Are there other ways of restricting access to multiple caps?

The RFDS understands that the FBT legislation places no limit on the number of times an employee can access the FBT cap. This can provide an advantage to some individuals within the NFP sector over others in certain circumstances including:

- An individual employee of one NFP who is at the same time an employee of another NFP and is therefore able to access the limit on more than one occasion;
- An individual employee who leaves the employ of one NFP to take up employment with another NFP in the same FBT year thereby accessing the concession a second time in the same FBT year.

The RFDS considers that it would be appropriate that the concession be limited to one per person per annum, but up to the maximum available for the employers during the course of that year.

By way of example if a nurse worked for a state hospital for 6 months where the cap is \$17,000 and six months for the RFDS where the cap is \$30,000, the nurse should not be penalised for the policy limits in the FBT system. The cap should reflect the higher cap that the nurse has for part of that year.

The RFDS considers that the FBT reporting system used by employers should capture the amount of the cap used by each employee and a schedule by employee could be supplied with an FBT return so the ATO can accumulate the cap in the income tax return process.

Q 36

Should the limitation on tax exempt bodies in the minor benefits exemption be removed? Is there any reason why the limitation should not be removed?

The exemption for minor benefits is about managing the administration and should have the same rules between a for profit and NFP.

Otherwise there is a confusion and complexity by introducing two sets of rules on how to calculate the taxable fringe benefits and the FBT area of taxation law ins already very complex.

If such a rule was introduced it also raises a question of commercial neutrality where NFP's are penalised.

Q 37 & Q38

Is the provision of FBT concessions to current eligible entities appropriate? Should the concessions be available to more NFP entities?

Should FBT concessions (that is, the exemption and rebate) be phased out?

The FBT responsibilities of the employer, NFP or profit-making include determining the reportable fringe benefits. This calculation is identical between the two categories of employer so produces the same number for an employee irrespective of the tax status of the employer.

The amount of reportable fringe benefits is included on the annual Payment Summary of the employee. The taxation system incorporates a new measure of income, Adjusted Taxable Income, which calculation includes:

- Taxable income
- Investment losses on real estate and investments
- Reportable superannuation contributions
- Reportable fringe benefits

The adjusted taxable income is the income level used to test a person's entitlement to Centrelink benefits such as Family tax Benefit, Private Health Insurance Rebate, Superannuation higher rates on contribution, Child Support

As a consequence of the use of the extended definition, an employee cannot convert salary to a non-taxable fringe benefit and thereby gain access to entitlements that they would not have otherwise accessed

The primary policy rationale for the FBT concession is that it creates a level playing field between NFPs and profit-driven companies in respect of employee recruitment and retention.

The FBT exemption allows NFPs 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 sectors such as the health sector, where highly skilled employees can attract large salaries, for example the pilots and medical staff employed by the RFDS.

The NFP sector cannot afford the salaries available in the for-profit sector, as the imperative is to minimise costs and maximise the amount spent on charitable activities. Whilst the profit-driven sector similarly seeks to minimise staffing costs, the NFP sector is at a particular disadvantage. Goods and services provided by the NFP sector are often provided at no cost, or at a rate substantially below market value. Whilst this is of substantial benefit to the user and community, the trade-off is that limited funds are available to offer attractive salaries to prospective employees. Any reduction in the FBT concessions will reduce the ability of NFPs to provide essential services at a reduced cost. For example, a private company seeking to maximise profit could not maintain the coverage of services currently supplied by the RFDS. Accordingly, Australians living in remote areas would be cut-off from emergency medical support (or could only receive such support at a commercial price, assuming private operators would be available). Alternatively, the public system would need to step in and provide a replacement service.

The RFDS employs around 800 staff nation-wide, and is highly dependent on use of the FBT concessions to attract and retain expert staff. Any reduction in the FBT concession would significantly affect the RFDS, would require us to pay considerably higher salaries to compete with the for-profit sector, and would have a direct impact on the scope of the services provided by the RFDS.

Any reduction in the concession would translate directly into a reduction in our service, which would be counter-productive, and no benefit for the public health system.

The RFDS maintains that the retention of the FBT concessions is important to the sector.

Q 39

Should FBT concessions be replaced with direct support for entities that benefit from the application of these concessions?

The FBT concessions are available to qualifying charities with a statutory cap. The list of those to whom the concession is available is controlled, ensuring that the concession is only available to those employer organisations that benefit the community.

The FBT concessions are used by those organisations to reduce their cost of employment. The RFDS applied saving from the FBT is across all of its charitable activities – under current Federal / State funding agreements some components are Federal funded and some are State and further as outlined elsewhere are from the accumulated reserves / income generated by the RFDS

The RFDS experience is that the message from State and Federal Governments is that there are very limited funds available and that the funding support is only available on selected projects.

In addition the regular message from government is that the charities should be looking to develop their own funding and be totally reliant on government. This suggestion is further weakening this approach and increasing direct reliance.

Q 40

Should FBT concessions be replaced with tax based support for entities that are eligible for example, by refundable tax offsets to employers, a direct tax offset to the employees or a tax free allowance for employees?

The suggestion raised by Q40 implies introducing a new suite of taxation rules that apply to only NFP's or those who work for NFP's.

This suggestion raises many questions:

- This introduces a new set of tax rules that mean that the legislation that applies to for profit entities is different to the NFP; at the moment there is one FBT legislation that calculates the taxable fringe benefits irrespective of the employer; NFP's then apply the per employee threshold to determine the actual FBT payable; the manner of recording the reportable fringe benefits to show on the payment summaries and be used in the determination of the individuals' Adjusted taxable income is the same between the for profit and the NFP sectors
- This introduces complexities for individuals who are work on a part time or casual basis for both for profits and NFP's as to how to determine the employee component
- If a benefit is passed to the employee through the tax system, there would need to be an integrity measure to ensure that the proportion of income through a NFP was commensurate with being entitled to accessing the employee concession.
- If a benefit is passed direct to the employee through the tax system, the employee is obtaining the benefit from the NFP sector rather than from his employer which would be unique to the tax system.

To introduce a system of refundable tax offsets to employers, a direct tax offset to the employees or a tax free allowance for employees would create substantial new complexity and administration, none of which in the opinion of the RFDS is warranted