Manager
Charities Unit
Indirect, Philanthropy and Resource Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

17 December 2012

Dear Manager

We are pleased to have the opportunity to respond to the NFP Sector Tax Concession Working Group Discussion Paper released by Treasury in November 2012.

OMF International (formerly known as the China Inland Mission and the Overseas Missionary Fellowship) has been sending missionaries to East Asia from Australia since our first workers were sent out in 1890.

We are a Christian organisation, established independently of denominational churches, for the purpose of the urgent Evangelisation of East Asia's peoples. We operate in partnership with Christians and local churches both in Australia and in our destination countries, and with the global network of OMF International centres.

Legally, OMF International is a Corporation Limited by Guarantee, endorsed by the Australian Taxation Office as an income tax exempt charity and able to access GST concessions and the FBT rebate.

We are a member of Missions Interlink, and therefore under the regulations, a prescribed institution for the purposes of paragraph 50-50(d) of the *Income Tax Assessment Act 1997*. We also employ religious practitioners, and pay exempt fringe benefits to our employees.

Our primary source of funding is from the donations of churches and individual supporters. Donations to OMF International are presently not tax deductible in Australia.

We trust that this submission (as detailed in the attached appendix) will assist you in this review.

Yours sincerely

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Synopsis: the view of OMF International

Chapter 1 – Income tax exemption and refundable franking credits

OMF International is of the view that the current income tax exemption and franking credit arrangements work effectively.

In particular, the franking credit arrangements ensure that charities are treated similarly to other recipients of dividend and trust distributions. This is because at present, tax paid at the corporate level is treated as a non-final tax when it is credited to each Australian recipient, and each recipient is either entitled to a refund, credited with a full amount of tax, or subject to a final taxation liability based on the level of franking credit.

Chapter 2 – Deductible Gift Recipients

OMF International does not at present have DGR status, and is not currently seeking it.

There are risks associated with a loss of independence that may come from obtaining DGR status.

It would however be more appropriate to extend DGR status rather than require charities to seek direct funding from the federal government.

We would also like to see reform of the capital gains tax provisions to encourage, rather than penalise, gifts given to charities without DGR status.

Chapter 3 – Current Fringe Benefits Tax Concessions

OMF International is supportive of retaining the existing fringe benefits tax concessions for its employees, and particularly for employed religious practitioners.

We are unable to see how these benefits could be removed without all or most of the following occurring:

- The transfer of significant funds previously used to fund religious activities to the government;
- Stress arising from the need to review and reconsider long-standing employee remuneration arrangements; and
- Risk of inaccurate reporting (particularly around the valuation of residential property for fringe benefits tax purposes) and misunderstandings of actual use of properties.

As we are reliant on the generosity of like-minded supporters, we are unable to guarantee that additional funds would be obtained from our supporters to offset the impact of changes to the Fringe Benefits Tax concessions, and particularly so if churches also faced similar changes.

In addition, the independence of the entire sector could be impacted by the need to seek specific government grants, at a level equivalent to funds lost from these changes.

Appendix 1- Responses to Consultation Questions

Chapter 1 – Income tax exemption and refundable franking credits

Questions 1 – 4: Criteria, categories and appropriateness of current income tax exemptions

We are of the view that the current categories and arrangements for income tax exemption are effective and appropriate in respect of religious groups focussed on international cross cultural mission.

Question 5: Should other types of NFP's also be able to claim a refund of franking credits?

The government is proposing to tax profits from unrelated activities which are not put towards charitable purposes.

We are of the view that the ability to claim franking credits would become essential where unrelated activities are taxable.

One mechanism which a charity may use to deal with the taxability of unrelated activities (and to minimise complexity) could be to establish a corporate entity. This corporate entity could then pay franked dividends out of surplus taxed profits to the charity for use in core charitable activities. A broad ability for charities to claim franking credits would ensure that there is no prejudice against a charity adopting this approach (as opposed to claiming the profits are otherwise put to charitable purpose.)

Question 6: Should the ability of tax exempt entities and DGRs to receive refunds for franking credits be limited?

The current operations of the franking mechanism allows companies, superannuation funds, charities and individuals to receive dividends in a tax neutral way. The ability to claim franking credits means that the income is effectively only taxed in the hands of the final recipient (by crediting a prior payment of tax on this income to the ultimate recipient).

Accordingly, the reforms introduced in the year 2000 to allow franking credits to be refunded to various charities merely establishes a level playing field with other recipients of dividend and trust income. Because charities would not otherwise pay tax on this income, they, like an individual with low levels of income, or a superannuation fund should be entitled to these refunds. It would be unjust and inequitable to allow credits for dividend income to each other category of recipient, and not to charities.

While we are not a DGR, we note that in respect of DGRs, any limit on the ability to claim a franking credit refund would preference donations of after-dividend income made by an individual or company as opposed to the donation of shares and/or ongoing dividend streams. The deductible donation of after-dividend income would neutralise the dividend income, while still leaving the individual/company still is able to use the franking credit to offset other taxes payable)

Further, consistent with our comments in response to Question 5, the ability to receive refunds for franking credits allows a charity flexibility and transparency in how to arrange its operations and funding sources.

Questions 7-9: NFP entities other than charities, government bodies, and threshold limits

We do not have a view on these questions, as they would not impact our organisation.

Question 10: Please outline any other suggestions you have to improve the fairness, simplicity and effectiveness of the income tax exemption regime, having regards to the terms of reference.

Please refer to our below comments in response to Question 18.

Chapter 2 – Deductible Gift Recipients

Question 11: Should all charities be DGRs? (Option 2.1)

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? (Option 2.2)

Option 2.1

In the scope of the current review, there is consideration of various tax exemptions which apply to religious organisations.

It is the view of OMF International that allocating DGR status to all charities would be preferable from the point of view of OMF International to the replacement of existing tax concessions with government grants.

However, as we will argue below, our view is that it is preferable to maintain the status quo, given the long-standing nature of the existing tax concessions, which have been built into the framework of charitable employment arrangements.

There is also a risk (which would not significantly impact OMF International) that extending deductible gift recipient status to many charities which do not currently have these processes would pose difficulties in determining, and receipting to an appropriate standard, amounts given through anonymous or collective sources (like a collection plate or donation box at a church).

Option 2.2

OMF International is involved in some activities which may entitle it to DGR status as a provider of overseas aid, both through the support of specific projects and the work performed by our members overseas. We intend for these activities to be performed with a level of professionalism and competency which we hope is comparable with other organisations specifically focussed on overseas aid. For example, in the wake of the Sendai earthquake/tsunami emergency of March 2011, over $30,000 was received by OMF International and passed on to the relevant project administered by OMF International in Japan for emergency earthquake relief.

However, as this aid and development work is pursued as part of a holistic approach to our charitable purposes for the advancement of religion, we may find it difficult to properly categorise which activities are classified as overseas aid, and which activities are not.

While it is possible that there would be more giving to specific aid related projects if OMF International held a separately endorsed DGR fund, we have not felt that there is sufficient demand for this type of fund to be administered by OMF International to manage the additional administrative restrictions which would apply.

We also submit that, depending on the circumstances of the committee's consideration of this option, there could be justification in distinguishing between "advancement of religion" charities, and prescribed institution for the purposes of paragraph 50-50(d) of the Income Tax Assessment Act 1997. This distinction already has been made for the need for a charity to operate "in Australia" and also in respect of employment income for eligible foreign service.

Question 12: Based on your response to Q11, should charities endorsed as DGRs be allowed to use DGRs funds to provide religious services, charitable child care services, and primary and secondary education? (Option 2.3)

If a broad definition of a DGR was adopted, it would be counter-productive to restrict the use of funds in a way that would cause a charity to move away from its presently existing mission, purpose and values.

Questions 13 - 17

We do not have a view on these questions.

Question 18: Should testamentary giving be encouraged through tax concessions and what mechanisms could be considered to address simplicity, integrity and effectiveness issues?

Under the capital gains tax regime donors are taxed on the full value of any gifts of CGT assets (e.g. shares, property, etc) provided to charitable organisations that are not DGRs. This distorts the quantum and type of donations that can be given to charitable organisations, either as surplus to the donor's needs, or as a testamentary gift.

Numerous reports cite the cost of housing in major Australian cities as being very expensive by global standards. As a result, many charitable organisations may find it difficult to provide suitable housing for their staff, and particularly for workers who may need (for the purpose of the charities activities) to be located in an area in which that worker may not otherwise be able to afford to live. The ability to donate an investment property to a charity without capital gains tax consequences, may assist organisations to meet particular housing needs.

> *For example, a testamentary estate had two assets, one being cash of $500,000 and the other being a property with a market value of $500,000.*
>
> *There is no tax difference whether the cash is distributed to a natural person or a charity beneficiary (both are free of tax).*
>
> *However, there is a tax difference whether the property is distributed to a natural person or to a charity. The estate would be required to pay capital gains tax based on an assumed market value sale if the property was given to the charity. The natural person would be able to defer the taxing point indefinitely (by way of rollover). Further, the natural person could reduce any ultimate capital gains tax liability through use of exemptions (e.g. the main residence exemption).*

The existing capital gains tax regime anti-avoidance provisions for gifts made to DGRs should also be sufficient for an extended exemption to gifts to charities. Charities are already regulated as to what they can do with funds, and are required to apply funds to a charitable purpose.

This change may appear to have a high revenue impact when calculated using "taxation expenditure" but it is unlikely much of this expenditure is actually additional real revenue (as the gifts would not otherwise have been structured in this way). There may be basis to reduce the revenue impact of these changes by limiting it to testamentary gifts. Additionally, any revenue effects of such a change would be more than offset by the community benefit that arises from increased targeted giving to charitable causes.

Mitchell Review

Specifically in respect of the proposal highlighted by the discussion paper from the Mitchell Review, we would favour a broad exemption from capital gains tax on gifts to charities as opposed to the complex property, tax and estate questions that would arise (as a result of the locking in of a certain future course of action) from giving a deduction at the time the will is made.

Question 19-27

We do not have a view on these questions.

Chapter 3 – Current Fringe Benefits Tax Concessions

Question 28 – 30, 38, 39, 40, 41-42: Exempt fringe benefits

Many charities have put in place systems to voluntarily limit the amount of exempt fringe benefits that can be claimed by their employees. If there is concern in relation to the overall abuse of the exempt benefits system, it would be helpful for these concerns to be raised directly with the sector, and specific consultation to occur as to proposed measures which might reign in the abuses. Otherwise, we fear that unintended consequences may arise, especially given the limited data that treasury has available on the extent of these benefits.

The largest exempt fringe benefit provided to religious workers is generally in respect of the cost of housing. In many cases, where owned housing is involved, these houses have been held by organisations for longer than the fringe benefits tax regime has been in existence, and involves premises that were purchased for much less than the current market value.

It would be a very significant cost burden on religious organisations to treat owned properties as fully taxable fringe benefits provided to religious workers, particularly where these church owned properties are in suburbs with more expensive housing, especially as the marginal rate of taxation that would apply to these workers (on a total package) would as a general rule be less than the fringe benefits tax rate.

Additionally, whether the rebate was eligible to apply or not, there would be a massive compliance burden to be required to estimate accurately a notional rental charge for these premises, particularly when they are used both for housing and for "ministry functions" including the hosting of meetings, the counselling and encouraging of guests, the use of a home office, and provision of other forms of hospitality.

For neutrality purposes it would also be difficult to grandfather any changes to property currently in use (as it would discriminate against new and growing religious groups, or groups reliant on rental properties) or to property owned by the religious organisation (as it would distort decisions about how best to use funds to provide housing).

While there could be clever ways to structure remuneration packages to avoid the full extent of the change, the removal of an exemption structure for religious organisations would likely lead to a large scale sale of good quality historic housing, and also prejudice charitable organisations against accepting the donation of properties. There would also be large and ongoing additional costs payable to the government from organisations that are funded currently by the after-tax generosity of their supporters.

Additionally, the removal of these salary packaging arrangements would dramatically alter the employment arrangements which many religious practitioners are used to, and have been operating under for long periods of service. If such a change was to be made, the government would be placing a large burden on charities to understand the full extent of existing remuneration arrangements, and having understood this, to reflect broadly similar levels of remuneration in the changed circumstances.

Additional costs of employment for religious practitioners could also have a foreseeable impact of reducing the number of administrative staff employed by religious organisations, as they seek to reduce costs.

Some religious workers, particularly those who are based overseas for significant periods of time, may be eligible for other forms of benefits, including the Living Away From Home Allowance, however the charitable sector, and more specifically, the missions sector, is unlikely to have much experience dealing with these arrangements.

These additional costs are unlikely to be able to be replaced by direct government grants in a way that preserves the independence of the religious organisations from the government. As mentioned previously in our submission, the only way to otherwise provide benefits of a similar scope to religious organisations, while preserving their independence from government, would be to extend tax deductibility to religious organisations more generally.

Questions 31-37

We do not have a view on these questions.

Chapters 4 – 6

The structure and scope of our operations mean that we do not have a view on the matters raised by these chapters.