



Law Council
OF AUSTRALIA

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Dear Sir or Madam

Not-For-Profit Sector – Tax Concession Working Group Discussion Paper

The Taxation Committee of the Business Law Section of the Law Council of Australia (the Committee) welcomes the opportunity to provide a submission regarding the Discussion Paper concerning tax concessions for the not-for-profit (NFP) sector (the Discussion Paper) released by the NFP Sector Tax Concession Working Group (Working Group).

1. **Proposed consideration of the mutuality principle**
 - (a) The Working Group has been tasked with examining the tax concessions available for the NFP sector and considering whether there are better ways to deliver those tax concessions. The Working Group has raised the mutuality principle in the Discussion Paper as one of the ‘tax concessions’ to be considered as part of this review.
 - (b) The mutuality principle is not a tax concession. It is a common law principle that extends beyond the NFP sector and as such ought not to be included in this review.
2. **Earning and use of funds**
 - (a) An NFP club that derives income from gaming, catering, entertainment and hospitality activities should not be taxed on profits derived from those activities provided it uses these profits only to further its altruistic objectives. The consistent approach of the Courts and the Commission has been to focus on the use to which those profits are put (i.e. furthering the altruistic purposes of the NFP) and not on sources and types of income earned. For example, see *Commissioner of Taxation of the Commonwealth v Word Investments Ltd* (2008) 251 ALR 206 (*Word Investments*).

- (b) It has been a long established and accepted principle that an NFP that conducts commercial activities to derive income or profits will not be taxed on those amounts provided they are directed back towards the altruistic purposes of the NFP. The Government has endorsed these principles: see Assistant Treasurer's Media Release No. 077, 10 May 2011. In the light of the Government's position, it ought not to matter that an NFP derives income/profit from commercial activities within the gambling, hospitality and alcohol sectors, provided profits from those commercial activities are used for the NFP's altruistic purposes.
- (c) This position was highlighted in *Word Investments*. In this case the taxpayer was a religious organisation that carried out commercial activities to raise profits. Profits from those activities were distributed to other charitable institutions so they could carry out their altruistic purposes. The High Court accepted the profits raised by the taxpayer under their commercial activities should not be subject to tax, as the profits were distributed within the charitable/altruistic objectives of the taxpayer.
- (d) The Commissioner accepts that an institution which carries out a commercial enterprise to generate surpluses/profits only to further its charitable purposes can still be a charitable institution (paragraphs 38, 61 and 275 of TR 2011/4).
- (e) The Working Group's terms of reference do not include reconsidering government reforms already in train, including those reforms relating to unrelated commercial activities and the application of the 'in Australia' requirement. This includes reforms already approved by the Government and introduced into Parliament (namely the 'in Australia' amendments). The review of tax concessions available for the NFP sector should not be used as a side-door to readdress issues on which the Government has already, and very recently, formed a position.

3. **Deductible gift recipient**

- (a) Extending Deductible Gift Recipient (DGR) status to all charities endorsed as Income Tax Exempt (ITE) (Reform Option 2.1) requires a balancing exercise. The current systems sets up a hierarchy of organisations that enjoy government support at different levels: at the lowest by not having to pay tax on earnings; and at the higher level by the additional effect of allowing tax deductions for donations to encourage further sources of revenue. The current system has a rationale that is commendable. There will no doubt be differing views in the community as to the merits of extending DGR status to all charitable bodies. There is no doubt, however, that the current system is cumbersome and on that footing support for Reform Option 2.1 can be justified. The effect, however, would be that tax deductions would be allowed for all donations to religious organisations which is not currently the case.
- (b) The threshold for deductible donations should be increased from its current level of \$2. The Committee supports the Working Group's recommendation to increase this threshold to \$25 (Option 2.10).

4. **Refundable franking credits**

Refunds of franking credits should be made available to all NFPs endorsed as ITEs. Any concession that will assist NFPs in furthering their altruistic purposes in a simple manner should be encouraged. The Committee agrees with Reform Option 1.2.

5. **Fringe Benefits Tax (FBT) concessions**

The Discussion Paper raises a number of options in relation to potential reform of various existing FBT concessions. In general, and subject to appropriately dealing with the equity of compromising a trade-off that was struck some years ago, the Committee agrees that FBT reform is necessary to rectify some of the inequity that results from the existing law.

It is probably important here to recognise that at least some of the organisations which receive tax free benefits (either under the FBT exemption caps or FBT rebate caps) are typically those which cannot remunerate employees in the same ways as the private sector and that one of the justifications given for the FBT concessions in the hospital sector for example was that the concession was a trade-off for lower remuneration. If it is to be seen as equitable for these employees to have access to benefits free of FBT, and the concession is abolished, then the trade-off that would be compromised as a result may need to be addressed.

Subject to these views, the Committee's response to each of the proposed reforms is set out below.

- (a) *Option 3.* The Committee supports the option of revising the list of entities eligible for the FBT exemption or rebate to ensure consistency of treatment amongst NFP sector employers. This will also provide for a fairer distribution of the tax concessions across a broader spectrum of employers.
- (b) *Option 3.2.* The Committee agrees with including meal and entertainment facility leasing benefits within the relevant caps. As a consequence of these benefits not being included in the caps, employees have been able to access tax-free benefits beyond the original policy intent of the legislation. In addition to extending meal entertainment expenses to large value transactions (such as weddings), it is evident that some employers are also allowing employees to salary sacrifice recreational entertainment which forms part of holiday expenditure (e.g. hotel rooms, cruises etc.). It is the Committee's view that this was never the policy intent of the law and it creates an unfair advantage for those employees who choose to salary sacrifice a large portion of their income into those categories of fringe benefits.

Whilst it could be argued that the organisations that receive tax free benefits (either under the FBT exemption caps or FBT rebate caps) are typically those which cannot remunerate employees the same way as the private sector, it is not, in the Committee's view, equitable for these employees to have access to uncapped tax-free benefits. A fairer and simpler way to correct this would be to either include meal and entertainment and entertainment facility leasing expenses within the current caps or, alternatively, to impose a separate cap on these specific benefits.

- (c) *Option 3.3.* Although the requirement to obtain declarations will create an additional compliance burden, the Committee agrees that this reform is preferable in order to remove the distortion in salary packaging tax free benefits from multiple employers. The Committee believes the simplest method to achieve this would be through an employee declaration process allowing for only one employer to apply the FBT cap. Allowing a proportion of the FBT cap to be applied at multiple employers could give rise to greater compliance risks (e.g. each employer applying the wrong proportion of FBT exempt benefits).
- (d) *Option 3.4.* The Committee agrees that the rate for FBT rebates should be aligned with the FBT rate of 46.5 per cent. This makes commercial sense and is merely a matter of aligning previous enactments of legislation to the current FBT rate.
- (e) *Option 3.5.* The Committee supports aligning the minor benefits exemption with the commercial sector. Allowing equal access to the exemption produces a fairer application of the FBT exemption and will ease the compliance burden by eliminating any confusion regarding the applicability of the rule.
- (f) *Option 3.6.* The Committee supports a simpler and fairer basis for compensating NFPs. If Option 3.6 is adopted so that the FBT concessions are phased out and replaced with direct government support, this should be done over the long term (for instance ten years as suggested in the Discussion Paper). Replacing the existing concessions with direct government funding would require careful consideration of the basis on which funding would be allocated to each NFP. Any reductions in funding could have an adverse impact on the ability of this sector to secure talent and to compete with private sector employers.
- (g) *Option 3.7.* The Committee believes the provision of direct government support (Option 3.6) or providing tax-based support mechanisms for the employer is also an acceptable means of eliminating the current distortions arising from the existing tax concessions. Whether this is accessed through a tax offset for employees or through the payment of allowances, the Committee believes this would achieve a better result than the current system which allows for employees potentially to direct an unlimited value of tax free benefits through salary sacrifice arrangements.
- (h) *Option 3.4.* This proposed reform has been suggested as another alternative to limiting the current FBT concessions. Whilst the Committee supports this suggestion, it would be necessary to consider carefully the types of benefits that would be regarded as incidental to employment and which would provide for adequate compensation to employees who are currently entitled to the existing concessions. As noted above, one of the key reasons for the enactment of the NFP concessions was based on the fact that many employees in this sector are not remunerated (as many of these employers have limited funds) in the same way as the private sector. Attracting employees to work in the NFP sector would therefore still require a sufficient incentive.

6. Other reforms to the charity sector

- (a) The Government's review of the NFP sector for reform purposes has been broadly split into three categories:
 - (1) Establish the ACNC – a one-stop regulator of the NFP sector which will remove complexity around the regulation currently in place;
 - (2) Harmonise and simplify the Commonwealth, State and Territory Governments' approach to NFP issues; and
 - (3) Reduce the red table for government-funded NFPs.
- (b) The Discussion Paper covers the review of tax concessions that are available to the NFP sector. With the exception of the mutuality principle, other tax concessions set out in the Discussion Paper do not overlap with other reviews undertaken or to be undertaken by the Government.
- (c) Any additional issues suggested for consideration under the Working Group's review of tax concessions for the NFP should fall within the terms of reference of this review. However, the Committee recognises there will be some overlap between this consultation and other reviews/amendments currently underway, including:
 - (1) introduction of a statutory definition of charity;
 - (2) the Federal Government's announcement concerning better targeting NFP tax concessions (to ensure profits from commercial activities are directed solely at furthering the charitable purposes of an NFP);
 - (3) amendments to the 'in Australia' special condition and other amendments contained in *Tax Laws Amendment (Special Conditions for Not-for profit Concessions) Bill 2012* (currently before the Senate); and
 - (4) review regulation of the fundraising/charities requirement by the States and Territories.
- (d) To the extent there is an overlap between this and other consultations, any additional recommendations should not conflict with or contradict positions or recommendations that have been made in other consultations.

7. Encouraging donations and simplicity

- (a) Any amendments proposed to tax concessions provided to the NFP sector should be made in line with the following policy objectives.
 - (1) Amendments to tax concessions should not discourage/reduce donations made to NFPs.

- (2) Tax concessions should be simple for NFPs to understand and comply with.

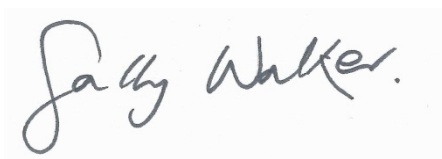
In this regard, the Committee considers the Working Group's guiding principles, that of recognising giving in Australia (principle 3) and simplicity (principle 5) are paramount to redesigning the tax concessions available to NFPs.

- (b) As highlighted in the Discussion Paper, the tax concessions provide a form of government assistance for worthy causes. They are a form of subsidy for the delivery of a public benefit. If tax concessions are reduced this will discourage potential donors from contributing to these worthy causes. A reduction in the donations to NFPs will reduce their ability to further their worthy charitable purposes.
- (c) Secondly, many NFPs do not have sophisticated accounting systems, or a thorough business knowledge (including a thorough knowledge of taxation laws). NFPs (regardless of size and business knowledge) are established to further a worthy cause that requires support. Any income they raise should be available to further the worthy cause. NFPs rarely have the funds of large organisations to maintain sophisticated accounting systems or to employ professionals with an in-depth knowledge of tax laws. The focus for those in the NFP sector should be on retaining as much of the income they receive for the altruistic cause for which they were established, rather than on employing professional advisers to assist them to charter the complexities of taxation law. In light of this, any tax concessions provided to NFPs should be simple so that all NFPs are able to understand and comply with requirements of tax concessions.

If you have any questions regarding this submission, please contact the Committee's incoming Chair, Mark Friezer, on 02-9353 4000 or via email: mfriezer@claytonutz.com.

This submission has been lodged by the authority delegated by Directors to the Secretary General, but does not necessarily reflect the personal views of each Director of the Law Council of Australia.

Yours faithfully

A handwritten signature in black ink that reads "Sally Walker". The signature is written in a cursive, flowing style.

Professor Sally Walker
Secretary-General