THE UNIVERSITY OF MELBOURNE

The University of Melbourne

Submission: Not-for-profit Sector Tax Concession Working Group

Fairer, simpler and more effective tax concessions for the not-for-profit sector. Discussion Paper, November 2012.

December 2012

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Executive Summary

The University of Melbourne is pleased to provide our comments and views regarding the Not-for-profit Sector Tax Concession Working Group Discussion Paper.

The University of Melbourne believes that the higher education sector plays an integral role in contributing to the nation's social, environmental and economic prosperity. We contribute to national prosperity in a number of key ways:

- Driving productivity by developing a highly skilled and adaptable workforce, able to generate substantial wealth.
- Producing world-leading research and innovation that addresses major social, economic and environmental challenges.
- Spreading the benefits of participation in higher education via our social inclusion and community engagement work.
- Contributing to a vibrant international student market which delivers export dollars and captures global talent.

Investment and reform in universities have the potential to deliver growth and productivity gains. KPMG-Econtech surveyed a large volume of literature to conclude the rates of return on investment in higher education average 15% for education and 25% for research[1]. The full and sustained implementation of the Review of Australian Higher Education Final Report, December 2008 (Bradley Review) vision would add some 5.6% to national productivity levels by 2040 and 6.4% to Australia's GDP.

This year's Mid-Year Economic and Fiscal Outlook (MYEFO) outlined over $1 billion in cuts to projected university funding over the next four years.

The funding cuts included the removal of the planned uplift to the Sustainable Research Excellence (SRE) program which attempts to contribute to the indirect costs of research. The much needed uplift has been deferred indefinitely, setting back years of campaigning from the sector for proper recognition of the full costs of research.

The University of Melbourne is facing significant new challenges particularly for funding research adequately. If the University was no longer exempt from income tax, using the corporate tax rate of 30%, the income tax liability for the University over the last 5 years would total around $122 million.

The University of Melbourne holds the firm view that the current tax exemptions and arrangements applicable to universities should remain. The University of Melbourne's status as an income tax exempt deductible gift recipient (DGR) assists the University in carrying out its important work in an environment of greater uncertainty around funding and government support.

As the Discussion Paper rightly points out, concessions are a form of government assistance to worthy causes. In economic terms, the work of the NFP sector generates positive externalities or 'spill over effects' not fully accounted for by private benefits derived from participation in the sector. Without incentives such as tax concessions, the critical provision of public education and research will come under more pressure.

[1] KPMG Econtech 2010, "Economic modelling of improved funding and reform arrangements for universities."

Additionally, we see a clear need for the mechanisms that encourage philanthropic giving to the University of Melbourne to be maintained and enhanced.

To further assist the NFP sector, a reduction in red-tape and administrative burden is needed. The University of Melbourne believes major efficiency gains from a reduction in administration costs can be achieved. Risk based reporting to government requirements are also important in reducing the administrative burden. This extends of course to the administration of tax arrangements and the like.

Recommendations

- The ability of the University of Melbourne to receive refunds for franking credits should not be curtailed. This would negatively impact earnings from investment in Australian shares, making investment in this asset class less attractive and reducing the funds available for critical core activities and capital expenditure.

- Income tax should not apply to the public higher education sector. Public universities are not-for-profit organisations formed for the purpose of advancing education for the public good. Our exemption from income tax on revenue assists in the provision of public services such as subsidised education.

- In order not to disadvantage or deter low income earners making donations to the not-for-profit sector, the $2 threshold should not be changed to $25.

- In order to encourage philanthropic giving to the NFP sector, donations should continue to be deductible at the individual taxpayer’s marginal tax rate. Furthermore, there is a case to further encourage giving by high income earners/donors who give large amounts to the NFP sector.

- The Government should establish a taskforce to further investigate how to increase the level of philanthropic giving in the Australian Higher Education sector. Two important aspects for the taskforce to consider are issues related to testamentary gifts and options for government matched funding programs to promote further philanthropy.

- The proposal for a clearing house for gifts to DGR entities should not proceed. Direct contact between donor and recipient is an important part of the process of charitable giving and receiving and a clearing house would essentially remove this important interaction.

- The government should allow all NFP’s an FBT exemption. Additionally, concessions should not be limited to non-remuneration benefits.

- The implementation of a principles based test would simplify compliance around fundraising activities, provided the principles are clear and easy to understand.

- The current concessional GST treatment for charitable institutions should be maintained. The concessions are a vital component of the provision of important university services such as affordable student accommodation.

- An opt-in arrangement for GST treatment of non-commercial supplies should be considered as it is likely to result in a reduced compliance burden, by removing the requirement for apportionment of supplies for nominal consideration.

Income Tax Exemption and Refundable Franking Credits

Investment and reform in universities has the potential to deliver growth and productivity gains that exceed many of the celebrated microeconomic reforms of the 1990s and 2000s. KPMG-Econtech surveyed a large volume of literature to conclude the rates of return on investment in higher education average 15% for education and 25% for research[2]. The full and sustained implementation of the *Review of Australian Higher Education Final Report, December 2008* vision would add some 5.6% to national productivity levels by 2040 and 6.4% to Australia's GDP.

One way that universities can encourage this type of income beyond direct government funding is through endowments and investment income, which are vital sources of income for the University of Melbourne. The changes proposed to refundable franking credits within the Discussion Paper would negatively impact earnings from investment in Australian shares, making investment in this asset class less attractive, and reducing the funds available to the University of Melbourne for critical core activities and capital expenditure. Since the 2006/07 financial year the University has received $62.22 million in refunds for franking credits. If this were removed it would result in significant negative impacts on employment, research outcomes and capital expenditure both within the University and across the sector.

Restrictions on franking credit refunds for NFPs would be inequitable compared to the treatment of other sectors as NFPs are unable to claim such credits against tax payable. The refund of franking credits is effectively a refund of tax paid by another taxpayer and as such is not a real cost to the Taxation System.

For these reasons, the University of Melbourne contends that the refund regime for franking credits should not be curtailed.

Income tax exemption is of great importance to the University of Melbourne and should be maintained. The University of Melbourne believes that it would be contrary to apply a business taxation system to the University sector, a sector that has very different goals and operations to business and industry.

This year's Mid-Year Economic and Fiscal Outlook (MYEFO) outlined over $1 billion in cuts to projected University funding over the next four years.

The funding cuts included the removal of the planned uplift to the Sustainable Research Excellence (SRE) program which attempts to contribute to the indirect costs of research. The much needed uplift has been deferred indefinitely, setting back years of campaigning from the sector for proper recognition of the full costs of research.

The University of Melbourne is facing significant new challenges particularly for funding research adequately. If the University was no longer exempt from income tax, using the corporate tax rate of 30%, the income tax liability for the University over the last 5 years would total around $122 million. The removal of this level of income from the University would have had a significant negative impact on employment, research outputs and investments made in infrastructure.

All funding and income received by the university is centralised in one account with a large percentage spent on improving and enhancing the University for students, staff and the community. In 2012, the University of Melbourne invested in a number of key capital works such

[2] KPMG Econtech 2010, "Economic modelling of improved funding and reform arrangements for universities."

as the Peter Doherty Institute of Immunology and Infectious Diseases. Once operational in 2014, the Doherty will house a coalition of infection and immunology experts to lead the fight against infectious human diseases. More than 700 scientists, researchers and staff will collaborate in a state-of-the-art facility and teach, train, provide scholarships for and inspire future generations of students, clinicians and researchers.

Deductible Gift Recipients

The University of Melbourne seeks to encourage gifts and donations from individuals and industry to contribute to such areas as research, scholarships and community engagement.

From its foundation in 1853, the University of Melbourne's alumni, staff, parents and friends have assured our University's success through their generous philanthropic support.

Thanks in part to generations of forward-thinking donors, the University of Melbourne is a global leader in research and education.

Gifts to the University of Melbourne from the community vary: from annual gifts to the University Annual Appeal, to major gifts such as the funding of scholarships as well as teaching and learning facilities. Over the years, it has been the support from donors that has enabled the University community to find solutions to some of society's problems.

There is a growing need for philanthropy to support charities and sectors such as Arts and Higher Education. Any move to introduce limits on the total amount that high income earners can give and claim as tax deductible will have a negative effect on those donors' philanthropy.

When not for profits enter into significant fundraising efforts, it is evidenced internationally that approximately 90% (or more) of the total will be raised from 10% (or less) of the donors[3]. This demonstrates that significant appeals are successful in financial terms due to relatively few large donations. To cap significant donors tax deductions would, therefore, have a profound impact upon philanthropic support in this context – one that the higher education sector is increasingly focussing upon.

The statistics referred to in the Discussion Paper, suggesting a five per cent reduction if a cap was placed upon high income earners, would seem an unrealistically low estimate.

In our experience, the fact that a donation is tax effective is very rarely the primary reason that a gift is made. However, by placing a cap on the amount an individual can claim, it acts as a disincentive to give and, perhaps more importantly, reinforces a perception that individuals are choosing to make a significant gift as a way of evading or dodging taxation.

A similar proposal that was to be introduced in the UK recently prompted a very severe backlash from philanthropists who objected not just to the proposal to limit the tax effectiveness of their giving but more significantly to the fact that the limit was seen as a measure to stop tax evasion. The UK proposal was eventually withdrawn.

The University of Melbourne does not support the proposal within the Discussion Paper to have a different set of tax incentives/rates for donors giving to Private Ancillary Funds (PAFs) as opposed

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[3] 2010-11 Ross-CASE Survey Report, 2012 "*Giving to Excellence: generating philanthropic support for UK Higher Education*".

to giving directly to NFP organisations. We believe this creates a two tier structure for giving that is more complex (therefore confusing) and could discourage direct gifts to NFP organisations.

Additionally, the University of Melbourne does not support the suggestion of a clearing house for gifts to DGR entities.

The Australian Charities and Not-for-profits Register (ACN register) should be an awareness raising tool which directs potential donors to individual DGR's websites or contact details. Direct contact between donor and recipient is an important part of the process of charitable giving and receiving and a clearing house would essentially remove this interaction.

In order to find the correct mix of tax incentives for donors, the University of Melbourne believes that the following two principles should be applied:

- Do not provide disincentives for low income earners to donate.
- Encourage high income earners and businesses to donate to the charitable and NFP sector.

The $2 threshold should not be changed to $25. Many low income earners may not be able to afford a donation of $25 and therefore an increase of the threshold to $25 will disadvantage those who give less. Moving the threshold to $25 would effectively provide a disincentive to those who are only able to give small amounts, and also those that may choose to make small donations frequently.

The University of Melbourne believes that donations should continue to be deductible at the individual taxpayer's marginal tax rate. This strategy would align with the principle of encouraging high income earners to give to the charitable and NFP sector.

Furthermore, we believe there may be a case for further encouragement for high income earners to donate more, potentially through an even higher nominal tax rate for those who give large volumes to the NFP sector.

The University of Melbourne generally supports the recommendations proposed in the Mitchell Review of *Private Sector Support for the Arts* (2012). The Review recommended that the Government introduce the capacity for private donors to make testamentary gifts in their wills to DGR arts organisations, and receive an immediate tax deduction equal to the present value of the gift. The University of Melbourne encourages the Government to further explore how a deduction could be allowed at the time the gift (to any NFP) is included in the will and not at the time of death. We understand that there would need to be consideration given to the cost impact on assessing and administering such a scheme. Examination should also include looking at the use of charitable remainder trusts and charitable lead trusts which such as those in the United States of America that provide a tax incentive for testamentary giving.

The University of Melbourne recommends that the Government establish a Taskforce to further investigate how to increase the level of Higher Education philanthropy within Australia. The Taskforce should consider issues relating to testamentary gifts and the exploration of government matched funding programs to promote further philanthropy.

Fringe Benefits Tax Concessions

To build the workforce Australia needs to meet the challenges ahead, we need adequately funded higher education to build higher productivity and economic growth and higher rates of labour force participation. This will subsequently bring higher tax revenues, lower unemployment rates, and broad societal benefits.

As outlined earlier in this paper, the University of Melbourne's contributions to employment go beyond direct employment. Our contributions include driving productivity by developing a highly skilled and adaptable workforce, able to generate substantial wealth and producing world-leading research and innovation that addresses major social, economic and environmental challenges.

We need to attract the best staff in order to be able to deliver these outcomes. We therefore believe that the University (and other NFPs like us) should be eligible for an FBT exemption.

We further contend that the application of the minor benefits exemption on meal entertainment should be allowed for income tax exempt entities. Allowing the exemption for income tax exempt entities will bring the exemption in line with the remainder of the section 58P Minor Benefits Exemption (Fringe Benefits Tax Assessment Act 1986), which allows income tax exempt entities to utilise the minor benefits exemption for other categories of benefits.

In addition, it is our view that the concessions should not be limited to non-remuneration benefits. A large number of employees' salary package benefits are low in value. The limitation of providing these benefits only as non-remuneration benefits will see employees of NFP's lose out as employers may not be willing to provide the benefits by way of free or discounted goods.

Goods and Services Tax Concessions

The University of Melbourne believes that the existing GST concessions for fundraising are an important part of our work as part of the not-for-profit sector. The concessions provide charities with a clear pathway for the GST treatment of fundraising activities and we contend that the concessions should continue to apply. Moreover, the Discussion Paper raises two additionally beneficial improvements.

1. The implementation of a principles based test would simplify compliance around fundraising activities, provided the principles are clear and easy to understand. The rules governing fundraising events could be amended to adopt a principles-based test under which certain NFP entities self-assess whether the event satisfies the requirements.

2. The University of Melbourne supports the provision of an opt-in arrangement for GST treatment of non-commercial supplies. Furthermore, that this would result in a reduced compliance burden where apportionment is required for supplies made for nominal consideration.

As a charitable institution the University of Melbourne utilises the concessional GST treatment on supplies made for nominal consideration. This concession provides us with the ability to treat the supply of student accommodations as GST-free rather than input taxed.

Students from low SES backgrounds, those from regional and remote areas as well as international students are beneficiaries of the provision of low-cost accommodation and any reduction to this concession would have a significant negative impact on our cash flow, inhibiting our ability to provide affordable housing to future students.

The University of Melbourne supports the current concessional GST treatment for charitable institutions and strongly recommends the concessions continue to apply to NFP entities.