Royal Automobile Club of Victoria

Submission in response to the Discussion Paper entitled

'Fairer, simpler and more effective tax concessions for the not-for-profit sector'

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1 Overview of submission

The Royal Automobile Club of Victoria Limited ("**RACV**") provides this submission in response to the discussion paper released by the Not-For-Profit Sector Tax Concession Working Group in November 2012 entitled '*Fairer, simpler and more effective tax concessions for the not-for-profit sector'* (the "**Discussion Paper**").

This submission addresses the proposed fringe benefits tax ("**FBT**") reform and includes: submission summary, relevant background and analysis of consultation questions in respect of the proposed reforms to the FBT concessions outlined in Chapter 3 of the Discussion Paper.

2 Background

RACV was established in 1903 and is now one of Australia's largest mutual clubs with over 2 million members. RACV is Victoria's peak advocacy body on all motoring and mobility issues and has a leading role in motor-related educational and environmental issues. RACV also delivers products and services to its members and the broader community in the fields of leisure, assurance, financial services, salary packaging, social well-being and the home.

RACV is committed to the broader community through its partnership programs, research funding, the provision of vital funds to not-for-profit grassroots community organisations through the RACV Foundation and Good Citizen Program. The RACV Community Foundation has been a significant contributor to over 400 charities and is heavily committed to helping community based not-for-profit ("**NFP**") organisations.

RACV is the parent company of a salary packaging provider, EPAC Salary Solutions ("EPAC"). EPAC is a national provider of general salary packaging, novated leasing and fleet financing and management solutions. In July 2011, RACV merged its Direct Salary Packaging Fleet Solutions business with EPAC to become one of the top 3 salary packaging providers in the Australian market today (by reference to the number of General Salary Packaging accounts). EPAC has government, private sector and not-for-profit clients across Australia.

EPAC has experience in assisting various entities with operating salary packaging programs for their employees. This includes assisting with administration and the provision of benefits to NFPs as well as interactions with the employer and the employee regarding the concessions.

Through the RACV Foundation and EPAC, RACV has a unique insight into the operation of the current FBT concessions provided to the NFP sector, the inefficiencies which exist, and the way in which the proposed reforms may impact the NFP sector.

3 Proposed FBT Reform

3.1 Summary

- The current system of providing FBT concessions to a range of NFP entities is long standing and well established. Whilst we agree there are areas within the current FBT concessions which would benefit from review and tightening, we consider that a complete overhaul of the concessions could create a major upheaval for both employers and employees within the NFP sector. We recommend that amendments are made to the current rules to promote equity and to target the areas of abuse identified in the Discussion Paper.
- Whilst the FBT concessions are quite complex and difficult to administer, there are salary packaging service providers such as EPAC that are able to provide employers and employees with a comprehensive service at a low cost.
- FBT concessions provide assistance for not-for-profits to compete with for-profit entities in attracting employees recognising the limited financial resources available within NFPs. By adopting a number of proposed changes to the current FBT concession regime, its operation can be improved, perceived inadequacies addressed and transparency provided. The changes include:
  - Avoiding the use of multiple caps, as it adds unnecessary complexity;
  - Preventing individuals from benefitting from multiple caps at different employers;
  - Aligning the FBT rebate rate to the FBT tax rate; and
  - Extending the minor benefit exemption to NFPs.
- We consider there is merit in reviewing whether a wider range of entities can be entitled to the current FBT concessions.
- Where the FBT concessions are to be replaced by alternative cash based methods, including the use of rebates, offsets or allowances, we would recommend the long-term revenue impact be considered. We consider that the costs of providing such cash incentives to all relevant employees may be significantly higher when compared to the value of FBT concessions that are currently received by the employees who engage in packaging benefits.

3.2 Reform options

3.2.1.1 Reform Option 1 – should the list of entities eligible for exemption or rebate be revised?

Q28 Assuming that the current two tiered concessions structure remains (see Part B), what criteria should determine an entity's eligibility to provide exempt benefits to its employees?

Assuming the two tiered system is maintained, we believe a review of eligibility should be undertaken to ensure the exemption is applied on a more equitable basis. As a potential first step, the exemption could be extended to entities which qualify under the categories of endorsement as Deductible Gift Recipients ("**DGRs**") within Subdivision 30-B of the *Income*

Tax Assessment Act 1997 that offer significant social benefits. The exemption could be further limited to certain subcategories within the broader DGR categories that are ultimately selected. The exemption could subsequently be reviewed to determine whether it is equitable to extend the exemption to further categories or subcategories of DGRs. Given the current endorsement processes in place by the ATO to ensure that only appropriate entities receive DGR endorsement within each category, the potential for abuse arising from a further extension of the concession to certain categories of endorsed DGRs would be limited.

Q29 Also assuming that the current two tiered concession structure remains (see Part B), what criteria should determine an entity's eligibility to provide rebateable benefits to its employees? Should this be restricted to charities? Should it be extended to all NFP entities? Are there any entities currently entitled to the concessions that should not be eligible?

Similar to our comments outlined above in Q28, we recommend a review of the current eligibility criteria be undertaken to ensure that they promote equity by providing concessions to those entities that operate to promote significant social benefits but may not meet the current eligibility criteria.

Q30 – Should there be a two tiered approach in relation to eligibility? For example, should all tax exempt entities be eligible for the rebate, but a more limited group be eligible for the exemption?

We support the desire to review the operation of the current two-tiered system on the ground of the complexity it creates and the administrative saving which may be found in a one-tiered system.

We acknowledge that there may be merit in a wider group of entities being considered for the concessions where those worthwhile entities operate to promote significant social benefits but may not meet the current eligibility criteria.

3.2.2 Short term reforms

3.2.2.1 Reform Option 2 – Include meal entertainment and entertainment facility leasing expense (EFLE) benefits within the relevant caps?

Q31 – Should salary sacrificed meal entertainment and entertainment facility leasing benefits be brought within the existing caps on FBT concessions?

We understand that the Working Group has concerns that there are instances where employees can salary package significant expenditure (e.g. weddings). We support the introduction of measures that would negate the ability for significant one off expenditures such as weddings to be sacrificed as we consider this is outside the intention of the concessions. A solution that would not create significant administrative burden for employers or be open to abuse is not immediately evident. Further work should be carried out to determine the most appropriate mechanism to achieve this outcome, however it is imperative that a proposed mechanism achieves its purpose in a cost efficient manner that avoids unnecessary administration.

Q32 – Should the caps for FBT concessions be increased if meal entertainment and entertainment facility leasing benefits are brought within the caps? Should there be a separate cap for meal entertainment and entertainment facility leasing benefits? If so, what would be an appropriate amount for such a cap?

We support the retention of the existing system whereby meal entertainment and entertainment facility leasing expenses are outside of the cap, however, to ensure the fairness of the system, we recommend the inclusion of a mechanism that eliminates the ability for significant one-off items to be salary sacrificed (refer question 31 above).

The addition of a separate meal entertainment and EFLE cap would result in additional administrative burden and time costs to employers who would be required to capture and split information into the two caps. It would be more practical to avoid unnecessary duplication, and the complication of multiple caps, and continue to maintain one cap for benefits.

In our experience, employees generally incur sufficient personal expenditure to reach their maximum cap without meal entertainment and EFLE. Placing meal entertainment and EFLE within the caps would essentially remove this benefit to the detriment of employees.

However, if meal entertainment and EFLE were to be included within the caps, we would recommend a once off increase in the cap to ensure employees are not unfairly disadvantaged by this change.

We also note that current exemption caps have not been revised since their introduction in April 2001. We recommend the current level of the caps be reviewed to ensure they bring the remuneration of employees in the NFP sector in line with the for-profit sector. Furthermore, we recommend that a periodical review of the concession caps be undertaken, for example, in line with periodical reviews of resident individual marginal tax rates.

Q33 – Are there any types of meal entertainment or entertainment facility leasing benefits that should remain exempt/rebateable if these items are otherwise subject to the relevant caps?

We support all efforts to ensure that the inclusions to the caps are kept as simple, transparent and as practical as possible.

We consider that the simplest and most transparent way to achieve this, and preserve the spirit of the FBT concessions for employees without adding significant administrative burden, is to continue to treat all meal entertainment and EFLE outside the relevant caps and introduce a mechanism to avoid the sacrifice of any significant one-off items.

3.2.2.2 Reform Option 3 – Require employment declarations to include information about FBT concessions to avoid employees from benefiting from multiple caps?

Q34 – 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?

We support the restriction of the concession to ensure that only one cap is received by each employee per year, regardless of whether they are employed in multiple NFPs.

We consider that the administration to check and confirm whether multiple caps are claimed may increase costs for employers and place a significant compliance burden on them. We recommend that alternative mechanisms be discussed in a consultation process with the industry, ATO and employers to develop an administratively acceptable solution. A possible solution could require employees to declare to each employer the amount of their cap they wish to utilise with the employer and require employers to separately report the amounts sacrificed under the cap via the employee's Payment Summary. This will allow the ATO to confirm if the cap is exceeded by an individual across multiple employers per annum and allow the ATO to make amendments to the individual's income tax assessment.

3.2.2.3 Reform Option 4 – Align the rate of fringe benefits tax rebates with the fringe benefits tax rate of 46.5%

Q35 – Should the rate for FBT rebates be re-aligned with the FBT tax rate? Is there any reason for not aligning the rates?

We support the alignment of the FBT rebate with the FBT rate of 46.5% for the reasons outlined in the Discussion Paper.

3.2.2.4 Reform Option 5 – Align the minor benefit exemption with the commercial sector

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?

We consider the limitation on tax exempt bodies to utilise the minor benefits exemption should be removed. The application of the minor benefits exemption to small token gifts (e.g. those for births, marriages and birthdays) will alleviate significant administrative burden in relation to tracking and recording of these benefits. Many of the smaller NFPs have minimal staff resources and the ability to reduce an administrative burden is welcomed.

3.2.3 Long term Reforms

3.2.3.1 Reform Option 6 – Phase out capped FBT concessions and replace with alternative government support

Q37 – Is the provision of FBT concessions to current eligible entities appropriate? Should the concessions be available to more NFP entities?

Please refer to our response in Question 28 and Question 29.

Q38 – Should FBT concessions (that is, the exemption and rebate) be phased out?

A major benefit of a phase out of the concessions which is outlined in the discussion paper is a reduction in FBT compliance burden. Whilst the current FBT concessions are imperfect, we believe there is significantly less burden in implementing changes to improve the operation and transparency in the established system compared to adopting wide scale reform and a completely new approach.

We consider the FBT burden would be reduced by implementing several suggested changes in the discussion paper including:

- Better defining and widening entities that are exempt and removing the rebate;
- Should the rebate be maintained, aligning the FBT rate with the FBT rebate rate;
- Harmonising the minor benefit exemption between NFPs and taxable entities; and
- Preventing individuals from benefitting from multiple caps with different employers.

We agree there are areas within the current concessions which would benefit from review to ensure the integrity of the concessions. However, we consider these can be best addressed by dialogue between the industry, employers and the ATO rather than via a complete overhaul.

At present, the industry data would suggest that not all employees are currently packaging the maximum level of benefits under the FBT concessions. The Australian Salary Packaging Industry Association estimates current salary packaging participation rates by qualifying employees of between 65% and 70%. Furthermore, not all active participants fully utilise their cap. In the event that an alternate cash based method was adopted, such that all employees of the relevant NFPs were able to receive the same benefit level enjoyed currently, there may be significant additional costs to revenue as the benefit would be provided to all employees rather than only those who utilise the concessions currently. Alternatively, where the overall revenue impact remained neutral, but the benefit was spread across all employees in the industry, there would be a significant number of employees that are currently salary sacrificing benefits who would be adversely impacted. This may affect the employer's ability to retain those employees and also affect the employer's ability to attract new staff. Therefore we recommend the long-term revenue impact of such a change be considered.

Q39 – Should FBT concessions be replaced with direct support for entities that benefit from the application of these concessions?

Whilst the current approach does place a significant administrative burden on employers and employees, we consider a direct funding approach would not alleviate the administrative burden on the NFPs that would be required to lodge applications for funding for projects and assistance with recruiting staff. The fact that the level of funding and acceptance of projects would be solely at the discretion of a government agency may also create a significant administrative burden on government. It would also limit an NFP's ability to plan appropriately and may impact budgets and forecasting when relying on uncertain cash flows. Where the available concessions that can be used to attract staff were unknown, we would expect this could create inherent uncertainty which would result in a detriment to NFPs.

As an outside observer, we believe it also raises issues of transparency regarding the efficacy of the projects that are accepted and funded, which NFPs deserve additional staffing and whether there will be a finite amount of resources allocated for all NFPs.

In addition, the proposed application process may unfairly disadvantage smaller NFPs who are unlikely to have the resources and ability to apply for funding of projects when compared to larger, more established NFPs.

We appreciate the current discussion around removing the FBT concessions in favour of adopting a newer, simpler system has merit and recommend further work be undertaken to consider other mechanisms of direct assistance that would promote equity, efficiency and transparency.

3.2.3.2 Reform Option 7 – Phase out fringe benefits tax concession and replace with alternative tax-based support mechanisms for eligible NFP entities?

Q40 – 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?

In our view, a tax offset or a tax free allowance would result in the simplest and most equitable and transparent option to allow eligible NFPs to attract staff. However, as outlined in question 38 above, not all employees are currently packaging the maximum level of benefits under the FBT concessions. The cost to revenue of providing tax free allowances or tax offsets to all relevant employees is likely to be significantly higher when compared to the value of FBT concessions currently received only by the employees who engage in packaging benefits. Alternatively, if the cost to revenue is kept neutral, a large number of employees currently working in the NFP sector and involved in salary packaging arrangements will have their current benefit significantly reduced. This will place NFPs at a significant disadvantage when competing for talent with the commercial sector.

The proposals in the discussion paper are for annual allowances/tax offsets. We note that the NFP sector relies on a vast array of casual and part time employees. The Discussion Paper suggestion of providing amounts to each employee based on different employer categories would not necessarily recognise this diverse range of employees and may result in inequitable distributions for part time, casual and full time workers.

3.2.3.3 Reform Option 8 – Limit concessions to benefits that are incidental to employment?

Q 41 – Should FBT concessions be limited to non-remuneration benefits?

The discussion paper suggestion of limiting the concessional FBT treatment to 'non remuneration' benefits will severely hamper an NFPs ability to attract employees from the commercial sector. By limiting concessions this will effectively be cutting salary and benefits of the NFP employees which goes against the reasons for having the concessions available for employees working with originations undertaking work of great societal value. The measures will not eliminate the compliance burden on employers. Employers will still be required to keep track of benefits provided to employees and split out those which are 'non-remuneration' from those which are. In fact, if employers are no longer engaging external help in relation to salary packaging and FBT compliance, they are likely to have to take on these roles internally, thus increasing the burden on the NFP.

Q42 – If FBT concessions are to be phased out or if concessions were to be limited to non-remuneration benefits, which entity types should be eligible to receive support to replace these concessions?

We do not support the limitation of the FBT concessions to non-remuneration benefits for the reasons outlined in our response to Question 41.