The Smith Family's submission to the Not-for-Profit Sector Tax Concession Working Group re the discussion paper *Fairer, Simpler and More Effective Tax Concessions for the Not-for-Profit Sector*

December 2012

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Background on The Smith Family

The Smith Family is a national, independent charity committed to increasing the educational participation and achievement of Australian children and young people in need. It is a company limited by guarantee and operates in every Australian state and territory. It has Public Benevolent Institution and Deductible Gift Recipient status, and is an Income Tax Exempt Charity.

The Smith Family has a strong focus on sustainability and, as such, has aimed to ensure its income is drawn from a range of sources. In 2011-12, The Smith Family's annual income was just over $70 million. A quarter of this was sourced from Government funding, 63% came from fundraising (donations and corporate support) and bequests, around 7% came from the VIEW (Voice, Interests and Education of Women) Clubs of Australia and 5% came from The Smith Family's recycling operations and other income.

Introduction and context

The Smith Family welcomes the Discussion Paper and its implicit acknowledgement of the crucial role played by the not-for-profit sector in the social and economic wellbeing of Australia, in line with the findings of a number of reviews and inquiries conducted over the last decade.

The Smith Family's comments in relation to tax concessions are provided in the context of recognising that changes must not adversely impact either the sector as a whole or its participant organisations. This approach is clearly at odds with one of the overriding terms of reference which requires "the Working Group to identify offsetting savings for any proposals that would have a budget cost".[1] Responses are limited to areas where changes would impact on the charitable sector.

While it is correct that the concept of fairness may mean that differing levels of support can be provided where justified, the above requirement means that any expansion of the concessions available to individual organisations within the sector will inevitably be unfair to other organisations which must inevitably have their concessions curtailed, leading to reductions in services and community benefit. This unfairness is especially the case because current arrangements have developed in response to the perceived value in promoting the work of those organisations through tax concessions.

The Discussion Paper records the Australian Government's estimate that in 2011-12 it provided around $4 billion of quantifiable support to the sector through tax concessions, which represents only 4% of the overall level of tax concessions provided. Reviewing concessions to the NFP sector by changing the mix of concessions available to particular organisations or the method of delivery will do little for the economy as a whole and runs the risk of significant adverse impact on those organisations which lose concessions or see them curtailed by any redistribution of those concessions.

The Smith Family endorses the rationales provided for providing tax concessions to the NFP sector, but takes issue with the reasons cited from the literature for limiting concessions. The tax system is riddled with examples of tax concessions for one group inevitably putting a greater tax burden on others. Concessions by definition mean that those who do not receive them will pay more (or receive less), but this is not a reason for concessions not to be made available in circumstances where there is a demonstrable community benefit.

[1] *Fairer, simpler and more effective tax concessions for the not-for-profit sector*, p8

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The notion of competitive neutrality will be discussed later in this submission, but it is The Smith Family's view that the concessions provided to the sector actually promote rather than hinder it.

The fact that some have questioned the nature of the public benefit provided by some entities within the sector may argue in favour of the concessions being enjoyed by such organisations being limited, but this does not support the need for sector-wide changes.

The numbering of sections below reflects the numbering used in the Discussion Paper.

3. Fringe Benefits Tax concessions

The Smith Family does not support any changes to the FBT exemption regime. The fringe benefits tax concession is critical to the effective operation of PBIs and others which have access to the concession on a number of levels.

Data included in the Discussion Paper show that FBT exemptions provide an estimated annual financial contribution of $2.4 billion to the sector overall. Withdrawal or curtailing of this benefit will represent a direct financial cost to the sector which will inevitably result in reduced services (or higher charges for those able to pass the costs on) and increased imposts on government.

Indeed we recommend that the FBT exemption thresholds be indexed – their value to the sector has been significantly eroded over the 12 years since they were put in place. With the cost of living having increased greatly over that time, the value of the FBT exemption has fallen substantially in real terms, resulting in the erosion of the sector's market competitiveness.

There has been much discussion over time of the need for competitive neutrality between the private and not-for-profit sectors. The FBT concession granted to PBIs and public and NFP hospitals was intended to address this concept in a measured way. It has provided beneficiaries with the opportunity to recruit staff on the open market by offering competitive salary packages to staff but at a reduced cost to the organisations concerned.

Fringe Benefits Tax is a tax on employers, not employees. Salaries of staff in the PBI sector are traditionally at the lower end of rates applicable to the general market in which the sector competes for professional and management personnel, and the likelihood that a PBI would pay a market rate and then pass on the additional financial benefit from the FBT concession would be small. At the same time, an employee who elects not to package his base salary will not expect to be paid more as a result – he will just work for less overall remuneration benefit.

The FBT concession simply allows organisations to gross up the value of packages to makes them comparable to the general market and to compete in that market to recruit appropriately skilled staff. This actually promotes competitive neutrality rather than obstructing it.

Option 3.3 considers whether there should be limits on employees benefitting from multiple caps. Given that the tax (if payable) is an employer obligation and the cap (if available) is a saving to the employer, it is employers rather than employees which will be disadvantaged by such a step, and as such this option is not supported.

Concern has been expressed about the potential for exploiting the present meal entertainment benefit exemption, and while there appears to be little evidence of this, it may be reasonable to impose a cap on the benefit such as $10,000 per annum. Anecdotal evidence is that the take-up rate in the sector in any case is not high, but placing a limit on it would go some way towards offsetting the cost of indexing the FBT exemption as proposed above.

Long-term reform options (section 3.4.4)

A principal benefit of FBT concessions is that their value to an organisation is linked to the level of employment in organisations from time to time (as well as the extent to which the benefits are taken up by staff), which may serve as a proxy for determining the level of subsidy available to them. They provide a relatively simple means of support, the administration of which can readily be outsourced to specialist service providers. Benefits to participating organisations are commensurate with their staffing levels, and costs to government are limited by the cap and reduced to the extent that employees elect not to take advantage of the facility.

Alternative measures such as direct support from government through grants will be complex to administer and subject to adjustment due to external factors over time as budgetary constraints ebb and flow, rather than being linked to the scale and operations of organisations themselves.

A further benefit of the present arrangements is that, with the exception of the caps themselves, the FBT arrangements apply consistently to all organisations, making them familiar to both management and staff alike across sectors. It is recommended that this approach be maintained in favour of alternatives such as tax offsets and tax-free allowances.

1. Income tax exemptions and refunds of franking credits

Income tax exemptions (section 1.4.1)

The public benefit test which is applied to charities is seen as an appropriate measure for determining eligibility for exemption from income tax as it stands at present. The provision of income tax exemptions is probably the simplest approach to supporting the sector as it avoids a significant compliance burden and therefore significant cost from all but the most complex of organisations, where issues may arise relating to unrelated commercial activities of otherwise exempt organisations.

The ‘public benefit’ requirement itself is an important component of a charity, with a relatively simple definition included in the legislation and complemented by guidelines from the ACNC being preferable to complex or multi-part definitions. The need for a charity to provide a public benefit directed to the benefit of the general community or to a sufficient section of the community may well be sufficient in the legislation with ACNC guidelines providing specific examples of particular categories of charity which satisfy the requirements. Charities tend to target particular sections of the ‘public’ rather than the whole community and both the legislation and guidelines need to reflect this. The Smith Family for example, targets its support to financially disadvantaged children, young people and their families.

Refunds of franking credits (section 1.5.1)

The importance of refunds of franking credits to charities should not be underestimated. With community and corporate support for the charitable sector increasingly tied to particular purposes, rather than being provided as untied funds, the availability of franking credits is an important source of funds which help to defray back office costs. The withdrawal of the benefit would represent a direct financial impost on those organisations which have been able to build up investment portfolios based on Australian investments to provide an income stream, and this in turn would lead inevitably to a reduction in services which those organisations are able to provide. Ultimately the burden of unmet need resulting from this would fall on government.

The Smith Family believes that the rationale behind the refund process being introduced in 2000 remains sound and should not be changed. The value of the franking credit concession ebbs and flows with the dividends declared by companies, which in turn reflect their financial performance at least to some degree. In years when companies perform well and deliver higher dividends, the government should expect to receive increased revenue from company tax, and is against this component of its revenue rather than total revenue that comparisons should be made.

2. Deductible gift recipients

At present all charities are eligible to be endorsed as DGRs, subject to their fitting into one of the 50 or so DGR categories which cover a broad range of public benefits. The range of categories does not require expansion. However the present requirement for entities to fit within one of the DGR categories should be reviewed. Given the overlapping nature of the work of organisations in terms of DGR categories, eligibility for endorsement at an entity level could be relaxed to one that requires its activities to fall within one or more DGR categories, thus eliminating the potential behavioural distortion and potential requirement for the establishment of multiple funds, and reducing compliance and administration costs at the same time.

The extent to which a broadening of the DGR base would encourage greater philanthropy is uncertain, and research into the potential impact needs to be conducted to ensure that there are no unforeseen adverse consequences. Broadening the DGR base may lead to a dilution of support away from organisations currently registered and promote the establishment of more and more smaller organisations whose ability to leverage the relatively low levels of support they are likely to receive would be very limited, resulting potentially in duplication of services and higher average administration costs.

Mechanisms to provide donors with a tax incentive (section 2.4.2)

The Smith Family does not support the introduction of a fixed tax offset in place of the present marginal tax rate deduction approach, unless the offset is set to match the highest marginal tax rate.

The data show that higher income earners give more, and this is hardly surprising given that they are likely also to have higher disposable incomes from which to make their contributions. Reducing the deductions available to this group is likely to mean a reduced incentive to give, and a consequent fall in support.

The Productivity Commission estimated that even an offset rate of 38% was likely to lead to a small decline in the overall level of giving. Clearly the minimum offset rate would have to exceed this level to maintain parity and to be set at a significantly higher level (such as 46.5%) to achieve increased contributions. Unless the object of any change is to provide greater incentives to give, there is no reason to change the present simple, transparent and effective system.

Encouraging charitable giving and reducing transaction costs (section 2.4.3)

Option 2.7 Creating a clearing house for donations to DGRs

While The Smith Family supports the use of the ACNC register by potential donors, the organisation does not support the establishment of a donation clearing house linked to the register. It is not part of the role of the ACNC to be undertaking administrative tasks such as donation processing on behalf of private sector organisations, particularly when there are already many providers of such services in the marketplace already to which links could be provided in the same way that links could be provided to individual DGRs. Payments through clearing houses inevitably attract fees which would have to be passed on to beneficiaries, who would in turn incur further costs importing data into their own systems.

Encouraging donors to donate to ACNC-registered charities is a sound approach, and donors will have confidence that their contributions are appropriately directed to their chosen charities by donating directly to them.

Option 2.8 Workplace giving

It is unlikely that the establishment of a clearing house will increase workplace giving, given that at the time that the giving arrangements are put in place, the employee has already identified the beneficiary organisation. There seems little to be gained from a company's paying the clearing house, which may well need to deduct handling fees to pass the funds through to the intended beneficiary.

The promotion of workplace giving provides opportunities for securing a regular and quantifiable income stream, but the downside to present arrangements is that the beneficiary organisation does not know who its supporters are, and thus cannot build the relationships with them which are the foundation for future direct engagement and the giving of more significant sums. What is needed is a mechanism which allows beneficiary organisations to know who their supporters are so that the can maintain contact.

Option 2.9 Eliminate public fund requirements charities registered by the ACNC

The administration of public funds separately from an organisation's overall business can be onerous. Registered organisations should all maintain books of account which enable separation of income and expenditure information which would enable compliance with public fund requirements without the maintenance of separate bank accounts. Acceptance of this approach would simplify operations and reduce compliance costs.

Option 2.10 Increase the threshold for deductible gifts from $2 to $25

The Smith Family supports an increase in the deductible donation threshold, provided that the threshold includes the annual value of pledge contributions. A number of charities receive pledge contributions of relatively small sums provided weekly or fortnightly from post-tax payroll deductions rather than through more conventional workplace giving, and it would be important to capture cumulative value of these contributions. From a practical viewpoint this should not be extended to the accumulation of ad hoc contributions which individually are less than the threshold.

Most charitable donations nowadays would exceed $25 in any case, and an increase in the threshold should lead to cost savings in terms of the need to provide receipts for smaller amounts, provided of course that regulations in some states which cover this aspect of donation handling are amended or withdrawn. The present cost of receipting minor donations would often exceed the value of the donation itself and therefore represent a net cost to the beneficiary.

Summary

In welcoming the opportunity to respond to the Discussion Paper The Smith Family has presented views on a number of key taxation concession measures and how they might be simplified and/or made more beneficial to the charity sector. These include:

3. Fringe Benefits Tax concessions	Retention of the present capped threshold arrangements but the caps to be indexed in line with CPI each year to avoid erosion of the value of the concession
1.1 Income Tax exemption	Maintenance of the present arrangements with eligibility subject to a public benefit test
1.2 Refundable franking credits	Maintenance of eligibility as a means of promoting and maximising an untied stream of funding for eligible organisations
2.4 Deductible gift recipients	Relaxation of eligibility requirements in relation to organisations potentially eligible under more than one category to minimise potential need for multiple funds within an organisation

The Smith Family would welcome the opportunity to discuss these matters more fully or provide further information where this may be requested.