NOT-FOR-PROFIT SECTOR TAX CONCESSION WORKING GROUP

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

Final Report
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Acronyms

ACNC	Australian Charities and Not-for-profits Commission
AFTS	*Australia's future tax system* report
ATO	Australian Taxation Office
CGT	capital gains tax
DGR	deductible gift recipient
FBT	fringe benefits tax
GST	goods and services tax
HPC	health promotion charity
ITAA 1997	*Income Tax Assessment Act 1997*
ITAA 1936	*Income Tax Assessment Act 1936*
NFP	not-for-profit
NRAS	National Rental Affordability Scheme
PAF	private ancillary fund
PuAF	public ancillary fund
PBI	public benevolent institution

Terms of Reference

Objective

1. The Working Group will consider whether there are better ways of delivering the current envelope of support provided through tax concessions to the NFP sector by the Australian Government.

Scope

2. The Working Group will examine the current range of tax concessions provided to the NFP sector in terms of their fairness, simplicity and effectiveness.

3. The Working Group will identify whether there are fairer, simpler and more effective ways of delivering the current envelope of support provided through tax concessions to the NFP sector.

4. The Working Group will identify offsetting budget savings from within the NFP sector for any proposals that have a budget cost. All proposals and offsetting budget savings examined by the Working Group will be costed by Treasury in accordance with the budget rules.

5. The Working Group will have regard to the Productivity Commission's 2010 report *Contribution of the Not-for-profit Sector*, the Australia's Future Tax System Review, and relevant international experience and expertise, in developing its recommendations.

6. The Working Group will have regard to the Government's broader NFP reform agenda in developing its recommendations.

Timing

7. The Working Group is expected to complete its work by December 2012.[1]

Consultation

8. The Working Group, with assistance from Treasury, will consult widely with the NFP sector, State and Territory governments, and the broader community.

9. The Working Group will provide the NFP Sector Reform Council with regular updates on its progress.

10. All meetings of the Working Group will be attended by a representative of Treasury and a representative of the Office for the Not for Profit Sector.

Support

11. The Working Group will be supported by a Secretariat within Treasury. The Secretariat will provide the Working Group with technical and legal advice as required.

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1 Since the Terms of Reference were settled, the Treasurer has agreed to a delayed timeframe for the final Report from the Working Group.

Guiding Principles for this Review

In undertaking this review, the Working Group established a set of principles, helping to set the framework and perspective to consider reform options. The application of these principles underpinned the reform options put forward in the Working Group's Discussion Paper,[2] and the findings presented in this Report. The submissions received and the targeted consultation sessions with organisations within the not-for-profit (NFP) sector have informed the findings presented in this Report.

1. **Understanding the envelope of support and underlying assumptions of the existing concessions**

   By understanding what the existing concessions are and their original intent and current scope of application, the Working Group will be better able to assess the appropriateness of the existing concessions.

2. **Maximise the social good**

   Ensure that the concessions are used in a way that provides the maximum social benefit by enabling the NFP sector to achieve their community and altruistic purposes.

3. **Recognise giving in Australia**

   The concessions should provide a supportive environment in which the community can support the NFP sector. The Working Group seeks to highlight the benefits of 'giving', and considers that this concept is broader than the term 'philanthropy'.

4. **Fairness**

   The concessions should be fair. The aim should be to treat like with like unless there is good rationale for differing treatments. Fairness can mean that different levels of support can be provided, where justified, in different circumstances. Concessions should be available having regard to purposes and activities rather than arbitrary legislative requirements.

5. **Simplicity**

   The concessions should be easy to understand and simple to apply. A simple and transparent system makes it easier for people to understand their obligations and entitlements. Organisations will be more likely to make the most beneficial choices for themselves and respond to intended policy signals. A simple and transparent system may also involve lower compliance and administration costs. However, it is acknowledged that there may be trade-offs between the principles of fairness and simplicity.

6. **Effectiveness**

   The concessions should enable effective policy outcomes that maximise the social good.

2 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).

7. Efficiency

The concessions should have the least possible cost to economic efficiency and with the lowest possible compliance and administration costs. So far as possible they should not distort decisions by NFPs.

8. Structural coherence

The concessions should be consistent with the Government's overall aims of providing support to the NFP sector.

9. Transparency

There should be a clear explanation of the rationale for the concessions to enable the sector and the broader public to understand why the tax concessions apply as they do.

Executive Summary

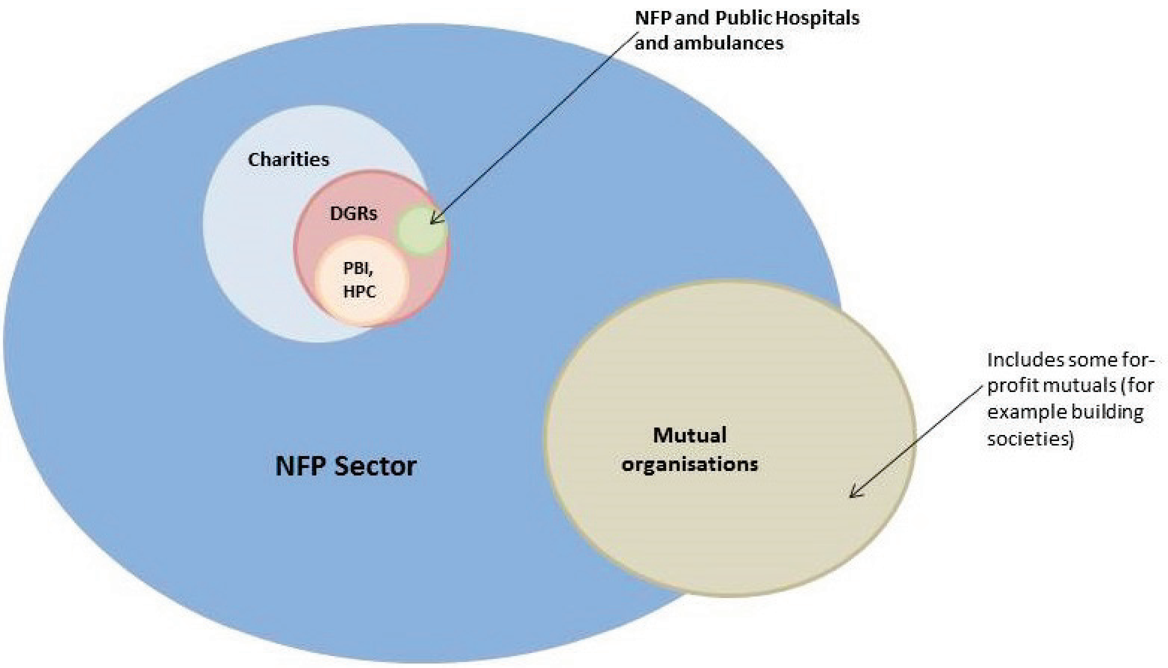
The Not-for-profit (NFP) Sector Tax Concession Working Group (the Working Group) was established in February 2012 by the then Assistant Treasurer, Senator the Hon Mark Arbib. The Terms of Reference (set out above) asked the Working Group to consider whether there are fairer, simpler and more effective ways of delivering the current envelope of support provided through tax concessions to the NFP sector.

The NFP sector

The NFP sector is large, consisting of approximately 600,000 organisations[3] and a number of different entity types. The types of concessions available to an NFP entity depend on the entity type and the activities that the NFP entity undertakes.

As of October 2012 there were 56,279 charities registered for tax concessions.[4] Of these, 29,046 were deductible gift recipients (DGRs), 8,909 were public benevolent institutions (PBIs), and 1,256 were health promotion charities (HPCs).[5] Due to insufficient data, it is difficult to estimate with certainty the number of mutual organisations in Australia

Figure 1: Entity types in the NFP sector



3 Productivity Commission, *Contribution of the Not-for-profit Sector,* Research Report, (2010).
4 Australian Taxation Office, *Taxation Statistics 2010-11* (2013).
5 Australian Taxation Office, *Taxation Statistics 2010-11* (2013).

As noted above, the NFP sector also includes some DGRs that are not charities. It also includes some bodies that have DGR status but would not qualify as charities because they are controlled by government, such as government public hospitals. HPCs are a form of charity that receive similar tax treatment to PBIs. Mutual organisations may be NFP or for- profit. Some mutual organisations are endorsed as charities by the ATO.

The Working Group has considered the issues in relation to all of these types of entities, and where in this Report there is discussion about particular types of entities, has made the effort to clearly identify who is affected.

Rationales for Providing and Limiting Tax Concessions

The Working Group was asked to consider whether there are better ways of delivering the current envelope of support provided through tax concessions to the NFP sector by the Australian Government. In doing so, the Working Group was asked to examine the current range of tax concessions provided to the NFP sector in terms of their fairness, simplicity and effectiveness.

In the Discussion Paper, three rationales for providing tax concessions to the NFP sector were identified.

1. Concessions are a form of government assistance to worthy causes. Without incentives such as tax concessions, the overall level of activity in the NFP sector may be below what is optimal for society.

2. Tax concessions to the NFP sector are a form of payment or subsidy for the delivery of goods or services that are of public benefit. Activities undertaken by the NFP sector save governments from making outlays for similar activities.

3. In relation to income tax, income tax is only borne by individuals and is imposed on entities as proxies for individuals. As charities and other NFPs are formed for the purposes of public benefit, not the private benefit of individuals, it is argued that they should not be within the income tax regime.

Arguments also exist for placing limitations on tax concessions provided to the NFP sector.

1. Tax concessions for one group within the community inevitably place a larger tax burden on others if a particular amount of taxation revenue is to be collected. A tax system with fewer concessions would tend to enable lower taxes to be levied.

2. Some tax concessions may raise issues of competitive neutrality.

3. Some have questioned the nature and scope of the public benefit provided by some entities that benefit from tax concessions, given the breadth of the current system.

Conduct of the review

The Working Group released a Discussion Paper in November 2012, which outlined various options within five key tax concession areas. The Discussion Paper sought feedback from stakeholders on each of the options and invited suggestions for other reforms within the Working Group’s Terms of Reference.

Over 225 submissions were received in response to the Discussion Paper, including 25 confidential submissions. A range of views were raised on all topics canvassed in the Discussion Paper. The Working Group also met with a number of stakeholders for further targeted consultations.

After considering these submissions and feedback from further consultations, the Working Group has made a number of findings and recommendations, which are set out below. Due to the diversity of the opinions expressed in the submissions, the Working Group has generally aimed to draw out key themes from the submissions, rather than address specific views from submissions.

For some of the issues raised in the Discussion Paper, the Working Group came to the conclusion that it would not recommend any change to existing arrangements. Where this is the case, the Working Group has noted a finding, but has not made a specific recommendation to retain current arrangements.

In accordance with the Terms of Reference, the recommendations of the Working Group have been costed by Treasury in accordance with budget rules. Because of the nature of some of the recommendations — for example, where the Working Group has recommended that a further review is required — not all of the recommendations have quantifiable costs or savings. Where there is an identifiable cost or saving, the Working Group has noted this in the relevant chapter.

Income Tax

Summary

- Income tax exempt status allows eligible NFP entities to use more of their income for carrying out their purposes. This exemption should reflect the value the community places on these purposes.
- There appears to be no clear principle underlying eligibility for tax exempt status. The Working Group considers that the principle of public benefit should be the most useful general guide for determining eligibility for tax exempt status.
- The $416 income threshold for taxable NFPs to be required to submit a tax return is too low. Introducing a tax free threshold at a suitable level would benefit NFPs that are not income tax exempt.
- Access to refunds of franking credits by endorsed tax concession charities and income tax exempt DGRs should continue.
- As a matter of principle, all NFPs seeking an income tax exemption should be endorsed by the Australian Taxation Office (ATO). While this would initially increase compliance costs for affected NFPs, it would help ensure that all NFPs that claim an income tax exemption are eligible to receive this concession.
- To correct an anomaly, income tax exempt status should be extended to funds that both provide money, property or benefits to income tax exempt deductible gift recipients, whether or not charities, and have other charitable purposes.

Recommendations – Income Tax

Recommendation 1: Review existing categories of entities for income tax exempt status

Existing categories of entities for income tax exempt status should be reviewed and consolidated, with a view to restricting access to entities that have purposes that are of significant public benefit (as currently understood at common law). This review should take into account the proposed statutory definition of charity.

Recommendation 2: Raise and simplify the tax threshold for taxable NFP entities

The $416 threshold for NFP entities that are not income tax exempt should be simplified to form a basic tax-free threshold, and raised to $10,000. Introducing a basic tax-free threshold would remove the current phase-in arrangements so that all eligible NFPs will not be required to pay tax on the first $10,000 of taxable income.

Recommendation 3: Extend the ATO endorsement framework to all NFPs accessing tax concessions

The ATO endorsement framework that is currently applied to charities should be extended to all NFP entities accessing tax concessions, to improve the integrity of the tax concessions. In view of the administrative and compliance task in bringing a large number of entities within the endorsement framework, this should occur in stages.

Recommendation 4: Rewrite the income tax exemption provisions for State and Territory government bodies

The income tax exemption provisions for State and Territory government bodies in Division 1AB of Part III of *Income Tax Assessment Act 1936* (ITAA 1936) should be simplified and consolidated into the *Income Tax Assessment Act 1997* (ITAA 1997).

Recommendation 5: Extend the income tax exemption for mixed charitable/DGR funds

Income tax exempt status should be extended to funds that both provide money, property or benefits to income tax exempt deductible gift recipients, whether or not charities, and have other charitable purposes. This recommendation should be reviewed following the introduction of the proposed statutory definition of charity.

Deductible Gift Recipients

Summary

- The deductible gift recipient (DGR) framework is intended to encourage philanthropy. However, the current system for granting DGR status is cumbersome, inequitable and anomalous. Further, the framework is not well placed to handle organisations that carry out a range of purposes that fit within a number of DGR categories. Reforming the framework would increase certainty, reduce red tape for eligible entities and should further increase philanthropy.

- DGR status should be extended to all charities, but restricted to activities that are not for the advancement of religion, charitable child care and primary and secondary education, except where this is sufficiently related to another charitable purpose.

- Except in the most exceptional circumstances, DGR status should be limited to charities and charitable-like government entities.

- In view of their uncertain impact on philanthropic giving, the Working Group is unable to support the following changes to tax incentives:

  – a tax offset for donations; or

  – a hybrid system for donations to private ancillary funds.

- Similarly, the Working Group is unable to support establishing a clearing house for donations to DGRs, on the basis that the large costs of establishing and administering the clearing house may outweigh the benefit to philanthropy.

- The Mitchell Review into *Private Sector Support for the Arts* recommended that irrevocable gifts of money or property to DGRs to take effect on a person's death should be deductible at the time of giving. The Working Group considers that there are legitimate concerns that such arrangements will present significant and unavoidable integrity risks to the taxation system. Testamentary gifts of property are currently exempt from CGT when the gift takes effect. The Working Group considers the existing testamentary gift concessions are appropriate.

- Following the establishment of the Australian Charities and Not-for-profits Commission (ACNC), there is less need for the integrity measures provided by the public fund requirements.

- The current minimum of $2 for deductible gifts is an anachronism and could be removed with few consequences.

- The Working Group considers administrative mechanisms to further promote giving should be developed, including simplifying processes for regular workplace giving for employees of organisations of all sizes.

Recommendations – Deductible Gift Recipients

Recommendation 6: Extend DGR status

1. DGR status should be extended to all charities that are registered with the ACNC, but use of tax deductible donations should be restricted to purposes and activities that are not solely for the advancement of religion, or the advancement of education through child care and primary and secondary education, except where the activity is sufficiently related to advancing another charitable purpose.

2. The restrictions noted above should also apply to any income derived from investment of DGR funds.

3. This extension should occur in stages, and preferably not until the proposed statutory definition of a charity has been legislated.

4. There should be a separate DGR category for entities that would be charities but for their connection with government (such as public museums and art galleries), subject to the same activity restrictions as charities.

5. Entities that are currently specifically listed, or endorsed under existing DGR categories, should generally be required to seek registration as a charity to retain their DGR status. It is expected that the majority of current specifically listed or endorsed entities would fit within the proposed framework.

6. There should be a review of entities that are DGRs, but fall outside the accepted charitable purposes framework, to determine whether they still merit DGR status. This review would include:

    a. entities that are currently specifically listed as DGRs in Division 30 of the ITAA 1997 that will not qualify to be registered as charities; and
    b. DGR general categories that fall outside of existing charitable purposes.

Recommendation 7: Simplify the property donation rules

The Government should review the property donation rules, to simplify their operation.

Recommendation 8: Remove the public fund requirements

The existing public fund requirements should be removed for charities registered with the ACNC.

Recommendation 9: Remove the minimum gift deduction threshold

The $2 threshold for deductible gifts should be removed.

Recommendation 10: Explore mechanisms to promote giving

The Government, in consultation with the NFP sector and employer and employee bodies, should explore development of mechanisms to further promote giving, including simplifying processes for regular workplace giving for employees of organisations of all sizes.

Recommendation 11: Modernise the anti-avoidance rules for gifts

The anti-avoidance rules for donations where the donor receives material private benefits should be rewritten in a simplified form and included in ITAA 1997. In rewriting the anti-avoidance rules (private benefit rules) regard should be had to whether the existing minor benefits rules for fundraising could be repealed and instead subject to the anti-avoidance rules, with the aim of further simplifying existing arrangements. The Commissioner of Taxation should consider developing guidelines relating to whether the benefit received by the donor is material.

Fringe Benefits Tax

Summary

- Fringe benefits tax (FBT) exemptions are primarily used by PBIs, health promotion charities, public and NFP hospitals, and public ambulance services, and the FBT rebate is used by other charities and certain other income tax exempt employers, to provide salary packaging benefits in order to attract and retain employees. FBT concessions are also used to compensate for funding shortfalls in the NFP sector.

- The benefit of FBT concessions is not evenly spread among NFP sector employees: only some entities are eligible for the capped FBT exemption while other entities (but not all income tax exempt entities) are eligible for the rebate. Even among eligible entities, salary packaging take-up rates vary.

- The FBT exemption caps have not been increased since they were introduced, meaning that the true value of these benefits has eroded over time.

- Given the current reliance by many organisations on FBT concessions as part of salary packaging, removing the concessions altogether without consideration of a mechanism to replace the support would have a significant impact. The Working Group proposes an alternative support payment to employers, possibly through the tax system, to replace the FBT concessions provided through salary packaging. A payment to employers would be simpler to administer than a payment to employees, would be more flexible, and would allow eligible NFPs to use it in the manner most appropriate for the organisation, such as in relation to attracting and retaining staff. The payment would be paid automatically to eligible NFPs.

- The Government should take a principled approach to determining eligibility for any payment to employers that replaces capped salary packaging FBT concessions. This would likely require a review to determine the best approach to eligibility.

- The uncapped access to meal entertainment and entertainment facility leasing benefits has raised concerns about the legitimacy of such concessions, especially since the rest of the community are not able to access such concessions or claim a deduction for such expenses. The benefit of this concession is also not evenly spread among NFP employees, tending to be more highly utilised by eligible employees on higher salaries.

- In accordance with the Terms of Reference for the review, any net savings from any recommendations adopted by the Government should be returned to the NFP sector as soon as practicable. The alternative support payment (Recommendation 12) would be a suitable mechanism for returning any net savings to the NFP sector.

Recommendations – Fringe Benefits Tax

Recommendation 12: Replace the NFP FBT concessions (only in relation to salary packaging arrangements) with an alternative support payment to eligible NFPs

1. The FBT concessions (set out below), accessed by way of salary packaging arrangements, should be replaced by an alternative support payment, with the following parameters:

    a. the payment should be provided periodically to eligible NFP employers (with employers deciding how the payment is to be applied to their purposes);

    b. the quantum of the payment should be based on an amount per employee, having regard to the basis of that employment, such as whether it is full-time or part-time and how much of a year the employee has been an employee;

    c. the payment should be indexed in line with the Consumer Price Index;

    d. the payment should be set at two tiers, with a higher amount set for NFPs with priority purposes; and

    e. the amount of the payment and those NFPs eligible to access it should be subject to separate consultative arrangements, which should have regard to the matters set out in (3) below.

2. The FBT concessions that should be replaced, subject to a review of valuation methodologies and compliance costs associated with removal of the relevant concessions for certain accommodation and board fringe benefits, are:

    a. exemption for benefits to employees of religious institutions (section 57);

    b. exemption for benefits provided to employees of public benevolent institutions, health promotion charities, public and NFP hospitals, and public ambulance services (section 57A);

    c. exemption for live-in domestic workers for religious institutions (section 58T); and

    d. rebate for certain tax exempt NFPs (section 65J).

3. There should be further consultation to determine:

    a. which categories of NFPs should be eligible to access the alternative support payment; and

    b. which purposes of those NFPs should be considered priority purposes and therefore able to access the higher level of the alternative support payment (see (1)(e) above).

4. The new alternative support payment should be implemented within the next 2 years.

5. In lieu of an alternative support payment, the Government should consult with State and Territory governments on the best mechanism to provide alternative support available to government hospitals and public ambulance services.

Recommendation 13: Include uncapped meal entertainment and entertainment facility leasing benefits in existing caps

As soon as practicable and independently of the implementation of Recommendation 12, the uncapped concessions in relation to salary sacrificed meal entertainment and entertainment facility leasing fringe benefits should be removed. These benefits should be treated consistently with other fringe benefits, that is, included within existing caps.

Recommendation 14: Remove eligibility for multiple caps

As soon as practicable and independently of the implementation of Recommendation 12, a mechanism should be introduced to ensure the capped FBT exemption for benefits provided to employees of PBIs, health promotion charities, public and NFP hospitals and public ambulance services, and the rebate provided to certain NFP employers, is only available in respect of an employee to the extent the employee has not received the benefit of the cap from another eligible employer within an FBT year.

Recommendation 15: Align FBT rebate rate with the FBT tax rate

As soon as practicable and independently of the implementation of Recommendation 12, the rate for the FBT rebate should be re-aligned with the FBT tax rate.

Recommendation 16: Align the minor benefits exemption with the commercial sector

The existing limitation on access to the minor benefits exemption in relation to tax exempt body entertainment benefits should be removed with a view to ensuring equity across the NFP sector and with the commercial sector.

Recommendation 17: Transitional payment to eligible NFP employers

In recognition of the ongoing devaluation of support provided to those entities affected by Recommendations 13, 14 and 15, a temporary transitional payment should be made to all eligible NFP employers.

This temporary payment should be:

1. automatic, and paid directly to NFPs currently eligible to access FBT concessions;
2. paid for two years, or until Recommendation 12 has been implemented;
3. first made in conjunction with the implementation of Recommendations 13, 14, 15; and
4. indexed, with the formula to calculate the transitional adjustment payment value similar to Recommendation 12(1).

Goods and Services Tax

Summary

- In general, non-commercial supplies made by charities are GST-free and their commercial activities are taxable. In some instances, charities can opt to treat their supplies as being input taxed. This means they can treat their supplies as non-taxable but cannot recover the GST, if any, on acquisitions related to the making of those supplies. The GST concessions that are available to NFP entities vary depending on the type of body.
- The current GST arrangements for fundraising create uncertainty for many NFPs. The ATO should consider improving its guidance on these issues.
- Two reform options were proposed in the consultation paper to address concerns about the current GST concessions. Submissions commented on both these options and suggested other changes to the existing range of GST concessions and arrangements.
- While several submissions expressed support for introducing a principles-based definition of fundraising activities that are input taxed, and introducing an opt-in arrangement for non-commercial supplies, on balance there is not a compelling case for change to these arrangements.
- There are different thresholds for GST-free supplies of residential accommodation (to be less than 75 per cent of the market price), and the rent requirement under the National Rental Affordability Scheme (NRAS; to be set at a rate that is less than 80 per cent of the prevailing market rate). This discrepancy may not be consistent with desired policy outcomes.
- Consultations highlighted a number of proposals that reduce the cost of the existing GST arrangements for the NFP sector. However, these proposals would also reduce GST revenue and are unlikely to receive the support of State and Territory governments.

Recommendations – Goods and Service Tax

Recommendation 18: Improve ATO guidance on GST and fundraising

The Commissioner of Taxation should consider improving ATO guidance on GST issues relating to fundraising.

Recommendation 19: Review interaction of GST and NRAS

The Government should consider whether the difference between the GST threshold of 75 per cent for GST-free supplies of residential accommodation and the 80 per cent threshold for affordable housing under the NRAS (the requirement for rent to be set at a rate that is at least 20 per cent below prevailing market rates) is consistent with the desired policy outcomes.

Mutuality, Clubs and Societies

Summary

- The mutuality principle has developed in an ad hoc manner in the common law since the late 1800s, when mutual organisations provided sickness and death insurance to their members, out of member contributions.
- Various member organisations such as clubs and societies, co-operatives, professional associations, and strata title bodies corporate, utilise the mutuality principle to some degree. However, the mutuality principle has been repealed or limited by the tax statute for various entities such as mutual insurance associations and trading cooperatives.
- As a matter of fundamental principle, tax exemption of income should apply only for organisations that are both NFP and for the public benefit. Many, but not all, mutual organisations are exempt either as charities, or tax-exempt NFP clubs or associations, under Division 50 of the ITAA 1997.
- The mutuality principle has become out-dated and its current application is not consistent with the fundamental principles of being NFP and for the public benefit. More specific concerns about the mutuality principle include:
  - integrity concerns about member and non-member receipts;
  - competitive neutrality concerns where mutual organisations are trading in competition with taxable businesses;
  - social policy concerns about significant gambling and hospitality receipts of some organisations, which are not subject to income tax at the Commonwealth level; and
  - concerns about private member benefit.
- It is recommended, on public benefit grounds, that the tax law should be amended to treat all member and non-member income of mutual organisations as assessable for taxation purposes in line with normal income tax principles.
- If this recommendation is not supported, all income from gaming, catering, entertainment and hospitality trading activities of mutual organisations should be treated as assessable.
- The majority of smaller mutual organisations that qualify as NFPs would not be adversely affected by the proposed tax changes, as they would either be tax exempt under Division 50 or would benefit from the higher tax-free threshold for NFP entities proposed in Recommendation 2 of this Report.

Recommendations – Mutuality, Clubs and Societies

Recommendation 20: Normal income tax rules should apply to all member and non-member receipts of mutual organisations

Normal income tax rules should apply to all receipts of mutual organisations, whether from members or non-members, as a matter of principle to be legislated in the ITAA 1997. As a result, the income of mutual organisations (including member receipts) would give rise to assessable income in the normal way and they would be able to claim appropriate deductions incurred in gaining that assessable income. This would enhance the efficiency, simplicity and equity of the tax law and would be consistent with fundamental principles.

The Government should review whether it would be appropriate to enact specific legislative rules that limit taxation of any particular types of mutual organisation or types of member income, so as to avoid unintended or undesirable consequences and undue compliance costs.

Recommendation 21: All gaming, catering, entertainment and hospitality receipts of mutual organisations be subject to normal income tax rules

If Recommendation 20 is not supported, all gaming, catering, entertainment and hospitality receipts of mutual organisations, whether member or non-member receipts, should be treated as assessable income. Mutual organisations that have such receipts would be able to deduct appropriate expenses under normal income tax rules.

Consolidating the benefits of reform

Summary

- The NFP sector and State and Territory governments should be consulted on the implementation of the Working Group's recommendations.
- Any net budget savings from the proposed reforms should be returned to the NFP sector.
- There is a need for an ongoing examination of anomalies, minor policy issues, and technical issues in respect of tax concessions for the NFP sector.

Recommendations – Consolidating the benefits of reform

Recommendation 22: Returning reform savings to the NFP sector

Any net savings arising from implementation of recommendations in this Report should be applied to the NFP tax concession envelope of support and returned to the NFP sector.

Recommendation 23: Forum for ongoing examination of NFP tax anomalies and minor policy and technical issues

The Commissioner of Taxation should:

1. consider broadening the role of the Charities Consultative Committee and the Clubs Consultative Forum to include:

    a. an ongoing examination of anomalies, minor policy issues, and technical issues in respect of tax concessions for the NFP sector; and

    b. recommendation on administrative or legislative changes to the Government as appropriate; and

2. continue liaison in relation to NFP sector issues with the ACNC and other regulators.

Chapter 1: Income Tax

Summary

- Income tax exempt status allows eligible NFP entities to use more of their income for carrying out their purposes. This exemption should reflect the value the community places on these purposes.
- There appears to be no clear principle underlying eligibility for tax exempt status. The Working Group considers that the principle of public benefit should be the most useful general guide for determining eligibility for tax exempt status.
- The $416 income threshold for taxable NFPs to be required to submit a tax return is too low. Introducing a tax free threshold at a suitable level would benefit NFPs that are not income tax exempt.
- Access to refunds of franking credits by endorsed tax concession charities and income tax exempt DGRs should continue.
- As a matter of principle, all NFPs seeking an income tax exemption should be endorsed by the Australian Taxation Office (ATO). While this would initially increase compliance costs for affected NFPs, it would help ensure that all NFPs that claim an income tax exemption are eligible to receive this concession.
- To correct an anomaly, income tax exempt status should be extended to funds that both provide money, property or benefits to income tax exempt deductible gift recipients, whether or not charities, and have other charitable purposes.

Introduction

The Government provides an exemption from income tax for various NFP entities.[6] In the absence of an exemption, charities and other NFPs would be subject to tax on their incomes. This would include income from businesses, income from investments (for example, rent, interest and dividends) and capital gains, but usually not gifts.

The income tax exemption is typically provided to charities and other entities that undertake purposes that are broadly beneficial to the community. Charities are NFPs that have a sole purpose that is charitable, for example:

- the relief of poverty or sickness or the needs of the aged;
- the advancement of religion;
- the advancement of education;
- the provision of child care services; or

6 See, generally, Division 50 of the *Income Tax Assessment Act* (ITAA 1997).

- other purposes beneficial to the community.[7]

Other types of entities that are exempt from income tax include:

- organisations established for community service purposes (other than political lobbying);
- employee associations, employer associations and trade unions;
- government bodies;
- public hospitals, hospitals operated by a NFP society or association, NFP private health insurers and collecting institutions (for example, public museums);
- resource development organisations;
- scientific organisations;
- animal racing, art, games, sport, literature, and music organisations;
- some State and Territory bodies; and
- Commonwealth statutory bodies exempted from tax under their own Act.

The Commissioner of Taxation can require an exempt NFP entity to lodge a tax return, but generally does not do so. Australian resident NFP companies that are not tax exempt are required to lodge an income tax return if they have taxable income that exceeds $416.

The total value of income tax concessions to the NFP sector cannot be reliably estimated, but is likely to be significant. The income tax exemption for charitable, religious, scientific and community service entities is likely to be the largest, followed by income tax exemption for industry-specific NFPs that promote the development of Australian resources and organisations for the encouragement of sport or culture.[8]

Certain income tax exempt entities may also benefit from a refund of franking credits on dividends from Australian companies.

Reform Options

The Discussion Paper considered the following reform options in relation to income tax concessions:

- reviewing eligibility for exemption from income tax;
- reviewing eligibility for refunds of franking credits;
- extending the ATO endorsement framework;
- rewriting and consolidating rules for State, Territory, and local government bodies; and
- increasing the tax free threshold for taxable NFPs.

7 It is proposed that a definition of charity for Commonwealth purposes be enacted. An exposure draft of the Charities Bill 2013 was released in April 2013.
8 Treasury, *Tax Expenditures Statement 2012* (2013), Items B63, B68, B69, B70 – see Appendix 2. These concessions are stated to be unquantifiable in the Tax Expenditures Statement.

Discussion and Findings

The reform options outlined in the Discussion Paper posed the question as to who should be eligible to access income tax exemptions, whether the current categories in Division 50 of the ITAA 1997 are appropriate, and who should be eligible for refunds of franking credits.

Income tax exemption and the refund of franking credits both allow eligible entities to use more income for carrying out their purposes. To the extent that this is revenue foregone, the exemptions should reflect the value that the community places on the activities of, and services provided by, these entities.

Eligibility for income tax exemptions

Division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997) lists about 21 categories that are currently eligible for income tax exempt status, many of which also have special conditions attached. However, there appears to be no clear principle underlying eligibility for the exemption.

One category is that of a registered charity, that is, a charity registered with the ACNC as having solely charitable purposes.[9] However, other entities that fall within a category of Division 50 would not qualify as charities, in some cases because they are controlled by government (for example, government public hospitals). Others could not be considered as charities because their activities fall outside the accepted charitable purposes (for example, an organisation established to encourage animal racing or sport).

Many submissions argued that the current income tax exempt categories are appropriate, but suggested that the existing categories could be revised.[10]

A few submissions suggested that a public benefit test should determine the tax exempt status of an entity.[11] Other submissions were of the view that any charity registered with the ACNC should receive an income tax exemption, without further tests or conditions being applied, and that all entities should have to satisfy the same conditions.[12]

In essence, the exemption is provided to organisations that are NFP and provide a significant public benefit to the community. However, the Working Group considers that there is a lack of clarity as to what organisations and activities are considered to be sufficiently for the public benefit, and that the existing income tax exemption categories should reviewed and consolidated. The nature of this recommendation — with outcomes subject to further review findings — is such that a reliable budget impact estimate cannot be provided.

9 The Government has proposed that a statutory definition of charity be enacted, which would establish criteria in legislation for the ACNC to determine whether an entity is charitable. An exposure draft of the Charities Bill 2013 was released in April 2013.

10 For example, Chartered Secretaries Australia, Community Business Bureau, Community Sector Banking, Crowe Horwath, Housing Industry Association, James Brown Memorial Trust, King and Wood Mallesons, Moore Stephens, Not for profit Accounting Specialists, Ports Australia, Variety Australia, Vision Australia.

11 For example, Vision Australia, The Reach Foundation and St Vincent de Paul Society National Council.

12 For example, CPA Australia and Crowe Horwath.

Recommendation 1: Review existing categories of entities for income tax exempt status

Existing categories of entities for income tax exempt status should be reviewed and consolidated, with a view to restricting access to entities that have purposes that are of significant public benefit (as currently understood at common law). This review should take into account the proposed statutory definition of charity.

No change to refundable franking credits

Entities endorsed as tax concession charities, or that are income tax exempt DGRs, can claim a refund of franking credits on franked distributions from Australian companies. This refund was introduced in 2000, to ensure that the tax treatment of dividends in the hands of these tax exempt entities is the same as that for individuals with no income tax liability.

As the Discussion Paper noted, the cost of this concession has grown considerably in recent years. For example, the cost increased from $510 million in 2007-08 to $800 million in 2011-12.[13]

In light of the increasing cost of this concession, and the need to consider whether this concession continues to be fair, simple and effective, the Discussion Paper posed the question of who should be eligible to claim a refund of franking credits.

Most submissions supported all charities being able to obtain refundable franking credits. Some provided examples of the impact on available sources of funds if the current arrangements were limited and suggested this might impede some private ancillary funds (PAFs) and public ancillary funds (PuAFs) in meeting their minimum distribution requirements.[14]

On the other hand, a few submissions expressed concern that access to refundable franking credits may have unintended consequences for smaller entities, arguing that such organisations generally do not have the skills or resources to undertake or effectively monitor share investments.[15] These submissions argued that the tax system should not be used to encourage NFPs to invest in securities given they are often using donated monies and, accordingly, limits on franking credit refunds would help discourage risky investments.

It is clear from the strong response to this issue that access to refunds of franking credits by income tax exempt charities and income tax exempt DGRs is highly valued. While this concession has an increasing budgetary cost, removal of this arrangement would significantly impact on the financial position of many NFP entities.

Access to refunds of franking credits by endorsed tax concession charities and income tax exempt deductible gift recipients (DGRs) should continue. The Working Group also considers there should be no extension to the types of entities eligible to receive franking credit refunds.

13 Treasury, *Tax Expenditures Statement 2011* (2012) and Treasury, *Tax Expenditures Statement 2012* (2013) – item B71, see Appendix 2.
14 For example, Universities Australia, Philanthropy Australia and JBWere.
15 For example, Community Southwest.

Introduce a tax free threshold for taxable NFPs

Taxable NFP entities that are taken to be companies for tax purposes must lodge a tax return if their income exceeds $416.[16] This is not a tax free threshold: while no tax is applied to the first $416 of income, a rate of 44 per cent applies to income between $417 and $915, and the 30 per cent company tax rate applies when income exceeds $916.

The Discussion Paper asked whether the $416 income threshold for submitting a tax return should be raised. Only a few submissions addressed this issue. Those that did were generally in favour of increasing this amount.[17] Some suggested adjusting the amount for inflation; others suggested raising it to a specific figure, such as to $18,200 (the tax-free threshold for individuals).[18]

The current $416 threshold has not been increased since its inclusion in 1986 in the *Income Tax Rates Act 1986*. The Working Group considers that NFP entities that do not qualify for an income tax exemption should have the benefit of a higher threshold before they are obliged to lodge a tax return or pay income tax.

The Working Group considers the threshold should be increased to $10,000, and the phase-in rates should also be removed. The new $10,000 threshold should be a tax-free threshold for taxable NFP entities, so that no tax is paid on the first $10,000 of taxable income, much like the current individual tax arrangements.

This new tax-free threshold would help to reduce the compliance burden on smaller NFP entities taken to be companies for tax purposes, including smaller NFP clubs and societies that may be affected by the recommended changes to the taxation of mutual organisations in Chapter 5.

This recommendation is estimated to cost around $1 million per annum.

Recommendation 2: Raise and simplify the tax threshold for taxable NFP entities

The $416 threshold for NFP entities that are not income tax exempt should be simplified to form a basic tax-free threshold, and raised to $10,000. Introducing a basic tax-free threshold would remove the current phase-in arrangements so that all eligible NFPs will not be required to pay tax on the first $10,000 of taxable income.

Extend the ATO endorsement framework

Under existing arrangements for charities, income tax exemption and certain other tax concessions (for example, FBT concessions) are available only if the Commissioner of Taxation endorses an entity as a charity.

Other types of entities, as mentioned above, can also be income tax exempt. These other entities do not need to be endorsed by the Commissioner of Taxation and can self-assess their eligibility for the exemption.

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16 A company for tax purposes includes any body corporate or unincorporated association or body of persons: section 995-1 of the ITAA 1997.

17 For example, Anglicare Australia, Community Council for Australia, Community Sector Banking, Community Southwest, CPA Australia, Moore Stephens, South Australia Council of Social Services, Surf Life Saving NSW.

18 For example, Moore Stephens, South Australia Council of Social Services, Surf Life Saving NSW and Vision Australia.

The Discussion Paper proposed that the current endorsement process for charities could be extended to all NFP entities that seek income tax exemption, FBT concessions, or GST concessions.

Submissions were generally supportive of the proposal to extend the endorsement framework and there was minimal support for continued self-assessment of exempt status by NFP organisations. Submissions suggested that extending the endorsement framework would reduce the need for NFPs to go through the more expensive ATO private rulings process,[19] and would avoid incorrect self-assessment and subsequent unexpected income tax liabilities.[20]

A number of submissions suggested that it would be appropriate for the ACNC to make that endorsement rather than the ATO. The Working Group considers that it would be premature to legislate to provide the ACNC with this role, but this should be considered if the ACNC regulatory framework is extended to NFP entities other than charities. The Government has stated that it will consider this extension after 1 July 2014.

The Working Group considers that entities that are income tax exempt or receive other tax concessions, other than registered charities and statutory bodies exempted from tax by their own Act, should be required to be endorsed. This will help ensure the integrity of the tax regime.

Approximately 125,000 NFPs are estimated to be able to self-assess as income tax exempt under current law. The Working Group recognises that extending the ATO endorsement framework to all NFPs accessing tax concessions will likely need to be undertaken in a staged approach and that the transition to an endorsement framework might increase compliance costs for some organisations. However, the endorsement process is a one-off event and once endorsed, there should be no additional compliance burden for endorsed organisations.

This recommendation is estimated to have minimal, but unquantifiable, impacts to revenue. However, it would result in ongoing administration costs for the ATO, which would be significant in the initial stages, depending on the transitional arrangements implemented.

Recommendation 3: Extend the ATO endorsement framework to all NFPs accessing tax concessions

The ATO endorsement framework that is currently applied to charities should be extended to all NFP entities accessing tax concessions, to improve the integrity of the tax concessions. In view of the administrative and compliance task in bringing a large number of entities within the endorsement framework, this should occur in stages.

Rewrite and consolidate rules for State and Territory government bodies

The Discussion Paper commented that provisions dealing with income tax exemptions for State, Territory and local government bodies in Division 1AB of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) could be simplified and consolidated into the ITAA 1997. These provisions provide that the income of some State and Territory bodies is exempt from taxation.

19 For example, Grant Thornton.
20 For example, Life Activities Clubs Victoria Inc.

While few submissions addressed this issue, the Working Group considers that there is a good case for rewriting and consolidating these rules into the ITAA 1997. Locating these rules with other provisions for income tax exemptions for NFPs would be simpler and improve understanding. This recommendation has no budget impact.

Recommendation 4: Rewrite the income tax exemption provisions for State and Territory government bodies

The income tax exemption provisions for State and Territory government bodies in Division 1AB of Part III of *Income Tax Assessment Act 1936* (ITAA 1936) should be simplified and consolidated into the ITAA 1997.

Mixed charitable/DGR funds

The Working Group has identified an anomaly in relation to charitable funds that both provide money, property or benefits to income tax exempt deductible gift recipients, whether or not charities for Commonwealth purposes,[21] and have other charitable purposes. At present, these funds cannot be income tax exempt. The Working Group considers that this anomaly should be addressed. The nature of this recommendation is such that a reliable budget impact estimate cannot be provided.

Recommendation 5: Extend the income tax exemption for mixed charitable/DGR funds

Income tax exempt status should be extended to funds that both provide money, property or benefits to income tax exempt deductible gift recipients, whether or not charities, and have other charitable purposes. This recommendation should be reviewed following the introduction of the proposed statutory definition of charity.

21 As covered by item 1 of the table in section 30-15 of ITAA 1997.

Chapter 2: Deductible gift recipients

Summary

- The deductible gift recipient (DGR) framework is intended to encourage philanthropy. However, the current system for granting DGR status is cumbersome, inequitable and anomalous. Further, the framework is not well placed to handle organisations that carry out a range of purposes that fit within a number of DGR categories. Reforming the framework would increase certainty, reduce red tape for eligible entities and should further increase philanthropy.
- DGR status should be extended to all charities, but restricted to activities that are not for the advancement of religion, charitable child care and primary and secondary education, except where this is sufficiently related to another charitable purpose.
- Except in the most exceptional circumstances, DGR status should be limited to charities and charitable-like government entities.
- In view of their uncertain impact on philanthropic giving, the Working Group is unable to support the following changes to tax incentives:
  - a tax offset for donations; or
  - a hybrid system for donations to private ancillary funds.
- Similarly, the Working Group is unable to support establishing a clearing house for donations to DGRs, on the basis that the large costs of establishing and administering the clearing house may outweigh the benefit to philanthropy.
- The Mitchell Review into *Private Sector Support for the Arts* recommended that irrevocable gifts of money or property to DGRs to take effect on a person's death should be deductible at the time of giving. The Working Group considers that there are legitimate concerns that such arrangements will present significant and unavoidable integrity risks to the taxation system. Testamentary gifts of property are currently exempt from CGT when the gift takes effect. The Working Group considers the existing testamentary gift concessions are appropriate.
- Following the establishment of the ACNC, there is less need for the integrity measures provided by the public fund requirements.
- The current minimum of $2 for deductible gifts is an anachronism and could be removed with few consequences.
- The Working Group considers administrative mechanisms to further promote giving should be developed, including simplifying processes for regular workplace giving for employees of organisations of all sizes.

Introduction

The provision of DGR status under Division 30 of the ITAA 1997 is the primary tax concession that promotes philanthropic giving to eligible entities. That status generally enables taxpayers to claim an income tax deduction for cash gifts made to such entities of $2 or more, or property gifts valued by the ATO at more than $5,000.[22]

The tax deductibility of gifts in Australia at the Commonwealth level was introduced in the *Income Tax Assessment Act 1915*. However, the ad hoc expansion of categories and other changes to the gift deduction arrangements over the past century have created a system which is complex, inequitable and anomalous and has not kept pace with changing community views.

DGR status can be provided by endorsement under a general category or specific listing. Division 30 of the ITAA 1997 sets out 50 general DGR categories. The most significant single entity type is 'public benevolent institutions' (PBIs) under the welfare and rights category.[23] Other general categories include health, education, research and environment and cultural organisations and international affairs.

Not all charities are currently able to be endorsed as a DGR. Approximately half of all registered Australian charities, about 29,046 entities,[24] currently have DGR status.

To become endorsed as a DGR an entity must apply for endorsement and comply with any relevant conditions. There are also around 200 entities that are specifically listed in the ITAA 1997 as DGRs as a result of approval by Parliament. In addition, organisations may be listed on one of the four DGR registers.[25] The process for requesting specific listing or for entry onto one of the DGR registers is typically time consuming and resource intensive.

In 2010-11 around 4.8 million taxpayers claimed a deduction for gifts to DGRs, and donated around $2.1 billion.[26] The gift deduction concession was estimated to cost government around $1 billion in the 2011-12 financial year and is estimated to cost approximately $1.1 billion in the 2012-13 financial year, with the deduction for gifts to private ancillary funds (PAFs) and public ancillary funds (PuAFs) costing another $135 million.[27]

Reform Options

The Discussion Paper considered the following reform options:

- extending DGR status to all charities;
- extending DGR status to most charities;
- establishing endorsement conditions relating to the scope of charitable activities;

22 Section 30-15, ITAA 1997.
23 To date, the term PBI has been interpreted strictly by the Courts so that a PBI must provide services directly for the relief of needs that require benevolence.
24 Australian Taxation Office, *Taxation Statistics 2010-11* (2013).
25 The four DGR registers are: the Register of Environmental Organisations, the Register of Harm Prevention Charities, the Register of Cultural Organisations, and the Overseas Aid Gift Deductibility Scheme. Ministerial approval is required for entities to be entered on one of these registers before they can be endorsed as a DGR by the Commissioner of Taxation.
26 Australian Taxation Office, *Taxation Statistics 2010-11* (2013).
27 Treasury, *Tax Expenditures Statement 2012* (2013), Items A64 and A65 – see Appendix 2.

- implementing a tax offset mechanism for gifts;
- allowing a hybrid system for donations to private ancillary funds;
- providing tax incentives to encourage testamentary giving;
- creating a clearing house for donations to DGRs;
- simplifying property donation rules and anti-avoidance rules;
- eliminating public fund requirements for charities registered by the ACNC; and
- increasing the threshold for a deductible gift from $2 to $25.

Discussion and Findings

Eligibility for DGR status

It is clear that participants in the NFP sector, and the broader public, see the DGR framework as a crucial support for philanthropic giving in Australia. DGR status is highly valued and the gift deduction is seen as a significant concession which provides an incentive for donors to give. The submissions on the DGR framework in the Discussion Paper were numerous and often detailed, demonstrating the level of interest in the community in the way the tax system encourages and supports philanthropic activity in our society. The Working Group supports the continuation of the DGR framework as the primary way to encourage philanthropy.

However, overall the Working Group found that the DGR framework requires reform. The framework has developed in an ad hoc fashion over time. There is no clear policy rationale for why some entities have been provided DGR status and others have not. The arbitrary nature of the categories leads to inequities and anomalies, with some entities being granted DGR status while similar entities or entities which provide significant public benefits have not.

Further, the DGR framework is not sufficiently flexible to reflect the way many community organisations currently work. For instance, because endorsement is entity based, an entity engaged in activities across more than one general DGR category may have to restrict its purposes and activities to fit with one general category, or set up other funds, authorities or institutions to carry on activities that fall within other categories. This adds complexity for entities that have multiple purposes that would otherwise satisfy DGR categories, such as some Indigenous charities.

The specific listing of entities by name also creates a two-tier system, suggesting that some entities are more deserving of assistance than others.

Reforming eligibility for DGR status by reference to clear criteria would increase certainty and reduce red tape for eligible entities.

The Discussion Paper raised the options of extending DGR status to: all charities; most charities (that is, excluding charities that advance religion or undertake charitable child care services or provide primary and secondary education); or retaining DGR endorsement at the entity level, but with endorsement conditions established to limit the scope of activities for which an entity can use its DGR funds.

Views in the submissions about extending DGR to all charities varied significantly. Most supported an extension to all charities. Some were concerned that an expansion would spread the donations more widely and limit funds to existing DGRs.[28] There was some opposition to extending DGR status to religious or sporting entities.[29] Some submissions said that activity based endorsement would be difficult to administer, and DGR endorsement at the entity level with restrictions on activity would be more appropriate.[30]

It is the view of the Working Group that DGR status should be provided to all charities that are registered with the ACNC, [31] subject to endorsement restrictions that limit the eligible activities for use of DGR funds. Charities whose purposes are principally for the advancement of religion, or the advancement of education through child care or primary and secondary education, would be permitted to be endorsed as DGRs provided that DGR funds are applied to activities which are for other charitable purposes (such as the relief of poverty) and not for activities solely for the advancement of religion, or the advancement of education through childcare or primary and secondary education. The same restrictions would also apply to any income derived from investment of these tax deductible donations. The DGR funds and associated income could, however, be applied by those charities to other activities that have a charitable purpose, such as health promotion activities. In addition, DGR status for school building or library funds, and scholarship funds, should not be affected.

The Working Group has decided not to recommend an unlimited extension of DGR status to all charities and instead to make this more limited recommendation for both principled and fiscal reasons. The Working Group notes that DGR status for gifts is an additional concession, over and above the basic tax exemption that recognises the public benefit provided by charities.

In the case of charities for the advancement of religion, it is the view of the Working Group that given the pluralist nature of our society, additional support through deductible donations is not warranted.

As a result of the private benefits provided by charities for the advancement of education through childcare or primary or secondary education, the unlimited extension of DGR status to all donations to these charities would generate significant integrity issues. For example, it would be difficult to distinguish between the payment of fees and voluntary donations.

The Working Group notes that the Gonski Report in 2011 recommended the creation of a national fund with DGR status to provide national leadership in philanthropy in schooling, and to support schools in need of assistance to develop philanthropic partnerships, rather than extending DGR status to schools.[32] The Government is continuing its consideration of this issue but has not yet issued a final response.

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28 For example, Community Employers WA, Philanthropy Australia, PowerHousing Australia, Rural Housing Network Limited, Southern Junction Community Services.

29 For example, Cancer Council SA, CoHousing Cooperative, Ku-Ring-Gai Neighbourhood Centre Inc., Vision Australia.

30 For example, Association of Australian Medical Research Institutes (AAMRI), Mission Australia, The Reach Foundation and WWF – Australia.

31 As noted in Chapter 1, the Government has proposed that a statutory definition of charity be enacted, which would establish criteria in legislation for the ACNC to determine whether an entity is charitable.

32 D Gonski, K Boston, K Greiner, C Lawrence, B Scales, and P Tannock, *Review of funding for schooling – Final Report* (2011).

In addition, Treasury has estimated that unlimited DGR status for entities established for the advancement of religion, or the advancement of education through child care and primary and secondary education would have an estimated fiscal cost of over $1 billion per annum. In the current fiscal environment this cost is high and would need to be offset from savings in (that is, reduction or removal of) existing NFP sector concessions. In contrast, the Working Group's recommendation is estimated to cost approximately $120 million per annum.

Making charitable status the basis for gift deductibility will ensure that entities make the case that they are pursuing charitable purposes and providing public benefits. The Working Group considers that this reform would remove the need for DGR specific listings in Division 30 of the ITAA 1997 except in exceptional circumstances, as generally entities currently specifically listed are also registered as a charity with the ACNC or would be eligible to become registered.

The Working Group also considers that DGR status should be provided to charity-like government entities, such as public museums and art galleries, which would not be charitable at common law because they are effectively government controlled.

These reforms would extend the DGR framework to a greater number of entities and simplify the framework for the majority of charities. Some complexity will remain for organisations subject to the restriction on use of DGR funds. However, the Working Group has concluded that this restriction is necessary to protect the integrity of the tax system and that such entities will be no worse off under the proposed arrangements than at present.

Recommendation 6: Extend DGR status

1. DGR status should be extended to all charities that are registered with the ACNC, but use of tax deductible donations should be restricted to purposes and activities that are not solely for the advancement of religion, or the advancement of education through child care and primary and secondary education, except where the activity is sufficiently related to advancing another charitable purpose.

2. The restrictions noted above should also apply to any income derived from investment of DGR funds.

3. This extension should occur in stages, and preferably not until the proposed statutory definition of a charity has been legislated.

4. There should be a separate DGR category for entities that would be charities but for their connection with government (such as public museums and art galleries), subject to the same activity restrictions as charities.

5. Entities that are currently specifically listed, or endorsed under existing DGR categories, should generally be required to seek registration as a charity to retain their DGR status. It is expected that the majority of current specifically listed or endorsed entities would fit within the proposed framework.

6. There should be a review of entities that are DGRs, but fall outside the accepted charitable purposes framework, to determine whether they still merit DGR status. This review would include:

    a. entities that are currently specifically listed as DGRs in Division 30 of the ITAA 1997 that will not qualify to be registered as charities; and

    b. DGR general categories that fall outside of existing charitable purposes.

No tax offset mechanism for gifts

While the current deduction mechanism for donations to DGR entities is simple, transparent and effective, it is also regressive. The DGR framework provides a greater relative benefit to higher income earners, as it allows taxpayers to claim a tax deduction for gifts to DGRs at their marginal tax rate. Lower income individuals receive less relative benefit, and individuals with no tax liability would not receive a tax benefit from donations to DGRs.

The Discussion Paper included an option for a tax offset mechanism that would provide a tax incentive for donations by lower income earners. A similar system has been in place in Canada since 1988, where the first $200 of donations is offset at the same percentage as the lowest marginal income tax rate, and donations in excess of $200 receive a tax offset at the highest marginal tax rate.

Such a mechanism would allow taxpayers to reduce their tax liability by a fixed percentage of their donations to DGR entities. It would be simple, produce minor administrative costs for the Government and taxpayers, and be a more equitable mechanism to encourage donations to DGRs.

Most submissions that responded to this option opposed it,[33] citing that it would be too complex and confusing for donors, and would reduce donations from higher income earners, and donations overall. Some submissions also noted that an offset may result in increased complexity for employers administering workplace giving programs, and deter people from participating in such programs.[34]

In view of the uncertain impact on philanthropic giving, the Working Group has decided not to recommend a tax offset system to replace the current gift deduction.

No hybrid system for donations to private ancillary funds

The Discussion Paper also noted the possibility of a hybrid offset system, which is related to the proposal for a tax offset mechanism. The option proposed that donations to PAFs, which are privately controlled DGR funds established for the sole purpose of distributing funds to other DGRs, could attract a deduction under the current mechanism, and donations made directly to DGRs could be offset under either a single or multiple tax offset system.

Some submissions noted that this proposal could have unintended consequences, resulting in donations being skewed towards PAFs and PuAFs, and away from other DGR organisations.[35]

As the Working Group has found that a tax offset system is not a viable reform option for the DGR framework, the proposal for a hybrid offset mechanism is also not recommended.

No reform to tax incentives for testamentary giving

The Discussion Paper considered the possibility of additional tax incentives to encourage testamentary giving. The Mitchell Review[36] recommended that the Government introduce measures to enable private donors to make testamentary gifts to DGR arts organisations and receive an immediate tax deduction equal to the present value of the gift. It was proposed that the deduction would be allowed at the time the gift was included in the donor's will rather than at the time of death.

The current law provides a tax deduction for gifts of cash or property made during the donor's lifetime but provides that a testamentary gift is not tax-deductible.[37] However, testamentary gifts of property are currently exempt from capital gains tax (CGT) when the gift to the DGR takes effect; that is, after the death of the donor.[38]

A number of submissions supported the extension of concessions, in particular a deduction for testamentary gifts to DGR organisations.[39] Submissions also indicated that both the current and proposed reform arrangements are complex.[40] A few submissions highlighted

33 For example, Anglican Retirement Villages, BDO, Cancer Council Australia, Centre for Appropriate Technology, Crowe Horwath, James Brown Memorial Trust, Lord Mayor's Charitable Foundation and The Reach Foundation.
34 For example, The Australian Charities Fund, Cancer Council SA, CPA Australia.
35 For example, Australian Communities Foundation and Changemakers Australia.
36 H Mitchell, *Building Support: Report of the Review of Private Sector Support for the Arts* (March 2012)
37 Section 30-15(2) of ITAA 1997.
38 A capital gain on a gift of property to a DGR organisation will not be subject to tax for the testator, the legal personal representative or beneficiaries of a deceased estate (s 118-60(1), (1A) and (2) of ITAA 1997).
39 For example, Cancer Council SA, Centre for Appropriate Technology and National Heart Foundation of Australia.
40 For example, James Brown Memorial Trust.

the risk of the benefit being provided to the individual before the public benefit has been realised, and the complexity and issue of avoidance involved in such arrangements.[41]

The option of a deduction during a testator's lifetime in respect of a gift of property to a DGR organisation raises concerns of equity, complexity, and integrity risk.

1. An immediate deduction for the full value of donated property, or a deduction spread over a set period of years, while the taxpayer retains ownership and control (and enjoyment) out of it, would give rise to a significant revenue cost.

2. The ability to retain ownership and control is not available to current donors under Division 30.

3. If the donation was to be spread over time until the date of death, this would require significant administrative resources including potential amendments to the testator's tax returns for a period of years. There are also integrity concerns as the testator would continue having the use and control of the property and may decide to revoke the gift or may lose title to the property as a result of a dispute or bankruptcy.

4. An immediate deduction for the full value of donated property would require valuation of the property at the time of donation; however, value may then fluctuate dramatically over time. Variations would either require amendments to the tax return deductible amounts in each year, or would provide either an over or under-statement of the appropriate deduction, depending on how the property was initially valued. There is a real possibility that the DGR would receive something less than the original value on the death of the donor.

It is the Working Group's view that existing taxation arrangements for testamentary giving which provide an exemption for gifts to DGRs on death are appropriate. Any additional support or new arrangements, such as that proposed in the Mitchell Review, would present significant integrity risks to the taxation system, particularly where the donor receives a tax benefit before the public benefit of the gift has been realised.

No clearing house for donations to DGRs

The Discussion Paper raised the option of establishing a central clearing house for gifts to DGR entities, with a view to promoting and encouraging charitable giving. Under this proposal, taxpayers could use an online register to search for particular types of DGR to support, and donate to these DGRs through the clearing house website. The Discussion Paper suggested that the clearing house could be linked with the register of charities maintained by the ACNC (the ACNC register). The intent of the proposal was to provide a facilitative website, in addition to those that already exist.

41 For example, the Public Trustee of Queensland and the Association of Australian Medical Research Institutes.

The majority of submissions opposed the idea of a clearing house. Many were concerned that a central clearing house would be the only donation point, rather than a supplementary facilitative site.[42] Some saw benefits in a clearing house concept, but wanted more information.[43]

There was concern at the estimated capital cost of $25 million for the clearing house, and questions over how it would be paid for, particularly given the Terms of Reference of the Working Group that require offsetting savings to be identified for any proposals that have a budget cost.

Privacy issues were also a concern, with some noting that a clearing house would likely collate sensitive information (such as personal details of donors and banking details) and that it would be important that safeguards were implemented to ensure that the information collected was kept confidential.[44]

A few submissions questioned how it would look for donors to be 'giving' money to the government to be distributed to the chosen charity.[45] Others, expressed concerns about how a clearing house would affect the relationship that organisations develop with donors, particularly as these relationships are very important in soliciting donations.[46]

For those submissions that supported the notion of a clearing house, it was noted that it would give smaller charities an online fundraising presence that they currently do not have, and help them avoid the administrative issues that arise with fundraising.[47]

Given the estimated cost, the lack of sector support for this particular proposal, and the fact that websites currently exist that aim to provide similar services, the Working Group does not consider that at this point in time a clearing house for DGRs is necessary or desirable.

Simplify the property donation rules

The Discussion Paper noted that the current property donation rules are complex and may be confusing for those seeking to use them. There is confusion over the types of property that can be donated on a tax deductible basis and donors face unnecessary costs from the valuation techniques required to obtain a tax deductible value for specific property types. The current rules require that donated property be valued by the Australian Valuation Office, part of the ATO. Different rules apply to trading stock, shares listed on the Australian Securities Exchange (ASX) and other types of property held for different periods of time by the donor.

42 For example, Anglican Retirement Villages, Australia Council for the Arts, Australian Conservation Foundation, Community Business Bureau, ECH/Resthaven/Eldercare and Fundraising Institute Australia.
43 For example, Centre for Appropriate Technology, Changemakers Australia, Good Beginnings Australia, Lord Mayor's Charitable Foundation and Mission Australia.
44 For example, Community Employers WA and South Australia Council of Social Services.
45 For example, Not-for-profit Accounting Specialists.
46 For example, RSPCA Australia, the Royal Flying Doctors Service and Australian Conservation Foundation.
47 For example, PriceWaterhouse Coopers and Changemakers Australia.

While very few submissions addressed this issue, those that did said that the current valuation requirements restrict donations of property.[48] Some submissions made suggestions about how to reduce the complexity of current requirements, including self-assessment and using the closing price for donated shares.[49]

Clarifying the property donation rules would help minimise costs faced by donors when gifting property to DGRs whilst maintaining adequate safeguards to protect the integrity of Australia's taxation system. Improvements would ensure that Australia's property donation rules are adequately meeting the needs of DGRs.

The view of the Working Group is that while the current rules are complex, self-assessment of the value of donated property would raise integrity concerns. However, the categories of eligible property and the valuation rules applying to such property could benefit from review and simplification. The nature of this recommendation — with outcomes subject to further review findings — is such that a reliable budget impact estimate cannot be provided.

Recommendation 7: Simplify the property donation rules

The Government should review the property donation rules, to simplify their operation.

Remove public fund requirements for charities registered by the ACNC

Currently it is a requirement that some types of DGRs be established as, or operate, a public fund.[50] The requirement to be or to have a public fund is in part intended to ensure that moneys and property donated to the fund, which attract a tax concession, are used for the purpose for which the fund has been granted DGR status. Ensuring DGR entities operate under appropriate frameworks and use funds in line with the purposes for which they were donated also helps to promote and encourage charitable giving. The public fund requirement has played an important role in ensuring the responsible operation of the entity and management of expenditure of monies which have been donated by the public.

One submission noted that the requirements were not particularly onerous.[51] However, most submissions favoured eliminating the public fund requirements for those charities registered with the ACNC, suggesting it would help to reduce red tape.[52]

The Working Group has found that there is less need for the integrity measures that are provided by the public fund requirements following the establishment of the ACNC. Charities that wish to access tax concessions will be required to register with the ACNC and meet appropriate governance and financial reporting standards, helping ensure that donated funds are used for their stated purpose. The Working Group recommends removal of the public fund requirement for charities registered with the ACNC. This recommendation is estimated to have no budget impact.

48 For example, Beehive Industries of WA, Centre for Appropriate Technology, Community Council for Australia, Diabetes Queensland, and King and Wood Mallesons.

49 For example, King & Wood Mallesons and Philanthropy Australia.

50 An explanation of the public fund requirements is contained in *Taxation Ruling TR 95/27 Income Tax: public funds*.

51 Vision Australia.

52 For example, Australian Catholic Bishops Conference, Catholic Health Australia, Community Council for Australia, South Pacific Division of the Seventh-day Adventist Church and South Australian Council of Social Services.

Recommendation 8: Remove the public fund requirements

The existing public fund requirements should be removed for charities registered with the ACNC.

Remove threshold for deductible gifts

The Discussion Paper raised the option of increasing the threshold for deductible gifts to DGRs from $2 to $25. The Discussion Paper suggested that a higher threshold could reduce the compliance burden currently associated with providing receipts for donations of $2 or more.

Several submissions expressed concerns about increasing the threshold. Submissions raised concerns that a high threshold would result in a disincentive to donors and might impact on workplace giving arrangements, because individual donations are typically small.[53] One submission argued against the increase in the threshold for this reason, but suggested that if it were to be increased that the individual receipt requirements be varied to address this, so that the threshold could be applied on an annual basis, rather than per donation.[54]

In its deliberations the Working Group explored the idea of removing the threshold completely. In considering the threshold, the Working Group found that $2 minimum donation threshold, which dates back to 1927, is clearly out-dated. An equivalent amount in today's terms would be approximately $72.

The Working Group considered whether removal of the minimum amount would impact on the administration of DGRs based on an increased demand for receipts. There is no taxation requirement for a DGR to provide a receipt although this is normally done to enable the donor to establish that the gift has been made. Gifts made to street collectors are usually not receipted. No other jurisdiction appears to impose a minimum although several impose maximum contribution limits.

For reasons of simplicity, the Working Group considers that the $2 minimum donation threshold should be removed. The Working Group recognises that this may result in initial transition costs for some DGRs but expects that it in the longer term it will simplify administration of donations. The budget impact of this proposal is unquantifiable, but expected to be minimal.

53 For example, Fundraising Institute Australia and Variety Australia.
54 The Smith Family.

Recommendation 9: Remove the minimum gift deduction threshold

The $2 threshold for deductible gifts should be removed.

Other areas for reform

Workplace giving

There was wide support in the submissions for mechanisms that would encourage workplace giving.[55]

Some of the barriers to workplace giving were identified in The Giving Business (2009) and Cutting to the Heart of Workplace Giving (2009) reports. They include:

1. limited awareness of workplace giving;
2. perceived complexity;
3. limited time and resources; and
4. lack of visible support from senior management for workplace giving, being important for the success of any workplace giving program.

Some submissions argued that payroll administration costs present a barrier to workplace giving.[56]

The Working Group has found that there is scope to provide better support for workplace giving. The Working Group considers mechanisms to further promote giving should be developed, including simplifying processes for regular workplace giving for employees of organisations of all sizes. The nature of this recommendation — with outcomes subject to further review findings — is such that a reliable budget impact estimate cannot be provided.

Recommendation 10: Explore mechanisms to promote giving

The Government, in consultation with the NFP sector and employer and employee bodies, should explore development of mechanisms to further promote giving, including simplifying processes for regular workplace giving for employees of organisations of all sizes.

Rewrite and simplify anti-avoidance rules for gifts

The anti-avoidance rules for donations where the donor receives material benefits have the effect that donations may not be tax deductible in some situations, including where donors are likely to receive private benefits as a result of the donation. In such cases a tax deduction is not allowed.

The current specific anti-avoidance provisions are contained in section 78A of the ITAA 1936, separate from the other key provisions for philanthropic giving. Further, the language of this old provision is complex and perhaps for that reason is not often applied.

55 For example, Good Beginnings Australia, JBWere, RSPCA Australia and Surf Life Saving NSW
56 For example, Centre for Appropriate Technology, CPA Australia and Surf Life Saving NSW.

There is also a regime that deals with minor benefits provided to donors at fundraising functions.[57] These rules are also very complex and specify fixed dollar amounts which have not kept pace with inflation. Some submissions raised concerns with the minor benefits rules,[58] noting in particular that they do not provide a flexible mechanism for developing fundraising techniques. The Working Group concluded that rather than including these rules in legislation it may be more appropriate for the ATO to develop administrative guidance about permissible and impermissible contributions. The nature of this recommendation is such that a reliable budget impact estimate cannot be provided.

Recommendation 11: Modernise the anti-avoidance rules for gifts

The anti-avoidance rules for donations where the donor receives material private benefits should be rewritten in a simplified form and included in ITAA 1997. In rewriting the anti-avoidance rules (private benefit rules) regard should be had to whether the existing minor benefits rules for fundraising could be repealed and instead subject to the anti-avoidance rules, with the aim of further simplifying existing arrangements. The Commissioner of Taxation should consider developing guidelines relating to whether the benefit received by the donor is material.

57 Section 30-15, Table Items 7 and 8 of the ITAA 1997.
58 For example, Australian Major Performing Arts Group.

Chapter 3: Fringe Benefits Tax Concessions

Summary

- Fringe benefits tax (FBT) exemptions are primarily used by PBIs, health promotion charities, public and NFP hospitals, and public ambulance services, and the FBT rebate is used by other charities and certain other income tax exempt employers, to provide salary packaging benefits in order to attract and retain employees. FBT concessions are also used to compensate for funding shortfalls in the NFP sector.

- The benefit of FBT concessions is not evenly spread among NFP sector employees: only some entities are eligible for the capped FBT exemption while other entities (but not all income tax exempt entities) are eligible for the rebate. Even among eligible entities, salary packaging take-up rates vary.

- The FBT exemption caps have not been increased since they were introduced, meaning that the true value of these benefits has eroded over time.

- Given the current reliance by many organisations on FBT concessions as part of salary packaging, removing the concessions altogether without consideration of a mechanism to replace the support would have a significant impact. The Working Group proposes an alternative support payment to employers, possibly through the tax system, to replace the FBT concessions provided through salary packaging. A payment to employers would be simpler to administer than a payment to employees, would be more flexible, and would allow eligible NFPs to use it in the manner most appropriate for the organisation, such as in relation to attracting and retaining staff. The payment would be paid automatically to eligible NFPs.

- The Government should take a principled approach to determining eligibility for any payment to employers that replaces capped salary packaging FBT concessions. This would likely require a review to determine the best approach to eligibility.

- The uncapped access to meal entertainment and entertainment facility leasing benefits has raised concerns about the legitimacy of such concessions, especially since the rest of the community are not able to access such concessions or claim a deduction for such expenses. The benefit of this concession is also not evenly spread among NFP employees, tending to be more highly utilised by eligible employees on higher salaries.

- In accordance with the Terms of Reference for the review, any net savings from any recommendations adopted by the Government should be returned to the NFP sector as soon as practicable. The alternative support payment (Recommendation 12) would be a suitable mechanism for returning any net savings to the NFP sector.

Introduction

A range of NFP entities are exempt from paying tax on fringe benefits provided to employees. A range of other NFP entities are eligible for a rebate of FBT on fringe benefits provided to employees.

The FBT concessions are highly valued by NFP entities that benefit from them. However, access to FBT concessions raises significant issues of efficiency, effectiveness, equity and fairness in the context of support across the whole NFP sector.

Under the current system of capped FBT concessions, there are three tiers of benefits. Public benevolent institutions (PBIs) and health promotion charities (HPCs) are subject to a $30,000 cap per employee per year for the FBT exemption. Public and NFP hospitals and ambulance services are subject to a $17,000 cap per employee per year for the FBT exemption. In addition, certain entities that are endorsed by the ATO as income tax exempt, but not entitled to the FBT exemption, may qualify for an FBT rebate up to a $30,000 cap per employee per year.

Employers entitled to the rebate can have their liability to pay FBT reduced by a rebate equal to 48 per cent of the gross FBT payable. Entities that qualify for the rebate include religious, certain educational, charitable, or scientific institutions, trade unions and employer associations, certain community organisations, and organisations established to promote the development of certain Australian resources. A number of income tax exempt entities are not eligible for the rebate.

The rules for calculating the caps exclude various benefits, including meal entertainment and entertainment facility leasing benefits.

The total quantifiable Commonwealth tax expenditures on FBT concessions provided to the NFP sector have been estimated to be in the order of $2.7 billion per annum. The largest concession, by total revenue foregone by the Commonwealth, is the exemption for PBIs, estimated at $1.4 billion for 2012-13.[59] Another significant concession is for public and NFP hospitals and ambulance services, with an estimated cost of $1.1 billion for 2012-13.[60] Unquantifiable FBT concessions (see Appendix 2) are likely to add several hundred million dollars to this total.

Anecdotal evidence suggests that fringe benefits that are typically provided under the capped FBT exemptions include cars, mortgage repayments, rent, credit card repayments and school fees. Employees often receive a ‘salary package’ which involves a ‘salary sacrifice’ so that benefits are provided out of pre-tax income. This can result in a significant tax saving. In some cases the tax saving is split between the employer and the employee.

Salary packaging arrangements are often complicated by interactions with various other transfer payments provided by the Australian Government, such as Family Tax Benefits and parenting payments. For instance, in some cases, an employee who salary packages may have a significantly higher reportable income for the purposes of various means tested Government payments than if they had received an equivalent amount of salary.

A number of concerns about the existing system of FBT concessions were raised in the Discussion Paper. These included that the capped FBT concessions require employers and employees to enter into salary packaging arrangements to obtain the maximum benefit from the concessions, and that these arrangements impose an administrative burden on eligible entities. In addition, there are concerns that some FBT concessions are being used outside of the initial policy intent, and concerns about equality of treatment and competitive neutrality when entities with similar activities qualify, or do not qualify for concessions based on their legal status.

59 Treasury, *Tax Expenditures Statement 2012* (2013), Item D14 – see Appendix 2.
60 Treasury, *Tax Expenditures Statement 2012* (2013), Item D11 – see Appendix 2.

Reform Options

The Discussion Paper proposed the following short term reform options for consideration in relation to FBT concessions:

- revise the list of entities eligible for the exemption or rebate;
- include meal entertainment and entertainment facility leasing benefits within the relevant caps;
- require employment declarations to include information about FBT concessions to avoid employees from benefiting from multiple caps;
- align the rate for FBT rebate with the FBT rate of 46.5 per cent; and
- align the application of the minor benefit exemption with the commercial sector.

The Discussion Paper also proposed the following long term reform options for consideration:

- phase out capped FBT concessions and replace them with alternative government support;
- phase out FBT concessions and replace them with alternative tax-based support for eligible not-for-profit entities; and
- limit concessions to benefits that are incidental to employment, that is, not part of a salary packaging arrangement.

Discussion and Findings

Submissions indicated that the FBT concessions are highly valued by the NFP sector, in part to compensate for funding shortfalls and budgetary constraints. Other submissions stated that use of the concessions was critical in aiding NFP organisations to attract and retain staff by decreasing the shortfall in net pay for their employees compared to similar roles in the commercial sector.[61]

The Working Group acknowledges the value of the FBT concessions, but considers that there is significant scope for reform of FBT concessions to deliver support to eligible entities in ways that would be fairer, simpler and more effective for the sector.

Concerns with the current FBT concessions

As the Discussion Paper indicated, the current arrangements raise concerns about administrative burdens, use of concessions outside of the initial policy intent, competitive neutrality and inconsistency of treatment. These concerns set the parameters for consideration of reform options.

61 For example, Association of Australian Medical Research Institutes, Australian Catholic Bishops Conference, Australian Medical Association and Australian Salaried Medical Officers Federation, Australian Nursing Federation, Australian Red Cross Society, Catholic Health Australia, Law Council of Australia, Lifeline Australia, National Council of Ambulance Unions, PriceWaterhouse Coopers, The Smith Family.

Administrative burdens

The current system of FBT concessions imposes compliance burdens and costs on employers and employees in the NFP sector. Salary packaging firms indicated in submissions that their fees are approximately 5 per cent of the tax benefit provided to employees. Websites maintained by certain prominent salary packaging firms indicate that fees can amount to approximately $250 per year per employee. Accordingly, based on an estimate of 480,000 eligible employees, salary packaging would be expected to impose a cost in the order of $120 million per annum on the NFP sector. Whilst this ignores the fact that not all eligible employees take up salary packaging arrangements, it also ignores costs that are internal to eligible entities or imposed on employees (such as the administrative cost for an employer of running an in-house salary packaging system, or the administrative cost for employees in entering into arrangements for salary packaging and monitoring expenditure on salary packaged benefits). These funds could be more effectively deployed by the sector to provide services to the community or higher remuneration to employees.

Use of concessions outside of initial policy intent

From the time that FBT was introduced, the treatment of certain fringe benefits has been controversial.

For example, this is evidenced by the numerous issues that arise regarding how to determine when meals provided to employees should, or should not, be subject to FBT. The law in this area is now relatively well settled and improvements in technology since 1986 also mean that it has become easier to account for certain benefits provided by entities external to an employer, such as restaurant meals. One approach is for salary packaging firms to distribute credit cards to employees of exempt entities that are used for purchasing meals and for leasing entertainment facilities. Notwithstanding this, difficulties remain in relation to recording the allocation of certain meal entertainment and entertainment facility leasing benefits to employees, for example, in relation to large functions such as a Christmas party.

Competitive neutrality

The provision of a concession to certain categories of entities necessarily involves a decision about which entities should be eligible. This creates issues of competitive neutrality when organisations that are not eligible for the concessions engage in similar activities to entities that are eligible for tax concessions. Examples in relation to entities from outside the NFP sector compared to those within the sector include private for-profit hospitals that compete with NFP and public hospitals; and restaurants and bars that compete with rebateable clubs. Examples within the NFP sector include charitable institutions that only qualify for an FBT rebate, or do not qualify for any FBT concessions, competing for staff with other types of charitable institutions that qualify as PBIs and so benefit from the FBT exemption.

Inconsistency of treatment

As noted above, capped FBT exemptions currently apply to PBIs, HPCs, public and NFP hospitals, and ambulance services. A capped FBT rebate also applies to some, but not all, income tax exempt entities, such as other charities and religious entities. In addition, there are two tiers for the capped FBT exemption: a higher tier for PBIs and HPCs, and a lower tier for public and NFP hospitals and public ambulance services.

Replace FBT concessions with an alternative support payment for eligible NFPs

The current FBT concessions represent a significant contribution by government to the operation of the NFP sector, at an estimated cost of around $3 billion per annum. In addition, fees paid to salary packaging providers, and other administrative costs borne by employers are significant. Reform to deliver the value of this concession in a more effective way would allow these resources to be spent on delivering better services to the community or higher salaries for NFP sector employees.

Removal of the FBT concessions would generate a cost for eligible NFPs and would, as noted above, have a critical negative effect on the ability of these NFPs to retain staff. The Working Group considers that replacing the FBT concessions used via salary packaging arrangements with an alternative support payment paid to NFPs would reduce administrative burdens and competitive neutrality issues. As this recommendation would deliver support equivalent in value to the current cost of NFP salary packaging FBT concessions, this recommendation is expected to be budget neutral.

Delivering the support to the NFP sector

The quantum of support to be provided to eligible NFP entities by means of an alternative support payment should, at a minimum, be equivalent to the current total cost to the Commonwealth of providing capped FBT concessions under current law. The Working Group considers that the level of the alternative support payment for eligible NFP employers would be based on an amount per employee, having regard to whether employees are full-time or part-time, and whether some employees are only employed for part of a year.

This payment would not be a grant. The option of providing grants to the sector to replace FBT concessions received no support in submissions. Submissions expressed significant concerns that provision of discretionary grants would impinge upon the independence of the sector and would create uncertainty about funding and continuity for entities that currently benefit from the capped FBT concessions.[62] In view of this, the Working Group considers that eligible NFP entities should receive the payment automatically once eligibility is determined, with no need to submit a formal application. The government should determine the best means to achieve this recommendation in the context of constitutional requirements for tax and spending laws, in negotiation with the States and Territories as needed.

In relation to eligibility, the Working Group notes that there are a number of anomalies at present about who is entitled to the different FBT benefits. As noted above, the current system of capped FBT exemptions involves two levels of benefit, with PBIs and charities that promote the prevention or control of disease in human beings subject to a $30,000 cap per employee per year, and public and NFP hospitals and ambulance services subject to a $17,000 cap per employee per year. In addition, a broad range of entities are eligible for a rebate of FBT payable.

The Working Group recommends that two tiers of concession only should be retained for the alternative support payment, with a larger benefit being provided to entities that promote purposes that can be identified as ‘priority purposes’.

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62 For example, Australian Baptist Ministries, Association of Australian Medical Research Institutes, Australian Red Cross Society, CPA Australia, Lifeline Australia, Royal Flying Doctors Service, Salvation Army and The Smith Family.

The Working Group considers that there should be further consultation to determine which categories of NFPs should be eligible to access the alternative support payment; and which purposes of those NFPs should be considered priority purposes and therefore able to access the higher tier of the alternative support payment.

Such a review would provide an opportunity to develop a principled basis upon which eligibility and quantum of support could be based. A starting point for consideration of eligibility for the lower tier could be those entities that are currently income tax exempt, with particular attention given to NFP entities that provide a significant public benefit, in line with other recommendations for NFP tax concessions.

The existing capped FBT concessions have not been indexed for inflation since their introduction. This has meant that the value of the concessions to the sector has declined over time, as recognised in various submissions received.[63] To protect against erosion of the alternative support payment by inflation, it should be indexed in line with the *Consumer Price Index*.

Payment to employers

The Working Group concluded that providing the alternative support payment to eligible NFP employers, rather than directly to employees, would maximise the social good achievable by the NFP sector. This is because NFP sector employers face challenges attracting and retaining staff that vary across occupational groupings. Submissions indicated that FBT concessions are crucial to attracting and retaining staff in the NFP sector,[64] and this was a key factor in the Working Group's thinking on whether the alternative support payment should be directed to employers or employees.

Submissions also indicated that some eligible NFP entities currently retain a portion of the benefit of FBT concessions and rely on this to supplement their operating budgets. An alternative support payment for employees would be received by some employees that do not require it in order to be attracted or retained by the NFP sector. Accordingly, removing FBT concessions and replacing them with a payment directly to employees would have implications for entities that currently rely on FBT concessions to supplement operating budgets.

Providing a payment to eligible NFP entities would also provide those entities with the greatest possible autonomy. The alternative of providing support directly to employees would take the decision about which employees should be entitled to support out of the hands of eligible entities. The Working Group considers that eligible entities are in the best position to decide whether and which employees should receive support. It is expected that NFP sector employers would apply the support provided by the alternative support payment to attract and retain staff in the most effective way.

63 For example, BDO, Hospital Research Foundation, James Brown Memorial Trust, Oxfam Australia, PowerHousing Australia, PriceWaterhouse Coopers, Royal Automobile Club of Victoria and The Smith Family.

64 For example, Association of Australian Medical Research Institutes, Australian Medical Association and Australian Salaried Medical Officers Association, Australian Red Cross Society, Central Land Council, Centre for Appropriate Technology, Housing Industry Association, Law Council of Australia, Lifeline Australia and The Smith Family.

Replacement support for public hospitals and ambulance services

In relation to the NFP and public hospitals and public ambulance services, the Working Group considers that only NFP hospitals should be eligible for the alternative support payment.

The Working Group notes that public hospitals and ambulance services are likely to be controlled by government and therefore not charities at common law. The Working Group is of the view that support for these types of entities should be a matter of inter-governmental agreement.

As employees of public hospitals and ambulance services are currently eligible for a capped FBT concession of $17,000, removal of this concession will have budgetary impacts for public hospitals and ambulance services. It may also have implications for the ability of public hospitals and ambulance services to attract and retain staff. Accordingly, the Australian Government should consult with State and Territory Governments on the best mechanism to provide alternative support to government hospitals and public ambulance services.

Recommendation 12: Replace the NFP FBT concessions (only in relation to salary packaging arrangements) with an alternative support payment to eligible NFPs

1. The FBT concessions (set out below), accessed by way of salary packaging arrangements, should be replaced by an alternative support payment, with the following parameters:

   a. the payment should be provided periodically to eligible NFP employers (with employers deciding how the payment is to be applied to their purposes);

   b. the quantum of the payment should be based on an amount per employee, having regard to the basis of that employment, such as whether it is full-time or part-time and how much of a year the employee has been an employee;

   c. the payment should be indexed in line with the *Consumer Price Index*;

   d. the payment should be set at two tiers, with a higher amount set for NFPs with priority purposes; and

   e. the amount of the payment and those NFPs eligible to access it should be subject to separate consultative arrangements, which should have regard to the matters set out in (3) below.

2. The FBT concessions that should be replaced, subject to a review of valuation methodologies and compliance costs associated with removal of the relevant concessions for certain accommodation and board fringe benefits, are:

   a. exemption for benefits to employees of religious institutions (section 57);

   b. exemption for benefits provided to employees of public benevolent institutions, health promotion charities, public and NFP hospitals and public ambulance services (section 57A);

   c. exemption for live-in domestic workers for religious institutions (section 58T); and

   d. rebate for certain tax exempt NFPs (section 65J).

3. There should be further consultation to determine:

   a. which categories of NFPs should be eligible to access the alternative support payment; and

   b. which purposes of those NFPs should be considered priority purposes and therefore able to access the higher level of the alternative support payment (see (1)(e) above).

4. The new alternative support payment should be implemented within the next 2 years.

5. In lieu of an alternative support payment, the Government should consult with State and Territory governments on the best mechanism to provide alternative support to government hospitals and public ambulance services.

Include uncapped meal entertainment and entertainment facility leasing benefits in existing FBT concession caps

The Discussion Paper noted that the Productivity Commission's 2010 Report raised particular concerns about the uncapped meal entertainment and entertainment facility leasing concessions.[65] These concessions allow employees of eligible entities to spend an unlimited amount on restaurant meals and hiring of entertainment facilities from pre-tax income, thereby reducing income tax payable. The concession is also promoted to be used for holiday accommodation and cruises. Salary packaging firms offer credit cards to facilitate these activities. The Productivity Commission provided examples of how $2,200 restaurant meals and $40,000 weddings could be paid for from pre-tax income to avoid significant amounts of tax that would otherwise be payable on the relevant employee's income.[66]

The Working Group notes that several submissions supported the current uncapped meal and entertainment facility exemption.[67] However, others supported the removal of the uncapped exemption, or including these benefits within the existing exemption caps.[68] The Working Group considers that the unlimited use of these FBT concessions, and the types of examples noted above, offend the principle of fairness. The value of these concessions could be better directed to maximise the social benefit being delivered by support for the sector by way of FBT concessions.

The Working Group recommends that until Recommendation 12 is implemented, restaurant meals and entertainment facility leasing should continue to be capable of being paid for by salary sacrifice, but these items should be subject to the relevant caps for FBT concessions. The Government should make this change as soon as practicable, with any savings returned to the sector by way of a transitional payment (see Recommendation 17).

This recommendation is estimated to save, on average, around $190 million per annum.

Recommendation 13: Include uncapped meal entertainment and entertainment facility leasing benefits in existing caps

As soon as practicable and independently of the implementation of Recommendation 12, the uncapped concessions in relation to salary sacrificed meal entertainment and entertainment facility leasing fringe benefits should be removed. These benefits should be treated consistently with other fringe benefits, that is, included within existing caps.

Remove eligibility for multiple caps

FBT is levied upon employers and the relevant concessional benefit caps apply per employee for each employer. This raises the possibility of employees with multiple employers receiving the benefit of multiple caps. In an extreme case, an employee with an income of $30,000 from each of three PBI employers could pay no income tax, despite having an income well in excess of the median income.

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65 Productivity Commission, *Contribution of the Not-for-profit Sector,* p.215.

66 Ibid.

67 For example, AMA Victoria, AAMRI, Australian Nursing Federation, Australian Red Cross, Cancer Council SA, Community Employers WA, CPA Australia, Deaf Society of NSW, NSW Health, Price Waterhouse Coopers, RACV Vitoria, Royal Guide Dogs Tasmania, Sids and Kids ACT, Victorian Healthcare Association.

68 For example, ACFID, Business SA, Catholic Health Australia, Community Business Bureau, Community Council for Australia, Community Sector Banking, Law Council of Australia, Not-for-profit Accounting Specialists, WWF Australia.

Several submissions supported introducing a limit of one FBT cap per employee for an income year.[69] To avoid potential misuse of the current system of capped FBT concessions, the Working Group recommends that the Government should, as soon as practicable, introduce a mechanism to provide that a capped concession is only available in respect of an employee to the extent the employee has not received the benefit of the cap from another eligible employer within the relevant FBT year.

This recommendation is estimated to save, on average, around $30 million per annum.

Recommendation 14: Remove eligibility for multiple caps

As soon as practicable and independently of the implementation of Recommendation 12, a mechanism should be introduced to ensure the capped FBT exemption for benefits provided to employees of PBIs, health promotion charities, public and NFP hospitals and public ambulance services, and the rebate provided to certain NFP employers, is only available in respect of an employee to the extent the employee has not received the benefit of the cap from another eligible employer within an FBT year.

Align FBT rebate rate with the FBT tax rate

The FBT tax rate is currently 46.5 per cent, which is the sum of the top marginal tax rate plus the Medicare levy.[70] The FBT rebate rate was not realigned with the FBT tax rate when the top marginal tax rate was reduced in the 2005-06 Budget. This appears to have been an oversight, and eligible entities are currently overcompensated by an FBT rebate rate of 48 per cent. There is no policy rationale for continuing to overcompensate with an FBT rebate rate that is higher than the FBT rate. The majority of submissions commenting on this proposal were supportive of the alignment.[71]

Accordingly, the Working Group recommends that the FBT rebate rate and the FBT tax rate are realigned. This recommendation is estimated to save around $3 million per annum.

Recommendation 15: Align FBT rebate rate with the FBT tax rate

As soon as practicable and independently of the implementation of Recommendation 12, the rate for the FBT rebate should be re-aligned with the FBT tax rate.

Align the minor benefits exemption with the commercial sector

Employers in the commercial sector are eligible for an exemption from FBT for benefits of up to $300 provided to employees infrequently. This allows employers to provide minor benefits exempt from FBT, such as a Christmas party or gift of flowers upon the birth of a child. Income tax exempt organisations cannot currently access this exemption in respect of

69 For example, Australian Nursing Federation, Grant Thornton, National Council of Ambulance Unions.

70 The top marginal tax rate is currently 45 per cent. The FBT tax rate will increase to 47 per cent from 1 April 2014, as a result of the increase in the rate of Medicare levy by 0.5 of a percentage point, to 2 per cent of taxable income, from 1 July 2014.

71 For example, Association of Australian Medical Research Institutes, Cancer Council SA, Centre for Appropriate Technology, Community Business Bureau, Community Council for Australia, Community Centre Banking, CPA Australia, Diabetes Queensland, Hospital Research Foundation, Housing Industry Association, James Brown Memorial Trust, Moore Stephens, New South Wales Health, Not-for-profit Accounting Specialists, PowerHousing Australia, The Reach Foundation, Vision Australia, War Widows' Guild of Australia NSW Ltd.

entertainment benefits except in very rare circumstances. This is particularly relevant to employers eligible for the FBT rebate. The policy rationale for limiting the exemption in this way is unclear.

The vast majority of submissions commenting on this proposal were supportive of removing this restriction on the minor benefits exemption.[72] Accordingly, the Working Group recommends that the restriction on the minor benefits exemption placed on income tax exempt bodies be removed. The budget impact of this proposal is unquantifiable, but is not expected to be large.

Recommendation 16: Align the minor benefits exemption with the commercial sector

The existing limitation on access to the minor benefits exemption in relation to tax exempt body entertainment benefits should be removed with a view to ensuring equity across the NFP sector and with the commercial sector.

Transitional payment

The Working Group notes that the real value of FBT concessions for the NFP sector has been declining over time, largely because the exemption thresholds have not been increased. Further, if the recommended alternative support payment outlined in Recommendation 12 is not introduced in conjunction with other FBT changes outlined in this chapter, this will have an adverse impact on many employers and employees in the NFP sector.

In light of this, the Working Group recommends that an automatic temporary transitional payment be made to eligible NFP employers. The payment would be made for two years, or until the alternative support payment in Recommendation 12 is introduced.

As the Terms of Reference for the Working Group provide that it will identify offsetting budget savings from within the NFP sector for any proposals that have a budget cost, the payment could be funded from the savings generated from Recommendations 13, 14 and 15.

Recommendation 17: Transitional payment to eligible NFP employers

In recognition of the ongoing devaluation of support provided to those entities affected by Recommendations 13, 14 and 15, a temporary transitional payment should be made to all eligible NFP employers.

This temporary payment should be:

1. automatic, and paid directly to NFPs eligible to access FBT concessions;
2. paid for two years, or until Recommendation 12 has been implemented;
3. first made in conjunction with the implementation of Recommendations 13, 14, 15; and
4. indexed, with the formula to calculate the transitional adjustment payment value similar to Recommendation 12(1).

72 For example, CPA Australia, Grant Thornton, Moore Stephens, New South Wales Health, St John's Ambulance, The Reach Foundation, War Widows' Guild of Australia NSW Ltd, Victorian Employers' Chamber of Commerce and Industry.

Chapter 4: Goods and Services Tax Concessions

Summary

- In general, non-commercial supplies made by charities are GST-free and their commercial activities are taxable. In some instances, charities can opt to treat their supplies as being input taxed. This means they can treat their supplies as non-taxable but cannot recover the GST, if any, on acquisitions related to the making of those supplies. The GST concessions that are available to NFP entities vary depending on the type of body.

- The current GST arrangements for fundraising create uncertainty for many NFPs. The ATO should consider improving its guidance on these issues.

- Two reform options were proposed in the consultation paper to address concerns about the current GST concessions. Submissions commented on both these options and suggested other changes to the existing range of GST concessions and arrangements.

- While several submissions expressed support for introducing a principles-based definition of fundraising activities that are input taxed, and introducing an opt-in arrangement for non-commercial supplies, on balance there is not a compelling case for change to these arrangements.

- There are different thresholds for GST-free supplies of residential accommodation (to be less than 75 per cent of the market price), and the rent requirement under the National Rental Affordability Scheme (to be set at a rate that is less than 80 per cent of the prevailing market rate). This discrepancy may not be consistent with desired policy outcomes.

- Consultations highlighted a number of proposals that reduce the cost of the existing GST arrangements for the NFP sector. However, these proposals would also reduce GST revenue, and are unlikely to receive the support of State and Territory governments.

Introduction

The GST was introduced in 2000 as a broad based tax to apply to most goods and services, with a limited number of exemptions.

It was recognised that charities, PBIs, community groups and religious organisations operate differently from businesses as they often supply goods or services for nominal or no charge, and a large proportion of their inputs and funding are generally provided in the form of donations. As a result, a number of charitable activities and non-commercial supplies of goods and services by these entities are treated as GST-free. The GST concessions that are available to NFP entities vary depending on the type of entity.

In addition, a number of administrative concessions are available for NFP entities to help simplify their GST reporting and accounting obligations. For example, all NFP entities have a higher GST registration turnover threshold of $150,000, compared to $75,000 for other entities. This means that NFP entities with smaller turnovers can choose to stay out of the GST system and as a result, avoid having to report and account for GST on the supplies they make.

NFP entities belonging to the same association have simplified GST grouping rules, with members of the same GST group benefiting from not having to account for GST on supplies they make to each other.

A number of supplies made by certain NFP entities are GST-free. Treating a supply as GST-free means that no GST is payable on the supplies made but allows the entity to claim input tax credits for any GST paid on the cost of their inputs.

Supplies that are GST-free include:

- supplies of raffle tickets, bingo games and specified gambling supplies, provided that the holding of the raffle or bingo event does not contravene a State or Territory law;
- supplies of accommodation for less than 75 per cent of the GST-inclusive market value of the supply, or less than 75 per cent of the cost to the supplier of providing the accommodation;
- non-commercial supplies other than accommodation for less than 50 per cent of the GST inclusive market value, or less than 75 per cent of the amount the supplier paid to acquire the thing; and
- supplies of donated second-hand goods.

Further, supplies of retirement village accommodation and related services by endorsed charitable institutions and endorsed trustees of charitable funds that operate retirement villages are GST-free. There are also a wide range of other GST concessions available to NFPs.

Reform Options

The Discussion Paper posed questions in respect of the operation of the GST concessions and proposed two possible reform options for the GST concessions:

- a proposed principles-based approach to the fundraising concession, which would allow certain NFP entities to self-assess whether their particular fundraising event satisfies the requirements; and
- an opt-in arrangement for the GST treatment of non-commercial supplies.

Discussion and Findings

The submissions indicate that there is general support for the retention of the current GST concessions. In addition to providing comments in relation to the GST reform options canvassed in the Discussion Paper, some submissions took the opportunity to raise a broad suite of proposals that they believed would further simplify or add to existing concessions.

The Working Group notes that extending GST-free treatment to additional transactions would constitute a change to the GST base which, consistent with the Intergovernmental Agreement on Federal Financial Relations, would require the unanimous agreement of the States and Territories. As such, a compelling case for change to the current GST concessions would be required.

Improve guidance on the fundraising concession

The Discussion Paper noted that a principles-based approach to the fundraising concession would allow certain NFP entities to self-assess whether their particular fundraising event satisfies the requirements. At present only a limited number of fundraising events are eligible and NFP entities need to seek the Commissioner of Taxation's approval for non-eligible events.

The GST fundraising concession is available in respect of fetes, balls, gala shows, dinners, performances and events where all goods are sold for $20 or less outside the ordinary course of the NFP entity's business. In addition to this concession, the Commissioner of Taxation may approve other events as fundraising events that may be treated as input taxed. A principles-based approach could replace the current concession by setting out high-level objectives, rather than prescriptive laws, against which certain NFP entities could self-assess whether its fundraising event satisfies the requirements.

A number of organisations considered that a principles-based approach for input taxed fundraising events would be beneficial and reduce compliance costs[73] while other submissions did not take this view.[74] The current limit on the number of fundraising events was also raised as an issue, especially for organisations that hold the same event in a number of different locations at different times.[75]

Given the contradictory views as to whether a principles-based approach would necessarily lead to lower compliance costs and reduced uncertainty, the Working Group does not recommend the replacement of existing fundraising provisions with a principles-based approach. However it was clear from submissions that the current provisions are complex, difficult to assess and give rise to uncertainty for many NFP entities. The Working Group is of the view that the ATO guidance on the fundraising concession could be improved. This recommendation has no budget impact.

Recommendation 18: Improve ATO guidance on GST and fundraising

The Commissioner of Taxation should consider improving ATO guidance on GST issues relating to fundraising.

No opt-in arrangement for GST treatment of non-commercial supplies

Currently NFPs may be required to treat some transactions as taxable and others as GST-free, resulting in administrative and compliance costs.

73 For example, Association of Australian Medical Research Institutes, Australian Major Performing Arts Group, Australian Red Cross Society, Cancer Council Australia, Crowe Horwath, Housing Industry Association, Lifeline Australia, Mission Australia, Pitcher Partners, University of Melbourne, Vision Australia.

74 For example, Cancer Council SA.

75 For example, Queensland Law Society, Royal Flying Doctors Service, Salvation Army.

The GST-free treatment of non-commercial supplies is beneficial to NFP entities. However, it can give rise to complexities in accounting and apportionment where a NFP makes a number of supplies relating to one event, some of which are for 'nominal' consideration while others are not. An opt-in arrangement would allow a NFP entity to treat all non-commercial supplies it makes as either taxable or input taxed. This would, for example, ensure consistent GST treatment of all tickets sold in relation to an event, thereby decreasing compliance costs in cases where only a small number of supplies are non-commercial.

Many organisations did not support opt-in arrangements to treat certain supplies as taxable or input taxed.[76] Most NFPs prefer GST-free treatment for these supplies, particularly if the consideration for these supplies is a nominal amount. Reasons for preference of GST-free treatment included that an opt-in approach would create problems for GST adjustment periods. It may also produce the possibility that if an entity opts to make a supply taxable and the recipient is not registered for GST, the recipient would bear the burden or the NFP entity would need to absorb the GST.

In the case of submissions that supported the opt-in option, there was no consensus as to whether the option favoured was to treat all supplies as taxable or, alternatively, treat all supplies as input taxed.[77] Some indicated that they would not anticipate many charities electing to use an opt-in approach.[78]

The Working Group considers that adding more options to treat supplies in different ways for GST purposes would not necessarily result in lower compliance costs and may increase complexity. Entities would need to adapt their established accounting systems to accommodate these changes, and they are likely to assess which approach will deliver the best overall outcome after taking into account the impact on administration costs and the net GST impact, which may well increase rather than reduce compliance costs for affected charities.

Market value threshold

Several submissions raised the issue of the market value threshold for GST-free supplies. As noted above, supplies of accommodation will be GST-free where they are provided for less than 75 per cent of the GST-inclusive market value of the supply, or less than 75 per cent of the cost to the supplier of providing the accommodation. Non-commercial supplies other than accommodation will be GST-free where they are supplied for less than 50 per cent of the GST inclusive market value, or less than 75 per cent of the amount the supplier paid to acquire the item.

Some suggested that the value threshold should apply to the total price for a class of supplies rather than to individual supplies of a good or service.[79] For example, this might mean that tickets to a concert could be considered on the basis of an average price, rather than individual prices. One charity noted high compliance costs with establishing a market price.[80]

In relation to accommodation, several community housing associations suggested increasing the threshold for housing to be deemed a GST-free supply, from 75 per cent of the market

76 For example, Australian Major Performing Arts Group, Moore Stephens Melbourne.
77 For example, Cancer Council Australia, Pitcher Partners, Salvation Army, SIDS and Kids ACT, University of Melbourne, Vision Australia.
78 King and Wood Mallesons, Moore Stephens Australia.
79 Australian Major Performing Arts Group, Live Performance Australia.
80 Mission Australia.

rate to 80 or 85 per cent, and adopting a pooled approach to revenue in assessing whether a charity is charging less than 75 per cent of the market value of supplies of accommodation.[81] The reason given for raising the threshold to 80 per cent was to ensure that this is consistent with the maximum rent level allowed to be charged under the National Rental Affordability Scheme (NRAS).

The Working Group considers that any changes to the current 75 per cent benchmark for accommodation would require careful analysis of how this would impact on competitive neutrality between 'non-commercial' and 'commercial' suppliers of low cost accommodation, and how this may impact on the overall supply of such accommodation.

This recommendation has no budget impact. However, as a change to the market price threshold for accommodation would likely have an adverse impact on GST revenue, this would require the support of State and Territory governments.

Recommendation 19: Review interaction of GST and NRAS

The Government should consider whether the difference between the market value threshold of 75 per cent for GST-free supplies of residential accommodation and the 80 per cent threshold for affordable housing under the NRAS (the requirement for rent to be set at a rate that is at least 20 per cent below prevailing market rates) is consistent with the desired policy outcomes.

81 Brisbane Housing Company, Foundation Housing Ltd, Haven, Housing Choices Australia, North Coast Community Housing, PowerHousing Australia, St George Community Housing, The Rural Housing Network, The Women's Housing Association.

Chapter 5: Mutuality, Clubs and Societies

Summary

- The mutuality principle has developed in an ad hoc manner in the common law since the late 1800s, when mutual organisations provided sickness and death insurance to their members, out of member contributions.
- Various member organisations such as clubs and societies, co-operatives, professional associations and strata title bodies corporate utilise the mutuality principle to some degree. However, the mutuality principle has been repealed or limited by the tax statute for various entities such as mutual insurance associations and trading cooperatives.
- As a matter of fundamental principle, tax exemption of income should apply only for organisations that are both NFP and for the public benefit. Many, but not all, mutual organisations are exempt either as charities, or tax-exempt NFP clubs or associations, under Division 50 of the ITAA 1997.
- The mutuality principle has become out-dated and its current application is not consistent with the fundamental principles of being NFP and for the public benefit. More specific concerns about the mutuality principle include:
  - integrity concerns about member and non-member receipts;
  - competitive neutrality concerns where mutual organisations are trading in competition with taxable businesses;
  - social policy concerns about significant gambling and hospitality receipts of some organisations, which are not subject to income tax at the Commonwealth level; and
  - concerns about private member benefit.
- It is recommended, on public benefit grounds, that the tax law should be amended to treat all member and non-member income of mutual organisations as assessable for taxation purposes in line with normal income tax principles.
- If this recommendation is not supported, all income from gaming, catering, entertainment and hospitality trading activities of mutual organisations should be treated as assessable.
- The majority of smaller mutual organisations that qualify as NFPs would not be adversely affected by the proposed tax changes, as they would either be tax exempt under Division 50 or would benefit from the higher tax-free threshold for NFP entities proposed in Recommendation 2 of this Report.

Introduction

The mutuality principle is a common law principle dating back more than 120 years to the late 19th century in the UK, and adopted by Australian courts. Under the mutuality principle, where a group of individuals join together to contribute to a common fund, created and controlled by all of them for a common purpose, any surplus created in the fund from the individual contributions or dealings between the members of the fund is not considered to be income for tax purposes.[82]

Historically, the mutuality principle was developed to apply to member-funded life and disability insurance, before commercial insurance was developed. Over time, the principle was also applied to social clubs and associations formed for a common purpose. Applying the mutuality principle means that member receipts (including subscriptions and trading income between the members and the entity) of eligible organisations are exempt from income tax. For example, the ATO provides the following explanation of the application of the principle of mutuality in the context of income tax:

> *"A licensed club is only assessable on trading income which relates to non-members and on income received from sources outside its general trading activities. This is due to the principle of mutuality that recognises that any surplus arising from contributions to a common fund created and controlled by people for a common purpose is not income."*[83]

However, all receipts of mutual organisations from external sources including non-members, capital gains and investment income are included in assessable income of the mutual organisation for tax purposes. A recent analysis commissioned by ClubsNSW indicates that on average, 22 per cent of the assessable income of licensed clubs is subject to income taxation because it comes from non-member sources.[84]

A consequence of the principle of mutuality applying is that expenses related to member income of mutual organisations are non-deductible. The ATO provides a formula to assist in the calculation of the proportion of a licensed club's trading surplus attributable to members and non-members. The formula allows a proportion of a licensed club's general expenses to be allowed as a deduction and a portion is non-allowable against non-assessable income.[85]

Other taxes will still apply to mutual organisations. GST applies to mutual organisations as it relates to taxable supplies and not to member transactions. Wine equalisation tax will apply to sales of wine by a wine club to its members even though the club benefits from the principle of mutuality.[86] This means that mutual organisations with trading activities must still file a BAS return even though their member income and expenses are outside the tax net.

82 See *Styles (Surveyor of Taxes) v New York Life Insurance Company* (1880) 14 App Cas 381 at 465 (UK); *Bohemians Club v. Acting FCT* (1918) 24 CLR 334. Also see Love, N. 'The application of the mutuality principle to timeshare companies', 34 *Australian Tax Review* 216 (2005) for a discussion of the early history; Love, N. 'The Relevance of the Mutuality Principle within the Nonprofit Sector', *Third Sector Review* 13(1) (2007).

83 ATO, Tax Determination TD 93/194 – *Income tax: how should a licensed club apportion expenses when calculating its taxable income?* (1993).

84 KPMG *National Club Census 2011: Report on the economic and social contribution of licensed clubs in Australia* (2012) p. 41.

85 ATO Tax Determination TD 93/194. There are some exceptions to this general principle, as outlined in this TD. Also see ATO) *Mutuality and taxable income* (2010).

86 ATO Interpretive Decision 2010/152 - *Wine Equalisation Tax: effect of principle of mutuality on sales by clubs and associations* (2010).

The ATO summarises the characteristics of organisations that can benefit from the mutuality principle which allows a surplus to be accumulated free of tax. These characteristics that are derived from the case law typically include:[87]

- the organisation is carried on for the benefit of its members collectively, not individually;
- the members of the organisation share a common purpose in which they all participate or are entitled to do so;
- the main purpose for which the organisation was established, and is operated, is the common purpose of the members;
- there is a common fund that gives effect to the common purpose and all the members contribute to it;
- all the contributions to the common fund are applied for the collective benefit of all the members, in line with the common purpose;
- different classes of memberships may exist with varying subscription rates, rights and entitlements to facilities;
- the members have ownership and control of the common fund; and
- the contributors to the common fund must be entitled to participate in any surplus of the common fund.

Most importantly, to benefit from the mutuality principle, funds in a mutual organisation must be used for a common purpose of members and not for their individual gain.

As noted by some submissions,[88] many mutual organisations are not NFPs because their members have the right to receive surplus of the common fund, which would not satisfy the criteria for a NFP organisation.

In contrast, some member-based NFP organisations have a non-distribution clause that specifically prohibits the distribution of surplus to members, requiring any surplus to be used for the common purpose of the organisation. Following a court decision that found these NFPs were not mutual organisations at common law, they were specifically brought within the scope of the mutuality principle for tax purposes by legislative amendment.[89]

87 ATO *Mutuality and taxable income* (2010), p. 7.
88 For example Mattila Lawyers.
89 Section 59-35 of the ITAA 1997 states that the mere existence of a non-distribution clause does not prevent mutuality applying to these organisations. The case was *Coleambally Irrigation Mutual Co-operative Ltd v Commissioner of Taxation* [2004] FCAFC 250.

Discussion and Findings

A diverse array of licensed clubs and societies, co-operatives, strata title bodies corporate and other organisations rely, to a greater or lesser degree, on the mutuality principle. The application of the mutuality principle has evolved considerably since the late 1800s to encompass this array of activities.

It has been observed that over the years, as the mutuality principle has been expanded in an ad hoc fashion through judicial decisions, it has grown to encompass substantial commercial activities that were not anticipated in the original principle, such as time share accommodation companies and substantial gaming and hospitality activities of clubs and societies.[90] As some mutuals organisations have a very large membership base, this enables them to generate large tax-free surpluses. This is likely to give rise to market distortions, as large mutual organisations have the capacity to provide cheaper services or improved facilities than for-profit hotels, restaurants or accommodation providers. A number of submissions raised concerns about the tax advantages provided to mutual organisations that operate as large commercial businesses.[91]

The mutuality principle has already been overtaken by legislation in many cases. Many entities that may have relied on mutuality in the past would now be covered by legislative rules, and to that extent do not rely on the principle today. A consequence of piecemeal legislative tax reform over the years is that the principle of mutuality now overlaps with these various statutory rules, adding complexity to the tax law. Trading cooperatives, mutual insurance associations[92] and credit unions[93] are all now subject to specific tax rules in respect of their member and non-member income. Life insurance companies and friendly societies (some of the original kinds of organisations that benefited from mutuality) are now taxed in the same manner as other entities offering similar services.[94]

Many other mutual organisations are now eligible for income tax exemption as charities or NFP associations or societies, under Division 50 of the ITAA 1997, and so no longer rely on the principle of mutuality. Societies, associations or clubs eligible under section 50-45 receive a tax exemption for all income, irrespective of whether their activities are mutual or non-mutual. This encompasses “A society, association or club established for the encouragement of: (a) animal racing; or (b) art; or (c) a game or sport; or (d) literature; or (e) music.” Nationally, 69 per cent of licensed clubs benefit from income tax exemption under one of these provisions.[95] Due to a lack of data about mutual organisations and about NFPs that self-assess as exempt, it is difficult to determine what percentage of other mutual organisations may benefit from an income tax exemption under Division 50.

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90 Australia, Parliament, House of Representatives Standing Committee on Banking, Finance and Public Administration, *Follow the yellow brick road* (1991), *Taxing Relaxing* (1995), Productivity Commission, *Australia’s Gambling Industries* (1999), Report No 10.
91 For example, Community Council for Australia and Community Business Bureau.
92 Section 121 of the ITAA 1936.
93 Sections 6H and 23G of the ITAA 1936.
94 Division 320 of the ITAA 1997.
95 KPMG, *National Club Census 2011* (2012), p. 40.

The Discussion Paper also noted a number of specific concerns about the operation of the mutuality principle, including:

- uncertainty and complexity in operation, for example, tracking mutual and non-mutual receipts;
- competitive neutrality concerns where clubs carry out trading activities with members in competition with non-exempt businesses;
- social policy concerns especially given income tax revenue foregone, for example, because much revenue of wealthier clubs is derived from gambling and hospitality (alcohol) services to members; and
- a concern about 'rorting' the system, for example, by clubs issuing temporary memberships to the wider public.

Mutual organisations are generally not required to spend their income or surplus on charitable purposes, or on purposes that otherwise have a public benefit. The surplus generated by mutual organisations can and is generally used for the benefit of members collectively, for example through new capital works (such as club premises), or in reduced costs of hospitality or other club services.

Some mutual organisations, such as large sporting and recreational clubs, typically make contributions to charities, as do many individual taxpayers. However, evidence indicates that such contributions made by large sporting and recreational clubs are typically small in proportion to overall revenue. KPMG's *National Club Census 2011* reported that from total revenue of $9.6 billion, Australian clubs provided approximately $220 million in cash payments and in-kind support to charities, non-profit organisations, local sporting teams, providing socially inclusive activities, and funding health and education programs (about 2 per cent of revenue).[96] Many of these payments to charities or community organisations were compulsory obligations, either related to the number of gaming machines or revenue from gaming machines. Were these mutual organisations to be subject to income tax, their donations to DGR entities would be deductible.

Application of fundamental principles for the NFP sector

To be eligible for the privilege of tax exempt treatment under the current income tax law, the Working Group considers that entities in the NFP sector should satisfy the following two fundamental principles:

1. be not for profit; and
2. provide public benefit.

The Working Group considers that if these two fundamental principles are not satisfied, then entities should in principle be subject to normal income tax rules.

96 KPMG, *National Club Census 2011* (2012), p. 79. While the overall social contribution is estimated by KPMG to be considerably larger than this, at $2.3 billion, this estimate by KPMG includes the private benefit of services to members, the market value of provision of low-cost facilities in the clubs such as bars, meeting rooms and various sports facilities, which are largely used by members, and the value of volunteer time in clubs which primarily benefits members.

Reform Options

The Discussion Paper considered a range of reform options that have been previously canvassed by other reviews:

- repeal the common law principle of mutuality and legislate a narrower principle;
- tax gaming, catering, entertainment and hospitality trading activities of NFP clubs and societies above a high threshold;
- extend the mutuality principle; or
- enact anti-avoidance rules, or enforce the principle more strictly.

Remove the principle of mutuality and replace it with normal income tax rules

The option of repealing the common law principle of mutuality was recommended in the 1999 *Review of Business Taxation.* It found that, as the current law was not designed to deal with the significant commercial activities undertaken under mutual principles, it effectively allows mutual organisations a disproportionate share of deductions against assessable income, while benefiting from the mutuality principle for member income.

The Working Group acknowledges that most submissions on this issue opposed a narrowing of the mutuality principle. Licensed clubs, motoring organisations, and some accounting and legal bodies all argued that the current arrangements are appropriate.[97]

However, several submissions supported increases in, or a review of, the taxation of mutual organisations.[98]

The Working Group considers that it is no longer appropriate that the mutuality principle continue to confer potentially significant tax free benefits on private members of mutual organisations, without any requirement that mutual organisations satisfy the two fundamental principles of NFP status and public benefit. The current application of mutuality does not reflect its original intent and does not consistently satisfy the two fundamental principles of tax exemption noted above. If the Australian income tax law is to depart from these two fundamental principles for the benefit of some groups of private individuals, this should be done explicitly in the tax statute and subject to clear statutory limits. It should not be the result of ad hoc judicial development of a 19th century principle that is not transparent and not subject to clear criteria.

Comparable jurisdictions no longer apply mutuality

Many jurisdictions where a common law principle of mutuality has historically applied have now legislated to replace or limit the mutuality principle. In other comparable jurisdictions, mutuality does not apply but specific legislative rules operate, for example for social or sporting clubs.

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97 For example Clubs Australia, CPA Australia, Grant Thornton, Joint submission from Queensland Amateur Sporting Clubs, Mattila Lawyers, Moore Stephens Australia, NRMA, RAA South Australia and Wynnum Manly Leagues Club.

98 For example ACOSS, Community Council for Australia, Community Employers WA and SACOSS.

- In New Zealand, statutory reforms override the common law principle of mutuality with respect to mutual transactions with members.[99] The principle of mutuality continues to apply to member subscriptions.[100]

- In Canada, the mutuality principle has been applied only infrequently by the courts. Today for a Canadian club or association to benefit from tax-exempt status, it must meet a NFP requirement and satisfy other conditions that are explicitly set out in the income tax statute.[101]

- The mutuality principle continues to apply in the United Kingdom, subject to certain limits in United Kingdom corporation tax concerning distributions to members.[102] Specific tax relief is also provided for Community Amateur Sports Clubs.[103]

- In the United States, social clubs that qualify as NFP are subject to a specific statutory rule that provides a benefit of tax exemption but strictly limits the exemption based on the source, level and application of the income of the club.[104] Such clubs are taxable on their non-member or unrelated business income and may be disqualified from the exemption if they conduct business with the general public or have, for example, corporate memberships.

Updating Australian income tax law

The Working Group has concluded that the common law mutuality principle is out-dated and should be removed. Mutuality should be replaced by the normal income tax rules in the tax statute, such that receipts from dealings with members would be assessable, and associated expenses would be deductible for mutual organisations in line with non-mutual entities.

Where NFP mutual organisations qualify for tax exemption because they operate for the public benefit as determined under Division 50 of the ITAA 1997, then all income of the organisation will be tax-exempt and there is no need to rely on the mutuality principle. The Working Group favours including all member receipts as assessable (and associated expenses as deductible). This would be simpler and avoid the significant integrity issues that may arise in distinguishing membership fees from receipts from members for trading or services obtained from the mutual organisation.

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99 Section CB 33 and s HE 2 of the *Income Tax Act 2007* (NZ) and analysis by the New Zealand Rewrite Advisory Panel, *Issues Log* (2009), accessed at http://www.rewriteadvisory.govt.nz/iss/i_127.php; and Inland Revenue New Zealand, 'Issue: Sections CB 33, DV 19 – Mutual associations and the mutuality principle', *Remedial Matters*, accessed at http://taxpolicy.ird.govt.nz/publications/2010-or-arttspkrm/remedial-matters.

100 New Zealand Inland Revenue Department, 'Mutuality Principal (sic)', *AGENTSanswers,* Issue 46 (June 2003*)*, accessed at http://www.ird.govt.nz/aboutir/newsletters/agents-answers/2003/agents-answers-issue46-06-03.html; Carla Cross (ed), *New Zealand Master Tax Guide 2011* (CCH New Zealand, 2011), 24-090; New Zealand Inland Revenue Department, 'Income and expenditure within a circle of membership', *AGENTSanswers, Issue 50 (October 2003),* accessed at http://www.ird.govt.nz/aboutir/newsletters/agents-answers/2003/agents-answers-issue50-10-03.html .

101 Section 149(1) of the Income Tax Act (Canada). See Canada Revenue Agency, *Non-profit organizations,* Bulletin IT 496-R (August 2001)*,*accessed at http://www.cra-arc.gc.ca/E/pub/tp/it496r/it496r-e.html.

102 See Sections 490 to 491 of the *Income and Corporation Taxes Act 1988* (UK). See HM Revenue & Customs, *BIM 24565 – Mutual trading: distributions*. Accessed from http://www.hmrc.gov.uk/manuals/bimmanual/BIM24565.htm.

103 See HM Revenue & Customs, *Tax relief for Community Amateur Sports Clubs,* Accessed from http://www.hmrc.gov.uk/charities/casc/tax-relief.htm.

104 US Internal Revenue Code, s 501(c)(7); see US Internal Revenue Service, http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Social-Clubs. See Bruce Hopkins, The Law of Tax-Exempt Organisations (Wiley, 10th ed, 2011), s 1.5 and Chapter 15.

The Working Group understands that this reform proposal is a significant updating of Australian income tax law. However, many mutual organisations that generate substantial tax-free income and conduct significant trading activities are already lodging income tax returns that segregate taxable and non-taxable receipts, and BAS returns in relation to GST, as well as paying other forms of taxation. The proposed reform should not impact substantially on the compliance costs of these organisations. Implementation of this reform will however require sufficient education and support from the ATO for smaller mutual organisations.

As discussed in Chapter 1, the Working Group has also recommended that a new tax free threshold of $10,000 should be introduced for taxable NFP entities, and that the ATO endorsement framework be extended to all NFP entities accessing tax concessions. Extending the ATO endorsement framework would increase certainty for smaller NFP entities that have self-assessed as satisfying the mutuality principle. The new tax free threshold would also assist smaller NFP clubs and societies affected by the recommended changes to the taxation of mutual organisations.

There may be a case to limit the taxation of mutual income for some kinds of mutual organisations, in a departure from the fundamental principles outlined above. This is recommended only where it is necessary to avoid unintended consequences or undue compliance costs. The Government should review whether, for example, strata title bodies corporate or some types of co-operatives should be subject to specific rules. Any such limitation of normal income tax rules should be done in clear and specific legislative provisions. The budget impact of this recommendation is unquantifiable, but could increase revenue in the order of $50 million a year.

Recommendation 20: Normal income tax rules should apply to all member and non-member receipts of mutual organisations

Normal income tax rules should apply to all receipts of mutual organisations, whether from members or non-members, as a matter of principle to be legislated in the ITAA 1997. As a result, the income of mutual organisations (including member receipts) would give rise to assessable income in the normal way and they would be able to claim appropriate deductions incurred in gaining that assessable income. This would enhance the efficiency, simplicity and equity of the tax law and would be consistent with fundamental principles.

The Government should review whether it would be appropriate to enact specific legislative rules that limit taxation of any particular types of mutual organisation or types of member income, so as to avoid unintended or undesirable consequences and undue compliance costs.

Tax gaming, catering, entertainment and hospitality trading activities

The Working Group has particular concerns over the way that mutuality is being applied by some mutual organisations, particularly for licensed clubs in relation to revenue from gambling and other entertainment facilities. Many large clubs derive significant revenue from gambling, entertainment and accommodation. Other mutual organisations, such as motoring organisations, have also invested in large resorts and hotels that provide significant private member benefit and that are operated on a commercial or trading basis.

The Working Group considered the option of taxing gaming, catering, entertainment and hospitality revenue above a high threshold and/or at a concessional tax rate. The report *Australia's Future Tax System* (AFTS) recommended that clubs with large trading activities from gaming, catering, entertainment and hospitality be subject to a concessional rate of tax to total net income from these activities, above a high threshold.[105] As noted in the Discussion Paper, this recommendation appears to have been motivated by concerns that these activities do not provide the same type of public benefit as other activities of NFPs. In the case of gambling and alcohol consumption, the public detriment may outweigh the relatively small public benefits that are derived from directing a small proportion of club income from these activities to charitable causes.

Submissions presented mixed views on this option. Some community welfare organisations argued for greater taxation of the gaming revenue of clubs.[106] Some organisations suggested that if any changes to the application of the mutuality principle were made, they should address activities of perceived social concern, such as gaming.[107] Submissions from licensed and sporting clubs strongly supported the current tax system.[108]
Some organisations that supported a threshold noted that any new threshold should be sufficiently high to ensure that smaller clubs remain viable.[109]

In some cases there does not appear to be a strong connection between the main purpose of the mutual organisation in respect of its members, and the provision of gaming, catering, entertainment, and hospitality activities. While these services may provide a private benefit to members, this does not appear sufficient to justify a tax exemption for member income derived from these services.

The Working Group considers that there are no compelling policy grounds to continue to provide a tax exemption for member income derived from these activities of mutual organisations. To do so would be inconsistent with the fundamental principles for tax exemption of NFP status and public benefit, set out above.

The Working Group has concluded that a threshold for taxation of gaming, catering, hospitality and entertainment revenue is not necessary in light of the new $10,000 tax free threshold for taxable NFP entities as proposed in Recommendation 2. There is also no sufficient justification for a different rate of tax to the general company tax rate. A different rate would also add complexity to the tax law. Many smaller NFP clubs that are potentially affected by this recommendation may be able to take advantage of the tax-free threshold, or may otherwise qualify for an income tax exemption under Division 50.

The Working Group also considered that this recommendation should apply to all mutual organisations that generate revenue from gaming, catering, entertainment, and hospitality activities, not just the licensed clubs sector. As a matter of simplicity and horizontal equity, all mutual organisations that generate member income from these activities should be subject to the same taxation arrangements. The budget impact of this recommendation is unquantifiable and the magnitude cannot be reliably estimated.

This recommendation will require affected mutual organisations to segregate the taxable revenues from gaming, catering, entertainment and hospitality activities (and associated deductible expenses) from other, non-taxable member receipts. This recommendation will generate some compliance costs. For this reason, the Working Group prefers the simpler approach set out in Recommendation 20 of applying normal income tax rules to all income and expenses of mutual organisations. However, most mutual organisations with this type of

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105 *Australia's Future Tax System* (2009), Recommendation 44.
106 For example, ACOSS and SACOSS.
107 For example, NRMA, RACV and RAA South Australia.
108 For example, Clubs Australia, Joint submission from Queensland Amateur Sporting Clubs and Wynnum Manly Leagues Club.
109 For example, Changemakers Australia.

trading income are already filing tax returns that segregate member from non-member income and expenses. It is therefore considered that any additional compliance costs will not be substantially greater than the current system.

Recommendation 21: All gaming, catering, entertainment and hospitality receipts of mutual organisations be subject to normal income tax rules

If Recommendation 20 is not supported, all gaming, catering, entertainment and hospitality receipts of mutual organisations, whether member or non-member receipts, should be treated as assessable income. Mutual organisations that have such receipts would be able to deduct appropriate expenses under normal income tax rules.

No extension to the mutuality principle

The Discussion Paper noted that a number of submissions to AFTS argued for extension of the mutuality principle to provide a full tax exemption for NFP member-based organisations. However, as a consequence of the Working Group's conclusions and Recommendations 20 and 21*,* the extension of the mutuality principle is not recommended. Very few submissions addressed this issue, with views for[110] and against[111] an extension to all member-based NFPs.

Anti-avoidance rules

The Discussion Paper also noted that it may be possible to increase compliance activity to address concerns about certain conduct that enables mutual organisations to lower their taxable income, or to enact specific anti-avoidance rules to address concerns about abuse of the principle.

One option could be to ensure that members are 'sufficiently connected' to a mutual before the principle of mutuality is applied. This would ensure that the principle of mutuality was not extended beyond its original intention.

Views in submissions on this issue diverged. A number of submissions argued that there was no need for new or tougher anti-avoidance rules.[112] However, other submissions noted concerns about potential abuse of temporary or instant memberships.[113]

The Working Group has concluded that enacting specific anti-avoidance rules in relation to mutuality is likely to increase complexity in the tax law without generating sufficient benefit. In view of the other recommendations in this chapter, the Working Group has not proposed enacting such rules or increasing compliance activity in relation to mutual organisations.

110 For example, Crowe Horwath and Moore Stephens Australia.
111 For example, Changemakers Australia.
112 For example, Clubs Australia, CPA Australia, Crowe Horwath, HIA Australia and Moore Stephens Australia.
113 For example, RACV.

Chapter 6: Consolidating the benefits of reform

Summary

- The NFP sector and State and Territory governments should be consulted on the implementation of the Working Group's recommendations.
- Any net budget savings from the proposed reforms should be returned to the NFP sector.
- There is a need for an ongoing examination of anomalies, minor policy issues, and technical issues in respect of tax concessions for the NFP sector.

Implementing reforms

The Working Group has made recommendations covering a wide range of tax issues relevant to the NFP sector. NFP entities and governments that will be affected by the proposed changes to FBT may need to consider how best to accommodate these changes. Many mutual organisations might also face changes to their tax arrangements due to these recommendations.

The Government should engage in a comprehensive dialogue with the NFP sector and State and Territory governments as a key element of implementing these proposed reforms, in order to work through the widespread and disparate impacts of the reforms.

In the course of its deliberations, the Working Group took account of a range of possible impacts on NFP entities that may arise from these recommendations. Accordingly, the objective of further consultation should be to identify, where necessary, any unintended consequences or undue compliance costs.

Sharing the benefits of reform in the NFP sector

The objective of the Working Group was to consider:

> *… whether there are better ways of delivering the current envelope of support provided through tax concessions to the NFP sector by the Australian Government* [114]

Consistent with the Working Group's Terms of Reference, wherever possible, all recommendations presented in this Report have been costed by Treasury in accordance with the budget rules.

Consistent with the Terms of Reference, the Working Group considers that any net savings arising from these recommendations should be returned to the NFP sector.

114 Terms of Reference, Not-for-profit Sector Tax Concession Working Group, above p 5.

Recommendation 22: Returning reform savings to the NFP sector

Any net savings arising from implementation of recommendations in this Report should be applied to the NFP tax concession envelope of support and returned to the NFP sector.

State and Territory tax concessions

Many submissions noted that there are inconsistent rules for NFP entities to qualify for State and Territory tax concessions, such as exemption from payroll tax or stamp duty, which often differ from Commonwealth concession requirements.

Some submissions argued more broadly for aligning and simplifying the eligibility categories for DGRs, income tax exemptions, franking refunds and GST concessions.[115] This would ensure the application of tax concessions is clear and consistent across the NFP sector.

Some submissions argued that concessions should be consolidated into a national framework to increase consistency and reduce uncertainty between levels of government.[116]

The Productivity Commission, in its 2010 report, recommended that State and Territory governments should utilise Commonwealth endorsement to determine eligibility for concessions in each jurisdiction, and seek to harmonise tax concessional status or definitions with the Commonwealth.[117]

The Working Group considers that harmonisation by Commonwealth, State, and Territory governments would result in a significant reduction in compliance costs for the NFP sector. This proposal falls outside the Working Group's Terms of Reference. However, this is clearly an area where adopting a national approach would lead to a reduction in complexity and lower administrative costs.

Ongoing consideration of NFP tax issues

In preparing this Report, the Working Group has also encountered a number of areas where:

- understanding of NFP tax arrangements is poor;
- the policy rationale for the design of a tax arrangement is unclear; or
- the arrangement appears to give rise to anomalies or minor technical concerns.

The ATO has ongoing processes for consulting with the NFP sector on tax issues. These include the Charities Consultative Committee and the Clubs Consultative Forum. The Charities Consultative Committee includes senior representatives of the charities sector, the ATO and Treasury, and the Clubs Consultative Forum comprises peak body representatives from the licensed club sector, industry members, tax practitioners and legal advisors. Both bodies provide an avenue for charities and the licensed club sector to raise tax issues of concern with the ATO.

115 For example, Chartered Secretaries Australia, King and Wood Mallesons, the Tax Institute.
116 For example Australian Catholic Bishops Conference, Grant Thornton, Vision Australia.
117 Productivity Commission, *Contribution of the Not-for-profit Sector*, Recommendation 7.2.

The Working Group considers that there would be benefit in having a forum for ongoing examination of tax concessions for the NFP sector, with a particular focus on apparent anomalies and minor policy and technical issues in connection with tax concessions. The forum could recommend administrative or legislative changes, to the Government as appropriate. The forum could also liaise with the ACNC and other relevant regulators. If appropriate, this could be achieved through expanding the current roles of the Charities Consultative Committee and the Clubs Consultative Forum. This recommendation has no budget impact.

Recommendation 23: Forum for ongoing examination of NFP tax anomalies and minor policy and technical issues

The Commissioner of Taxation should:

1. consider broadening the role of the Charities Consultative Committee and the Clubs Consultative Forum to include:

   a. an ongoing examination of anomalies, minor policy issues, and technical issues in respect of tax concessions for the NFP sector;
   b. recommendations on administrative or legislative changes to the Government as appropriate; and

2. continue liaison in relation to NFP sector issues with the ACNC and other regulators.

Appendix 1: The Not-For-Profit Sector Tax Concession Working Group

The NFP Sector Tax Concession Working Group was established in February 2012 by the then Assistant Treasurer, Senator the Hon Mark Arbib, with Terms of Reference requiring it to consider ideas for better delivering the support currently provided through tax concessions to the NFP sector.

The Working Group was supported by representatives from the Department of the Treasury (Secretariat), the Department of the Prime Minister and Cabinet and the ATO.

Linda Lavarch (Chair)

Linda Lavarch is the Chair of the Federal Government's Not-for-profit Sector Reform Council, having been appointed in December 2010. At the time of this appointment, Linda was a Research Fellow at the Australian Centre for Philanthropy and Non-profit Studies (ACPNS) at the Queensland University of Technology (QUT) coordinating a nonprofit model laws project, a position she held until the end of 2012. Linda is now a member of the Advisory Board of ACPNS. Prior to these positions Linda served in the Queensland Parliament from 1997 to 2009. During her Parliamentary career she held many positions including serving as the Queensland Attorney General in 2005/06. Linda currently serves as a Director on the Board of the Australian Cervical Cancer Foundation and has previously served as Chair of the Board of Directors of Coast2Bay Housing Group, a non-profit social and affordable housing company, and on the board of Hockey Queensland. Linda is a lawyer by profession, having been admitted to practice in 1986.

John Emerson AM

John Emerson is recognised Australia wide as an expert in the tax laws applicable to charities. He joined the law firm of Freehills in 1971, was admitted to partnership in 1976, and became a consultant with the global firm of Herbert Smith Freehills in 2012. John has been appointed as a Member of the Order of Australia (AM) 'for services to law and to the community, particularly through the provision of advice to charities and not-for-profit organisations and the development of public administration reform to encourage philanthropy in Australia'. He is the Herbert Smith Freehills Melbourne office Pro Bono Partner and is a member of the Board of Taxation and of a number of legal and public sector committees active in the charity tax and pro bono areas.

Brian Lucas

Brian Lucas is a Catholic priest of the Archdiocese of Sydney. He is presently the General Secretary of the Australian Catholic Bishops Conference in Canberra. Prior to that appointment he was the Financial Administrator and Secretary of the Archdiocese of Sydney. He has academic qualifications in law, general studies and theology. He is an adjunct professor of the Australian Catholic University, and a member of the ATO Charities Consultative Committee. He has served on numerous Boards and Advisory Bodies for Church and other not for profit organisations. He is a co-author of the *Church Administration Handbook.*

Elizabeth Lucas

Elizabeth Lucas is a Tax Partner with Grant Thornton Australia. Elizabeth was appointed as a member of the ATO's National Tax Liaison Group — FBT Subcommittee on 11 September 1997 and she chairs the Taxation Institute's FBT sub-committee. Elizabeth has a wealth of experience and knowledge on fringe benefits tax and other taxes gained over more than 20 years consulting in this area. Elizabeth has particular experience in the NFP sector, having advised a broad spectrum of many NFP clients.

Greg Mackie OAM

Greg Mackie was formerly Executive Director of Ageing in SA Health and held the positions of Deputy Chief Executive in the Department of the Premier and Cabinet South Australia and Executive Director of Art SA. He has also been an elected member of the Adelaide City Council and was for 23 years a founding director of Imprints Booksellers in Adelaide. With past service on many arts boards, he was awarded the Medal of the Order of Australia in 2002 for his services to the arts, in particular as founder of the Adelaide Festival of Ideas. He has served widely in the community and arts sectors.

Tim Morris Smith

Tim Morris Smith joined Mission Australia as CFO in 2008. He is a UK Chartered Accountant with 20 years' experience providing strategic financial leadership and controllership in US, European and Australian companies, including special purpose entities, superannuation funds and trusts. At Mission Australia, Tim provides oversight for ethics, risk management, compliance and corporate governance, ensuring compliance with government obligations and regulatory requirements.

Heather Neil

Heather Neil has spent most of her career in the non-profit sector, working in sustainability, environment, city planning, health and most recently the animal welfare sector. Across all of these roles, Heather has been involved in informing, engaging and supporting community and individual action and influencing public policy and private sector practices. She has worked closely with Boards, members and volunteers as well as governments and other stakeholders. Heather has been CEO of RSPCA Australia for six years.

Ann O'Connell

Ann O'Connell is a professor of law at the Melbourne Law School. She holds degrees in arts (economics) and law and a master of laws by thesis from the University of Melbourne. Ann carries out research in corporate law and taxation, including in relation to the NFP sector. She is also Special Counsel at Allens, a member of the Advisory Panel to the Australian Board of Taxation, a Visiting Fellow at the Centre of Tax Law, Cambridge University, and a member of the ATO's Public Rulings Panel.

Anne Robinson

Admitted as a solicitor in 1980, Anne worked in two major Sydney law firms in commercial law, including resource development, finance and banking. Since then a significant part of Anne's compliance and preventative law work has been with NFP and educational institutions, covering a wide range of charities and education law issues. It was a logical step therefore in 2001 to establish Prolegis to act only for charities and other NFP organisations. In 2009 Anne established the Australian Charity Law Association, a body which exists to support the work of the charity and NFP sector in Australia by providing education for practitioners in this field, and support for charity law reform. In addition to her legal work, Anne has also been involved in governance of NFP organisations for 25 years, including serving on the boards of two large Sydney independent schools for 16 years, and also as a director and Chairman of the Board of World Vision Australia for 12 years until 2012.

Miranda Stewart

Miranda Stewart is Professor and Director of Taxation Studies at Melbourne Law School, University of Melbourne. She is an International Fellow of the Centre of Business Taxation at Oxford University and previously worked for the Australian Government in tax policy and legislation and in private practice at Arthur Robinson & Hedderwicks. She has taught at New York University School of Law, Osgoode Hall Law School, York University, Toronto, Canada and the University of Florida Law School. Miranda has many years' experience in comparative tax law and policy research and is co-author of many books and articles including Death and Taxes: Tax effective Estate Planning (4th ed, 2012 with Michael Flynn) and Tax Law and Political Institutions (ed, 2006), as well as acting as a consultant to governments and non-government organisations on tax reform.

Joe Zabar

Joe Zabar is UnitingCare Australia's Director of Services Sustainability responsible for identifying and advocating reforms to policy and processes that enhance the viability and sustainability of social services. Prior to joining UnitingCare Australia, Joe was a senior executive with the international development and humanitarian response organisation, CARE Australia. Joe has spent most of his working career in the area of international development in both the non-government and government sectors.

Appendix 2: NFP tax concessions —Tax Expenditures Statement 2012[118]

Exemptions	TES number and legislative reference	2011-12 $m	2012-13 $m	2013-14 $m	2014-15 $m	2015-16 $m
Deduction claimed by donors for gifts to deductible gift recipients	A64, Division 30 of the ITAA 1997	1,010	1,120	1,210	1,300	1,390
Deduction claimed by donors for gifts to private ancillary funds	A65, Item 2 of the table in Section 30-15 of the ITAA 1997	135	135	135	135	135
Income of certain international organisations is exempt from income tax (that is, UN, and WTO)	B5, Section 6 of the *international Organisations (Privileges and Immunities) Act 1963*	*	*	*	*	*
Interest withholding tax and dividend withholding tax exemptions for overseas charitable institutions	B6, paragraph 128B(3)(aa) of the *Income Tax Assessment Act 1936*	*	*	*	*	*
Income tax exemption for NFP private health insurers	B22, Item 6.3 of the table in Section 50-30 of the ITAA 1997	95	95	95	95	95
Tax exemption for incentives provided by governments under the National Rental Affordability Scheme — charities can choose to receive the payment as either alternative support mechanism or cash payment.	B32, Division 380 of the ITAA 1997	1	3	8	36	54
Income tax exemption for recreation-type NFP societies (that is, clubs or associations established for the encouragement of sport, music, or community service purposes)	B34, Section 50-10, and 50-45 of the ITAA 1997	*	*	*	*	*
Income tax exemption for industry-specific NFP societies and associations	B63, Section 50-40 of the ITAA 1997	*	*	*	*	*
Income tax exemption for non-charitable public or private ancillary funds	B67 — Section 50-20 of the ITAA 1997	Included in B68				
Income tax exemption for charitable funds (that is, religious or public educational institutions and funds, and clubs for community service purposes)	B68, Sections 50-5, 50-52 and 50-60 of the ITAA 1997	*	*	*	*	*
Income tax exemption for charitable, religious, scientific and community services entities	B69, sections 50-5 and 50-10 of the *Income Tax Assessment Act 1997* (ITAA 1997)	*	*	*	*	*

118 Treasury, *Tax Expenditures Statement 2012* (2013).

Exemptions	TES number and legislative reference	2011-12 $m	2012-13 $m	2013-14 $m	2014-15 $m	2015-16 $m
Income tax exemption for small NFP companies that has taxable income not exceeding $416 in a given income year	B70, Subsection 23(6) of the *Income Tax Rates Act 1986*	..	..	..	..	..
Refundable franking credits for charities and DGRs	B71, Subdivision 207-E of the *ITAA 1997*	800	*	*	*	*
FBT exemption for charities promoting the prevention or control of disease in human beings	D10, Section 5B and subsection 57A(5) of the *Fringe Benefits Tax Assessment Act 1986*	95	105	110	115	125
FBT exemption for public and NFP hospitals, and public ambulance services	D11, sections 57A(3) and 57A(4) of the *Fringe Benefits Tax Assessment Act 1986*	1,000	1,100	1,150	1,250	1,300
Exemption for accommodation, fuel and meals for live-in employees caring for the elderly or disadvantaged	D13, Sections 58 and 58U of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
Public benevolent institutions are provided with an exemption for FBT up to $30,000	D14, Subsection 57A(1)) of the *Fringe Benefits Tax Assessment Act 1986*	1,280	1,410	1,530	1,650	1,780
Exemption for certain fringe benefits provided to live-in employees providing domestic services to religious institutions and practitioners	D17, Section 58T of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
Exemption for fringe benefits provided to certain employees of religious institutions	D18, section 57 of the *Fringe Benefits Tax Assessment Act 1986*	85	90	95	105	110
Donations to DGRs made under salary sacrifice arrangements are FBT exempt	D47, Subsection 148(2) of the *Fringe Benefits Tax Assessment Act 1986*	*	*	*	*	*
FBT rebate for certain NFP, non-government bodies (includes religious institutions, trade unions, NFP scientific institutions)	D51, Section 65J of the *Fringe Benefits Tax Assessment Act 1986*	35	45	50	55	65
Capital gains tax exemption for the disposal of assets under the Cultural Gifts program	E9, Subsection 118-60(2) of the ITAA 1997	*	*	*	*	*
Testamentary gifts (that is, gifts made under a will) to a DGR are exempted from capital gains tax	E31, Subsections 118-60(1) and (1A) of the ITAA 1997	*	*	*	*	*
GST-free treatment — supplies by charitable institutions and non-profit bodies	H4, *A New Tax System (Goods and Services Tax) Act 1999*	*	*	*	*	*
GST exemption for the supply of religious services	H22, *A New Tax System (Goods and Services Tax) Act 1999*	25	30	30	30	35

Notes: * represents estimates that are unquantifiable
.. represents estimates that are rounded to zero

Appendix 3: List of submissions

- AAMRI
- ACT Government
- Adam Johnston
- Aged and Community Services Australia
- Allan Whitehead
- AMA Victoria
- Andrew B Spannenberg
- Anglican Church Diocese of Sydney
- Anglican Retirement Villages
- Anglicare Australia
- Australasian Men's Health Forum
- Australasian Society of Association Executives
- Australia Council for the Arts
- Australian Association of Christian Schools
- Australian Baptist Ministries
- Australian Catholic Bishops Conference
- Australian Christian Lobby
- Australian Communities Foundation
- Australian Conservation Foundation
- Australian Council for International Development
- Australian Council Of Jewish Schools
- Australian Council of Social Service
- Australian Council of Trade Unions
- Australian Indigenous Governance Institute Limited
- Australian Major Performing Arts Group
- Australian Medical Association and the Australian Salaried Medical Officers Federation
- Australian Museum
- Australian Neighbourhood Houses & Centres
- Australian Nursing Federation
- Australian Red Cross Society
- Australian Services Union

- BDO
- Beehive Industries of W.A. Inc.
- Bill Johnstone
- BoysTown
- Brian Page
- Brisbane Housing Company
- Bukal Consultancy Services P/L
- Business SA
- Cancer Council Australia
- Cancer Council SA
- Catholic Health Australia
- Central Land Council
- Centre for Appropriate Technology Inc
- Chamber of Commerce and Industry of WA
- Changemakers
- Chartered Secretaries Australia
- Church of Jesus Christ of Latter-day Saints
- Clubs Australia
- Cohousing Cooperative
- Community Alliance SA
- Community Business Bureau Inc.
- Community Council for Australia
- Community Employers WA
- Community Sector Banking
- Community Southwest
- Connecting Up Inc
- Conservation Council of SA
- Corporation of the Diocesan Synod of North Queensland
- CPA Australia
- Crowe Horwath
- Cure for Life Foundation
- Daniel Memmott
- Danks Trust
- Deaf Society of NSW
- Diabetes Queensland

- Diocese of Willochra
- ECH, Resthaven & Eldercare
- EPIC Employment Service Inc.
- Fig Tree Pocket Equestrian Club
- Foundation for Young Australians
- Foundation Housing Limited
- Fundraising Institute Australia
- GMHBA Limited
- Golf Australia
- Good Beginnings Australia
- Grant Thornton
- Greenfleet
- Group of Eight
- Haven
- Helen Macpherson Smith Trust
- Hillsong Church
- Housing Choices Australia Ltd
- Housing Industry Association
- Illawarra Forum
- Independent Schools Council of Australia
- Inspire Foundation
- Institute of Chartered Accountants Australia
- Institute of Public Accountants
- Interreach
- IRT
- James Brown Memorial Trust
- JBWere
- John Church
- John McLaren
- Joint submission from Queensland Sporting Clubs
- King & Wood Mallesons
- Ku-ring-gai Neighbourhood Centre Inc
- Leading Age Services Australia Qld
- Life Activities Clubs Victoria Inc
- Lifeline Australia

- Live Performance Australia
- Lord Mayor's Charitable Foundation
- Maroochy Waterwatch
- Master Builders Australia Ltd
- MATTILA Lawyers
- McMillanShakespeareGroup
- Mervyn Williams and Martin Kirkness
- Metro Church Toowoomba
- Mirboo North & District Community Foundations
- Mission Australia
- Monivae College
- Moore Stephens Australia
- Moore Stephens Melbourne
- Multiple Sclerosis Australia
- National Association for the Visual Arts
- National Council of Ambulance Unions
- National Heart Foundation of Australia
- National Parks Association of NSW
- National Aboriginal and Torres Strait Islander Legal Services
- Netball Australia
- North Australian Aboriginal Justice Agency Ltd
- North Coast Community Housing Company Ltd
- Not For Profit Accounting Specialists
- Novita Children's Services
- NRMA Motoring and Services
- NSW Federation of Housing Associations
- NSW Health
- OMF International
- Oxfam Australia
- Palmerston Association
- Peninsula Atheists
- Peninsula Health
- Peter Scott
- Philanthropy Australia
- Pitcher Partners

- Ports Australia
- PowerHousing Australia
- Public Health Association of Australia
- PwC Australia
- Queensland Council of Social Service
- Queensland Law Society
- RACV
- Road Safety Education
- Royal Automobile Association of SA Inc
- Royal Flying Doctors Service
- Royal Guide Dogs Tasmania
- Royal Society for the Blind
- RSPCA Australia
- Rural Housing Network Limited
- Salvation Army
- SDN Children's Services
- Sids and Kids ACT
- South Australian Council of Social Service Inc
- South Pacific Division of the Seventh-day Adventist Church
- Southern Junction Community Services
- Sovereign Hill Museums Association
- Spinal Injuries Association
- St George Community Housing
- St John Ambulance Australia
- St Vincent de Paul Society (WA) Inc
- St Vincent de Paul Society National Council
- Starlight Children's Foundation
- Surf Life Saving NSW
- SYC
- Taxation Committee of the Business Law Section of the Law Council of Australia
- The Australian Charities Fund
- The Hospital Reseach Foundation
- The Hugh Williamson Foundation
- The Ian Potter Foundation
- The Myer Family Company

- The Public Trustee of Queensland
- The Reach Foundation
- The Smith Family
- The Tax Institute
- Toukley & District Senior Citizens Club Inc.
- Trust for Nature
- Trust for Nature (Victoria)
- Uniting Church in Australia
- UnitingCare Australia
- Universities Australia
- University of Melbourne
- University of Sydney
- Variety Australia
- Victorian Employers' Chamber of Commerce & Industry
- Victorian Healthcare Association
- Victorian Hospitals' Industrial Association
- Vision Australia
- Voiceless
- WA Council of Social Service
- Wanslea Family Services Inc
- War Widows' Guild of Australia NSW Ltd
- Warakirri Asset Management
- Women's Housing Association Inc.
- WWF-Australia
- Wynnum Manly Leagues Club Ltd
- YWCA