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Tax insights

Talking tax reform: Not-for-profit sector

Understanding the context of the current arrangements for the Not-for-profit sector

The NFP sector and the community are intrinsically co-dependent, with Australian taxpayers supporting many NFP organisations and NFP organisations providing essential services to many disadvantaged people in the community. NFPs also provide many other services to the public (such as education, religion, sport and culture). In addition, the NFP sector is economically significant, generating revenue of about $107 billion, with total assets of $176 billion and employing approximately 1.1 million people (2012-13).

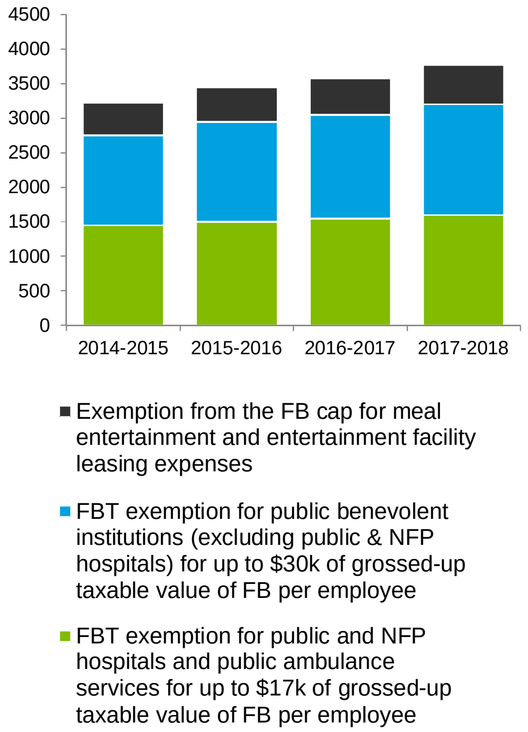
Reforming government concessions to the sector is a particularly sensitive issue, given the real possibility that any change could result in a decrease in funding and/or an increase in uncertainty around future income streams.

In terms of the concessions provided, there have been long standing concerns that fringe benefit concessions are not well designed in that:

- The benefits of FBT concessions are not evenly spread among NFP sector employees; only some entities are eligible for the capped FBT concession and some eligible for the rebate

Are the tax arrangements for the NFP sector appropriate? Why or why not?

- Apart from the recent temporary increase in connection with the Temporary Budget Repair levy, the $17,000 and $30,000 FBT exemption caps have not increased in the 15 years since they were introduced (and consequently their value has been eroded)
- The increasing cost of the concessions is also a focus of concern; FBT concessions have been costed in the Treasury Tax Expenditures Statement 2014 with a steadily increasing trajectory:



Some reform to concessions is already taking place. The 2015-2016 Federal Budget introduced a separate single grossed-up cap of $5,000 for salary sacrificed meal entertainment and entertainment facility leasing expenses for employees from 1 April 2016. In addition, all use of meal entertainment benefits is becoming reportable. Prior to this change, there were questions as to the appropriateness of the uncapped access to this concession on the grounds of fairness and equity.

A range of licenced clubs and societies, co-operatives, strata title bodies and other associations utilise the mutuality principle (which broadly excludes as income, transactions from members). There are also specific concerns about the mutuality principle; such as:

- 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
- Concerns about private member benefit.

A substantive review of the tax concessions for the NFP sector has already been performed by the NFP sector Tax Concession Group and recommendations included in their final report in May 2013. Some of the principal recommendations were:

- Income tax: To raise and simplify the tax threshold for taxable NFPs from $416 to $10,000
- Income tax: Normal income tax rules should apply to all member and non-member receipts of mutual organisations
- Income tax: All gaming, catering, entertainment and hospitality receipts of mutual organisations be subject to normal tax rules
- DGR status: The Government should review the property donation rules to simplify their operation
- FBT: Replace the following FBT concessions with an alternative support payment per eligible employee:
  - Exemption for benefits to employees of religious institutions
  - Exemption for benefits provided to employees of PBIs, health promotion charities, public & NFP hospitals, and public ambulance services
  - Exemption for live-in domestic workers for religious institutions
  - Rebate for certain tax exempt NFP (s65J)
- FBT: Ensure the capped FBT exemption for benefits provided to employees of PBIs, health promotion charities, public and NFP hospitals and public ambulance services is not available multiple times to an employee through multiple employers.

In addition to the above concerns around FBT and mutuality, the recent Tax Discussion Paper also considered that there was no clear rationale for providing income tax exempt status to a range of organisations such as employee or employer organisations and clubs established to encourage animal racing, sport, art, literature and music.

In terms of other reports and reviews of industry, the same themes around tax reform have been repeated, with the recent Productivity Commission Inquiry report into Childcare and Early Childhood Learning recommending that:

- The Australian government should remove eligibility of not-for profit early childhood care providers to FBT exemptions and rebates
- State and territory governments should remove eligibility of all not-for-profit childcare providers to payroll tax exemptions.

Red Tape and regulation is also a focus, with the Tax Discussion Paper indicating that the process of NFP organisations seeking DGR status is cumbersome and time consuming.

Implications for NFPs

There are opportunities to make submissions in respect of both the Tax Discussion Paper and the Green Paper. Further consultation about the Green Paper options will happen later this year:

- You may like to consider strategic partnerships: A cohesive partnership with a significant business organisation or industry organisation could add weight to your submission and also provide balance to their submission
- The Government is particularly focused on removing red tape, therefore any submission containing sensible suggestions to reduce unwieldy regulation, duplication or administration is likely to be embraced.

There are two key issues which appear frequently in Government initiated inquiries into the NFP sector:

- The issue of competitive neutrality – where NFPs compete in industries where there are commercial competitors who do not enjoy the same level of tax concessions
- Whether the concessions are achieving their policy objectives (particularly the FBT exemption caps and employee eligibility for multiple caps).

NFP organisations may like to consider what would be the impact on their service delivery should these particular concessions be removed in the future, and what types of funding could be an appropriate alternative.

It is also important for NFP organisations to be aware that some State and Territory governments are currently reviewing their tax systems. This review stands a good chance of leading to major changes to the way in which payroll tax and land tax are levied, and possibly also a narrowing of exemptions.

Deloitte perspectives

The rationale for providing tax concessions to the NFP sector continues to be valid, that is: without incentives, the overall level of activity in the NFP sector may be below what is optimal in society. The sector needs a financial assistance framework that supports it effectively.

It is therefore important that any changes to the funding models or tax concessions for NFPs are introduced in a manner that will cause minimal disruption to the sector; with sufficient notice so that transitional issues can be managed, and any necessary restructuring can be done in a measured and considered manner. We would suggest a lead time of 2-5 years should be allowed.

Any reform of the taxation arrangements for the sector should:

- Maintain the existing funding levels
- Be sufficiently certain (ie. tax concessions should not be replaced by a discretionary grant system as this could vary year to year depending on the government at the time, the economic conditions and other priorities).

From a regulatory and red tape reduction perspective, the existing tax concessions are complicated and difficult to administer. The concessions should be streamlined to apply as much as possible across all types of NFP entities. For example:

- Donations to all registered charities should be tax deductible. The difference between DGR status and charitable status is confusing
- The process for applying for DGR status could be streamlined.

From an equity perspective, some FBT and income tax concessions should be reviewed with a view to considering whether they have achieved their policy objective.

In addition, it should be acknowledged that the NFP sector is currently experiencing significant disruption as it adapts to challenges such as the aging population, changing trends around disadvantage, changing fund-raising and donation patterns and considers new ways to deliver services to its clients.

The sector will need to be more innovative in its service delivery, and increasingly agile in managing its assets to the best advantage. As the Australian economy continues to adapt to the end of the mining boom, and governments seek to change community expectations around government support, the NFP sector will become increasingly important in providing gap services to the poor and disadvantaged.

NFPs will continue to be key influencers in the debate around Government support, and this influence is likely to increase over time. However, some consolidation of the NFP sector is required, and a reform of tax concessions may provide the impetus to commence this consolidation.

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