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Charities Alert

Tax concessions for the not-for-profit sector

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On 2 November 2012 the Commonwealth government released the 'Not-for-profit sector tax concession working group' discussion paper (**Discussion Paper**). The purpose of this article is to discuss some of the key issues associated with the Discussion Paper.

Background

The Tax Concession Working Group (**Group**) was established by the Commonwealth government in February 2012. Its purpose was to consider ideas for better delivering the support currently provided through tax concessions for the not-for-profit (**NFP**) sector.

The Discussion Paper identifies specific issues that the Group believed important to consider, and asks 57 specific consultation questions. It appears to be a genuine discussion paper, in the sense of raising issues and asking for feedback and comments. For example, it states that the Discussion Paper is not a position paper and the options raised are not recommendations. So it seems that it would be worthwhile for NFPs to carefully consider the issues raised and how they will affect them, and participate in the consultation process.

The closing date for submissions is Monday 17 December 2012. The final date for the Group's report is now March 2013 (it was previously December 2012).

Key areas discussed

The key areas discussed in the Discussion Paper are:

- who should be exempt from income tax
- who should be eligible for refunds of franking credits, and should the ability to claim refunds be limited
- who should be entitled to receive deductible gifts (ie who should be 'a deductible gift recipient' (**DGR**))
- what tax concessions should be given to persons who make donations to DGRs (eg deductions or tax offsets (ie rebates))
- what should the minimum donation be before the donor is entitled to a tax concession
- should fringe benefits tax (**FBT**) concessions continue, or be replaced with something else
- if FBT concessions were to be replaced with something else, what should that be
- should changes be made to the goods and services tax (**GST**) concessions, and if so, what
- how should clubs be taxed?

This article will examine only some of the key aspects associated with what we consider to be the more interesting and important aspects of the Discussion Paper. These are not exhaustive and NFPs should carefully consider how the issues raised will affect them. It does not discuss other important tax reforms that may affect NFPs, such as taxing charities on 'unrelated commercial activities'.

Who should be eligible for refunds of franking credits?

In 2000 the tax law was changed to allow entities endorsed as tax exempt charities or tax exempt DGRs to claim a refund of franking credits on franked distributions made from Australian companies. The first important point to appreciate is that the refund is not available to all NFPs. So, for example, it applies to endorsed charitable institutions and funds, and endorsed DGRs, but it does not apply to tax exempt NFPs that are not required to be endorsed. Consultation question 5 is:

- 'Should other types of NFPs also be able to claim a refund of franking credits?'

We suggest that NFPs who are currently not entitled to claim a refund of franking credits consider:

- does this drive your investment decisions
- what would be the financial impact for you if refunds were allowed

- what additional benevolent services could you provide if refunds were allowed
- are refunds available to another NFP that provides the same or similar services?

The other very important issue raised in the Discussion Paper is the cost to revenue of the ability of NFPs to claim refunds of franking credits. For example, the Discussion Paper (page 15) states that the growth in this tax expenditure has averaged 12% per year over the last 5 years, when the average growth in Government revenue over the same period was 3.6% (though the growth in this tax expenditure fluctuated significantly during this period). The Discussion Paper also states (page 15) that 'It might also be argued that NFPs that are entitled to refunds of franking credits are likely to be large, well-resourced NFPs and that perhaps the tax expenditure could be used in a way that benefits a broader range of entities'.

We suggest that NFPs who are currently entitled to claim a refund of franking credits consider:

- what would be the impact on your investment decisions if refunds were not permitted
- what would be the impact on your services if refunds were not permitted
- if you are a 'large, well resourced NFP', what would be the particular consequences for you if you were denied refunds of franking credits and smaller organisations offering the same or similar services were allowed refunds of franking credits
- what reasons can you give to government to support the retention of the ability to obtain refunds of franking credits?

Who should be a DGR?

Broadly, DGRs are a subset of tax exempt NFPs. They are essentially NFPs that satisfy particular statutory requirements. As the Discussion Paper notes on page 19, there are around 50 general DGR categories, grouped into 14 overarching categories such as health, ancillary funds and welfare and rights. The most significant type are public benevolent institutions (**PBIs**). A PBI is essentially a NFP that provides direct services to people in need. So, for example, a NFP that provides medical services to people with a particular disease (eg cancer) could be a PBI, but a NFP that provides general public awareness services about cancer would not be a PBI (though it could be a tax exempt charity).

A specific question raised by the Discussion Paper (question 11) is whether all charities should be DGRs. At page 23 the Discussion Paper states that a possible reform is to expand DGR status to all endorsed charities. It considers that such a reform could significantly improve the fairness of the DGR system by making all charities operating for the public benefit to be eligible to be endorsed as DGRs. It anticipates that this would increase the number of DGRs from around 28,000 to at least 56,000.

Of course this raises the issue of cost to the revenue. In the current political climate it is unlikely that the Commonwealth government would introduce a reform that would have a significant net cost to revenue. So does this mean that this idea is not worth considering?

Interestingly, it appears that considering it is not a waste of time. On page 24 of the Discussion Paper the Group states that if DGR status were extended to all charities the estimated cost to revenue would be at least $1 billion a year. So where could $1 billion come from to make up for this cost? The Discussion Paper doesn't have an answer to this.

However, the Discussion Paper raises the possibility of a plan B, which seems would not have a material cost to revenue. Plan B (our words and not the Discussion Paper's words) is for DGR endorsement to be allowed for all charities, but limit the scope of activities for which the entity could use its DGR funds (page 25). Entities would not be able to use DGR funds for the advancement of religion, charitable child care services, and primary and secondary education.

The Discussion Paper on page 25 states that Treasury's preliminary estimates are that this would provide 42,000 charities with access to DGR funds (an increase of about 14,000), and have a cost to revenue of about $120 million a year. So where will this money come from?

This time there is a suggestion. For entities that are exempt from FBT, but subject to a cap on the benefits that can be provided that are exempt from FBT (discussed below), the provision of 'meal entertainment' and 'entertainment facility leasing' benefits are not subject to any cap. Such benefits include paying for meals at restaurants using an employer credit card and sacrificing salary for the employer to pay for a wedding. Where such benefits are salary packaged, they allow FBT exemptions in excess of the caps.

The Discussion Paper on page 59 indicates that bringing meal entertainment and venue hire within the relevant caps would generate an additional $100 million a year. This is about the same as the cost to the revenue of the plan B extension of DGRs. It seems to us that meal entertainment and venue hire not being subject to the caps is an accident of the complexity of the FBT legislation. So it may be politically possible for the Commonwealth government to remove this concession.

While there may be no significant net impact on the revenue by extending the DGR regime and removing these FBT concessions, it would essentially mean that current FBT exempt employers (or their employees) who are using these benefits in addition to benefits up to the cap would be funding the extension of the DGR regime.

We suggest that NFPs who are currently using meal entertainment and venue hire benefits in addition to capped benefits consider:

- are there any reasons you can give to government for the retention of the current concession
- what would be the impact on you, or employees, if this concession were removed
- would removal of the concession make it more difficult to obtain and retain key employees?

We suggest that NFPs who are not currently DGRs but who may become DGRs under the proposal raised in the Discussion Paper and be able to effectively use DGR funds consider:

- what would be the impact if donations to you were to become tax deductible
- what problems with fundraising do you currently have because you do not have DGR status
- what additional benevolent services could you provide if you could access DGR funds
- what reasons do you have relevant to your specific circumstances for the extension of the DGR regime?

What tax concessions should be given to persons who make donations to DGRs?

Broadly, currently deductions are allowed for donations to DGRs. The Discussion Paper at page 26 states that this mechanism is simple, transparent and effective. So why raise this as an issue?

The reason for this is that a tax **deduction** has a greater benefit the higher the donor's marginal tax rate. A tax offset (ie a rebate) has the same effect for everyone, irrespective of their tax rate (though unless the tax offsets are refundable, even they would not have a tax benefit for persons with no tax liability).

In summary, the options raised in the Discussion Paper involve:

- the current deduction system
- a fixed tax offset (ie rebate) eg 38%
- a two-tiered offset eg 34% for donations up to $1,000 a year and a 38% offset for donations of more than $1,000 a year
- a hybrid system of retaining deductions in some cases and allowing offsets in others eg donations to private ancillary funds (**PAFs**) could attract a tax deduction, and donations direct to DGRs could be offset under a single or multiple tax offset system.

We suggest that current DGRs, and charities who may be able to utilise DGR funds under the reform discussed above, consider:

- in what tax bracket are most of your donors
- would lowering the effective tax benefit (eg currently 46.5% to a donor in the top tax bracket to 34% or 38%) have a negative impact on what you think you would be able to obtain as donations
- if there is a tax advantage in donors donating to a PAF rather than directly to you, what do you think the impact on you would be eg do you currently have large donors who may change their donating behaviour (for a donation to a PAF, broadly, only 5% of that donation needs to be distributed to a 'doing' DGR each year)?

What should the minimum donation be before the donor is entitled to a tax concession?

Currently, donations of $2 or more are deductible. This $2 threshold was introduced in 1927 (reduced then from 20 pounds to 1 pound (page 18 of the Discussion Paper)). The Discussion Paper discusses raising the threshold (eg to $25 per gift). It considers this would simplify administration for DGRs and donors (page 31).

We suggest that current DGRs, and charities who may be able to utilise DGR funds under the reform discussed above, consider:

- what, if any, are the administrative problems that you face with small donations
- do you want the government to solve these problems for you
- do you think raising the threshold will result in more or less donations to you?

Should FBT concessions continue, or be replaced with something else, and if so, what?

The current FBT system in general, and as it applies to the NFP sector, is quite complicated. For example:

- certain benefits are exempt and not subject to any caps eg PBIs providing meal entertainment expenses, benefits to religious practitioners
- certain benefits are exempt, but subject to a $30,000 grossed-up taxable value cap per employee eg PBIs that are not hospitals
- certain benefits are exempt, but subject to a $17,000 grossed-up taxable value cap per employee eg PBIs that are hospitals

- certain NFPs are entitled to a rebate on benefits subject to a $30,000 grossed-up taxable value per employee (with the rebate on meal entertainment and entertainment facility not being capped)
- other NFPs are not entitled to an exemption or rebate.

To add to the complexity, salary packaging has different tax benefits depending upon the marginal tax rate of the employee. And the revenue cost of all this is significant. The Discussion Paper at page 34 states that the total quantifiable cost is about $2.5 billion (presumably a year) with additional unquantified FBT concessions likely to add several hundred million. The Discussion Paper at page 34 indicates that the cost to revenue for NFPs who are entitled to exemptions with a $30,000 cap per employee was about $1.3 billion for 2011-12 and for NFPs who are entitled to exemptions with a $17,000 cap per employee the cost to revenue was about $1 billion.

The Discussion Paper at pages 37 to 38 raises the following concerns with the current FBT concessions:

- inconsistency of treatment between different types of NFPs
- competitive advantages provided to certain NFPs as against taxable competitors eg NFP private hospitals v private for-profit hospitals
- concessions that do not seem to have a policy justification eg meal entertainment and entertainment facility benefits
- administrative burdens for NFPs eg administering salary packaging.

Reform options raised in the Discussion Paper include:

- including meal entertainment and entertainment facility benefits within the caps
- employees only being entitled to one cap, not a separate cap for each employer
- phasing out the capped FBT concessions and replacing them with alternative government support eg direct government grants
- phasing out the FBT concessions and replacing them with alternative tax-based mechanisms eg a refundable tax offset for eligible employers (suggested that this could be about $2,800 per employee of a PBI), or a direct tax offset or a capped tax-free allowance for employees of eligible employers
- limit concessions to benefits that are incidental to employment, which would retain the essence of the current system but eliminate concessional treatment of salary packaged benefits.

We suggest that NFPs, both those currently entitled to FBT concessions and those that are not, consider:

- how is the current FBT system impacting on you
- what problems do you face with the duel cap system
- what would the impact be on you if there were only one cap, eg between the existing 2 caps
- do you think the current system should be retained
- what would the consequences be for you if you had to apply to a government agency for a grant similar to the financial impact of the current FBT concessions you are receiving eg what should be the eligibility criteria, what additional costs would there be to you
- would a grant of a fixed amount per employee instead of the current system have a positive or negative impact on you
- if the current system were retained, but you could not apply the tax concessions to packaged benefits, what would be the impact on you?

Conclusion

The Discussion Paper raises many significant issues. For example, any extension of the DGR system or removal of FBT concessions may have significant ramifications. We recommend that NFPs carefully consider the issues raised in the Discussion Paper and how they will be impacted by them.

It seems that the Group will genuinely take into account submissions on the Discussion Paper. NFPs now have the opportunity to be part of the consultation process. For details on how to make a submission please click here.

Our tax group can assist by advising on the ramifications for you of any of the reforms discussed in the Discussion Paper, and helping with any submissions. We believe that submissions, particularly with concrete examples dealing with any concerns that NFPs may have with any of the reforms raised in the Discussion Paper, should improve the eventual recommendations. Also, submissions on any reforms that are supported should also lead to a better result.

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