Catholic Social Services
Australia

Better Targeting of Not-For-Profit Tax Concessions

Submission in response to the Treasury Consultation Paper

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Better targeting of not-for- profit tax concessions

This submission provides a response to the 27 May 2011 Treasury Consultation Paper on "Better targeting of not-for-profit tax concessions'. It is based on advice from the membership of Catholic Social Services Australia.

Catholic Social Services Australia welcomes the opportunity to contribute to policy development on the issues highlighted in the Consultation Paper. This submission is part of a wider submission of the Australian Catholic Bishops Conference.

The submission is structured as follows:

Introduction

Revenue generated by not-for-profit agencies should be applied to the core mission and purpose of those agencies. Within the Catholic Social Services Australia network, revenue generated from service operations is directed back into the core mission and services of member agencies.

Catholic Social Services Australia members are concerned that implementation of an unrelated business income tax (UBIT) as proposed in the Consultation Paper is likely to reduce the resources available to provide community services. Some member agencies believe that they would be unable to continue their full range of community services for disadvantaged Australians if they implemented the UBIT as proposed.

Catholic Social Services Australia endorses the proposal made in the submission by the Australian Catholic Bishops Conference that the appropriate sequence of reforms in this area would be to first establish the Australian Charities and Not-for-Profit Commission (ACNC) and codify a common law definition of 'charity' before finalising legislation on tax concessions.

About Catholic Social Services Australia

Catholic Social Services Australia has 70 member agencies located in Australia (Appendix 1) and is the peak national body for the Catholic Church on social services. Its members employ around 10,000 people and provide 500 different services to over a million people each year in metropolitan, regional and rural Australia.

Its mission is to promote a fairer, more inclusive society that gives preference to helping people most in need. It is committed to an Australian society that reflects and supports the dignity, equality and participation of all people. To this end, Catholic Social Services Australia works with Catholic agencies, governments, other churches and all people of goodwill to develop social welfare policies and other strategic responses that work towards the economic, social and spiritual wellbeing of the Australian community.

Summary of Recommendations

Recommendation 1:

Establish a definition of charity before drafting legislation.

Recommendation 2:

Address concerns about inappropriate use of NFP tax concessions through a review of the adequacy of existing federal and state mechanisms and consider whether the ACNC should have the power to investigate agencies where there is a demonstrable case presented.

Recommendation 3

Ensure that the proposed measures do not inadvertently reduce the resources available for essential social service delivery and discourage holistic ('wrap-around') responses, innovation and social entrepreneurship.

Recommendation 4:

Ensure that the compliance red tape burden on NFP agencies is not increased due to these measures.

Recommendation 5:

Define related business, unrelated business, commercial activity, unrelated commercial activity or establish a relevant principle for the application of these terms.

Recommendation 6:

Specify the basis for reinvestment of retained earnings

Recommendation 7:

Accept that competitive neutrality will operate differently in markets where NFP's and for-profits operate side-by side.

Policy Setting

The major reviews of the not-for-profit (NFP) sector conducted between 1995 and 2010 all recommended significant reform to government regulatory arrangements for the sector. Regrettably, little change took place. However, in the 2007 federal election campaign, the ALP made a commitment to implement a social inclusion policy and, after the election, was vigorous in pursuing a National Compact with the Not-for-Profit sector.

With the stated policy goal of "improving the way we work together now and in the future", that process culminated in the signing of a National Compact in 2010. This set the scene for a period of intense activity, leading to a NFP Reform Council, an Office for the NFP sector in the Department of Prime Minister and Cabinet and a 2011/12 budget announcement to establish an Australian Charities and Not-for-Profit Commission (ACNC).

In that setting, the announcement of the proposed unrelated business income tax (UBIT) in the 2011/12 Federal Budget appeared at odds with the National Compact principles and the pattern of collaboration which had been established with the sector since 2007. Having engaged as a network with the federal government to pursue a reduction in NFP red tape and compliance costs, promote innovation and transparency and other measures, the UBIT announcement reflected a major change of approach. Moreover, neither the budget announcement nor the Consultation Paper provide the basic information needed for the sector to consider the substantial 'new risks' to which the Assistant Treasurer has referred[1].

The conclusion from "Australia's Future Tax System Review" is relevant to the process involved in developing any NFP tax legislation. It said that:

> *"Tax policy, legislation and administration should be developed using a consultative, transparent approach to help achieve better targeted and more practical solutions, reduce unintended consequences and support community confidence in the system."* [2]

In May last year, the Deputy Prime Minister and Treasurer Swan explained the Government's response to that Review. Referring to the 'first steps in a 10 year agenda', he identified a number of policy changes which the Government would not implement at any stage. One of those was that the Government would not:

> *"Do any changes to the tax system that harm the not-for-profit sector, including removing the benefit of tax concessions, raising the gift deductibility threshold or changing income tax arrangements for clubs (see Rec 9e, 13, 41, 43 & 44)."*[3]

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[1] Assistant Treasurer's National Press Club Address, 27 May 2011. (http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=speeches/2011/019.htm&pageID=005&min=brs&Year=&DocType=1)

[2] Australia's Future Tax System: Report to the Treasurer, December 2009, Part Two, Detailed Anaylsis, p. 649. (http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/Publications/Papers/Final_Report_Part_2/index.htm)

[3] Treasurer's Media Release No. 028, 2 May 2011. (http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/028.htm&pageID=003&min=wms&Year=2010&DocType=0)

Given the Treasurer's statement; the National Compact commitment about a process for achieving reform change; the recommendation of the "Australia's Future Tax System Review" and the absence of evidence about the substantial new risks facing Government, Catholic Social Services Australia finds the urgency of the proposed UBIT perplexing.

Our network recommends that legislated tax reform for NFPs should be undertaken only after:

- a statutory definition of charity and an ACNC are in place and;
- a review of weaknesses in existing state and federal regulatory powers regarding risks has been carried out.

Recommendations

Recommendation 1

Establish a definition of charity before legislating on NFP tax matters.

The Government has committed to put in place a statutory definition of charity by 1 July 2013, following a period of consultation. Yet it proposes to legislate a UBIT in advance of that critical process. Catholic Social Services Australia believes that legislative changes to the framework of NFP tax concessions needs to be based on clarity about a definition of charity.

We endorse the proposal made in the Australian Catholic Bishops Conference submission that the ACNC should be first established, to then oversee the codification of the common law definition of 'charity' and that, then, legislation relating to future access to tax concessions be considered.

Recommendation 2:

Address concerns about inappropriate use of NFP tax concessions through a review of the adequacy of existing state and federal mechanisms and consider whether the ACNC should have the power to investigate agencies if there is a demonstrable case presented.

The Consultation Paper (para. 40) refers to the proposed changes being based on a principles-based approach to tax law design in accordance with the Government's commitment to improving tax system governance. Such an approach would normally start with an articulation of the specific nature and scale of new risk involved and an analysis of whether current regulatory remedies available to federal and state governments are adequate. These steps are especially important when the administrative and financial cost of the measures to many charities and NFP agencies could be substantial.

Therefore, Catholic Social Services Australia recommends that a review of weaknesses in applying the existing federal and state regulatory powers be undertaken as a matter of urgency. This would include powers related to tax avoidance and the structure of Division 50 of the Income Tax Assessment Act 1997 and the powers of the State and Territory Attorneys-General.

One option is for the ACNC to be given powers to investigate NFP agencies which are suspected of redirecting their surplus to other than their core function and purpose, if there is a demonstrable case presented.

The role of the Board of Taxation should also be considered in this regard. It has the capacity to examine any Bill to ensure that it will meet the policy aims of Government.

Recommendation 3

Ensure that the proposed measures do not inadvertently reduce the resources available for essential social service delivery and discourage holistic (wrap-around) responses, innovation and social entrepreneurship.

A range of Catholic Social Services Australia members had advised that the administrative costs associated with implementing the UBIT are likely to be substantial and that they would divert limited resources away from core service delivery. There is also the probability of loss of access to existing NFP tax exemptions, especially under Options 1 & 2 (Paragraphs 54-64) which would have a significant impact on wage costs.

An example is of one Catholic Social Services Australia member which delivers domestic violence and homelessness services, accommodation support, casework and counselling to homeless women and children and to women and children affected by domestic violence. Annual expenditure for these services is approximately $450,000. The organisation currently receives only $72,000 from the state government for the program. The shortfall of $378,000 needed to operate these services is generated by operating centre-based and home-based child care services, as well as from donations and investments. All revenue from these sources is ultimately directed back into the core functions and purpose.

If Option 1 as proposed in this Consultation Paper was to apply to such a child care service, the likely outcome would be a reduction in funding available to support the mission and purpose of the organisation in assisting women and children who are homeless and escaping domestic violence.

Another example is of a member delivering employment services under the Jobs Services Australia contract. In this case, the requirement to create a separate entity in which no FBT exemptions would be available for staff salaries would undermine the agency’s capacity to operate this service. In this case, because only a small surplus is achieved (and not every year), the agency assesses the lost FBT exemptions would make the operation unviable.

Recommendation 4

Ensure that the compliance red tape burden on NFP agencies is not increased due to these measures.

The additional red tape and compliance costs of the proposed UBIT are expected to be much higher than anticipated by Government. Advice from Catholic Social Services Australia members points to boards and managers needing to access legal and accounting advice to ensure satisfactory compliance with the new measures and to make necessary changes to their governance structures.

Based on external advice, one of our larger members estimates the costs associated with compliance under the UBIT as follows:

> *"The initial **internal** establishment costs and changes to the current system are estimated at not less than $250,000.*
>
> *The on-going **internal** cost of tracking surpluses and their application is anticipated to involve two people and a total cost of around $200,000 per annum.*
>
> *The initial **external** establishment costs, for legal and accounting fees are estimated at not less than $30,000.*
>
> *The **external** costs associated with tax advice on issues to do with stamp duty and capital gains tax may not arise initially but are estimated at $10,000 per transaction. External advice on transfer pricing issues is estimated at not less than $5,000 per annum. The cost could be a lot greater.*
>
> *In addition, the ongoing **external** costs of tracking surpluses in the application are estimated at not less than $5,000 per annum."*

These additional costs translate directly into fewer resources for disadvantaged clients.

Recommendation 5

Define 'related business', 'unrelated business', 'commercial activity', 'unrelated commercial activity' or establish a relevant principle for the application of these terms.

The absence of a definition of *related business, unrelated business, and commercial activities* was a principal concern expressed about the Consultation Paper by the Catholic Social Services Australia network. An appropriate definition would reflect the large diversity of services provided by NFP agencies and the ways in which those services are linked to core mission and purpose.

Activities which generate a surplus and lead to a financial transfer to the agency's core mission and purpose over time should be treated as "related". There is a high risk that any other approach would diminish both service innovation to meet client needs and resources available for service to individuals and families in the community. This would also run counter to the Government's consistent promotion of greater enterprise by the sector in diversifying its income sources and service offerings.

In addition to adopting a broad definition of "related business", Catholic Social Services Australia recommends that a self-assessment methodology be used by NFP agencies in defining related or unrelated business and that the ATO to provide detailed guidance in advance of the implementation of legislative measures.

Recommendation 6

Specify the basis for reinvestment of retained earnings

The Consultation Paper's treatment of earnings is a particular concern to the Catholic Social Services Australia network because a significant range of uses of retained earnings are still tied to the agency's core mission and purpose. These include investment for medium term viability and broadening client services to meet demand. As long as these investments are demonstrably linked to the agency's core mission and purpose, they should not be subject to the removal of tax concessions or income tax. Nor should any arbitrary 'fixed cap' figure be placed on NFP's retained earnings.

The experience of this network is that the level of retained earnings required to keep operations fluid and realise enhanced service delivery options is relative to the scope and nature of services delivered by each individual member agency. In addition, the ATO should consider any surpluses from such entities within a multi-year framework, so that surpluses can be seen to be linked to the core mission and purpose of the agency over time.

Recommendation 7

Accept that competitive neutrality will operate differently/look different in markets where NFP's and for-profits operate side-by side

The Consultation Paper suggests that NFPs with tax concession status are provided with special advantages in operating against for-profit providers. This is an opinion which was considered and rejected by the Industry Commission Inquiry of 1995, the Productivity Commission Review into the Not-for Profit sector of 2009 and Australian's Future Tax System" in 2010.

For example, the Industry Commission concluded that:

> *"Income tax exemption does not compromise competitive neutrality between organisations. All organisations which, regardless of their taxation status, aim to maximise their surplus (profit), are unaffected in their business decisions by their tax or tax-exempt status. CSWO commercial activities do have certain advantages over for-profit firms, such as better cash flows. However, for-profits also have certain advantages over CSWO commercial organisations.*

These include easier access to capital, both equity and debt, and the ability to personally benefit from profits. The overall situation is unclear."[4]

The Australian's Future Tax System Review similarly concluded that there was no significant lack of competitive neutrality:

"The NFP income tax concessions do not generally violate the principle of competitive neutrality where NFP organisations operate in commercial markets." [5]

The Consultation Paper provided no reason to believe that circumstances had changed to warrant an alternative analysis on this matter.

Conclusion

Catholic Social Services Australia fully supports the Government in its efforts to ensure that revenue generated by not-for-profit agencies should be applied to the core mission and purpose of those agencies.

The UBIT as proposed in the Consultation Paper has the potential to have unintended negative impacts on the NFP sector.

[4] Industry Commission, Charitable Organisations in Australia, Report No. 45 1995. Para K.2.4 at page K5).(http://www.pc.gov.au/ic/inquiry/45charit)

[5] Australia's Future Tax System: Report to the Treasurer, December 2009, Part Two, Detailed Anaylsis, para B3-2, p. 209. (http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/Publications/Papers/Final_Report_Part_2/index.htm

Member Organisations

BoysTown
Bridgeworks Employment and Training
Catholic Community Services
Catherine House Inc.
CatholicCare Hunter-Manning
CatholicCare Canberra & Goulburn
CatholicCare Melbourne *(Formerly Centacare Catholic Family Services)*
CatholicCare NT
CatholicCare Social Services - Diocese of Parramatta
CatholicCare Sydney
CatholicCare Wollongong
Catholic Marriage Education Services (Perth)
Catholic Society for Marriage Education
Centacare Ballina (St Francis Xavier's Parish)
Centacare Brisbane
Centacare Casino, St Mary's Parish
Centacare Catholic Diocese of Ballarat Inc
Centacare Catholic Family Services Adelaide
Centacare Catholic Family Services Broken Bay
Centacare Catholic Family Services Port Pirie Diocese
Centacare Catholic Family Services Townsville
Centacare Catholic Family Services Wagga Wagga
Centacare Cairns
Centacare Employment & Training Perth
Centacare Family and Community Services Bathurst
Centacare Geraldton
Centacare Gippsland (Sale)
Centacare Kimberley
Centacare New England North West
Centacare Port Macquarie
Centacare Rockhampton
Centacare Sandhurst (Bendigo)
Centacare Tasmania
Centacare Toowoomba
Centacare Wilcannia-Forbes
Centrecare Inc. Perth
Conference of Leaders of Religious Institutes in NSW CLRI (NSW)

Daughters of Charity of St Vincent de Paul
Dunlea Centre, Australia’s Original Boys’ Town
Good Grief
Jesuit Social Services
MacKillop Family Services
Marist Youth Care
Marriage Education Program Inc.
Maronite Community and Social Services
Mary Aikenhead Ministries
Marymead Child and Family Centre
MercyCare
North West Queensland Indigenous Catholic Social Services
Mercy Family Services (Qld)
Personal Advocacy Services
Rosemount Good Shepherd Youth & Family Services
Sacred Heart Mission St Kilda
Sisters of Charity of Australia (Associate Member)
Sisters of Mercy Brisbane CLT
Sisters of Mercy Grafton (Associate Member)
Sisters of Mercy Parramatta
Sisters of Saint Joseph of the Sacred Heart CLT
Sisters of St Joseph Ain Karim
Sisters of The Good Samaritan
South Australian Province of the Sisters of St Joseph
St Anthony's Family Care
St Francis Social Services
St John of God Health Care - Social Outreach and Advocacy
St Joseph’s Cowper Inc
St John of God Casa Venegas
St Michael's Family Centre Limited
St Patrick's Community Support Centre (Fremantle)
Sts Peter & Paul Centacare
Trustees of the Presentation Sisters (Wagga)