

1 May 2009

Supplementary submission to the review of Australia's future tax system

This submission sets out the additional views of the Australian Conservation Foundation (ACF) on the Consultation Paper on Australia's future tax system. ACF's original submission to the review, dated 30 October 2008, addresses several sections of the Consultation Paper in detail, particularly 12 (Fuel, Roads and Transport), 13 (Impacts on the Environment) and 14 (Natural Resource Charging).

This submission provides some additional information on the environmental impacts of the fringe benefits tax (issue 13), and some views on the taxation of not-for-profit organisations (issue 7). We would be pleased discuss further any of the ideas and concepts outlined in this submission.

Summary

1. Fringe Benefits Tax Reform

The FBT statutory fraction for company cars should be based on the Green Vehicle Guide rating for the vehicle, rather than distance driven per year. Economic modelling shows that such a shift would reduce emissions from new vehicles by at least 20%, be revenue-positive, and would support transition of domestic production to cleaner vehicles.

2. Not-for-profit organisations

ACF is broadly supportive of the current system of NFP tax concessions. The system could be improved by:

- Consolidating the number of categories of NFPs (provided that existing NFPs are not subject to a reduction in entitlements);
- Reducing compliance costs by eliminating duplicative procedures, such separate assessments of charitable status by numerous state and federal authorities;
- Establishment of a national regulator for the NFP sector; and
- Retention of tax concessions as the primary form of support for NFP sector, as a more efficient and desirable than other forms of direct support, such as government grants.

1. Fringe Benefits Tax reform

Q13.2 Noting that many submissions raise concerns over unintended environmental consequences of taxes and transfers, such as the fringe benefits tax concession for cars, are there features of the tax-transfer system which encourage poor environmental outcomes and how might such outcomes be addressed?

As noted in the consultation paper, there is widespread concern that the way in which company car benefits are valued for FBT purposes provides an incentive for personal vehicle use over other modes of transport, and encourages excessive driving. ACF's analysis of the issue is contained in Section 5 of our original submission.

Since our original submission, additional work has been conducted on the implications of restructuring the FBT rule, so that the statutory fraction applicable to a company car benefit is based on the efficiency of the vehicle, rather than the distance driven per year.

The Australian Government Green Vehicle Guide¹ provides a useful existing benchmark for such a reform. The following table is an example of how this reform could be implemented.

Kilometres driven	FBT statutory fraction
Less than 15,000	26.0%
15,000-24,999	20.0%
25,000-40,000	11.0%
More than 40,000	7.0%

Current formula encourages excessive driving...

Green Vehicle Guide Rating	FBT statutory fraction
4 - 5 Stars	7.5%
3.5 Stars	12.0%
3 Stars	20.0%
Less than 3 Stars	24.0%

...reform based on green vehicle guide rating would reward efficiency.

According to modelling conducted by Access Economics and commissioned by McMillan Shakespeare Australia (Australia's largest salary packaging company), tying FBT concessions to the Green Vehicle Guide star rating system would shift car purchasing decisions towards more efficient vehicles, resulting in a 20% reduction in greenhouse emissions from new vehicle fleets. Additional reductions are likely to the extent that the reforms result in fewer average kilometres per vehicle per year.

The modelling also shows that this reform would result in a net positive impact on government revenue of \$186 million annually, and would have minimal negative impact on domestic manufacturing. Based on the current production mix for domestic and foreign vehicles, the proposed reform could reduce demand for domestic vehicles from 1.1 % - 1.7%.

However, a shift to production of efficient vehicles, as all Australian manufacturers are planning, will reduce or eliminate even that minor impact. Efforts to re-tool the Australian car industry for cleaner vehicle include a significant Commonwealth investment through the Green Car Innovation Fund. Of the Australian manufacturers, Ford has announced it will begin production of a small car in Melbourne from 2011, Toyota will commence Camry hybrid production in Australia in 2010, and Holden will produce a

¹ www.greenvehicleguide.gov.au

small car in Adelaide from 2010. FBT reform will help drive market demand for this new generation of domestically-produced efficient cars.

FBT reform would have administrative benefits as well. Currently, assessment of FBT rates entails significant burdens, as drivers must maintain records of fuel purchases each year. A regime based on the green car rating requires no ongoing record-keeping burden, thus simplifying the tax system for taxpayers and the ATO alike.

The submission of McMillan Shakespeare Australia to the Review includes the economic modelling by Access Economics referenced above. It is our understanding that Salary Smart, another major salary packaging company, is supportive of this reform in principle as well, based on their submission to the Review.

2. Not-for-profit organisations

Q7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

Q7.2 Given the impact of the tax concessions for NFP organisations on competition, compliance costs and equity, would alternative arrangements (such as the provision of direct funding) be a more efficient way of assisting these organisations to further their philanthropic and community-based activities?

ACF supports the overall system of tax concessions for NFP organisations. These organisations play a critical role in civil society, and support through the tax system is an appropriate and generally efficient way to foster philanthropy a culture of philanthropy, public service and community engagement that individuals who support NFPs epitomise.

There are, however, areas where improvement of the system is desirable. The current structure can create unnecessary complexity and compliance costs, particularly through the proliferation of categories of NFPs and through a lack of inter- and intra-governmental coordination on tax issues relevant to NFPs. The establishment of a national regulatory body for NFPs would assist in ensuring ongoing efficiency and effectiveness of NFP regulation.

While the administration of the existing concessions can be improved, replacement of existing concessions by other means (such as direct grants) would generally not be a more efficient way of assisting NFP organisations. Grants would entail significantly higher administrative costs for NFPs and governments alike, would reduce certainty of funding, and could have serious adverse consequences for the independence of NFP organisations from governments.

2.1 Simplification of categories of NFP organisations

As noted in the consultation paper, there are numerous categories of NFP organisations. At the Commonwealth level, distinctions are made among deductible gift recipients (DGRs), income-tax exempt charities (ITECs), public benevolent institutions (PBIs), community service organisations (CSOs), and an array of sub-categories within each of these. When various state categories are added, the list grows further.

It would appear that the types of organisations and the entitlements for each have developed organically over time, with little apparent rationale behind the distinctions between them. There is substantial overlap between some categories, with associated administrative duplication and complexity.

There appears to be a good case for rationalising the number of categories of NFP organisations, provided that such a process would not reduce the entitlements that current NFPs can access. For example, it may be desirable to combine the categories of DGR, ITEC and PBI into a single category of “charity”, with the benefits of each of those three separate categories accruing to all qualifying “charities”.

2.2 *Reduction in compliance costs*

There is currently no central regulator or coordinating body for regulation of the not-for-profit sector in Australia. With respect to taxation, the lack of coordination among state and federal agencies can impose significant regulatory burdens for little discernable benefit.

For example, a major review conducted on behalf of the National Roundtable of Nonprofit Organisations, “The Assessment of Charitable Status in Australia, identified 178 pieces of legislation under which a NFP’s status as a charity has to be determined, and no fewer than 19 government agencies at Commonwealth and State levels (including the ATO and state revenue agencies) that are regularly involved in making those determinations. Each of these 19 has its own processes, forms and evidentiary requirements. Each undertakes its own assessment of an entity’s status as a charity, even though the legal test is identical. On occasion, they reach inconsistent results, or conduct separate reviews with little or no coordination with other authorities.

The ACF’s experience under this system is instructive. The Commonwealth recognised ACF as a charity in 1970, but ACF has had to apply separately to each state revenue office for recognition as a charity as well, for state tax purposes.

Notwithstanding the Commonwealth recognition of ACF as a charity, Victoria initially refused to accord ACF charitable status. This led to a legal challenge, culminating in a legal challenge that resulted in ACF being recognised as a charity for purposes of the Victorian Payroll Tax Act in 2002.²

The process entailed an exhaustive examination of the ACF’s Constitution, purpose and activities, and resulted in a decision that ACF was a charity under the common law, and was therefore entitled to the payroll tax concessions.

Only three years later, ACF was faced with yet another review of its charitable status by the Australian Taxation Office, as part of the ATO’s ongoing compliance program. The review covered the same ground as the Victorian process, and reached the same conclusion. Each process consumed many dozens of hours of staff time, including significant senior management attention.

Of course, none of these processes was in any sense improper, yet it is unclear what was gained by having two regulators examining the same substantive question in such detail within such a relatively brief timeframe. A system of a single national determination of charitable status would have served all involved much better.

2.3 *Establishment of a NFP national regulatory body*

The National Roundtable of Nonprofit Organisations has for many years called for reform to address the numerous, inconsistent and overlapping laws and agencies regulating the not-for-profit sector, particularly in relation to taxation law³. Most recently the case for establishing a national NFP regulator, with responsibility for determining charitable status (amongst other things) was made by many during the recent Senate enquiry into NFP disclosure regimes, and is one of the principal recommendations in

² Australian Conservation Foundation Inc v Commissioner for State Revenue Victoria [2002] VCAT 1491

³ See National Roundtable of Nonprofit Organisations – Nonprofit Regulation Reform Program – May 2004 (http://www.nonprofitroundtable.org.au/Content/NavigationMenu2/PolicyRegulatoryReform/documents2/Reg_Ref orm-Statement.pdf)

the Committee's report⁴. ACF strongly supports that recommendation, and the establishment of a national regulator would greatly facilitate the resolution of the regulatory inefficiencies described above, among others.

2.4 The efficiency of current NFP tax concessions, compared to direct grants or other support

Governments are, understandably, geared to pursuing a particular agenda, derived from the political process. The purpose of civil society, on the other hand, is to constitute an independent source of strength within society, which is at once able to give expression to a diversity of viewpoints and priorities, including priorities not shared by the government of the day, and also to be an independent check and source of accountability for governments.

Frequently there will be constructive cooperation between governments and NFPs on a wide range of issues. However, the potential for differences can not be ignored, and there will always be the possibility of tension or even conflict between the desires of government to prosecute their agenda, and the role of NFPs in pursuing other priorities and monitoring government performance.

In this regard, the temptation for governments to utilise grant agreements or other forms of support as points of leverage and influence on NFPs can not be disregarded. For example, governments may be inclined to refuse grants, or to attach onerous conditions to such grants, for NFPs that have been critical of the government.

Of course, this is a possibility for benefits such as tax concessions as well, but in practice grant programs can be used as pressure points on nonprofit organisations much more readily than tax rules, which generally provide entitlements of broad applicability that are much more difficult to change. It is instructive that many Commonwealth grant agreements up until 2008 included "non-advocacy clauses", which prohibited recipients from engaging in critical communications.

The ability of governments to attach conditions to grants stands in stark contrast to the requirement that charitable donations be made unconditionally. As a consequence, indirect forms of funding such as the existing NFP tax concessions provide organisations with far more freedom to set their own agendas and develop more appropriately targeted programs than would otherwise be the case.

Freedom from government interference (both real and perceived) is particularly important for advocacy organisations whose reputations are built on an ability to comment openly on government policy. Increased reliance on government funding diminishes an advocate's effectiveness and places it at constant risk of 'biting the hand that feeds it'. It is an invidious position and one that many leading advocate organisations actively resist for good reason.

Furthermore, one of the major advantages of the current NFP tax concessions is the extent to which they minimise the cost and time associated with compliance (although there is scope for improvement, as outlined above).

Removing existing NFP tax concessions in favour of more direct forms of funding would undoubtedly create new and unwelcome administrative burdens for NFPs and governments alike. In order to be effective, such a system would require significantly improved cooperation and coordination between government departments at all levels, something our federal system has always found difficult to achieve. For example, a recent study by the Centre of Philanthropy and Non Profit Studies revealed major inconsistencies between funding application and acquittal documentation across (and sometimes

⁴ Senate Standing Committee of Economics – Disclosure regimes for charities and not-for-profit organisations. December 2008 (Recommendation 3)

even within) various government departments, including numerous differences in the required accounting and reporting standards⁵.

The extent to which direct funding programs can achieve their stated aims is also largely dependent on the extent to which they are effectively promoted. Organisations that may be eligible for funding can easily miss out due to ineffective promotion and inflexible deadlines. Furthermore, strict eligibility criteria can encourage the 'shoehorning' of worthy initiatives into unsuitable programs, which in turn undermines both the project and program alike.

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The Australian Conservation Foundation is committed to achieve a healthy environment for all Australians. We work with the community, business and government to protect, restore and sustain our environment.

⁵ Centre of Philanthropy & Non Profit Studies (QUT): *How long is a Piece of Red Tape? The Paperwork Reporting Costs of Government Grants* (2008).