Fundraising Institute Australia

AUSTRALIAN TAXATION OFFICE
AUSTRALIA'S FUTURE TAX SYSTEM REVIEW

FUNDRAISING INSTITUTE AUSTRALIA
SUBMISSIONS

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

It is important to distinguish between charities and other types of NFPs. Charities aim at accruing a surplus for distribution according to their missions, which must include a public benefit. NFPs of other types include licensed clubs, which do not share the interest of charities as they answer only to their members and do not distribute their surplus, but apply it for the benefit only of their members, not for public benefit. Therefore, a 'one size fits all' tax treatment is not suitable because of the different needs of charities and other types of NFP.

As the peak body for fundraisers in Australia, FIA's comments apply only to the needs of charities, not all types of NFPs.

Fundraising regulation

Fundraising is a key activity of nonprofit organisations, attracting 87% of adult Australians to donate to their causes. The research of the *Giving Australia* report found that:

> In the year to January 2005, 13.4 million people donated $5.7 billion to nonprofit organisations, while a further $2 billion was provided by 10.5 million individuals through 'charity gambling' or support for events.
> (Giving Australia, *Research on Philanthropy in Australia*, Summary of Findings 2005)

When business giving is taken into account, a further $3.3 billion from 67% of all businesses, it is estimated that $11 billion is given in money, goods and services to nonprofit organisations.

There is an urgent need to reduce the regulatory burden for fundraising by nonprofit organisations. Fundraising, regulated through state legislation, suffers from a lack of national harmonisation, making national campaigns more expensive and less efficient. Regulation shows scant attention to being proportional to risk. Realistically the compliance and administrative burden should be reduced for SMEs, the majority of nonprofit organisations being small and their fundraising posing little risk to public confidence in accountability for their gifts, while a new national framework could regulate fundraising of medium to large nonprofit organisations in their fundraising activities.

While current state government regulation manages financial risk (although not for the significant number of organisations that are exempt from state regulation), there is no overarching national compliance to protect reputational risk among the nonprofit organisations. Industry regulation however establishes reporting standards and

monitors accountability and transparency of fundraising practices, enhancing ethical practice and professional standards alongside a legislative framework.

Reputational risk should be managed nationally through the support and promotion of industry self-regulation and the adoption of codes in order to promote public trust and confidence in professional fundraising.

FIA believes that moving towards national harmonisation and national regulation of fundraising laws is positive and deserves encouragement.

Research has shown that the regulatory environment that governs the establishment and operations of NFPs plays a critical role in sustaining and encouraging those very organisations. (Salamon, 1997, The International Guide to Nonprofit Law, John Wiley and Sons; Lyons, M, 2003 "The legal and regulatory environment of the third sector", *The Asian Journal of Public Administration*, 25(1), pp 87-107) The regulatory environment and specific laws can either support the development of a healthy and vibrant third sector or stunt its growth and vitality. The relationship between the legal environment and the third sector was examined in the Johns Hopkins Comparative Nonprofit Sector project, on the of the most comprehensive comparative not for profit data sets developed. Studies based on that data show that a country's laws and legal framework favourable to the not for profit sector is positively related to the development and size of the not for profit sector in that country. (Salamon and Toepler 2000, "*The influence of the legal environment on the development of the nonprofit sector*" Working Paper No 17, Centre for Civil Society Studies, The Johns Hopkings University Institute for Policy Studies) In an analysis of 13 countries, 4 countries scored highly in terms of having highly favourable legal frameworks for NFPs:

- Israel
- Netherlands
- USA
- Mexico

These countries also had the relatively largest NFP sectors in terms of share of total employment. Australia and most European countries ranked in the middle (ie had medium scores with respect to their legal framework and clustered around the middle in terms of NFP share of employment). Brazil and Japan scored poorly in terms of their legal environment for NFPs and share of NFP employment.

The Australian situation may not seem negative in a comparative sense but it is not optimal and there is scope to significantly improve the regulatory environment for NFPs in Australia.

In his review of the legal and regulatory environment for NFP organisations in Australia, Professor Mark Lyons identified five failings of the law:

- Laws are not informed with a clear knowledge of the NFP sector and its operating logic;

- Insufficient attention is paid by legislators to the changing character of NFP organisations and changes in the economic and social environment of the sector;
- Laws are allowed to grow in a piecemeal fashion, inevitably to anachronisms and contradictions;
- Laws are not enforced, or are enforced haphazardly, even vindictively, usually because governments fail to budget sufficiently for their proper regulation;
- Laws are enforced over-rigorously, by a bureaucracy that ignores the intent of a law and effectively ensures that no organisation can benefit.(Lyons, 2003)

Lyons illustrates these failures with particular reference to the various modes of incorporation available to NFP organisations in Australia and the legislative environment relating to fundraising as follows:

> *The contrast between the simple legislative environment provided for for-profit companies and the confusing muddle confronting those wishing to incorporate and raise funds for third sector organisations is nicely illustrated when we turn to fundraising. When for-profit companies wish to raise funds, by issuing shares or debentures, they seek permission from the same regulator that handled their incorporation. When nonprofits wish to raise funds, they must seek a licence from yet another regulator. These are state and territory government agencies, operating under different pieces of legislation that differ in some aspects across jurisdictions. These differences make conducting a national fundraising campaign a nightmare.* (Lyons 2003)

Lyons' view is supported by the findings from the extensive survey based study conducted by Woodward and Marshall (2004, A Better Framework – reforming not-for-profit regulation, University of Melbourne: Centre for Corporate Law and Securities Regulation) of almost 2000 NFPs in Australia that are registered as companies limited by guarantee. Among other things, this study highlighted:

- The myriad possible legal structures that exist for not-for-profits;
- The confusing mix that exists between State and Commonwealth regulations and regulators;
- The lack of nationally consistent reporting obligations;
- The fact that most not-for-profits want a new regulator (other than ASIC at Commonwealth level) to oversee their organisations.

As the authors note:

> *The underlying health of the NFP sector is at risk. The regulatory framework that underpins the sector is complex and riddled with inconsistencies. It is time for some preventative medicine. The relevant laws and regulatory bodies need to be fair, consistent and clear in order to promote NFPs that are transparent, accountable and credible. If these fundamentals are right, then growth and innovation are more likely to occur* (Woodward and Marshall 2004).

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FIA believes that the national harmonisation of fundraising legislation will be more successful and effective if it takes place together with wider reform of the regulatory environment of the NFP sector, such as the development of national accounting standards for the sector. This is supported by:

- Woodward and Marshall (2004, A Better Framework – reforming not-for-profit regulation, University of Melbourne: Centre for Corporate Law and Securities Regulation)
- The Commonwealth Government commissioned *Inquiry into Charitable and Related Organisations*, 2001;
- The Industry Commission's report on *Charitable Organisations in Australia,* 1995;
- CPA Australia, Financial Reporting by not-for-Profit Entities (2000)

FIA supports the general thrust of these reports' recommendations on national harmonisation of regulation. In particular, FIA suggests the government consider the following evidence-based recommendations in Woodward and Marshall (2004):

- Establish a single Commonwealth statutory framework covering all corporate bodies, including for profit, not for profit, and incorporated associations. The States would need to refer all powers to the Commonwealth (eg as occurred for company regulation) for this to occur. This would enable a national approach to the regulation of not for profit organisations by a body like ASIC;
- Introducing a single specialist not for profit legal structure, perhaps by combining the best aspects of the Corporations Act 2001 and the State laws relating to incorporated associations;
- Developing and implementing specific national accounting standards for NFP organisations;
- Unifying the reporting and disclosure obligations for NFP organisations across State and Commonwealth jurisdictions;
- Developing a simple Standard Information Return similar to those used in the USA, UK and proposed for New Zealand as a means for NFP organisations to provide relevant information on their purposes and activities (including aspects of fundraising) to the public.

FIA recognises that such recommendations would involve all State and Commonwealth agencies. Professor Lyons concluded that NFPs would benefit enormously:

> *…if there was a single piece of legislation for incorporating all third sector organisations that sought a legal personality. In that way, the third sector would have a common identity to act as a counterweight to its diversity. Such legislation would clearly have to recognise some variations; placing easier reporting requirements on small organisations, for example. And it ought to allow organisations to pursue different models of governance, provided some basic accountabilities were met. Drafting such legislation would be challenging.* (Lyons 2003)

FIA believes that an important first step in meeting the challenge of drafting harmonising legislation is engaging with State and Commonwealth governments and other relevant stakeholders.

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?**

To answer this question, FIA will first examine the current arrangements for tax concessions for charities before proceeding to discuss alternative arrangements.

Current arrangements for tax concessions

At present, the current arrangements for tax concessions for charities are limited to:

- Income tax exemption
- Gift deductibility
- Fringe benefit tax.

Income tax exemption

Australia has had a long history of allowing tax exempt status for charities, which have been exempt from income tax federally since the introduction of the first Commonwealth income tax legislation in 1915, continuing to the present day. (O'Connell, A, *The tax position of charities in Australia – why does it have to be so complicated,* (2008)AT Rev 17 at 21). The Full Federal Court confirmed in *FCT v Word Investments Ltd* [2007] FCFCA 171 that, where profit from commercial activities is used for charitable purposes, this will not affect an entity's charitable status.

At present, it is impossible to quantify the value of the income tax exemption to charities, as this information is not collected by Treasury or the Australian Taxation Office (O'Connell, 2008, citing Treasury, *Tax Expenditure Statement 2006*, item B4).

However, Professor Miles McGregor-Lowndes (McGregor-Lowndes M, *Public/private Accountability and the Tax Exempt Status of Charitable Organisations, Seminar Paper for Social Policy and Research Centre* (UNSW, 20 February 2003) suggests that tax expenditure analysis is not appropriate for charities for the following reasons:

1. There is insufficient data on analysing the revenue foregone;
2. As charities have always been outside the taxation base, the loss to revenue is nil;
3. As the taxation base applies, primarily to individuals and companies or other profit making entities, it is not appropriate to tax charities, which are not profit making, but for the public benefit;

4. Imposing tax on charities would not result in much additional income, as charities produce surplus to be applied for the public benefit, rather than income to be taxed.

These reasons justify the retention of the status quo ie income tax exemption status for charities.

Gift deductibility

Gifts to charities have been deductible in Australia since the introduction of Commonwealth income tax legislation in 1915 (O'Connell, 2008).

O'Connell has pointed out that gift deductibility effectively involves a government subsidy of the donor's gift to the charity (O'Connell, 2008). Treasury has estimated that the cost of providing gift deductibility was $710 million for 2007 – 2008 (O'Connell, 2008, citing Treasury, *Tax Expenditure Statement 2006*, item A64). By contrast, the general level of giving in Australia is around $11 billion (Giving Australia: *Research on Philanthropy in Australia*, Summary of Findings, 2005) Given the size of revenue from charities in Australia, this is a very modest level of subsidy, being much less than 1 per cent of all giving.

There is no good economic reason to reduce this level of subsidy; or waive tax deductibility; or reduce the number of Deductible Gift Recipients (DGRs). Rather, government support should be increased.

Fringe benefits tax

A number of charities enhance salary packages with fringe benefits in order to offer competitive remuneration in the employment market.

Public benevolent institutions are exempted from fringe benefits tax (FBT). The definition of a "public benevolent institution" is limited and does not apply to all charities or DGRs. The exemption has been extended to public hospitals, health promotion charities and ambulance services. A cap was placed on benefits in 2000 to prevent abuse of the FBT exemption.

For charities, the major problem with the FBT deduction is that tax exempt employers cannot take advantage of tax deductions for FBT payments, because they do not pay tax. Thus, FBT payments benefit their employees, but not the employers. Certain tax exempt employers are entitled to a rebate but this does not apply to all DGRs, but only certain charities which are deemed to have a public benevolent purpose. Charities would benefit from a wider application of the FBT deduction, as it would assist them to employ and retain highly qualified employees. It would also be more equitable to apply the FBT deduction to all charities, not only those which fall within the definition of "public benevolent institution."

Alternative arrangements for tax concessions

Question 7.2 refers to the provision of direct funding as an alternative to the current tax concessions. Direct funding by government of charities is a welcome inclusion to

the ways in which charities can raise funds, but is not a substitute for tax concessions. There is no need for the "either/or" approach – ie either tax concessions or direct funding. There is room for both.

Public sector support is a critical factor in the growth of the not for profit sector, particularly where governments provide funds for private charities to administer and distribute (Salamon and Anheir, 1999, *The emerging sector revisited*, Baltimore: Centre for Civil Society Studies, Institute for Policy Studies, Johns Hopkins University.)

Australian charities follow a fee dominant model ie 63% of funds are privately raised, although, surprisingly, not from private philanthropy but from fees and payments, rather than reliance on government funding (Salamon and Anheir, 1999). While the market in Australia for non profit services is large, further growth is limited because of the dependence on private fundraising. As only about 30% of funding in Australia comes from government, with the remainder raised privately, further support by government will increase the non profit sector's efficiency and effectiveness.

Cost of compliance

Charities would benefit if compliance were made easier and the costs of compliance reduced.

The Allen Consulting Group reviewed the costs of compliance for the State Services Authority in Victoria in 2007. It concluded that considerable savings could be made among other things by the following:

- Removing requirements for filing annual returns;
- Improving governance arrangements;
- Removing prohibitions on trading;
- Improving the consistency and reduce the duplication in data and reports required by government departments;
- Increasing access to quality standards across government departments and programs;
- Improve the consistency in financial and accounting terms for grant reporting as well as the measures and approaches used by government departments to account for grants;
- Improve information for NFPs to reduce costs to associations in searching and submitting information.

The Allen Consulting Group concluded that savings in Victoria alone would exceed $24 million per year, leading to a total savings over 10 years of more than $200 million. (The Allen Consulting Group, Review of NFP Regulation, 2007). If applied to the whole of Australia, savings to charities over a ten year period would easily exceed $1 billion.

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Recommendations

FIA recommends the following actions to be taken in order to enhance the valuable contribution made by charities to the Australian economy and public benefit:

1. Facilitate financial accounting and reporting for charities by developing an appropriate accounting and reporting standard;

2. Remove barriers to compliance by streamlining compliance and removing interdepartmental reporting contradictions;

3. Assist charities with the cost of compliance by waiving licence and statutory fees;

4. Assist charities by ensuring that the taxation system recognises that they produce surplus for the public benefit, rather than profit for members; specifically by:
   - Maintaining income tax exempt status;
   - Improve tax deductible status for all DGRs;
   - Allow FBT deductions to apply to all DGRs.

5. Provide direct financial support to charities, while maintaining existing concessions, to enable the NFP sector to grow.

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