Northern Rivers Social Development Council

Submission to the Review of Australia's Tax System

Background

Northern Rivers Social Development Council (NRSDC) is a community-based, not-for-profit organisation that promotes fairness and social inclusion in the Northern Rivers Region of NSW. NRSDC represents and strengthens communities and services by:

- Providing opportunities and services to alleviate disadvantage
- Engaging in advocacy and promotion
- Informing and educating people, organisations and government
- Encouraging partnerships
- Undertaking research and planning for future needs.

The Northern Rivers is home to 270,000 people and is the fastest growing region in NSW, increasing by 3000 people each year. Despite the region's many natural and cultural attributes, many residents are struggling. Incomes in the Northern Rivers are roughly two thirds of the national average. Unemployment is one and a half times the national average. Some communities in our region are amongst the most disadvantaged in the country. Residents in the region experience significant cost of living issues including housing costs that exceed many metropolitan centres and high transport costs associated with lack of public transport options and large distances required to access employment education and service in a rural area.

This submission recognises that the taxation system plays a vital role in promoting social inclusion by:

- Providing a sustainable revenue base for Government to fund the economic and social infrastructure necessary to maintain and improve quality of life
- Providing incentives for people to move from income support into paid employment

- Providing specific incentives for enable non-for-profit organisations to efficiently and effectively provide infrastructure, services and support to vulnerable people in the community.

In summary a well designed taxation system can act as a primary lever for government to reduce social exclusion, promote equity and economic participation of marginalised communities.

This submission includes some general comments relating to the taxation system and then responds to specific questions in the Discussion Paper relating to taxation treatment for not-for-profit agencies.

1. General comments on the taxation system

Adequacy of Revenue

NRSDC notes the importance of ensuring that the budget is balanced over the longer term. Reforms to the taxation system should ensure that government revenue over the longer term will be sufficient to meet expenditure requirements. In particular, the taxation system should ensure that sufficient revenue is generated over the longer term to meet the infrastructure, service delivery and income support needs of Australia ageing population. We support the view of the Australian Council of Social Service (ACOSS) that taxation reform should strengthen rather than diminish future public revenue.

It should be noted, however, that some measures designed to save revenue can also result in increased cost to government. For example, as outlined below a reform to increase revenue by reducing access to Fringe Benefits Tax exemptions and Deducible Gift Recipient Status would be likely to increase government expenditure on social security, community services and criminal justice system expenditure. We suggest that the following principles should apply to reforms of the taxation system designed to protect revenues:

- **Taxation reform should strengthen rather than diminish future public revenue**
- **Taxation reform should take into account the impact of future demographic trends such as ageing of the population on government expenditure and should ensure that sufficient revenue is generated to support future demand**
- **The full effect of reform measures designed to protect revenue should be carefully consider that ensure they do not result in increased cost to government and are not regressive in effect.**

Equity

Progressive taxation measures have the scope to reduce the inequitable distribution of income and wealth in Australia. The 2006 ABS survey of *Household Income and Income Distribution* indicates that the top 20%of households received 38% of all household income and held 60% of all household wealth. By comparison, the bottom 20% of households received 18% of all income and held just 1% of all household wealth. These figures indicates that lower income households often spend all of their income on meeting daily needs (consumption) and, unlike higher income households, are unable to accumulate longer term savings.

It should be noted that differences in income levels may arise from unequal opportunities, for example through living in an area experiencing locational disadvantage or living with disability, rather than as a result of differences in individual ability or work ethic etc. As indicated by ACOSS in their submission to this Review (p19) this provides a strong case for government action to reduce income differences.

NRSDC also notes that interaction between the taxation and social security systems can mean that low to middle income earners face high effective tax rates when they make the transition from income support to work. This further contributes to inequality within the taxation system.

We suggest the following equity principles should underpin reform of the taxation system:

- **The overall effect of reform to the taxation system should be to make the system more progressive by shifting the incidence of taxation from lower and middle income households to higher income households**
- **The government should acknowledge that consumption taxes place a disproportionate burden on lower income households and avoid shifting the incidence of taxation from income to consumption**
- **Taxation and/or social security system reforms are required to reduce the high effective tax rates faced by low and middle income earners who are returning to work.**

2. Not for Profit Organisations

As the Discussion Paper notes, not-for-profit community organisations (NFPs) perform a valuable role in Australian society. Within the Northern Rivers region, like many non-metropolitan areas, NFPs deliver community services at low cost and generate social capital in localities where government or commercial service provision is not considered viable.

The Discussion Paper attempts to quantify the government revenue forgone through the current system that allows NFPs to access Fringe Benefits Tax (FBT) exemptions and Deductible Gift Recipient (DGR) status. NRSDC considers it misleading to refer solely to revenue foregone without considering the significant direct and indirect cost reductions to government that these concessions provide.

The Review should undertake modelling to quantify the direct and indirect savings to government that tax concessions to not-for-profit agencies generate.

Direct Savings

NFPs have an increasingly important role in the provision of services, support and infrastructure for vulnerable people in the community as both state and federal tiers of government shift away from direct service delivery. NFPs provide equivalent services to government at reduced cost; largely due to the comparatively lower salaries paid to NFP workers. The majority of service delivery by NFPs is directly funded by Government. In addition some NFPs supplement funds for service delivery through donations. DGR status is a necessary pre-condition to receipt of donations – particularly donations provided by larger philanthropic trusts. Tax concessions for philanthropic donations represent only a third of the total value to the community provided by these donations.

Rates of pay in the Awards that apply to NFPs are generally lower than Government Awards for equivalent work. This is because NFP Awards assume that workers will have access to FBT exemptions on a significant portion of salary (up to $30,000 per year). In turn the level of government funding for NFPS is based on the lower cost of service delivery arising out the lower awards.

Removal of access to FBT exemptions would remove a primary incentive to attract skilled professionals to work in the NFP sector. The work undertaken within the sector is complex, requires a high level of expertise and there is a shortage of workers with appropriate qualifications. The NFP sector has to compete with the health and government sectors for skilled workers and would need to increase pay rates to remain competitive. This would then increase the cost of service delivery by NFPs.

Levels for government funding for NFPS also take into account the fact that NFPs may supplement income through deductible donations. For example, within the NSW child protection system, the funding formula for out-of-home care services for children does not cover the full costs of service delivery. The formula requires services to provide a significant proportion of their revenue through fund raising activities.

Consequently any reform that reduces access to FBT exemptions or DGR tax concessions will either reduce the overall level of service delivery by funded NFPs or require government to provide higher funding levels of funding.

Removal of DGR status would remove the incentive for corporations and individuals to donate significant sums of money to NFPs. This would potentially lead to higher demands for direct government funding to replace the lost income and maintain service delivery. In this regard we note that the government has recently had to allocate funding to NFPS through the *Jobs Fund* to replace philanthropic income lost as a result of the Global Financial Crisis. Removal of DGR status would require this temporary measure to become permanent and the quantum of funding provided would need to increase substantially.

Indirect Savings

NFPs focus on building resilience and capacity in communities and individuals. NFPs work with individuals and communities to strengthen their capacity participate in economic activity. Some agencies, such as Job Network providers have a direct focus on assisting people to obtain paid employment. Other NFPs are increasingly focussed on prevention and early intervention strategies that support individuals before they move into crisis. Examples of these include youth services, mentoring programs and family support agencies.

These agencies reduce reliance on income support payments, child protection costs, medical system costs, remedial education and criminal justice system expenditure. Available research indicates that these programs save governments significant amounts of expenditure. For example longitudinal research into the US based Perry Preschool program for children from disadvantaged families found that for every one dollar of government expenditure on the program, the government realised savings of $7.16 in government expenditure by the time participants reached age 27 with these savings rising to $12.90 by age 40.[1]

As outlined below in our response to the questions in the Discussion Paper, taxation treatment of the NFP sector needs to take into account the considerable indirect saving to government achieved through service delivery

Responses to Discussion Paper Questions

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?

NFPs should be able to retain access to taxation concessions including FBT exemptions and DGR status to support their operation at the lowest possible cost to Government. NRSDC supports simplification and modernisation of the rules governing access to these concessions and compliance requirements.

Currently the rules regarding access to Public Benevolent Institution (PBI) and DGR status are currently too restrictive and do not reflect current best practice in community service delivery. There is currently an over-emphasis on direct service delivery to a specifically defined client group of individuals. The rules favour agencies that provide direct client services to people who are entrenched within and dependent on a high cost welfare service delivery. The rules discourage agencies from engaging in preventative work despite the

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[1] L J Schweinhardt, *The High/Scope Preschool Study Through Age 40, Summary Conclusions and Frequently asked Questions*; http://www.highscope.org/file/Research/PerryProject/3_specialsummary%20col%2006%2007.pdf

clear evidence that preventative work is a more cost effective way to work. The current restrictive rules regarding access to PBI and DGR status therefore limit the indirect savings to government referred to above.

NRSDC notes that these matters were comprehensively canvassed by the Charitable Definitions Inquiry in 2001[2]. The Inquiry noted that the current rules are archaic and argued for modernisation. Similarly the recent Senate Standing Committee on Economics Committee report on Charities noted that reforms to the definitions are required.[3] As indicated above, our view is that access to these concessions is essential for NFPs to carry out their work. The cost to government of restricting access to these measures is likely to outweigh any boost to revenue resulting from either maintaining current restrictions or further restricting access to the concessions.

At a minimum, reforms should be introduced to enable NFPs that provide preventative services to qualify for PBI and thus DGR status. This could be achieved by revising the current definition of Public Benevolent Institution used by the Australian Taxation Office to include agencies that provide preventative services.

NRSDC considers that more comprehensive reforms should be pursued. **Modern definitions of charitable purposes and benevolent charities should be adopted in accordance with the recommendations of the Charitable Definitions Inquiry**.

NRSDC notes to option of providing additional funding to NFPs in place if taxation concessions referred to in the Discussion Paper. We do not support this approach. To be effective, this approach would require a firm commitment by government to fully compensate NGOs for economic costs associated with the loss of FBT exemptions and income from deductible donations. Full compensation to NGOs for loss of DGR income will greatly exceed the additional government revenue raised.

Tony Davies
CEO
Northern Rivers Social Development Council
(02) 6620 1808

2 *Report of the Inquiry into the Definition of Charities and Related Organisations*, Australian Government, June 2001, *http://www.cdi.gov.au/html/report.htm*

3 *Report on Disclosure Regimes for not-for-profit charities,*
http://www.aph.gov.au/Senate/committee/economics_ctte/charities_08/report/c08.htm