

# Royal Flying Doctor Service of Australia - Submission to Henry Review on Australia's future tax system

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## 1 Executive summary

### 1.1 This submission

This submission responds to the matters raised by Chapter 7 of the consultation paper released by the Australian Taxation Office (“ATO”) titled “Australia’s future tax system” (“**Consultation Paper**”), which relates to the tax concessions available to not-for-profit (“NFP”) organisations.

This submission responds to the following issues raised by the Consultation Paper:

- (a) **Fringe benefits tax concessions** - proposing an increase in the concession, and a response to the Panel’s request for comments about whether it is possible to simplify the FBT requirements;
- (b) **Deductible Gift Recipient (“DGR”) status** - addressing the suggestion that there is vertical inequity in the current system, and commenting on submissions about compliance costs;
- (c) **Competitive neutrality** - addressing the suggestion that tax concessions give NFP organisations an unfair advantage in their commercial operations, and that income from commercial operations should be taxed;
- (d) **GST concessions** -the two primary concessions utilised provide for a greater donation benefit to the RFDS from the efforts of volunteers;
- (e) **Direct funding model** - responding to the Panel’s suggestions about a “direct funding” model for supporting NFPs; and
- (f) **State legislation** - proposing that State and federal fundraising legislation badly needs to be consolidated into a uniform national scheme; and
- (g) **Increased accountability and reporting** – proposing that NFPs above a threshold be required to submit an annual return to a body charged with the responsibility of ensuring that the NFP is continuing to act in a manner that allows access to the taxation concessions.

### 1.2 Consultation Paper

The Consultation Paper recognises that “NFP organisations perform a valuable role in Australian society”<sup>1</sup> but that the “tax concessions for the NFP

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<sup>1</sup> Consultation Paper at p161.

sector are complex and unevenly applied”<sup>2</sup>. This provides the basis for the inquiry in respect of NFP tax concessions.

In addition, the Consultation Paper identifies two Consultation questions:

- Q7.1 What is the appropriate tax treatment for NFP organisations?
- 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?

### 1.3 Summary

The key points of this submission are:

#### **FBT concessions**

- (a) The FBT concessions are critical to NFP organisations, particularly in sectors where highly qualified staff are required such as in aviation and health. These concessions help to create a level playing field with for-profit companies that attract staff by paying higher salaries than the NFP sector can offer.
- (b) In terms of the complexity of the current concessions, we support simplifying the concessions. A minimal change that could be considered is to put public hospitals and ambulance services into the same FBT category as public benevolent institutions, given the lack of a clear rationale for the difference. This would reduce the number of different concessions from three to two, with corresponding benefits for compliance and administration costs.
- (c) We also suggest that the current thresholds be updated to address the erosion of the value of these thresholds over time, and that they be indexed to CPI to account for increasing salary and wages costs.

#### **DGR status**

- (d) The RFDS supports the closely held nature of DGR status, as we believe it is appropriate for private funding to be concentrated in the areas of greatest public benefit. However, we also believe it appropriate for the Government to review the DGR categories periodically to ensure they remain in line with changing community needs and expectations.
- (e) The RFDS in particular supports the public list of endorsed DGR entities, with the transparency that brings.
- (f) The RFDS disputes the “vertical inequity” argument for gift deductibility, that donors who have a higher marginal tax rate receive a comparatively greater benefit from their deduction than those in lower income tax brackets. We suggest that the DGR status is at the

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<sup>2</sup> Consultation Paper at p161.

heart of developing a culture of private philanthropy in Australia, and that the tax system should encourage the greatest donations from those with the most to give.

- (g) In terms of compliance costs, the RFDS agrees that compliance requirements for NFPs are onerous, but would not support any lessening of the rules for DGR status. We believe that organisations receiving money from public donations should have high standards of accountability and transparency, to maintain the public faith that their money will be used for the purposes donation and that administrative costs will be minimised.
- (h) We do not receive feedback from our donors that compliance is a particular burden, or that compliance costs are excessive. We believe that introducing a requirement for donors to quote their tax file number would be counter-productive, and may potentially cause some donors not to donate.

### **Competitive neutrality**

- (i) The RFDS strongly disagrees with the proposition that many NFPs are competing with for-profit organisations on an unfair basis due to the tax concessions they receive. As concluded in previous inquiries, competitive neutrality is far more based on the way an organisation behaves than on its tax status.
- (j) Consistent with government policy, we suggest Australia needs a strong independent not-for-profit sector, that has a number of different sources of income and is not overly reliant on government funding. Taxing the commercial activities of NFPs is, we submit, a step in the wrong direction.
- (k) We also suggest that any change to the current position needs to be thought through carefully, as the extent to which NFPs engage in commercial operations, and the rationale for doing so, varies enormously. For example, the RFDS' commercial operations are the same kind of operation as its charitable activities, and are the result of governments increasingly tendering for provision of government services, not the result of the RFDS moving into a commercial area of operations. The RFDS' primary goal remains the provision of emergency aeromedical transport and health services in rural and remote areas, at no cost to the patient. This has not changed in 80 years of operations.
- (l) If there is a concern that some NFPs are competing on an unfair basis, we submit that that should be addressed through the introduction of greater transparency and accountability in commercial operations, not through the removal of tax concessions that will have more negative impacts than positives.

## **GST concessions**

- (m) While not of benefit to the RFDS, the increased threshold for GST registration is of value to small NFPs, and we support the maintenance of this concession.

## **Direct funding model**

- (n) It is difficult to see the advantage of moving to a direct funding model when the current taxation arrangements seem to be achieving what they set out to do. We have a significant not-for-profit sector in Australia that is recognised as making a real contribution to society and in particular to those parts of society that are most disadvantaged. We also see the effectiveness of the current regime in increasing levels of private donation over the past 15 years. We submit that now is not the time to change the fundamentals of the model without some real tangible benefits which do not seem to us to be apparent.

## **Increased accountability and reporting**

- (o) The RFDS proposes that NFPs above a threshold be required to submit an annual return to a body charged with the responsibility of ensuring that the NFP is continuing to act in a manner that allows access to the taxation concessions.

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## **2 Background**

### **2.1 RFDS**

The RFDS is a not-for-profit organisation which provides emergency aeromedical evacuation services and health clinics in rural and remote Australia, as well as inter-hospital air ambulance services between medical facilities around Australia.

The RFDS is made up of seven entities, comprising six Operating Sections and the Australian Council, which is the national body. The Australian Council holds the funding agreement with the Commonwealth, and manages and distributes Commonwealth Government funds to each of the Operating Sections. It also coordinates national strategies. The Operating Sections are the operational bodies which own the aircraft and bases, and employ the pilots for the service. They also hold the funding agreements with the various State and Territory governments.

The RFDS is endorsed by the ATO as a Public Benevolent Institution (“**PBI**”) and as a Deductible Gift Recipient (“**DGR**”).

The RFDS qualifies for the following tax concessions:

- (a) income tax exemption;
- (b) FBT concession; and
- (c) as a charity, certain concessions in the GST legislation relating to sub entities and fundraising activities.

Further information about the RFDS is available on our website:  
<http://www.flyingdoctor.net/>.

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## **3 Fringe benefits tax concessions**

### **3.1 Background**

The ATO is permitted to endorse prescribed types of organisations (including PBIs) so that they are exempted from paying FBT up to a set threshold. Once the total value of fringe benefits received by an employee is greater than the threshold, the organisation is required to pay FBT on the excess amount.

The thresholds vary between:

- (a) Public benevolent institutions - which have a \$30,000 threshold;
- (b) NFP and public hospitals and ambulance services - which have a \$17,000 threshold; and
- (c) Charitable institutions - which have the benefit of an FBT rebate.

The RFDS is entitled to the FBT exemption at the \$30,000 rate, as a PBI. We are also entitled to the rebate as a charitable institution, for expenditure in excess of the exemption threshold.

### **3.2 Existing submissions**

Some submissions have recommended the following reforms:

- (a) raising the FBT threshold to \$40,000;
- (b) indexing the threshold to CPI; and
- (c) increasing the threshold to reflect the value of any PAYG tax cuts.

The RFDS agrees with the suggestion that the FBT threshold should be raised by an amount, as the financial benefit contained in the original policy intent of the legislation has been eroded over time by the increased cost of employment. We also agree with the suggestion that the threshold should be indexed to CPI, to reflect ongoing increases in the cost of salary and wages particularly for highly qualified staff.

The importance of this concession to the RFDS and other NFP organisations is explained below.

### **3.3 The importance of the FBT concession**

The primary policy rationale for the FBT concession is that it creates a level playing field between NFPs and profit-driven companies in respect of employee recruitment and retention.

The Consultation Paper notes that:

*“This is a particularly significant concession for hospitals, given that the NFP health sector constitutes a large share of the health industry*

*and competes directly with the private health sector for qualified staff. Some [organisations] have criticised the concessions on the grounds that they have led to staff losses (through the inability to match market salaries for qualified staff) and resulted in a greater proportion of their funds being directed to salaries.”*

We would argue that the opposite is the case. The exemption allows NFPs to use fringe benefits to attract and retain quality employees who may otherwise be enticed by the higher salaries available in the corporate sector. This is particularly important in sectors such as the health sector, where highly skilled employees can attract large salaries, for example the pilots and medical staff employed by the RFDS.

The NFP sector cannot afford the salaries available in the for-profit sector, as the imperative is to minimise costs and maximise the amount spent on charitable activities. Whilst the profit-driven sector similarly seeks to minimise staffing costs, the NFP sector is at a particular disadvantage. Goods and services provided by the NFP sector are often provided at no cost, or at a rate substantially below market value. Whilst this is of substantial benefit to the user and community, the trade-off is that limited funds are available to offer attractive salaries to prospective employees. Any reduction in the FBT concessions will reduce the ability of NFPs to provide essential services at a reduced cost. For example, a private company seeking to maximise profit could not maintain the coverage of services currently supplied by the RFDS. Accordingly, Australians living in remote areas would be cut-off from emergency medical support (or could only receive such support at a commercial price, assuming private operators would be available). Alternatively, the public system would need to step in and provide a replacement service.

The RFDS employs around 800 staff nation-wide, and is highly dependent on use of the FBT concessions to attract and retain expert staff. Any reduction in the FBT concession would significantly affect the RFDS, would require us to pay considerably higher salaries to compete with the for-profit sector, and would have a direct impact on the scope of the services provided by the RFDS. Any reduction in the concession would translate directly into a reduction in our service, which would be counter-productive, and no benefit for the public health system.

### **3.4 Improving simplicity of the FBT concessions**

The Consultation Paper states that the government has asked the Panel to examine the complexity of the FBT concession for the NFP sector, and “*make recommendations to improve equity and simplicity for the longer term*”.

The RFDS supports improving simplicity for the FBT concessions. However, the RFDS (as with other NFP’s) is required to collate the value of fringe benefits supplied to employees to test this amount against the threshold (currently \$30,000 per employee) and to record the taxable value of the fringe benefits for inclusion on the PAYG Payment Summaries.

If the level of exemption is to be capped, an NFP is still required to collate all of the same information as a normal taxpayer so that the FBT calculation can be completed. Similarly this information is required to be collated if the total

fringe benefits received by the employee is to be included on the PAYG Payment Summary for each employee.

Many of the social security benefits and other tax concessions are means tested with the taxable value of the fringe benefits included in the definition of income for that means test.

Therefore if the employees of NFP's are to be treated on the same basis as employees of other organisations, this information must be collated and calculated for the FBT return cap test and the consistent taxation treatment of the NFP employees.

Consequently, the RFDS suggests that it will be difficult to modify these requirement without introducing fresh tax distortions.

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## **4 DGR status**

### **4.1 Background**

An entity which is endorsed by the ATO as a DGR is entitled to receive gifts which permit their donors to claim a tax deduction (for amounts of \$2 or more). There are two categories of DGR endorsement:

- (a) an entity which is endorsed in its own right; or
- (b) an entity which is endorsed only in relation to a fund, authority or institution it operates. In this case, only gifts to that fund, authority or institution are tax deductible.

The RFDS falls within paragraph (a) above.

The main policy rationale for tax deductibility of this nature is that it will encourage individuals and businesses to make increased charitable donations. However, the Consultation Paper does acknowledge that “the degree to which this is the case is unclear”<sup>3</sup>.

As the Consultation Paper states, DGR status is restricted to “a closely targeted set of organisations”. The paper goes on to state that “[w]hile these categories have been created to reflect community demand and government priorities for the sector, some submissions indicate that they should be redefined as community activity and priorities change”.

The RFDS supports the closely held nature of the exemption, as we believe it is appropriate that private funding is concentrated in the areas of greatest public benefit. However, we also support periodic review of the DGR categories as the needs of the community do change over time, and it is not possible to develop a set of worthwhile activities that will definitively stand the test of time. Having said that, the RFDS does not have a particular expansion to the existing categories that it seeks to make at this time.

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<sup>3</sup> Consultation Paper at p165.

#### **4.2 Acknowledgement of beneficial aspects of the current scheme**

The RFDS acknowledges that there are several aspects of the current DGR concessional structure which are valuable and should be retained. The current scheme promotes transparency, with members of the public being able to access a list of endorsed DGR entities and search specific entities on the Australia government's "ABN Lookup" website<sup>4</sup>. This transparency is vital in ensuring that the tax concessions are not incorrectly claimed by ineligible organisations.

#### **4.3 Vertical inequity issue**

The Consultation Paper referred to the perceived "vertical inequity of gift deductibility"<sup>5</sup>. This refers to the fact that donors who pay higher marginal rates of tax receive a comparatively greater benefit from their deduction than donors in lower income tax brackets. The alternative proposed is a flat rate tax benefit for donors, or some other system that ignores the donor's marginal tax rate.

With due respect these proposals seem to us to miss the point. The DGR system is designed to elicit the largest donations from those with the most financial capacity to give. As mentioned elsewhere in this submission, this is part of developing a culture of private philanthropy in this country, particularly from wealthy individuals and companies. The rise of corporate charitable giving programs in the last 5 years, many of which match corporate to employee donations, is an example of the success of this initiative.

To say that wealthy individuals receive a greater tax benefit than others, and that this is somehow objectionable, seems to us a philosophical objection only. The fact that the deduction obtained by the donor is at their marginal tax rate is at the heart of this system. A change to this would threaten the donation base of all NFPs, and would seem to us to be entirely without benefit.

The future financial viability of the RFDS is dependent upon the receipt of donations. As part of the financial management of the individual RFDS Sections, an analysis is made (as best as possible) of the profile of the donor and of those who may be targeted as donors. In assessing this profile the RFDS believes that the full deductibility of donations is a key factor in the minds of those who donate.

Two recent activities highlight the importance of this.

In 2006 the South East Section initiated a fund raising campaign to assist with the replacement of two ageing aircraft at the Broken Hill base. A well-planned campaign identified a number of key influential people who each influenced colleagues and associates to contribute significant sums to this aircraft replacement campaign. Deductibility for these donations was a question asked by all donors, and all required the supporting documentation to substantiate their income tax deduction for their donation. The outcome

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<sup>4</sup> "ABN Lookup", Australian Government, <http://www.abn.business.gov.au>, last accessed 2 March 2009.

<sup>5</sup> Consultation Paper at p165.

was a successful campaign to raise over \$10 million dollars to fund these aircraft.

In 2008, the Queensland Section purchased a new King Air aircraft at a cost in excess of \$7.5 million where the entire source of funds for this aircraft acquisition was from donations.

Whilst the RFDS does not have access to the detailed taxable income profiles of its donors, there is clear anecdotal evidence that the large donations are received from those who are most likely to be on higher marginal incomes, and that the tax deductible status is a fundamental factor in the decision on whether to make any donation.

If a system was introduced that required all donors to submit their tax file number to the DGR in order to obtain an income tax deduction, the RFDS is concerned that this would significantly inhibit the spontaneous donations that are received at fund raising events and in the public places.

#### **4.4 Compliance costs for NFPs**

The Consultation Paper refers to a number of submissions that suggest compliance costs for NFP organisations with DGR status should be reduced.

The requirements for being endorsed as a DGR are stringent, and include that the organisation must:

- (a) have an ABN;
- (b) have acceptable rules regarding dealing with the transfer of surplus gifts and deductible contributions on winding up or revocation of endorsement;
- (c) satisfy the gift fund requirements (if applicable); and
- (d) be in Australia.

Although onerous, the RFDS' submission is that these requirements are appropriate for organisations that obtain money from the public for stated charitable purposes. It is incumbent on DGR organisations to set high standards of transparency and accountability, to maintain public faith that their money will be used for the purposes donated and that administrative costs will be appropriately minimised.

#### **4.5 Compliance costs for donors**

The Consultation Paper refers to suggestions in the submissions that compliance costs for donors should be reduced, such as enabling DGRs to collect and store tax file numbers and allowing donation information to be pre-filled on tax returns.

We do not receive feedback from our donors that compliance is a particular burden, or that compliance costs are excessive. All that is required for a donor is to keep a record of their deductible gift and provide a total figure for the year's donations in their income tax return.

We question the effectiveness of introducing such a system unless it were introduced on a mandatory basis. Further, we suggest that seeking to require provision of tax file numbers for donations may impact on the willingness of people to donate, given the sensitivity of privacy issues, and the need for donors to have their tax file number at hand. Overall, this proposal does not seem productive.

Given the strict privacy rules relating to the use of tax file numbers, the collection and recording of tax file numbers requires appropriate systems and controls to be in place.

If it were considered that the risk to revenue was high, a substantial benchmark for the level of donation at which a tax file number must be supplied could be established. For example, a donation of \$50,000. A reasonable benchmark could provide a balance between the additional administration for the NFP and the revenue concerns.

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## 5 Competitive Neutrality

### 5.1 Background

A charitable tax concession will extend to the commercial activities of an NFP in certain circumstances. This was recognised in the Consultation Paper, which states that:

*“(i)f an entity’s purpose is solely charitable, it can undertake other activities that are incidental to, and in advancement of, its charitable purpose. These may include commercial activities.”*

This was recently confirmed in *Commissioner of Taxation v Word Investments Ltd*<sup>6</sup> where the High Court found that:

*“[Word Investments] was not prevented from being a “charitable institution” by reason of the fact that its objects were not confined to charitable purposes. A power to retain profits did not negate its character as a charitable institution if it was in aid of its charitable purposes.”*<sup>7</sup> (our emphasis)

The Consultation Paper states that “many submissions express concern over the number of NFP organisation establishing business ventures, suggesting that these tax concessions unfairly disadvantage competing taxable entities”.

The paper also noted that NFP organisations are “servicing commercial markets unrelated to their philanthropic activities, including: turf supplies; insurance; music sales; pizza shops; and breakfast and health foods”.

### 5.2 Concerns expressed in submissions received by the Review

The RFDS has not been able to identify any references to competitive neutrality concerns in the submissions that are publicly available. Perhaps these concerns were raised in submissions not intended for publication. The

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<sup>6</sup> (2008) 251 ALR 206.

<sup>7</sup> 2008) 251 ALR 206 at 206. <sup>7</sup>

RFDS also acknowledges that this issue has been discussed in the media, in the context of this Inquiry, particularly in respect of Sanitarium Health Foods, which was reported as owned by the Seventh Day Adventist Church.

Competitive neutrality has been raised as an issue on occasion over the years, the stated concerns including:

- (a) that NFP organisations engaged in commercial operations have an unfair advantage over for-profit organisations competing in the same area. This advantage is said to be due to the concessional taxation treatment enjoyed by some NFP organisations, in particular the exemptions from income tax and the former sales tax, and FBT concessions.

It is said that, as a result of these concessions, NFP organisations are able to cut prices and expand their operations more rapidly than their tax paying counterparts<sup>8</sup>; and

- (b) that tax concessions encourage the inefficient allocation of resources which prevents the emergence of best practice and reduces competition (resulting in higher prices and/or lower quality goods and services being provided).

Proponents of these arguments suggest that principles of competitive neutrality should be applied to NFP organisations, so that they should have any concessional taxation treatment removed for their commercial operations. In particular, that income from commercial operations should be subject to income tax.

The term “commercial operations” is one that requires careful definition.

Governments at both State and Commonwealth levels regularly require arrangements with service providers including the RFDS to enter into contractual arrangements. These are often offered as a tender process in which both an NFP and a traditional business can compete. The services provided under this contract will be consistent with those provided by the NFP as part of its charitable activities. The funds received under these contracts may be likened to a contribution to costs.

This style of commercial operation can be distinguished from the situation where a business providing different services or goods to those that form part of the activities of the NFP is owned by the NFP, and the proceeds / profits that the business generates are used by the NFP to further its objects.

The RFDS “commercial operations” are the first category, namely on a similar type to those provided to the community at no charge, albeit with support from Government and the public.

The RFDS disagrees that NFP organisations which undertake activities that are similar to their regular charitable activities enjoy an unfair advantage over for-profit organisations in this way, and suggests that imposing tax on

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<sup>8</sup> See Industry Commission, *Charitable Organisations in Australia*, 1995 at 309.

commercial operations would only reduce the funding available for charitable activities and increase the reliance of the NFP sector on government funding.

This seems counter to government policy in recent years, of seeking to reduce the extent to which NFP organisations are reliant on government funding, and to have a strong NFP sector that has developed a number of different sources of income.

### 5.3 Findings of previous inquiries

The “competitive neutrality” argument has been scrutinised and dismissed by a number of previous inquiries.

The *Inquiry into the Definition of Charities and Related Organisations*, June 2001 rejected the suggestion that principles of competitive neutrality should be applied to the not-for-profit sector (at pages 229 - 231 of the Report).

The Inquiry had received a small number of submissions that argued not-for-profit organisations conducting commercial operations should be denied charitable status, and accordingly the Inquiry principally looked at the issue from this perspective. This suggestion was conclusively rejected by the Inquiry.

For example, Recommendation 18 of the Report concluded that “*commercial purposes should not deny charitable status where such purposes further, or are in aid of, the dominant charitable purposes or where they are incidental or ancillary to the dominant charitable purposes.*”<sup>9</sup> As mentioned in section 3.1 above, the only circumstance where an NFP organisation can conduct commercial activities and retain its charitable status, is where it is in aid of its charitable purposes.

However, the Inquiry also referred to the findings of the Industry Commission’s Report *Charitable Organisations in Australia*, 1995 (“**1995 Report**”) and were supportive of the conclusion drawn by the Industry Commission in that report that an income tax exemption does not in fact provide a competitive advantage for a not-for-profit organisation’s commercial operations<sup>10</sup>. The 1995 Report stated that payment (or non-payment) of “after-profit” taxes “should not affect the behaviour of an organisation when deciding how to set its prices and how to minimise its costs.”<sup>11</sup> This is because all organisations make business decisions which aim to maximise profit and minimise costs, regardless of their taxation status.

The Inquiry also noted that, since the Industry Commission’s Report, other tax concessions available to not-for-profit organisations have been considerably reduced. In particular:

- (a) the abolition of sales tax and its replacement with the GST (the GST exemption is only available for supplies not provided commercially); and

<sup>9</sup> Treasury, *Report of the Inquiry into the Definition of Charities and Related Organisations*, 2001 at 17.

<sup>10</sup> 1995 Report at K.2.4, as reproduced in Consultation Paper at p163.

<sup>11</sup> See above n5 at XXXI.

- (b) various limitations that have since been imposed on FBT concessions.

#### **5.4 Alleged unfair advantage over for-profit organisations**

As mentioned above, the RFDS disagrees that NFP organisations enjoy an unfair advantage over for-profit organisations due to the tax treatment they receive. One of the comments of the Industry Commission was that:

*“It is the behaviour of the charities themselves, not their taxation treatment, which may represent ‘unfair competition’.”*

This is borne out by the RFDS’ experience. As mentioned above, the Royal Flying Doctor Service provides emergency aeromedical evacuation services and healthcare clinics in rural and remote areas, and inter-hospital air ambulance services, across the country. Our operations are funded in part by:

- (a) Commonwealth funding for rural and remote services;
- (b) State/Territory funding for air ambulance services; and
- (c) public fundraising.

Some of the State and Territory services are tendered for commercially, in competition with private operators. The remainder of our services are not provided in competition with private operators, and there is probably no private organisation that could provide the same coverage as the RFDS in the remote areas.

All activities within the broader RFDS organisation are conducted in a business style. A term that has been used to describe participants in the NFP sector is that it should be described as a Not for Loss Sector. That is the NFP organisation sets its budgets and direction each year with the goal that it will finish the year with a surplus of income over expenditure. This surplus is essential if the NFP is to be able to acquire additional assets for use in its activities and to fund the continued expansion and provision of services.

Our commercial operations are conducted on a commercial basis. We tender a commercial price and margin, as we believe we need to make a commercial return to properly price the risk of these operations. In New South Wales and Victoria, there is no cross-subsidisation between this and the other parts of the organisation, and the aircraft, pilots and other personnel and infrastructure required are sourced under separate arrangements from the rest of our activities. Our operations in Queensland have also started to move in this direction, and we suspect this will be the trend for the rest of the organisation in the coming years.

The latest round of Commonwealth funding was preceded by a detailed review of the RFDS’ cost structures, to ensure that there is a detailed understanding of what the Commonwealth is funding and how it dovetails into the State and Territory funding. Our funding agreement with the Commonwealth contains requirements designed to ensure that Commonwealth funding is not used outside the Commonwealth-funded services, and State and Territory funding agreements contain similar requirements.

The real difference between us and our for-profit competitors is that, instead of profits being returned to shareholders, they are put towards funding our other services, which are provided free of charge to the public. Accordingly, the effect of losing our tax exempt status on income derived from our commercial operations, would simply be to reduce our ability to provide emergency evacuation and other healthcare services in rural and remote areas. This would increase the cost to the public health system of providing health services in these areas, which would be entirely counter-productive.

The other comment we would make is that the extent and manner in which NFP organisations engage in commercial operations vary enormously, and there are perhaps as many variations on the theme as there are not-for-profit organisations. To conclude that all NFPs are obtaining an advantage (or even an unfair advantage) over their for-profit competitors is a significant oversimplification, and ignores the vast diversity of the sector.

If there is a concern that there is inappropriate competitive behaviour, or unfair advantage, in some parts of the NFP sector, we suggest that should be addressed by the introduction of greater transparency and accountability in commercial activities, not by the removal of tax concessions.

Competition law will also provide a framework for activities undertaken.

## **5.5 Other aspects of competition**

In RFDS' submission, there are many ways in which non-profit organisations are already subject to requirements that place them on a level playing field with the for-profit sector. This applies particularly to the large organisations that are subject to the Corporations Act, and have significant agreements with the Commonwealth, State and Territory Governments. RFDS' consolidated revenue for the 2007/08 financial year was in excess of \$180 million.

For example, as mentioned above, the RFDS has extensive transparency and accountability obligations in our government contracts. These are designed to demonstrate that:

- (a) we are providing a value-for-money service, consistent with Commonwealth, State and Territory governance legislation and spending policies;
- (b) administration costs are minimised; and
- (c) our services are run as an efficient national operation, with economies of scale, providing a seamless service across the country.

This means the RFDS is subject to the same efficiency drivers as the for-profit sector, the key difference being that all our funding is put into delivering services, rather than into dividends for shareholders.

We are also required to demonstrate that we are meeting rigorous service standards and quality requirements, equivalent to for-profit operations. This is particularly so in the aviation and health businesses, where we are subject to extensive regulation of pilots, maintenance arrangements and flying operations on the aviation side, and the same is true for our medical operations. None of our aircraft operations are run by volunteers, but by

professional pilots, doctors and other staff, and there is no advantage to being a not-for-profit organisation in this regard.

Finally, under the Corporations Act the RFDS is subject to financial accountability and audit requirements, in addition to more general requirements under occupational health and safety, workplace, environmental and other legislation.

Other large NFP organisations, particularly in the health sector, are in a similar heavily-regulated position to the RFDS, for example the private hospitals.

We also believe that NFP organisations are under considerable scrutiny in terms of minimising administrative costs, and maximising the amount that is available to be spent on charitable activities, and it is likely that there will be an increasing focus on this. For example, the Senate *Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations* has recently examined issues of accountability and transparent use of public and government funding by the NFP sector, and has recommended the establishment of a single regulator for the NFP sector with the role of establishing best practice standards for NFPs and the ability to investigate complaints relating to the operation of NFPs.

## **5.6 Alleged impact on the overall market allocation of resources**

The RFDS submits that it is unlikely that the overall market allocation of resources is compromised as a result of NFP organisations receiving income tax exemptions.

In fact, our experience is that the RFDS is providing a service that no private organisation is willing to provide on a national basis. Our goal remains to provide a service at no cost to the patient, and we have provided such a service for 80 years since the service was established in 1928.

What has changed in that time has been a move by government to increasingly select service providers for government services on the basis of public tenders, to demonstrate value for money, accountability and other government requirements. It is not that the RFDS has moved into commercial operations unrelated to its core activities, or in some way distorted the market, rather the various governments have imposed increasingly commercial requirements on those same activities. In other words, the market has changed around us.

The fact that the RFDS has continued to operate successfully under changing market conditions over the period we have, demonstrates that there is a need for our services, and this need has been consistently recognised by Commonwealth, State and Territory Governments.

## **5.7 Other reasons for not taxing commercial activities**

There are a range of other reasons for not taxing the commercial activities of NFP organisations. These include:

- (a) charities are unable to raise equity or debt in capital markets. Instead, NFPs can undertake capital works and support longer term

commitments by generating surplus funds from grants, donations and net income from commercial activities. Accordingly, commercial activities are an important source of funding for longer-term planning by NFPs and increasing the size and scale of their charitable activities. This was acknowledged in the 2001 Report<sup>12</sup>;

- (b) an attempt to tax only the commercial activities of a NFP would require that a legal distinction be drawn between the NFP's charitable (or "core") operations and its commercial (or "unrelated") business, introducing greater complexity and compliance costs for the sector, which would particularly impact on small NFPs.

The 1995 Report concluded that such a distinction (as applies in the United States) would "generate only limited benefits"<sup>13</sup> and would be "complex, rarely used and generally ineffective"<sup>14</sup>.

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## 6 GST concessions

The main GST concessions utilised by the RFDS organisation are:

- The ability to establish sub entities, each of which can separately choose their GST status; and
- The ability to elect to treat a fund raising function as input taxed, so that the organisation is able to forego the claim on input tax credits on the costs rather than being required to charge one eleventh of the ticket price.

The RFDS organisation takes advantage of both of these concessions and the benefit of each is to increase the income generated through the efforts of volunteers.

The sub entity concession is used for the establishment of auxiliaries in local communities. As a sub entity, they can remain part of the RFDS organisation for control and insurance purposes. The activities of these auxiliaries are heavily focused on fund raising, and quite often utilising donated goods and services. By the sub entity being able to choose not to be registered for GST, the amount of income raised by fundraising activities is maximised.

Similarly a fund raising function for the RFDS will often include a donation element in the ticket price, so again the benefit of the GST concession of being able to elect to input tax that fundraising function will be to increase the income from that activity.

The above uses are consistent with the intent of these concessions as outlined in the Explanatory Memorandum to the GST legislation.

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<sup>12</sup> See above n4 at 226.

<sup>13</sup> See above n6 at 314.

<sup>14</sup> See above n9.

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## 7 Direct funding model

The Consultation Paper states that:

*“Internationally, a range of models are used to provide government support for NFP organisations, including direct funding and simplified tax concessions. In the case of direct funding, some models provide government contributions independent of public contributions, while others match government contributions with public contributions.”*

It is difficult to see the advantage for the taxpayer, the government or the NFP organisations themselves in moving to a direct funding model that would make NFPs more reliant on government funding or, in the case of matched contributions, would reduce the incentive on the private sector to make donations to NFPs.

The policy focus over the last 10 years has been to develop a strong NFP sector that is increasingly independent of government funding, and to develop a culture of private philanthropy particularly from wealthy individuals and corporations. At the same time, there has been an increasing focus on transparency and accountability of expenditure of public funds by NFPs, as mentioned above, and this is expected to continue with the Senate *Inquiry into the Disclosure Regimes for Charities and Not-for-Profit Organisations*.

The current approach has been successful in stimulating significant private contributions to charity, as demonstrated by the Queensland University of Technology report “An Examination of Tax Deductible Donations made by Individual Australian Taxpayers in 2005-06”. The report states that, using a base year of 1978-79, the average tax-deductible donation is “far exceeding” the inflation-adjusted average donation as measured by the CPI.

The report also concludes that 4.2 million Australian taxpayers made and claimed a donation in 2005-06, which equates to 36.45% of the Australian taxpaying population. This participation percentage has been increasing slightly over the last 11 years, and is at its highest level since 1992-93.

It is submitted that this is not the time to change the overall model without significant tangible benefits in the new approach. If there are issues that need to be addressed, they are in the areas of transparency and accountability, and more consistent national regulation, and these are being pursued through the Senate Inquiry.

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## 8 State legislation

While presumably beyond the scope of this Review, there is one area of regulation that imposes an undue burden on NFP organisations, and that is fundraising legislation.

Currently fundraising is regulated by different laws in each State and Territory, which impose different requirements and standards. Accordingly, the conduct of a national fundraising campaign requires separate registration and approval from each State and Territory’s regulatory body, at considerable added cost.

It is difficult to see any rationale for separate fundraising regulatory regimes. Uniform national regulation, as recommended by the Senate Inquiry, would remove unnecessary duplication and cost, both for the NFP sector and the regulators themselves. This is an issue that impacts on NFP organisations both large and small and we welcome the outcome of the Senate Inquiry.

The RFDS (and other charitable entities and public benevolent institutions) enjoys concessions under State legislation providing relief from Payroll Tax, Stamp Duty and Land Tax.

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## **9 Increased accountability and reporting**

Currently there appears to be very limited formalised accountability required of the NFP sector in terms of the use of the various taxation concessions, and how these are applied within the broad intent of those concessions.

Those NFPs that are incorporated are required to prepare their financial statements under the Corporations Act rules, and to lodge those with ASIC where they are placed on the public record.

The standard constitution requirements for the income tax concession require the NFP to be audited each year.

However, there does not appear to be any formal process under which the manner of use of those taxation concessions is tested or reviewed.

The RFDS suggests that each NFP above a particular size should be required to file an annual return similar to an income tax return, but with their annual report attached. The information in that annual return could allow the body charged with supervision of NFPs to review the activities and to be able to satisfy itself that the taxation concessions are being applied in a manner consistent with their intent.

The size threshold could be, for example, being registered for GST, or include all entities that enjoy DGR status.