

Sector in the sights

Tax not only affects the work of the community sector, but the sector itself. After years of inactivity, it's now facing significant tax reform and the devil may be in the detail, says Myles McGregor-Lowndes from the Australian Centre of Philanthropy and Nonprofit Studies.

The taxation environment for community sector organisations may change significantly in the immediate future after a decade of incremental administrative reform and two decades of inquiries that have spawned many disregarded recommendations.

It is yet unclear whether the real driver for the mooted reforms is the revenue authorities' desire for greater regulation and compliance, leading to a constriction of concessional treatment, or to ensure the benefits which the community sector brings to Australian society and general community well-being. At present, the rhetoric oscillates between these motives and it is not inconceivable that different policy actors are pursuing different purposes for taxation reform for the community sector. This article reviews recent reforms for the sector, identifies reforms currently proposed and then looks to possible future taxation reform.

REFORMS SINCE THE GST

The introduction of the Goods and Service Tax (GST) marked an increased focus on taxation of the community services sector by the Australian Tax Office (ATO), with the need to identify charitable and deductible gift recipient status accurately, for certain GST concessions and treatments. This required registration of all such entities through an endorsement process. Together with selective audits, this has reduced the number of organisations eligible for such concessions. Very few minor categories of income tax exemption have been added; for example, closed religious orders and self-help groups. Fringe Benefits Tax (FBT) concessions were capped to either \$30,000 or \$17,000 per employee and left unindexed, resulting in erosion of their value over time.

During this time there was an inquiry into the suitability of the common law definition of charity (the Charities Definition Inquiry) which recommended expanding the definition of charity by amending federal legislation. While a draft bill was prepared, only a few minor issues were eventually legislated because of concern over various features of the bill, including advocacy and the treatment of unrelated business income. One of the drivers for the Inquiry's recommendations was the lack of cases considering the common law definition of charity taken to the High Court. However, subsequently, three High Court cases have in fact advanced the common law treatment of issues surrounding charities' unrelated income, advocacy, and performing overlapping government functions. All three cases were decided in favour of the charity leading to advancement or clarification of the law of charity.

The Howard Government sought to increase philanthropy through a combination of awareness campaigns and taxation incentives for gift donations. New taxation incentives included averaging of gifts over a period of income years and deductibility of conservation covenants; but the most significant was a private foundation vehicle – Private Ancillary Funds – to allow tax deductibility of gifts from private families or businesses. Tax deductible gifts have risen rapidly: from \$744 million in 2000 to over \$2 billion in 2009.



IMPENDING REFORMS

The 2011 Budget included plans for a number of reforms which concern the community sector:

- introduction of a statutory definition of 'charity' for federal purposes by 1 July 2013; this will take its lead from the Charities Definition Inquiry which recommended a wider definition of charity than was achieved through legislative amendment;
- consultation with states and territories to develop and adopt a uniform definition of charity;
- establishment of an Australian Charities and Not-for-Profits Commission (ACNC), which will re-assess the charitable status of organisations on the basis of the new charity definition;
- establishment by the ACNC of a general reporting framework for charities through a public information portal by 1 July 2013; and
- removing tax concessions from income generated by and retained in new unrelated commercial activities commencing after 10 May 2011 (Budget night). Initially only applying to new commercial activities, existing activities

will be phased in over time after consultation. Treasury subsequently released a Consultation Paper about reforming the use of tax concessions by businesses operated by not-for-profit (NFP) entities. It broadly proposed that NFP entities pay tax on any retained earnings (i.e. income not remitted and applied to the purposes of the tax concession entity) and that existing input tax concessions such as FBT and GST would not be available for unrelated commercial activities.

Further, the Government has indicated that it intends to amend the taxation laws to prevent community sector organisations transferring untaxed funds overseas, by requiring tax exempt organisations to operate and pursue their objectives principally (more than 50 per cent) in Australia.

From 1 January 2012 the Government also intends to reform the regulation of Public Ancillary Funds (often known as 'community foundations'). These funds seek donations from the public and then distribute the funds only to other deductible gift recipients. The reforms include a minimum annual distribution of 4 per cent of net assets; requiring funds to have a corporate trustee; and requiring them to file audited financial returns.



FUTURE REFORMS

There are many recommendations yet to be actioned by the Government; the most controversial is likely to be that involving the FBT concessions. The Australia's Future Tax System Review, led by Ken Henry, recommended that FBT concessions enjoyed by the sector should be reconfigured. This was supported by the Productivity Commission's research report on the NFP sector. The recommendation included a 10 year phase-out period, with the

concession reduced gradually and replaced with direct government funding. The rationale for this reform is that the FBT concession gives community sector organisations a competitive advantage in mixed sector markets (e.g. hospitals and nursing homes) contributing to wage inflation and exacerbating labour shortages. In its place, direct government funding would be available to all tax concession community sector organisations, for funding specific projects or to assist with the cost of recruiting specialist staff. The report did note that removing FBT concessions where there was no direct for-profit competition may result in downsizing or closure of programs.

The Productivity Commission Research Report also drew attention to the FBT meal entertainment benefit – which, through a twist of the law, is presently uncapped – and noted that there was a strong case to limit or eliminate this concession.

Further, the Productivity Commission suggested that the common law of mutuality which applies to machine gaming clubs might be ripe for reform on competitive neutrality grounds and that the scope of gift deductibility should be widened progressively to include all endorsed charitable funds and institutions.



CONCLUSION

After years of inactivity in both the legislative and judicial arenas, the community services environment is facing a relatively active phase in taxation reform. Most of the proposals before Parliament are clearly aimed to increase regulation on, and enhance compliance of, the community sector. Arguably, improved accountability should boost the community's trust of the sector, through better governance and sustainability, leading to increased donations and

volunteerism. Widening the scope of community organisations that will qualify for charity status, reducing the red tape costs of achieving that status, and streamlined financial filing may also be realised. The devil will be in the detail, and the outcome affected by whether the dominant motive is to restrict concessional treatments or to facilitate a robust and sustainable community organisations sector.

Key dates

- **2001:** Inquiry into the definition of charities and related organisations
- **2008:** Senate inquiry into the disclosure regimes for charities and not-for-profit organisations
- **2010:** Review of Australia's Future Tax System
- **2010:** Productivity Commission inquiry into contribution of the not-for-profit sector
- **2010:** Senate inquiry into the Tax Laws Amendment (Public Benefit Test) Bill 2010
- **2011:** Consultation paper - scoping study for a national not-for-profit regulator

Professor Myles McGregor-Lowndes OAM is the Director of The Australian Centre of Philanthropy and Nonprofit Studies (ACPNs) at the Queensland University of Technology. He has written extensively about nonprofit tax and regulation, nonprofit legal entities, government grants and standard charts of accounts as a means of reducing the compliance burden. He is a founding member of the ATO Charities Consultative Committee.

