

Community Council for Australia – Access Economics Report April 2010

Background and summary of Report

Australian taxpayers support many community and other not-for-profit (NFP) organisations. The activities of these organisations have considerable social impact and touch the lives of many Australians, including some of the most disadvantaged members of the community.

The Australian Government has recently undertaken a ‘root and branch’ review of the tax system (the Henry Review). The recommendations of the review together with the Government’s formal response are due for imminent public release. It is possible that the Henry Review will recommend changes that affect public funding of the NFP sector — either by directly targeting concessions available to the sector or as a by-product of broader structural changes to the tax system. Some of these reforms may be long-term, perhaps for implementation over the next 10 years or so.

In this context, the Community Council for Australia (CCA) engaged Access Economics to examine tax concession arrangements applying to community organisations and to identify directions for reform in light of possible recommendations of the Henry Review. The intent is to, through an economic framework, consider potential reforms that may arise. In doing so, the report aims to provide the community sector with a robust and economically credible basis on which to engage in the debate on tax reform that is likely to follow release of the Henry Review and the Government’s response.

The report contains a set of high-level principles to help frame the CCA’s advocacy during the tax reform process has been developed

Reforming government funding arrangements for the community sector is and will always be a difficult and sensitive issue; many stakeholders voice concerns about changes to current funding arrangements and the potential detrimental effects on support and services delivered to the public through the sector.

These concerns should not be taken lightly; they reinforce the considerable difficulties and uncertainties that will be involved in reforming the mechanisms by which taxpayer support is provided. The issues need to be addressed by the Government in its response to the Henry Review.

The NFP sector is not only large and diverse but has somewhat ‘fuzzy’ boundaries separating its various components. These delineations are more than academic; they have legal and regulatory implications and play a part in differentiating the challenges and issues facing constituents. In line with the direct interests of CCA, this report concentrates on community organisations rather than the wider NFP sector, where ‘community organisations’ are taken to be not-for-profit organisations that do not operate in the market and have a community focus. Such organisations encompass many social services, arts and culture, recreation, environment, education and philanthropic organisations.

Reforms flowing from the Henry Review provide an opportunity to improve funding and regulatory arrangements to the benefit of both community organisations and taxpayers. Such reforms will be pivotal in ensuring that the community sector is well-placed to meet future challenges, in turn enhancing social capital and promoting the wellbeing of all Australians.

Community organisations make an important contribution to Australian society in areas such as social assistance, health, education, arts and culture, and emergency relief. In doing so, they help build a stronger, fairer and more inclusive community.

Recognising their social contributions, Australian governments provide a range of financial support to community organisations. This includes indirect assistance through the tax system, as well as more direct forms of support (for example, acting as a 'buyer' of certain services). As part of the overall assistance given to the community sector, the Australian Government provided around \$2.35 billion in tax concessions in 2009-10.

The current arrangements for assisting community organisations through the tax system have a range of shortcomings. The system is complex, lacks transparency and certain aspects of tax relief are less than efficient. Such issues create problems for both the sector itself and for government, making reform in the area a key issue for public policy. Importantly, these issues are now being examined as part of the Australian Government's review of the tax system.

There are strong economic reasons for maintaining a combination of indirect assistance through the tax system coupled with direct forms of support which more closely target particular social priority areas. Within such a framework, substantial improvements are possible.

Many key deficiencies of current support arrangements could be addressed by three key measures:

- streamlining administrative and compliance requirements;
- extending tax concessions for donors and tightening forms of input tax concessions (such as certain exemptions from fringe benefits tax); and
- greater reliance on more direct forms of public support.

It is possible that some, if not all, of these reforms will be included (in varying degrees) as part of the Government's long term tax reform agenda. Such changes will have substantial funding and operational implications for community organisations and the entire not-for-profit sector. In this regard, it is essential that government adopts and articulates a clear and coherent policy approach in devising any reform program.

Major considerations in implementing reform will include ensuring that an adequate funding base for organisations is maintained (including through the transitional phase), that the service delivery capacity of organisations is not undermined — particularly their ability to attract and retain high-quality staff — and important socially innovative activities are not discouraged.

High-level principles for reform

Some key high-level principles underpinning a financial assistance framework that effectively and efficiently supports the community sector are:

- ***First do no harm***
- ***Help avoid unintended consequences***
- ***Revenue-neutrality is important***
- ***Support arrangements should be transparent and simply administered***
- ***Taxpayer interests should be safeguarded***
- ***Establish an appropriate lead time for reform***

A key aspect of these principles is minimising risks to the sector associated with changing financial support mechanisms. While there are compelling reasons to reform present arrangements, it is important that the transitional challenges and structural adjustments associated with funding reform are not underestimated. Many parts of the sector have been long established, and indeed thrive, under the present support framework.

Initiatives to reform funding arrangements for community organisations form a central part of a broader agenda to improve the regulation and operation of the not-for-profit sector. Other aspects of this agenda include harmonising regulatory frameworks within and across jurisdictions, streamlining fundraising legislation and capability-building to maximise the sector's social contribution to the community. These reforms are critical to ensure the sector is well-placed to meet future challenges such as an ageing population, changing (perhaps concentrating) patterns of disadvantage and adapting to new service delivery requirements.

Key messages for CCA based on the Report

- CCA welcomes the imminent release of the Henry Review; it comes shortly after the release of the Productivity Commission report and the signing of the National Compact. It is part of a trilogy of events that will shape the future of the NFP sector.
- CCA have commissioned a study by Access Economics examining taxation arrangements for the not-for-profit (NFP) sector to help inform the debate we will be having with the Government and the sector on future tax arrangements.
- The purpose of commissioning this report was to get an independent, balanced and qualitative economic review and preview of the current situation and what may be. The report will help CCA contribute to an informed debate going forward.
- CCA are open to consider the potential and alternative reform scenarios, but encourage government and other stakeholders to take a carefully considered, engaging and inclusive approach to exploring alternate scenarios.
- The Access Economics Report provides a detailed overview of the current level of complexity with taxation arrangements and concessions for the not-for-profit sector, highlighting why reform is needed.
- The report aims to provide the community and not-for-profit sector with a robust and economically credible basis on which to engage in the national debate on tax reform that is likely to follow release of the Henry Review and the Government's response.
- The Access Economics report CCA are releasing clearly identifies some significant deficiencies with current taxation arrangements and concessions for the not-for-profit sector. These include:
 1. **Inconsistencies and compliance costs in the administration and application of DGR concessions -**
 - Donations to *all* registered charities should be tax deductible. It is inequitable and confusing to the public that some charities are registered as DGR and others are not. It is an acknowledged view that the Australian public believes that their donations to charities should continue to be tax deductible, and significant changes to deductibility would be strongly opposed by the public.
 - Charitable donations should attract a tax deduction at the top marginal rate so that the value of a donation is the same for all tax payers. This would promote equity and encourage philanthropic giving.
 - The report gives the reasons for direct government funding of the community and wider not-for-profit sector as well as the economic costs and benefits of indirect funding (through tax deductions of donations and the like). The indirect funding via tax deductions for donations is an important part of the social fabric of Australia and provides the capacity for social innovation, for the support of innovative but perhaps less 'popular' causes, and gives the opportunity for charities and other organisations to get support for those whose lives are at risk.

2. **Inefficiencies, costs and inconsistencies in application of the Fringe Benefits Tax;** at the moment, the FBT benefits attributed to this sector are costly to administer. CCA believes that some concessions such as meals allowances should be reviewed.
 3. **General efficiency and effectiveness;** greater efficiency and improvements in streamlining administration and compliance requirements can be achieved by having a National Registrar and an Office for Community Sector Engagement for the Sector as recommended recently by the Productivity Commission. Both will help with the implementation of sector reforms and ongoing engagement between the Sector and Government, especially the necessary cross-departmental coordination.
- There will be considerable difficulties and uncertainties that will be involved in reforming the mechanisms by which taxpayer support is provided. The issues will need to be addressed by the Government in its response to the Henry Review.
 - CCA wishes to see the following principles for reform applying to taxation arrangements for the not-for-profit sector:
 - **Do no harm:** Taxation reforms and any alternative funding assistance must ensure the continued sustainability of the sector.
 - **Avoid unintended consequences:** Any changes need to consider the complex interactions between support measures and not have adverse effects on operational flexibility and innovation including the capacity to engage and retain staff.
 - **Revenue neutrality:** Any reductions in support mechanisms to the sector via the taxation system need to be offset with compensatory support (e.g. removal or reduction of FBT exemptions would need to be offset by benefits for NFP staff).
 - **Support arrangements:** Needs to be transparent and simply administered – whether via the taxation system or more direct funding support.
 - **Taxpayers' value:** Taxpayers should have choice but should get value for money in any taxation or direct funding provided by government to the community sector.
 - **Transition Plan:** A lead time of 2 – 5 years should be applied in allowing transitioning to new taxation/funding arrangements to allow the sector to adjust. Some transitional arrangements could have a 10 year horizon.
 - A key aspect of these principles is minimising risks to the sector associated with changing financial support mechanisms. The social benefits delivered by NFPs are not easily measured, and intended consequences may include shredding the fabric of Civil Society.
 - CCA will review in detail what the Henry Review is proposing for the not-for-profit sector and what the Government's initial response will be to this; when appropriate we will respond accordingly.