

# Blake Dawson

## BY EMAIL AND POST

Contribution of the Not for Profit Sector  
Productivity Commission  
GPO Box 1428  
CANBERRA CITY ACT 2601  
email: nfp@pc.gov.au

T 61 3 9679 3000  
F 61 3 9679 3111  
DX 187 Melbourne

GPO Box 4958  
Melbourne VIC 3001  
Australia

[www.blakedawson.com](http://www.blakedawson.com)

28 May 2009

## Productivity Commission review – Contribution of the not for profit sector

We welcome the review of the contribution of the not for profit (NFP) sector and appreciate the invitation to make submissions to the Productivity Commission.

We refer to the list of issues set out in the Terms of Reference (Terms) for the review, under the heading "Scope of study". We also refer to the Issues Paper released by the Productivity Commission in April 2009 (Issues Paper).

In this letter we make submissions on those issues relevant to our practice and that of our NFP clients, broadly related to the following categories of issues, as identified by the Productivity Commission on page 16 of the Issues Paper:

- (a) Considering ways of enhancing the efficiency and effectiveness of the NFP sector, in particular, through removing unnecessary burdens or impediments to the efficient and effective operation of community organisations generally, including unnecessary or ineffective regulatory requirements and governance arrangements, while having regard to the need to maintain transparency and accountability; and
- (b) Examining the NFP sector's provision of government funded services, by considering and implementing options for improving the efficient and effective delivery of government-funded services by community organisations, including improved funding, contractual and reporting arrangements with government, while having regard to the need for transparency and accountability; and
- (c) Examining trends and developments impacting on the sector, by having regard to:
  - (i) the changing nature of relationships between government, business and community organisations in recent times, their general impacts, and opportunities to enhance such relationships to optimise outcomes by the sector and its contribution to society;
  - (ii) the extent to which tax deductibility influences both decisions to donate and the overall pool of philanthropic funds; and
  - (iii) the extent to which tax exemptions accessed by commercial operations of NFP organisations may affect the competitive neutrality of the market.

Our reference  
TMD IWM RCA SHI

Partner  
Teresa Dyson  
T 61 7 3259 7369  
[teresa.dyson@blakedawson.com](mailto:teresa.dyson@blakedawson.com)

We would welcome the opportunity to be further involved in the review, including participating in any working party or roundtable addressing these or other areas.

## 1. EXECUTIVE SUMMARY

In brief, we submit:

- (a) There are currently a number of burdens to the efficient and effective operations of NFPs, including the following:
  - (i) confusion over the merits and nature of different types of legal structures to establish NFPs, and lack of access to information on this issue;
  - (ii) the existence of differing fundraising legislation in each State or Territory, and the absence of a database or central resource that brings together the various requirements in a manageable manner;
  - (iii) the lack of a definitive stance on whether the ATO or another body should have key responsibility for regulating the NFP sector;
  - (iv) the ongoing reliance on the (now outdated) common law definition of charity to ascertain when entities are eligible for tax concessions; and
  - (v) confusion over the merits and nature of the different categories of NFPs.
- (b) We suggest that some of these burdens could be alleviated through the NFP section of the ATO establishing a central resource for NFPs (and their advisers) to access to ascertain basic advice on establishing, operating and maintaining a NFP (including, but not limited to, advice on applying for tax concessions).
- (c) We have noted a number of trends in the interaction between government, business and the NFP sector, and suggest that, among other things, the NFP branch of the ATO could be granted more independence to adapt and respond to these trends as they continue to evolve, as well as to insulate it from the overall revenue focus of the ATO.
- (d) The existence of tax deductibility for gifts to certain NFPs remains central to encouraging philanthropy and should not be removed.
- (e) The existence of tax concessions does not significantly hamper competitive neutrality. However it may be useful to consider whether other, less tangible aspects of NFPs (such as their reputation or the community's high regard for their activities) could, and should, provide a degree of competitive advantage. If there are particular areas of concern, a targeted approach would be preferable to a blanket ban on commercial activities.

To place the Productivity Commission's review in context, we emphasise that the review is one of at least six major inquiries or initiatives at the federal level relating to the NFP sector since 1995.<sup>1</sup> Accordingly, we also consider that:

- (a) any reform proposals should heed the prior recommendations and ongoing work of these inquiries and initiatives; and

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<sup>1</sup> Industry Commission, 'Charitable Organisations in Australia' (1995); Australian Government, 'Report of the Inquiry into the Definition of Charities and Related Organisations' (2001); Senate Standing Committee on Economics 'Disclosure Regimes for Charities and Not-For-Profit Organisations' (2008); Australian Government, A National Compact <<http://www.socialinclusion.gov.au/Compact/Pages/default.aspx>> (accessed 30 April 2009); Julia Gillard Deputy Prime Minister, Media Release - The Honourable Wayne Swan MP, 'Australia's Future Tax System' (12 May 2008).

- (b) no further inquiries or initiatives should be commissioned (other than into specific issues raised by the current reform proposals) until the current reform proposals are implemented or considered in further detail.

We acknowledge the breadth of the NFP sector and the existence of competing considerations between various areas of Government as to how the NFP sector is regulated. However, attempts to resolve this complexity in a piecemeal manner (ie through numerous reviews focusing on particular areas of dispute and adopting small scale reform rather than a broad overhaul of the NFP system) have led, and will continue to lead, to further complexity and inequality in how various NFPs are required to administer their operations.

## **2. UNNECESSARY BURDENS OR IMPEDIMENTS TO THE EFFICIENT AND EFFECTIVE OPERATION OF COMMUNITY ORGANISATIONS GENERALLY**

### **2.1 Confusion over types of legal structures**

We refer to Chapter 7 of the Senate Standing Committee on Economics' Report titled "Disclosure Regimes for Charities and Not for Profit Organisations" 2008 (**SSCE Report**). Chapter 7 of the SSCE Report addresses the various legal entities that charitable entities may utilise and identifies some of the problems associated with determining which structure is appropriate for their needs.

We agree with these comments and endorse the need to simplify or clarify the available types of organisations, so that persons wishing to establish a NFP entity are able to access basic information relevant to decisions on the structure of their organisation, without necessarily having to obtain detailed legal advice.

### **2.2 Different fundraising legislation in every jurisdiction**

We refer to Chapter 9 of the SSCE Report. Chapter 9 addresses the problems raised by various States and Territories having different fundraising laws, and the need for a revised regulatory framework.

We agree with this conclusion and submit that the current structure of fundraising regulation is an unnecessary burden on the efficient operation of national NFPs, and NFPs that operate in more than one State or Territory. As a practical example, one of our NFP clients who operates nationally has had to obtain separate advice from various legal practitioners as to the rules and regulations they must comply with to conduct one fundraising event across several states.

Even if reform to the regulation of fundraising is not immediate, we suggest that incremental steps be taken, such as establishing a fundraising database or some other central reference point for NFPs organising fundraising events.

### **2.3 Regulatory issues and viability of alternative regulator**

The Australian Taxation Office (**ATO**) currently has key responsibility for regulating the NFP sector as it determines whether a NFP entity is entitled to access relevant tax concessions. In certain cases, entities that do not meet the eligibility criteria for the specific categories of "income tax exempt charities" (**ITECs**) or "deductible gift recipients" (**DGRs**) may apply to the Treasurer for specific listing as an ITEC or DGR, as appropriate. Accordingly, at a Federal level, the NFP sector is primarily a function of the revenue / treasury arm of government.

In other common law countries including the United Kingdom, Canada and New Zealand, charitable entities are regulated by a separate charities commission.

We consider that the establishment of an Australian charities commission is a long term objective that the Government may consider once the reviews outlined at 1 above are completed, provided that the measures effected by those reviews do not achieve the level of success that the Government and NFP sector consider appropriate. However, it is our view that any reforms proposed by the Productivity Commission should seek to improve the current regulation of NFPs, and their interaction with the ATO, rather than overhaul the system. We propose some relevant measures in detail at 4 below. We also note that debate about the introduction of a new body to regulate charities could be perceived as a means to delay or fail to "fix" the problems with our existing system.

## 2.4 Ongoing reliance on common law definition of "charity"

We consider that the ongoing reliance on the common law definition of "charity" to determine the nature of community organisations and the rights and concessions available to them, should cease. In our experience, the definition is unduly restrictive on the activities of NFPs and we suggested that a new definition be legislated to override the common law definition of "charity".

### (a) Limited relevance of the common law definition of "charity"

The definition of "charity" no longer reflects societal conceptions of this term, as evidenced by revisiting (and arguable expansion of) the common law concept of "charity" through:

- (i) the recent High Court decision in *Commissioner of Taxation v Word Investments Ltd* [2008] HCA 55 (**Word Investments**);
- (ii) the Federal Court's decision in *Victorian Women Lawyers Association v Commissioner of Taxation* [2008] FCA 983; and
- (iii) the Administrative Appeals Tribunal's decision in *Aid/Watch Inc v Commissioner of Taxation* [2008] AATA 652.

We do not propose to discuss the limited relevance of the common law definition of "charity" in any detail in this submission and refer the Productivity Commission to the reforms proposed by the Report of the Inquiry into the Definition of Charities and Related Organisations (2001) (**Definition of Charities Report**).

### (b) Burdens/impediments that the definition of "charity" places on NFPs

The common law definition of "charity" is relevant to entities accessing the following tax concessions:

- (i) ITEC status under Division 50 of the *Income Tax Assessment Act 1997* (Cth);
- (ii) entitlement to franking offsets in relation to franked dividends (see Subdivision 207-E of the *Income Tax Assessment Act 1997* (Cth));
- (iii) GST concession charity status under Division 176 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth); and
- (iv) FBT rebatable employer status under section 65J of the *Fringe Benefits Tax Assessment Act 1986* (Cth).

Many philanthropic organisations are prohibited from donating to NFPs that are not endorsed for the above tax concessions and, in particular, NFPs that are not endorsed as ITECs. Accordingly, characterisation of a NFP as a "charity" at common law is central to the ability of NFPs to obtain access to funding. This

requirement means that NFPs are, to a degree, restricted from engaging in certain activities (such as advocacy) because those activities are not within the scope of the common law definition of "charity" (at least in the ATO's view). This impedes the ability of NFPs to act in the manner that best serves the community and, based on the discussion at (a) above, is no longer a justifiable restriction on the activities of NFPs.

From a pragmatic point of view, and in our experience, the need to comply with the common law definition of "charity" can require NFPs to:

- (i) limit their advocacy and/or political objects and activities, to ensure that these do not form the main or dominant purpose of the NFP;
- (ii) approach public announcements and interactions with the media with caution, to ensure that their statements are predominantly factual rather than advocacy-based; and
- (iii) in certain cases, refrain from advocating changes to law which would be of benefit to those persons that the NFP seeks to benefit.

We consider that the existence of these burdens provides support for introducing a legislative definition of "charity" that overrides the relevance of the common law definition of "charity" in respect of determining an entity's entitlements to tax concessions.

## 2.5 Confusion over categories of NFPs for the various tax concessions

The Australia's Future Tax System Review Panel's paper titled "Consultation Paper" 2008 (**Henry Review Consultation Paper**) sets out a table 7.1 in Chapter 7. The table sets out the main categories of NFPs and acknowledges that NFPs may fall within more than one category. In our experience, the degree of overlap is very substantial (typically, for instance, a public benevolent institution would be both a charity and a DGR). This increases the technical and practical complexity of the provisions.

Greater simplification and consolidation of the provisions would be welcomed. For instance:

- (a) as recommended in section 2.4 above, adopting a legislative definition of "charity" that clearly enunciates a contemporary definition; and
- (b) adopting a broader and simpler welfare organisation entry point to DGR status than the concept of a "public benevolent institution" – see the Industry Commission's Report titled "Charitable Organisations in Australia" 1995 (**IC Report**) and the Definition of Charities Report.<sup>2</sup> This should permit the removal of a number of additional current categories of DGR.

## 3. OPTIONS FOR IMPROVING THE EFFICIENT AND EFFECTIVE DELIVERY OF GOVERNMENT-FUNDED SERVICES BY COMMUNITY ORGANISATIONS

We refer to the IC Report. Among other things, Chapter 17 of the IC Report suggests establishing a national database to assist with the collection of information and statistics relevant to the NFP sector. We suggest that such a database could be administered by a specific NFP area of the ATO, and could provide information and resources that would assist to reduce the burdens identified at 2 above. We understand that Recommendation

<sup>2</sup> Industry Commission, 'Charitable Organisations in Australia' (1995) 283; Australian Government, 'Report of the Inquiry into the Definition of Charities and Related Organisations' (2001) 258.

17.1 of the IC Report (relation to the production of a framework for the collection and publication of statistics) is being implemented and suggest that the development of the database could "tie in" with the implementation of the framework.

In particular, the database could be accessible via the internet to all NFPs, and contain details of the following important matters:

- (a) factors relevant to determining which type of legal structure is appropriate for a particular NFP organisation, and details of how to establish that entity;
- (b) details of services available to assist NFPs with establishing their entity, applying for tax concessions, and obtaining compliance assistance (eg, through increasing awareness of organisations that can arrange volunteer professionals)<sup>3</sup> and
- (c) requirements relating to fundraising in each State and Territory.

These are basic queries or issues that we often deal with in practice. We anticipate that many organisations would have precedent documents or well developed materials that could assist with the above and would be pleased to assist with such an initiative.

#### 4. **THE CHANGING NATURE OF RELATIONSHIPS BETWEEN GOVERNMENT, BUSINESS AND COMMUNITY ORGANISATIONS IN RECENT TIMES**

Over the last five to ten years, we have noticed several trends in the relationships of our clients in the NFP sector, with government and business.

Broadly, the trends are:

- (a) far greater interaction with the ATO in relation to obtaining tax endorsement and ongoing endorsement compliance;
- (b) a greater desire on the part of business and private donors to form ongoing, interactive relationships with the NFPs they donate to;
- (c) an increased tendency to impose restrictions on advocacy activities in government funding agreements; and
- (d) greater desire by, and expectations of, NFPs in relation to undertaking commercial activities in achieving their mission.

We discuss the relevant trends, and some steps that may be taken in response to these trends, in detail below.

##### 4.1 **Identified trends**

###### (a) **Greater interaction with the ATO**

The adoption of an endorsement system (with application from 1 July 2000 or 1 July 2005, as applicable) for many NFPs to access income tax exemption, deductible gift recipient status, FBT concessions and GST concessions has required greater ATO involvement in assessing whether NFPs qualify for the concessions.

In addition, the endorsement provisions of the *Taxation Administration Act 1953* (Cth) provide the ATO with a monitoring function in relation to continued eligibility

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<sup>3</sup> For example, Skillsbank Victoria (see <http://nevictoria.skillsbank.com.au/>).

of many NFPs for concessions.<sup>4</sup> The ATO's ongoing regulatory role appears set for expansion, at least in relation to "private ancillary funds", in accordance with the exposure draft legislation released by Treasury.<sup>5</sup>

The Senate Standing Committee on Economics in its SSCE Report has reflected misgivings over a broad role for the ATO in regulating NFPs.<sup>6</sup> In our experience, the ATO adopts a proactive and relatively balanced approach in its gatekeeper role. However, there have been a number of instances where the ATO's function as a revenue arm of government has caused it to adopt an overly conservative interpretation of the activities or purposes of particular NFP categories. This potentially suppresses innovation by NFPs in tackling social issues.

For instance, we have had difficulty convincing the ATO that the use of sporting activities/events to deliver public health and harm prevention programmes to Indigenous youth is consistent with charitable status. A number of clients have also expressed concern over the ATO's attitude toward the use of advocacy to address systemic issues, as opposed to a traditional band-aid approach on a case by case basis. We are also aware that the ATO has adopted a strict approach in relation to charities wishing to assist disadvantaged Indigenous Australians by promoting business development in Indigenous communities.

**(b) Greater desire of donors to form ongoing relationships with NFPs**

In this context, there are concerns over the extent to which donors can impose conditions on donations before the donation stops being a "gift" (and hence deductible, for non-business related donations) or else gives rise to a separate trust (which would require its own, separate, endorsement as a DGR before the donation gives rise to a deduction).

Clarification on this issue would be useful to encourage continued donations and to prevent donors from taking steps to "characterise" their contributions as other forms of deductible payments, such as advertising expenses, which potentially compromise the independent "face" of NFPs.

**(c) Increased restriction on advocacy activities**

We have noted an increase in the restrictions that the Government imposes on NFPs, when providing funding. These restrictions have, among other things, inhibited the ability of NFPs to engage in advocacy activities.

Imposing advocacy restrictions has negative implications on the ability of NFPs to address systemic issues. A number of our NFP clients have expressed concern over the extent of their ability to conduct advocacy activities while retaining their charitable status.

**(d) Greater focus on commercial activities**

We have noted a greater desire on the part of NFPs to undertake commercial activities in achieving their objects, as well as increased expectations that NFPs

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<sup>4</sup> See Division 426 of Schedule 1 to the *Taxation Administration Act 1953* (Cth).

<sup>5</sup> Exposure Draft Tax Laws Amendment (2009 Measures No. 4) Bill 2009 (Cth).

<sup>6</sup> Senate Standing Committee on Economics 'Disclosure Regimes for Charities and Not-For-Profit Organisations' (2008) [5.30]-[5.31].

will conduct commercial activities on the part of State and Federal governments – see the Definition of Charities Report.<sup>7</sup>

#### 4.2 Proposed reforms in response to identified trends

In response to the trends (and the issues that these trends give rise to) discussed in 4.1 above, we recommend that the Productivity Commission should:

- (a) consider the extent to which it is appropriate for the ATO to endorse and monitor NFPs in relation to tax concessions. While we have expressed at 2.3 above that we do not agree with the introduction of a single, national, regulator (as proposed by the Senate Standing Committee on Economics in its SSCE Report) at the current time, we suggest that the non-profit division within the ATO should be given greater independence and a broader role;
- (b) take steps to permit greater ongoing involvement by donors in the activities of NFPs to assist the transfer of skills and expertise by donors to the NFPs. We note that this may also assist more strategic giving; and
- (c) in accordance with recommendation 17 of the Definition of Charities Report,<sup>8</sup> introduce legislation to expressly broaden the definition of "charity" to permit NFPs to conduct advocacy activities (but not to promote a political party or a candidate for a political office). Government funding agreements should also permit such advocacy activities.

While conducting commercial activities raises particular issues for NFPs and the broader community (including concerns over competitive neutrality, as discussed at 6 below) we consider that a blanket prohibition on commercial activities is unwarranted if the activities support the NFP's objectives (for instance, see *Word Investments*). Instead, we recommend that any limitations be targeted toward the specific issues of concern.

### 5. THE EXTENT TO WHICH TAX DEDUCTIBILITY INFLUENCES BOTH DECISIONS TO DONATE AND THE OVERALL POOL OF PHILANTHROPIC FUNDS

#### 5.1 Ongoing relevance of tax deductibility for gifts to DGRs

Division 30 of the Tax Act entitles donors to claim an income tax deduction for donations of over \$2, made to DGRs. Some donors may, alternatively, be entitled to deduct certain business expenses (such as advertising and sponsorship) under section 8-1 of the Tax Act.

We note that the availability of an alternative tax deductions for business donors under section 8-1 does not assist private philanthropy and, further, can lead to undesirable outcomes if NFPs are pushed towards a situation in which they must agree to advertise or promote their corporate donors in order to obtain funding. Accordingly, we consider that the gift deductibility concession is of continuing relevance to decisions to donate.

<sup>7</sup> Australian Government, 'Report of the Inquiry into the Definition of Charities and Related Organisations' (2001) 223-224. See especially Commonwealth Department of Health and Aged Care, submission extract at 223

<sup>8</sup> Australian Government, 'Report of the Inquiry into the Definition of Charities and Related Organisations' (2001) 218.



## 5.2 Viability of alternatives to gift deductibility concession

Various alternatives to the gift deductibility concession are discussed in the Henry Review Consultation Paper in the context of reducing compliance costs<sup>9</sup>. Alternative proposals include:

- (a) removing the gift deductibility concession;
- (b) providing a flat-rate rebate for donors; and
- (c) introducing a system based on the Gift Aid model used in the United Kingdom where tax benefits are paid directly to the charity.

In our view, option (a) above would only be viable if options (b) or (c) offered more suitable alternatives than the gift deductibility concession. We consider that neither alternative is preferable to the gift deductibility concession, on the following basis:

- (a) Providing a flat rebate raises the question of whether different arrangements should apply to natural person as opposed to corporate donors (as is the case in New Zealand) and whether a refund or carry-forward of the rebate would be permitted for persons with insufficient taxable income for the rebate to be fully utilised (as is the case for natural persons in relation to excess franking offsets). Our view is that achieving equity is likely to increase complexity and discourage donations by higher income earners (assuming that the rebate will be of less benefit to a top rate taxpayer than the current gift deduction).
- (b) The UK Gift Aid scheme is unavailable to non-taxpayers and permits additional income tax relief for higher rate taxpayers. Accordingly, the increased complexity does not appear to warrant the marginal equity gain.

Our recommendations for improvement of the existing provisions include broadening the ability of donors to make directed gifts or to otherwise retain an on-going involvement in a DGR's use of a donation. Currently, if a donor wishes to attach conditions to a gift, there is a risk in some circumstances that the gift will not be a "gift" for the purposes of the DGR provisions or that the gift is subject to a trust obligation which means that the recipient is not the endorsed DGR in its own right.

## 6. IMPACT OF TAX EXEMPTIONS ACCESSED BY COMMERCIAL OPERATIONS OF NFP ORGANISATIONS ON THE COMPETITIVE NEUTRALITY OF THE MARKET

### 6.1 Competitive neutrality generally

Following the High Court's decision in *Word Investments* (and subject to the Henry Review and Treasury's consideration of this issue), it appears that an NFP undertaking commercial activities, and contributing the profits of these activities to achieve its charitable objectives, may still be characterised as a "charity" at common law, provided that the ultimate objects and purposes that the NFP applies the profits to are "charitable" in nature. The Terms touch upon the growing concern that the ability of NFP organisations (who have access to significant tax concessions) to carry on business activities may provide such organisations with a competitive advantage over tax-paying entities.

Concerns about competitive neutrality have previously been considered, and dismissed by, the IC Report and the Definition of Charities Report. The Definition of Charities Report recommended that NFP organisations should not be precluded from engaging in commercial activities where they further a dominant charitable purpose or where they are

<sup>9</sup> Australia's Future Tax System Consultation Paper, 10 December 2008, Section 7.

merely incidental to the dominant purpose. The I C Report also comprehensively reviewed this issue and found that the system of income tax concessions did not impact on competitive neutrality.

We note that, while the Terms request comments on the impact of taxation concessions on the competitive neutrality of NFPs, the Issues Paper implicitly identifies a less tangible (but arguably competitive) advantage that may be available to NFPs carrying on business activities (at page 19):

[T]he absence of a profit motive enables the pursuit of activities which, while valuable to the community, might not be undertaken by business. For many not for profit organisations, this willingness to act in the interests of the community, and the perception that they exist to 'do good', can have significant impacts on the contributions made by not for profit organisations. This additional value comes from the generation of trust, altruistic motives of volunteer workers (and often paid workers who earn less than their market wage), and enhanced organisational effectiveness driven by a focus on meeting the needs of users rather than maximising profits. Reflecting these features, survey data suggest[s] that not for profit organisations are often viewed as more effective service providers than government or business...

This advantage is clearly more difficult to quantify and, given our expertise, we focus in this submission on the existence or otherwise of a tangible competitive advantage arising from available tax concessions rather than any "perception" advantage that may arise for NFPs. However, we feel it pertinent to note that NFPs may derive a competitive advantage be from sources other than tax concessions, and consider that, if we are to revisit the issue of competitive neutrality, this issue may also warrant consideration.

## 6.2 Impact of tax concessions on competitive neutrality

We discuss the advantages conferred by various tax concessions, and their potential effect on competitive neutrality, in further detail below.

### (a) Income tax

According to the High Court's judgment in *Word Investments*, provided that a NFP's purpose is solely charitable, it is entitled to carry out commercial activities which are incidental to, and in furtherance of, its charitable purpose. Such commercial activities typically provide a source of funds for the NFP to carry out activities which directly (as opposed to the indirect effect of fundraising) achieve its charitable purpose. In some instances, they may also result in a public benefit.

The Terms query how tax exemptions available to NFPs might adversely impact upon the competitive neutrality of the markets in which NFPs operate commercial enterprises, by giving those NFPs a competitive advantage. From an income tax perspective, the key tax advantage available for NFPs is ITEC status.

We make the following comments on the issue:

- (i) The drivers for NFPs to undertake commercial activities include the expectations of State and Federal governments – see the Definition of Charities Report.<sup>10</sup>
- (ii) A significant proportion of NFPs are already carrying out commercial activities – see the relevant ABS data<sup>11</sup> and the report titled "Giving Australia: Research on Philanthropy in Australia".<sup>12</sup>

<sup>10</sup> Definition of Charities Report 223-224. See especially Commonwealth Department of Health and Aged Care, submission extract at 223

- (iii) The concern over NFPs conducting "commercial activities" seems equally applicable to the carrying out of traditionally accepted activities which directly effect a NFP's purpose and for which the NFP charges a fee. For instance, the provision of health or education services for a fee. The I C Report likewise suggests that it is not appropriate to draw a distinction between such 'related' and 'unrelated' commercial activities for the purposes of competitive neutrality.<sup>13</sup>
- (iv) A loss of "competitive neutrality" requires more than the mere existence of an income tax exemption. The existence of the exemption must be matched with a particular behaviour, such as "predatory pricing" or "subsidized market expansion", on the part of the NFP.<sup>14</sup> As noted in the I C Report, NFPs are likely to seek to maximise the profits from their commercial activities (to use for their core objectives), rather than undertake anti-competitive behaviour<sup>15</sup>
- (v) To the extent that there is a loss of competitive neutrality due to below cost pricing or subsidised service delivery, we understand from a number of our NFP clients that this occurs in their areas of core service delivery in circumstances where the market would not otherwise provide services at a cost which those in need of the services could afford. Loss of the ability to cross-subsidise would result in certain services becoming unavailable. In this context, some of our NFP clients note a relatively endemic expectation on the part of government that NFP services should be supplied to government at less than market rates, or in some instances, cost.
- (vi) Loss of the income tax exemption would need to be met by a corresponding increase in funding by government (or business) in order for NFPs to continue to provide the same level of services.

Accordingly, we consider that the impact of the income tax exemption on competitive neutrality is minimal and does not warrant major reform taking place. To the extent that any changes are introduced, we recommend that they be targeted toward anti-competitive behaviour, rather than toward 'unrelated' activities.

**(b) Fringe benefits tax (FBT)**

The current FBT concessions available to NFP organisations, particularly the FBT exemption, provide them with a cost saving advantage over tax-paying entities in recruiting and maintaining staff.

However, to limit the advantage of NFP organisations the concessions are capped at a set amount depending on the type of NFP. Accordingly, the Definition of Charities Report found that in the intervening years between that report and the

<sup>11</sup> In the 1999-2000 income year, 58% of non-profit institution income was generated from the "sales of goods and services": Australian Bureau of Statistics, Non-Profit Institutions Satellite Account, Cat No5256.0 (2002).

<sup>12</sup> Department of Family and Community Services, Giving Australia: Research on Philanthropy in Australia (2005) 43.

<sup>13</sup> Industry Commission Report 310.

<sup>14</sup> JD Colombo, 'Commercial Activity and Charitable Tax Exemption' (2002) 44 William and Mary Law Review 487, 529-530.

<sup>15</sup> Industry Commission Report 311-312.

ICReport, many of these advantages had been scaled back through the capping of amounts.<sup>16</sup>

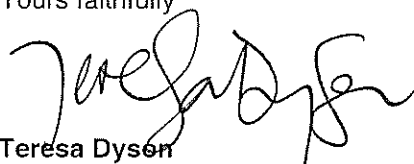
In our experience, the FBT exemption is highly valued by eligible NFPs and its loss would be likely to result in reduced levels of service, unless the difference is made up in other ways (eg by direct funding). We therefore recommend retaining that the FBT exemption be retained, using caps (where they do not already exist) to limit any impact on competitive neutrality.

**(c) Goods and services tax (GST)**

We consider that the GST concessions are unlikely to impact on competitive neutrality and do not recommend any changes.

If you would like to discuss the submissions in this letter further, please contact Teresa Dyson on (07) 3259 7369.

Yours faithfully



**Teresa Dyson**  
Partner  
T 61 7 3259 7369  
teresa.dyson@blakedawson.com

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<sup>16</sup> Definition of Charities Report 230.