



# **AUSTRALIA COUNCIL**

**SUBMISSION TO  
INQUIRY REGARDING THE DEFINITION OF  
CHARITIES AND RELATED ORGANISATIONS**

## Executive Summary

The Australia Council welcomes the Inquiry into the Definition of Charities and Related Organisations.

The Inquiry presents an opportunity to enhance the clarity and consistency of existing definitions and, as a result, enhance reporting and governance of the charitable sector.

The Australia Council recommends that any new definition of a charity should include, without ambiguity, nonprofit arts and cultural organisations. In particular, the charitable tenets of the ‘advancement of education’ or ‘any other purpose beneficial to the community’ should be clarified to reflect the role of arts and cultural organisations.

Participation in arts and cultural activities is strongly related to other forms of civic engagement and ‘social capital’. Council believes that the arts create not just a benefit for the people who attend, for which they can be charged, but also a benefit that accrues to everyone, both to those who do *and* those who do not attend. This benefit, the public benefit, cannot be charged to everyone and is therefore paid for by the government. Council’s submission details public benefits suggested by economists and reasons for national support for arts and cultural activities.

An unambiguous definition of charity would simplify the interpretation of the law and remove the need for a single regulatory body to administer the law.

Council believes that it is appropriate to rely on the sole or dominant purpose of an organisation as the key criterion for it to be classed as a charity. The critical issue is the purpose to which an organisation’s funds are applied rather than the nature of individual activities.

Council maintains that any changes to the definition of charities and other related organisations should not decrease the current level, or the impact of government support for arts and culture in Australia.

We note the sensitivities of the arts industry to changes in the operating environment. If existing tax concessions were not maintained, we would be concerned that the financial viability of many arts organisations would be in jeopardy. While the tax expenditures available to arts and cultural charitable organisations are less than 1/10<sup>th</sup> of 1% of the Federal Government’s total tax expenditures, the particular impact on the arts and cultural sector would be considerable.

# Table of Contents

<b>1. Introduction</b>	2
<b>2. Implications of current social expectations and experiences for defining charities and related organisations</b>	4
2.1 Arts and Cultural Sector	4
2.2 Benefits of retaining arts organisations in the definition of a charity	5
2.2.1 Educational (knowledge) value	5
2.2.2 Contemporary community benefit	6
2.3 Rationale underlying government support for arts and culture	7
2.3.1 Economic arguments	8
2.3.2 Elaboration of public benefit of the arts – education and community benefits	8
2.4 Current government support for charitable arts organisations in Australia	9
2.5 Financial data/impact	12
2.6 Wholly or partially charitable organisations	14
<b>3. Existing Definitions of charities and related organisations in Australia</b>	15
3.1 Nonprofit organisations	15
3.2 Charities	15
3.2.1 What is a charity?	16
3.2.2 Charities – examples	17
3.2.3 Non-charities – examples	17
3.3 Public Benevolent Institutions	17
<b>4. Definitions used in overseas jurisdictions</b>	19
4.1 Nonprofit organisations	19
4.2 Charities	20
<b>5. Options for enhancing the existing definitions in Australia</b>	21
<b>6. Conclusion</b>	23
<b>Appendix 1 – A compendium of reasons for national support for arts and cultural activities</b>	24
<b>Appendix 2 – Financial data for charitable arts organisations</b>	25
<b>Appendix 3 – Organisations included in financial data (confidential)</b>	31
<b>Bibliography</b>	32
<b>Endnotes</b>	35

# 1. Introduction

Australia currently boasts a dynamic arts and cultural sector, with outstanding artists and arts organisations. The Commonwealth Government has demonstrated its commitment to Australian art and culture through its continued support of the industry through public subsidy.

The arts and cultural sector is large and diverse, with a mix of many organisations and individual artists working across a range of artforms (theatre, dance, music, visual arts, craft, design, Indigenous arts, literature, digital media, film, etc). Nonprofit arts organisations exist alongside government providers and commercial or for-profit providers.

A number of Australia's major nonprofit arts organisations qualify for assistance delivered through the tax system under the *Income Tax Assessment Act 1997* by virtue of the fact that they can be included in the common law definition of 'charitable purpose' through the definitions of advancement of education or any other purpose beneficial to the community. This has enabled nonprofit arts organisations to take advantage of exemptions or concessions from certain State and Commonwealth charges.

The Australia Council is concerned that potential changes to definitions of charities and other related organisations do not inadvertently or otherwise decrease the current level of government support for the arts.

Government support for the arts is delivered in a number of ways, most notably for the present purposes, via tax expenditures (i.e. arrangements within the tax system that confer a benefit on certain classes of tax payers or activities). While the Australia Council recognises that the pretext of this Inquiry is not to set parameters for eligibility for tax relief or other concessions, any revision to legislation does have an impact on this matter, and on behalf of arts organisations, this will be addressed within the scope of this submission.

The Australia Council suggests that in any proposed changes to the definition of charitable status the current advantages of exemption from certain Federal, State and local government charges by nonprofit arts organisations through their registration as a charity are preserved.

If Parliament modifies the current definition of charity it will give significant weight to fiscal concerns and tax expenditures consequent upon any broadening of the definition. The Australia Council supports the view that any changes should be revenue neutral for government.

The Australia Council is not suggesting that the existing definition of arts organisations as charities be expanded beyond the current definition or criteria currently in place. However, the Australia Council recommends that nonprofit arts and cultural organisations are unambiguously included in any new definition of charity and that the tenets of the 'advancement of education' or 'any other purpose beneficial to the community' are clarified to reflect the role of such organisations.

This submission is structured in response to the key issues in the Inquiry Issues Paper and follows the same broad headings:

- The implications of current social expectations and experiences for defining charities and related organisations;
- Existing definitions used in Australia, including the continuing relevance of the ‘public benevolent institution’ definition;
- Existing definitions used overseas; and
- Options for enhancing the existing definitions in Australia.

## 2. Implications of current social expectations and experiences for defining charities and related organisations

Nonprofit and charitable organisations are currently facing an environment in considerable flux:

*Australia's nonprofit organisations in different fields are affected by the same forces: by social and economic changes that encourage people to form, join, support or drop out of nonprofit organisations; by governments, which regulate their activity, often support them and sometimes take them over; and by for-profit firms that often support and sometimes compete with them.*<sup>1</sup>

### 2.1 Arts and Cultural Sector

Australia's cultural landscape is rich and diverse. The arts and culture engage millions of Australians each year. In recent years the Australia Council has worked with government to develop qualitative and quantitative analyses of the importance of the arts in the lives of all Australians.

According to the 1996 *Census of Population and Housing*, there were 156,739 people working in a cultural occupation as their main job. However in March 1997, an Australian Bureau of Statistics (ABS) survey collected information about the involvement of persons aged 15 and over in selected culture and leisure activities during the previous 12 months. The survey showed that 2.2 million people (15.1% of the Australian population aged 15 and over) were involved in culture and leisure activities (excluding involvement solely for the respondent's own use). Of these persons, 40.2% received some payment.<sup>2</sup> Most of these involvements were of a short-term and part-time nature, being 13 weeks or less duration and less than ten hours a week. The arts and cultural sector has a strong reliance on the work of many volunteers.

In the arts and culture, nonprofit organisations are a mixture of member and public serving.<sup>3</sup> At one level, nonprofit organisations enable amateur thespians and chorists to engage in their art and occasionally, to perform for others. However, most of these are purely volunteer associations and are not included in formal measurements of the number of arts organisations in Australia.

The economic impact of nonprofit arts organisations comes mainly from those organisations with charitable status, for example: performing arts companies (such as Bell Shakespeare); community radio and television stations; nonprofit libraries and museums. There are currently just over 1,000 arts and cultural organisations that receive some form of tax exemption as a result of their charitable status. As a comparison, the total number of organisations engaged in arts and cultural activities is estimated to be several tens of thousands (at least 30,000).

In the report, *Australians and the Arts*, one of the principal findings is that 89% of Australians feel proud when they see the creative talent of Australians being recognised locally and internationally. 85% of people agree that "the arts should be an important part of the education of every Australian kid" and 80% of people agree that "the arts are at the heart of every form of popular entertainment."<sup>4</sup>

## 2.2 Benefits of Retaining Arts Organisations in the Definition of a Charity

Nonprofit arts and cultural organisations are currently implicitly included in the definition of charities in Australia.

Most nonprofit cultural organisations claim exemption from income tax under two sections of the *Income Tax Assessment Act 1936* (Cth), that is Section 23 (e) “income of a religious, scientific, charitable or public education institution” or 23 (g) “income of a society, association or club which is not carried on for the purposes of profit or gain to its individual members and is a society, association or club established for musical purposes, or for the encouragement of music, art, science or literature”. Section 50-5 of the *Income Tax Assessment Act 1997* replaces Section 23 of the ITAA 1936 without changing the concepts of Section 23. “Charitable institution” has the same meaning in Section 50-5 of the ITAA 1997 as it had in Section 23 of the ITAA 1936.<sup>5</sup>

Arts and cultural organisations should be retained in the definition of charitable purpose because they meet the requirements of the ‘advancement of education’ and ‘other purposes beneficial to the community’.

### 2.2.1 Educational (knowledge) value

The Preamble of the Statute of Elizabeth states that there may be trusts for the promotion of educative functions of the community – for the encouragement of knowledge or activity. “Education is not restricted to the narrow sense of someone teaching a class but including the education of artistic taste.”<sup>6</sup> The definition includes the promotion and dissemination of knowledge or awareness (knowledge economy). In particular, “...the promotion or encouragement of those arts and graces of life which are perhaps the finest and best part of human character.”<sup>7</sup>

This Statute forms the basis of many definitions of charity around the world. The principles contained within the Statute are essential for any potential changes to the overall definition of charity in Australia.

The Charity Commission in the United Kingdom embraces a wide parameter when defining education within the context of charities, with the intent of including some of the more indirect aspects of arts and cultural programs.

*The advancement of education is not limited to formal education at schools, colleges or universities.*<sup>8</sup>

A significant study by researchers in the United States has found that students with high levels of participation in the arts outperform those who don’t by virtually every measure.<sup>9</sup> Young people exposed to the arts excelled in areas such as the ability to test and develop ideas, and to formulate processes. The research also shows categorically that sustained participation in music and theatre are correlated with success in maths and reading proficiency.

There are many other reports that cite the importance of the educational value of the arts:

*Another general benefit is the uncompensated educational value of the arts. Artistic activities... may help a society to foster creativity, to improve the capacity for cultural evaluation and to develop aesthetic standards, aspects that benefit all persons in a society. The corresponding utilities are difficult, and sometimes impossible, to internalise within the market.*<sup>10</sup>

*Attending an opera, theater, or going to a museum, it is alleged leads a consumer to be a better citizen. This rationale appears to be based on the proposition that the arts are educational, that they improve the quality of citizenship, that they make the citizen more thoughtful, and that they teach him about the world. It is undoubtedly true that there is something in this position.*<sup>11</sup>

### **2.2.2 Contemporary community benefit**

A great many of the charitable arts organisations in Australia have a community arts focus. There is a critical link between community culture and social cohesion. Participation in arts and cultural activities is strongly related to other forms of civic engagement and ‘social capital’. The concept of social capital is consistent with the familiar concepts of financial capital, physical capital and human capital. Social capital describes “...the capacity for mutual cooperation towards the collective well-being within a community or wider society.”<sup>12</sup>

A recent ‘Social Impact of the Arts Project’ based in Philadelphia demonstrated the impact of the arts on building the social fabric of a community:

*The institutional infrastructure is stronger in neighbourhoods with many cultural organizations. These communities tend to have more social and voluntary organizations of all kinds—neighbourhood improvement, houses of worship, youth and social service, schools and child care, social and fraternal, recreational, business and labour, special interest—as well as arts and culture.*<sup>13</sup>

Arts and culture are central to social change movements. Cultural programs help strengthen diverse communities and bind communities together. Community arts and cultural organisations promote processes through which local residents take an interest in their own communities. Artists with a disability, Restless Dance Company for example, use artistic productions to educate community members, promoting awareness which can lead to social change.

One of the major objectives of the Australia Council’s Community Cultural Development Fund is to provide funding to enable communities to advance their artistic and social aspirations by working closely with professional artists. Through these collaborations communities are assisted to maintain or reclaim their culture, to address issues of concern to them and to create contemporary artistic works that reflect the richness and diversity of Australian communities and their cultural life.

In 1994, the Australia Council’s Community Cultural Development Unit supported a national study to examine the long-term benefit of 89 community based arts projects



they had funded in 1991. The study tested educational, social, artistic and economic indicators commonly accepted by government arts funding bodies and community arts practitioners as describing the long-term value of the work.<sup>14</sup>

The study found that the communities concerned could demonstrate distinct links between the impact of the arts projects and lasting social, educational, artistic and economic outcomes. The resulting publication, *Creating Social Capital*<sup>15</sup>, revealed that publicly funded community arts projects were powerful catalysts for community development and renewal as well as agents for substantial individual benefit.

The overall findings show that survey respondents recorded positive impact for each outcome area as follows:

- 96% recognised positive educational outcomes
- 94% recognised positive artistic outcomes
- 90% recognised positive social outcomes
- 72% recognised positive economic outcomes<sup>16</sup>

### ***Case Study***

The following case study is just one example of the type of the work being undertaken by Community Cultural Development practitioners around the country.

The Department of Education, Training and Youth Affairs has identified preventative strategies to reduce the incidence of domestic violence within the community. One initiative has been to fund domestic violence prevention workshops for young people aged 12-25 years across Australia.

BIG hART is an arts-based nonprofit organisation, which conducts projects for marginalised young people aimed at re-engaging them with the community. They provide an intensive, personal development process to increase individual's self-esteem and community integration through involvement in the creation of artistic productions.

BIG hART conducted a series of national domestic violence prevention workshops that involved particularly disadvantaged young people in the creation of productions that were then presented to mainstream young people and the broader public. A peer education model was used to create a community cultural shift and generate positive media stories concerning the issue.

The main approach was the recruitment of young people to participate in the development of arts-based productions (films, dramatic productions) which were then shown firstly at public 'performances' and secondly to school groups, as part of a facilitated educational process, including classroom discussion. BIG hART also negotiated with Life Line to provide counsellors to be trained for the project.<sup>17</sup>

## **2.3 Rationale underlying government support for arts and culture**

Nonprofit arts organisations are not run to make a profit for owners or shareholders and are not under the formal control of government. These organisations differ from

both for-profit and government organisations in the ways they are governed, in the variety of their sources of income and in their frequent reliance on volunteers.

Many of the major theories of nonprofit organisations are developed within economics. They posit a model of for-profit firms competing in efficient markets as the norm and explain both governments and nonprofit organisations as a response to market failure. There are very strong reasons for public support of the arts; these include information failures, distributional issues, positive externalities (spillover effects) and public benefits.

### **2.3.1 Economic Arguments**

The essence of the public benefit argument is that the arts create not just a benefit for the people who attend, for which they can be charged, but also a benefit that accrues to everyone, both to those who do *and* those who do not attend. This benefit, the public benefit, cannot be charged to everyone and is therefore paid for by the government. In other words, in relation to some activities, including the arts, there may be significant private and public benefits associated with their production and consumption.

Such a situation will arise when, for example, a drama production not only provides a benefit to those who attend (i.e. enjoyment of the drama), but also provides other benefits (e.g. international prestige for the country), both for those who do attend and the relatively vast number of those who do not attend.<sup>18</sup>

A role of government is to subsidise goods that generate positive externalities (spillover effects). The case for support for the arts by the state has been based on market failures, in particular the positive externalities culture provides for society.

Externalities cause market inefficiencies because they inhibit the ability of market prices to convey accurate information about how much to produce and how much to buy. Where positive externalities are generated by a good or service, pure market forces will leave society undersupplied. Solutions to this market failure include government support to the nonprofit sector via subsidy or indirectly via tax breaks. Tax exemptions accord financial advantages that offset, in whole or in part, the significant financial disadvantage nonprofits have in raising capital because of their inability to offer an equity stake in their operations to potential investors.

### **2.3.2 Elaboration of public benefits of the arts – education and community benefits**

The particular public benefits from the arts that the Industries Assistance Commission (IAC) identified as justifying government support stemmed from their role in education and in cultural development (in the 1976 Inquiry into Commonwealth Assistance to the Performing Arts). Other economists have elaborated on the public benefits from the arts. Among the other public benefits suggested by economists have been:

- Enhancement of national identity or pride and of international prestige;
- Direct and indirect economic benefits including
  - Attractive to business, consumers and tourists
  - Labour intensive, absorbing a full range of job skills
  - Direct and multiplier effects on the economy

- Ecologically and environmentally sound
- In demand by a class of individual the attraction of which to a community might be economically beneficial
- Potential to benefit future generations by providing them with an element of cultural continuity (option demand for both present and future generations)
- Development of socially critical and other innovative/experimental work

A recent report in the *Los Angeles Times* (18/8/2000) quoted Bill Ivey, Chair of the National Endowment for the Arts in the United States, as saying that “We’ve seen [during the past decade] a shift from funding what would traditionally be called ‘pure arts activity’ to more arts with social purpose... Almost every week there’s some new piece of evidence that indicates ways in which art helps communities flourish, helps young people do better in school, helps communities revitalise downtown districts.”<sup>19</sup>

A compendium of reasons for national support for arts and cultural activities is attached in Appendix 1. The following quote illustrates the diversity of benefits that arts and cultural activities deliver to society:

*Like language, the arts are one of the principal means by which a society binds itself together and transmits its beliefs and standards from one generation to another. The arts perform this function when they embody, reinforce, and celebrate the values of their society, when they confirm and exemplify the lessons simultaneously taught by the family, by the formal structures of education, and by the mass media in all their variety. In this function, the arts play a critically important role. Not only do they provide a kind of social “glue”, but they also furnish a means by which society can identify and distinguish itself from others.*<sup>20</sup>

## **2.4 Current Government Support for Charitable Arts Organisations in Australia**

There are well-established reasons for government to support the arts. At present, a proportion of this support is provided through the classification of arts bodies as charities or related organisations. In the main, these categories are the means by which the government delivers funding through the tax system (tax expenditures) to the arts.

The Department of Communications, Information Technology and the Arts (DCITA) administers three tax incentive programs that are specifically intended to assist charitable organisations in the arts and cultural sector: the Register of Cultural Organisations, the Cultural Gifts Program, and the Cultural Bequests Program.

### ***Register of Cultural Organisations***

The Register of Cultural Organisations (ROCO), established in 1991, allows qualifying cultural organisations to offer donors the incentive of a charitable deduction. A donor is allowed to deduct from taxable income donations of cash or property that are made to nonprofit organisations appearing on the Register. The Register currently lists some 773 cultural bodies. These organisations must have a principal purpose in promoting literature, music, performing arts, visual arts, craft, design, film, video, television, radio, community arts, Aboriginal arts, or movable

cultural heritage. They must be properly constituted, have a main purpose that is cultural, and maintain a separate fund for the receipt of public donations that must be used exclusively for the cultural purposes of the organisation. The ROCO Guide July 2000 includes extracts from *The Income Tax Assessment Act 1997* which defines a cultural organisation as:

- (a) a body corporate; or
- (b) a trust; or
- (c) an unincorporated body established for a public purpose by the Commonwealth, a State or Territory;

that satisfies each requirement in the section.

Once eligibility criteria have been met, organisations must be approved by both the Minister for Communications, Information Technology and the Arts, and the Treasurer before they can be entered on the Register. After approval for entry on the Register, organisations are required, in accordance with Subdivision 30-BA of the *Income Tax Assessment Act 1997* to seek endorsement as a Deductible Gift Recipient (DGR) from the Australian Tax Office (ATO). Cultural organisations must have agreed to give the Secretary to the Department of Communications and the Arts, at intervals of 6 months, statistical information about gifts made to the public fund during the last 6 months.

The Register is primarily comprised of music and other performing arts organisations but there is also active participation by visual art, craft and design groups, literary groups, community radio and historical societies. (Public art galleries, museums, and libraries are covered by the Cultural Gifts Program and are not part of the Register.) Between 1991 and 1998 registered organisations have attracted cash donations to a total value of \$68.5 million.<sup>21</sup>

The Register of Cultural Organisations comprises organisations from the following areas:

- Capital City CBD – 400 (52%)
- Capital City Suburban – 182 (23%)
- Regional/Country organisations: 191 (25%)
- Total number: 773 (as at 8/12/00)

A great many of the organisations on ROCO that receive concessional tax treatment are community-based.

*Not surprisingly, the capital city CBD organisations, which include the elite or flagship cultural groups, are receiving by far the most support through donations. However the participation rates of suburban and rural groups is good – they account for over 70% of ROCO organisations and receive some 40% in value of donations.<sup>22</sup>*

### ***Cultural Gifts Program***

The Cultural Gifts Program (formerly the Taxation Incentives for the Arts Scheme) provides an incentive for gifts of significant cultural heritage items to public art galleries, museums, and libraries. More than 370 institutions currently participate in this scheme. Under this program a donor is entitled to a deduction from taxable income for the market value of the gift. Two valuations by approved appraisers are

required and the donor can claim the average of the two values as the deduction. The Commissioner of Taxation can vary or disallow the deduction if the gift is given with conditions that prevent or delay the receiving institution from having clear title, custody and control over the item or that involve a material benefit to the donor.

ATO Taxation Ruling TR2000/10 sets out the views of the ATO on what is a public collecting institution (public library, public museum and public art gallery) for the purposes of gift deductibility under Division 30 of *the Income Tax Assessment Act 1997*.

Materials describing the program make it clear that the Australian Government considers this to be a tax expenditure and estimate the extent of that expenditure: "...the policy objective of the program is to attract significantly cultural material into public collections and ... gifts are funded by the Government through the donor's tax deduction (estimated to be about 40 percent of the value of the gift)."<sup>23</sup> Gifts of cash to these public collecting institutions can also be deducted from income prior to donors calculating their taxes. Between 1991 and 1998 the scheme attracted over 3,000 donations with a total value of some \$86.4 million.<sup>24</sup>

The participants of the Cultural Gifts Program are from the following areas:

- Capital city – 192 (52%)
- Metropolitan – 59 (16%)
- Regional Centre – 86 (23%)
- Remote community – 8 (2%)
- Town – 27 (7%)
- Total number of participants - 372

### ***Cultural Bequests Program***

The Commonwealth Cultural Bequests Program began in 1998/99 and operates as a supplement to the Cultural Gifts Program. It is designed to encourage private collectors to bequeath nationally significant cultural items to public art galleries, museums and libraries by allowing the value of the bequest to be deducted from the donor's estate and by exempting the bequest from capital gains tax. The program is unique in that it operates within a limit on the total value of bequests that can be authorised each year. This limit, currently set at \$5 million per year, constrains the amount of foregone taxes that can be spent via this tax expenditure and creates a situation in which the government may have to consider competitive applications.

An American academic provides the following assessment of the operation and accountability of Australia's tax incentive programs that assist charitable organisations in the arts and cultural sector:

*Taken together, these three schemes provide a framework for an unusually constrained set of tax-based incentives. The government through its registration, approval, and review mechanisms exercises a relatively firm hand on the system to assure that it operates within the grain of public policy in a way that other, more automatic tax incentives find it difficult to do.*<sup>25</sup>

Tax concessions are a major part of policy in relation to the arts, not only in Australia, but also in the United States and Europe:

*...the individual charitable contribution deduction is the most important part of tax policy that affects the arts in the United States, and this does not necessarily result from significantly more favourable tax laws in this regard but from the fact that more people actually avail themselves of the tax concession. ...the same applies to capital transfers (gifts and bequests).<sup>26</sup>*

## 2.5 Financial Data/Impact

Nonprofit arts organisations generally have tenuous financial circumstances and if charitable status were revoked the impact on organisations and industry may be critical. Supporting financial analysis of such nonprofit arts organisations funded by the Australia Council is included in Appendix 1 and shows that arts organisations have all the financial characteristics of charities, namely:

- low liquidity
- large levels of debt (in terms of balance sheet liabilities)
- low reserves and low operating margins (making it difficult for these organisations to withstand financial shocks, such as poor box office, loss of public subsidy or loss of charitable tax concessions)
- high reliance on public subsidy - on average these organisations receive between 49% and 62% of their income from grants.

A number of Australia's major nonprofit arts organisations, which are supported by the Australia Council, are currently on the Register of Cultural Organisations, are Income Tax Exempt Charities and are Deductible Gift Recipients with concessional Fringe Benefits Tax treatment. There is also a range of concessions available to these organisations from Federal, State and Local Government charges (e.g. payroll tax, stamp duty etc.). The impact of State and Local Government concessions will not be detailed in this submission due to the lack of suitable data.

Treasury's *Tax Expenditures Statement 1997-98* provides the most up-to-date details on the financial benefits that individuals and businesses derive from tax concessions of various kinds from the Commonwealth Government. These concessions are usually delivered by tax exemptions, tax deductions, tax rebates or reduced tax rates.

The *Tax Expenditures Statement* provides a breakdown of tax expenditures by function, with details for the 'culture and recreation' industry (which includes sport). In 1997-98, the exemption of income of nonprofit societies, associations or clubs established for the promotion or encouragement of sport, games, music, art etc. and nonprofit friendly societies (other than a friendly society dispensary) and nonprofit community service organisations amounted to \$25M. This compares with a total tax expenditure of \$22,314M across functions. The revenue costs to government of maintaining tax concessions to arts and cultural charitable organisations is less than 1/10<sup>th</sup> of 1% of total tax expenditures,<sup>27</sup> however this amount is of vital importance to the viability of the organisations that receive the tax concessions.<sup>28</sup>

The Commonwealth Government acknowledged its concern for the sustainability of Australia's largest performing arts organisations by conducting an inquiry into the

sector. The findings of the 1999 Major Performing Arts Inquiry, *Securing the Future*,<sup>29</sup> identified ways in which the financial difficulties of the 29 companies involved may be addressed. All of these organisations are on ROCO except for one, which has DGR endorsement.

The Commonwealth Government further demonstrated its concern about the sustainability of charitable arts organisations when the Department of Treasury commissioned consultants Econtech to undertake a study into the expected impact of The New Tax System on the Arts.

The Econtech report of 3 June 2000 acknowledged that some arts products may be able to be sold GST-free if the ‘non-commercial’ activity provisions applying to charities applied to arts and cultural organisations on ROCO.<sup>30</sup> Specifically, organisations that have access to government support to provide their products at less than 75% of cost will meet the non-commercial test and be able to sell their products GST-free.

At the time of writing the Econtech report there was some uncertainty about the extent of the application of the test, and Econtech conducted modelling based on best and worst-case scenarios. In the best-case scenario it was assumed that the arts products of charitable arts organisations are GST-free, while the worst-case scenario assumed that the arts products would be subject to GST.

“In the best-case scenario where products from charitable arts organisations are supplied GST-Free, their prices are expected to fall by 0.9% in 2000/01 and 2.1% in the long-term...which is estimated to stimulate a gain in consumer demand for these products of about 3%”.<sup>31</sup>

“In the worst case scenario, where GST of 10% does need to be added to selling prices, consumer prices will rise by 9.0% in 2000/01 and 7.7% in the long-term.”<sup>32</sup> The report goes on to describe the resultant associated decrease in consumer demand for arts products of about 6%.<sup>33</sup>

Therefore, if the arts organisations’ charitable status and GST-free provisions were revoked, it is estimated that there would be a significant increase in prices and a resultant decrease in demand. A great many of the organisations with access to the GST-free provisions are community-based and may not survive such a financial shock.

The preservation of tax expenditures to charitable arts and cultural organisations is critical to the financial health of an important part of the sector. If concessions to charitable arts organisations were not continued, it would certainly generate requests to Federal and State Governments for greatly increased subsidy. In other words, many of Australia’s key arts organisations, which contribute to the economic and social health of Australia, may not survive if these concessions are withdrawn and additional government subsidy to cover these costs is not provided.

*One of the alleged major advantages of indirect funding through tax concessions is that it will lead to more financial stability for arts institutions and protect them from the whim of government policymakers.*<sup>34</sup>

## **2.6 Wholly or Partially Charitable Organisations**

The Inquiry has raised the issue of whether an organisation could be regarded as wholly or partially charitable, religious or community service not-for-profit if the emphasis of the definition moves from the purpose of the organisation as a whole to the purpose of each of the activities of the organisation.

An arts organisation may engage in commercial activities to cross-subsidise its charitable purpose. Any earnings that cross-subsidise an organisation's charitable core activities merely reduce the organisation's reliance on other sources of income such as government grants, corporate sponsorship or donations to achieve those purposes. The central characteristic of nonprofit organisations is not that profits are not made, but that profits are not distributed.

The Australia Council believes that it is appropriate to rely on the sole or dominant purpose of an organisation as the key criterion to define it as charitable.

The critical issue is the purpose to which the profits are applied, not the nature of individual activities.



### 3. Existing definitions of charities and related organisations in Australia

This section describes existing definitions of nonprofit organisations, charities and public benevolent institutions in Australia and the relevance of these definitions to the arts and cultural sector.

#### 3.1 Nonprofit Organisations

Nonprofit organisations in Australia have broader purposes than charities, for example, they can engage in political activity and lobbying and provide services to members as well as the public. The ATO has defined nonprofit organisations in its *Charity Pack* as:

*An organisation is nonprofit if it is not carried on for the profit or gain of its individual members. This applies for direct and indirect gains, and both while the organisation is being carried on and on its winding up. The ATO accepts an organisation as nonprofit if its constitution or governing documents prohibit distribution of profits or gains to individual members and its actions are consistent with the prohibition.*<sup>35</sup>

Liffman provides further explanation relevant to Australia:

*The not for profit sector, as usually defined, covers an extraordinarily vast and diverse range of organisations and activities, from the tiniest self-help groups, through large, well-recognised charitable institutions, to major private schools, trade unions, sporting clubs, churches, universities, and leading hospitals and research institutions.*<sup>36</sup>

*What lies behind the term 'not for profit' is that there are no shareholders or owners, and any retained earnings are therefore returned to the agency's budget for use in its continuing work. The term 'not for profit' does not mean that surpluses are not made, but simply that profits - in the form of benefits to individuals - are not distributed.*<sup>37</sup>

#### 3.2 Charities

The legal definition of charity status has great power in various countries. Australia's legal definition of charities is based on the common law of England. Australian organisations have been chosen to receive charity status according to broad principles drawn up 400 years ago in a Preamble to an Elizabethan Statute.

All State and Territory Governments rely on the legal definition of charities based on the common law of England. However, regulatory regimes may produce contradictions – what is required in one State to receive tax concessions may be prohibited in another. This submission will not provide details on the variety of legislative differences across states and territories in Australia.

### 3.2.1 What is a charity?

The ATO definition of charities is:

*Charities include most religious institutions, aged person homes, homeless hostels, organisations relieving the special needs of people with disabilities and societies that promote the fine arts.*<sup>38</sup>

A charity is an institution or fund established for a purpose that the law regards as charitable. The term ‘charitable’ has a technical legal meaning which is different from its everyday meaning. Charitable purposes, as per the Statute of Elizabeth, are:

- the relief of poverty or sickness of the needs of the aged,
- the advancement of education,
- the advancement of religion, and
- other purposes beneficial to the community.

An explanation of what is included in the ‘other purposes beneficial to the community’ category is provided in the ATO’s *Charities Consultative Committee Resolved Issues as at 1 July 2000* publication:

*Charitable activities for other purposes that may be beneficial to the community include:*

- *preserving defence and public order*
- *relieving stress due to natural disasters*
- *providing community facilities such as a museum, library, hall, garden or fire service*
- *promoting art and culture such as through music and drama*
- *promoting health, for example through educating the public about disease*
- *protecting animals*
- *scouts*<sup>39</sup>

The ATO further clarifies the position of nonprofit arts and cultural organisations within the definition of charities:

*Nonprofit entities that operate for the public benefit to advance the arts or educate the public in the arts are charities.*<sup>40</sup>

The characteristics of a charity are:

- it is an entity which is also a trust fund or an institution.
- it exists for the public benefit or the relief of poverty.
- its purposes are charitable within the legal sense of that term.
- it is nonprofit, and
- its sole or dominant purpose is charitable.<sup>41</sup>

For the ATO’s purposes, recreational, entertainment, lobbying and private bodies are not charities. Organisations that are primarily for the benefit of members are not charities.<sup>42</sup> However, if an entity’s purpose is otherwise charitable, the presence of political, lobbying or promotional activity that is incidental to the charitable aims will not prevent it being a charity.<sup>43</sup>

“An entity is not charitable if it is carried on for the purposes of profit or gain to particular persons including its owners or members.... A charity can be nonprofit and still make a profit. However, any profits it makes must be used for charitable purposes. The profits must not be distributed to owners, members or other private persons.”<sup>44</sup>

The ATO provides examples of organisations that are charities and organisations that are not charities to clarify the distinction:

### 3.2.2 Charities – examples

- *arts societies* which encourage and promote the cultivation and appreciation of the fine arts.
- *ballet foundations* to promote and encourage interest in ballet.
- *bodies promoting culture and the arts in schools.*
- *choral and orchestral societies.*
- *friends of public museums and art galleries.*
- *opera companies* that are nonprofit.
- *public art galleries*
- *public libraries.*
- *public museums.*
- *trust funds* distributing solely to charities that promote the arts.

### 3.2.3 Non-charities – examples

- *antique or vintage car clubs.*
- *bridge and other card clubs.*
- *camera clubs.*
- *cinema clubs.*
- *doll clubs.*
- *ethnic social and cultural associations.*
- *historical re-enactment clubs.*
- *professional associations* of artists, dancers, musicians, curators, educators in the cultural arts field, and the like.
- *science fiction clubs.*
- *social clubs and organisations.*
- *stamp-collecting clubs.*
- *trade unions.*<sup>45</sup>

## 3.3 Public Benevolent Institutions

A Public Benevolent Institution (PBI) is an institution organised for the direct relief of poverty, sickness, suffering, distress, misfortune, disability or helplessness. The characteristics of a PBI are:

- it is set up for needs that require benevolent relief
- it relieves those needs by directly providing services to people suffering them
- it is carried on for the public benefit
- it is nonprofit
- it is an institution, and

- its dominant purpose is providing benevolent relief.<sup>46</sup>

The benefit to an organisation of being classified as a PBI is that it can satisfy the general provisions of section 30-45 of the *Income Tax Assessment Act (1997)*. This means that if the organisation's activities fit within the definition it will be accepted as a 'Deductible Gift Recipient' and it does not need to be specifically named in the Act (which requires ultimate approval by the Prime Minister).

PBI status also currently provides concessional Fringe Benefits Tax (FBT) treatment on any fringe benefits provided to employees. From 1 April 2001, the concessional FBT treatment currently available to PBIs and most charitable institutions will be capped at \$30,000 of grossed-up taxable value per employee. There are also some GST concessions.

The criteria that must be met for an arts and cultural organisation to be listed on the Register of Cultural Organisations should, in most circumstances, exclude an organisation from also being a PBI. A PBI might set up a 'cultural fund' but the two funds would need to be mutually exclusive: any tax deductible donations could not be 'interchanged' and FBT exemption concessions could not be carried through to employees of the 'cultural fund'.

In light of this, the existing definition of a PBI does not impact significantly on the arts and cultural sector.

## 4. Definitions used in overseas jurisdictions

This section describes existing definitions of nonprofit organisations and charities from overseas jurisdictions and examines the relevance of these definitions to the arts and cultural sector.

The Canadian Coalition of National Voluntary Organizations (NVO) believes that the definition of charity continues to be problematic for the sector:

*The law is outdated, the process for acceptance/rejection is not transparent, the rules are open to wide interpretation and the means for redress costly, arbitrary and not uniformly applied. There are a variety of issues requiring clarification and further study, reflection and input, specifically:*

- *expanding the definition of a charity while still respecting the differences between the broader categorization of nonprofit, for profit and government sectors;*
- *rules about commercial activity; and,*
- *advocacy/lobbying<sup>47</sup>*

In general, the NVO would like the law more liberally applied and would support charitable status being given to those groups providing an identifiable public benefit.

With regard to rules related to commercial activity the NVO believes the importance of the issue has been exaggerated:

*Charities operate for the purpose of advancing their mission and values and providing services, not making a profit. In our increasingly complex society there are no longer clear lines of delineation between the private, public and voluntary sectors in terms of what each does. However, the purpose for which each carries out its activities or services is very clear. Existing regulations do not allow charities to operate businesses unrelated to their mission. The need to diversify sources of funding is a key ingredient of the effective organization of the future. So long as the organization's mission is the focal point of activity, we do not see a fundamental problem.<sup>48</sup>*

### 4.1 Nonprofit organisations

In the United States, the Johns Hopkins Comparative Nonprofit Sector Project has developed a structural-operational definition of nonprofit organisations so as to facilitate comparison of nonprofit sectors across countries.<sup>49</sup> The nonprofit sector may be defined as the set of institutions in any society that share five key characteristics:

1. Organised/Formal – a group must have some structure or rules (constitution)
2. Self-governing – an organisation is independent of other organisations and whether or not the organisation was recognised in law as an employer
3. Private – an organisation is structurally and operationally independent of government
4. Nonprofit distributing – crucial test, distinguishes nonprofit organisations from a for-profit firm, making the largest possible profit is not an objective and no surplus can be distributed to members or staff

5. Voluntary – an organisation embodies some meaningful degree of voluntary involvement (staff, boards) and membership of an organisation is usually voluntary

*A wide range of entities fits comfortably within the nonprofit sector as defined using our preferred “structural-operational” definition. This includes organizations in culture and recreation, education, research, health, social services, development, housing, advocacy, philanthropy, religion, and business representation.*<sup>50</sup>

## 4.2 Charities

Many countries around the world rely on the definition of charities based on the Statute of Elizabeth in English law.

*In Anglo-Saxon countries, the legal term “charitable” has a special technical meaning and “embraces arts, culture, education and other activities as well that, while contributing to public welfare, do not necessarily target the poor.”*<sup>51</sup>

Charity status is granted to English charitable organisations on the basis of this 17<sup>th</sup> century law and is interpreted according to 21<sup>st</sup> century needs by the Charity Commission, whose members are appointed by the government of the day.

The English Charities Commission classifies charities and assigns them to different tax bands. Charitable organisations that receive the most generous tax concessions are those that stay close to the humanitarian aims of charity law (provision of food, shelter, clothing, health care and education). Cultural organisations all receive lower levels of tax concessions. Possibly this situation has occurred because the English government offsets the shortfall in indirect assistance to charitable arts organisations with funds from their lotteries revenue. Australia does not have access to such lotteries revenue.

If a structure similar to the Charities Commission was established to administer and monitor charities in Australia as a result of this current Inquiry, the Australia Council suggests that there would need to be certain differences in its operation. A structure such as this would not provide the same degree of long-term financial stability for the charitable arts organisations as tax concessions, and charitable arts organisations in Australia do not have access to a dedicated pool of lotteries funds.

However, if this Inquiry results in an unambiguous definition of charity there would be little need to establish a single regulatory body to oversee the interpretation of the law. Indeed a devolved model of regulation and governance of charitable organisations, such as DCITA’s management of the Register of Cultural Organisations, could be extended to other sectors.

## 5. Options for enhancing the existing definitions in Australia

The Australia Council views this Inquiry as an opportunity to enhance the clarity and consistency of existing definitions. A simple, unambiguous definition of charity that is easy to administer would be a major achievement in the realm of public policy.

Arts organisations should continue to be included within the definition of charitable purpose.

The essential attribute of a charitable activity is that it seeks the welfare of the public or is of public benefit and it is not concerned with the conferment of private advantage. The Australia Council recommends that nonprofit arts and cultural organisations are unambiguously included in any new definition of charity and that the tenets of the ‘advancement of education’ or ‘any other purpose beneficial to the community’ are clarified to reflect the role of such organisations.

The ATO specifies ‘societies that promote the fine arts’ in their precis of organisations that qualify for charitable status. The Australia Council proposes that the category of charity be re-defined to specifically include the term ‘cultural organisation’ so that any revised legislation would recognise this group as deserving of continued special attention.

Nonprofit arts organisations exist alongside government providers and commercial or for-profit providers. Council is not suggesting that the existing definition of arts organisations as charities be expanded beyond the current definition or criteria currently in place.

Any change in the definition should seek to strengthen the charitable sector and simplify and enhance reporting and governance. However, Council offers two cautions: excessively onerous regulations and reporting requirements must be avoided or the spirit of volunteerism itself could be undermined; and the considerable diversity within the charitable sector must be respected and accommodated.

This opinion is consistent with that of the Centre for Australian Community Organisations and Management (CACOM):

*... (It) has been widely acknowledged that there is a need to establish clearer and more consistent accountability (State/Federal government requirements) for nonprofit organisations. Increasing government regulation and scrutiny generates increasing costs for community organisations. However, a set of accounting standards which make organisations more clearly and publicly accountable would be welcome.<sup>52</sup>*

Again, any change in the definition of charity should seek to clarify advocacy rules. The meaning of advocacy has become unfairly charged with negative overtones. Its original meaning relates to “one who pleads the cause of another or to be a supporter.” The role of education or advocating a cause is both a necessary activity and a responsibility of a charity in support of its work in service of others. The complex reality of the cultural sector today requires greater advocacy efforts by arts organisations of all types.

However, it is acknowledged that an organisation established for political purposes would sit more comfortably within the definition of a nonprofit organisation rather than a charity.

The Australia Council suggests that a charity be defined as an organisation which meets all the following criteria:

- An entity that is also a trust fund or an institution. (An entity for these purposes includes a corporation, unincorporated association, trust or partnership.)
- Carried on for the relief of poverty or the public benefit (including organisations that encourage and promote the cultivation and appreciation of the arts and culture)
- Operated on a nonprofit basis and is not operated merely for the joint benefit of its members (the payment of directors' fees is prohibited)
- Provides services to the public (this does not necessarily mean the whole community)
- Operated in accordance with the legislative and public fund requirements
- On dissolution, remaining assets are passed to a similar nonprofit organisation
- The presence of promotional, lobbying or political activity that is incidental to the organisation's charitable aims should not prevent it being a charity



## **6. Conclusion**

The revised definition of Charities is necessarily strategic and an articulation of government policy. In Australia, and indeed in most countries around the world, there is a history of subsidy to the arts and culture using tax-generated funds. The Australia Council is concerned that nonprofit arts and cultural organisations should not be disadvantaged by a change in the definition of charities. A change that affects the sector's concessional tax treatment would, in effect, be an unintended change in the federal government's policy stance. The potential distributive effects of marginal changes may have a significant effect on the level of support for the nonprofit arts and cultural subsector.

The Australia Council recommends that nonprofit arts and cultural organisations are unambiguously included in any new definition of charity and that the tenets of the 'advancement of education' or 'any other purpose beneficial to the community' are clarified to reflect the role of such organisations.

# Appendix 1

## A compendium of reasons for national support for arts and cultural activities

- Preservation and reinforcement of national cultural identity
- International prestige
- Preservation of cultural evidence and the fostering of culture (development of socially critical and other innovative/experimental work)
- Promote artistic excellence
- Facilitate greater access to the arts
- Option demand:
  - Transmission of cultural heritage from one generation to the next
  - Existence value (consumers may value the Sydney Opera House but may never attend performances there)
- Education:
  - Education of the young
  - Universal education
  - People discover strength, skills and opportunities for self-development through the arts
- Social cohesion:
  - Arts have the potential to change deep rooted attitudes and may be a tool for social improvement
  - Many projects use skills of professional artists to work with marginalised or disadvantaged individuals (multicultural, Indigenous, regional, youth)
  - Raising the general quality of life (quality of life considerations are important in the location decisions of firms and households)
- Economic Impact -
  - Strong positive effects of local production of arts and culture on local economic development (cultural exports, local multiplier effects e.g. Adelaide Festival)
  - Investing in a vital sector of the economy – entertainment and culture that pays (e.g. book publishing, record, tape and CD production and film making)

## Appendix 2

### Financial Data for Charitable Arts Organisations

The following financial data was compiled from audited accounts of Australia's key charitable arts organisations that receive either triennial or project funding from the Australia Council. Typically these organisations also receive funding from their relevant state and territory governments. All organisations are nonprofit and are listed on the Register of Cultural Organisations as deductible gift recipients. Most, if not all, organisations have been endorsed as Income Tax Exempt Charities (ITEC).

This data adopts the financial ratios recommended by Centre for Australian Community Organisations and Management (CACOM),<sup>53</sup> as well as those used in the arts sector to monitor financial sustainability. These financial ratios can be used for comparative purposes with other nonprofit organisations in charities sector.

In the following tables, performance against these indicators confirms that arts organisations have all the financial characteristics of charities, namely:

- low liquidity
- large levels of debt (in terms of balance sheet liabilities)
- low reserves and low operating margins (making it difficult for these organisations to withstand financial shocks, such as poor box office, loss of public subsidy or loss of charitable tax concessions)
- high reliance on public subsidy - on average these funded organisations receive between 49% and 62% of their income from grants
- variations in the quality of financial reporting

It is worth noting that the CACOM paper stated repeatedly that arts organisations were by far the most vulnerable nonprofit organisations in their sample.

### **Financial impact of loss of charitable status**

Arts organisations benefit from the concessions granted to charities by all levels of government. The financial impact of losing these concessions would be severe.

- **Goods and Services Tax**

Loss of the 75% GST-free concession<sup>54</sup> could result in organisations increasing prices or absorbing the GST within sale prices. This could mean lower returns or loss of sales - both resulting in lower income. Organisations providing community theatre, arts services to schools, disability arts and regional arts are particularly vulnerable to the removal of this concession, given that their prices are relatively inelastic.

- **Deductible Gift Recipient (DGR) Endorsement**

Loss of DGR status would remove the tax incentive for donations by the general public to arts organisations. Some organisations have been very successful at raising funds this way, notably art galleries and museums.

- **Income Tax Exemption (ITEC)**

Loss of ITEC status could result in arts organisations being taxed at the nonprofit income tax rate of 34%. Organisations would also lose FBT concessions.

- **Public Benevolent Institution (PBI) Status**

Arts organisations are likely to only have PBI status by virtue of being a subsidiary of a larger charitable organisation. Changes to this status would have minimal impact on the sector.

- **State Taxes and Duties**

Changes to definitions in state legislation could result in arts organisations losing current exemptions from Financial Institutions Duty<sup>55</sup>, Bank Debits Tax, some stamp duties, payroll tax and land tax. Some arts organisations may lose other concessions provided by state and local government to charities, such as rate rebates and access to government contracts and suppliers. Removal of charitable status would therefore increase their costs.

### **About the data**

This submission reviews the financial data of 109 arts organisations funded by the Australia Council. All organisations are listed on the Register of Cultural Organisations<sup>56</sup> (ROCO) and the sample size represents 14% of all ROCO. With one exception, organisations that do not appear on ROCO but have DGR endorsement were excluded from this report. The data is divided into two groups: major performing arts organisations and non-major performing arts organisations<sup>57</sup>. The following table shows the breakdown:

<b>Organisations on the Register of Cultural Organisations (ROCO)</b>		
Major Performing Arts	Non Major Performing Arts	Total sample as a % of all ROCO Organisations
29	80	14%

### **Major Performing Arts Organisations**

These organisations are the 29 largest performing arts organisations in Australia. Data was compiled from Appendix 2, *Securing The Future*<sup>58</sup>. Only 1998 data was available. The financial data is a mix of calendar and financial years. All organisations are on the Register of Cultural Organisations except Melbourne Theatre Company, which has DGR endorsement as a subsidiary of University of Melbourne.

### **Non Major Performing Arts Organisations**

These organisations are funded through the Australia Council either by triennial or project funding. Only ROCO organisations are included in the report. Financial data is for the 1999 calendar year.

All financial data is from audited accounts supplied by the organisations as part of their funding acquittal.

The data sample includes:

- All states and territories;

- Regional and metropolitan based organisations;
- The largest and smallest organisations;
- All artforms and practice including contemporary arts, disability arts, Indigenous arts, community arts, arts in education, youth arts, publishing, writer's centres, regional exhibitions, service organisations, music ensembles etc.

All organisations are nonprofit and income tax exempt. The sample does not include museums, large state or national art galleries and libraries. (Appendix 3 lists the names of the organisations included in this sample. NB: This information is confidential)

### **Financial Data and Performance**

The purpose of providing this data is to reaffirm that arts organisations have the same or similar financial characteristics as the charities sector generally.

There are substantial differences between the best and worst results. There is no uniform reason for this: 1999 was an average year in the life of an arts organisation. However, some of variations can be attributed to the quality of audited financial reports particularly those supplied by incorporated associations. The financial reports from these organisations are more likely to be special purpose financial reporting and be qualified by their auditor because of insufficient controls on revenue (not unlike the charities sector generally according to the Institute of Chartered Accountants). There are also classification issues particularly in the balance sheet. Note that income from donations is not reported because in the Australia Council data collection this is source of income is aggregated with sponsorship and fundraising income.

### **Major Performing Arts Organisations**

**Table 1: Major Performing Arts Organisations: Overview of financial performance (1998)**

	<b>Turnover \$'000</b>	<b>Net Assets \$'000</b>	<b>Operating Profit / Loss \$'000</b>	<b>Grants as a % of Total Income</b>	<b>Sponsorship and Donations as % of Total Income</b>
All Organisations	218,131	12,432			36,185
Average	7,036	429	( 39)	49%	15%
Top	43,494	8,638	1,812	95%	37%
Bottom	1,361	( 1,263)	( 1,063)	11%	3%

**Table 2: Major Performing Arts Organisations: Performance against financial indicators (1998)**

	<b>Working Capital Ratio</b>	<b>Debt/Equity Ratio</b>	<b>Reserves Ratio</b>	<b>Operating Margin</b>
Benchmarks	more than 2:1	Less than 33%	more than 20%	at least breakeven
Average	1.17	464%	3%	( 3%)
Top	3.93	26%	42%	9%
Bottom	0.23	10491% ( 2152%) <sup>1</sup>	( 29%)	( 52%)
No of Organisations below benchmark	25	28	26	15
% of Organisations below benchmark	86%	97%	90%	48%

**Arts Organisations (excluding Major Performing Arts Organisations)**

**Table 3: Arts Organisations (excluding Major Performing Arts): Overview of Financial Performance (1999 Calendar Year)**

	<b>Turnover \$'000</b>	<b>Net Assets \$'000</b>	<b>Operating Surplus (Deficit) \$'000</b>	<b>Grants as a % of Total Income \$'000</b>
All Organisations	43,399	8,448		
Average	542	104	5	62%
Top	1,872	861	179	98%
Bottom	22	(163)	(138)	7%

**Table 4: Arts Organisations (excluding Major Performing Arts): Performance against financial indicators (1999 Calendar Year)**

	<b>Liquidity Ratio</b>	<b>Debt/Equity Ratio</b>	<b>Reserves Ratio</b>	<b>Operating Margin</b>
Benchmarks	more than 1.00	Less than 33%	more than 20%	At least breakeven
Average	1.99	51%	20%	0.26%
Top	23.88	0%	122%	22.50%
Minimum	(0.23)	2000% (16703%) <sup>59</sup>	(15%)	(16.33%)
No of Organisations below benchmark	22	68	52	32
% of Organisations below benchmark	28%	84%	65%	40%

## **Explanation of Financial Data and Indicators**

This submission uses a combination of financial indicators recommended by CACOM<sup>53</sup> and those used by the arts sector to monitor financial sustainability. The following explains how these ratios are used in the arts sector and offers some further comments on factors influencing performance against these indicators:

### **Financial Data**

- Turnover is annual costs or total expenditure (and not income as is generally used in business).
- Net Assets is assets less liabilities. Also referred to as Equity, Accumulated Funds or Accumulated Reserves.
- Grant income is grant income from all sources: Australia Council and other Commonwealth funding, state and local government.

### **Financial Indicators**

- **Liquidity Ratio**

This ratio is current assets less inventory over current liabilities. It is designed to measure whether an organisation can meet all its liabilities due for payment in the immediate future from cash or assets that can be quickly converted into cash. This is commonly referred to as the Quick Ratio. The standard business benchmark is 1 to 1, i.e. an organisation should have at least \$1 in current assets to cover \$1 in current liabilities.

One factor impacting performance against this ratio is that most arts organisations are carrying prepaid grants and subscriptions as liabilities in their balance sheet. However, poor performance against this indicator demonstrates the extent to which some organisations rely on these items for cash flow.

- **Working Capital Ratio**

Working Capital Ratio is current assets over current liabilities. It is similar to the Liquidity Ratio but includes inventory and prepayments in current assets. This ratio is used for major performing arts organisations because of data availability.

- **Debt/Equity Ratio**

This is the ratio of an organisation's liabilities or debt to its equity or net assets, (i.e. what is left when liabilities are subtracted from assets). It is a simple way of determining solvency by measuring how much of an organisation's assets are owned by its creditors.

The benchmark for the data is that recommended by CACOM<sup>53</sup>, i.e. organisations should have no more than 33 cents of debt per \$1.00 of equity.

The data shows that most arts organisations are highly at risk. However, once again it is worth noting that many organisations are showing prepaid grants and subscriptions in their liabilities, which are not real debts because repayment is not generally required. Nonetheless, organisations that are

strong-performers with good reserves report well against this benchmark. Nonprofit arts organisations may keep low reserves, as in the past, arts funding agencies advised arts organisations that high reserves made them vulnerable to funding cuts.

- **Reserves Ratio**

This is a standard ratio used in the arts sector to measure reserves or net assets. The ratio is net assets over turnover (expressed as expenditure in the arts sector).

*Securing the Future*<sup>60</sup> recommended a benchmark of 20% for the arts sector as the minimum standard. This allows organisations some capacity to withstand financial shock. It must be stressed this is the bare minimum. In a successful business enterprise, the benchmark would be at least 1000% reflecting ownership of assets like property, brand names and equipment.

On average, non-major performing arts organisations appear to perform satisfactorily against this indicator. However, it is worth noting that those organisations which appear to have strong reserves may still be at risk because those reserves are made up of non-liquid assets like art collections: assets which cannot be easily converted to cash. In fact, often the liquid reserves of these organisations are very low, less than 10 weeks coverage being the norm.

- **Operating Margin**

This is a standard ratio which shows how much of an organisation's income is profit or surplus. The ratio is income over expenditure. In this submission, this is treated as income and expenditure before abnormals.

The benchmark of breakeven is very low. 10% is usually recommended to allow organisations some capacity to build reserves. However, most arts organisations struggle just to breakeven each year as the data shows. In fact, 48% of major organisations and 40% of other arts organisations reported an operating deficit.



## **Appendix 3**

**Organisations included in financial data (appendix 2)**

***THIS INFORMATION IS CONFIDENTIAL***

## Bibliography

- Anheier, Helmut K. & Salamon, Lester M. (eds) 1998, *The nonprofit sector in the developing world – A comparative analysis*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.
- Archambault, Edith 1997, *The nonprofit sector in France*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.
- Australian Association of Philanthropy 1991, *Giving Australia: A Quantitative Exploration Of The Philanthropic Sector Of The Australian Economy For The 1988-1989 Financial Year*, Australian Association of Philanthropy, Melbourne.
- Australian Bureau of Statistics 1997, *Work in Selected Culture/Leisure Activities*, Cat. No. 6281.0, ABS, Canberra
- Australian Taxation Office 2000, *Charities Consultative Committee Resolved Issues as at 1 July 2000*, ATO, Canberra.
- Australian Taxation Office 2000, *Charity Pack – A Taxation Guide For Charitable Institutions And Funds*, ATO, Canberra.
- Barbetta, Gian Paolo (ed) 1997, *The nonprofit sector in Italy*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.
- Baumol, W.J. & Bowen, W.G. 1965, 'On the Performing Arts: The Anatomy of Their Economic Problems', in *The American Economic Review*, vol. 55, issue ½, pp495-502.
- Bromley, Blake 1999, 'Answering the Broadbent Question: A case for a common law definition of charity', response to the Broadbent Report, *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector*.
- Buckmaster, N., Lyons, M. & Bridges, A. 1994, *Financial Ratio Analysis and Nonprofit Organisations: A Review and Exploratory Study of the Financial Risk, and Vulnerability of Ninety Large Nonprofit Organisations in New South Wales*, Centre for Australian Community Organisations and Management Working Paper 26, University of Technology, Sydney.
- Charity Commission 2000, 'Registering as a Charity', [www.charity-commission.gov.uk/CC21](http://www.charity-commission.gov.uk/CC21).
- Clotfelter, Charles C. (ed) 1992, *Who Benefits from the Nonprofit Sector*, University of Chicago Press, Chicago.
- Cultural Ministers Council Statistics Working Group 1999, *Cultural Funding in Australia: Three tiers of Government 1997-98*, National Centre for Culture and Recreation Statistics, ABS, Canberra.
- Department of Communications, Information Technology and the Arts 1999, *Securing the Future*, DCITA, Canberra.
- Department of Education, Training and Youth Affairs 2000, *Young People Say "DV – No Way" – Evaluation of the National Domestic Violence Prevention Workshops for Young People*, DETYA, Canberra.
- Department of Treasury 1999, *Tax Expenditures Statement 1997-98*, AGPS, Canberra.

- Econtech 2000, *The Expected Impact of The New Tax System on the Arts*, (Report commissioned by the Commonwealth Department of the Treasury – still to be publicly released.)
- Fiske, Edward B. (ed) 1999, *Champions of Change: The impact of the arts on learning*, Arts Education Partnership and The President's Committee on the Arts and the Humanities, Washington.
- Frey, Bruno S. & Pommerehne, Werner W. 1989, *Muses and Markets: Explorations in the Economics of the Arts*, Basil Blackwell Publishers, Oxford.
- Gardiner-Garden, John 1994, *Arts Policy in Australia: A history of Commonwealth involvement in the Arts*, Parliamentary Research Service, Background Paper No. 5.
- Hatton, A. 1998, *Submission to the Panel on Accountability and Governance*, The Coalition of National Voluntary Organizations, Canada.
- Industry Commission 1995, *Charitable Organisations in Australia*, AGPS, Canberra.
- Leat, Diana & Lethlean, Esther 2000, *Trusts and Foundations in Australia*, Philanthropy Australia, Monograph #2 April.
- Liberal Party of Australia 1994, *The Cultural Frontier – Coalition Priorities for the Arts*, Canberra.
- Liffman, Michael 2000, 'The "nonprofit" motive in civil society', *Australian Philanthropy: Research Papers 2000*, Philanthropy Australia, Monograph #3 May, pp21-24.
- Lundström, Tommy & Wijkström, Filip 1997, *The nonprofit sector in Sweden*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.
- Lyons, Mark 1999, 'Australia's nonprofit sector', *Year Book Australia*, Australian Bureau of Statistics 1999, Cat. no. 1301.01, ABS, Canberra.
- Lyons, Mark 1998, 'Defining The Nonprofit Sector: Australia', *Working Papers of the Johns Hopkins Comparative Nonprofit Sector Project*, no. 30, Lester M. Salamon & Helmut K. Anheier (eds), The Johns Hopkins Institute for Policy Studies, Baltimore.
- Lyons, Mark 1994, *Charitable Organisations in Australia: A Strategic Assessment of the Industry Commission's Draft Report*, Centre for Australian Community Organisations and Management Working Paper No. 25, University of Technology, Sydney.
- Madden, Christopher 1998, 'The Economic Benefits of Art', Discussion paper, Creative New Zealand.
- Marsden, Sally & Thiele, Martin (eds) 2000, *Risking Art. Art for Survival: Outlining the role of the Arts in services to marginalised young people*, Jesuit Social Services, Richmond.
- McCarthy, Kathleen D., Hodgkinson, Virginia A. & Sumariwalla, Russy D. (eds) 1992, *The nonprofit sector in the global community: voices from many nations*, Jossey-Bass Publishers, San Francisco.
- Moore, T. 1968, *The Economics of the American Theater*, Duke University Press, Durham.
- O'Hagan, John 1998, *The State and the Arts: An Analysis of Key Economic Policy Issues in Europe and the United States*. Edward Elgar Publishing, Cheltenham.

- Parsons, Phillip (ed) 1987, *Shooting the Pianist: The Role of Government in the Arts*, Currency Press, Sydney.
- Penhallurick, Liz 1998, 'Tax Breaks for Philanthropy', *Smarts*, vol. 13, pp6-7.
- Pettit, Phillip H. 1974, *Equity and the Law of Trusts*, Butterworths, London.
- Rowse, Tim 1985, *Arguing the Arts: The Funding of the Arts in Australia*, Penguin Books, Ringwood.
- Saatchi & Saatchi Australia 2000, *Australians and the Arts: What do the arts mean to Australians?*, Australia Council, Sydney.
- Salamon, Lester M. 1996, 'Defining the nonprofit sector: The United States', *Centre for Civil Society Studies Working Paper Series*, no.18, The Johns Hopkins University Institute for Policy Studies, Baltimore.
- Salamon, Lester M. & Anheier, Helmut, K. (eds) 1997, *Defining the nonprofit sector: A cross-national analysis*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.
- Salamon, Lester M. & Toepler, Stefan 2000, 'The Influence of the Legal Environment on the Development of the Nonprofit Sector', *Centre for Civil Society Studies Working Paper Series*, no.17, The Johns Hopkins University Institute for Policy Studies, Baltimore.
- Schuster, J. Mark 1999, 'The Other Side of the Subsidized Muse: Indirect Aid Revisited', *Journal of Cultural Economics*, vol. 23, nos. 1-2, pp51-70.
- Seares, Margaret 2000, 'Rebuilding Our Communities: The Role of the Arts in Public Policy', *Creating Waves – Regional Arts Australia 2<sup>nd</sup> National Conference*, October 2000, Esperance.
- Shubik, Martin 1999, 'Culture and Commerce', *Journal of Cultural Economics*, vol. 23, nos. 1-2, pp13-30.
- University of Pennsylvania School of Social Work, *Social Impact of the Arts Project*, [www.ssw.upenn.edu/SIAP](http://www.ssw.upenn.edu/SIAP)
- Weil, S. 1995, *A Cabinet of Curiosities: Inquiries into Museums and Their Prospects*, Smithsonian Institution Press, Washington.
- Williams, Deidre 1995, *Creating Social Capital: A Study of the Long-term Benefits from Community-based Arts Funding*, Community Arts Network of South Australia, Adelaide.
- Williams, Deidre 1997, 'How the Arts Measure Up: Australian research into social impact', *Social Impact of the Arts Working Paper No. 8*, Comedia, Gloucestershire.
- Yamamoto, Tadashi 1998, *The nonprofit sector in Japan*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester.

## Endnotes

<sup>1</sup> Lyons, Mark 1998, 'Defining The Nonprofit Sector: Australia', *Working Papers of the Johns Hopkins Comparative Nonprofit Sector Project*, no. 30, Lester M. Salamon & Helmut K. Anheier (eds), The Johns Hopkins Institute for Policy Studies, Baltimore, p2.

<sup>2</sup> Australian Bureau of Statistics 1997, *Work in Selected Culture/Leisure Activities*, Cat. No. 6281.0, ABS, Canberra.

<sup>3</sup> Lyons, Mark 1999, 'Australia's nonprofit sector', *Year Book Australia*, Australian Bureau of Statistics 1999, Cat. no. 1301.01, ABS, Canberra.

<sup>4</sup> Saatchi & Saatchi Australia 2000, *Australians and the Arts: What do the arts mean to Australians?*, Australia Council, Sydney, pp11-12.

<sup>5</sup> Australian Taxation Office 2000, *Charities Consultative Committee Resolved Issues as at 1 July 2000*, ATO, Canberra, p14.

<sup>6</sup> Pettit, Phillip H. 1974, *Equity and the Law of Trusts*, Butterworths, London, p172.

<sup>7</sup> *ibid.*

<sup>8</sup> Charity Commission, 'Registering as a Charity', [www.charity-commission.gov.uk/CC21](http://www.charity-commission.gov.uk/CC21).

<sup>9</sup> Fiske, Edward B. (ed) 1999, *Champions of Change: The impact of the arts on learning*, Arts Education Partnership and The President's Committee on the Arts and the Humanities, Washington.

<sup>10</sup> Frey, Bruno S. & Pommerehne, Werner W. 1989, *Muses and Markets: Explorations in the Economics of the Arts*, Basil Blackwell Publishers, Oxford, p19.

<sup>11</sup> Moore, T. 1968, *The Economics of the American Theater*, Duke University Press, Durham, pp 26-27.

<sup>12</sup> Williams, Deidre 1997, 'How the Arts Measure Up: Australian research into social impact', *Social Impact of the Arts Working Paper No. 8*, Comedia, Gloucestershire.

<sup>13</sup> University of Pennsylvania School of Social Work, *Social Impact of the Arts Project*, [www.ssw.upenn.edu/SIAP/Findings.html](http://www.ssw.upenn.edu/SIAP/Findings.html)

<sup>14</sup> Williams 1997, *op. cit.*

<sup>15</sup> *ibid.*

<sup>16</sup> *ibid.*

<sup>17</sup> Department of Education, Training and Youth Affairs 2000, *Young People Say "DV – No Way" – Evaluation of the National Domestic Violence Prevention Workshops for Young People*, DETYA, Canberra.

<sup>18</sup> O'Hagan, John 1998, *The State and the Arts: An Analysis of Key Economic Policy Issues in Europe and the United States*. Edward Elgar Publishing, Cheltenham, pp21-22.

<sup>19</sup> Seares, Margaret 2000, 'Rebuilding Our Communities: The Role of the Arts in Public Policy', *Creating Waves – Regional Arts Australia 2<sup>nd</sup> National Conference*, October 2000, Esperance.

<sup>20</sup> Weil, S. 1995, *A Cabinet of Curiosities: Inquiries into Museums and Their Prospects*, Smithsonian Institution Press, Washington.

<sup>21</sup> Penhallurick, Liz 1998, 'Tax Breaks for Philanthropy', *Smarts*, vol. 13, p6.

<sup>22</sup> *ibid.*

<sup>23</sup> Information from DCITA website, [www.dcita.gov.au/responsi/gifts/index.html](http://www.dcita.gov.au/responsi/gifts/index.html)

<sup>24</sup> Penhallurick 1998, *op. cit.*, p7.

<sup>25</sup> Schuster, J. Mark 1999, 'The Other Side of the Subsidized Muse: Indirect Aid Revisited', *Journal of Cultural Economics*, vol. 23, nos. 1-2, p.55.

<sup>26</sup> O'Hagan 1998, *op. cit.*, p 126.

<sup>27</sup> If the figure for sport is excluded.

<sup>28</sup> Figures for the capital gains tax exemption for the disposal of an asset under the Cultural Bequests program [Section 118-60 ITAA97] were not available for 1997-98 as the Cultural Bequests program did not begin until 1998-99.

<sup>29</sup> Department of Communications, Information Technology and the Arts 1999, *Securing the Future*, DCITA, Canberra.

<sup>30</sup> Econtech 2000, *The Expected Impact of The New Tax System on the Arts*, (Report commissioned by the Commonwealth Department of the Treasury – still to be publicly released.)

- 
- <sup>31</sup> Econtech, op. cit., pp 17-21.
- <sup>32</sup> Econtech, op. cit., p 17.
- <sup>33</sup> Econtech, op. cit., p 20.
- <sup>34</sup> O'Hagan 1998, op. cit., p 125.
- <sup>35</sup> Australian Taxation Office 2000, *Charity Pack – A Taxation Guide For Charitable Institutions And Funds*, ATO, Canberra, p 61.
- <sup>36</sup> Liffman, Michael 2000, 'The "nonprofit" motive in civil society', *Australian Philanthropy: Research Papers 2000*, Philanthropy Australia, Monograph #3 May, p22.
- <sup>37</sup> Liffman, op. cit., p21.
- <sup>38</sup> ATO, *Charity Pack*, p 38.
- <sup>39</sup> ATO, *Charities Consultative Committee Resolved Issues as at 1 July 2000*.
- <sup>40</sup> ATO, *Charity Pack*, p 46.
- <sup>41</sup> ATO, *Charity Pack*, p 38.
- <sup>42</sup> ATO, *Charity Pack*, p 46.
- <sup>43</sup> ATO, *Charity Pack*, p 41.
- <sup>44</sup> ATO, *Charity Pack*, p 40.
- <sup>45</sup> ATO, *Charity Pack*, p 46.
- <sup>46</sup> ATO, *Charity Pack*, p 61.
- <sup>47</sup> Hatton, A. 1998, *Submission to the Panel on Accountability and Governance*, The Coalition of National Voluntary Organizations, Canada.
- <sup>48</sup> *ibid*.
- <sup>49</sup> Lyons 1998, op. cit., pp 11-15.
- <sup>50</sup> Salamon, Lester M. & Anheier, Helmut, K. (eds) 1997, *Defining the nonprofit sector: A cross-national analysis*, Johns Hopkins Nonprofit Sector Series, Manchester University Press, Manchester, p 40.
- <sup>51</sup> Salamon, Lester M. 1996, 'Defining the nonprofit sector: The United States', *Centre for Civil Society Studies Working Paper Series*, no.18, The Johns Hopkins University Institute for Policy Studies, Baltimore, p.9.
- <sup>52</sup> Lyons, Mark 1994, *Charitable Organisations in Australia: A Strategic Assessment of the Industry Commission's Draft Report*, Centre for Australian Community Organisations and Management Working Paper No. 25, University of Technology, Sydney, p11.
- <sup>53</sup> Buckmaster, N., Lyons, M. & Bridges, A. 1994, *Financial Ratio Analysis and Nonprofit Organisations: A Review and Exploratory Study of the Financial Risk, and Vulnerability of Ninety Large Nonprofit Organisations in New South Wales*, Centre for Australian Community Organisations and Management Working Paper 26, University of Technology, Sydney.
- <sup>54</sup> A supply is *GST-free* if the supply is less than 75% of the consideration the supplier provided.
- <sup>55</sup> Although this is due to be abolished from July 2001.
- <sup>56</sup> As at June 29 2000.
- <sup>57</sup> Also referred to by the arts sector as 2<sup>nd</sup> and 3<sup>rd</sup> tier arts organisations, the 1<sup>st</sup> tier being the 29 major performing arts organisations.
- <sup>58</sup> Department of Communications Information Technology and the Arts, op. cit.
- <sup>59</sup> Reflects negative equity.
- <sup>60</sup> Department of Communications Information Technology and the Arts, op. cit., "Recommendation 17.1.1: Each company should be encouraged, as part of its funding agreement, to build reserves up to 20% of its annual costs."