

7: Not-for-profit sector

Overview

This chapter provides an overview of the not-for-profit (NFP) sector in Australia and the tax concessions available to different types of NFP organisations.

Key points

- The NFP sector is large and diverse and provides important benefits for the Australian community.
- Governments provide a number of tax concessions to support the NFP sector. While these tax concessions help increase the level of activity in the NFP sector, the value of revenue forgone from the concessions is significant and growing steadily.
- Tax concessions for the sector can also increase complexity, in part because they vary according to the type and purpose of NFP organisations. In some cases, NFP tax concessions may provide NFPs with a competitive advantage over their commercial competitors.

7.1: Not-for-profit sector

Not-for-profit (NFP) organisations play an important and intrinsic role in Australian society. NFPs are diverse, providing their members, clients and the general community with a range of services, including welfare, education, religion, health, sport and culture.

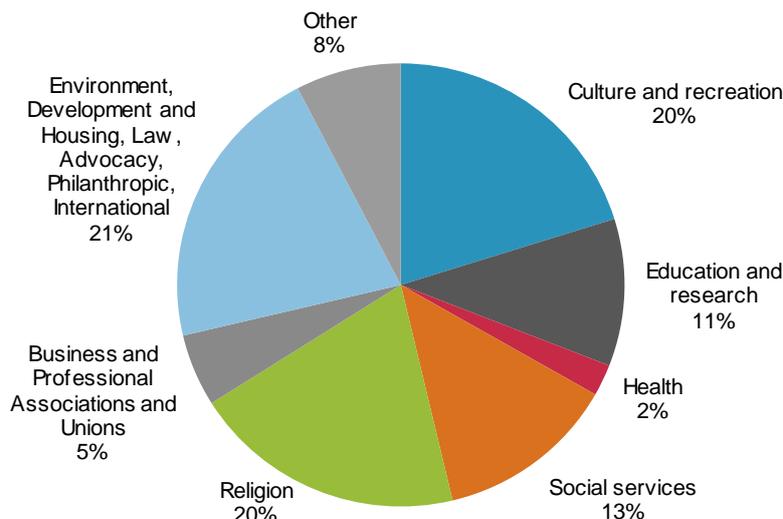
There are around 600,000 NFPs in Australia, the majority of which are small, unincorporated or non-employed organisations that undertake activities to meet local needs and rely on the volunteer contributions of community members. Of these NFPs, around 60,000 are registered charities.¹⁴¹

¹⁴¹ Australian Charities and Not-For-Profits Commission 2014, *Homepage*, viewed 1 December 2014: <http://acnc.gov.au/>.

According to the Australian Bureau of Statistics (ABS), there are almost 57,000 NFPs that are economically significant.¹⁴² As a proportion of the economy, in 2012-13, these NFPs accounted for around 3.8 per cent of GDP (up from 3.2 per cent of GDP in 2006-07). They generated revenue of about \$107 billion, had total assets worth about \$176 billion and net worth of about \$123 billion at the end of June 2013.¹⁴³

Economically significant NFPs operate in both market and non-market sectors (such as religion) (Chart 7.1). Government funding (including tied funding) accounts for just over 38 per cent of the revenue of these NFPs, donations account for a further 5 per cent, while income from donated goods and services accounts for close to half of their revenue.¹⁴⁴

Chart 7.1 Share of NFP organisations by activity, 2012-13



Source: ABS 2014, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13*, cat. no. 5256.0, ABS, Canberra.

Almost 1.1 million people are employed by economically significant NFPs, with around 70 per cent employed in three sectors — social services, education and research and health.¹⁴⁵ These three sectors also dominate contributions to gross value added (Chart 7.2).¹⁴⁶

142 Economically significant NFPs are defined as organisations registered with the ATO with an ABN and classified to either the non-financial corporations sector or the non-profit institutions serving households sector in the national accounts.

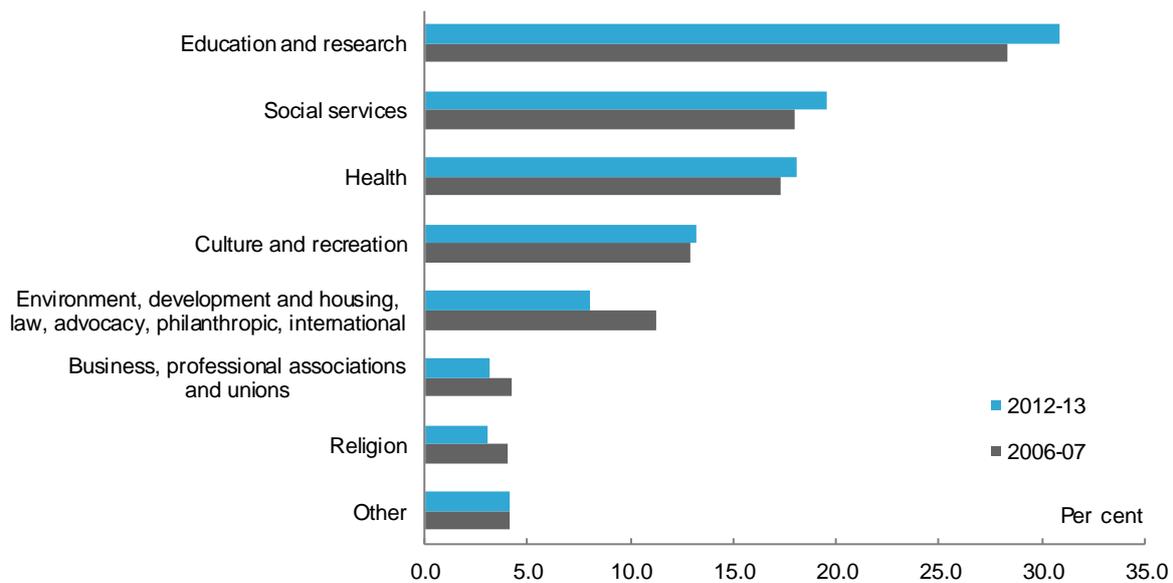
143 ABS 2014, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13*, cat. no. 5256.0, ABS, Canberra.

144 ABS 2014, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13*, cat. no. 5256.0, ABS, Canberra.

145 ABS 2014, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13*, cat. no. 5256.0, ABS, Canberra.

146 As defined by the ABS, 'gross value added' represents the total market value of goods and services produced in Australia within a given period after deducting the cost of goods and services used in the process of production.

Chart 7.2 Shares of total gross value added by activity



Source: ABS 2014, *Australian National Accounts: Non-Profit Institutions Satellite Account, 2012-13*, cat. no. 5256.0, ABS, Canberra.

7.2: The role of tax concessions

In recognition of the NFP sector's contribution to the Australian community, it has been a longstanding policy of successive governments to provide support to the sector in the form of tax concessions.

At the state and local government level, many charitable institutions are exempt from state and local government taxes.¹⁴⁷ Exemptions differ across jurisdictions, but may be available for taxes, including municipal rates, payroll tax, stamp duty, motor vehicle registration and land tax. At the Commonwealth level, these tax concessions vary according to the type of entity as well as the activities that the NFP undertakes (Table 7.1). These tax concessions include income tax exemption; a higher GST registration threshold; the ability to make supplies GST-free in certain circumstances; capped exemptions from (or rebates of) fringe benefits tax (FBT); and the ability to receive tax deductible gifts.

¹⁴⁷ State and territory taxes are discussed in Chapter 8.

Table 7.1 Main tax concessions for main types of NFP entity

	Charities ¹	Public Benevolent Institutions (PBIs) and health promotion charities	NFP public hospitals and NFP public ambulance services	Deductible gift recipients ²	Tax exempt clubs and other NFP entities
Income tax exemption	Yes	Yes	Yes	No	Yes
Refundable franking credits	Yes	Yes	Yes	Yes	No
FBT exemption (\$17,000 cap) ³	No	No	Yes	No	No
FBT exemption (\$30,000 cap) ³	No	Yes	No	No	No
FBT rebate	Charitable institutions only	No	No	No	Some non-clubs only
Other FBT concessions	Yes	Yes	Yes	No	No
GST concessions	Yes	Yes	Charities only	Yes	No
Deductible gifts	No	Yes	No	Yes	No

(a) Charities endorsed as deductible gift recipients or specifically listed in the *Income Tax Assessment Act 1997* can receive deductible gifts.

(b) Deductible gift recipients are generally charities that also have income tax exemptions, but income tax and FBT concessions do not automatically flow from an entity having DGR status.

(c) These caps were temporarily increased (to \$17,667 and \$31,177) as part of the 2014-15 Budget measure to introduce a Temporary Budget Repair levy.

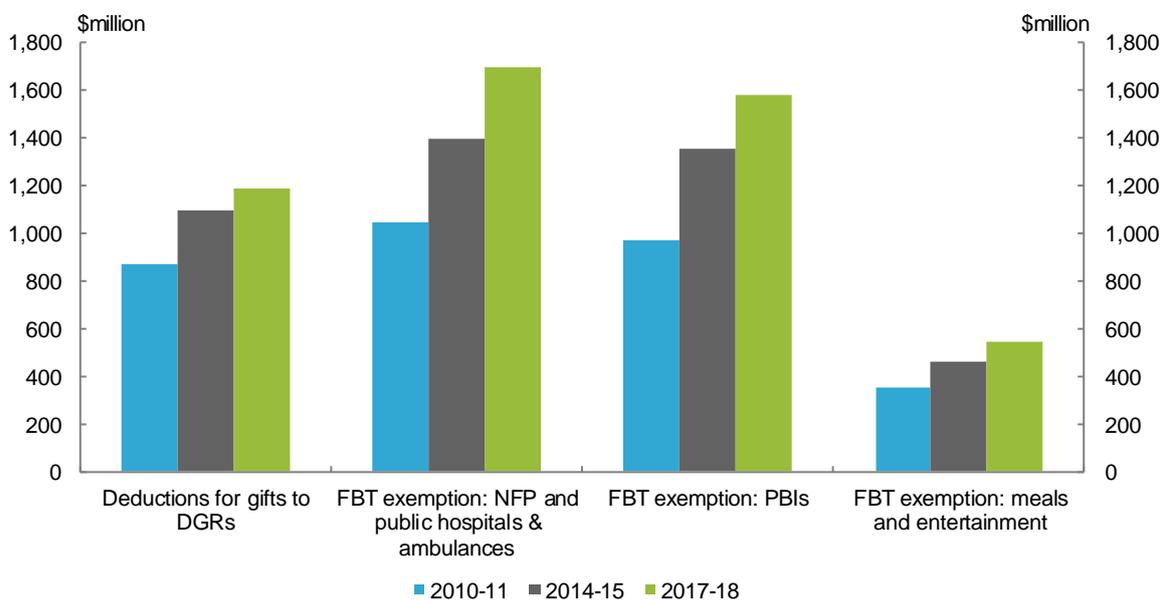
Recognising the wider benefits of NFP activity (particularly where an NFP provides services that for-profit private sector organisations do not), these tax concessions arguably help to both improve societal outcomes and ensure that the overall level of activity in the NFP sector is closer to optimal. Notwithstanding this, it is important to assess their effectiveness to ensure that the concessions continue to meet their intended policy objectives, do not result in unintended consequences (such as high compliance costs or an uncompetitive advantage) and deliver the greatest possible community benefit. This is particularly important considering the revenue forgone as a result of these tax concessions.

NFP tax concessions result in significant revenue forgone. The two largest groups of tax concessions involve exemptions from paying fringe benefits tax (FBT) for public benevolent institutions (PBIs), health promotion charities (HPCs), public hospitals, non-profit hospitals, and public ambulance services; and income tax deductions for making gifts to DGRs. The amount of revenue forgone from these concessions has been increasing, particularly the FBT exemptions.

By 2017-18, the PBI concession is estimated to result in revenue forgone of nearly \$1.6 billion, from almost \$1 billion in 2010-11 (Chart 7.3). In comparison, the deduction for gifts to DGRs has remained relatively stable, increasing from nearly \$900 million in 2010-11 to almost \$1.2 billion in 2017-18. However, the actual revenue forgone from NFP concessions cannot be quantified because many organisations are not required to submit tax returns. This means that the actual revenue forgone is likely to be higher than is currently reported.

Given the size and reach of the NFP sector, some tax concessions may result in distortions that affect the broader allocation of resources in the economy, particularly where they operate in competition with for-profit providers. These distortions arise when the prices that NFPs pay for their inputs (such as labour) are altered by the presence of concessions in the tax legislation.

Chart 7.3 Estimated revenue forgone for selected Commonwealth tax concessions



Source: Australian Government 2015, *Tax Expenditures Statement 2014*, Australian Government, Canberra.

Fringe benefits tax concessions

A range of NFP entities are exempt from paying tax on fringe benefits provided to employees up to a monetary limit per employee (either \$17,000 or \$30,000 for certain NFPs, excluding the temporary increase associated with the Temporary Budget Repair Levy) or are entitled to a rebate. By utilising salary sacrificing arrangements, the cost of labour to these NFPs is reduced. This lower cost could be used by the NFP to offer employees a higher salary, providing them with an advantage in hiring and retaining staff. This concession effectively provides a wage subsidy to those employed by eligible NFP organisations, which must be paid for by all other taxpayers. This concessional treatment is particularly problematic where the NFP competes with for-profit providers, in particular in the hospital sector. These concessions allow employees of eligible entities to spend from pre-tax income, thereby

reducing income tax payable. There is evidence that some employers and employees have tax-sharing arrangements to share this benefit.¹⁴⁸

While there are capping thresholds on the fringe benefits tax concession, meal entertainment and entertainment facility leasing benefits are excluded from the caps and are unlimited. Benefits received by eligible NFP employees exempt from tax and not limited by a cap include payments for holidays, weddings and family celebrations. Expenditure on this concession in terms of revenue forgone was estimated to be around \$430 million in 2013-14, and is estimated to rise to around \$545 million in 2017-18.¹⁴⁹

Another issue results from FBT being levied on individual employers with caps assessed per employee. This allows employees with more than one employer to receive benefits with multiple caps.

Income tax exemption and mutuality

A range of NFP organisations are eligible for income tax exempt status, such as employee or employer associations and clubs established to encourage animal racing, sport, art, literature or music. Although an income tax exemption does not pose as many concerns regarding competitive advantage and any retained earnings must ultimately be used to further their purposes, there appears to be no clear rationale underlying this exemption.

Membership organisations not prescribed as income tax exempt may utilise the mutuality principle. Under the mutuality principle, where a group of individuals join together to contribute to a common fund, created and controlled by all of them for a common purpose, any surplus created in the fund from the individual contributions or dealings between the members of the fund is not considered to be income for tax purposes. For a mutual organisation, income received from transactions with their members is tax exempt. A range of licensed clubs and societies, co-operatives, strata title bodies corporate and other associations utilise the mutuality principle.

Deductible gift recipients

Some NFP organisations, including around half of all registered charities, are eligible for deductible gift recipient (DGR) status. This entitles donors to claim a tax deduction for any eligible gifts they make to such organisations.

Organisations that seek DGR status generally apply to the ATO for endorsement as a DGR. However, in the areas of foreign aid, environment, culture and harm prevention, organisations must apply to the relevant department and seek the approval of the Minister as well as the Treasurer. In exceptional cases, organisations are specifically listed in the tax legislation.

148 For example, the NSW Department of Health specifies in its Salary Packaging Policy and Procedure Manual that benefits made available for salary packaging will be shared on a 50-50 basis.

149 Australian Government 2014, *Tax Expenditures Statement 2013*, Australian Government, Canberra.

While DGR status is highly valued, the process for applying for it can be time consuming. In addition, organisations that operate across a range of DGR categories may not be eligible to be endorsed under a single category. This may require them to restructure, seek specific listing by name in the *Income Tax Assessment Act 1997*, or forgo DGR status altogether. There are also different requirements for DGR status across the different general categories, which creates further complexity.

Discussion questions:

47. Are the current tax arrangements for the NFP sector appropriate? Why or why not?
48. To what extent do the tax arrangements for the NFP sector raise particular concerns about competitive advantage compared to the tax arrangements for for-profit organisations?
49. What, if any, administrative arrangements could be simplified that would result in similar outcomes, but with reduced compliance costs?
50. What, if any, changes could be made to the current tax arrangements for the NFP sector that would enable the sector to deliver benefits to the Australian community more efficiently or effectively?

