

MAKINSON & d'APICE  
LAWYERS

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**BY EMAIL:** nfpreform@treasury.gov.au

The Manager  
Philanthropy and Exemptions Unit  
Personal and Retirement Income Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sir/Madam

**Better Targeting of Not-For-Profit Tax Concessions**

We are a law firm based in Sydney which has a proud history of having provided professional advice to the Charities and Not-For-Profit (NFP) sector since the firm's inception in 1859.

We act for a large number of Church bodies, community groups, welfare organisations and others involved in the NFP sector.

We are of the view that an Unrelated Business Income Tax (UBIT) which is proposed to be imposed upon NFPs is not justified and not appropriate.

We make the following comments in respect of issues raised in the Consultation Paper:

1. The Consultation Paper presents no empirical evidence of any abuse or loss of revenue which would justify the imposition of a UBIT. Various Inquiries that have been conducted over an extended period have not raised the need for a UBIT as a serious issue or as a recommendation to Government. As far back as 1995, the Industry Commission's Report on *Charitable Organisations in Australia* provided:

*"... the Commission has resisted calls for a tax on the unrelated business activities of [NFPs]. Unrelated business income is a concept that is too difficult to define and too costly to enforce and consequently the costs are likely to outweigh the benefits." (paragraph 12.7.4)*

More recently, Treasurer Wayne Swan, stated:

*"We will not implement any changes that harm the Not-For-Profit sector, including removing tax concessions."*

The Government has indicated that it is not seeking to impose a UBIT for the purpose of raising any significant revenue. In the absence of any evidence of abuse and the raising of any significant revenue, we do not understand the rationale for the introduction of a UBIT.

2. If the principle rationale is to create a level playing field then it is clear that the playing field will never be level as NFPs and For-Profit entities are separately motivated. To the extent that NFPs operate unrelated commercial activities, they do so with a view to creating a surplus for the purpose of the NFP. Whilst that may not attract UBIT if the surplus is applied towards to the NFP, it will still involve very significant compliance costs (see later). For-Profits are motivated by creation of wealth for the benefit of their owners.

NFPs are engaged in more intrinsically risky activities, eg providing services often to underprivileged members of our community. For-Profits will choose to provide such community services as will return an appropriate profit. For-Profits also have access to capital which is not generally available to NFPs.

Even if it were the intention of the Government to create a level playing field by the introduction of a UBIT, the proposal will not achieve that outcome in most cases. The tax outcome in the often quoted case of *Sanitarium Health Food Company* would not be different under a UBIT if its surplus were repatriated to the NFP which owns it.

We submit that the UBIT will not create competitive neutrality in any event.

3. Any one of the options considered in paragraphs 51 to 68 of the Consultation Paper will involve significant legal and accounting costs for the NFPs. We note that there are over 600,000 NFPs with an ABN in Australia. Even if only a small portion of those NFPs were engaged in unrelated commercial activities - say 10% - this would impose significant compliance costs upon 60,000 entities in Australia. If the cost imposition on each were, say, \$10,000.00 per annum then this would mean a cost to NFPs of \$600 million annually. This amount would not then be available to be applied towards the altruistic purposes of the NFP - even if at the end of the day there was not a single cent of tax paid.
4. There must be a high threshold below which NFPs are not required to incur such compliance costs. The examples of "small scale" or "low risk" activity identified in paragraph 48 of the Consultation Paper (eg lamington drives) are, with respect, inappropriately low. In a sector which has been shown in independent studies to be significantly compliant, and in the context that the Government is stating that it is not seeking to raise any significant revenue through the UBIT, the compliance threshold must be set high. Annual turnover exceeding \$2 million being the "small business" amount used by the Government would in our view be appropriate.
5. The threshold at which an undertaking becomes a separate "activity" for the purpose of UBIT also needs to be set high. We suggest this should either be the greater of annual turnover of \$150,000.00 or 10% of the total turnover of the NFP whichever is higher.
6. It is difficult to understand how the concept of "low risk" activity referred to in paragraph 48 of the Consultation Paper can be adopted. NFPs are typically involved in high risk activities being activities which For-Profit entities are not prepared to undertake.
7. Another method of reducing the number of NFPs which would be subject to compliance requirements (and resulting cost) would be a broad definition of the concept of "unrelated". It is important that certainty is created for NFPs so that they will clearly know the extent to which they are subjected to a compliance regime. The following activities at least should be specifically identified as being related activities:

- the core purpose of the NFP;

- an altruistic activity;
  - an activity which is ancillary to or incidental to the altruistic purpose of the NFP;
  - an activity which supports the altruistic purpose of the NFP by providing infrastructure services including but not limited to insurances, finance, procurement, hospitality, resources and staffing;
  - the sale of surplus assets of the NFP which have been used or were purchased or donated with the intention of being used for an altruistic purpose;
  - the sale or licensing of by-products created in the course of carrying out an altruistic activity;
  - the sale or licensing of items that promote or support the altruistic purpose of the NFP;
  - an activity which utilises the excess capacity of an NFP;
  - transactions between NFPs.
8. The concept of “altruistic” purpose needs to be defined broadly as well and in our view should mean any purpose that would attract an entitlement to a tax concession under the *Income Tax Assessment Act*, *A New Tax System (Goods and Services Tax) Act* or the *Fringe Benefits Tax Act*.
9. The definition of a “new activity” discussed at paragraph 81 of the Consultation Paper is too broad. It should be remembered that the definition referred to in paragraph 81 only applies in circumstances where there has been a change in ownership of a taxable entity. In any event, the changes that could constitute a “new activity” are too broad in the circumstances and create uncertainty in the NFP sector.
10. In the context of the Government having decided to establish the Australian Charities and Not-For-Profit Commission (**ACNC**), any significant change in the regulation of the NFP sector should await the active operation of ACNC and be a matter upon which it provides advice to Government. There appears to be no imperative to impose a UBIT at this stage and, in any event, not prior to the operation of the ACNC.
11. Option 1 which is discussed at paragraph 53 and following has the following potential adverse impacts:
- not all NFPs can access franked dividends;
  - not all NFPs have DGR status or have an “associated” entity which is a DGR;
  - there will be significant costs on assignment of assets to a new entity, eg stamp duty, GST;
  - there will be issues around determining the CGT cost base of the assets in the new entity;
  - the new entity would not qualify to be a member of a GST religious group even though its associated NFP may be a member;
  - there will be a need for significant administration by way of separate Accounts and separate Business Activity Statements;



- there may be joint employees, ie employees of the NFP and the new entity. These expenses will need to be allocated appropriately. Industrial issues may arise;
  - all other expenses will need to be allocated appropriately;
  - the new entity will require capitalisation;
  - the retention of prudential surpluses by the new entity would attract UBIT;
  - if the unrelated activity involved the sale of surplus land and this was caught by UBIT, then query whether the margin scheme could be used on the sale of that asset to a third party for GST purposes.
12. Option 2 contains many of the same negative impacts as Option 1 and in addition would require complex changes to the tax laws.
13. Option 3 would require less structural change but there would still be a need for the NFP to develop appropriate internal systems to identify unrelated activities, allocate expenses and credits between activities, etc.
14. There are likely to be a considerable number of unintended consequences of the imposition of a UBIT.

It is our view that the imposition of a UBIT is not justified based on:

- a lack of evidence of abuse under the current system by NFPs;
- the statement by Government that it is not looking to achieve significant revenue from the imposition of a UBIT;
- the substantial compliance costs to the sector which will detract from the capacity of NFPs to provide their altruistic services to the community
- the additional cost to Government in increased funding for NFPs and the cost of its own administration of this new system.

Yours faithfully



**Makinson & d'Apice**