

Parliament of the Commonwealth of Australia

**SENATE ECONOMICS LEGISLATION
COMMITTEE**

**CONSIDERATION OF LEGISLATION
REFERRED TO THE COMMITTEE**

A New Tax System (Tax Administration) Bill 1999

November 1999

Commonwealth of Australia

ISSN 1326-9321

This report was produced from camera-ready copy and was printed by the Senate Printing Unit, Parliament House, Canberra

Senate Economics Legislation Committee

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for inquiry into A New Tax System (Tax Administration) Bill 1999

* for inquiry into the Taxation Laws Amendment Bill (No. 8) 1999

+ for inquiry into the Diesel and Alternative Fuels Grants Scheme (Administration and Compliance) Bill 1999

** for inquiry into the Taxation Laws Amendment Bill (No. 9) 1999

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REPORT

Background to the inquiry

1.1 A New Tax System (Tax Administration) Bill 1999 was introduced into the House of Representatives on 2 September 1999. Following a report by the Selection of Bills Committee, the Senate referred the Bill to this Committee on 13 October 1999 for examination and report by 29 November 1999.¹

1.2 In particular, the Committee was asked to examine:

the implications and potential impacts of proposed changes on non-profit organisations, with particular reference to Schedules 7 & 8 of the Bill dealing with the endorsement deductible gift recipients and entities exempt from income tax.

1.3 The committee secretariat contacted a number of interested parties and received six submissions to the inquiry (see Appendix 1). The Committee held a public hearing on the Bill in Canberra on 17 November 1999. A list of witnesses who gave evidence at the hearing appears in Appendix 2, and the full transcript of the hearing is available at the Internet address of <http://www.aph.gov.au/hansard>.

The Bill

1.4 The Bill implements a number of tax administration measures of the new taxation system including:

- pay as you go (PAYG) withholding system and PAYG instalments;
- collection and recovery rules;
- binding oral advice on income tax matters;
- payment, ABN and identification verification system;
- shorter period of review for taxpayers with simple tax affairs;
- endorsement of deductible gift recipients and tax exempt charities;
- administration of BAS (business activity statement) obligations;
- provisional tax - technical correction.

1.5 Specifically, the Committee is required to consider two schedules of the Bill. These are Schedule 7 which deals with deductible gift recipient status and Schedule 8 which concerns tax exempt charities.

1.6 Schedule 7 will require an entity seeking deductible gift recipient status to:

¹ Selection of Bills Committee Report No. 17 of 1999, dated 13 October 1999.

- obtain an Australian Business Number (ABN);
- be endorsed by the Commissioner as a gift deductible entity; and
- be registered in the ABN register as a deductible gift recipient.

1.7 A receipt issued by such an entity for a gift to the entity or to a fund, authority or institution operated by the entity must show the entity's ABN to enable the donor to obtain a tax deduction.

1.8 Schedule 8 will require any charity seeking income tax exemption to:

- obtain an ABN; and
- be endorsed by the Commissioner as exempt from income tax.

Regulation Impact Statement (RIS)

1.9 The Regulation Impact Statement states that the objective of the measures is to improve the integrity of the taxation system in respect of those entities or funds entitled to receive gifts that are tax deductible to the donor gifts and in respect of income tax exempt charities.

1.10 According to the RIS, there are around 30,000 charities entitled to receive tax deductible gifts. The number of other entities or funds entitled to receive such gifts is unknown as there is currently no requirement in tax law for them to obtain ATO confirmation of this status. The number of tax exempt charities is not known but it is estimated at more than 200,000.

1.11 The RIS states that the measures will particularly affect the Australian Taxation Office while charities should incur minimal compliance costs. Most charities will apply for an ABN for other purposes and will need to provide limited information to satisfy the requirements of endorsement.

ISSUES RAISED IN EVIDENCE

1.12 While submitters generally welcomed the provisions of the Bill, there were several particular concerns raised in submissions and in evidence given to the Committee. These concerns relate to:

- limits on the use of the gift fund;
- criteria for endorsement as tax exempt and
- the treatment of subsidiaries of endorsed entities.

Limits on the use of the gift fund

1.13 In Schedule 7, proposed section 30-125(4) provides that an endorsed entity must:

... maintain for the principal purpose of the fund, authority or institution a fund (the *gift fund*):

- (a) to which gifts of money or property for that purpose are to be made; and
- (b) to which any money received by the entity because of such gifts is to be credited; and
- (c) that does not receive any other money or property.

1.14 Proposed section 30-125(5) limits the use of the gift fund by providing that:

The entity must use the following only for the principal purpose of the fund, authority or institution:

- (a) gifts made to the gift fund;
- (b) any money received because of such gifts.

1.15 A number of submitters are concerned that these limits on the use of gift funds would preclude entities from using the funds for fundraising expenses, administration costs and marketing. Representatives of the not-for-profit sector consider that this measure may affect their ability to meet their objectives by reducing the funds available for their principal purpose activities.

1.16 The Australian Catholic Church Tax Working Group stated that the costs of administration and fundraising should be able to be met from a gift fund.² Mr O'Flynn, representing the Tax Working Group, argued that if fundraising costs could not be met from the gift fund, the church would have to raise extra funds to meet costs or cut programs.³

1.17 The Fundraising Institute-Australia provided comments from some organisations stating that this limitation would affect their fundraising, an essential part of their

2 Submission No. 3, Australian Catholic Church Tax Working Group, p. 2.

3 Hansard, p. E11.

resources.⁴ The Institute told the Committee that from information received from its member organisations, fundraising costs generally amounted to some 24% of the total amount raised.⁵

1.18 The Institute noted that most charitable organisations would clearly define their charitable purposes, and in fact do so to obtain their gift deductible entity status. However, few organisations would specify that their purpose includes fundraising as a means of financing their principal activity.⁶

1.19 If the gift fund cannot be used for fundraising, the Institute suggested that this could result in a reduction of an organisation's ability to raise funds and a consequential reduction in the provision of services.

1.20 Accordingly, the Institute suggested the following amendment (in bold below) to proposed section 30-125(5):

The entity must use the following only for the principal purpose of the fund, authority or institution **or for costs associated with establishing, maintaining and obtaining such gift funds:**

- (a) gifts made to the gift fund;
- (b) any money received because of such gifts.

1.21 The Australian Conservation Foundation also expressed concern about the possible restriction on the use of the gift fund and supported the Fundraising Institute's suggested amendment to the proposed section 30-125(5).⁷

1.22 However, when asked about the Fundraising Institute's proposed amendment concerning the limit on the use of the gift fund, Mr Miller, Assistant Commissioner, ATO, replied that the ATO did not consider an amendment necessary.⁸ Mr Miller added:

We understand, and have always understood, that it does include those additional costs. In fact, in the explanatory memorandum we actually talk about including the ancillary costs. Maybe we needed to be a bit clearer in the explanatory memorandum but that means all those costs incurred in whatever the organisation needs to do to collect, promote, market and get donations coming in to them; it includes the building they live in and everything else—all the other ancillary costs involved with such an organisation.⁹

1.23 Nonetheless, Mr Miller conceded that if agencies were confused about the use of the fund, the ATO could re-examine the issue:

4 Submission No. 4, Fundraising Institute - Australia Inc., p. 3.

5 Submission No. 4, Fundraising Institute - Australia Inc., Executive Summary.

6 Submission No. 4, Fundraising Institute - Australia Inc., p. 4.

7 Submission No. 6, Australian Conservation Foundation, p. 2.

8 Hansard, p. E26.

9 Hansard, p. E26.

If there is still confusion out there and they would like some form of tax determination, we can certainly look at that. Our understanding is that the law is fine to include all those costs.¹⁰

1.24 The Committee notes concerns in the not-for-profit sector about limits on the use of the gift fund. However, the ATO has advised that when the legislation was framed it was understood that fundraising and related costs were a legitimate use of the fund. As is set out in paragraph 6.16 of the explanatory memorandum, the principal purpose of the fund includes purposes incidental to the principal purpose.¹¹ The actual fund raising by a fund is clearly incidental to the fund itself.

Recommendation

1.25 The Committee recommends the ATO issue a public ruling as soon as possible after the legislation is enacted to make this point clear.

Criteria for tax exemption bodies

1.26 Schedule 8 contains provisions for endorsing entities as exempt from income tax. The amendments provide that, to be tax exempt, a charitable entity must be endorsed by the Commissioner as having met requirements set out in section 50-110.

1.27 One body, Group Training Australia (GTA), expressed concern that it could lose its current tax exempt status under these proposed provisions. GTA represents over 100 not-for-profit group training companies (GTCs). The companies are involved in the vocational education and training sector.

1.28 Group training companies currently receive government grants to assist with operating costs and have obtained tax concessions including tax exemption from company tax, sales tax, tax deductibility for donations.

1.29 Mr Buchanan, Managing Director of GTA, told the Committee that on the basis of discussions with the ATO, group training companies would lose their tax exempt status.¹²

1.30 A further concern of GTA is how the ATO will view surplus funds accumulated by training companies when assessing their tax exempt status. GTA is concerned that the ATO will see the surplus as profit rather than 'reserves to maintain the employment of our apprentices and to keep ... operating'.¹³

1.31 GTA expressed concern that increased costs resulting from loss of tax exempt status, compounded by the impact of the GST, will lead to a decrease in the employment of apprentices. They considered that employers would seek simpler alternatives, including casual and non-training based employment.¹⁴

10 Hansard, p. E26

11 Explanatory Memorandum, p. 109.

12 Hansard, p. E6.

13 Hansard, p. E9.

14 Hansard, p. E7.

ATO response

1.32 ATO officers provided responses to both issues raised by GTA.

Surplus issue

1.33 The ATO indicated that, in relation to the GTCs, a surplus would not affect the ATO's determination of their tax exempt status:

A fund established for public charitable purposes is not exempt from income tax if the fund is not applied for the purposes for which it was established. The accumulation of a surplus excessive to needs may indicate that the fund is not being applied for its principal purposes.

The indications to the Senate Committee were that Group Training Companies are incorporated companies rather than trusts and that the levels of their surplus funds were related to normal business activities only. In these circumstances, the existence of surplus funds is not a consideration in determining income tax exempt status.¹⁵

Tax exempt status

1.34 However, the ATO's answer to the broader question of whether the GTCs would be tax exempt under the new provisions is ambivalent:

the exempt provision they come under is educational body. Because they are educational they would also be charitable. ... If the companies or trusts or whatever their structure is were established for a private purpose such as to deal with the apprentices for an industry, company of something like that, then that would not be for a public purpose and would therefore not be charitable.¹⁶

1.35 The Committee is concerned that the ATO's response is open to wide interpretation. While the ATO apparently indicates that it would classify GTCs as educational organisations and therefore tax exempt, the latter part of the ATO response indicates that the issue is less clear cut. Organisations such as GTCs might also be viewed as 'established for a private purpose such as to deal with the apprentices for an industry'. The Committee considers that the ATO should further clarify its position with respect to the status of such organisations.

Treatment of subsidiaries of endorsed entities

1.36 The Australian Catholic Church Tax Working Group expressed concern that the legislation lacks clarity about the tax exempt and gift deductible status of their subsidiary organisations. The Group contended that if all subsidiaries must be registered, compliance will impose considerable legal and administrative burdens.

1.37 Representing the Group, Mr O'Flynn pointed out that the church is organised within a series of trust structures. While there is generally only one legal entity within each area, there are a great many organisations within the structure. For example, within the

15 ATO Answers to questions on notice, 23 November 1999 (See Appendix 3)

16 Hansard, E27.

Melbourne diocese, there are approximately 250 parishes and thousands of other associated organisations.

1.38 Mr O'Flynn summed up the Groups concerns about the tax exempt status in the following terms:

The main point they want to put to you is that, if the trust is a tax exempt organisation, all of those entities, subsidiaries and bodies that work within the trust - not separately incorporated or separately under any other legal structure, but those that belong to the trust - should then take the tax exempt status of the trust.¹⁷

1.39 In the Working Group's view, this concern applies equally to the gift recipient status of subsidiaries.

1.40 In answer to the concerns of the Tax Working Group, Mr Ahern, ATO, told the Committee that:

The subsidiarity side of things comes in with the question of whether the body is exempt or not. The provisions of the law that exist at present apply to exempt an entity from income tax. That is not going to be changed under these provisions that are in the bill at present.

The Catholic Church has a problem in trying to identify where the entity lies. There is an argument to say that the entity lies at the property trust that might arise under the act of parliament giving its legal existence. But in other cases, it could arise much lower. A lot of the independent schools, for instance, have been incorporated as separate companies and they would be entities in themselves. What needs to be resolved with the Catholic Church is where those entities lie. To the extent that it is an entity, then it does need to be endorsed separately. If the entity does lie at that top level of the property trust, then everything within that property trust would also be exempt. That is the way it operates at present. The endorsement requirements make them make decisions about that ...

If they do break it down and there is an entity down there, that entity will have to be endorsed. For instance, if a diocese has 250 schools ... and they are separate entities, then they will have to be endorsed. But the odds are that they are not separate entities and will not have to be endorsed. I do not think the Catholic Church has yet addressed the answer. They have identified the problem but they have not really resolved whether that lies at that higher level or at the lower level. Here they are asking for the structure not to be broken down, but they are asking for the structure to be broken down to much lower levels for GST purposes. We do have a direct conflict there. For one reason they are asking to build it up and for another to break it down. They do have a unique situation and there are problems. We are trying to work with them to resolve that.¹⁸

1.41 In relation to the Tax Working Group's notion of 'grouping' of entities, the Committee notes the Treasurer's press release of 29 October 1999 in which he announces proposed changes to requirements to register for GST for non-profit organisations (see

17 Hansard, p. E10.

18 Hansard, p. E31.

Appendix 4). The press release notes that the additional flexibility will enable many non-profit organisations to achieve substantial reductions in their compliance costs.

Definition of charitable institutions

1.42 The Tax Working Group suggested that the nature of charitable activities be embodied specifically in the legislation. In particular, that it be recognised that the charitable activities that are undertaken by churches include the advancement of religion.

1.43 Dr McGregor-Lowndes suggested that a body, possibly the Australian Law Reform Commission, look at the definition of a charitable institution and that of a public benevolent institute (PBI). He suggested that current definitions are not clear, and are outmoded and out of touch with modern social policy.

Impact on the ATO and organisations

1.44 Dr McGregor-Lowndes expressed concern that the endorsement and registration of both gift deductible recipients and tax exempt organisations would not be completed by 1 July 2000.

1.45 Dr McGregor-Lowndes questioned the ability of the ATO to manage the process, pointing out that the number of organisations involved would increase from 30 000 to 200 000. This would place significant strain on the ATO.

1.46 Similarly, the endorsement and registration process would involve considerable paperwork for the organisations themselves, particularly at a time of flux with the introduction of the GST and changes to the FBT.

1.47 In response to these concerns, Mr Ahern of the ATO explained that in relation to gift deductible status, traditionally an organisation seeking this status provides the tax office with a copy of their constitution, details of their activities and other relevant details. Confirmation is made on the basis of this information. Mr Ahern continued:

That process is going to be continued, but we are hoping that the majority of gift deductible entities would have already come to the tax office. So there might not be as big a workload there as you would think. No-one really knows the extent of it, and we are trying to identify the issues and respond to them to make sure that we can get all the endorsement on the gift side done by 30 June.¹⁹

1.48 In relation to tax exemption, Mr Ahern advised that the ATO will continue to rely on a self assessment approach with organisations themselves, in the first instance, reviewing their status and reporting to the ATO accordingly.

On the exempt side of things the approach in the past has been to encourage people to self-assess. ... We are trying to inform people of what is required before they can become endorsed and are asking them to review their status and then to declare that they satisfy those requirements. In other words, they are still self-assessing. The reason we had to adopt that approach was that the practicalities of

19 Hansard, p. E28.

the situation are such that we could not review 200,000 exempt bodies in the time frame available.²⁰

1.49 The self assessment approach uses risk management strategies to identify possible areas of non-compliance. Mr Ahern assured the Committee that the information provided by organisations would enable the ATO to make risk assessments and it would act accordingly if the need arose.

1.50 With regard to organisations seeking to be treated as gift deductible recipients, the ATO would check applications in cases where organisations had not already been reviewed:

... the application form requires people to declare that they satisfy certain criteria. We are trying to give them as much information as we can so that they can review their situation at present to see whether they satisfy the requirements for being endorsed, and if they are satisfied they will fill in the form and we will accept it, on the exemption side. On the gift side, we will still review it. If we have reviewed them already we will not do it a second time, but if we have not reviewed them before we will still review them.²¹

Recommendation

1.51 The Committee recommends that the Bill be passed.

Senator the Hon Brian Gibson
Chairman

20 Hansard, p. E28.

21 Hansard, p. E34.

**LABOR SENATORS' MINORITY REPORT
ON
A NEW TAX SYSTEM (TAX ADMINISTRATION) BILL 1999**

Labor Senators reserve their position on this legislation.

Senator the Hon Nick Sherry

Senator George Campbell

AUSTRALIAN DEMOCRAT SENATORS' MINORITY REPORT ON A NEW TAX SYSTEM (TAX ADMINISTRATION) BILL 1999

Introduction

This Bill has a potential impact on not for profit organisations. We believe these organisations perform a crucial role in improving the well being of millions of Australians in their communities and any potential impact on their operations should be scrutinised closely

Preamble

As outlined by the Australian Catholic Church Tax Working Group submission to the inquiry, the complexity of their structure is a reflection of what the greater picture is within the charities sector, especially in the areas of church run charities. The sector is made up of many thousands of organisations, many of them not showing up on government records. It is not simply a case of slotting them into the same category as businesses as has become a trend in Australia. They have not been treated as such in the past and there is no clear reason why this should now become the case. Quite the contrary is required. There is a strong need to examine via an inquiry the broader picture of what charities and the not-for-profit sector is, the contribution it makes to Australian society and how Government policy can enhance the activities of these groups.

Schedules 7 and 8 of the Bill

Fundraising is the vital part of all charities. To offer tax-deductibility to donors for their gifts is an incentive for philanthropy in Australia. Even though profits are made, unlike for-profit business, these organisations do not distribute financial rewards to shareholders but put it back into service provision for their communities. However, the main purpose for which they have been granted gift deductibility needs to be supported by the organisation and ancillary costs are incurred. As Mr Zerman, President of the Fundraising Institute Australia Ltd, said at the hearing "you need to be able to spend money to raise money". The Democrats support the Committee's recommendation that the ATO issue a public ruling clarifying that fundraising and administrative costs all seen as legitimate. However, we believe it would be best to put the matter beyond all doubt by either an amendment or a categorical statement by the Minister in the Senate chamber."

Recommendation: That an amendment be made to section 30-125 to widen the ambit of the clause to include all the ancillary costs. If it is not possible to get a form of words which would guarantee the broader ambit, the Minister should make a clear statement in the Senate chamber verifying that this is the intent of the legislation, in line with the comments made by the ATO at the Committee hearing

The registering process and administration requirements of a 'fund' or 'entity' being issued with an Australian Business Number (ABN) is an area that the Democrats are concerned with. While the Democrats are supportive of the issuing of an ABN to funds and entities as a step towards gaining more understanding of and recognition for the not-for-profit sector, the Democrats are also aware of the additional work created by the process for charities and government. The Democrats are in agreement with the statement of Dr McGregor-Lowndes

that “The ROGATE proposals have caught the nonprofit sector by surprise and many organisations do not know of the Bill or its implications”. It is expected that the ATO will have to deal with more than 200,000 registrations. Each of these organisations will need to divert time and resources away from their service provision as they work out what will be required of them to ‘re-register’ their funds or entities. Some organisations will need to deal with internal administrative and management issues such as constitutional changes to re-register successfully which is a process that can take months.

Recommendation: That the ATO not penalise any non-complying organisations for a one year period from 1 July 2000 to 30 June 2001

Closing Remarks

The Democrats are supportive of moves to bring together information about the largely unknown not-for-profit sector in Australia. It is a way of revealing the huge contribution this third sector of society makes to the fabric of society. Thousands of hours are worked and donated to creating and keeping a sense of community every year. Real relief needs to be given to make the transitions of new tax systems manageable by a sector of society that contributes so much and yet gets rarely thanked. It would cost the Government millions of dollars each year if it had to pay for all the voluntary services provided to the community by not-for-profits.

Senator John Woodley
Participating Member

Senator Andrew Bartlett
Participating Member

APPENDIX 1**LIST OF SUBMISSIONS**

- 1 Queensland Council of Social Service Inc., Red Hill, Qld**
- 2 Group Training Australia, Sydney, NSW**
- 3 Australian Catholic Church Tax Working Group, East
Melbourne, Vic**
- 4 Fundraising Institute - Australia Ltd., Chatswood, NSW**
- 5 Dr Myles McGregor-Lowndes, Brisbane, Qld**
- 6 Australian Conservation Foundation, Fitzroy, Vic**

APPENDIX 2**LIST OF WITNESSES****Wednesday, 17 November 1999****Fundraising Institute - Australia Ltd**

Dr Wayne Clarke, CEO

Mr David Zerman, Acting National President &

Director of Fundraising & Philanthropy, Royal Flying Doctor Service (Vic)

Group Training Australia

Mr Andrew Buchanan, Managing Director

Mr Michael Kirby, Director, and Manager of ATEL

Australian Catholic Church Tax Working Group

Mr Herbie O'Flynn

Dr Myles McGregor-Lowndes**Australian Conservation Foundation**

Mr Michael Kerr, Legal Advisor

Australian Taxation Office

Mr Geoff Miller, Assistant Commissioner

Mr Jim McLean, Director, Technical Management and Government Liaison Small
Business

Mr Mick Ahern, Manager, Registration of Charities Project