

# McMillanShakespeareGroup

Submission to:

## **The Not-for-profit (NFP) Sector Tax Concession Working Group**

Discussion Paper:

### **Fairer, simpler and more effective tax concessions for the Not-for-profit sector**

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# Foreword

On 2 November 2012 the Not-for-profit Sector Tax Concession Working Group released a discussion paper, *Fairer, simpler and more effective tax concessions for the not-for-profit sector*.

Concessions identified in the discussion paper for review are:

- Income tax exemption and refundable franking credits
- Deductible gift recipients
- FBT concessions
- GST concessions
- Mutuality, clubs & societies

In response to the discussion paper, McMillan Shakespeare Limited has prepared this submission focussing on the options arising from and issues pertaining specifically to the FBT concessions section of the discussion paper.

To assist in the preparation and economic analysis within this submission, McMillan Shakespeare commissioned the services of Systems Knowledge Concepts Pty Ltd (SKC) – a leading economics consultancy specialising in research, analysis and advice in policy formation, regulation, and economic impact evaluation and cost benefit evaluation. PricewaterhouseCoopers (PWC) and Lateral Economics were also commissioned to undertake policy costing arising from the analysis and recommendations contained herein.

McMillan Shakespeare, through its operating subsidiaries Maxxia and RemServ, has been a major participant in the NFP Health, Aged Care and Charities sector for more than 20 years as a trusted provider of outsourced salary packaging/workplace benefit administration services.

McMillan Shakespeare, self-evidently, has a commercial interest in the Working Group's review of the FBT concessions. However, as Australia's largest administrator of FBT concessions, and given its relationship and understanding of the NFP sector, McMillan Shakespeare is also seeking to assist the sector in advocating its views on these matters.

McMillan Shakespeare has prepared this paper in order to examine the matters raised in the discussion paper and analyse whether the current FBT concessions regime most efficiently and effectively supports the government's intention (and the NFP sector's objective) of attracting, retaining and rewarding quality, committed staff. We believe our submission clearly demonstrates the case for retention and, where appropriate, enhancement of the FBT concessions regime in support of the sector and middle to low income earners who are heavily reliant on the concessions.

As context to the Working Group's review and responses to the discussion paper, there are three important aspects that warrant highlighting:

### **No net cost to government**

The first is the key requirement among the Working Group's terms of reference, which is that offsetting budget savings must be identified from within the NFP sector for any proposals that have a budget cost. In other words, there should be no net cost to government for any proposals arising from the Working Group.

### **Government's position is abundantly clear**

The second is the Commonwealth Government's response on 2 May 2010 to the Australia's Future Tax System Review<sup>1</sup>, which stated that *"In the interests of business and community certainty, the Government advises that it will not implement the following policies at any stage.....do any changes to the tax system that harm the not-for-profit sector, including removing the benefit of tax concessions."*

### **Representation of the public health system**

Despite employees in the in the public / NFP hospital and ambulance services sectors receiving \$1 billion annually in FBT concessions<sup>2</sup>, there appears to be no direct representation of the public health system sector on the NFP Tax Concessions Working Group. Given the quantum of services delivered to the community and the importance of the FBT concessions to the sustainability of the health system, we trust that the potential impacts of any change to the

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<sup>1</sup><http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/028.htm&pageID=003&min=wms&Year=&DocType>

<sup>2</sup> Not-for-profit sector tax concession Working Group, discussion paper, November 2012

current concessions will be appropriately considered in concert with the relevant stakeholders.

To assist with informing responses to issues raised in the discussion paper, the analysis in this submission is supported by the findings of two surveys conducted across the NFP sector by SKC Consulting.

The surveys, of NFP sector employees and employers, were responded to by more than 3,000 employees and 100 employers (representing 60,000 employees) respectively, with the relevant findings contained within this paper. Further information regarding the surveys is contained within **Appendix B**.

This paper builds upon the work of Lateral Economics in 2010<sup>3</sup> in response to both the Productivity Commission Report in the 'Contribution of the Not-for-Profit Sector' in January 2010 and the 'Australia's Future Tax System Review' in April 2010. Noted Australian economist and former Productivity Commission Associate Commissioner Dr Nicholas Gruen prepared the Lateral Economics report.

The NFP sector provides a broad range of vital services to a significant proportion of Australians, typically those who are less able to pay for care or other types of services. An important characteristic of the NFP sector is that it draws on the community's philanthropic motivations. Clearly, volunteers are philanthropically motivated but so are NFP employees who work for lower incomes than they could earn elsewhere. The sector is also supported by the donations of individuals and corporations.

Government support to the sector is also indispensable and this is provided through direct and indirect channels. The FBT concessions fall into the latter category and are regarded by the sector as vital to the ability of NFP organisations to attract and retain employees.

This point has been made so often that its impact is at risk of being lost, however NFP organisations remain emphatic that without the concessions their ability to compete with for-profit and other sectors for employees would be seriously compromised.

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<sup>3</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010

### **Continuing reviews place unreasonable burden on NFP sector**

We also note that the sector is becoming increasingly frustrated from what it describes as 'review' fatigue; that is the continual diversion of stretched resources to respond to reviews of core sustainability drivers. For example, the tax concessions have been reviewed three times in four years (Productivity Commission, the Henry review and now the NFP Tax Concession Working Group). This would appear unreasonable, particularly in circumstances where the government was so emphatic in its response to the Henry review which created the impression that these matters had been addressed.

We commend this paper to you and welcome further dialogue in support of Australia's vital and diverse NFP sector.

# Executive summary

The core objective of the Working Group is identified in its terms of reference<sup>4</sup>:

*The Working Group will consider whether there are better ways of delivering the current envelope of support provided through tax concessions to the NFP sector by the Australian Government.*

Given this objective, it is clear that the Working Group's concern is not with the magnitude of support provided to the NFP sector but rather with the efficiency of the delivery mechanism. Our objective in this paper is to explore the efficacy of the current FBT concessions framework and review, in a comparative sense, the alternatives that have been suggested.

The FBT concessions play a critical role in supporting the NFP sector to attract and retain employees by offsetting, at least partially, their significant disadvantage as buyers in the labour market compared with other sectors. To emphasise this point ACOSS states *"attraction and retention of staff is the single biggest challenge facing not-for-profit community services."*<sup>5</sup>

The central theme of this paper is that the FBT concessions are an efficient benefit delivery mechanism, provide greater benefit at a lower cost in comparison with other alternatives and are critical for the on-going sustainability of the NFP sector. In support of this position we will elaborate on the following:

- the FBT concessions operate at low administrative cost and our survey<sup>6</sup> indicates in excess of **91 per cent** of NFP managers report that the associated administrative effort is 'almost entirely automated', 'routine and simple' or 'acceptable' and this is generally the case whether NFPs use third party salary packaging providers or not
- the concessions are highly valued by the overwhelming majority of employees with over **95 per cent** reporting in our survey that it is 'very

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<sup>4</sup> Not-for-profit sector tax concession Working Group, discussion paper, November 2012, p4.

<sup>5</sup> ACOSS, Analysis of FWA decision on ASU's Equal Remuneration Order application for community sector workers, 1 February 2012

<sup>6</sup> References to 'the or our survey' are to either the survey of employees or employers undertaken as part of the analysis undertaken herein. Where the context is not obvious we use the terms 'employee survey' or 'employer survey' to disambiguate. An overview of the survey can be found in Appendix B.

important' or 'quite important' in influencing whether they remain in the sector

- over **95 per cent** of NFP employers indicated in our survey that the FBT concessions are 'important' or 'critical' for attracting employees, whilst almost **30 per cent** of employers indicated they could lose more than **30 per cent** of their employees if the concessions were removed without compensation
- alternative benefit delivery systems being considered by the Working Group have significant efficiency shortcomings, are not preferred by NFP managers and carry significant risks in and of themselves and associated with the fundamental changes that they imply. The Commonwealth's own 2008 Strategic Review of the Administration of Australian Government Grant Programs<sup>7</sup> identified substantive issues with the administration of grant funding schemes
- an alternative funding model involving a grant mechanism is opposed by the overwhelming majority (90 per cent) of the sector, with only **8.2 per cent** of organisations in the SKC survey expressing a view that it would be 'generally positive with some drawbacks' and **2.1 per cent** indicating 'it would be a very positive change for the sector'. Grant arrangements carry their own not insignificant administration costs and a lack of funding surety makes strategic planning for NFP organisations more difficult
- in the scenario where all eligible employees were to receive an alternative tax based support allowance (or equivalent) to the value of the current net benefit received by participating employees, PricewaterhouseCoopers<sup>8</sup> (PWC) have calculated the additional cost to government to be in the order of **\$2.1 billion per annum**.
- alternatively, in order to satisfy the no net cost to government term of reference, the current total value of FBT concessions would need to be spread across all eligible employees. PWC estimate this will result in a reduction in the net benefit amount of around **\$5,000 per employee in the PBI sector** (representing a **66 per cent** decrease in the current benefit they receive) and a decrease of around **\$2,000 per employee in the public / NFP hospitals and ambulance services sector** (representing a **47 per cent** decrease in the current benefit they receive) – producing a detrimental impact for around **400,000 employees**

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<sup>7</sup> Commonwealth of Australia, Department of Finance and Deregulation, *Strategic Review of the Administration of Australian Government Grant Programs*, 2008, p8.

<sup>8</sup> Refer Appendix D



- across the NFP sector the cost for the provision of third-party salary packaging services faces competitive pressure and has fallen by around **50%** in real terms over the past eight years. This suggests that the delivery system is becoming more efficient over time, a characteristic not shared by the alternative delivery options
- survey respondents in the public / NFP health sector on average said that they would require the additional remuneration of \$8,041 per year to compensate for the loss of the FBT concessions. The average concession benefit value as noted by PWC<sup>9</sup> is \$4,216, **a difference of \$3,825 per employee** between the actual and perceived value of the core concession or \$907 million across the participating employee population. As detailed in the 2010 Lateral Economics report<sup>10</sup>, employees may value the FBT concessions for their 'symbolic' value. This symbolic recognition is likely a significant factor that encourages the philanthropic motivations of employees in the sector. The desire to be of service to the community and the satisfaction that is derived from helping others are no doubt sources of what economists call 'psychic income'. To the extent that symbolic value is present, the FBT concessions can be seen as a mechanism that, by recognising them, encourages workers to make philanthropic contributions. In this sense, it could be said that this contribution represents an annual saving of up to \$907 million to government
- opportunities do exist to enhance the current FBT concessions regime, including a capping arrangement for ancillary benefits namely meal entertainment and entertainment facility leasing expenses

## COMPETITIVE NEUTRALITY

The discussion paper suggests that the provision of FBT concessions to the NFP sector may be in conflict with the principle of competitive neutrality.

However, competitive neutrality is of limited relevance in respect of the NFP sector and the concessions they receive, as acknowledged by the Productivity Commission which concluded that non-neutralities are not a major issues in most areas in which NFPs operate:

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<sup>9</sup> Refer Appendix D

<sup>10</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 28

*While inequitable and distorting, such concessions are an important and reliable source of support for many NFPs, especially to attract and retain staff. Most of these NFPs do not compete directly with for-profit businesses, and for the few that do, they tend to be delivering government services.<sup>11</sup>*

This is primarily due to the fact that NFP organisations typically service distinct markets and most obviously this is the case with respect to charities. However, we argue it is also true for NFP hospitals and aged care providers on the basis that they provide a distinct set of services for particular groups in the community.

In addition, there are differences on the input side of the NFP sector compared with the for-profit sector; NFP employees have different motivations from those in the for-profit sector, NFP organisations have different access to finance, insurance services and capital, indicating competitive neutrality is of limited relevance on the input as well as the output side.

We further note that the FBT concessions are only one of many interventions by governments in the NFP sector and the broader health care and aged care sectors. Thus, the argument for removing the FBT concessions on theoretical grounds is, in fact, highly partial and lacks credibility unless it is applied to all interventions.

### **EFFICIENCY CHARACTERISTICS OF THE FBT CONCESSION**

There is a view held by some that the FBT concessions are administratively burdensome and inefficient while alternatives such as direct grants, or even alternative tax-based support schemes, are considered to be preferable as a result of their purported transparency and efficiency. Upon closer examination, however, the reality appears to be the opposite.

In practice, the FBT concessions have evolved to become a flexible efficient mechanism that enables the NFP sector to attract and retain employees, in particular and critically, skilled employees.

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<sup>11</sup> Productivity Commission 2010, Contribution of the Not-for-Profit Sector, Research Report, Canberra, p. xxxi.

The FBT concessions have an important efficiency characteristic that is usually overlooked. The flexibility of the concessions enables employers and employees to construct suitable remuneration packages on a case-by-case basis. This means that a 'self-selection' process is in operation, which determines, within limits, how much benefit is delivered to attract a particular employee.

The administration costs of managing salary packaging are relatively low at around 5 per cent of the benefit delivered and these costs are subject to competitive pressure in the market for third-party remuneration benefit providers.

Responses to our survey indicate that more than **91 per cent** of employers found the amount of administrative effort 'almost entirely automated, very little effort', 'routine or simple', or 'acceptable'.

Other desirable characteristics of the FBT concessions are that it is the beneficiaries of the system (the employees) who generally meet the relevant administrative fees of participation and so these costs form part of their decision-making. This would not be the case, for example, under a system of direct funding grants in which government and NFP organisations would directly bear these costs.

## NFP MANAGERS STRONGLY SUPPORT FBT CONCESSIONS

If there were significant disagreement among managers in the NFP sector about the efficacy of FBT concessions, there would be a stronger case for changing benefit delivery mechanisms. This however is **not the case**.

NFP senior managers speak emphatically and with near unanimity in support of the FBT concessions (see the comments from the survey at right). It is not only the absolute level of funding from government that these managers are concerned with. They are also concerned with flexibility, certainty and autonomy all of which the FBT concessions provide and without which they face the potential for bureaucratic interference, uncertainty and an inability to undertake long term planning. They express strongly their view that such outcomes are undesirable and potentially very disruptive.

We believe that these views simply cannot be ignored. NFP managers are experienced in both grant and FBT concessions administration and are arguably better positioned than any other stakeholder to identify what is in the best interests of the sector.

### EMPLOYER SURVEY RESPONSES:

*“Would be replacing a system that is established with one that has less certainty (direct funding, application process, specified term) impacting negatively on workforce planning.”*

*“Funding grants are here today, gone tomorrow. Not reliable. Stay with the FBT concessions.”*

*“Fixed term funding would mean that NFP would restrict their planning cycles thus diminishing long term programs.”*

## WAGE DISPARITIES SIGNIFICANT AND PERSISTENT

The existence of significant income disparities between the NFP sector on the one hand and the Government and for-profit sectors on the other is confirmed from many sources. The February 2012 Fair Work Australia decision to grant wage increases to community sector workers ranging from **19 to 41 per cent** provides a powerful testament to the level of income disparity within the sector.

Importantly, the FBT concessions go some way towards bridging the gap between NFP incomes and those of other sectors, standing testament to the inherent need for the concessions. This being said, the ability of the concessions to address this gap is shrinking as the real value of the FBT concessions has fallen by more than **30 per cent** since the inception of the capping limits in 2000/2001 as a result of their non-indexation, despite the assurances of the Commonwealth Government in April 2000 that it would review the level of the cap from time to time in the light of general salary movements.

### **FBT CONCESSIONS BENEFIT A BROAD RANGE OF EMPLOYEES**

The current system delivers the maximum benefit to low to middle income earners when expressed as a percentage increase in disposable income. The maximum percentage increase (12 per cent) in disposable income due to salary packaging falls in the \$30,000-\$60,000 income bracket which is typical of the incomes earned in this sector. The absolute size of concession benefits is larger for higher income earners but these greater absolute benefits are vital in order to attract skilled employees.

### **IMPACT OF A REDUCTION / LOSS OF FBT CONCESSIONS**

The employer and employee surveys conducted as part of this submission indicate that both groups regard the FBT concessions as important. Over **95 per cent** of employees reported that FBT concessions were 'Very important' or 'Quite important' in determining whether they would remain in the NFP sector.

Almost **30 per cent** of employers say they could lose more than **30 per cent** of their employees if the concessions were removed without compensation.

### **OPPORTUNITIES TO IMPROVE THE CURRENT SYSTEM**

Having outlined some of the desirable and effective characteristics of current FBT concessions regime, it is important to acknowledge that there are opportunities for improvement.

#### **Meal entertainment and entertainment facility leasing**

Concerns in the discussion paper have been raised about potential overuse of the meal entertainment and entertainment facility leasing concessions. This concern can be easily dealt with through minor changes to the current system. We recommend a simple capping of these concessions that will eliminate overuse but retain the benefit unchanged for the vast majority of employees who use them appropriately. As we discuss in this paper, these benefits have become mainstream remuneration practice for the sector and their removal would cause significant harm.

Modelling undertaken by Lateral Economics for this paper (*see Section 3.2.4*) indicates that introducing respective \$10,000 grossed up (\$4,843 Type 1 GST inclusive actual expenditure) caps on each of the meal entertainment and entertainment facility leasing expense concessions would result in a saving to government revenue of **\$643 million** net present value (NPV) over a **10 year period**. This result includes indexation being applied to the caps going forward.

#### **Indexation of core concession caps**

We also note that the value of the caps on the core FBT concessions has been eroded by around 30 per cent due to inflation and non-indexing since their introduction in 2000 and 2001 – this is despite the commitment of the Federal Treasurer in April 2000 that the government would review the level of the caps from time to time in the light of general salary movements.

We understand that the NFP sector is generally of the view that this erosion of value warrants redress. The saving derived from a cap on meal entertainment and entertainment facility leasing expenses could be redirected to the indexation of the core capping limits.

#### **Other**

We concur that on a consistency and fairness basis the limitation of tax-exempt bodies claiming the minor benefit exemption should be removed. Additionally, the rate for FBT rebates should also be aligned with the FBT rate.

Finally, whilst we agree theoretically that employees should not be able to access multiple FBT caps during the year, the instances of this are minor and the administrative costs and burden for employers and the government would outweigh the benefits accruing from such a policy change.

#### **THE CASE FOR RETENTION OF BENEFITS**

Our examination of the issues suggests that the purported shortcomings of the FBT concessions outlined in the discussion paper are overstated but that the strengths of these concessions are underappreciated. Alternative mechanisms come with significant cost, are less efficient to administer and have the potential to generate demonstrable unintended consequences. Further, the substantive risks and uncertainties associated with wholesale change in fundamental funding structures are seldom acknowledged and remain unquantified.

We believe that it is particularly inappropriate to consider such a significant change at a time when there is heightened demand for the services of NFP organisations due to an ageing population, rapid industrial change, uncertainty in job markets and a substantial lack of confidence in the global economic environment.

These factors also tend to diminish the level of donations from individuals and corporations further limiting the resources NFP organisations have to attract and retain staff. We believe that the conclusion of the 2010 Lateral Economics report<sup>12</sup> on the fringe benefit tax concessions is still relevant:

*In short, while it would be a 'courageous' thing to do – in Sir Humphrey's sense of that term – substituting FBT concessions with grants or some similar mechanism is unlikely to produce economic benefits of any magnitude and could very easily produce net costs. The government would be better advised to spend its political capital on reform that generates clearer and larger economic and social benefits.*

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<sup>12</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 9

# List of acronyms

ACNC	Australian Charities and Not for profits Commission
AFTS	Australia's future tax system report
ATO	Australian Taxation Office
CDI	Charities definition inquiry report
CGT	capital gains tax
DGR	deductible gift recipient
FBT	fringe benefits tax
GST	goods and services tax
ITAA 1997	Income Tax Assessment Act 1997
ITAA 1936	Income Tax Assessment Act 1936
NFP	not-for-profit
PAF	private ancillary fund
PAYG	pay as you go
PBI	public benevolent institution
PC	Productivity Commission
TCWC	Not-for-profit Sector Tax Concession Working Group



# Part A:

## Background to FBT concessions and the NFP sector

# 1. Background: FBT concessions and the NFP sector

## 1.1 The NFP sector in Australia

The Productivity Commission reports that there are some 600,000 NFP organisations in Australia. Of these some 59,000 are deemed to be economically significant. The sector accounts for 4.1 per cent of 2006-07 GDP and 8.5 per cent of total employment<sup>13</sup>. Organisations in the NFP sector are diverse in structure and size. NFP organisations are active in a wide variety of fields including crisis care for at risk individuals and families, medical care and aged care, religion, sports and the arts.

An obvious and important feature of the NFP sector is the large number of volunteer workers that it attracts. The participation of volunteer workers creates significant leverage for the funds that government contributes to the NFP sector – the Office of the Not for Profit Sector reports the value of volunteering at \$14 billion per annum derived from six million volunteers<sup>14</sup>.

Government funding makes up more than one third of total revenue for the NFP sector with almost 50 per cent being derived from self-generated sources (mainly fees for service). Revenue through philanthropy and income from related or affiliated organisations makes up the balance.

The FBT concessions are available for a subset of the NFP sector where the organisation is a public benevolent institution, public or NFP hospital or religious institution (in respect of religious practitioners). Certain other organisations qualify for an FBT rebate and include religious, certain educational, charitable or scientific institutions, trade unions and employer associations, community organisations and organisations established to promote the development of certain Australian resources.<sup>15</sup> These organisations are the focus of this paper and we will be examining in detail the role and

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<sup>13</sup> The Productivity Commission, Contribution of the Not-for-Profit Sector, Productivity Commission Research Report October 2009.

<sup>14</sup> <http://www.notforprofit.gov.au/volunteering>

<sup>15</sup> NFP Sector Tax Concession Working Group discussion paper November 2012

efficacy of FBT concessions in enabling them to attract and retain employees who are essential in the delivery of their services to the community.

## 1.2 Use of FBT concessions in the NFP sector

NFP organisations receive both direct and indirect support from governments. Indirect funding is mostly in the form of tax concessions of various kinds. The *Not-for-profit Sector Tax Concession Working Group discussion paper* provided the data shown in **Exhibit 1**, which is based on Treasury estimates. This data indicates the level of support received by various parts of the NFP sector via the FBT concessions.

Clearly, FBT concessions provide significant benefits to the sector and because of the way they are structured, that is, through personal tax concessions, these benefits are focused on improving the capacity of NFP organisations to attract and retain employees.

Exhibit 1: Main Fringe Benefits Tax concessions for the NFP sector (Treasury estimates)

Concession	Limitations	Estimated value in 2011-12	Estimated number of employees within the relevant sector
Exemption for public benevolent institutions (other than public and NFP hospitals)	\$30,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	\$1.3 billion	485,000
Exemption for public and NFP hospitals and public ambulance services	\$17,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	\$1.0 billion	450,000
Exemption for certain fringe benefits provided to live-in employees of religious institutions	No limit	**	**
Exemption for charities promoting the prevention or control of disease in human beings	\$30,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	\$90 million	24,000
Exemption for practice, study, teaching or propagation of religious beliefs by religious practitioner	No Limit	\$85 million	**
Parking for employees of scientific, religious, charitable or other public education institutions	No Limit	**	**
Rebate of FBT for certain NFP entities	\$30,000 of grossed-up taxable value per employee (rebate on meal entertainment and entertainment facility leasing is uncapped)	\$35 million	440,000

\*\* The relevant value is difficult to estimate with precision, as there is limited reporting on this area of activity.

Source: Not-for-profit sector tax concession working group, discussion paper, p36

The central focus of this paper is to address whether the FBT concessions constitute an *efficient mechanism* for the delivery of government financial support to the NFP sector. Putting this another way: on a pragmatic basis, are FBT concessions a targeted and efficient way of using taxpayer dollars to equitably assist with the sustainable delivery of NFP services?

It is estimated that around one third of the eligible charity workforce access the FBT concessions via salary packaging arrangements. The participation rate for public / NFP hospitals and ambulance services is estimated to be circa 52 per cent<sup>16</sup>. In both cases the participation figure is generally greater for larger organisations.

Whilst these benefits go some way to closing the income differentials between sectors, it only partially succeeds as pointed out by the Productivity Commission, *“Even when FBT exemptions are considered, wages in the community sector are still considerably lower than equivalent positions in the public”*<sup>17</sup>.

As an aside, we note that despite the higher level of participation in salary packaging from employees in the public / NFP hospitals and ambulance services sector (representing circa an additional 80,000 employees when compared with the charitable workforce), there appears to be no direct representation from this sector on the NFP Tax Concessions Working Group. Given the quantum of services delivered to the community and the importance of the FBT concessions to the health system, we trust that the potential impacts of any change to the current concessions will be appropriately considered in concert with the relevant stakeholders.

### 1.3 Income differentials between NFP and for-profit sectors

There is widespread agreement that incomes are lower in the NFP sector compared with both government and for-profit sectors. **Exhibit 2** provides a summary prepared by the Productivity Commission.

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<sup>16</sup> ATO Tax Facts

<sup>17</sup> The Productivity Commission, Contribution of the Not-for-Profit Sector, Productivity Commission Research Report October 2009, p264.

## Exhibit 2: NFP income differentials

### Box 10.5 Pay gaps between not-for-profit and government positions

A number of submissions noted that in the community services sector, gross wage rates were significantly lower in NFPs compared to government agencies and, as a consequence, many employees were moving to government positions.

- In Victoria, due to limited funding, NFPs could only offer wages \$10 000 to \$15 000 below comparable government organisations (Precision Consultancy 2007).
- In 2008 there was an estimated wage disparity of up to \$20 000 between public and community sector workers in the ACT (ACTCOSS 2008).
- Community services workers in WA were found to be paid up to \$22 000 less than similar positions in the public sector in 2007 (WAAMH et al. 2008).
- Family Relationship Services Australia estimated:  
... that the average difference in salary between staff employed in direct service delivery in the community sector and those performing similar work in the public sector is between \$15,000 and \$30,000 per annum for each full time equivalent position. (sub. 132, p. 9)
- The Australian Council of Social Services estimated:  
... a gap of between 20-30% for similar roles in community as opposed to government sectors. This gap widens to as much as 40-50% for senior policy experts and managers. (sub. 118, p. 32)

Sources: ACOSS (sub. 118); ACTCOSS (2008); FRSA (sub. 132); Precision Consultancy (2007); WAAMH et al. (2008).

Source: Productivity Commission report, p265

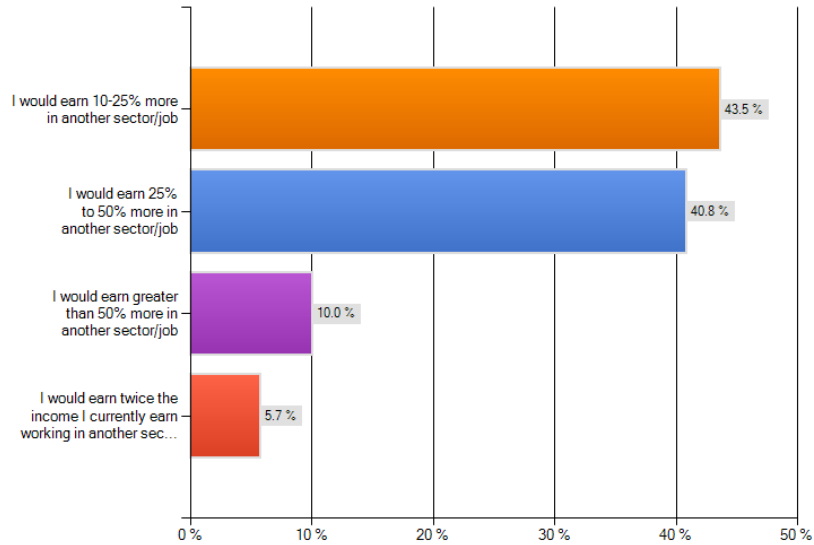
NFP employees and employers also confirm there is a significant income differential between sectors as indicated by our survey results. Employees were asked the question '*consider your current job in the NFP sector and consider whether you could earn more working outside of the NFP sector*'. Over **84 per cent** of respondents were of the view that they could earn more income outside of the sector.

**Exhibit 3** shows responses from this group of respondents to the question '*how much more could you earn outside the NFP sector?*' Of the **84 per cent** of employees who were of the view that they could earn more outside of the sector, **43.5 per cent** thought **10-25 per cent** more and a further **41 per cent** thought **25-50 per cent** more.

NFP employers' responses were quite similar as shown in **Exhibit 4**. These responses indicate **70 per cent** of employers believe that their employees could earn between **10 and 50 per cent more** outside of the sector.

### Exhibit 3: How much more could you earn outside the NFP sector?

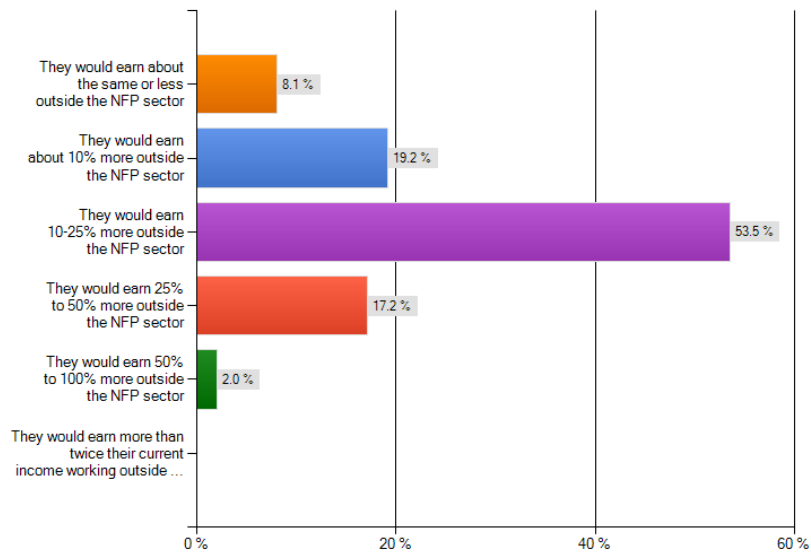
If you worked in another sector and/or another type of job outside of the NFP sector and your primary objective was to earn the maximum possible income that you could, how much more do you think you could earn? (please select one)



Source: SKC survey

### Exhibit 4: How much more could your employees earn outside the NFP sector?

Consider a typical employee in your organisation with a particular level of skills, qualifications and experience. Which of the following best describes, in your opinion, what this typical employee would earn working outside the NFP sector compared to what they currently earn:



Source: SKC survey

It should be emphasised that the views put forward by employees are not based on uniformed speculation. According to our survey results, a significant proportion of NFP employees have worked in 'non-NFP organisations' and many of them advise that they actively monitor the job market.

A further illustration of the income differentials existing within the wider sector is demonstrated by the February 2012 Fair Work Australia's (FWA) decision handing down increased wage rates as agreed by the Commonwealth Government and the Australian Services Union in November 2011 ranging from 19 to 41 per cent to community social workers. This range provides a further demonstration of the level of income disparities.

Given the FWA decision, it might be argued that this differential has been addressed and that the need for support to this specific part of the NFP sector via the FBT concessions is now not necessary. There are, however, a number of considerations that suggest that this is not the case:

- The decision does not apply to all workers in the NFP sector
- The proposed increases only partially close the differential gap
- The implementation period is 8 years and there is no guarantee that for-profit income increases will not outstrip these increases in this period

*"The workforce crisis in Aged Care has developed due to the disparity in wage levels between employees in the aged care sector and those in the acute care sector. Carers in aged care are paid less than their counterparts in the acute hospital sector, both public and private."*

*INQUIRY INTO CARING FOR OLDER AUSTRALIANS 2010, Submission to the Productivity Commission by the Health Services Union Tasmania.*

*"Improved employment terms and conditions are the foundation for building a larger supply of workers in the aged care sector. The most notable shortcoming is the low wage rates for personal carers and the long standing disparity between the wages paid to nurses employed in the aged care sector compared to those employed in comparable settings..."*

*CARING FOR OLDER AUSTRALIANS: OVERVIEW, Productivity Commission 2011, Report No. 53, Final Inquiry Report, Canberra*

*"There needs to be occupational equity between professions that have the same requirements, skill, knowledge, education and training or quite simply comparative value. Currently, non-government sector employees are being paid less than their peers in the government sector – in some cases there is almost a 50 per cent disparity."*

*EQUAL PAY FOR COMMUNITY SECTORY WORKERS, Julie Edwards, CEO, Jesuit Social Services*

<http://www.jss.org.au/policy-and-advocacy/news/200-equal-pay-for-community-sector-workers>



- There remains uncertainty as to how the sector will fund such increases given that it ostensibly will be reliant on Commonwealth and State Governments (over a long period of time) coming together to provide the necessary resourcing – such commitments have not yet been finalised

Whilst there is diversity of opinion about the extent of the differential there is agreement that a differential nevertheless exists. The extent of differentials will vary across various job types and qualifications levels.

Additionally, even with the existence of the concessions and the advantages they provide, the sector still struggles to attract employees driven in part by its inherent conditions that are generally less favourable than the for-profit sector. This suggests that the concessions are by no means generous. The critical point is that the differentials are significant and persistent.

We also note that the core concessions are not indexed and that their real value has declined over the past decade. From our dialogue with the NFP sector, it is our understanding that they believe this continued erosion is a key area of concern requiring attention in order to restore the relative value of the concessions

It is worth remarking that when announcing the introduction of the capping limits in April 2000, the Federal Treasurer stated *“The Government has further agreed to review the level of the cap from time to time in the light of general salary movements.”*<sup>18</sup>

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<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2000/022.htm&pageID=003&min=phc&Year=2000&DocType=0>

## 1.4 Importance of FBT concessions to the NFP sector

As implied in the name, firms in the for-profit sector have the objective of maximising profit in order to maximise value for their shareholders. NFP organisations, in contrast, attempt to deliver the maximum level of services feasible given their resource constraints. Because NFP organisations explicitly focus on parts of ‘the market’, which have a lower capacity to pay for services, they are typically not as well resourced as for-profit organisations.

*Over 95 per cent of NFP employees rate FBT concessions as ‘Very important’ or ‘Quite important’ in influencing whether they remain in the sector.*

Therefore, other things being equal, NFP organisations will be less able to attract resources than firms in the for-profit sector. The critical role that the FBT concessions play is enabling NFP organisations to partly overcome this disadvantage in relation to the attraction and retention of labour.

As stated above, notwithstanding the existence of the FBT concessions, the sector still finds it difficult to attract, reward and retain employees. According to ACOSS, its annual community sector surveys consistently find that **“attraction and retention of staff is the single biggest challenge facing not-for-profit community services.”**<sup>19</sup>

### EMPLOYER SURVEY RESPONSES: IMPORTANCE OF FBT CONCESSIONS

*“Absolutely critical in recruiting and retaining the high quality of scientific staff required to undertake valuable cancer research.”*

*“FBT concessions delivered in the form of salary packaging and salary sacrifice has enabled us to attract and retain staff who could earn more outside the NFP sector. The concessions result in bringing the NFP wages closer to the non NFP and are vital to the vibrancy of this important sector in delivering social and health services to the community.”*

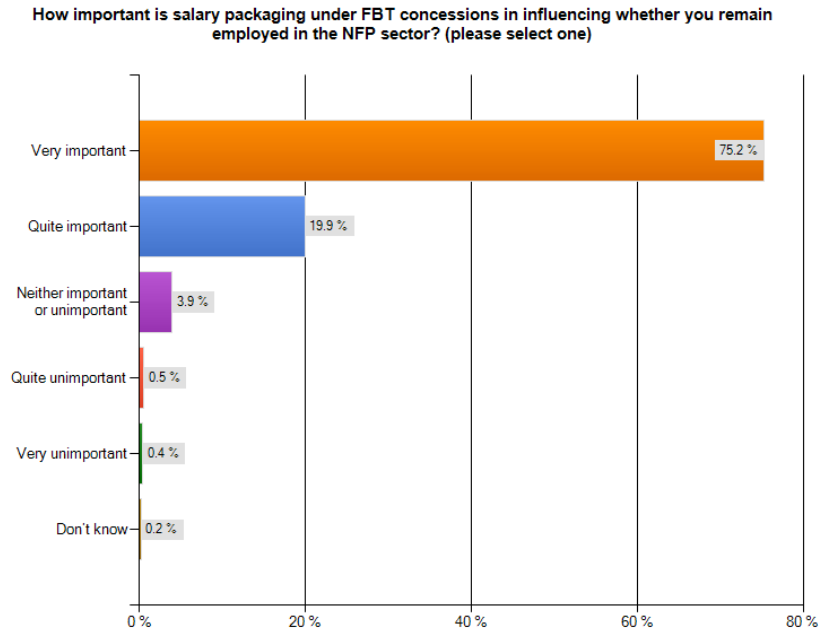
*“FBT concessions and salary packaging are critical to our ability to attract and retain the right staff. Without these, we simply could not compete in the open marketplace with the level of remuneration available in the private sector.”*

*“Salary packaging is what makes the difference in being able to match the very poor conditions in Residential Aged Care facility where the care staff and the Nursing staff are paid well below those of their fellow nursing staff in acute facilities. Salary packaging enables us to be a little comparative in what is a very small pool of candidates, to attract and retain those staff. Being a regional & remote facility it is even harder for us. Funding is way below par, and to impose FBT on facilities such as ours would be another blow that could be the fatal one.”*

<sup>19</sup> ACOSS, Analysis of FWA decision on ASU’s Equal Remuneration Order application for community sector workers, 1 February 2012

It is clear from range of sources including previous studies, submissions from NFP organisations, surveys of employees and employers, and from stakeholder interviews that NFP organisations value the FBT concessions highly and regard them as critical to attracting employees. More than **95 per cent** of employee survey respondents who participate in salary packaging regard it as ‘very important’ or ‘quite important’ in respect of influencing whether they remain in the NFP sector as shown in **Exhibit 5**.

**Exhibit 5: Importance of FBT’s salary packaging**

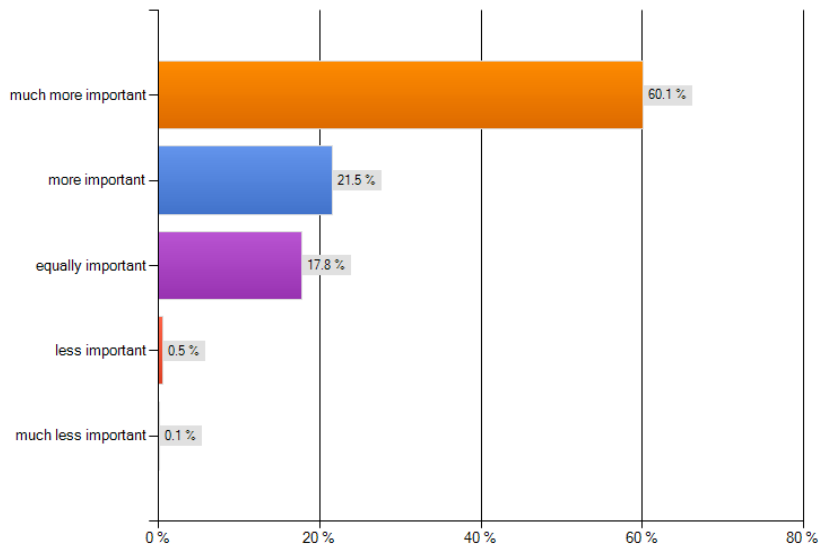


Source: SKC survey

Employees also believe that salary packaging is likely to become more important to their household budgets in the future (**Exhibit 6**). Almost **60 per cent** say salary packaging will be ‘much more important’ to their households in future.

### Exhibit 6: Importance of salary packaging in the future

Looking ahead, do you think that the current FBT concessions/salary packaging benefits are likely to be more or less important to you and your household budget compared to when you first commenced salary packaging?



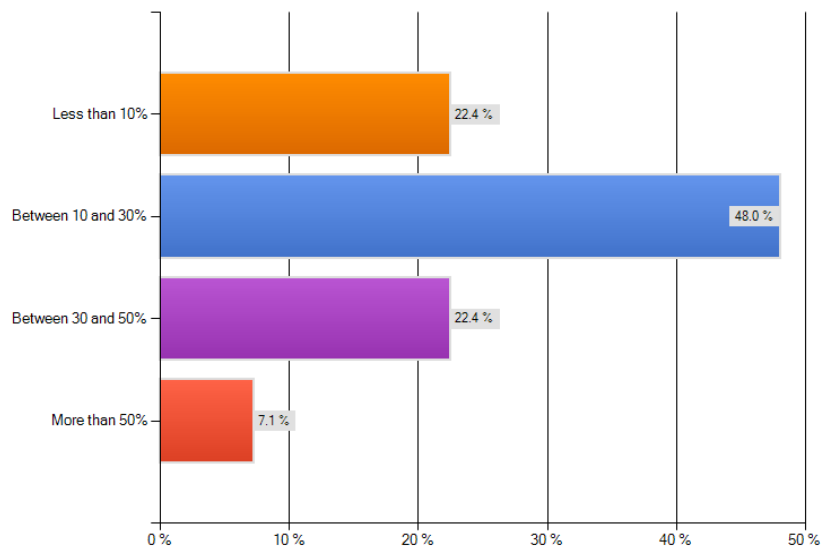
Source: SKC survey

Employers were asked to speculate on the impact that the removal of the FBT concessions might have on their ability to retain employees. The results of this question are shown in **Exhibit 7**. These results deserve emphasis. Almost **30 per cent of employers** say they could lose more than 30 per cent of their employees if the concessions were removed without compensation. The extent of this potential exodus is not surprising given that around **40 per cent** of employee survey respondents advised that FBT concessions constitute between **21-40 per cent** of their total household income.

The responses to the question in Exhibit 7 indicate how important the FBT benefits are and illustrate the risk involved in providing benefits via alternative mechanisms that potentially will not deliver benefits to employees that are commensurate with the benefits currently delivered under the FBT concessions regime.

## Exhibit 7: Impact of loss of FBT concessions

If the FBT concessions currently available to your employees were to be materially reduced without equivalent offsetting compensation, the percentage of my employees I would be likely to lose would be:



Source: SKC survey

### 1.5 Why FBT concessions are an appropriate and efficient mechanism for delivering benefits to the NFP sector

It is clear from the foregoing discussion that FBT concessions are widely used and highly valued by the NFP sector. This strong preference by the sector for the FBT concessions regime seems at odds with the conclusions of economic theory that a system of direct grants would be more efficient and less economically distorting than the concessions.

It would seem logical that, if it were clear that grants were more efficient, the NFP sector would prefer them – it would mean that they would be better able to turn each dollar of government funding into services.

As is sometimes the case in the application of economic theory to real world policy problems, it is possible that the economic analysis being applied is abstracting from too many important features in the real world operation of the FBT concessions and the alternative of direct grants (and alternative tax-based options). This doesn't mean that economic theory is at fault – what is needed is a theoretical approach that is more grounded in the pragmatic objectives of NFP organisations.

A simple approach to the economics of NFP organisations would be based on the notion that they are mainly interested in maximising the support from government. NFPs, however, have more complex objectives. Certainly, they are interested in the level of government funding but they have other concerns such as the flexibility, certainty and autonomy of the financial support they receive. These aspects reflect the inherent needs of the NFP sector as they seek to plan for and execute their services across the community.

Some people believe the FBT concessions are administratively burdensome and inefficient while alternatives such as direct grants, or even alternative tax based schemes, are considered to be transparent and efficient. Upon closer examination, however, the reality appears to be the opposite.

In practice the FBT concessions and the way they are administered have evolved to become a flexible efficient mechanism that helps to directly address the most significant and systematic operational challenge they face.

FBT concessions have a number of desirable characteristics:

- the concessions are 'hands off' meaning that the benefit is legislated and certain and there is no direct administrative or bureaucratic intervention which creates risk and uncertainty for NFP organisations which might otherwise compromise their autonomy and investment decisions
- the concessions are long running, predictable and well understood which provides NFP organisations with the certainty they need to undertake long term service provision and resource planning
- the concessions are flexible enabling employers and employees to design specifically suitable remuneration packages – this 'self-selection' effectively creates a marketplace in which employees and employers can negotiate overall remuneration based on the organisation's capacity to pay and its access to concessions. This marketplace minimises the cost of the concessions to government while maximising the number of employees that can be attracted to the NFP sector.

It is abundantly clear from the responses of employers to our survey that senior NFP managers are very concerned about the risks and uncertainties associated with alternatives to the FBT concessions. As the Lateral Economics report<sup>20</sup> put it:

*A particularly pertinent example of the negative efficiency impacts of a grants or subsidy scheme is on the capacity of NFPs to undertake effective long term planning. Any government grant or subsidy scheme will introduce uncertainty in relation to on-going funding, impose political risk and generally reduce the independence of NFPs. Long term planning will be affected to the extent that any grant or subsidy scheme does not provide guaranteed long term funding. Uncertainty may also flow due to the 'bureaucratic risk' involved in a grant or subsidy assessment and administration program. It is also likely that these uncertainties will encourage some NFPs to engage staff on shorter contracts rather than by more certain, long-term arrangements. This will lead to NFPs under-investing in staff career in skills development to the long-term detriment of service delivery.*

In addition to the potential negative outcomes of alternative benefit delivery systems, there are also risks associated with a transition to a new system. Critically, these include industrial unrest and increased costs to government.

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<sup>20</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 4

# Part B:

## Specific responses to the Working Group discussion paper



## 2. General issues and concerns

In Part B we discuss specific issues and questions raised by the Working Group.

The general concerns raised were:

- inconsistency of treatment
- competitive neutrality
- use of concessions outside of initial policy intent
- administrative burdens.

These general concerns and issues are discussed in Section 2 below.

The discussion paper then moved on to pose a number of questions regarding reform options in two categories:

- Short term reform options
- Long term reform options

Our responses to specific questions are contained in Section 3 below.

### 2.1 Key points summary

- Middle to low income earners are major users of FBT concessions indicating that access to the benefit is not inherent to the system but rather a function of other issues such as awareness of the benefits and employer educational activities
- The principle of competitive neutrality is of limited relevance, as acknowledged by the Productivity Commission<sup>21</sup>, in respect of the NFP sector and the concessions they receive
- The evidence suggests that administrative burdens and compliance costs for the operation of FBT concessions are modest and do not present an issue for NFP organisations. There is no evidence that the costs associated with alternative mechanisms would deliver any meaningful efficiency / cost savings in this regard

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<sup>21</sup> Contribution of the Not-for-Profit Sector Productivity Commission Research Report January 2010 Page 197

- Whilst it can be argued that there is some use of minor concessions outside of the original policy intent, such usage is now embedded in mainstream remuneration practice. There are sensible reforms that can be undertaken to minimise the overuse of ancillary benefits

## 2.2 Inconsistency of treatment

The Working Group noted that some stakeholders might question the current structure of eligibility for FBT exemptions and rebates as they apply to various categories of NFP organisations.

Whilst it is inevitable that some degree of inconsistency will be present in any policy regime that requires definitions and cut-off points, we contend that the current FBT concessions available for PBIs, public and NFP hospitals, charities, public ambulance services, religious institutions and other NFP entities are well founded, well understood and operate efficiently as intended given that the services these organisations provide create significant public benefit.

We acknowledge that there may be a case for rationalising the number of categories of NFP organisations in relation to FBT concessions, and in fact widening accessibility for the benefit of the sector, provided that such a process would not reduce the level of entitlements that current NFPs can access.

It is our view that the issues of eligibility and related criteria are more appropriately canvassed through existing statutory reform activities established by government and informed by the wider sector, outside of the Working Group. This will help to ensure that a consistent and informed view of definitional and eligibility aspects are contemplated and fully understood in the context of the wider sector and its ongoing sustainability. Our further comment on this issue is contained in our response to Questions 28-30 (see section 3.1).

## 2.3 Competitive neutrality

### 2.3.1 Key points summary

- Competitive neutrality is of limited relevance to the NFP sector because NFP organisations service distinct market niches and employ labour with different characteristics to the for-profit sector.
- The previous point is clearly relevant to charities but is also true of public and NFP hospitals.
- Organisations in the health and aged care sectors use other inputs besides labour. Whilst both NFP and for-profit organisations have access to these inputs, for example capital, the access can often be on quite different terms, which create divergences from competitive neutrality. The FBT concessions go some way to offsetting this issue.
- FBT concessions are only one of many government interventions which create multiple divergences from competitive neutrality – e.g. it is far from clear that the removal of FBT would decrease the divergence from competitive neutrality.

### 2.3.2 Is competitive neutrality relevant to the NFP sector?

The principle of competitive neutrality in policy-making asserts that government interventions should not affect the terms that similar firms face in either their output or input markets. If interventions do affect firms in this way some firms will be disadvantaged and some advantaged and this will lead to a misallocation of resources.

In this paper we do not argue against the principle of competitive neutrality on theoretical grounds. It is however our view that competitive neutrality is only of significance where non-neutrality can affect the allocation of resources within a particular market. In the case at hand the Productivity Commission itself indicates that non-neutralities are not a major issue in most areas in which NFPs operate.

*While inequitable and distorting, such concessions are an important and reliable source of support for many NFPs, especially to attract and retain staff. Most of these NFPs do not compete directly with for-profit businesses, and for the few that do, they tend to be delivering government services.<sup>22</sup>*

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<sup>22</sup> Productivity Commission 2010, Contribution of the Not-for-Profit Sector, Research Report, Canberra, p. xxxi.

Importantly, the Commission found that competitive neutrality was only a substantial issue *“in a small number of areas, notably hospitals”*.

### 2.3.3 Competitive neutrality and sub-sectors of the NFP sector

The definition of markets and their boundaries is quite complex. Firms are said to be within a particular market if the products and services they sell are *close substitutes* (whether two products are close substitutes is typically a question of degree rather than clear cut certainty). The question of market definition is relevant to competitive neutrality because the principle of competitive neutrality can only be applied within a particular market.

The NFP sector is made up of subsectors including charities, hospital and aged care providers that provide quite different services, which are not close substitutes. Charities, for example, provide services and goods free of charge (or at low cost) to disadvantaged persons who would otherwise not be able to afford these from the for-profit sector. Thus, the output of charities and for-profit organisations are not close substitutes and therefore competitive neutrality would not apply.

### 2.3.4 Is competitive neutrality relevant to the NFP and aged care hospital sectors?

Even within the hospital sector there are important differences between NFP and for-profit employees, patients and clinical activities. NFP clientele tend to be less well off, have a lower capacity to pay for services, generally do not have private health cover as well as being located in less affluent areas. NFP hospitals’ clinical, community and educational activities are more tightly focused on need rather than motivated by profit.

The Lateral Economics 2010 report compared the services and activities of two Melbourne hospitals in the same geographic area – The Avenue (for-profit) and Cabrini (NFP). This comparison demonstrates that compared with The Avenue, Cabrini Hospital:

- provides significantly different medical, surgical and clinical services
- runs numerous community service programs
- undertakes many research programs
- undertakes significant levels of pro bono services.

It is significant that these differences were pronounced even though the two hospitals were within three kilometres of each other in the same municipality of Stonnington, Melbourne. It would be reasonable to expect even larger differences for those NFP hospitals that service disadvantaged areas (see Appendix A for more detail on the differences between the two hospitals' services and activities).

The comparison delineates material differences in services provided, most notably in low margin medical services together with the range of community programs, and research and education services which the NFP facility, namely Cabrini, provides.

These significant differences between the services provided by NFP and for-profit hospitals and differences in the markets that they serve argue for the interpretation that the principle of competitive neutrality is of limited relevance even in the case of the public hospital sector. These same arguments can be applied to the distinction between the for-profit and NFP aged care sectors.

### 2.3.5 Competitive neutrality, labour markets and the motivations of NFP employees

Determining the relevance of competitive neutrality also requires not only examining output markets but also the input markets where organisations access the resources they need to deliver services. It is possible, for example, that organisations that deliver similar services may, in fact, access different types of employees from different parts of the labour market. To the extent that this is true, the principle of competitive neutrality would not apply between such organisations. We suggest that the following characteristics of NFP employees and workplaces indicate that competitive neutrality may be less relevant than asserted by some stakeholders, including the Productivity Commission:

- working environments are quite different in the for-profit and NFP sectors. It is typically the case that NFP organisations do not enjoy the quality of infrastructure and access to resources that prevails in the for-profit sector. The nature and immediacy of workloads is also a key point of difference, particularly so in the comparison between public hospitals, with their breadth of services and emergency departments, and for-profit hospitals

- NFP employees are likely to be motivated differently from for-profit employees: NFP employees tend to emphasise non-monetary motivations such as community service
- NFP employees may have different demographic characteristics and financial needs to for-profit employees: NFP managers have suggested that employees in the NFP sector tend to be either younger or older than in other sectors on average because at these ages employees are able to cope with lower incomes

To the extent that these characteristics are true there is less cause for concern about competitive neutrality between the NFP and for-profit sectors in respect of labour. As the Lateral Economics report<sup>23</sup> put it:

*The NFP sector tends to draw on groups of workers whose elasticity of labour supply tends to be high. The greater informality of the NFP health sector and its closeness to the community, it is also likely that this effect is not trivial. This effect will offset any losses from the NFP's use of its access to the FBT concession to out-compete the for profit sector for labour. Although there may well be fewer workers in this category, each worker that the NFP sector draws into the labour force is likely to contribute more to social welfare than the decrement in social welfare involved in someone moving from the for profit sector to the NFP sector where they are (probably only marginally) less productive.*

In addition to this consideration, there is evidence that workers in the NFP sector tend to overvalue the FBT concession. This suggests that in terms of the impact on the motivations for NFP employees, the FBT concession is a cost-effective regime for government as the actual cost of the concession is lower than its perceived value in the eyes of the recipient.

To attempt to quantify this effect we turn to one of the employee survey questions: *If the FBT concession was discontinued for workers in the NFP sector, how much would your remuneration need to increase per week (in compensation) for you to be willing to stay in your current job/role?*

For respondents in public / NFP health sector the average value of responses was \$8,041 per year. The average concession benefit value as noted by PwC<sup>24</sup> is

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<sup>23</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 28

<sup>24</sup> Appendix D

\$4,216, a difference of \$3,825 per employee between the actual and perceived value of the core concession or \$907 million across the participating employee population. It could be said that the \$907 million represents a funding saving to government.

There may be a number of reasons for this difference. It could be a lack of accurate information or more likely it is that employees place a symbolic value of the receipt of a benefit that provides personal recognition for their service to the community.

### 2.3.6 Other inputs and organisational structures

There are significant differences between NFP and for-profit organisations in terms of their access to other types of inputs besides labour. In particular, for-profit organisations have access to equity funding but NFPs do not. The two types of organisations have access to debt funding on quite different terms. NFP hospitals also typically face significantly inferior terms in dealing with health insurance providers. NFP organisations may receive donor funds. All of these factors affect the competitive neutrality and FBT concessions may well be a minor consideration compared to some of these other sources of competitive non-neutrality.

### 2.3.7 Multiple government interventions

The FBT concession is only one of many interventions by governments in the NFP sector and the broader health care and aged care sectors. As the Lateral Economics report<sup>25</sup> put it:

*Thus, there is a complex matrix of influences on the price of inputs used by hospitals from multiple government interventions and concessions. It is the sum of all these influences on the relative prices of inputs that determine the net divergence from competitive neutrality in the hospital sector. Taking a partial approach (for example, by focusing only on the FBT concession) to this complex reality may result in perverse policy recommendations. For example, it is possible to imagine a situation where the removal of the FBT concession for NFP hospitals causes the extent to which competitive neutrality is violated to increase rather than decrease because of the complex influences on input costs of various other concessions and interventions.*

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<sup>25</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 32

Thus, the argument for removing the FBT concessions on theoretical grounds is, in fact, highly partial and lacks credibility unless it is applied to all interventions.

## 2.4 Administrative burdens

The Working Group expresses the concern (para 141) that offering fringe benefits “*imposes considerable compliance burdens on eligible entities*”. In addition the concern was expressed that “*anecdotally, the take up rate is often not commensurate with the effort exerted in offering salary packaging arrangements. Take up rates tend to be higher for more highly paid employees than for lower paid employees, apparently due to the higher tax savings.*”

### 2.4.1 Key points summary

- There is no evidence that salary packaging is excessively costly in administrative terms at around **5 per cent** of the value of the benefit delivered. Our survey responses from employers also overwhelmingly demonstrate the administration simplicity of the current arrangements.
- Participation in salary packaging arrangements occurs across a range of income cohorts in the NFP sector, for both full-time and part-time employees, indicating the policy is working well and enabling NFP organisations to attract skilled labour.
- Lower income earners participate significantly in salary packaging and their percentage benefits are greater than those of higher income earners.

### 2.4.2 The administrative cost of salary packaging

*“92 per cent of employers say FBT administrative effort is either ‘routine or simple’, ‘almost entirely automated, very little effort’ or ‘acceptable’.*

The administrative cost of operating any policy warrants due consideration. Anecdotal claims that compliance costs for the FBT concessions are high or excessive are unsubstantiated in our opinion. In any case, the proposition that compliance costs are high cannot be meaningfully assessed without reference to the real world costs of compliance for alternative benefit delivery systems.

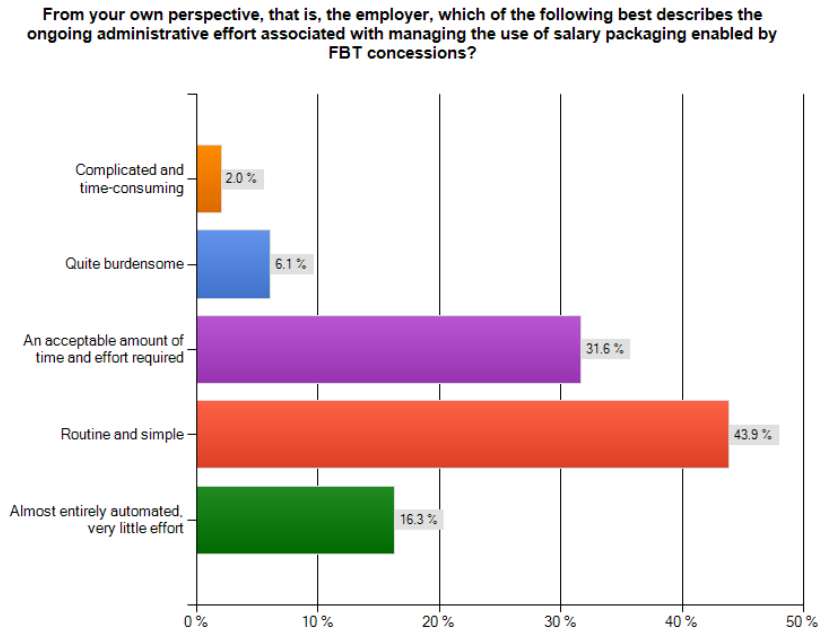
Where possible, the cost of salary packaging needs be assessed with reference to quantitative data. McMillan Shakespeare data indicates that support delivered via FBT based salary packaging costs organisations around 5 per cent of the total, for example, a fee of \$160 on a benefit of \$4,000.

Further, the cost of delivering support to the sector via salary packaging can only be sensibly assessed as being excessive or otherwise compared to some alternative mechanism that delivers comparable support. Direct grants, for



example, entail significant compliance costs for government and for applicant organisations as do alternative tax-based schemes (this is discussed in more detail in Section 3.3.3)

**Exhibit 8: Administrative effort for FBT concessions**



Source: SKC survey

Our survey data indicates that a clear majority of NFP sector organisations find the administrative effort associated with FBT concessions ‘routine and simple’ or ‘Almost entirely automated very little effort’ as shown in **Exhibit 8**.

**Exhibit 9** shows the responses to the question of administrative effort cross-tabulated by the responses to the question: *Do you have professional assistance, that is, a third party salary packaging administrator/company, to help your organisation manage the provision of FBT concessions?* A total of 98 NFP organisations responded to this question and 70 answered ‘Yes’ and 28 ‘No’. The results show that there is very little difference in the perceived effort associated with the administration of FBT concessions for organisations that do or do not use the services of a third party salary packaging provider.

**EMPLOYER SURVEY  
RESPONDENT**

*The current system is easy to manage, understandable and a real draw card for staff, particularly skilled and professionally qualified. With a minimum admin support function, we have an automated system, that if changed would be a huge loss. Leave it alone for the NFP's, particularly the genuine PBI groups.*

**Exhibit 9: Administrative effort for FBT concessions by response to having professional salary packaging assistance**

	Do you have professional assistance, that is, a third party salary-packaging administrator/company, to help your organisation manage the provision of FBT concessions?		
	Yes	No	Response Totals
<b>Complicated and time-consuming</b>	2.9%	0.0%	2.1%
<b>Quite burdensome</b>	5.8%	7.1%	6.2%
<b>An acceptable amount of time and effort required</b>	29.0%	39.3%	32.0%
<b>Routine and simple</b>	43.5%	46.4%	44.3%
<b>Almost entirely automated, very little effort</b>	18.8%	7.1%	15.5%
<b>TOTAL (%)</b>	71.4%	28.6%	100%
<b>TOTAL (number)</b>	70	28	98

Source: SKC survey

### 2.4.3 Higher take up among higher income earners

Participation in salary packaging arrangements occurs across a range of income cohorts in the NFP sector, for both full-time and part-time employees.

For example, Catholic Health Australia<sup>26</sup>, in its submission to the Henry Review in 2010, stated that the majority of employees who salary package are low and middle income earners, earning \$30,000-\$60,000 per annum.

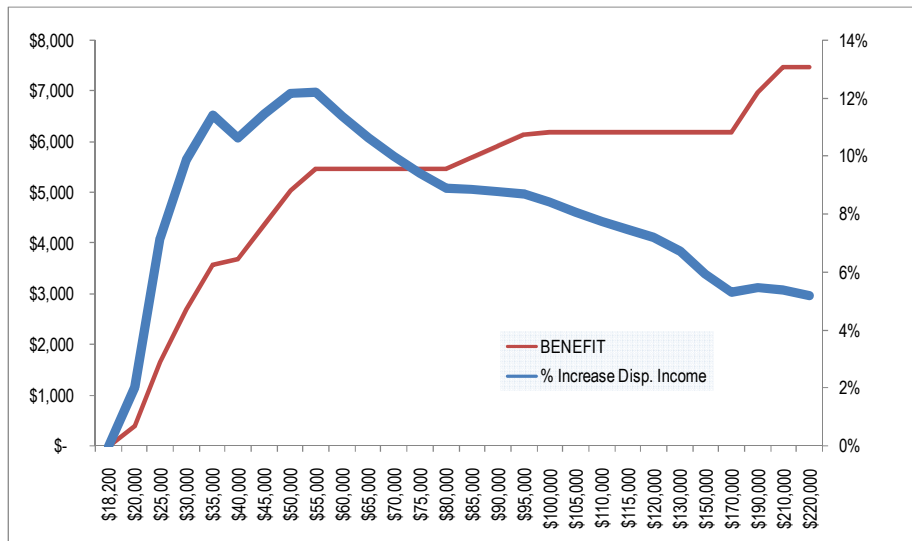
This correlates with our survey responses, with over **43 per cent** of employees who responded earning between \$31,200 and \$67,599 per annum.

<sup>26</sup> Catholic Health Australia, Submission to the Review of "Australia's Future Tax System" - (Henry Review), p5

Notably, more highly paid employees in the sector face higher marginal taxation rates meaning that FBT concessions have greater absolute value than at lower incomes. However, the concessions deliver the maximum benefit to low-to-middle income earners when expressed as a percentage increase in disposable income, therefore rating highly in terms of equity and fairness in our opinion.

As the following chart demonstrates, the maximum percentage increase (12%) in disposable income falls in the \$40,000-\$60,000 annual income bracket which is typical of the incomes derived in this sector (the IBIS World Industry Report X0021 Charities and NFP Organisations in Australia, October 2012, confirms that the average wage in the sector during 2011-12 was \$48,623 per employee):

**Exhibit 10: Absolute benefit and percentage increase in disposable income from salary packaging \$16,050 by level of taxable income<sup>27</sup>**



Source: McMillan Shakespeare Limited

<sup>27</sup> The equivalent non grossed up expenses amount for a GST free benefit payment (\$30,000 grossed up)

# 3. Analysis of Reform Options

## 3.1 Eligibility

**Option 3.1:** Should the list of entities eligible for the exemption or rebate be revised?

**Consultation questions:**

**Q 28** Assuming that the current two tiered concessions structure remains (see Part B), what criteria should determine an entity's eligibility to provide exempt benefits to its employees?

**Q 29** Also assuming that the current two tiered concession structure remains (see Part B), what criteria should determine an entity's eligibility to provide rebateable benefits to its employees? Should this be restricted to charities? Should it be extended to all NFP entities? Are there any entities currently entitled to the concessions that should not be eligible?

**Q 30** Should there be a two tiered approach in relation to eligibility? For example, should all tax exempt entities be eligible for the rebate, but a more limited group be eligible for the exemption?

**Response:**

The Working Group noted that some stakeholders question the current structure of eligibility for FBT exemptions and rebates as they apply to various categories of NFP organisations.

The NFP sector is not only large and diverse but has somewhat 'fuzzy' boundaries separating its various types of organisations. The diversity of services provided by NFP is illustrated by the fact that they range from the provision of emergency care to individuals and families at risk to the operation of clubs for entertainment and recreation.

The reasons that different types of organisations attract different concessions are both functional and historical. For example, the classes of NFP organisation eligible for PBI status are based on the preamble of the Charitable Uses Act 1601 ('Statute of Elizabeth'). The interpretation of 'benevolence' derived from the Statute of Elizabeth excludes activities that have evolved to be valued by the community, such as animal welfare, international aid and development, and the promotion of human rights. Accordingly, it could be argued that the current hierarchy of concessions does not fully reflect current community views about the merit and social worth of different activities and thus some form of review is necessary.

However, whilst it is inevitable that some degree of inconsistency will be present in any policy regime that requires definitions and cut-off points, we nonetheless contend that the general structure of benefits is a logical response to the functional roles that various NFPs take in the community. For example, benevolent institutions provide care to the neediest parts of the community and have very little, if any, opportunity to charge for services and accordingly attract the highest level of FBT concessions.

We hold the view that the current FBT concessions available for PBIs, public and NFP hospitals, charities, public ambulance services, religious institutions and other NFP entities are well founded, well understood and operate efficiently as intended given that the services these organisations provide create significant public benefit. Many of these services, if not provided by NFPs, would need to be provided by government almost certainly at greater cost (particularly considering the ability of NFPs to attract volunteer labour).

Significantly, the principles and policies that enable NFPs to access FBT benefits are long established and well embedded in sector practices. Any significant changes to the framework run the risk of unintended consequences. That is, any change needs to consider dynamic interactions between support measures, including potentially adverse effects on operational flexibility and social innovation.

Given these foundations as a backdrop, and in consideration of the nature and depth of the sector, including ongoing efforts to provide a statutory definition of a charity, we believe that there are other stakeholders who are more appropriately placed to provide authoritative comment on the issues raised in Questions 28 to 30 in the discussion paper.

To this end we note that there are a range of reforms currently before the NFP sector. Principally, this includes:

1. The assessment of charitable status will be made by a new statutory authority, the Australian Charities and Not-for-Profits Commission (ACNC)
2. From 1 July 2013, a new statutory definition of “charity” will be introduced by government

Whilst there may be a case for rationalising the number of categories of NFP organisations in relation to FBT concessions and in fact widening accessibility for the benefit of the sector and the wider community, provided that such a process would not reduce the level of entitlements that current NFPs can access, it is our view that the issues of eligibility and related criteria are more appropriately canvassed through existing statutory channels established by government and informed by the wider sector, outside of the Working Group. This will help to ensure that a consistent and informed view of definitional and eligibility aspects are contemplated and fully understood in the context of the wider sector and its ongoing sustainability.

## 3.2 Part A — Short-term reform options

**Option 3.2: Include meal entertainment and entertainment facility leasing benefits within the relevant caps**

### Consultation questions

- Q 31** Should salary sacrificed meal entertainment and entertainment facility leasing benefits be brought within the existing caps on FBT concessions?
- Q 32** Should the caps for FBT concessions be increased if meal entertainment and entertainment facility leasing benefits are brought within the caps? Should there be a separate cap for meal entertainment and entertainment facility leasing benefits? If so, what would be an appropriate amount for such a cap?
- Q33** Are there any types of meal entertainment or entertainment facility leasing benefits that should remain exempt/rebatable if these items are otherwise subject to the relevant caps?

### 3.2.1 General comments on salary sacrificed meal entertainment and entertainment facility leasing benefits

Salary sacrificed meal entertainment and entertainment facility leasing benefits are an integral feature in enabling eligible employers within the NFP sector to create an overall remuneration benefits package that is closer to private and related sectors income levels. These concessions go part way to offsetting inherent income disparities.

It is also important to note that working conditions such as the quality of workplace facilities, access to resources and workload dynamics often favour the for-profit sector. An example of this situation is public hospitals with ageing infrastructure and severe service delivery pressure as compared against for-profit hospitals that typically enjoy more modern facilities, better access to resources and less workload pressures driven by a more selective case mix.

We note from discussion and analysis with sector stakeholders, that whilst overall utilisation of these specific benefits remains relatively low with modest average expenditure, it is utilised by a cross section of employees and is particularly important for the engagement of highly skilled (and scarce) health professionals (e.g. surgeons, visiting specialists) who are generally the most difficult for the public and NFP health system to attract and retain.

These stakeholders also advised that some employers already place a voluntary cap on the use of these specific benefits by their employees. This is probably a reflection of the conservative nature of the sector.

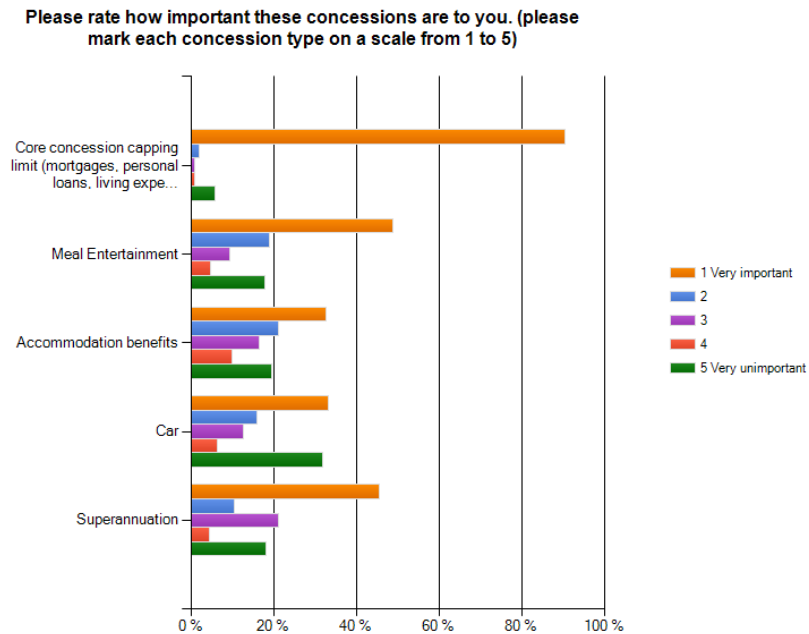
Analysis by McMillan Shakespeare of its customer database confirms relatively modest expenditure across these benefits, in comparison to the value derived for the NFP sector and the communities that they serve. McMillan Shakespeare's data set for the 2012 FBT year illustrates that the average expenditure for meal entertainment is approximately \$3,500 per annum. The average for entertainment facility leasing expenses is slightly less at \$3,200 per annum.

Whilst this data illustrates overall responsible use by employees who place high intrinsic value upon these benefit, we understand that pockets of behaviour exist which see use of these benefits outside the average.

Additional information on the importance of the concessions from employees' perspective was sought in our survey. Employees were asked to rate the importance of individual concession types on a scale from 'very important' to 'very unimportant'. The results are shown in **Exhibit 11**.



### Exhibit 11: Importance of particular concessions



Source: SKC survey

We believe that particular cases of higher use should not necessarily constitute a case for abandoning a concession that is otherwise fulfilling a demonstrable and tangible need across the NFP sector for a significant number of employees and their respective employer organisations. This is particularly the case when such instances can be dealt with via minor amendments to the existing concession framework, should it be deemed necessary.

An evidence-based approach to policy development requires that a quantitative assessment be made of the merits of a particular policy as a whole. Any policy will generate both positive and negative outcomes and the relative value of these outcomes to the public interest needs to be evaluated in a quantitative manner.

Critically, here we must ask whether the relatively small fiscal benefit to government generated through any significant change to the current operation of the meal entertainment and entertainment facility leasing benefits, outweighs the associated risk and disruption to the NFP sector, including potential loss of an important and entrenched attraction and retention tool, and the likely flow on cost inflationary and industrial pressures for the sector.

### 3.2.2 Q31 Should salary sacrificed meal entertainment and entertainment facility leasing benefits be brought within the existing caps on FBT concessions?

#### **Response:**

In effect, by collapsing these benefits into the core FBT concession this policy change would eliminate both concessions. Treasury estimate that yearly savings of \$100 million<sup>28</sup> would result from this reform. To place this saving in context it would represent 2.5 per cent of the quantified tax concession support received by the sector (\$4 billion<sup>29</sup>).

The key considerations and likely impacts are as follows:

- the fundamental role that the benefits play in attracting and retaining key skilled employees in the sector would be lost, thus impacting social welfare and a range of health programs
- wage demands, from various occupational groups, to 'compensate' lost entitlements. If NFP organisations sought to retain employees who had lost this benefit, they would need to increase their explicit remuneration. This would in turn create changes in remuneration relativities between employees within particular organisations and would likely lead to demands from employees who previously did not utilise these benefits. This is likely to result in new and significant compensation wage costs for the NFP sector, including flow on to other 'on costs' such as superannuation, workers' compensation and employment payment termination obligations
- any wage compensation increase, irrespective of how it is presented, is also likely to have flow on effects for related occupational groups

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<sup>28</sup> <sup>29</sup> TCWG discussion paper November 2012

In summary we suggest that these impacts are likely to mean that the financial impact on NFP organisations would be substantially greater than the lost value of the meal entertainment and entertainment facility leasing concession (and fiscal benefit to government). The projected savings of eliminating the meal entertainment and entertainment leasing benefits are, on balance, likely to be significantly smaller than the increased cost to the sector and government, and importantly the overall likely flow on impact to the sustainable delivery of services by the sector.

### 3.2.3 Q32 Should the caps on core concessions be increased if meal entertainment and entertainment facility leasing expenses are brought within the caps?

Note, we have answered question 32 in two parts below:

#### **Response – Part 1:**

Whilst taking the step of including meal entertainment and entertainment facility leasing benefits under the existing FBT capped core concessions, and increasing the capping level accordingly appears to have some benefits on the grounds of equity, it fails from an efficiency and cost to government perspective.

In terms of efficiency, the current FBT concessions regime enhances the ‘self-selection’ characteristic described in Section 1.5. Under this framework, concessions such as the meal entertainment and entertainment facility leasing benefits only have a cost to government for those individuals who determine that utilisation of these benefits is necessary in order to in part ‘bridge’ relevant and specific remuneration gaps.

Lifting the cap in this manner would unintentionally provide the opportunity for all eligible employees to increase the level of remuneration they sacrifice, rather than just the smaller subset of employees (i.e. notionally less than 20 per cent) who utilise the meal entertainment and entertainment facility leasing concessions.

We therefore contend that meal entertainment and entertainment facility leasing benefits should continue to stand alone, albeit with consideration of a suitable cap on employee use of the benefits in order to contain any unintended higher levels of use.

3.2.4 Q32 Should there be a separate cap for meal entertainment and entertainment facility leasing benefits? If so, what would be an appropriate amount for such a cap?

**Response – Part 2:**

Based on our research and analysis the extent of overuse of these benefits is exaggerated. We are however of the view that respective caps of \$10,000 grossed up (\$4,843 Type 1 GST inclusive actual expenditure) on each of the meal entertainment and entertainment facility leasing expense concessions should be implemented, including the application of indexation to the caps.

The expenditure should also be included in the employees Reportable Fringe Benefits Amount on payment summaries such that the value is taken into consideration for government social assistance payments. This preserves what is now a critical remuneration benefit for the sector, thus providing certainty, whilst acting to prevent overuse.

Lateral Economics have modelled the impact to tax revenue for the recommended capping of these benefits as shown below:

	Impact on 2013 revenue (\$m)	PV of 10 year revenue impact (\$m)
<b>Placement of a \$10,000 grossed up (\$4,843 Type 1 GST inclusive actual expenditure) cap on each of the meal entertainment and entertainment facility leasing benefit concessions</b>	<b>+90</b>	<b>+643</b>

Source: Lateral Economics modelling December 2012

Explanation of the modelling undertaken by Lateral Economics is contained within Appendix C.

3.2.5 Q33 Are there any types of meal entertainment or entertainment facility leasing benefits that should be remain exempt/rebateable if these items are otherwise subject to the relevant caps?

**Response:**

As already outlined, meal entertainment and entertainment facility leasing benefits play an important role in attracting and retaining key skilled employees in the sector. We believe there remains significant merit in the retention of these benefits, albeit with consideration of caps to prevent overuse. We contend that no other changes to these benefits warrant attention.

**Option 3.3: Require employment declarations to include information about FBT concessions to avoid employees from benefiting from multiple caps**

**Consultation question**

**Q 34** Should there be a requirement on eligible employers to deny FBT concessions to employees that have claimed a concession from another employer? Would this impose an unacceptable compliance burden on those employers? Are there other ways of restricting access to multiple caps?

**Response:**

We understand that some employees, as a result of being employed by multiple employers during the FBT year, are able to sacrifice benefits up to the relevant core concession caps with each employer.

We understand that the prevalence of employees claiming multiple caps is low. Based on 2012 FBT year data, we calculate this to be **1 per cent** of participants amongst McMillan Shakespeare contracts under management, which collectively represent circa 50% of the outsourced salary packaging administration market. Presumably this scenario is most likely to occur in the specialist health sector where demand for specific highly skilled labour services materially outstrips supply.<sup>30</sup>

In respect of the health sector it is however important to note that in all states other than Victoria an employee cannot access multiple caps within the public health system, as there is a single employer for FBT purposes. It is however possible to access multiple caps by working within a public hospital and a NFP hospital or a PBI.

As a result such labour can often be spread across multiple organisations that pragmatically must 'fight' to secure such services. This is particularly challenging when the NFP sector is competing with the resource capacity of the for-profit sector. Under such circumstances the ability for the specialised employee to salary sacrifice further benefits can be one of the important attractor determinants.

Whilst prima facie the ability to benefit from multiple caps applications would appear to raise issues of equity and fairness, we question the importance of such services to the NFP sector, the impact denial of multiple caps would produce for particular NFP organisations/providers and whether the associated administrative and compliance costs outweigh the fiscal benefits to government.

Consideration of these questions aside, we believe that a move to a requirement on eligible employers to deny FBT concessions to employees that have claimed a concession from another employer would place an unreasonable administrative impost on employers given their inability to meaningfully substantiate other employment and associated FBT benefit receipt.

In summary it is our view that administrative costs and complexity outweigh any benefits which would be derived by implementing this policy.

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<sup>30</sup> <http://ausmed.ama.com.au/severe-shortage-gps-and-other-specialists-looms>  
<http://au.news.yahoo.com/thewest/a/-/newshome/13347982/crisis-looms-over-lack-of-specialist-doctors/>

**Option 3.4: Align the rate for fringe benefits tax rebates with the fringe benefits tax rate of 46.5 per cent**

**Consultation question**

**Q 35**            **Should the rate for FBT rebates be re-aligned with the FBT tax rate? Is there any reason for not aligning the rates?**

**Response:**

The FBT rebate was announced in December 1992 by the then Federal Treasurer to "ensure that the amount of FBT payable by eligible organisations after April 1994 will be similar to that due under the current structure of the FBT".

Therefore, the rebate was to compensate eligible entities for the "gross-up" mechanism, which commenced 1 April 1994. As such, logically, we can see no meaningful reason as to why the FBT rebate should not be reduced to a rate of 46.5 per cent.

**Option 3.5: Align the minor benefit exemption with the commercial sector**

**Consultation question**

**Q 36**            **Should the limitation on tax-exempt bodies in the minor benefits exemption be removed? Is there any reason why the limitation should not be removed?**

**Response:**

The explanatory memorandum to the Fringe Benefits Tax Assessment Act 1986 discusses the rationale behind excluding tax-exempt bodies from the minor benefit exemption for entertainment expenses, on the basis that these expenses are personal in nature.

For tax-paying entities, a "penalty" still exists in the form of a denied income tax deduction. This penalty does not exist for tax-exempt entities.

Given the marginal difference and the limited extent of entertainment benefits for non-tax-exempt entities (note: salary sacrifice meal entertainment is already excluded from the minor benefit exemption due to the reward for service exclusion), we contend that this change could potentially be supported under a goal of simplicity.

### 3.3 Part B — Long-term reform options

<b>Option 3.6:</b>	<b>Phase out capped FBT concessions and replace with alternative government support</b>
<b>Consultation questions</b>	
<b>Q 37</b>	<b>Is the provision of FBT concessions to current eligible entities appropriate? Should the concessions be available to more NFP entities?</b>
<b>Q 38</b>	<b>Should FBT concessions (that is, the exemption and rebate) be phased out?</b>
<b>Q 39</b>	<b>Should FBT concessions be replaced with direct support for entities that benefit from the application of these concessions?</b>

#### 3.3.1 Q37 Is the provision of FBT concessions to current eligible entities appropriate? Should the concessions be available to more NFP entities?

**Response:**

Please refer to our previous response in Section 3.1.

#### 3.3.2 Q38 Should FBT concessions (that is, the exemption and rebate) be phased out?

**Response:**

It is clear from our research evidenced in this paper that such a reform would cause material harm to the sector. The concessions not only provide the sector with critical financial support but do so in a way that provides NFP organisations with flexibility, certainty and autonomy; all of which are highly valued by a sector facing challenges on many fronts.



The role and significance of FBT concessions has been emphasised repeatedly in this document. FBT concessions are deeply embedded in the expectations, practices and systems of the NFP sector, a point reinforced by the Productivity Commission and the Henry Tax Review. To reiterate:

- the FBT concessions are regarded by managers as critical to their ability to attract and retain staff
- the FBT concessions only go part way to bridging the remuneration gap between the NFP and the for-profit sectors
- the concessions are highly valued by employees, above their pure monetary equivalent
- there is a real risk that significant numbers of employees would leave the sector if the FBT concessions were eliminated

Given the high level of support for the current FBT concessions framework, we believe that unless there is a high level of confidence from the sector in an alternative benefit delivery mechanism based on it being more efficient, simpler and cost neutral, then the FBT concessions regime should remain in place.

### 3.3.3 Q 39 Should FBT concessions be replaced with direct support for entities that benefit from the application of these concessions?

**Response:**

In theoretical terms a system of direct support to NFP organisations commensurate with value of the FBT concessions, both now and into the future, would be a sensible alternative provided that the positive administrative characteristics of the current system were effectively retained, that certainty for NFP organisations was maintained and the funding envelope was not increased in net terms<sup>31</sup>.

Our research and modelling suggests that this is simply not achievable. As we detail below and in response to question 40, the alternative administration systems have numerous downsides, both practical and financial, and are strongly opposed by the sector.

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<sup>31</sup> NFP Sector Tax Concession Working Group terms of reference “The Working Group will identify offsetting budget savings from within the NFP sector for any proposals that have a budget cost.”

In responding to this question it is important to consider the effectiveness of the current system so as to determine what improvement opportunities might exist. The central thrust of this paper has been that the FBT concessions are, in fact, an efficient mechanism to deliver required support to the NFP sector. The fundamental elements that support this position are as follows:

- The administrative cost is around 5 per cent of the financial benefit derived by the employee. This figure is relatively, low; it has fallen significantly over in recent years down from an average fee of around \$350 eight years ago to less than \$160 today.
- The vast majority of the delivery costs of the FBT concessions are generally borne by the end recipient being the employee; not government nor the employer
- More than **91<sup>32</sup>per cent** of employers surveyed believe that there is an acceptable level of effort or virtually no work at all associated with delivering these benefits. The survey results indicate that there is virtually no difference in this opinion between companies employing third party administrators and those who self-administer
- The FBT concessions framework is a known quantity for NFP organisations allowing them to effectively structure their remuneration practices and plan for the future on firm ground. This is not the case with alternative delivery mechanisms as we discuss below.

On the measures of cost effectiveness and alignment to the sector's needs, it is difficult to argue that a significant opportunity exists to deliver material benefits by reforming the current FBT concessions delivery system. The widespread and forthright opposition from the sector to such a reform and the lack of a sector sponsored alternative in our mind supports this view. This is in contradiction to the demands of the private sector to simplify unrelated aspects of FBT administration.

Having regard for the effectiveness of the current system and the government's requirement that an alternative delivery system be cost neutral<sup>33</sup>, it is our contention that the current system remains a superior option.

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<sup>32</sup> SKC Survey Nov 2012

<sup>33</sup> NFP Sector Tax Concession Working Group terms of reference "The Working Group will identify offsetting budget savings from within the NFP sector for any proposals that have a budget cost."

### 3.3.3.1 Are direct grants more administratively efficient?

It is claimed by some stakeholders that direct grants are preferable to tax based support because their administrative costs are lower. This claim, however, is difficult to quantify and few efforts have been made to do so. As argued elsewhere in this document (See Section 2.4.2), the costs associated with FBT concession salary packaging are well known and moderate whereas the administration costs associated with grants are unknown. As discussed in the Lateral Economics report<sup>34</sup>:

*Generally the cost of administering an employee's salary packaging on behalf of their employer by an outsourced specialist company is around \$160.00 per annum. This equates to around 1 per cent for charitable employees or 1.75 per cent of the salary packaging value for a NFP Health Care employee. However the correct measure is probably the cost of administering the concession compared with the after tax benefit of the concession which produces costs of around 5-8 per cent of the employee benefits generated.*

It is far from clear that were a system of direct grants to be used to deliver support to the NFP sector that such a mechanism could operate at a cost comparable to the FBT concessions. Government must administer grants and the Commonwealth's own 2008 *Strategic Review of the Administration of Australian Government Grant Programs*<sup>35</sup> concluded that:

*Major issues and criticisms raised in the ANAO's reports have included deficiencies in the application of the financial framework governing the expenditure of public money; weaknesses in program planning, design and decision-making processes; deficiencies in program guidelines; flaws in procedures for selecting grant recipients and projects, and a more general lack of transparency; a lack of effective documentation, especially of the reasons for key decisions; weaknesses in funding agreements, including a lack of clarity as to the roles and responsibilities of different parties; a lack of effective oversight of funded projects; and major weaknesses in performance monitoring, evaluation and accountability arrangements.*

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<sup>34</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 36

<sup>35</sup> Commonwealth of Australia, Department of Finance and Deregulation, *Strategic Review of the Administration of Australian Government Grant Programs*, 2008, p8.

Such conclusions indicate that a substantial level of scepticism would be appropriate when contemplating the potential efficacy of grants based delivery mechanisms.

Consideration of administration effort by government agencies in managing grants illustrates why this process can be so costly. Over the grants life cycle, government bodies are expected to develop criteria and advertise programs, submit or receive applications, evaluate proposals, inform successful and unsuccessful applicants, create and implement contracts between the grants body and recipients, manage payment schedules, check on progress and ensure adequate reporting and governance.

Organisations receiving grants also face significant compliance and management costs. Many if not most grant-based organisations have inadequate reporting and tracking systems and processes to fulfil the criteria for grants. For example, the Australian National Audit Office found that the IT systems of the National Health and Medical Research Council did not adequately support grants of millions of dollars in research funds.

The administration and technology/systems burden placed upon those organisations receiving grants is substantial. On the other hand, those organisations accessing legislated FBT concessions have well developed systems and processes that require minimal management and intervention and are very cost effective.

Current salary packaging arrangements are delivered at known cost because they have been in existence for a significant period of time and systems have been developed to administer and deliver the benefits efficiently. The third party market for providing these services is a competitive one and there is evidence that the costs of third-party delivery of salary administration are subject to robust competitive pressures. This would not be the case of the costs of government delivery of direct grants.

In addition, it is important to recognise that employees themselves generally bear the costs of administration and make their own decisions about whether it is in their interests to access the concessions based on their personal circumstances. Thus, again, the 'self-selection' principle operates – only those employees who decide they need the concession to remain in the NFP sector access the concession. Also, under a system of direct grants the burden of administrative costs would shift from the recipient to government. These considerations suggest that costs to the government and taxpayers are likely to increase under a system of direct grants that deliver commensurate support to the NFP sector.

### **3.3.3.2 Risk and uncertainty associate with direct grants**

NFP organisations would also face ongoing risk and uncertainty about whether grants would be approved and at what level. Such uncertainty would make long-term investment planning problematic and create an environment in which long-term contract creation with key personnel more difficult and risky, potentially reducing the attractiveness of the NFP sector to more highly qualified and skilled employees.

We must remember that the FBT concessions target employment expenses, that is fixed and variable operating costs of organisations within the sector. These costs cannot be made subject to the whim of government; otherwise material industrial unrest is likely to occur together with significant uncertainty for the sector.

Another concern with direct grants is that they introduce the potential for administrative influences in the allocation of funding. Such influences add another layer of risk and uncertainty for NFP organisations and arguably reduce the independence of NFP organisations.

### **3.3.3.3 FBT concessions are widely supported by NFPs; grants are not**

To reiterate, all parties in the discussion are agreed that support to the NFP sector from government is necessary and that criticisms of FBT concessions are generally not related to the rationale of such support. Given this is the case; it should be cause for concern for the proponents of direct subsidies that there is

virtually no support for these mechanisms in the NFP sector itself. As the Lateral Economics report<sup>36</sup> noted:

*It is important to point out, however, that stakeholders were unanimous in emphasising strongly the importance of this kind of independence in the day-to-day operations and in being able to determine the strategic directions of their organisations.*

*These strongly voiced concerns should not be dismissed lightly and it is far from obvious that they should be dismissed in favour of gains which are hypothetical, not-quantified and are argued for from exclusively theoretical considerations.*

The comment below from the Salvation Army<sup>37</sup> is characteristic of such concerns:

**THE SALVATION ARMY**

*The Salvation Army does not believe it would be possible to adequately perform the current services it provides if it were required to petition/apply to Governments for funding that is intended to compensate The Salvation Army for forgoing taxation concessions (of any kind). The Salvation Army believes such a system would be inefficient and result in increased administration costs and not be of any overall benefit to the Australian public.*

In the survey of NFP employers respondents were posed the following question:

*In some recent discussions of policy in support of the NFP sector, alternative support mechanisms to replace the current FBT concessions have been canvassed. One of the alternatives raised is a system of direct funding grants to NFPs, made for a specified term following an application to Government. If such a grant scheme replaced existing FBT concessions and delivered funding equivalent to FBT concessions, which of the following do you think best describes the likely impact on the NFP sector:*

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<sup>36</sup> Lateral Economics, The case for retaining FBT concessions for Not-for-Profit Hospitals/Aged Care and Public Benevolent Institutions (Charities), April 2010, p. 40

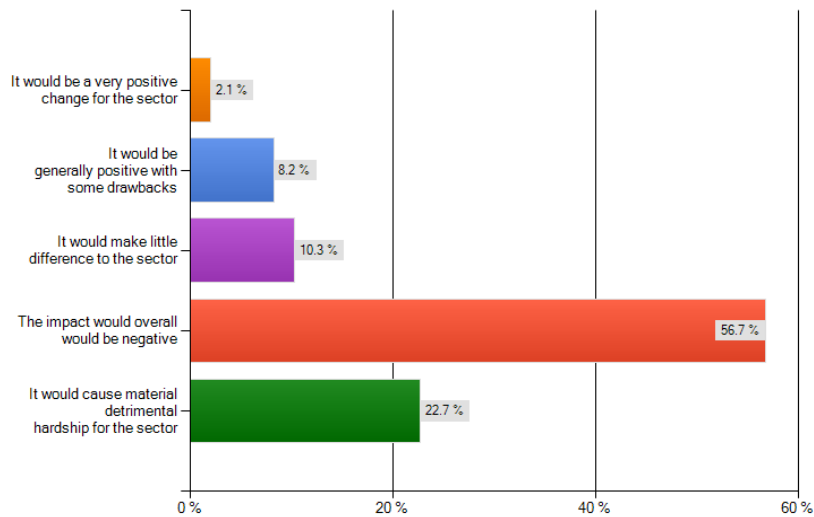
<sup>37</sup> Ibid, p40

The responses shown in **Exhibit 12** further indicate that NFP organisations remain highly sceptical about the benefits and operation of direct grants. Only **8.2 per cent** of organisations in the SKC survey expressed the view that it would be ‘generally positive with some drawbacks’ and **2.1 per cent** said it would be a very positive change for the sector’. This response may be because NFP managers highly value the independence and certainty that comes with the FBT concessions and, as most of them are highly experienced in grant application processes, they believe a shift from FBT concessions to grants would be significantly more costly than beneficial.

Finally, any policy change carries with it risks of unexpected transition costs and unintended consequences. Nonetheless, in cases where policies are clearly and demonstrably failing, policy change is justified. We contend that the FBT concessions are demonstrably not such a case.

### Exhibit 12: Impact on the NFP sector of a shift to direct grants

In some recent discussions of policy in support of the NFP sector, alternative support mechanisms to replace the current FBT concessions have been canvassed. One of the alternatives raised is a system of direct funding grants to NFPs, made for a specified term following an application to Government. If such a grant scheme replaced existing FBT concessions and delivered funding equivalent to FBT concessions, which of the following do you think best describes the likely impact on the NFP sector:



Source: SKC survey

**EMPLOYER SURVEY RESPONSES:  
GRANTS AS ALTERNATIVE TO FBT CONCESSIONS**

*“The current FBT system is simple to manage and employees are able to opt in/out as desired. A system of grants would come with compliance salary issues particular in administering and negotiations with unions for applicable clauses in enterprise agreements.”*

*“Would be replacing a system that is established with one that has less certainty (direct funding, application process, specified term) impacting negatively on workforce planning. Would also be introducing a system which would require greater resources for the purpose of assessment, compliance, preparation of applications, etc, for both government and the organizations impacted.”*

*“Funding grants are here today, gone tomorrow. Not reliable. Stay with the FBT concessions.”*

*“Fixed term funding would mean that NFP would restrict their planning cycles thus diminishing long term programs.”*

*“Government cannot be trusted to maintain funding, at least now it is legislated.”*

*“Grants have enormous red tape linked to them, the admin burden would be high, the provision of grants are uncertain we would need to tell staff their salaries could not be certain at that level and if the money dried up staff cuts would be necessary. Recruitment and retention would be a nightmare.”*

*“The current FBT system is simple to manage and employees are able to opt in/out as desired. A system of grants would come with compliance salary issues particular in administering and negotiations with unions for applicable clauses in enterprise agreements.”*

*“Fixed term funding would mean that NFP’s would restrict their planning cycles thus diminishing long term programs.”*



### 3.3.3.4 Potential for flow on effects and additional costs to Government

One of the most fundamental and important differences between the FBT concessions and a grants system is the coverage of employees. Whereas somewhere between 30 and circa 50 per cent of eligible employees access the FBT concessions, there would be pressure for the benefits derived from grants to be spread across all employees. This is because the benefit would be part of every employee's core remuneration rather than a tax concession. This would disrupt current pay relativities, require award change and have additional cost and flow on effects. These points were made in KPMG's report for Catholic Health Australia.<sup>38</sup> KPMG pointed out that replacing FBT concessions with direct grants could have a number of adverse effects:

- *The funding for PBIs and public hospitals will be required to pass on the additional funding to equivalent to the current FBT concessions for each employee*
- *May cause wages pressure in other sectors. (Police, Education) private sector, for profit private health.*
- *Increased costs to employers e.g. additional superannuation and other costs*

The KPMG report also predicted that: *"direct funding will conservatively cost the government an additional \$2.2 billion annually above and beyond the current cost of the FBT concessions provided for by the government."*

These comments illustrate the equity efficiency trade off described elsewhere in this document. Government can target benefits to those employees who require incentives to participate in the NFP sector where incomes are generally lower. This is what the FBT concessions achieve. The alternative is to distribute the benefit to all employees in the sector. This, however, is likely to decrease the average benefits to those employees currently salary packaging under FBT concessions which risks losing them from the NFP sector. If the government wants to raise incomes to all employees *and* maintain higher benefits to higher skilled and qualified personnel it will face significantly inflated levels of expenditure.

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<sup>38</sup> KPMG, Concessional Tax Benefits to Not-For-Profit Hospitals and Aged Care Services, 19 November 2009.

**Option 3.7: Phase out fringe benefits tax concession and replace with alternative tax-based support mechanisms for eligible not-for-profit entities**

**Consultation question**

**Q 40 Should FBT concessions be replaced with tax based support for entities that are eligible for example, by refundable tax offsets to employers, a direct tax offset to the employees or a tax free allowance for employees?**

**3.3.4 Q 40 Refundable tax offsets payable to eligible entities**

**Response:**

In relation to a refundable direct tax offset for employers as outlined in the discussion paper, it is unclear as to what payments of tax such an offset would be directed towards as the vast majority of NFP organisations accessing the concessions are exempt from income tax and most State and Territory taxes.

That issue aside, this scheme would mean that any benefit flows directly to the employer, similar to that of a direct funding grant, and accordingly producing many of the undesirable consequences of such a scheme. Furthermore, the employer would have discretion as to how to disburse the benefit to employees and therefore there can be no guarantee that such a scheme would be more equitable than the FBT concessions.

If the funding envelope is the same it is difficult to see what the merits of such a system are. In order for the employer to increase the benefit allocation to a particular employee or group of employees other employees must have their benefit reduced. By necessity such a reduction would likely occur in the \$20,000-\$60,000 income brackets due to the distribution of current benefit concessions which are concentrated in this grouping.

Such a scheme is not likely to be simpler to operate than the FBT concessions. As discussed in section 2.4, FBT compliance processes are largely automated and employers overwhelmingly state that compliance costs are not excessive.

To manage a refundable tax offset program employers would need to record and report numbers of employees, devise policies and mechanisms to disperse the benefit to employees and manage disputes about such disbursements. Such processes could easily become more expensive than FBT concession compliance management.

Probably a more important problem, however, is that under this scheme the employer may elect to be selective in terms of their allocation of the benefit. This would disturb existing relativities between various types of employees in the NFP sector and would likely result in industrial claims by employees who were not awarded additional payments by their employer.

This could mean, in effect, a general increase in wage demands throughout the sector, which would likely put NFP organisations under significant financial pressure.

Such changes would also likely create pressure to change existing award structures and potentially lead to other industrial relations issues which in all likelihood would flow on into the for-profit and government sectors and lead to increased costs there. As our survey shows, **47%** of employees would consider leaving the sector if there was a material reduction in their current fringe benefits without equivalent compensation.

In addition to these outcomes, the refundable tax offset proposal has a number of undesirable characteristics, in addition to those inherent within direct funding grants.

NFP organisations face the risk that government would make variations to the level of payment per employee with the potential value of \$2,800 quoted in the Working Paper only being the starting point for such a scheme.

The question as to what extent this payment would be indexed also arises. Any failure to index would obviously erode the real value over time.

In addition, the refundable tax offsets proposal would have an inherent dynamic *inefficiency* compared with the FBT concession because it would not facilitate changes to the mix of skills within NFP organisations.

For example, a particular NFP organisation may make a strategic determination to change its service delivery mix to address a market need. It may be that this change in service delivery mix requires a higher proportion of skilled personnel.

Under an FBT concessions regime it is able to create remuneration packages to attract such staff. Under a refundable tax offsets scheme it would be constrained with the blanket solution of a uniform payment per employee, which may not be competitive. Or as discussed above, some portion of benefits would be taken from other staff in order to give the 'sought after' employee a higher benefit value.

These points again highlight that NFP managers are dependent upon flexibility, certainty and autonomy, and is a factor as to why they express such a strong preference for the FBT concessions.

### 3.3.5 Q40 Direct tax offset / tax allowance for employees of eligible entities

#### **Response:**

The first question in considering the impact of this benefit delivery system is whether the offset would be applied to all NFP employees or only those currently salary packaging under FBT concessions.

#### 3.3.5.1 If all eligible employees were to receive a benefit

If all employees were to qualify and the costs to government were to be held constant this would necessarily mean a significant decrease in the size of the benefit received by current recipients. For example, at the current participation rate in salary packaging across PBIs and public/NFP hospitals this would impact circa **400,000 employees**.

The alternative scenario is that all eligible employees receive the value of the benefit as per current recipients. This would dramatically increase the cost to government.

PWC have modelled (appendix D) the financial impact as follows:

#### **SCENARIO A. – CURRENT TOTAL COST HELD CONSTANT**

In order to satisfy the **no net cost to government** term of reference in the discussion paper, the current total value of FBT concessions would need to be spread across **all** eligible employees in the NFP sector, rather than just those employees who currently participate in salary packaging.

We note that ATO statistics (2011/12) utilised by PWC in their modelling, as contained in appendix D, indicate that some 34.2 per cent of eligible PBI employees and 52.7 per cent eligible employees in the public/NFP hospitals sector currently participate in salary packaging. McMillan Shakespeare notes that the average salary packaging employee participation rates across its client base are materially higher than that indicated by the ATO.

Importantly, PWC estimate that in order to satisfy the no net cost to government requirement, this would result in a reduction in the net benefit amount to **each employee currently salary** packaging as follows:

- a reduction of around **\$5,000 for each employee in the PBI sector** - representing a 66 per cent decrease in the current benefit they receive, and
- a reduction of around **\$2,000 for each employee in the public / NFP hospitals and ambulance services sector** - representing a 47 per cent decrease in the current benefit they receive

All up, such a reform would impose a detrimental impact to around **400,000 employees** in the NFP sector.

#### **SCENARIO B. – CURRENT BENEFIT VALUE PER EMPLOYEE HELD CONSTANT**

PWC estimates that:

- if the participating employees in the PBI sector were to be not disadvantaged *and* the current average level benefit level of \$7,601 were to be applied to non-participating employees (i.e. all employees in the sector), then the extra cost to government would be circa **\$1.4 billion per annum**, and

- if the participating employees in the public / NFP health sector were to be not disadvantaged *and* a benefit of \$4,216 were to be paid to non-participating employees, then the extra cost to government would be circa **\$700 million per annum**.

The combined cost to Government across the sector is estimated to be circa **\$2.1 billion per annum**.

Providing an equal benefit through a tax offset is a solution that is skewed heavily towards the equity side of the efficiency equity trade-off.

There is no escaping the fact that meeting efficiency and equity goals simultaneously will require a significant increase in government expenditure. Achieving an equity objective by providing an equal benefit to all NFP employees will particularly alienate employees who currently rely on the level of benefit they derive from FBT concessions, and, based on survey results, will in all likelihood lead to a material exodus of such employees from the sector.

Again, this scheme also does not provide NFP organisations with the flexibility and autonomy that they need to effectively deliver services.

As in the previous example, this scheme would also disturb existing wage relativities and probably require significant industrial relations changes and these would flow on to the for-profit and government sectors.

### 3.3.5.2 If only currently participating employees were to receive a benefit

It is difficult to see how this variation of the direct tax offset would operate in practice. If only currently participating employees were eligible then how would new employees be attracted to the sector and how do organisations address growth in their staff numbers? This approach would not achieve any equity goal except among the participating employees who would now move from a situation where packaging and remuneration were determined on a case-by-case basis to one where the benefit was equal for each participating employee. Inevitably, some would be worse off and some would be better off and those that were in the later category might leave the NFP sector.

Again, this would remove the self-selection mechanism that is at the core of the FBT concessions and eliminate its efficiency benefits. This variation would also disturb existing relativities and likely require significant award and other industrial relations changes.

### 3.3.5.3 Other issues

There is also the question of timing for the receipt of benefits and how that may change, particularly under a tax-offset model. In order for a tax offset method to not negatively impact the timing of the benefits received by the employee, a tax instalment variation arrangement would need to be established with its own administrative costs on the organisation and employees.

The government's liability for social assistance payments is likely to increase under both the tax offset and the tax-free allowance regimes. This is because the grossed-up value of most fringe benefits is currently included in the assessment of income for various Commonwealth social assistance payments; whereas tax-free allowances or offsets currently have no equivalent gross-up process (i.e. they are not typically captured in the employee's payment summary). This issue would likely require changes in reporting arrangements to ensure that unintended increases to social assistance benefits do not occur.

There are a number of other downstream impacts to related areas, such as superannuation payments, payroll tax, workers' compensation and employment termination and redundancy obligations. These would require examination for unintended consequences resulting from the implementation of a tax offset or tax-free allowance regime.

It needs to be emphasised that all of these alternative tax-based systems represent fundamental departures from the existing systems and practices. Such radical change implies significant and, to some degree, unknown costs and risks, particularly in the notoriously difficult and expensive information technology arena.

**Option 3.8: Limit concessions to benefits that are incidental to employment**

**Consultation questions**

**Q 41 Should FBT concessions be limited to non-remuneration benefits?**

**Response:**

This option appears to be somewhat of a ‘reoccurrence’ of themes raised in previous sections of the discussion paper whereby the continuance of the FBT regime has been placed in question. Given that such a proposition has already been canvassed and addressed in detail, we query the intent of question 41 and whether in fact the Working Group meant this question to address something else entirely. If so, the Working Group may need to consider whether public clarification is necessary as this question may have been misinterpreted by respondents.

That being said, our response to question 41 (as it stands) is that by limiting the FBT concessions to non-remuneration benefits government would effectively be withdrawing this funding support to the sector. This would contravene the Government’s stated position in response to the Henry Review recommendations *"In the interests of business and community certainty, the Government advises that it will not implement the following policies at any stage.....do any changes to the tax system that harm the not-for-profit sector, including removing the benefit of tax concessions."*<sup>39</sup>

The sector is already under enormous pressure with rapidly increasing demand for services, government funding constraints and reducing private donations (down 6.3% in 2009/10<sup>40</sup>). As we have identified and articulated consistently throughout this paper, the ability to attract and retain staff would be materially impacted, a mass exodus of staff would likely occur, ultimately leading to a material and potentially non reversible reduction in the breadth, depth and quality of services delivered which can only be to the significant detriment of the wider community.

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<sup>39</sup> Commonwealth Government’s response on 2 May 2010 to the Australia’s Future Tax System Review

<sup>40</sup> ATO Tax Statistics [http://www.ato.gov.au/content/downloads/cor00305922\\_2010CH10CDG.pdf](http://www.ato.gov.au/content/downloads/cor00305922_2010CH10CDG.pdf)



## 4. References

Catholic Health Australia, Submission to the Review of "Australia's Future Tax System" - (Henry Review).

Frey, B. and Goette, L. (1999) 'Does Pay Motivate Volunteers,' Institute for Empirical Research in Economics, *University of Zurich, Working Paper Series*, Working paper No. 7.

Frey, B. (2008), 'Motivation crowding theory – a new approach to behaviour' in Productivity Commission, 2008, *Behavioural Economics and Public Policy*, *Proceedings of a Roundtable in Melbourne 8-9 August 2007*. p. 37-54.

KPMG (2009), Concessional Tax Benefits to Not-For-Profit Hospitals and Aged Care Services, report for Catholic Health Australia.

Mason, A., Street, A., Miraldo, M. and Siciliani, L (2009), Should prospective payments be differentiated for public and private healthcare providers? *Health Economics, Policy and Law* 4:383-403 Cambridge University Press

Not-for-profit sector tax concession Working Group, discussion paper, November 2012.

The Productivity Commission, Contribution of the Not-for-Profit Sector, Productivity Commission Research Report October 2009.

Submissions to the Productivity Commission:

- Epworth HealthCare
- Friendly Society Private Hospitals
- The Church of Jesus Christ of Latter-Day Saints
- Uniting Care Australia
- The Salvation Army

Appendix: A

Comparative table of hospital services



# Appendix: B

## Survey of NFP employers and employees

Systems Knowledge Concepts Pty Ltd, a leading economic analysis consultancy, was engaged to conduct a survey of employees and employers in the not-for-profit (NFP) sector.

The objective of the survey was to learn more about the role that Fringe Benefit Tax (FBT) concessions play in supporting NFP organisations and their employees.

The survey was conducted over a two-week period from 16 November to 30 November 2012.

A total of 3,223 employees from a broad range of NFP organisations across Australia completed the survey.

A total of 102 NFP employers from a similarly broad range responded to the survey. These organisations represent over 60,000 employees in the sector.



# *systems knowledge concepts*

## FBT concessions for the NFP Sector survey of **employer** sentiment

### Summary of survey results

5 December 2012

Prepared for	McMillan Shakespeare Ltd
Contact	Simon Molloy Managing Director
Team	Simon Molloy Leanne Buller

# 1 Summary of survey results

## Introduction

Systems Knowledge Concepts Pty Ltd, a leading economic analysis consultancy, was engaged to conduct a survey of employers in the not-for-profit (NFP) sector.

The objective of the survey was to learn more about the role that Fringe Benefit Tax (FBT) concessions play in supporting NFP organisations and their employees.

The survey was conducted over a ten day period from 20 November to 30 November 2012.

A total of **102 employers** across the NFP sector completed the survey.

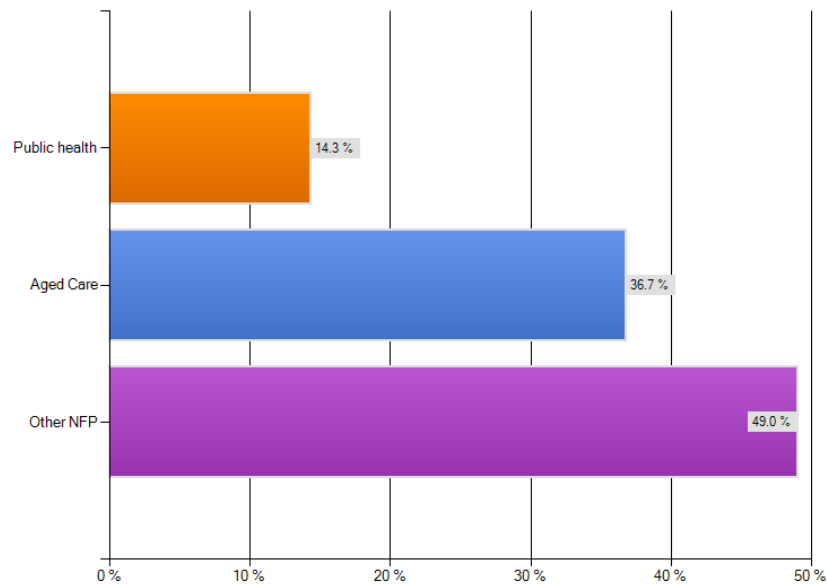
## Summary of key questions

This document provides a summary of responses to questions which are of most relevance to understanding the role of FBT concessions in the NFP sector. Accordingly not all questions and their responses are re-produced in this summary.

Verbatim answers to questions 14 and 15 have not been included in this document so to ensure that individual organisations cannot be identified from the content of the responses received.

## Question 1

Which part of the NFP sector does your organisation operate in?



## Question 2

**Approximately how many people are employed in your organisation (on any basis: full-time, part-time or casual)?**

99 organisations answered the question. The average number of employees per organisation was 610 representing a total of 60,411 employees.

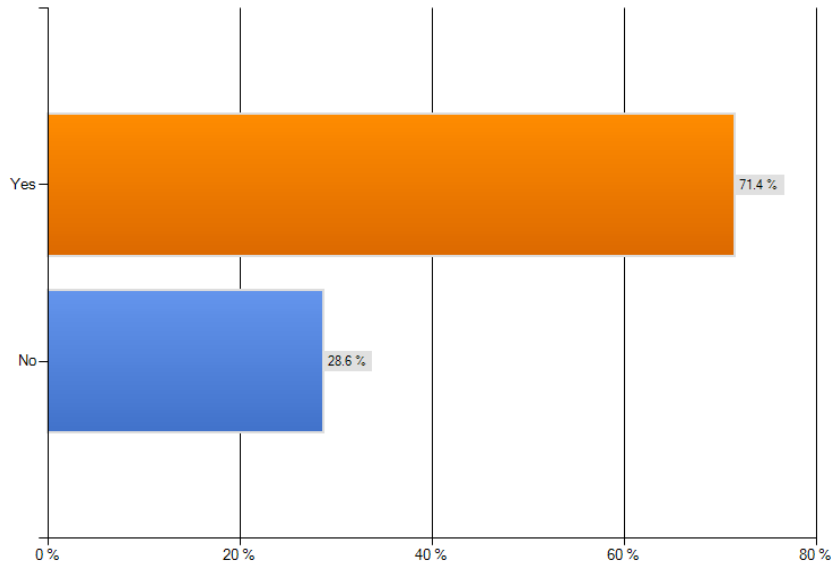
## Question 5

**Approximately what percentage of your employees make use of salary packaging arrangements courtesy of FBT concessions?**

99 organisations answered the question. The average response was that 58.39% of employees make use of salary packaging arrangements.

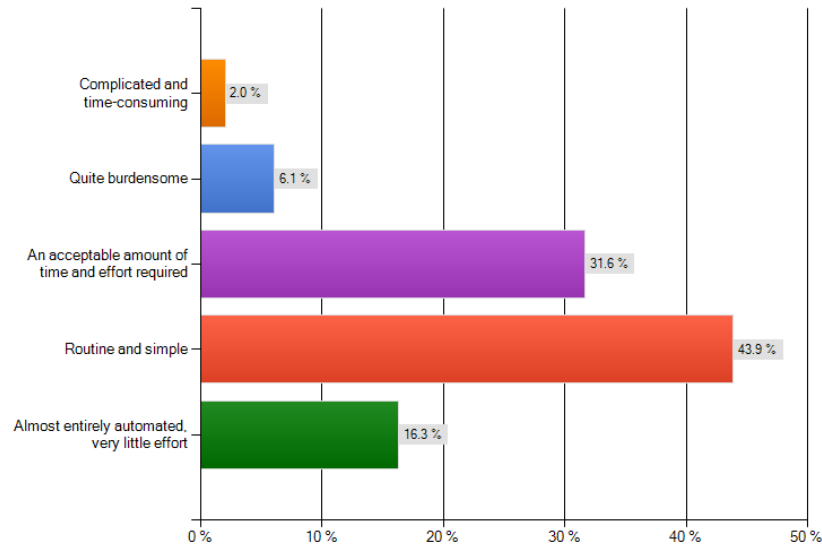
### Question 6

Do you have professional assistance, that is, a third party salary packaging administrator/company, to help your organisation manage the provision of FBT concessions?



### Question 7

From your own perspective, that is, the employer, which of the following best describes the ongoing administrative effort associated with managing the use of salary packaging enabled by FBT concessions?

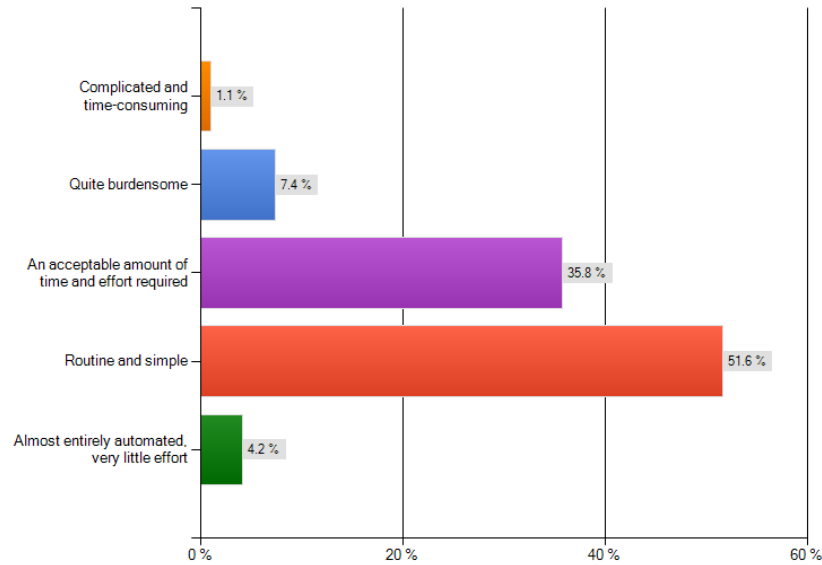


**SKC takeout from Q7: for 91% of employers, the effort to administer FBT concessions is either acceptable or minimal**



### Question 8

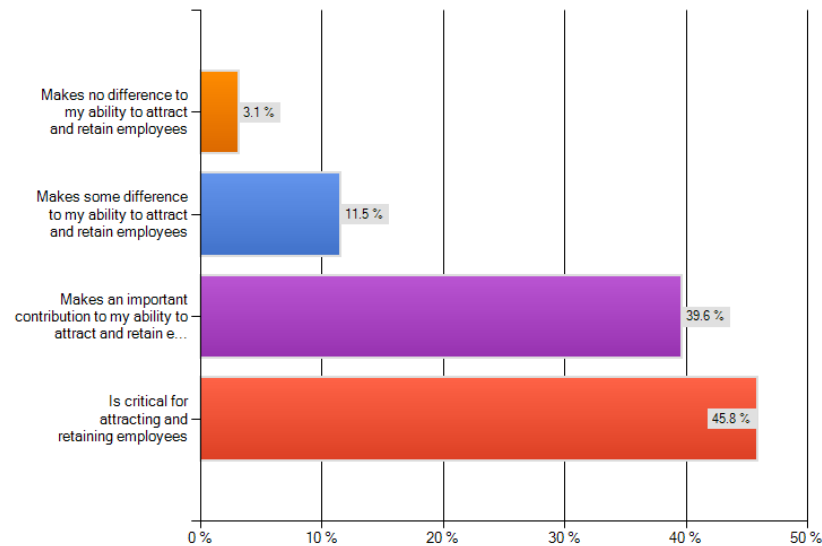
What about the start-up arrangements associated with setting up salary packaging arrangements (enabled by FBT concessions) for a new employee? For you, as the employer, are they:



**SKC takeout from Q8:** for more than 90% of employers, the effort associated with setting up salary packaging arrangements for a new employee is either acceptable or simple/very little effort

### Question 9

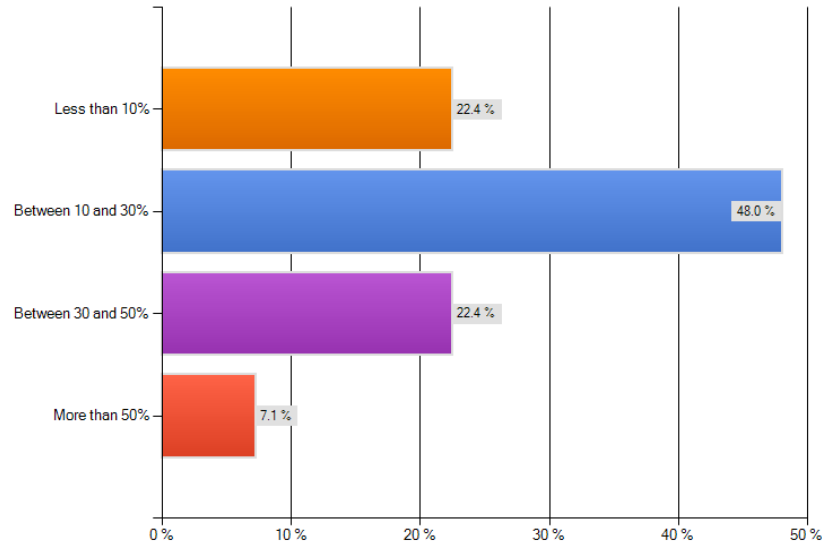
Which of the following best describes the importance of salary packaging (enabled by FBT concessions) in determining your ability to attract and retain employees? FBT concessions/salary packaging:



**SKC takeout from Q9:** more than 85% of employers state that salary packaging is either important or critical in the attraction and retention of employees

### Question 10

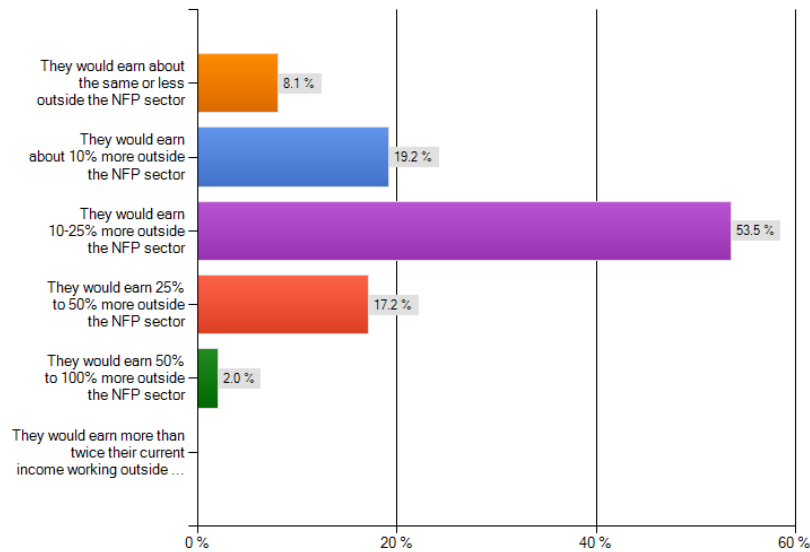
If the FBT concessions currently available to your employees were to be materially reduced without equivalent offsetting compensation, the percentage of my employees I would be likely to lose would be:



**SKC takeout from Q10: nearly 30% of employers believe they would lose at least 30% of their staff if the current FBT concessions were materially reduced without offsetting compensation**

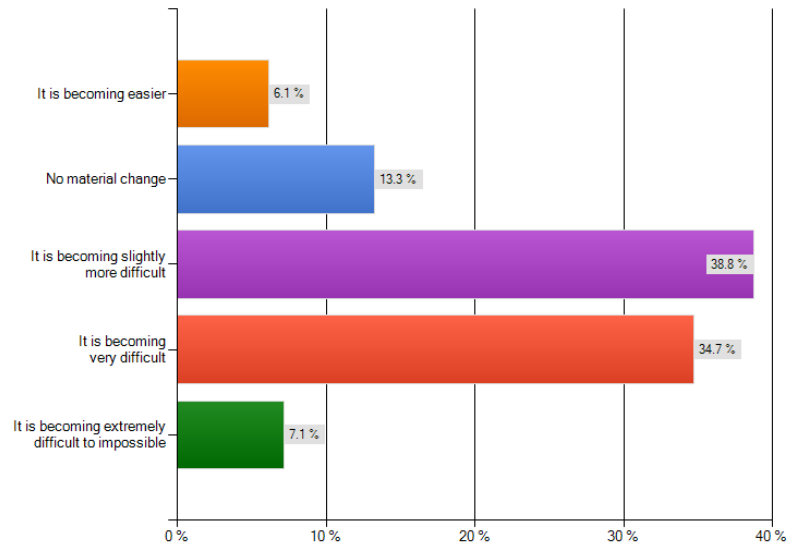
### Question 11

Consider a typical employee in your organisation with a particular level of skills, qualifications and experience. Which of the following best describes, in your opinion, what this typical employee would earn working outside the NFP sector compared to what they currently earn:



### Question 12

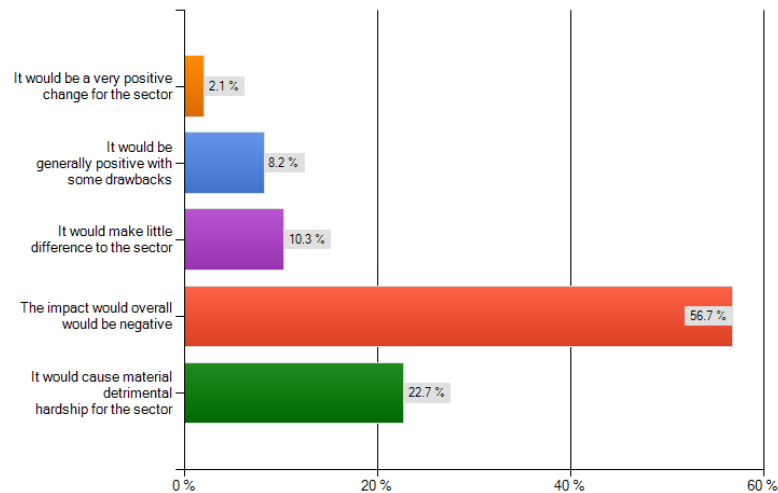
Which of the following statements best describes your current experience in attracting and retaining staff in your organisation:



**SKC takeout from Q12: more than 80% of employers state it is becoming more difficult than it has been to attract and retain staff**

### Question 13

In some recent discussions of policy in support of the NFP sector, alternative support mechanisms to replace the current FBT concessions have been canvassed. One of the alternatives raised is a system of direct funding grants to NFPs, made for a specified term following an application to Government. If such a grant scheme replaced existing FBT concessions and delivered funding equivalent to FBT concessions, which of the following do you think best describes the likely impact on the NFP sector:



**SKC takeout from Q13: around 79% of employers believe that a grant type funding system as an alternative to the FBT concessions would be detrimental to their organisation**



# *systems knowledge concepts*

Survey of salary packaging benefits for employees in the  
not-for-profit sector: **Employees**

Summary of survey results

5 December 2012

Prepared for	McMillan Shakespeare Ltd
Contact	Simon Molloy Managing Director
Team	Simon Molloy Leanne Buller

## 2 Summary of survey results

### Introduction

Systems Knowledge Concepts Pty Ltd, a leading economic analysis consultancy, was engaged to conduct a survey of employees in the not-for-profit (NFP) sector.

The objective of the survey was to learn more about the role that Fringe Benefit Tax (FBT) concessions play in supporting NFP organisations and their employees.

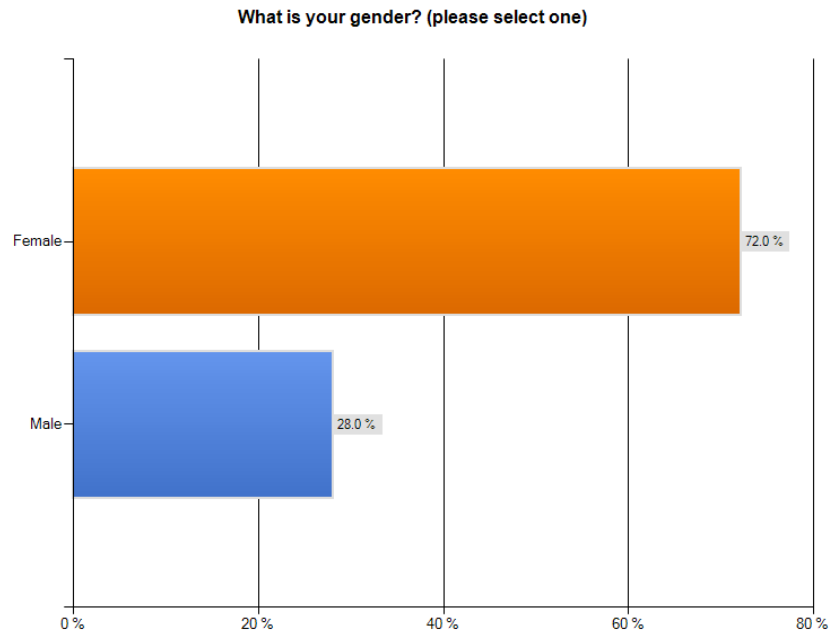
The survey was conducted over a two-week period from 16 November 2012 to 30 November 2012.

A total of **3,223 employees** from a broad range of NFP organisations across Australia completed the survey.

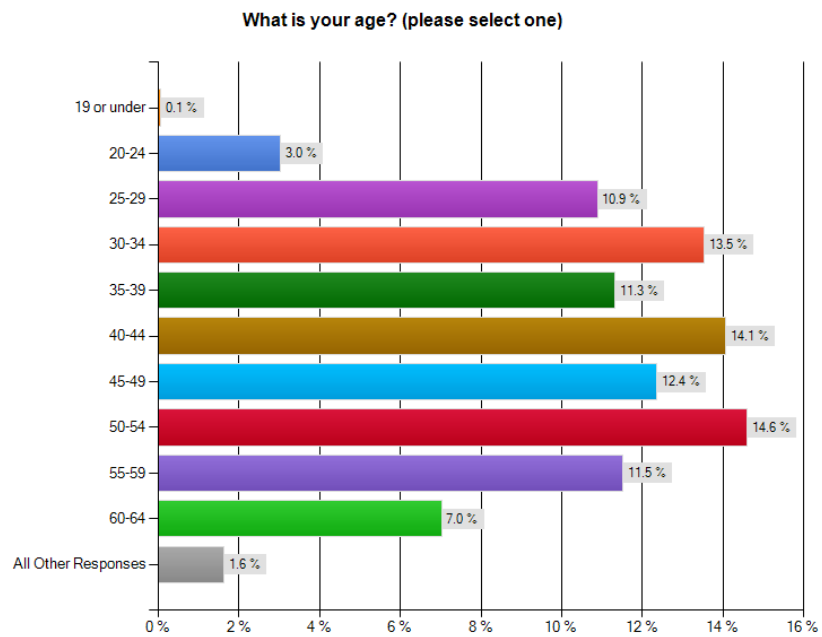
### Summary of key questions

This document provides a summary of responses to questions which are of most relevance to understanding the role of FBT concessions in the NFP sector. Accordingly not all questions and their responses are re-produced in this summary.

### Question 1

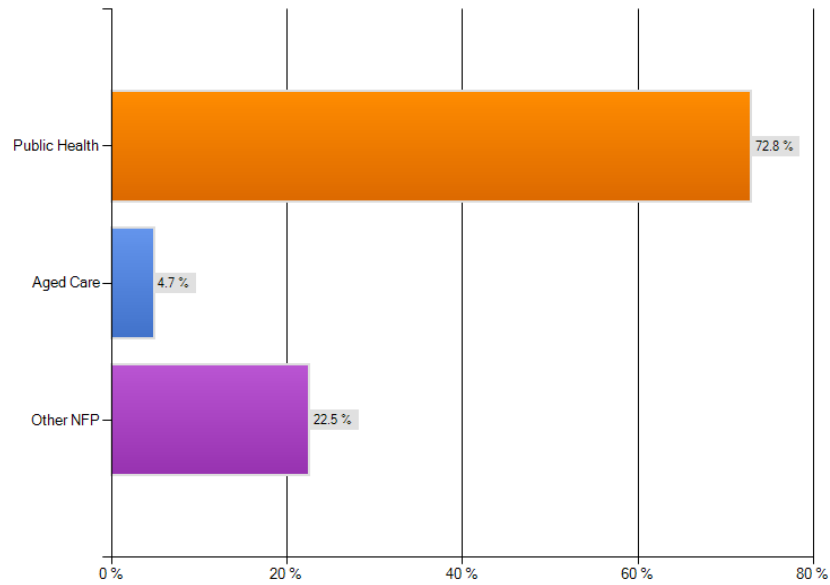


### Question 2



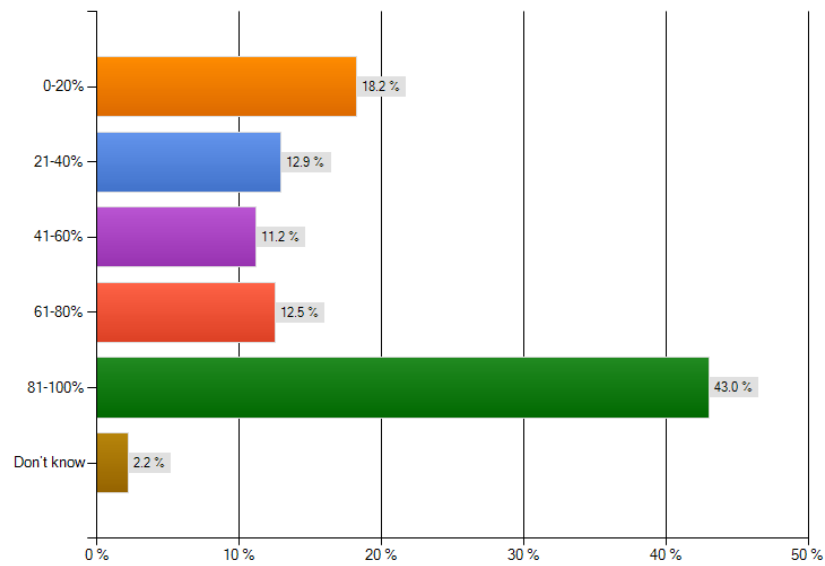
### Question 4

Which part of the NFP sector are you currently working in?



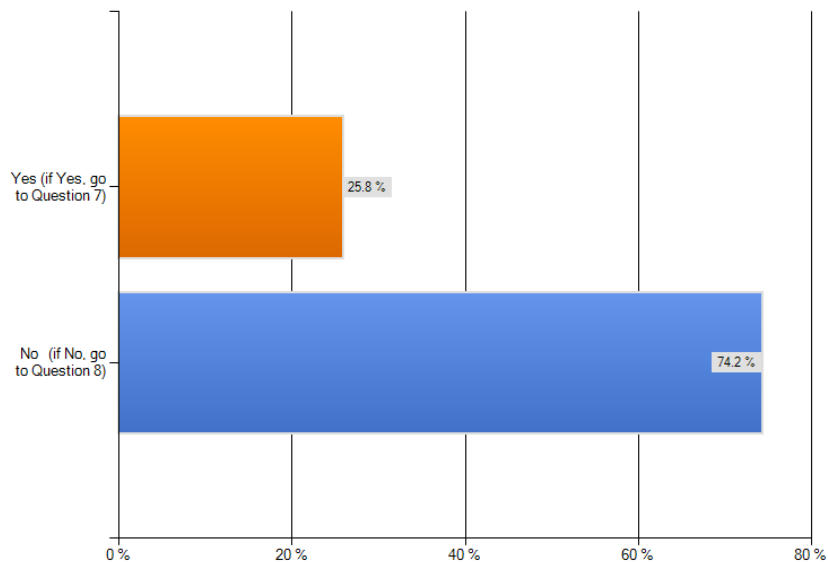
### Question 5

Approximately what percentage of your working life has been spent working in the NFP sector? (please select one)



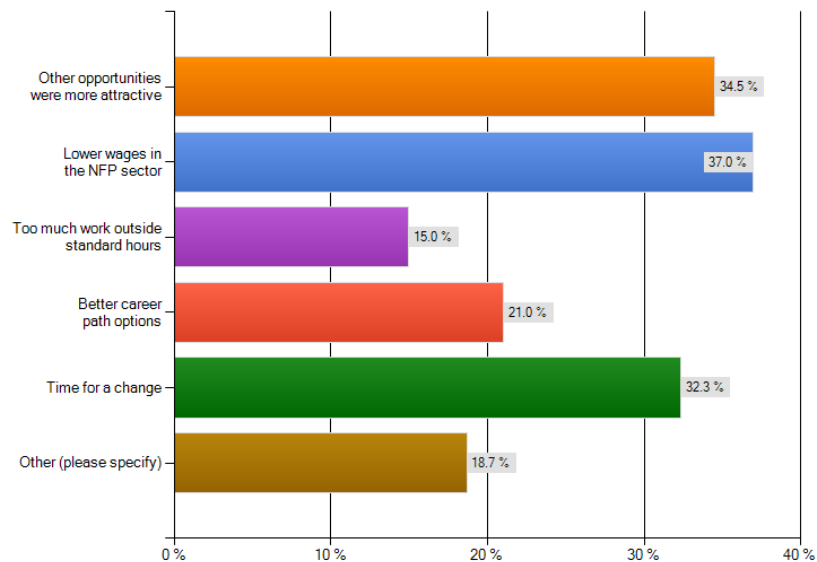
### Question 6

During your working life, have you ever moved from the NFP sector to another sector?  
(please select one)



### Question 7

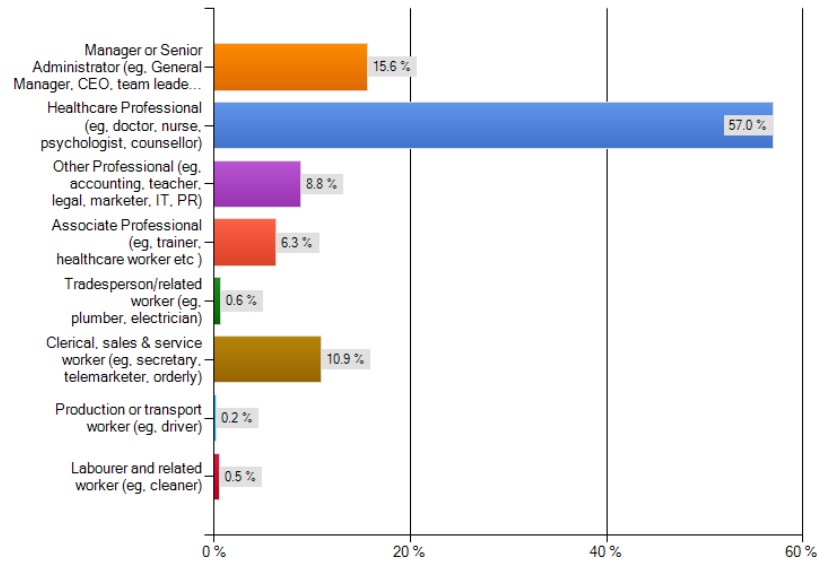
If you answered yes to Question 6, what were the main reasons why you moved? (please select as many as apply)





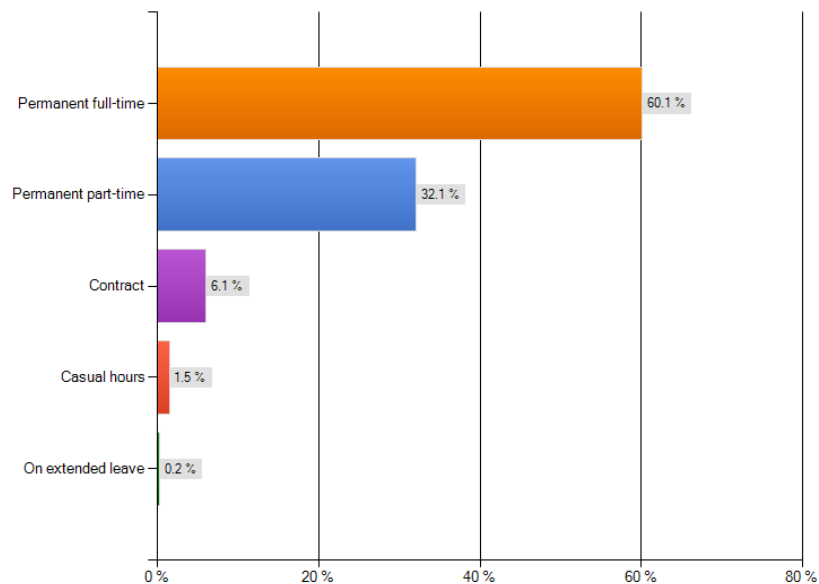
### Question 8

What is your current occupation? (please select the closest fit to your role from the drop-down list)



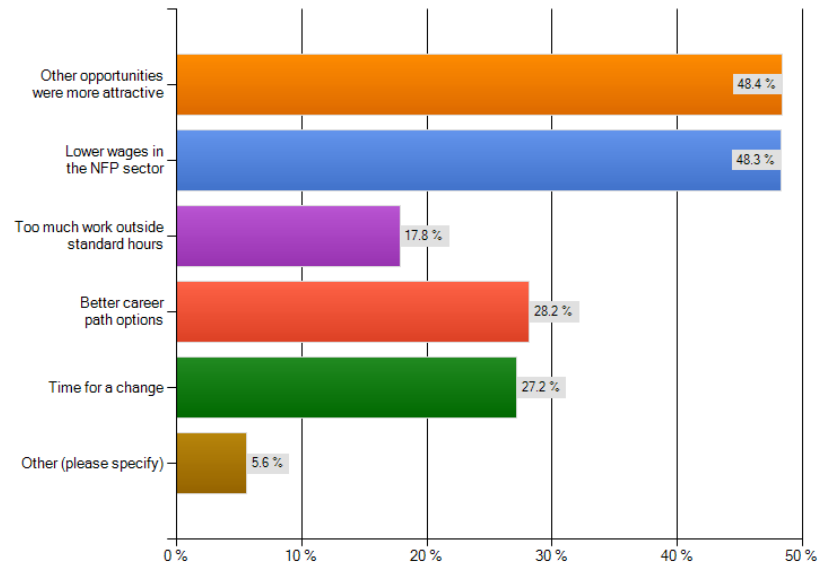
### Question 10

What is your current employment status? (please select one)



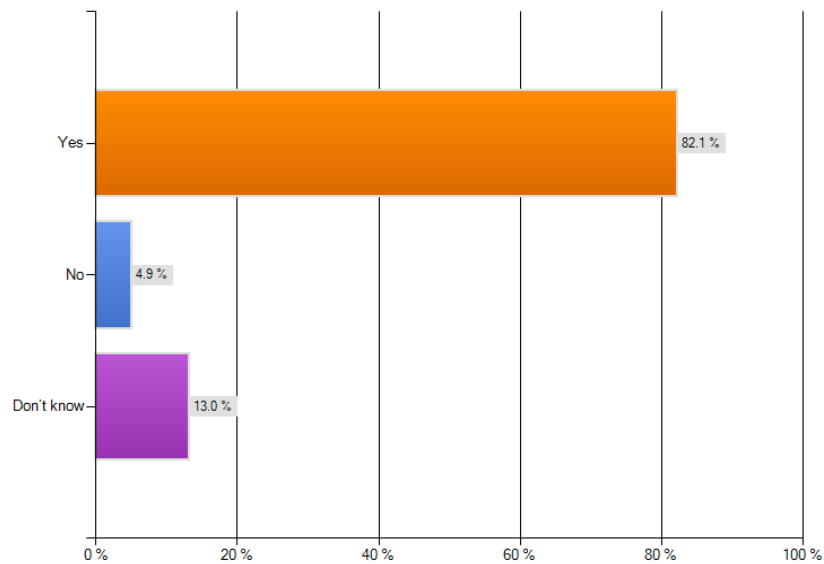
### Question 11

If you were to work for a sector other than the NFP sector, which of the following would be the main reasons for moving? (please select as many as apply)



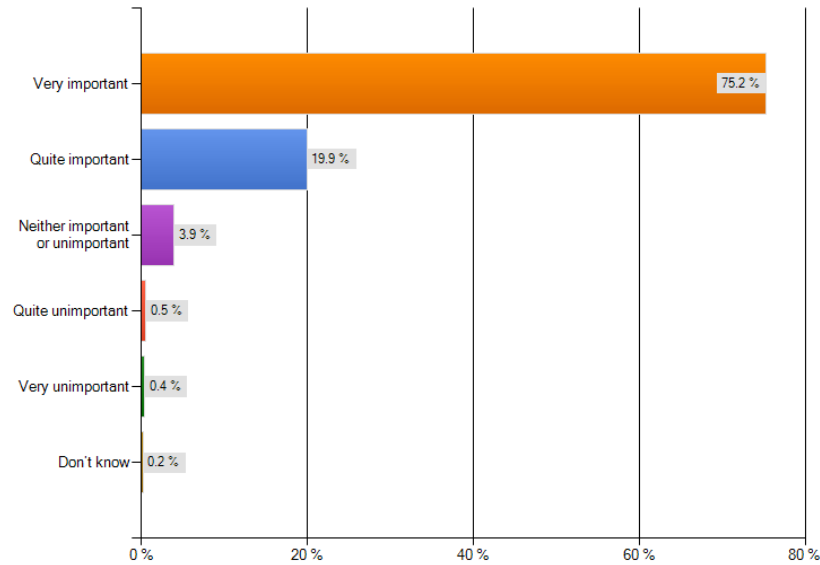
### Question 12

Does your remuneration include any salary packaging under FBT concessions? (please select one)



### Question 13

How important is salary packaging under FBT concessions in influencing whether you remain employed in the NFP sector? (please select one)

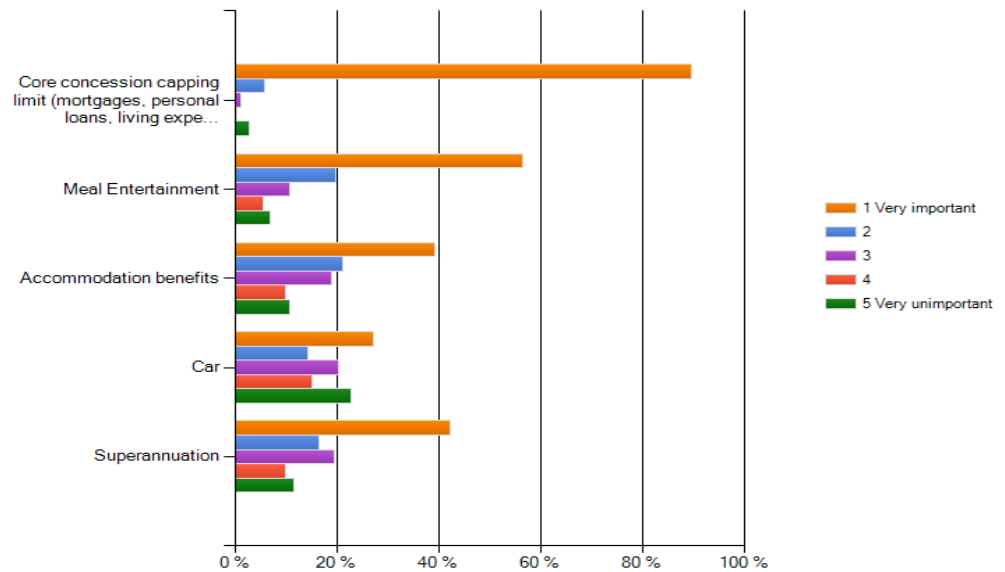


*SKC takeout from Q13: more than 95% of employees state the availability of salary packaging is either very or quite important in influencing whether they remain employed in the NFP sector*

### Question 16

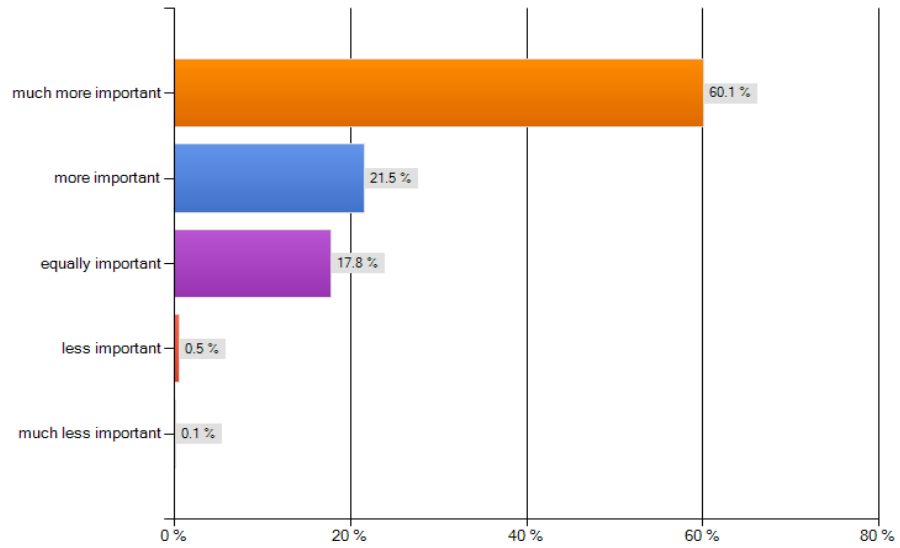
*Note: rating scale from 1 to 5 where 1 is the most important*

Please rate how important these concessions are to you. (please mark each concession type on a scale from 1 to 5)



**Question 17**

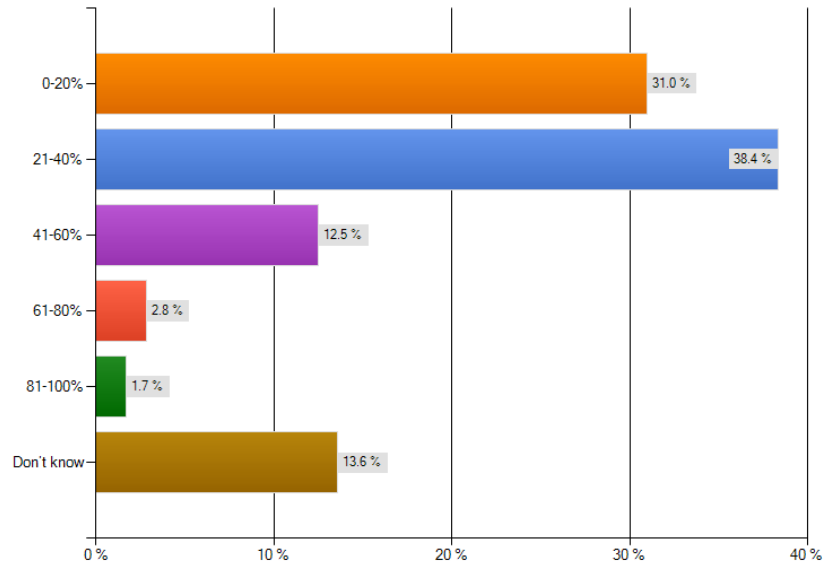
Looking ahead, do you think that the current FBT concessions/salary packaging benefits are likely to be more or less important to you and your household budget compared to when you first commenced salary packaging?



*SKC takeout from Q17: more than 80% of employees believe that FBT concessions are likely to become more important to them in future*

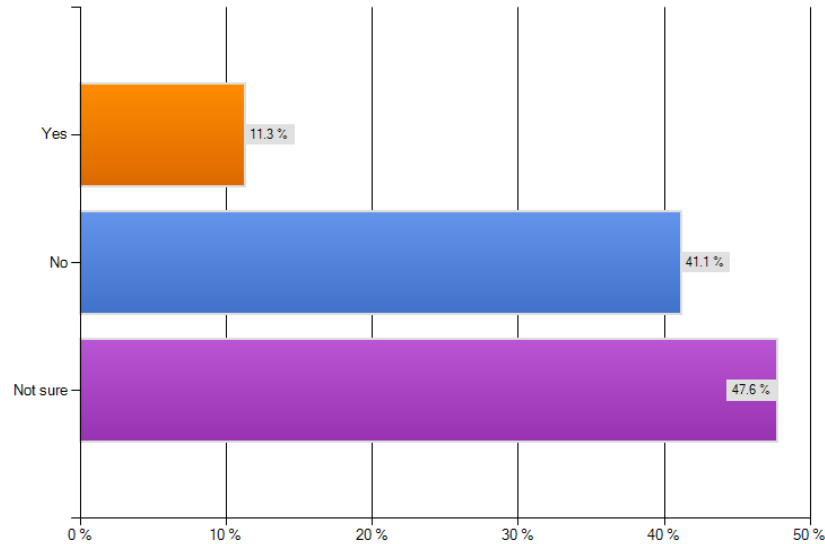
**Question 18**

Approximately what percentage of your total household income is made up of FBT concessions (of all types)? (please select one)



### Question 20

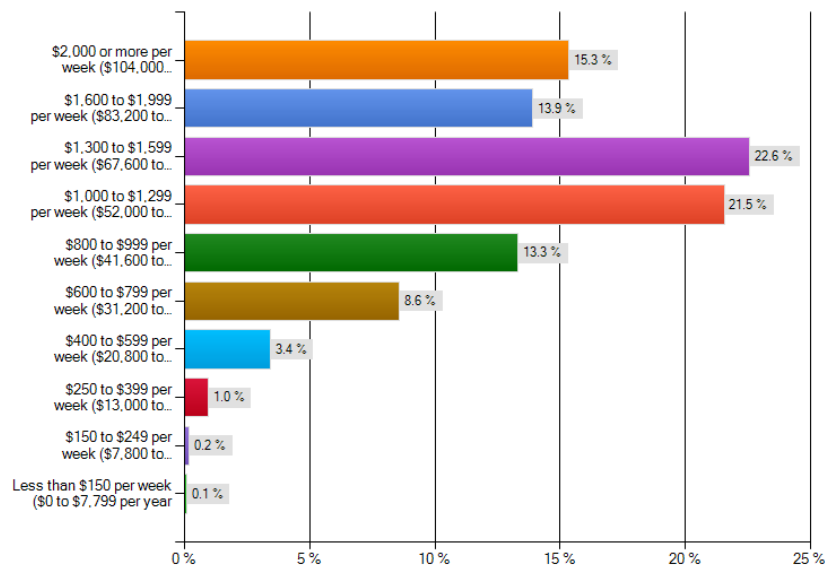
If the FBT concession was discontinued for workers in the NFP sector and no compensating changes were made to your remuneration, would you continue to work in the sector? (please select one)



*SKC takeout from Q20: only 11.3% of employees stated that they definitely would continue to work in the sector if FBT concessions were discontinued with no compensating changes*

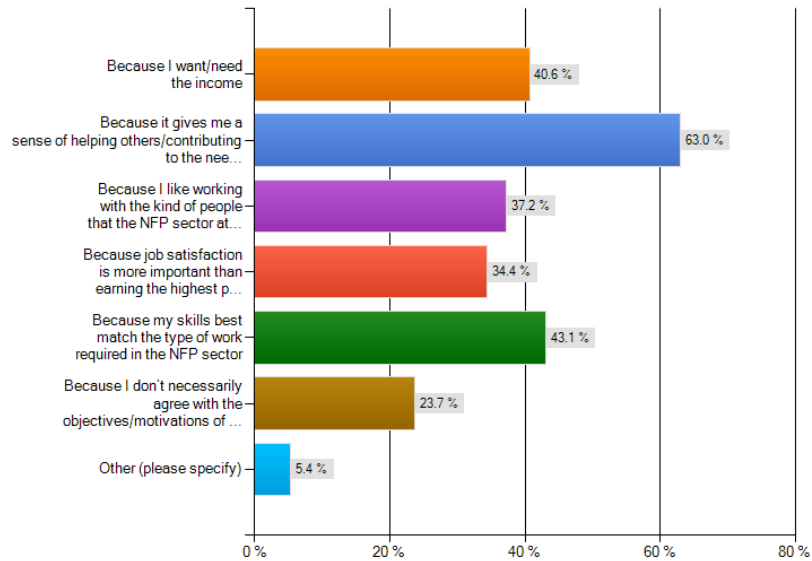
### Question 22

What is the total gross income you normally receive, including all of your wages, salaries, government benefits, pensions, allowances and other income? (please select one)



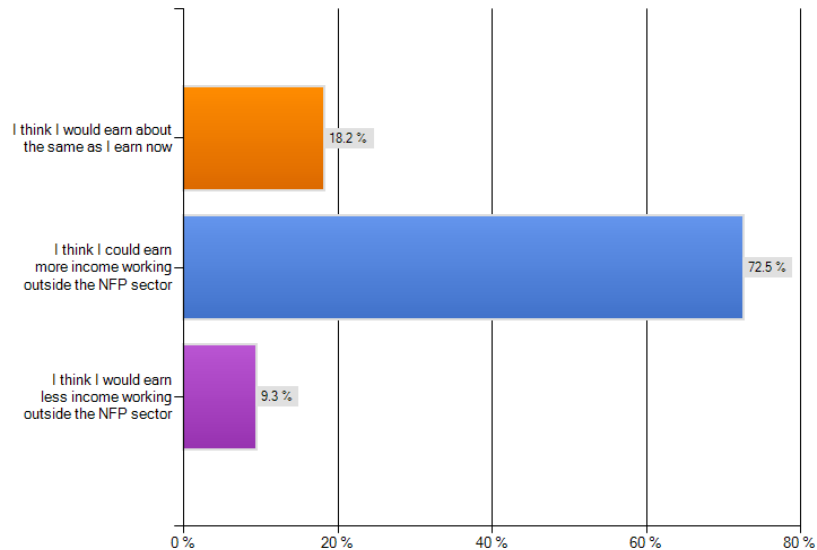
### Question 23

Which of the following best describes the reasons that you work in the NFP sector?  
(select as many as apply)



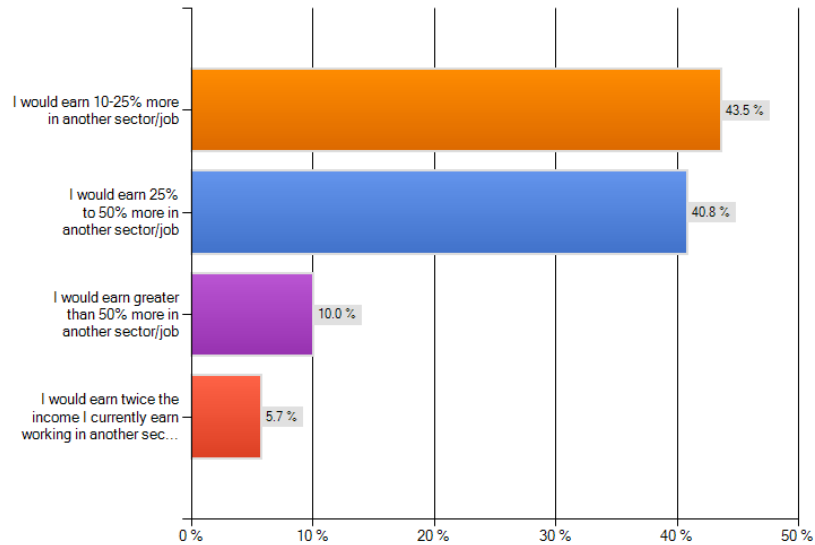
### Question 24

Consider your current job in the NFP sector and consider whether you could earn more working outside of the NFP sector. Which of the following best describes the income you think you could earn working outside of the NFP sector? (please select one)



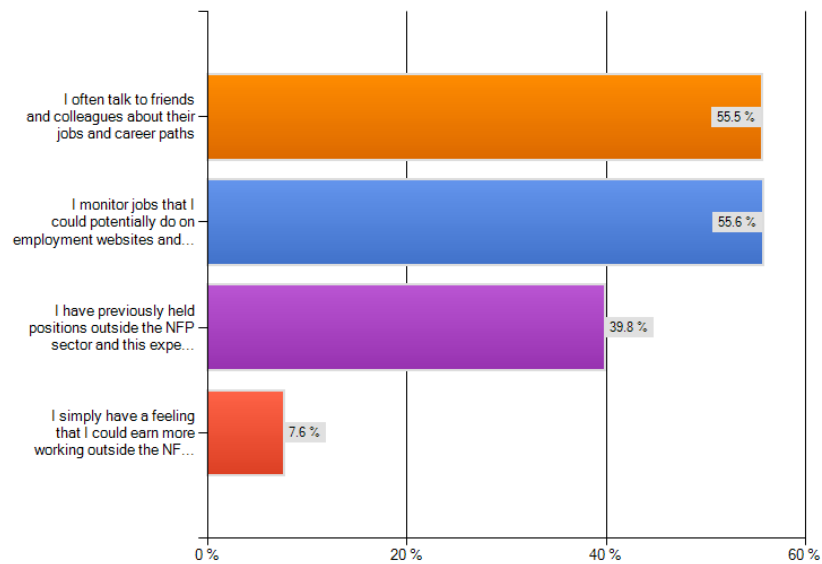
### Question 25

If you worked in another sector and/or another type of job outside of the NFP sector and your primary objective was to earn the maximum possible income that you could, how much more do you think you could earn? (please select one)



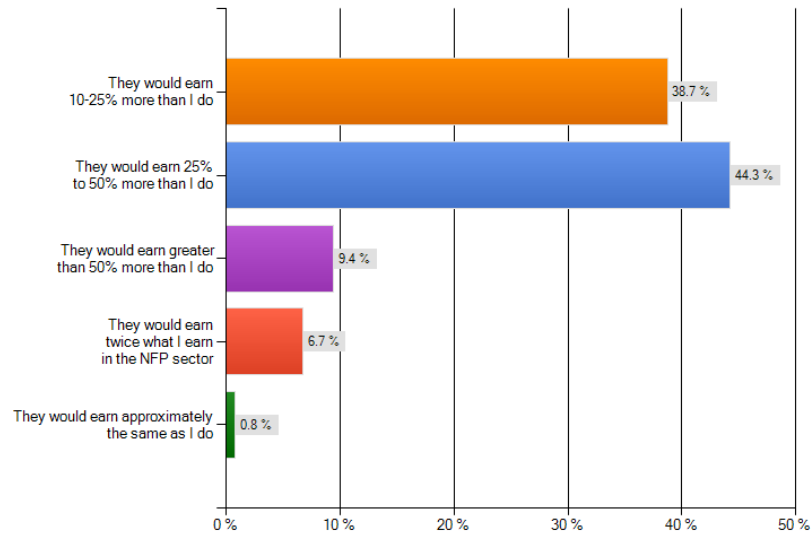
### Question 26

Why do you believe that you could earn more in another job outside of the NFP sector? (please select as many as apply)



### Question 27

Imagine another employee (perhaps someone you know) who works in another sector and/or job outside of the NFP sector and has very similar qualifications, experience and knowledge as yourself. Which of the following, in your view, best describes what such a person would earn, on average, compared to you? (please select one)



END



# Appendix: C

## Lateral Economics Analysis

# Estimating the impact of changes to FBT concessions – meal entertainment and entertainment facility leasing

December 2012



# Contents

- Contents ..... 3
- 1 Introduction..... 4
- 2 Economic modelling ..... 5
  - 2.1 Data ..... 5
  - 2.2 Model Structure..... 5
  - 2.3 Model results..... 6



## 1 Introduction

On 2 November 2012 the Not-for-profit Sector Tax Concession Working Group released a discussion paper, *Fairer, simpler and more effective tax concessions for the not-for-profit sector*.

In response to the discussion paper, McMillan Shakespeare Limited commissioned Lateral Economics to develop an economic model of the impact to government revenue of potential changes to the meal entertainment and entertainment facility leasing benefit concession arrangements.

Lateral Economics are an advisory consultancy with specialist expertise in economic reform and public policy.

## 2 Economic modelling

### 2.1 Data

The primary data set used in the modelling was Maxxia's<sup>1</sup> database of client employees which provided an annualised value of meal entertainment and entertainment facility concessions cross-classified by organization type – charity, PBI or 'rebateable' which define types of concessions for which employees are eligible.

### 2.2 Model Structure

The model estimates the actual impact to taxation revenue to concessions claimed by employees in the Maxxia database in 2013 by using the inflation adjusted claims of 2012. These are summed and then multiplied by the relevant tax rate.

The calculations are then scaled up to the whole of the sector based on the number of employees in the client base relative to the estimated number of employees for the whole of the sector in as presented in the discussion paper (p 36).

It is possible that Maxxia clients are a biased sample of the entire population. For this reason the model provides for a discount factor which can be separately applied for Charities, PBIs and Rebateable NFPs. In the modelling scenarios below these discount factors have been set to zero but can be altered for other possibilities.

In determining the tax rate to be used in the modelling there are two possibilities:

- FBT is charged at 46.5%. Therefore, using this rate calculates the maximum amount of revenue that could be theoretically foregone for the given level of claims.
- The calculation could be based on the marginal tax rates of the employee making the claim, assuming that employees would require what they claim as additional income in compensation if the FBT concession were not available and income tax would be payable on this amount at the relevant marginal rate. The average annual income for people in private sector employment in Community and Personal Service Occupations in 2011 (Census data) was \$45,000, and the marginal tax rate applicable is 32.5 per cent. It is noted, however, that in a scenario where these benefits were removed the employee would be worse off if they only received the amount claimed in FBT benefits as a compensating increase in taxable salary. Therefore, it would cost the NFP organisation more in salary, and the government would forgo the additional revenue on those wages, pushing the appropriate rate closer to the FBT rate. As such, using the marginal tax rate would be a minimum estimate. There is also the Medicare levy to consider in this equation.

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<sup>1</sup> Maxxia is an operating division of McMillan Shakespeare Ltd.



Given these considerations, and given that a proportion of the employees claiming concessions will be in higher tax brackets than 32.5 per cent we have elected to use a tax rate of 35 per cent in the model.

The tax foregone is forecast forward for 10 years based on assumptions of employment growth in the sector of 1 per cent per year<sup>2</sup> and inflation at 2.5 per cent. A discount rate of 7 per cent is used. It is assumed that the value of claims increases with inflation until it reaches the cap.

The model is designed to enable scenario testing based on various assumptions with respect to the implementation of policy parameters as shown in Exhibit 1. It is possible to estimate the revenue impacts of imposing caps and of applying indexation in any combination.

**Exhibit 1: Modelled policy parameters and settings**

	Current		Proposed	
	Amount	Indexed	Amount	Indexed
Cap – Meal entertainment	Uncapped	No	See exhibit 3	See exhibit 3
Cap – Entertainment facility leasing	Uncapped	No		

## 2.3 Model results

Using a tax rate of 35 per cent to reflect a conservative estimate of impact (a higher value of the tax rate will cause estimates to be higher) the model generates the results shown in Exhibit 2.

<sup>2</sup> IBISWorld Industry Report X0021, Charities and Not-for-Profit Organisations in Australia forecasts employment growth in the sector in the range 1.7 to 3.0 per cent over the next five years. We have used a conservative figure of 1 per cent throughout the analysis period and we do not expect the results to be very sensitive to small changes in this assumption. A sensitivity analysis at 2% employment growth produces figures of \$92 million for 2013-14 and \$683 million NPV for the 10 year period compared with the results in Exhibit 2.



Exhibit 2: Results of modelling

	Estimated cost to revenue 2013-14 (\$m)	Estimated cost to revenue 10 year PV (\$m)	Impact on 2013-14 revenue (\$m)	PV of 10 year revenue impact (\$m)
<b>Model baseline No caps No indexation</b>	2,652	18,901	-	-
<b>\$10,000 grossed up caps with indexation on meal entertainment, and entertainment facility leasing benefits (two separate caps)</b>	2,561	18,258	<b>+90</b>	<b>+643</b>

Thus, the impact of applying \$10,000 grossed up (\$4,843 type 1 GST inclusive actual expenditure) caps to both meals and entertainment and entertainment facility leasing expense concessions and, in addition, applying full indexation going forward is a saving to revenue of \$90 million in 2012-14 and a saving of \$643 million NPV over the 10 year analysis period at a discount rate of 7%.



# Appendix: D

## PricewaterhouseCoopers Analysis





# *Impact assessment of changes to FBT concessions*

*McMillan Shakespeare  
Group*

*Impact assessment of  
changes to FBT  
concessions*

*December 2012*

## Technical Report

# *Contents*

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# 1 Modelling FBT concessions

## 1.1 Introduction

McMillan Shakespeare commissioned PwC to model the impact of changes to the fringe benefit tax (FBT) concessions for two groups of employees in the not-for-profit sector, namely Public Benevolent Institutions (PBIs) and public and not-for-profit (NFP) hospitals and public ambulance services. A key objective of this modelling is to inform McMillan Shakespeare's written submission in response to the Government's Not-For-Profit Sector Tax Concession Working Group (TCWG) discussion paper.

The TCWG discussion paper outlined three central policy options for consideration, namely:

**Option 1** – Refundable tax offsets payable to eligible entities: As a replacement of the current FBT exemption system, the government provides a tax offset to eligible employers, which is then distributed to employees at their discretion.

**Option 2** – Direct tax offset for employees of eligible entities: The current FBT system is abolished and replaced with a tax offsets provided directly to employees.

**Option 3** – Tax-free allowance: provides eligible entities with a level of funding to be distributed to employees in the form of tax free allowance.

Our approach was to develop a baseline model to measure the current utilisation and concession amounts and was used as the foundation to develop two scenarios that would inform a response to the policy options above. In the two scenarios modelled, both expand current utilisations rates to 100 per cent, while

- i) applying current average concessions rates across income levels to measure the potential cost to government if only participation rates increased under the current arrangements; and
- ii) maintaining the costs to government at the current total concession amount to measure the impact to employees.

### 1.1.1 Assumptions, limitations and validity

The assumptions are based on data from official sources (detailed in Section 2.2) and the application of taxation rates for 2011-12.

The impact of changes to FBT concessions is estimated for the two largest groups in the NFP sector and the value of the concessions and employment numbers are based on the data provided in the TCWG discussion paper (see Table 1)

**Table 1: Largest two FBT concessions for the NFP sector**

Concession	Limitations	Estimated value in 2011-12	Estimated number of employees in relevant sector
Exemption for public benevolent institutions (other than public and NFP hospitals)	\$30,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	\$1.26 billion	485,000
Exemption for public and NFP hospitals and public ambulance services	\$17,000 of grossed-up taxable value per employee (meal entertainment and entertainment facility leasing is uncapped)	\$1.0 billion	450,000

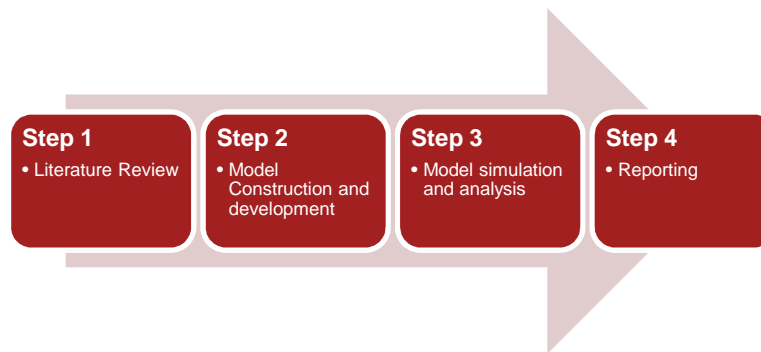
Source: Not-for-Profit Tax Concession Working Group discussion paper, Treasury, 2012.

## 2 Approach

### 2.1 Methodology of Modelling FBT Concessions

The PwC approach to modelling FBT concessions consisted of four stages (Figure 1), and is outlined below.

**Figure 1 Our Proposed Approach**



1. **Literature review:** A review of literature was conducted to provide a basis for the structure of the modelling. A data audit was also undertaken to supply reliable inputs to the modelling, including assumptions, parameters and data. This stage allowed the inputs to be evidence-based and transparent.
2. **Model construction and development:** The model was constructed to calculate a baseline that replicated the current cost of FBT concessions and the current utilisation rates, and developed to calculate the impact of expanding current utilisations rates to 100 per cent, while
  - a. applying current average concessions rates across income levels to measure the potential cost to government if only participation rates increased under the current arrangements; and
  - b. maintaining the costs to government at the current total concession amount to measure the impact to employees.
3. **Model simulation and analysis:** The model generated detailed estimates of the impacts of additional costs to government and changes in benefits to employees for each NPF group by individual income level.
4. **Reporting:** The approach and methodology to calculating the baseline estimates and an analysis of each scenario is presented in this short technical report.

### 2.2 Data sources

Table 2 provides a list of the main data sources used to inform the PwC modelling and reporting.

**Table 2: Data sources**

Data source	Provider	Detail	Dates
Not-for-Profit Sector Concession Working Group discussion paper	The Treasury	Estimates of FBT concessions and employment in each relevant sector	2010-2015
Taxation Statistics 2009-10	ATO	Charities and deductible gifts: Employees of tax concession charities, by type and remuneration	2009-10
Taxation Statistics 2008-09	ATO	Charities and deductible gifts: Employees of tax concession charities, by type and remuneration	2008-09

# 3 *Analysis of FBT concessions*

## 3.1 *Calculating the baseline*

The baseline is designed to replicate the current cost of FBT concessions and provide a base to estimate the impact of change to FBT concessions. The baseline was constructed by pegging the total concession amounts to the Treasury estimates for 2011-12 and disaggregating the total by income level based on detail from the latest available ATO data and tax rates for 2010-11.

The modelling provided detailed baseline data by income level on the:

- proportion of FBT concessions
- total concession amounts
- total employees
- employees with reportable fringe benefits
- average reportable fringe benefits
- average concession amounts
- proportion of the cap amounts.

For each of the variables above, the baseline data was also further split between fringe benefit amounts below and above the caps, which are \$17,000 for hospitals and \$30,000 for PBIs.

## 3.2 *Estimating scenario 1*

Scenario 1 estimates the total cost to government if employee participation in FBT concessions were to increase to 100 per cent. This provides an estimate of the maximum funding required by Government in accommodating for the entire sector, but at current average amounts per employee by income level.

This is modelled in a three step approach. Step 1 uses the model output for all employees (above and below the cap) that are currently utilising FBT concessions. Step 2 involves applying the same average FBT concession amounts per person by income level and applies this to remaining workforce. Step 3 totals these two groups together by income level.

This scenario provides insights into the additional cost associated with increasing participation rates from current levels to 100 per cent.

## 3.3 *Estimating scenario 2*

Scenario 2 models the impact to employees of maintaining the current cost to government while increasing participation to 100 per cent. The net effect of this scenario is an averaging of the concession amounts equally across every income level for every employee.

This is also modelled in a similar three step approach. Step 1 applies the new average concession amount to each of the income levels for those employees current receiving FBT concessions. Step 2 involves applying the same average FBT concession amount per person by income level to the remaining workforce. Step 3 totals these two groups together by income level, where the average FBT concessions is constant across all income levels.

This would involve a scenario whereby the current FBT exemption system is replaced with an alternative system, such as a tax offset system providing benefits directly to the employee. Using this mechanism to redistribute the concessions, it is assumed that there will be full participation across the sector.

### 3.4 Notes

Scenarios 1 and 2 are designed to inform the impact of possible policies, in particular those designed to increase participation rates. The first and the third policy options proposed in the TCWG discussion paper include the tax offsets payable to eligible entities, and funding for tax-free allowances respectively. These policies were not analysed in this modelling exercise.

In Option 1, a tax offset is granted to employers in lieu of the FBT exemption, and employers are then given the discretion to allocate the benefits to their employees (although it is unclear what actual tax the NFP entity would be paying to get a tax offset against). This policy is likely to keep the cost to government constant. However, there is difficulty in predicting the behaviour patterns of employers in the distribution of benefits to employees. Employers may distribute benefits more generously to certain employees, or maintain an even spread across all employees.

The third option proposed by the TCWG discussion paper was a tax-free allowance system. This system involved constructing the provision of funding to each entity and gives employers the ability to pay a tax free allowance to employees.

The modelling and analysis presented in the report provide insight on the likely impact of various policy options for FBT concessions.

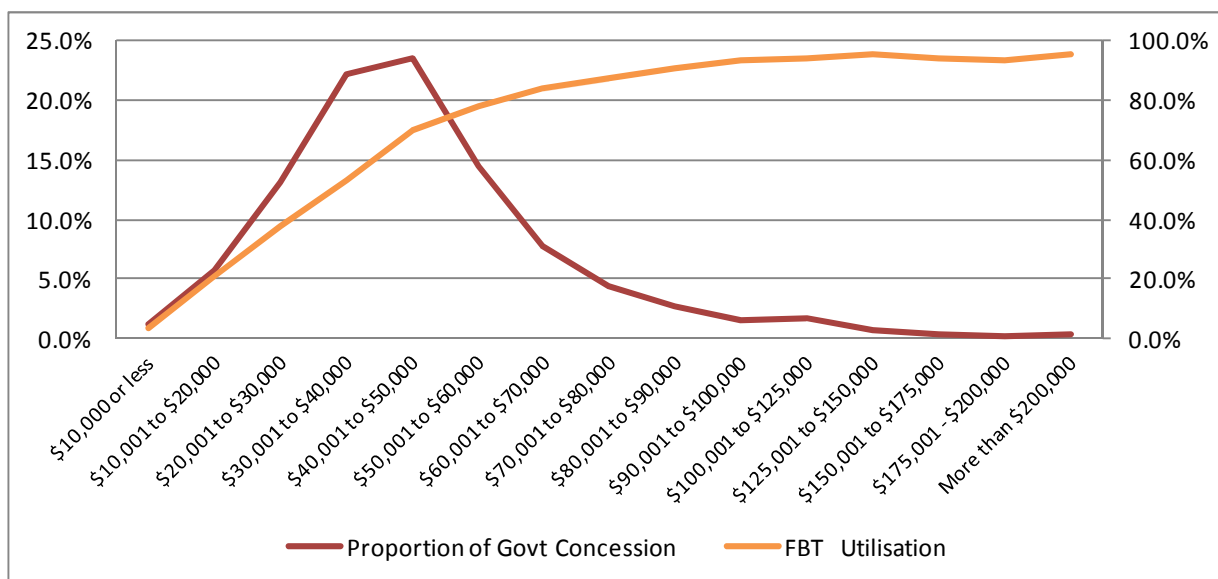
### 3.5 Public Benevolent Institutions (PBIs)

#### Baseline

It is estimated that for PBIs, the majority of total reportable fringe benefits are received by those in the \$30,001 to \$40,000 and \$40,001 to \$50,000 income brackets (reflective of employee numbers, utilisation rates and average concession amounts by income level). The participation rate of employees claiming FBT concessions steadily increases at a declining rate as their level of income increases. That is, while high income earners are more likely to participate and at higher average concession amounts, most of the total concession amount sits with the lower income levels.

Figure 2 shows the distribution of the total concession amount for PBIs (\$1.26 billion in 2011-12) and the participation of employees, both by income level.

**Figure 2: Distribution of Concessions and FBT Participation, PBIs: 2011-12**

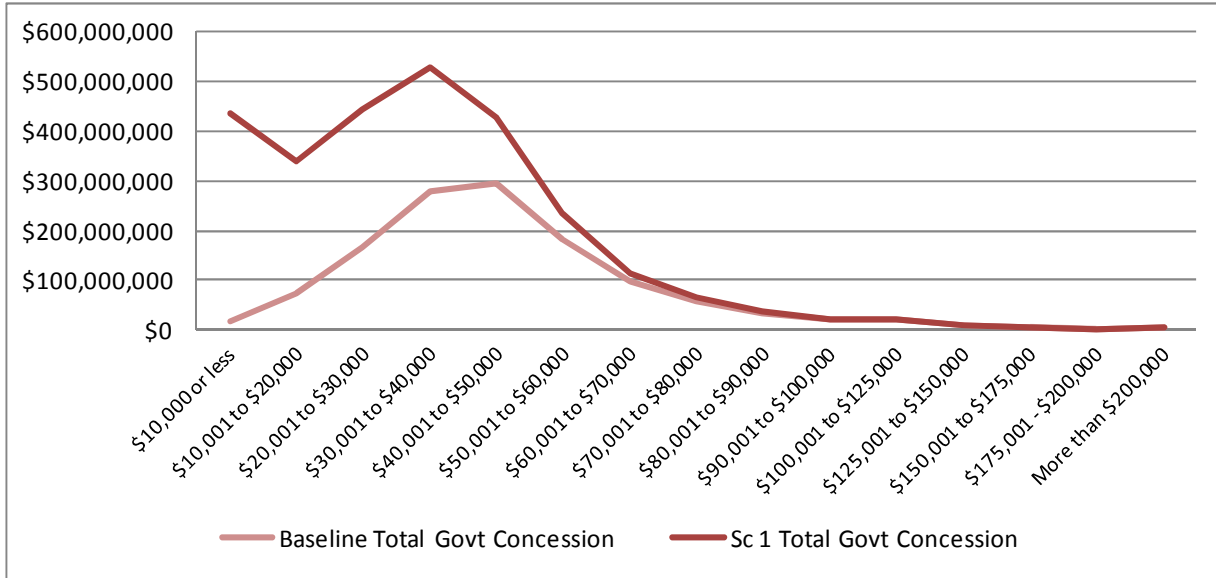


Source: Treasury, ATO and PwC estimates

## Scenario 1

This scenario increases participation to 100 per cent, while maintain current average concession amounts by income level. The results show that the cost to government for the FBT concession is estimated at \$2.68 billion for PBIs (comprising \$1.26 billion for current participants and \$1.42 billion for the new participants). Due to the composition of the workforce and current utilisation rates, the majority of the concession amount falls with the lower income levels (Figure 3).

**Figure 3: Distribution of Concessions, PBIs: 2011-12**

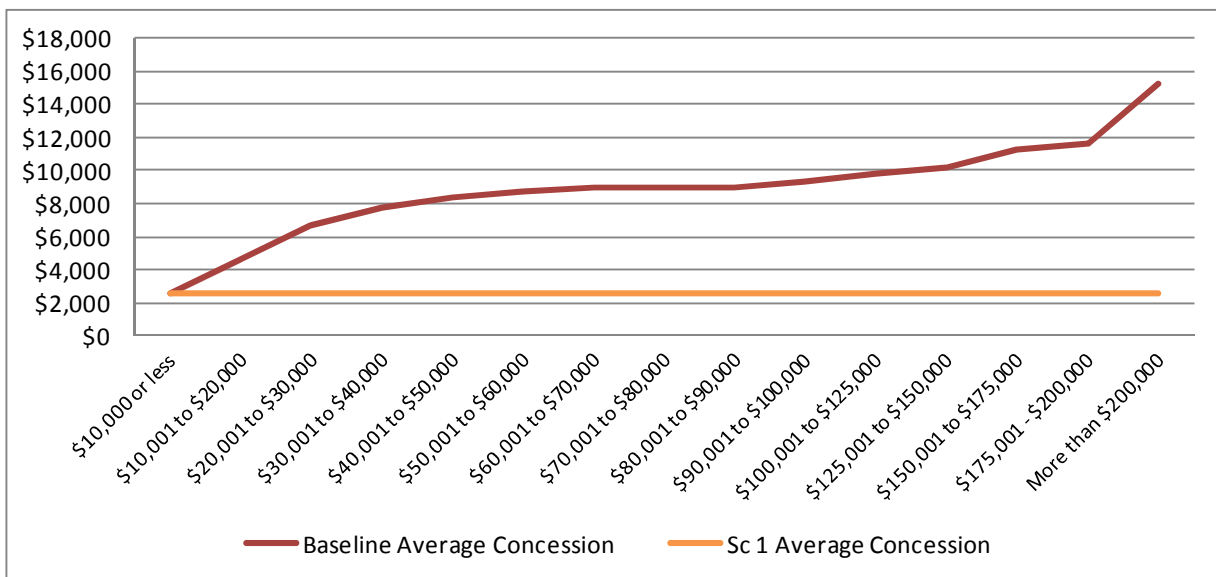


Source: Treasury, ATO and PwC estimates

## Scenario 2

Scenario 2 also increases participation to 100 per cent, but maintains the current total amount of concessions at the 2011-12 level. An average concession amount is estimated per employee is applied equally to each employee across the PBI sector. The results in redistribution away from current average concession rates by income level to an average of \$2,598 per employee (Figure 4).

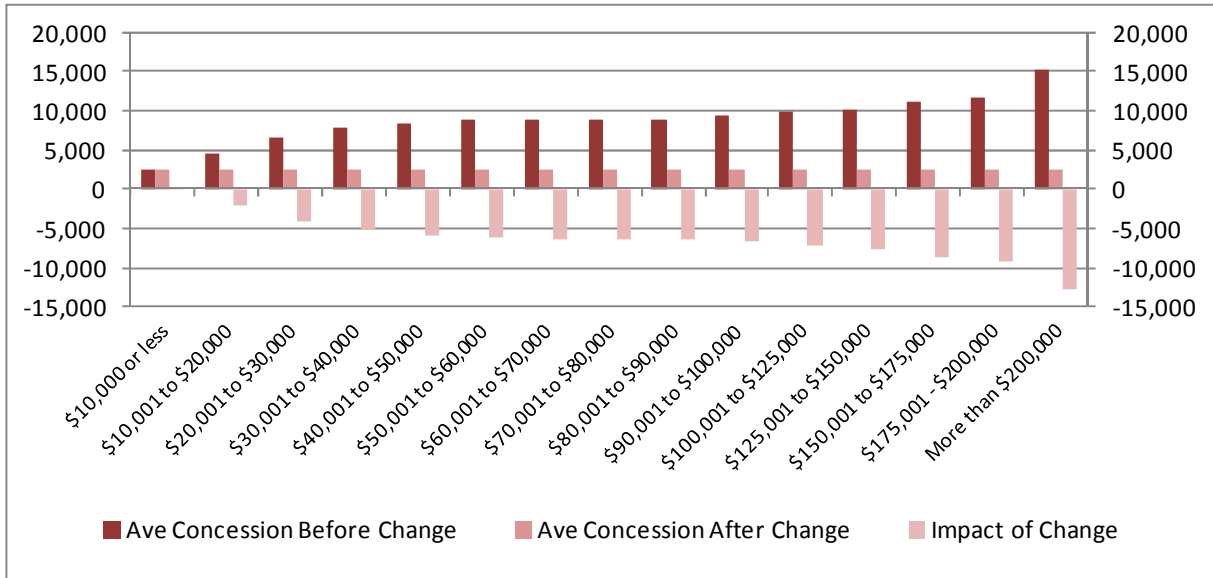
**Figure 4: Average concession amounts, PBIs, 2011-12**



Source: Treasury, ATO and PwC estimates

This redistribution results in those not previously receiving any benefit now receiving a concession of \$2,598 per employee. It is also results in a reduction of average concession by income level for the majority of employees in the sector that are currently receiving FBT concessions (Figure 5).

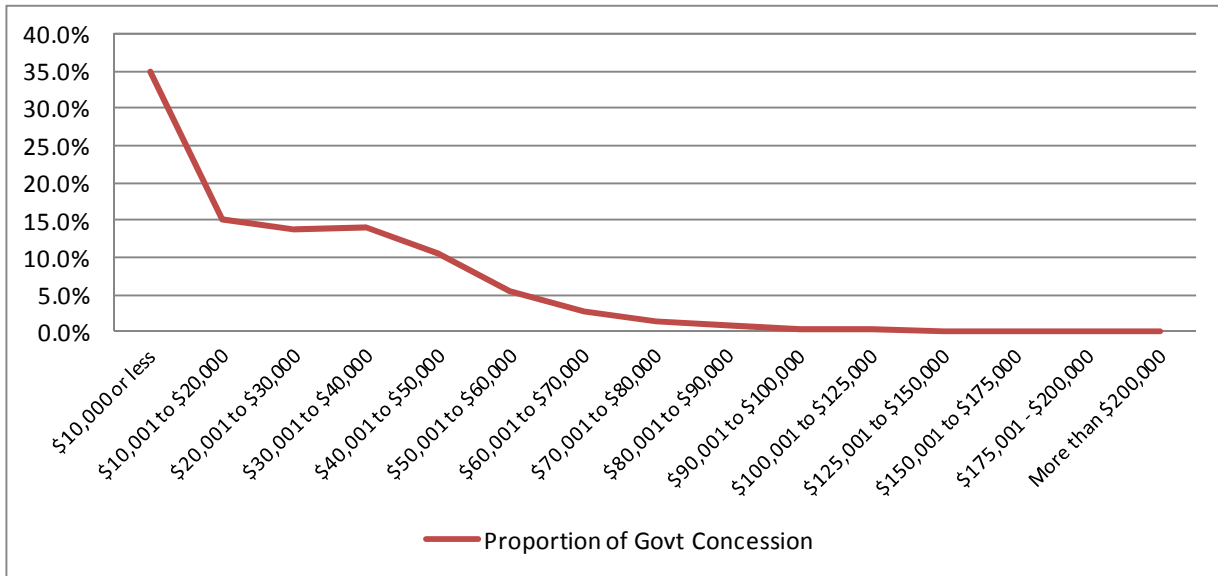
**Figure 5: Concessions of current participants, PBIs, 2011-12**



Source: Treasury, ATO and PwC estimates

Due to the higher number of employees in the lower income brackets, the concessions in total are distributed in larger amounts at the lower end of the income levels (Figure 6). Consequently, concession amount also generally decreases as income increases.

**Figure 6: Distribution of concessions for Scenario 2, PBIs, 2011-12**



Source: Treasury, ATO and PwC estimates



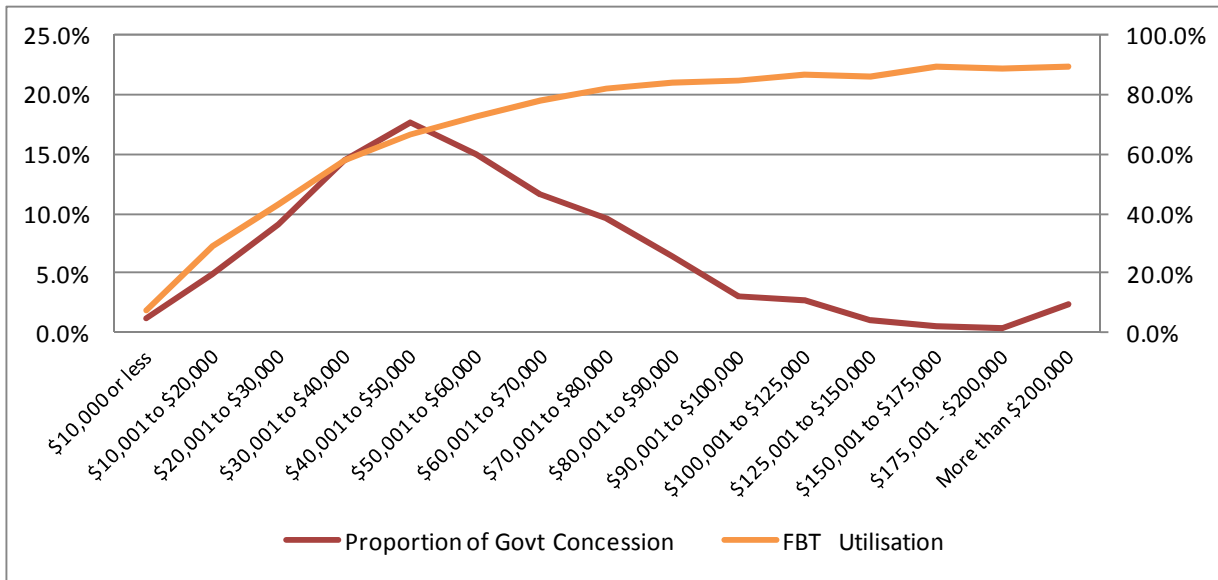
### 3.6 Public and NFP hospitals and public ambulance services (hospitals)

#### Baseline

It is estimated that for hospitals, the majority of total reportable fringe benefits are received by those in the \$30,001 to \$40,000, \$40,001 to \$50,000 and \$50,001 to \$60,000 income brackets (again reflective of employee numbers, utilisation rates and average concession amounts by income level). The participation rate of employees claiming FBT concessions steadily increases at a declining rate as their level of income increases, but does not reach the same rates as for PBIs. Consistent with this, while high income earners are more likely to participate and at higher average concession amounts, most of the total concession amount sits with the lower income levels.

Figure 7 shows the distribution of the total concession amount for hospitals (\$1.00 billion in 2011-12) and the participation of employees, both by income level.

**Figure 7: Distribution of Concessions and FBT Participation, Hospitals: 2011-12**

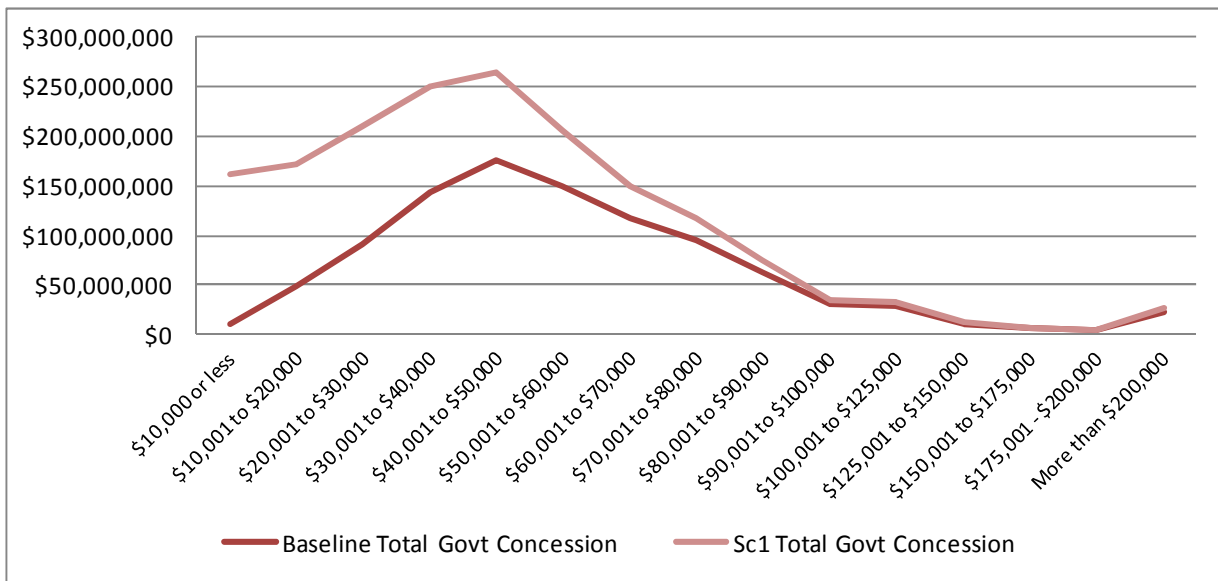


Source: Treasury, ATO and PwC estimates

#### Scenario 1

This scenario increases participation to 100 per cent for the sector, while maintain current average concession amounts by income level. The results show that the cost to government for the FBT concession is estimated at \$1.72 billion for hospitals (comprising \$1.00 billion for current participants and \$0.72 billion for the new participants). Due to the composition of the workforce and current utilisation rates, the majority of the concession amount falls with the lower income levels (Figure 8).

**Figure 8: Distribution of Concessions, Hospitals: 2011-12**

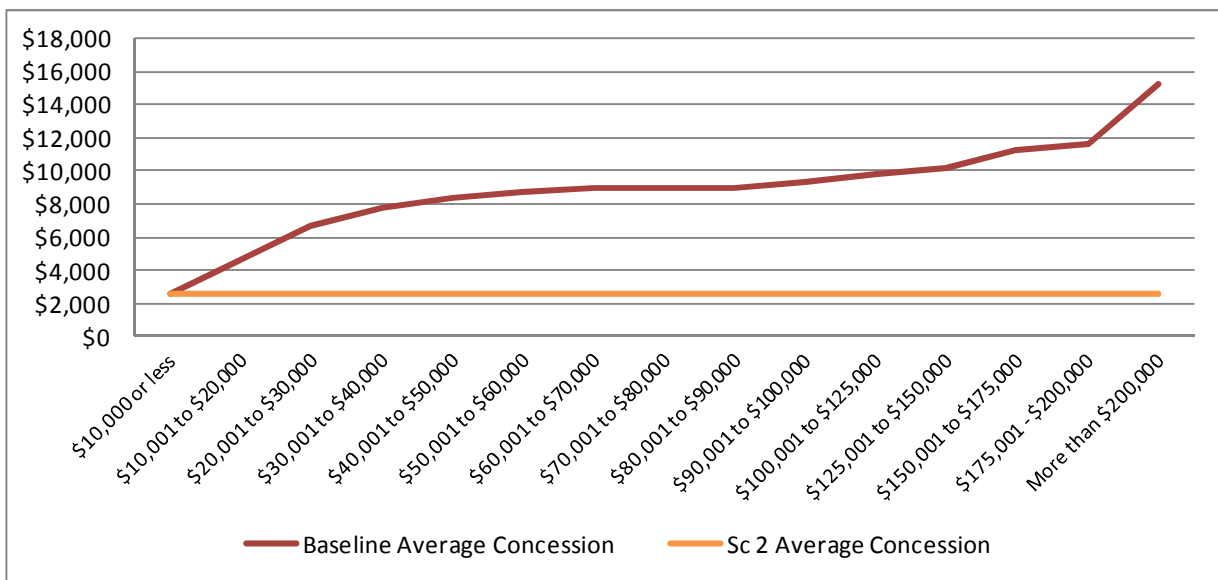


Source: Treasury, ATO and PwC estimates

**Scenario 2**

Scenario 2 also increases participation to 100 per cent, but maintains the current total amount of concessions at the 2011-12 level for hospitals. An average concession amount is estimated per employee is applied equally to each employee across the PBI sector. The results in redistribution away from current average concession rates by income level to an average of \$2,222 per employee (Figure 9).

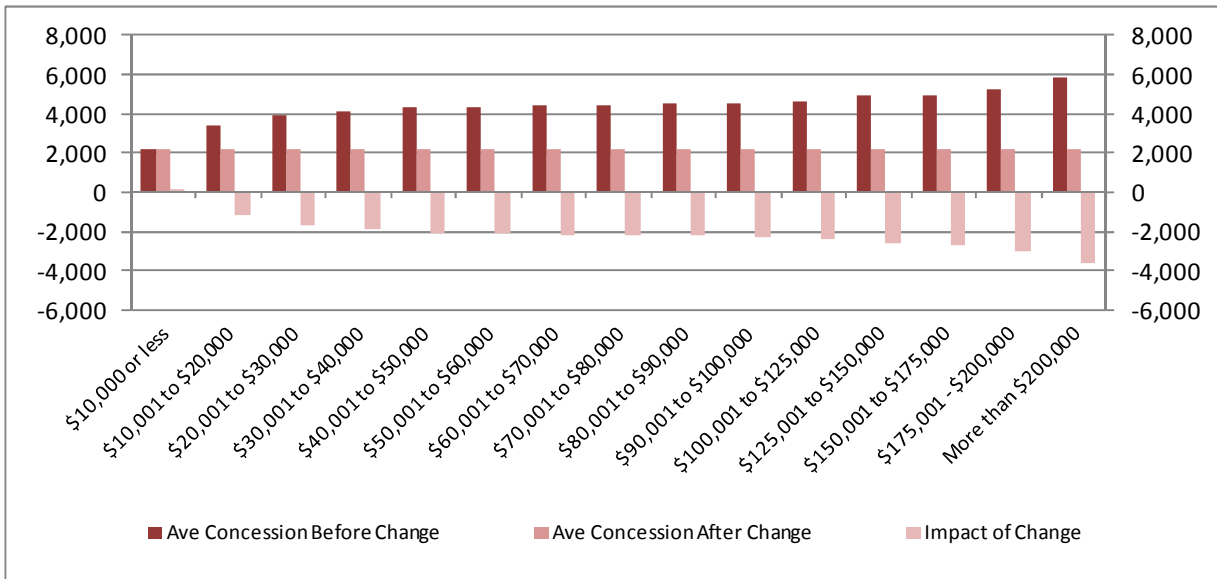
**Figure 9: Average concession amounts, Hospitals, 2011-12**



Source: Treasury, ATO and PwC estimates

The redistribution for hospitals results in those not previously receiving any benefit now receiving a concession of \$2,222 per employee. It is also results in a reduction of average concession by income level for the majority of employees in the sector that are currently receiving FBT concessions (Figure 10).

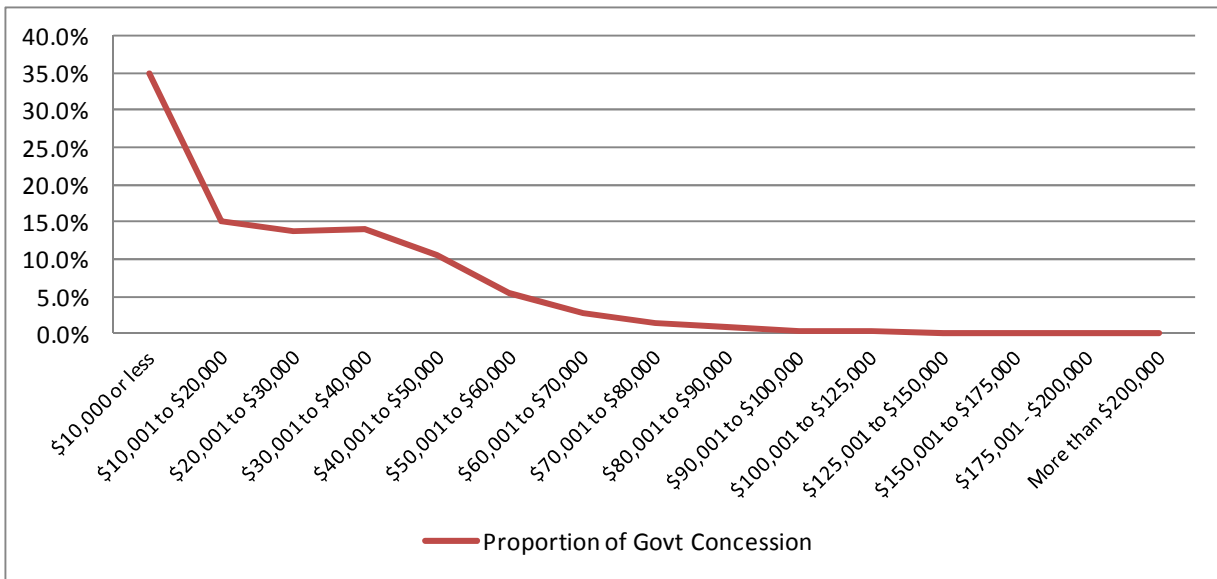
**Figure 10: Concessions of current participants, Hospitals, 2011-12**



Source: Treasury, ATO and PwC estimates

Again, the higher number of employees in the lower income brackets results in the total concession amount being distributed in larger amounts at the lower end of the income levels (Figure 11). Consequently, concession amount also generally decreases as income increases, due to employee distribution.

**Figure 11: Distribution of concessions for Scenario 2, Hospitals, 2011-12**



Source: Treasury, ATO and PwC estimates

## 4 Summary

A summary the key results from the impact assessment is presented in Table 3.

**Table 3: Summary results, 2011-12**

	PBIs			Hospitals		
	Baseline	Scenario 1	Scenario 2	Baseline	Scenario 1	Scenario 2
Total Employment, no.	485,000	485,000	485,000	450,000	450,000	450,000
Employees with reportable fringe benefits, no.	165,770	485,000	485,000	237,204	450,000	450,000
Utilisation, %	34.2%	100.0%	100.0%	52.7%	100.0%	100.0%
Total FBT concession amount, \$bn	\$1.26	\$2.68	\$1.26	\$1.00	\$1.72	\$1.00
Cap, \$	\$30,000	\$30,000	\$30,000	\$17,000	\$17,000	\$17,000
Average FBT concession amount, \$	\$7,601	\$5,536	\$2,598	\$4,216	\$3,831	\$2,222
Average FBT concession amount, %	54.5%	39.7%	18.6%	53.3%	48.5%	28.1%

Source: Treasury, ATO and PwC estimates