DF Mortimer & Associates

Law Institute Victoria
Member of the LIV

Our Ref: DFM:09/0005
Your Ref:

24 November 2009

Not For Profit Sector
Productivity Commission
GPO 1429
CANBERRA ACT 2061

nfp@pc.gov.au

Dear Commissioners

Draft Research Report on Contribution of the Not-for Profit sector

The purpose of this submission is to comment on the approach taken by the Commissioners in chapter 8 of the draft research report on the Contribution of the Not for Profit Sector ("the draft Report").

In our opinion, the draft Report fails to consider whether the mandatory “public benefit test” may exempt charitable not for profit organisations from the “competitive neutrality principle”. In our opinion this failure makes the Commissioners conclusion less compelling than it could be that some not for profit organisations (“NFPs”) have “violated” the competitive neutrality principle.

So that we are not misunderstood, our submission is not intended as a criticism of competition policy *per se* or the merit or otherwise of its stated goal, namely an increase in economic growth. Nor do we intend by this submission to criticise the "purpose" of for-profit entities.

Background

DF Mortimer and Associates is a law firm that focuses exclusively on the law of NFPs.

We welcome the decision by the federal government to request the Productivity Commission to undertake a research study on the Contribution of the Not-for-Profit Sector.

DF Mortimer & Associates Pty Ltd
ABN 48 135 534 851
9/135 Mooltan Street
Travancore VIC 3032
P (03) 9370 9333
F (03) 9370 9333
www.dfmortimer.com.au
dmortimer@dfmortimer.com.au

Competitive neutrality

The terms of reference require the Commissioners to "examine the extent to which tax exemptions accessed by the commercial operations of not-for-profit organisations may affect the competitive neutrality of the market".

Chapter 8 of the draft Report addresses this question. This chapter concludes that the competitive neutrality principle is "violated" by NFPs entitled to input tax concessions (such as FBT and payroll tax concessions).

We understand the "competitive neutrality principle" to be the one articulated in the COAG Competition Principles Agreement dated 11 April 1995 as amended ("the Agreement"). We note that the Agreement is said at section 3(1) to apply to government owned enterprises to eliminate "resource allocation distortions" arising out of public ownership.

The Agreement expressly excludes NFPs. Despite this, the Commissioners are required by the terms of reference to apply the competition neutrality principle to NFPs.

Section 5(1) of the Agreement states:

> The guiding principle is that legislation (including Acts, enactments, Ordinances or regulations) should not restrict competition unless it can be demonstrated that:
>
> (a) the benefits of the restriction to the community as a whole outweigh the costs; and
>
> (b) the objectives of the legislation can only be achieved by restricting competition.

That is, legislation may restrict competition if this can be justified on “public interest” grounds. It follows that where exceptions (a) and (b) apply, a NFP would be exempt from the competitive neutrality principle.

It may be the public interest test described in section 5(1) of the Agreement is a concept coterminous with the “public benefit test” as applied to charitable NFPs in particular.

The Public Benefit test

We think it within its terms of reference for the Commissioners to consider the extent to which NFPs may be exempt from the competitive neutrality principle.

The draft Report goes someway to adressing this question by mentioning the "public benefit (spillovers)" provided by NFPs. In our view however the Commissioners have not gone far enough.

We think the Commissioners have failed to consider the mandatory "public benefit test" particularly applicable to charitable NFPs. This test effectively imposes a legal constraint upon the "purpose" of a charitable NFP and how it may apply its funds. This legal constraint is generally found in common law, however jurisdictions such as the United Kingdom have codified the test in statute.

We see no need to further rehearse the public benefit test here as Commissioner Fitzgerald will be familiar with it from his work on the *Report on the Inquiry into the Definition of Charities and Related Organisations* (2003). The public benefit test is discussed at chapter 13. It is worth noting however that for-profit organisations are not subject to the public benefit test, despite the assertion in the draft Report that a for-profit company may act like a NFP "if its owners wish".

We acknowledge the public benefit test has problems. It is not comprehensively codified in statute. There can be problems identifying "the public" or "a section of the public". There are also problems identifying "benefit"'. However the test is applied and entities are denied charitable status if they fail to meet the test. The public benefit test could be improved.

Further consideration?

None of the problems with the public benefit test seem to us to be a sufficient reason for the Commissioners to not consider whether the test exempts charitable NFPs in particular from the competitive neutrality principle. Such consideration may lead the Commissioners to conclusions other than the one they have presented in chapter 8 of the draft Report.

For example, the terms of reference appear not to prevent the Commissioners from reaching a conclusion that the public benefit test be improved to better regulate NFPs rather than suggesting as they have done, that input tax concessions be removed.

We note for example that the public benefit test has been codified by the UK *Charities Act 2006*. We note also that the UK Charity Commission has adopted a principle of "no net harm" to further refine the public benefit test.

We think that without a discussion on the public benefit test, the Report on the Contribution of the Not for Profit Sector will be unable to present a compelling case that certain NFPs "violate" the competitive neutrality principle. We encourage the Commissioners to consider whether the public benefit test will exempt NFPs from the competitive neutrality principles when they prepare their final draft of the Report.

Yours faithfully
DF MORTIMER & ASSOCIATES

Derek Mortimer
Principal