Submission to the Ralph Committee

Review of Business Taxation

A Platform For Consultation

Discussion Paper 2

Submission

Australian Friendly Societies Pharmacies Association Inc.

(AFSPA)

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Executive Summary

1. Not-for-profit entities such as Friendly Society Pharmacies operate pharmacies today as a continuation of their long tradition of community service to ensure the supply of the highest standard of pharmaceutical products and related services, to their members and the community in which they operate, at an affordable price.

   They operate in a truly co-operative not-for-profit structure and should be clearly distinguished from for-profit entities and from other Friendly Societies, which may typically be financial type institutions.

   Friendly Society Pharmacies should be excluded from any changes proposed by the Review to simplify the present business taxation system by treating all entities as companies.

2. This submission disagrees strongly with the view expressed by the Review that horizontal equity only should be the dominant focus of considerations under the proposed National Objectives.

   Not-for-profit entities do not participate in business activities for the same commercial purposes and interests as for-profit entities. Their purpose is to serve their members and their communities and any surplus income goes back into the business to fund asset replacement and the services they provide.

   The personal tax system and Social Security and related payments systems are not capable of fully compensating either individuals or the community generally if they were to be deprived of the totality of the value of the benefits and services presently contributed to the nation's welfare by the not-for-profit sector of which Friendly Society Pharmacies are a part.

3. Governments of Australia have historically recognized and used tax expenditures or concessions as a policy tool to advance social policy objectives. It is the view of this Association that the benefits that accrue to the community from such a policy are invaluable and the continued application of this policy should not be denied to Government for the sake of the short-term goal of simplifying the business tax system.

About the Association

The Australian Friendly Societies Pharmacies Association Inc. (AFSPA) is a not-for-profit national body representing the interests of its members who are not-for-profit Friendly Society Pharmacies registered under the various State Friendly Society Acts or other relevant legislation within the Commonwealth of Australia.

The objects of the Association include:

- Provide a not-for-profit Association of Friendly Societies Pharmacies which are registered under the various State Friendly Societies Acts or other relevant legislation;
- Promoting community pharmacy and the interests of affiliated pharmacy Societies and their members;
- Monitor and closely consider all matters emanating from Federal legislation that has or may have an effect on the Association or its affiliated pharmacies or their members; and
- Make representations and submissions where deemed necessary or desirable to the appropriate persons, entities or authorities in respect of any matter affecting the interests of affiliated pharmacies or their members.

The Association presently has 30 Friendly Society members operating a total of 102 not-for-profit Friendly Society Pharmacies with memberships of approximately 395,000 covering some 800,000 individuals.

About Friendly Society Pharmacies (Dispensaries)[1]

Friendly Society Dispensaries were first established in Australia by Friendly Societies in the 1840's. Their establishment then was in direct response to two significant problems of the day:

- The high cost of medicines for their, mainly poor, members; and
- The fact that many chemists commonly adulterated their drugs[2].

The purpose of Friendly Societies in establishing their own Dispensaries was to ensure the supply, to their members, of quality medicines as prescribed and at an affordable price. They were able to do this because the Dispensaries were established and operated by the Friendly Societies on a true not-for-profit, co-operative principle.

Throughout their history in Australia from those very early days up to and including the present time the not-for-profit Pharmacies have had to struggle for their continued survival against the powerful vested interests of the commercial chemists and drug suppliers. Such interests have over many decades been successful in restricting the

[1] Dispensary was the early description of today's modern pharmacy and survives still in some Acts and in the names of the Friendly Societies themselves eg Ballarat UFS Dispensary est. 1880. For this submission the word Pharmacy or Pharmacies will be used.

[2] *Mutual Aid or Welfare State* Australia's Friendly Societies David Green & Lawrence Cromwell ISBN 086861 6567

growth of Friendly Society Pharmacies by promoting oppressive legislation which still today curtails the opening of new Friendly Society Pharmacies and restricts the relocation of existing ones.

At the same time the Friendly Society Pharmacies also laboured under manifestly unfair tax burdens which were not lifted until 1982 from which time they were taxed as other not-for-profit companies.

Notwithstanding these immense difficulties, Friendly Society Pharmacies continue to operate and where they do they have brought more affordable pharmaceuticals to their members and increased competition and professional service to the community. They continually provide the best range and quality of pharmaceutical products at the most affordable prices, creating a market driven balance of prices that are in the best interests of consumers in those areas. This tradition, since the establishment of Friendly Society Pharmacies, has protected the local community from what would certainly be higher pharmacy prices.

The Review

Recommendations of the Review are to be consistent with the following aims:
- Improving the competitiveness and efficiency of Australian business, and thereby the competitiveness of the Australian economy;
- Providing a secure source of revenue;
- Enhancing the stability of taxation arrangements;
- Improving simplicity and transparency; and
- Reducing the costs of compliance.

As an aid to transparency the Review has formulated four taxation benchmarks:
- An investment taxation benchmark;
- An entity taxation benchmark;
- An international taxation benchmark; and
- A tax incentive benchmark.

It is intended that these benchmarks be applied consistently on business income in accordance with National Objectives identified by the Review as:
- Optimising economic growth;
- Ensuring equity; and
- Facilitating simplicity.

To achieve reform in business taxation the Review proposes two significant changes to present business taxation arrangements that are of grave concern to this Association and its members.

The first concern of AFSPA is the proposal that, primarily for the purpose of simplicity, all business entities should be taxed as companies.

Business Entities

In describing its reasons for this approach and articulating in detail the present complexities that have developed because of past differential tax treatment of different entities, the Ralph Review does not specifically refer to the not-for-profit organizations of Friendly Society Pharmacies but it does refer to Friendly Societies generally.

This submission stresses to the Review that the Friendly Society Pharmacies must be distinguished from other Friendly Society business entities that may not be not-for-profit organizations

This Association is particularly concerned to ensure that the proposed changes to the taxation of co-operatives generally and the limitations proposed to the mutuality principle do not go so far as to include the not-for-profit Friendly Society Pharmacies; and that the present status of its members, the not-for-profit Friendly Society Pharmacies, is preserved.

The Review states that in the absence of Division 9 of the *Income Tax Assessment Act 1936* co-operatives would otherwise be taxed as companies. It goes on to state that even by trading with members their income is derived in the same way as for other businesses carrying on similar activities; and that members enter into co-operatives for similar commercial purposes as they enter into business relationships with other companies with which they may trade.

It is the submission of this Association that that conclusion is not one that should be drawn in regard to the not-for-profit Friendly Society Pharmacies. Any surplus income derived from business activities with members and non members alike goes back into the pharmacy business for asset replacement and to support the many additional community health services provided by a not-for-profit pharmacy. Income derived from business dealings with non-members and investments is of course taxed at the present company rate.

In short, members participate in the business of not-for-profit Friendly Society Pharmacies for reasons that are fundamentally different to those reasons that might motivate people to participate in business activities conducted by other business entities including other Friendly Societies' businesses.

The second concern of this Association is that under the reform process it is recommended by the Review that horizontal equity should be the dominant dimension of the equity objective.

Equity

Horizontal equity is described, broadly, as taxpayers in similar circumstances should be taxed similarly and vertical equity is described, also broadly, as being, that tax burdens should depend on ability to pay and that those more able to pay should pay more tax.

The Review argues that the focus of business tax should be on horizontal equity on the grounds that the personal tax system and social security and related payments systems are sufficient to reflect vertical equity concerns.

It is this Association's submission that this philosophy goes to the very heart of why not-for-profit entities should continue to be taxed differentially from companies. Not-for-profit entities like Friendly Society Pharmacies do not provide their services for a commercial intent; they provide their services as true co-operatives investing in mutual aid to the benefit of the community.

For-profit entities provide services for which the profit margins are within commercial benchmarks in order to provide a return on capital invested. In contrast the emphasis of not-for-profit entities such as Friendly Society Pharmacies is to return surpluses as a proportion of business conducted to fund services that, because of lower (or negative) profit margins, would not be undertaken by the purely for-profit organizations.

Applying tax equivalence measures to all entities without differentiating their purpose is itself inequitable.

Use of Tax Expenditures as Policy Tools

The Review in its first discussion paper *A Strong Foundation* stated that "tax expenditures" or " tax concessions" are variations in the tax system used to effect other policy objectives or to correct market failures.

The Review went on to state that without guiding principles, this use of the business tax system to achieve other policy objectives can be a source of complexity. The pursuit of simplicity in business taxation should not be pursued to the extent that it precludes other considerations entirely. Complexity in application is not in itself an argument for the abolition of present tax concessions for, in particular, not-for-profit entities.

The purpose of such initiatives is to enable what the Review describes as "taxation expenditures" to be used to purchase services for the community that would otherwise be foregone by Government or for-profit providers. The current taxation arrangements that apply to not-for-profit entities as a consequence of the principle of mutuality results in the same beneficial outcome.

It is the view of this Association that such objectives of Government should continue to be valid objectives of any taxation system. The present taxation provisions as applied to not-for-profit entities do not provide benefits for personal or company gain but instead benefits communities which in turn ultimately benefits the Government's welfare policies and expenditure budget.

The validity of this view is reinforced by the Government's recent announcement regarding new business taxation policy when it stated that corporate charity was to be amongst its top policy priorities.

Under this new policy four amendments are to be made to the *Income Tax Assessment Act 1936* to provide for significant tax concessions to those businesses which make certain donations to eligible bodies; and donations made under the Cultural Gifts Program will be exempt from Capital Gains Tax. The proposed amendments are to commence on 1 July 1999; the tax to be foregone in the first year of operation is estimated to be $51 million.

In announcing its new policy the Prime Minister said:

"……truly great nations find within themselves ways to mutually support and nurture each element of their societies…..to seek out common goals, common values……"[3]

The words of the Prime Minister echo the philosophy of Friendly Society Pharmacies and other not-for-profit entities and sums up the reasons why they exist.

Their purpose is to provide benefits to the community in a manner that could not be replicated by Government services or fully compensated by either the personal tax system or the social security or related payments systems.

The value of the community services provided by not-for-profit entities should not be either wiped out or diluted by a taxation system that makes no provision for the direct transfer of benefits to the community by the effect of the mutuality principle or direct tax concessions as recently announced, simply because it adds "complexity" to the business taxation system.

[3] Media Report 26 March 1999

Conclusion

Friendly Society Pharmacies have served the needs of their members and the communities in which they operate for over 150 years. There were times during that period when they struggled for decades to survive under oppressive legislation and until the 1980s grossly unfair taxation arrangements.

It would have been easy for the Friendly Societies then to have closed their Pharmacies but their belief in the purpose of their existence and their concern for the needs of their members and the communities they served kept them operating.

Today the not-for-profit Friendly Society Pharmacy movement is vigorous and its value to the community generally, in continuing to provide competitive, highly professional and cost effective pharmacy services through its co-operative not-for-profit structure, should not be underestimated. Likewise its continuation should not be threatened by business tax reform measures that do not discern between not-for-profit entities and other entities.