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### **Draft Taxation Ruling TR 2011/D5 – Independent School Sector Comments**

The Independent Schools Council of Australia (ISCA) welcomes the opportunity to provide comments to the Australian Taxation Office (ATO) on the Draft Taxation Ruling TR 2011/D5 regarding the proposed changes to the operation of school or college building funds. ISCA is the peak national body covering the independent schools sector which also comprises the eight state and territory Associations of Independent Schools. Through these Associations, ISCA represents a sector with 1,090 schools and around 550,000 students, accounting for nearly 16 per cent of Australian school enrolments. ISCA's major role is to bring the unique needs of independent schools to the attention of the Australian Government and to represent the sector on national issues.

Independent schools are a diverse group of non-government schools serving a range of different communities. Many independent schools provide a religious or values-based education. Others promote a particular educational philosophy or interpretation of mainstream education.

All of these schools are not-for-profit institutions that are set up and governed independently on an individual school basis. Independent schools are registered with the relevant state or territory education authority. As a school, they have current reporting responsibilities to both the Commonwealth and State/Territory Governments on a range of schooling issues. Their legal structures can be diverse with many falling into the following categories:

- Schools that are fully owned by a church (e.g. some Uniting Church Schools);
- Schools established by state Acts of Parliament with the specific purpose of establishing the school as a charitable institution (e.g. some Grammar Schools);
- Schools which are an administrative unit operating within an Association or “system” owned by a church;
- Schools which are a company. Many of these are limited by guarantee and assets can be owned by an underlying church property trust. In some cases, the company owns the school outright;
- Public benevolent institutions (e.g. Yiparinya Indigenous School).



Some schools with common aims, religious affiliations and/or educational philosophies also belong to a system within the sector. This means that some operational functions are carried out by the system on behalf of all schools within the system. However, all schools have formal boards of governors or committees of management who are the key decision-making bodies for most independent schools and are responsible for issues such as the school's educational provision, current and future development and staffing.

Many independent schools are faith-based schools with varying degrees of legal and administrative links to their church bodies encompassing the full spectrum of faiths across the Australian community including not only the well-known Anglican, Uniting Church and Catholic schools, but also Lutheran, Baptist, Seventh Day Adventist, Islamic, Greek Orthodox, Christian and Jewish schools. Table 1 below provides a breakdown of the affiliations of independent schools.

**Table 1: Affiliations of independent schools, 2010**

Affiliation	Schools	Student FTE	%
Anglican	156	137,812	25.2%
Non-Denominational	188	72,100	13.2%
Christian Schools	136	53,757	9.8%
Catholic	64	50,702	9.3%
Uniting Church in Australia	43	49,289	9.0%
Lutheran	85	36,549	6.7%
Inter-Denominational	29	20,725	3.8%
Islamic	32	20,198	3.7%
Baptist	42	17,803	3.3%
Seventh Day Adventist	47	11,043	2.0%
Presbyterian	14	9,844	1.8%
Jewish	20	9,004	1.6%
Steiner School	42	7,515	1.4%
Pentecostal	16	6,838	1.3%
Assemblies of God	10	5,596	1.0%
Greek Orthodox	8	3,894	0.7%
Montessori School	39	3,955	0.7%
Brethren	8	4,025	0.7%
Other Catholic	8	3,469	0.6%
Other Orthodox	6	2,129	0.4%
Other Religious Affiliation*	11	5,033	0.9%
Other**	83	14,607	2.7%

\*Other Religious includes Churches of Christ, Ananda Marga, Hare Krishna and Society of Friends

\*\*Other includes special schools, international schools, indigenous schools, and community schools.

In order to be eligible for Commonwealth Government funding assistance, non-government schools must be not-for-profit. This is made clear in the *Schools Assistance Act 2008* Administrative Guidelines: Commonwealth Programs for Non-government Schools 2009-12 which state under the Commonwealth's requirements for eligibility for Commonwealth funding:

*“The memorandum and articles or other instruments by which incorporation is effected must:*

- a) include the power of the incorporated body to conduct a school; and*
- b) provide for the non-profit status of the body including a requirement that any surpluses generated by the school, or recognised group of non-government schools be used for the purposes of the school or recognised*

*group of non-government schools and not be transferred to any other activity that the body is authorised to undertake.”*

Currently in many areas of Australia there is unmet demand for places in independent schools, with many independent schools having extensive waiting lists. Examination of the growth in enrolments in independent schools over several decades shows that these increased enrolments have been achieved for the most part by increasing the size of existing independent schools rather than the costly undertaking of establishing new independent schools. As the large number of schools with extensive waiting lists would indicate, many schools have now reached their optimal operational size and have limited further capacity for expansion.

By 2020, DEEWR predicts that school enrolments in Australia will increase by 700,000 and of these, 150,000 will enrol in independent schools. This equates to the need a further 300 independent schools by 2020. Governments at both national and state/territory level will need to find the billions of additional dollars to accommodate the national expansion of student enrolments in all sectors. Raising the required level of funding for investment in new schools and upgraded facilities will be a huge burden for either level of government. Governments have acknowledged and supported the role of the non-government sector in establishing new schools by providing significant capital assistance to establish new schools and to expand existing schools. Without the capacity of the non-government sector to leverage private capital investment, governments are unlikely to be able to meet future demands for school enrolments and educational outcomes could be seriously compromised.

This current unmet demand for independent education, together with the projected enrolment growth and need for unprecedented expansion of new schools, means that significant resources will need to be directed to new independent schools. A continuing high level of investment in capital facilities for independent schools is required to support the enrolment growth that is occurring in the sector. The impact of these increased demands is reflected in the overall level of capital expenditure being incurred, which in the independent schools sector totalled \$1.7 billion in 2009. However, the greatest impact of this growth is expected to be on the smaller schools (over 200 independent schools have less than 50 students) without the resource base to finance building programs from parental contributions alone.

In the independent sector capital development is mostly financed by family contribution. In 2009 some \$403 million of parental contribution to the sector was contributed to be spent on capital development – for new facilities to meet the demands of growing student enrolments, for the refurbishment of existing buildings and to upgrade facilities and equipment to meet changing curriculum needs.

Independent committees, called Block Grant Authorities (BGAs) in each state and territory, administer the relatively small but important annual Capital Grants Program for non-government schools on behalf of the Australian Government. BGAs are third party legal entities which have been established to receive and assess applications, make recommendations to the Minister about various matters and administer non-government capital grants for participating schools.

There are two BGAs in each State, one Catholic and one Independent. There is a joint Catholic/Independent BGA in each of the Northern Territory and the Australian Capital Territory. Non-government schools wishing to apply for Australian Government grants must join the relevant BGA.

Australian Government Capital Grants are allocated between states and territories according to enrolment share, while the allocation to each BGA is calculated based on the proportion of General Recurrent Grant funding to schools in the BGA (accounting for 60 per cent of capital funding) and the proportion of total state/territory non-government enrolments (40 per cent of capital funding).

In the independent sector Australian Government Capital Grants (appropriated under the Schools Assistance Act 2008) are distributed on a needs basis, with priority given to disadvantaged school

communities with the least capacity to raise funds. In 2008, 65 per cent of total capital funding available to independent schools went to schools with an SES score below 100, and 88 per cent of grants went to schools with an SES score less than 110. (SES scores range from approximately 70 to more than 130.) As a result, many long-established independent schools receive no capital grants from governments. The extent and quality of their facilities reflect instead generations of contribution from families, former students and other donors which is in part facilitated by the existence of school building funds.

The independent sector is the fastest growing schooling sector and as such the demand for capital support is high. Many independent schools have these building funds as the only means of raising much needed private revenue associated with the continued provision of suitable capital investment for school building activities. Parents contribute more than 80 per cent of the cost of buildings and equipment in the independent sector, mainly through school fees and building funds. (This figure reflects the long term funding trends in the sector and does not include the one-off effect of the Building the Education Revolution).

Most independent schools also need to borrow funds to finance capital development and spread the cost of these borrowings over the generations of students who will benefit from the investment. This debt servicing is built into school fees. In 2009, the net borrowings of the sector for capital purposes were \$3 billion, which equates to approximately \$6,200 per student.

In early 2009 the Australian Government's Building the Education Revolution (BER) economic stimulus package was announced which included significant funding being made available to the independent school sector. This amounted to \$1.8 billion in school infrastructure in the independent sector and highlighted the benefits to many schools of the current deductible gift status of school building funds. This direct BER investment was increased in the independent sector as additional funding was contributed towards BER projects by independent school communities. The BER initiative directly leveraged an additional \$370 million in private contributions from these independent school communities towards BER projects.

The importance of school building funds to the future delivery of school infrastructure and attainment of educational outcomes in independent schools cannot be stressed too highly. With this in mind ISCA, on behalf of the independent school sector, has the following comments to make regarding the questions raised in the draft ruling:

### **General Comments**

The draft ruling would appear more restrictive on schools than the previous ruling and some schools may have to change their methods of applying DGR status to their schools. Although, much of schools' current practices are likely to remain unaffected. The areas that may have to change revolve around buildings that are used for multiple purposes – either simultaneously or separately. These would involve:

- Buildings which are used for religious purposes
- Buildings which are used by the community
- Buildings in which the schools undertake some commercial activities.

A further concern is the amount of grey area in some of the elements of the ruling. The aim of the ruling seems to seek the answer to three main questions:

- Does the school control the building?
- How often is the building used as a school building?
- In the event of a timing clash between different users, whose use takes priority?

It would seem that the last question could be the final, determinant factor. The problem for schools is that this assumes that the question has a simple answer – but what if circumstances dictate a different answer at different times? For instance, a school may have priority access to its chapel during school hours, while the church group has priority access outside of school hours.

In particular, the old ruling (TR 96/8) did allow a DGR to cover any building which was ‘connected with the curriculum of the school’ (paragraph 13). Now, under paragraph 20 of the new ruling (TR 2011/D5), the building must be an ‘integral part’ of the school’s operation. Similarly, paragraphs 23-25 note that buildings used for multiple purposes can only be included where the other use is ‘integral’ or ‘only minor or occasional’. While the ATO notes that this is a question of fact, the examples provided may not be sufficient to determine the answer to such a question. For instance, how would a school measure ‘minor or occasional use’ – by time allocated, by number of users, by revenue generated, by expenditure incurred?

In the examples provided by the ATO, the ruling outlines activities at each end of a spectrum of behaviours. While the two end points may clearly be in and out, where to draw the line between them is not so clear cut (see for instance paragraphs 64 and 65, discussed below). Again, this comes back to the ‘matter of fact’ – who determines this fact and when and how? How do they ensure that the matter of fact is determined on a consistent basis?

Another item of concern is the fact that ruling TR 96/8 was withdrawn on 30 November 2011, while the existing ruling is still only a draft. While the preamble to the draft ruling notes that anyone who relies on it is protected from interest and penalties, it does not provide similar protection those who rely on the old ruling. The logical course of action, therefore, would be for a school to comply with the draft ruling, even though it may subsequently be altered. As a procedural issue, we would argue that the existing ruling should remain in force until the content of the replacement ruling is confirmed, to prevent confusion. I would ask the ATO to note that the ATO was contacted to ask about this issue, and was told that it was a legal issue, and one about which they could not speak. The advice was that, if a school was concerned, they should seek a private ruling on the issue (which would take a couple of months, and which may or may not correspond to the final version of the draft ruling).

## **Specific Comments**

### *Paragraphs 10 & 11: Meaning of ‘established and maintained solely’*

Dealing with the meaning of ‘established and maintained solely’ appear much narrower than the ‘established and maintained exclusively’ in the original ruling. Rather than focusing on the general intent of the fund, it now obliges schools to look much more specifically at the purpose to which individual buildings are put. It would appear that schools must now go building by building, to determine which buildings are covered and which are not. Under the old ruling, it appears much easier for a school to justify the inclusion of a building in a DGR. While this change does not necessarily seem unreasonable, it is likely to require schools to undertake an audit of their buildings, to see whether buildings that were previously included need to be excluded.

### *Paragraphs 12 & 13: What is a ‘building’?*

ISCA would want to ensure that this definition covered the COLA (Covered Open Learning Areas) structures such as those built under the BER programme. A number of these structures may not have walls and in some instances, have a rudimentary floor yet we would understand that these should fall within the definition of school building.

*Paragraphs 27 & 28: 'Building used both as a school and for other purposes'*

It would appear from the examples given that the ATO recognises that the access to school buildings through the partnering of schools with their community groups is to be viewed as “minor or occasional” in determining whether a building is established and maintained solely for school use.

ISCA is concerned that the definition in point 27 of “minor” in quantitative terms (even if regular) or only occurs from time to time, may not cover the many situations in independent schools where a faith-based organisation may use a facility for a whole day each weekend. While we would not want to see a percentage placed on the usage, we are concerned that the term “minor” is open to significant interpretational differences which may limit the capacity of schools to make their facilities available to the community for fear of breaching this provision. This potentially conflicts with Australian Government requirements for BER and other capital programs that school facilities funded by the Australian Government either partially or fully, must be made available for community use.

Additionally, there are independent schools who have buildings which are integral to the school use, but are also highly sought facilities for out of hours hire due to the particular nature or capacity of the building (e.g. for weddings, sporting events or functions) .

ISCA is concerned that the hire of these facilities (in some cases for a financial return) would not be considered to be “minor or occasional” use in that they may not fit the definition of “occurs from time to time”. We believe that Point 28 better defines the term “minor or occasional” and that the situation would be much better clarified if Point 27 were deleted.

*Paragraph 32: 'Multi-purpose complexes'*

This paragraph dealing with buildings used for multiple purposes, would seem to imply that a school may have to set up two separate funds for two parts of a building which has multiple uses – one a DGR and one not, and the school would then have to pro rata costs for that building, with appropriate allocations from each fund. This could be unnecessarily complex.

*Paragraph 48: 'Maintenance costs'*

It would appear that maintenance and insurance costs remain legitimate expenses covered by a DGR. This would be a positive outcome.

*Paragraphs 56-59: 'Buildings on land that is leased'*

It would appear that the draft ruling specifically refers to buildings owned *or controlled* by a qualifying body, and that paragraphs 56-59 confirm that a DGR can cover buildings that are leased by schools. This would be a positive outcome.

*Paragraphs 64 & 65: 'Building integral to the operation of a school' and 'building not integral to the operation of a school'.*

These paragraphs give examples of when the use of a canteen for school purposes is ‘integral’ or ‘incidental’. In 64, the canteen is only used during school hours for school students, and is included. In 65, the canteen is used both outside school hours and for outside patrons, and is excluded. This does not identify what happens (for instance), with a middle situation – where the canteen is available to outside patrons, but only during school hours. ISCA has concerns with the premise that making a facility available to the public automatically makes it ‘incidental’ to the school’s operations. An example is a member school which operates a VET course in hospitality. As part of the course, they have a restaurant (part of an approved training facility), which provides meals to the general public outside of school hours. Much (but not all) of the time, this restaurant is at least partially staffed by students, undertaking accredited VET courses. However, it is not practical or economic for the school to open

the facility only when these students are available. The ruling seems to imply (although not confirming it absolutely) that such an operation would be deemed to be 'incidental', purely because it also has a commercial aspect.

*Paragraphs 162 & 163: Building used both as a school and for other purposes'.*

ISCA is concerned that the community use of buildings funded under the BER are effectively deemed to be incidental (see paragraphs 162 and 163), while other buildings, which may have been set up in very similar circumstances, and with similar intentions, do not receive the same benefit. This means that, in effect, the source of the funding can impact on the tax implications for the school. This would not be a positive outcome.

Yours sincerely

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