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RE: Review of ATO advice on scholarships – discussion paper

There are a number of scholarships provided to assist medical students including the Medical Rural Bonded Scholarship (MRBS) Scheme, the Rural Australia Medical Undergraduate Scholarship (RAMUS) Scheme, the Puggy Hunter Memorial Scholarships and the John Flynn Placement Program (JFPP).

While it would appear that RAMUS, the JFPP and the Puggy Hunter Memorial Scholarships are unlikely to be impacted by the approach outlined in the ATO discussion paper, we are concerned that, in relation to the MRBS or similarly designed programs, it will disturb a long established interpretation of relevant taxation law. It will undermine future efforts to address medical workforce shortages and have a direct impact on the MRBS and its existing participants.

The AMA notes that scholarships paid to a full-time student at a school, college or university currently are exempt from taxation, subject to specific exceptions and conditions. Paragraph 51-35(e) of the *Income Tax Assessment Act 1997* (ITAA 1997) specifies the following is not exempt under section 51-10:

‘a payment under a scholarship where the scholarship is not provided principally for educational purposes;’

In relation to the MRBS Scheme, it has been treated as having tax exempt status with the Department of Health (DoH) publishing the following advice:

The Scholarship currently meets the requirements of exemption under 51-10 of the Income Tax Assessment Act 1997 and is therefore exempt from income tax. MRBS Scheme participants are not required to include the Scholarship income in their tax return¹.

The same publication goes on to state that the source of this advice is the ATO as follows:

2.26 Will I have to pay income tax on the MRBS Scheme?

No. The Australian Taxation Office has advised that the MRBS Scheme is currently exempt from income tax because it meets the requirements for exemption under section 51-10 of the Income Tax Assessment Act 1997.

Current MRBS participants have entered the scheme with the clear understanding that scholarship payments would be tax exempt. This would have been a critical consideration in their decision to accept an MRBS place at university and, if the ATO changes its position on this, then they will have been fundamentally misled and now locked into commitments that they might otherwise have declined. If the ATO is intent on changing its position, then the tax exempt status of existing recipients should be grandfathered as part of any changes.

Impact on MRBS and similar programs

The MRBS was established in 2001 and was closed off to new entrants following the 2015 Budget. In 2015, there were 421 MRBS students still at medical school receiving this scholarship and it will be some years before all of these students graduate. Besides a quarantined Commonwealth Supported Place at medical school, the MRBS provides recipients with financial and non-financial support to assist with their education. The latter includes communication, educational and networking activities. As part of the scholarship conditions, recipients must agree to work in designated rural areas for six years once they have attained fellowship of a medical college.

From our reading of the ATO discussion paper, the MRBS and similar programs will be caught by the ATO's proposal to interpret paragraph 51-35(e) very narrowly, such that a 'principal purpose' need not involve commercial benefits. Unfortunately, the ATO proposes to take a very black and white view according to the following statement taken from the discussion paper:

For example in a government program for a bonded scholarship, the fact that there is an intended work outcome such as geographical placement, means that the principal purpose of the provider of the scholarship is not one (principally) of providing education. Rather the principal purpose is one of ensuring that certain activities are provided in a particular area by the former student, consistent with the main purpose of the government, being its policy intent, and not providing education to a particular student or students.

In seeking to draw such a black and white distinction we think that the ATO has given too much weight to the return of service obligations and little consideration to other relevant factors. Clearly the provision of a quarantined CSP place at medical school as well as financial and non-financial support for an MRBS recipient's education are very relevant factors in determining what the principal purpose of a scholarship is.

The ATO discussion paper makes reference to the case of *Federal Commissioner Of Taxation V Hall*ⁱⁱⁱ in the context of its analysis of 'principal purpose'. We would agree that the reasoning in *Hall*ⁱⁱⁱ is still valid, despite legislative amendments since it was decided. On this point, we note that the respondent in *Hall*^{iv} was in a very different situation from that of a student bonded to work in a particular area after graduation. In *Hall*, the money provided was based on a fellowship for specific research:

'The money was obtained ... for a special purpose, and for a named person, [the respondent]; and the donor of the money was allowed to remain with the belief that it was paying [the respondent] for a specific task being undertaken in pursuance of its charitable objects. Fundamentally the payment was for the provision of assistance...in a project...for the Foundation.'^v

Although we note the Court's view in *Hall*^{vi} that the provider of the funds was doing so for 'purposes of its own'^{vii}, the case is distinguishable by the very specific nature of the respondent's activities during the period of his university study. His activities were more in the nature of research and work on a survey. Education was clearly a collateral benefit of what was essentially a paid position as a research fellow. This is very different from an undergraduate course in medicine.

The case of *Ranson*^{viii} has also been cited in the discussion paper in the context of the relationship between the scholarship provider and the recipient and it is noted that: 'Where the granting of the scholarship is in anyway conditional upon the student working with the provider, even expectation of an employment or contract for labour relationship, then the scholarship will not be exempt'.

Again, we concur that the reasoning in *Ranson*^{ix} remains relevant, but we would note in that case, the provider of the scholarship was a commercial entity, operating for obvious commercial purposes. Scholarships provided by the Commonwealth, even where there is a service obligation to the Commonwealth, should not be characterised in the same way. The policy intent of providing doctors in areas of need is not based on commercial gain.

The design of the MRBS shows that the Commonwealth understands that, while the return of service is important, educational support is a critical component of the scheme. From the perspective of the recipient the financial and other support for their education will clearly be the most important consideration. Indeed, if the latter were not the case, they would have no reason to enter the MRBS scheme in the first place.

We can understand the policy position that scholarships that are offered in return for a direct or indirect commercial benefit to the provider should be subject to income tax. However, it seems contrary to good public policy for the ATO to take a position that the tax-free status of scholarships like the MRBS should be in question simply because there is a benefit to the community incorporated into the scholarship conditions. Virtually every scholarship has a component that is outside of a narrow 'education' interpretation. The fact that the recipient, the provider and the community are all likely to benefit from the education of individuals is a natural consequence of education.

The disparity in access to health services between metropolitan and rural areas is well known. According to the Australian Institute of Health and Welfare in its report, *Australia's Health 2014*^x:

'People living in rural and remote areas have less access to health services, travel greater distances to seek medical attention, and generally have higher rates of ill health and mortality than people living in larger cities.'^{xi}

The same report also highlights that *'The supply of all medical practitioners decreased with remoteness.'*^{xii}

In this context, programs like the MRBS can play an important role in addressing disparities in access to health care. While we appreciate the ATO's position that clear advice may obviate the need for a number of class rulings and save resources, the blunt approach that is proposed has the potential to significantly undermine the value and impact of programs like these. It gives rise

to significant negative unintended consequences through the interpretation of the concept of educational purposes under s51-35 in such a narrow way.

Our concerns with the discussion paper could be neatly addressed by removing the consideration 'non-commercial benefits' when determining if a scholarship is principally for educational purposes. This would effectively make scholarships exempt from tax unless they are very specifically for the commercial benefit of a private entity. We do not see this as being inconsistent with the relevant provisions of the ITAA 1997 and at the same time it would support good public policy.

The AMA would be happy to discuss this issue with the ATO in further detail at any time. Should you have any queries, please contact Warwick Hough on (02) 6270 5488.

Yours sincerely



Dr Michael Gannon
President

ⁱ Department of Health. 'Medical Rural Bonded Scholarship Scheme. Student Information Booklet for 2015'. Page 6. Accessed 20 February 2017.

ⁱⁱ *Federal Commissioner Of Taxation V Hall* - (1975) 6 ALR 457

ⁱⁱⁱ Ibid

^{iv} Ibid

^v Ibid, 468

^{vi} *Federal Commissioner Of Taxation V Hall* - (1975) 6 ALR 457

^{vii} Ibid, 467

^{viii} *Federal Commissioner of Taxation v Ranson* (1989) 25 FCR 57

^{ix} Ibid.

^x <http://www.aihw.gov.au/WorkArea/DownloadAsset.aspx?id=60129548150>

^{xi} Ibid, p24, citing AIHW 2013e. Rural health. Canberra: AIHW <<http://www.aihw.gov.au/rural-health/>

^{xii} Ibid, p 367.