A submission of The Smith Family

to

Australia’s Future Tax System Review

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THE SMITH FAMILY

everyone’s family

Preface

The Smith Family[1] welcomes the opportunity to make this submission to Australia's Future Tax System Review. The design of the tax and transfer systems impacts significantly on the distribution of income and opportunity in society. Given low socio-economic background is closely correlated with life outcomes for children and young people, the overall level of taxation and the design features of transfer payments are likely to be key determinants of outcomes for children and young people.

The Tax Review provides a fundamental opportunity to redesign these systems and invest in the future of Australian society. The design of the tax and transfer systems should recognise that children and young people not developing optimally imposes significant costs on society and limits development of human capital.

After a long period of economic prosperity and security, Australia is now feeling the impact of the global financial crisis, with Government spending measures being put in place to limit the adverse impacts as much as possible. In such a context, tax policy can be a powerful partner to Government spending and careful consideration of the design of tax policy and the role it can play in assisting economic activity and the non-profit sector becomes even more significant.

The Smith Family has been part of the Australian non-profit landscape for over 87 years, working together with caring Australians to unlock opportunities for disadvantaged families to participate more fully in society. Featuring evidence-based research and with special regard to disadvantaged communities, our submission provides a perspective on the contemporary challenges children, young people and their families face, and how Australia's tax and transfer systems can facilitate better educational outcomes and life chances for children and young people, greater workforce participation and productivity, and lifelong learning.

Our submission will also address how the current treatment of tax and compliance obligations affect a national social enterprise such as The Smith Family, and identify features that are essential for the long term sustainability of organizations such as ours.

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[1] See Appendix I.

1. Promoting social inclusion through a simple and equitable tax system

The design of the tax and transfer systems impacts significantly on the distribution of income and opportunity in society. The Australian Government has clearly articulated a vision for a "fairer" socially inclusive Australia – a society whereby individuals, families and communities have an opportunity to participate fully in all aspects of Australian life. To be socially included, all Australians must be given the opportunity to: secure a job, access services, connect with family, friends, work, personal interests and local community, deal with personal crisis and have their voices heard. To this end, the review of Australia's tax system is an important opportunity to reduce some of the social and economic barriers that restrict disadvantaged families' ability to experience real social and economic choices in life.

Over the last decade, The Smith Family has conducted a range of research projects around these barriers that illustrate the cumulative reinforcement of disadvantaging factors in Australian families, with financial hardship one of the root causes along with low levels of education. Poor financial management at the level of the household, combined with the complexity of the taxation system has acted as a disincentive for low income parents to invest in their employability, leading to poor role-modeling and further limitations around parents' ability to provide a stimulating and supportive home environment for their kids. The *indirect* impacts of a complex and inequitable tax system are therefore significant, in hindering the optimal development and socioeconomic participation of the next generation of Australians.

For example, our most recent research report '*Home to school transitions for financially disadvantaged children*' shows that clear links exist between financially disadvantaged families and children's readiness for school and their later academic achievement and adjustment. The report uses data from Growing up in Australia: The Longitudinal study of Australian Children and finds that children from financially disadvantaged families are at greater risk of poor school readiness due to the much higher rates of risk factors evident among this group and the accumulation of risks experienced. Children from financially disadvantaged families who had shown low school readiness at 4-5 years also tended to have more literacy/numeracy problems, lower engagement in learning and more social/emotional difficulties at 6-7 years than children from non-financially disadvantaged families.[2]

[2] Smart, D., Sanson, A., Baxter, J. & Hayes, A. (2008) *Home to school transitions for financially disadvantaged children.* The Smith Family / Australian Institute of Family Studies: Australia.

A simpler, streamlined tax and transfer system

The current tax and transfer systems have, in part, evolved separately. Together, they determine the disposable income of families and young people, their incentives to work and save, and their investment decisions, including in education and training. While in the past individuals were more likely to be in either one system or the other, today they are more likely to be in both.[3] Many families receive transfers and pay tax in the same year or over a period of years.

The Smith Family is concerned that complexity in the system may provide perverse incentives and distort decisions relating to work, consumption and saving practices that see the disadvantaged making poor, uninformed choices that adversely affect their financial situation and increase the level of uncertainty about the expected payoffs to long-term investment decisions, such as investment in education.

Income taxes, the Family Tax Benefit, child care payments and rebates, allowance payments such as the Newstart Allowance and the Youth Allowance are the main Australian government taxes and transfers impacting on children and young people. However, different bases of assessment are used across these, including the definition of income, the unit of assessment, the period of assessment and the basis of eligibility.

Different types of payments are taxed differently. Some payments, such as the Newstart Allowance, Youth Allowance, the student payments of Austudy and ABSTUDY, and Parenting Payment are taxed as income, with tax offsets that are designed to ensure the tax liability for maximum rate full-year recipients is zero. Other payments, including Family Tax Benefit, childcare assistance payments, assistance on the birth or adoption of a child (Baby Bonus, Carer Payment and most supplementary payments (e.g. Rent Assistance) are not included as income for tax purposes.

These different bases and different forms of treatment of payments have been used largely to achieve a targeted system, but they lead to many families and young people struggling to navigate a myriad of provisions and rules. Clearly, there is a need for much greater integration and simplification of the tax and transfer systems. Reducing the complexity could improve the overall efficiency of the system and reduce the administration costs. It can also improve the transparency of the systems, which is especially important for the less financially literate in society, which include a majority of children, young people and families from low socio-economic backgrounds.

In reviewing the tax and transfer systems, it is also essential to get the right balance to ensure that families and young people can have their basic needs met and experience a decent standard of living, while incentives to invest and engage in paid employment are not weakened. The latter is particularly important to minimise the risk of children and young people who do not have parents in paid employment experiencing a lack of positive role

[3] Commonwealth Government (2008) *Tax Review Consultation paper.* Commonwealth, ACT p34.

models in addition to significant economic disadvantage. Recent research has made clear the long-term impacts that can arise from growing up in a jobless household, revealing that by Year 3, children from families where neither parent has worked for twelve months or more, perform considerably worse against reading, writing and numeracy benchmarks.[4]

In addition to these changes regarding the way in which the tax system targets or segments Australian families, it would also be beneficial to enhance how the current system operates or interacts with these families. Research has shown that due to poor savings practices and financial literacy skills, low-income families are those most in need of regular income supplements, and yet at present they are required to wait for an end of tax year rebate. Such families may also find it difficult to estimate their annual income accurately and any system that requires estimation of annual income and that has the potential to leave families with a debt that must be repaid to the government should be avoided. The latter situation places additional financial burden on families who can least afford it. Rebates should therefore be available throughout the year based on actual income.

Support by the Australian government is generally targeted to lower income families and individuals through the use of means tests. While the use of means tests is supported, it is desirable to review the basis and operation of the means tests to remove perverse incentives for female and youth employment and poverty traps. [5]

Recommendation 1:

The Smith Family recommends that the re-design of the tax and transfer systems reduce complexity, and support parents and young people to accurately assess their financial situation and adequately plan for their future. Such a system would also look to better balance support for the disadvantaged with incentives for workforce participation.

Recommendation 2:

The Smith Family recommends that families be able to choose whether to receive regular family rebates during the year or to wait for a single end of year rebate.

Recommendation 3:

The Smith Family recommends that the basis and operation of means tests be reviewed to remove perverse incentives for female and youth employment and poverty traps.

[4] (2008) *National Assessment Program Literacy and Numeracy, Achievement in Reading, Writing, Language Conventions and Numeracy*

[5] Aust Government (2008). *Social Inclusion Cabinet website:* http://www.socialinclusion.gov.au/ *viewed 6.08/08*

Ensuring vertical equity in the tax system

The *Tax Review Consultation paper* (2008) notes that equity is generally agreed to be an important principle for the system, but there is no consensus about exactly what equity is or how to measure it. In his *Nicomachean Ethics,* Aristotle equated fairness with justice and suggested that in a just system "equals are to be treated equally and un-equals unequally".[6] In 1776, Adam Smith further developed this definition and stated that "the subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities".[7] This describes a transfer system based on the principle of vertical equity.

Vertical equity supposes that people who have different levels of income, should pay levels of tax consistent with their income, or ability to pay.[8] The overall combination of the tax and transfer systems in Australia is progressive and redistributive. The Smith Family proposes that personal income tax levels continue to be driven by the principle of vertical equity, with high earning tax payers offsetting the tax burden for low income earners and disadvantaged Australians. Concomitant with our Mission to unlock opportunities for disadvantaged families to participate more fully in society, The Smith Family believes this will help enable people to escape poverty and improve their life opportunities.

Recommendation 4:
The Smith Family recommends that personal income tax levels and benefit withdrawal thresholds continue to be driven by the principle of vertical equity, building on the foundations of social inclusion as the desired outcome of the Australia's tax and transfer systems.

[6] Aristotle (1975, Translation by H. Rackham). *The Nicomachean Ethics.* Cambridge: Harvard University Press. Cited in American Institute of Certified Public Accountants (AICPA) (2007) *Tax Policy Concept statement: Tax Equity and Fairness.* AICPA: USA.
[7] Smith, A. (1976) [1776]. *An Inquiry into the Nature and Wealth of Nations.* E. Cannan (ed.). Chicago: The University of Chicago Press.
[8] Zajac, E. E. (1995). *Political Economy of Fairness.* MIT Press: Cambridge.

2. A 'parent–friendly' tax system to support children's optimal development in the early years

Parents perform the most critical task in our nation, raising the next generation of Australians and contributing to the human capital that the nation requires for both social and economic prosperity. While the current tax system recognises the importance of families through a number of targeted initiatives, there are still gaps and opportunities to support their critical role more comprehensively.

The issue of paid parental leave is critical in this respect, with Australia is still only one of two OECD countries that have not implemented such a scheme.[9] Research indicates that paid leave with employment protection can strengthen mothers' attachment to the labour market, recommending around six months as optimum.[10] A Paid Parental Leave Scheme in particular provides an important opportunity to support parental care in the crucial early years, strengthen families and promote a healthy work/life balance. Ensuring that a streamlined tax system is able to support and complement these policies could therefore be a powerful way to further reduce the tail of disadvantage in the future.

While paid parental leave provides a specific opportunity, it is important for the future tax system more broadly to provide integrated and clearly communicated 'parent-friendly' incentives. This will be fundamental in breaking the cycle of intergenerational disadvantage and strengthening the family unit within society. From a preventive perspective, the tax system would do well to focus in particular on supporting the early years, which Australian and international evidence has confirmed as a formative period, setting the foundations for life and being a crucial factor in determining an individual's life chances as they progress through the various stages and transitions of the life course. Neurological, psychological and sociological research indicates that an adult's physical and mental health and well-being are influenced by the developmental opportunities in the early years, when a child's brain is rapidly developing, and the foundations for learning, behaviour and health over the life course are set.[11]

Research by The Smith Family and others has shown that early intervention programs can work towards decreasing the number of individuals reliant on income support, with education critical in enabling people to become 'self-reliant' and in facilitating 'social inclusion'. Poverty is well recognised as being intergenerational, but access to quality and productive education may lead to upward socio-economic mobility; thus overcoming the need for / instance of welfare dependency. Channelling resources into parental education and early childhood intervention will significantly decrease the amount of money the nation spends on income support. Numerous cost-benefit analyses, meta-analyses and longitudinal

[9] Australia and the US are the only two countries in the OECD who do not have a paid parental scheme. Source: Productivity Commission 2008, *Paid Parental Leave: Support for Parents with Newborn Children*, Draft Inquiry Report, Canberra.

[10] OECD (2007), *Babies and Bosses - A Synthesis of Findings for OECD Countries.* OECD: France.

[11] Shonkoff, J.P. and Phillips, D.A. (eds) (2000), From Neurons to Neighbourhoods: The Science of Early Childhood Development, National Academy Press, Washington, DC.

studies, including those by Karoly and others at the RAND Corporation, by the Nobel Laureate James Heckman, and the well known High/Scope Perry Preschool Study all highlight the significant returns, with benefit cost ratios of up to 17:1, to investment in the early years and the value of governments supporting positive early childhood experiences.

We know that parents play a critical role in supporting and participating in the early development of their children, with the quality of the family environment a powerful factor in reducing the chances of the cycle of disadvantage continuing to the next generation. With few resources to draw upon, creating a positive family environment for early childhood development can prove extremely challenging for low SES families. Factors such as the number of books in the home and the child's exposure to different educational toys and resources have therefore been shown in research to be crucial in this respect.[12] However, fewer financial resources significantly constrain the ability of many disadvantaged parents to invest in these resources and provide the most advantageous home environment for their children.

Recommendation 5:
The Smith Family recommends that the tax system promote a 'parent-friendly' perspective that includes supporting a paid parental leave policy with provisions set at minimum wage, for all new mothers with a reasonable attachment to the workforce, to cover a minimum duration of six months. This will allow parents to stay at home and care for their babies without risk of financial strain or disadvantage, and give Australian children the best possible start in life.

[12] The Smith Family / Centre for Community Child Health (2004) *Let's Read – Literature Review.* Supported by the Telstra Foundation, March 2004.

3. Supporting the acquisition of skills by children and young people to build a future

Early interventions with children are not so productive if they are not followed up with ongoing investments during their primary and high school years. We need to invest early in children and not stop.[13] Research has identified a clear relationship between the development of good literacy and numeracy skills at an early age, and higher levels of educational achievement, greater employability, higher earnings and greater social participation. Conversely, poor literacy and numeracy skills have been linked to higher rates of welfare dependency, low self-esteem, substance abuse and teenage parenting. Findings also show that achievement gaps tend to widen as students progress through school.

Achievement in school is one of the strong predictors of student outcomes and future life chances. Drawing on the ABS Education and Work survey, the Foundation for Young Australians' report *How young people are faring* (2008) presents figures on the education and labour market status of school leavers in the year after leaving, showing the relative impact of leaving school early compared with completing Year 12. School completers have an advantage over early leavers in terms of both entering further education (six in every ten compared with around one-third of early leavers) and when it comes to the labour market, where they are more likely to secure employment, especially full-time work. While research from many different sectors has confirmed the multiple benefits of schooling to the end of year 12 in accessing employment and moving beyond the limitations of intergenerational disadvantage,[14] students from disadvantaged backgrounds are continually identified as having disproportionately high rates of early school leaving.[15] For example, in 2006, only 58% of young people from low SES backgrounds attained Yr 12 or equivalent compared to 71% for all students.[16]

Research has shown that for the long term and very long term unemployed, personal factors such as low literacy and numeracy, an absence of the vocational skills required by employers and poor exposure to work experience can act as barriers preventing them from finding sustainable employment.[17] It is no coincidence that early school leavers and the low skilled make up a majority of the long term unemployed.

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[13] Heckman, J.J. (2006) 'The Economics of Human Skills: Evidence and Policy Implications'. Presentation to the Research School of Social Sciences, The Australia National University, 7 February 2006

[14] Entry requirements for many jobs now increasingly demand high levels of educational attainment meaning that 'twelve years of schooling are now considered a basic requirement for an educated population' (Bagnall, 2001). Those who leave early are more likely to be unemployed, obtain low skilled work, earn less money and have a higher probability of not being in the labour force compared to those who complete Year 12 (Fullarton, 2001).

[15] Early school leavers are defined here as those students who are unable for whatever reason to complete schooling to the end of Year 12 or its equivalent.

[16] Australian Bureau of Statistics (2006b) *Schools, Australia* Canberra: ABS.

[17] Martyn, T. (2006) *Training for work is more effective than working from the dole.* Uniya Jesuit Social Justice Centre: Sydney.

Further to this Australia faces a particular skills shortage at the trade and associate professional levels. Currently, 87 per cent of available jobs require post-school qualifications, but 50 per cent of the workforce lacks these qualifications.[18] We are failing more than 300,000 young people aged between 15 and 24 who are either unemployed or working part-time and not undertaking full-time education. Currently, the overall level of unemployment is 4.3 per cent; the unemployment rate for 15-to-24-year-olds is more than double that rate at 9.1 per cent.

The Smith Family has continually focused its program initiatives to assist disadvantaged Australians in acquiring skills to participate in the new knowledge economy. Our flagship *Learning for Life* program currently supports close to 30,000 students across 94 communities nationwide, and provides education support, financial scholarships and role model guidance through mentors from birth through school to work / further learning transitions. We have also produced a number of reports over the years exploring the various financial, educational and technological barriers that disadvantaged students face in participating throughout the education system.[19] The Higher Education Loan Program (HELP) allows eligible students to defer their student contribution (through HECS-HELP) and repay it later through the taxation system. With regard to university costs, external research has revealed how HECS and HECS-HELP have increased participation rates for middle and high SES students, however, the scheme has not significantly increased the participation of low SES students. Our research has shown that low-income households devote much less of their budgets to education than medium and high-SES groups, which suggests that low SES students, even with HECS-HELP assistance can still face significant financial challenges.

Furthermore, the current HECS may be providing disincentives for low income students to complete more expensive and time-consuming degrees compared to less expensive degrees taking shorter times. This situation is exacerbated by a strong demand from industry for employees with work experience, as well as university qualifications. While cadetships, where students combine work and study, would be a good approach to addressing these needs, the current tax system provides a significant financial disincentive for employers to pay the HECS fees of employees. Under current legislation, employers who pay the HECS fees of student employees incur Fringe Benefits Tax at the top individual marginal rate of 46.5%. This limits the number of employers who are willing to develop cadetship programs.

The commitment by the Australian government, under the National Early Years Workforce Strategy, to pay half the HECS-HELP debts for early childhood education teachers who work in rural and regional areas, Indigenous communities and areas of socio-economic

[18] Heather Ridout, CEO of the Australian Industry Group (AiG) commenting on the skills and training reforms proposed by the Victorian Government highlighted four critical tests for the reform to meet the needs of more young people in need of contemporary work ready skills: a real increase in the overall investment in skills development; a quantifiable and relevant increase in the skill levels of the working age population; quality improvement; and, compatibility with the national training system (The Australian, 02 July, 2008).

[19] The Smith Family (2003). *Barriers to Participation – Financial, Educational and Technological*. The Smith Family / Orfeus Research: Sydney

disadvantage for up to five years is also a welcome development.[20] Similar arrangements should be established for young people in other professions who work in rural and regional areas, Indigenous communities and areas of socio-economic disadvantage.

Recommendation 6:

The Smith Family recommends that the HECS-HELP scheme be reviewed and redesigned to remove disincentives for low income young people to undertake tertiary studies and to avoid having young people start their full time working life with a substantial debt.

Youth allowances also require review. Youth Allowance (Student) is for full-time students in secondary or tertiary education or training and full-time Australian apprentices aged 16 to 24 years, undertaking an approved course of study. Youth Allowance (Other) is for young people aged 16 to 20 not in full-time study who are seeking or preparing for work or temporarily unable to work.

While rates for people with children are similar to equivalent Newstart Allowance rates, lower rates are paid to partnered young people without children or living away from home, and young people living at home. Youth Allowance for non-independent young people is paid subject to parental means testing. Youth Allowance for 16-17 year olds is lower than FTB for younger children, which is a clear anomaly as costs of children rise with age.

Recommendation 7:
The Smith Family recommends that the parental income test for Youth Allowance be redesigned to increase the levels of payment for young people and achieve greater parity with Newstart.

It maybe also possible to use the business tax system to increase employment opportunities and workforce engagement for young people. Tax incentives could be considered for businesses that employ longer term unemployed young people or participate in youth mentoring programs and programs for increasing youth engagement with work.

Recommendation 8:

The Smith Family recommends that tax incentives be provided for businesses that employ longer term unemployed young people, or participate in youth mentoring programs and programs for increasing youth engagement with work.

[20] The Australian Government is investing $126.6 million over four years to train and retain a high quality early childhood education workforce. This funding will provide incentives to improve the qualifications of child care workers and support more early childhood teachers, including in remote and disadvantaged areas. The reduction in HECS-HELP debts will provide a benefit of up to $1 600 per year over five years, for a total benefit of $8 000, to eligible early childhood teachers. In addition to lower HECS–HELP debts the Government has also committed to provide fee free access to early childhood TAFE Diploma and Advanced Diploma courses with ready access to a university place in an early childhood teaching degree course. retrieved 30/04/09 http://www.deewr.gov.au/EarlyChildhood/OfficeOfEarlyChildhood/Workforce/Documents/National_Early_Years_Workforce_Strategy.pdf

4. The impact of the tax and transfer system on non-profit organisations

Tax treatment for NFP organisations, including compliance obligations

The taxation system provides a number of concessions and benefits to the not-for-profit sector which are aimed at enhancing its capacity to provide support to the community in a multitude of forms. Principal concessions allowed by the Commonwealth include exemptions from Income and Capital Gains taxes, and limited Fringe Benefits and Goods and Services Tax concessions, while state-based concessions relate principally to payroll tax and certain stamp duties. In addition, the Commonwealth effectively provides an additional concession through the tax deductibility of gifts to certain not-for-profit organisations by individuals.

The overall taxation system for not-for-profit organisations is a confusing one with many tax concessions being differentially applied according to the nature of each type of not-for-profit organisation (for example charities, public benevolent institutions and health promotion charities, deductible gift recipients, not-for-profit and public hospitals), while state-based taxes and duties are inconsistently applied. Clearly greater benefits accrue to those organisations which can be classified as public benevolent institutions and health promotion charities, as demonstrated in Table 7.1 on Page 162 of *Australia's future tax system – Consultation Paper*.

The cost of the concessions provided to the sector is relatively small when compared to the multiplier effect of the increased community investment which they promote. Estimates are available for the cost of tax deductibility of donations and of FBT concessions, the lack of estimates in relation to income tax revenue foregone is probably not important – the sector is, after all, defined as not-for-profit, so this amount will not be large. Similarly, the quantum of foregone GST revenue is likely to be small – only smaller organisations are able to take advantage of the concession and while they do not remit GST on otherwise taxable revenue, they are not in a position to claim input tax credits on their purchases.

From this it follows that any reduction in those concessions will have a significantly greater detrimental effect on the sector than the savings generated to the Commonwealth and/or states, and to the extent that changes apply to the community services sector, there is a strong likelihood that demand for support through the welfare benefits system would increase.

The extent of confusion in the sector about the availability and applicability of tax concessions which was articulated in the 2001 *Report of the Inquiry into the Definition of Charities and Related Organisations* (referenced in *Australia's future tax system – Consultation Paper*) is essentially unchanged. There is scope to simplify the arrangements by removing some of the distinctions between different not-for-profit categories, but this should be done on the basis of expanding eligibility for concessions rather than limiting them, as this approach would allow government to make relatively low cost changes which would make a significant contribution to the financial capacity of the sector.

Fringe Benefits Tax

One of the key concessions in the sector, at least among public benevolent institutions and health promotion charities, is the exemption from the payment of Fringe Benefits Tax. In line with its initial intent, this concession has been very useful in allowing not-for-profit organisations to compete with the private sector for the services of high calibre staff by offering market value salary packages at reduced cost, and maximising the resources available for service delivery. Because the exemption has been capped, however, its value has been steadily and significantly eroded by the impact of both inflation and changes to marginal tax rates since the grossed up taxable value of $30,000 was set in July 2000.

If non-profit organisations are to be able to continue to compete effectively with the private sector for staff this threshold needs to be increased either by indexation (or perhaps alternatively by considering setting the exemption as a percentage of an employee's overall package). While it is appropriate that the Panel has been asked to examine the complexity of existing FBT arrangements for the not-for-profit sector, we suggest that this is a matter of concern to all sectors as the cost of compliance with FBT legislation is significant for any business, although the complexities may differ from sector to sector.

Dividend Imputation Scheme

The not-for-profit sector benefits from the dividend imputation scheme, which allows income tax exempt investors to claim credits for the tax already paid by Australian companies. Organisations in this sector have had to diversify their sources of funding in the face of increasing demands on their services and in order to guarantee the availability of regular income streams that allow them to address those needs in a sustainable fashion. The possibility of the dividend imputation scheme being wound back (as has been mooted recently in the context of offsetting the cost of a reduction in the company tax rate), particularly in the current economic environment, will have a substantial detrimental effect on the capacity and security of the sector.

The scheme also benefits self-funded retirees through their superannuation funds, effectively providing them with a higher rate of return than would otherwise be available. As with the not-for-profit sector, a winding back of the scheme may therefore adversely affect their fund returns. This may lead to a drop in our revenues, as self-funded retirees are some of our strongest supporters, as well as increasing the burden on public funds through increases in pension costs.

Funding and tax concessions for non-profit organisations

Tax concessions as they are presently structured serve to help eligible organisations to compete with the private sector in the area of staffing (discussed above), and to encourage philanthropy in the community through the tax deductibility of donations, and the broadening of the definition of what is a donation in the context of fundraising functions has been helpful in recent years in expanding the potential to raise funds from the public.

Gift deductibility

Support from and engagement with the community are at the core of The Smith Family's vision of a more caring and cohesive Australian society. While the extent to which tax deductibility promotes increased giving may be unclear, it is not unreasonable to expect that a move away from the present taxation-supported approach to giving in favour of approaches such as direct funding will, at least in the short term, lead to an overall reduction in giving, with an attendant adverse impact on levels of personal involvement.

Care would need to be taken in seeking to re-structure this process, and the alternative models suggested such as the UK Gift Aid scheme may serve simply to shift some of the perceived compliance burden (and hence cost) onto the beneficiaries, while the suggestion that Deductible Gift Recipients be allowed to collect tax file numbers and pass donation details to the Australian Taxation Office would be inherently unworkable. At the end of the matter, it is up to the individual to whether or not to claim his entitlements and those that wish to do so will collect the necessary information for this to happen. It is The Smith Family's experience that very few donors find the need to request replacement receipts, and in any case with the growing access to email, the cost to DGRs of meeting such requests has been falling.

WorkPlace Giving - Using corporate partnerships to stretch the dollar further

It is possible to model a donor leverage effect arising from non-profit organisations being able to 'stretch' the value of the funds they receive.

The financial value of Workplace Giving is contributing to what The Smith Family refers to as the 'virtuous circle'. Participation in pre-tax Workplace Giving opportunities encourages supportive employers to match employee contributions, and to commit to Corporate Social Responsibility (CSR) in other ways. Similarly, employee Volunteering Programs give staff the chance to learn more about their community needs and bring this new consciousness and awareness back into the corporation with them. The culture of CSR and community partnerships then becomes more widely propagated internally, impacting the employer's view of how their company situates itself within the community. This then contributes to the creation of a supportive environment for the broader and fuller adoption of CSR within the company's operations, leading to greater community involvement and thus completing the virtuous circle between businesses, their staff and their communities.

Income tax exemptions for commercial activities

The appropriateness of the income tax exemptions granted to the commercial activities of income tax exempt charities has been considered by many inquiries during the last 15 years and most recently in a specific set of circumstances by the High Court of Australia (*Commissioner of Taxation v Word Investments Limited* [2008] HCA 55). The argument for removing the income tax exemption has been based principally on assumptions that it provides a competitive advantage to the exempt body. This is not the case. The view expressed by the Industry Commission in its 1995 report *Charitable Organisations in Australia* remains valid today:

> *…the income tax exemption does not compromise competitive neutrality between organisations. All organisations which, regardless of their taxation status aim to maximise their surplus (profit) are unaffected in their business decisions by their tax or exempt status.*

Not-for-profit organisations generally operate commercial activities to support their missions either directly (in the case, for example, of sheltered workshops) or indirectly as a source of funds to support their programs. The organisations concerned seek to maximise the returns from all of their activities, as does any commercial business Whether or not those returns are taxed subsequently is irrelevant to any discussion of competitive advantage – the imposition of income tax would simply serve the reduce the resources available for the charitable activities of the organisations concerned, and to increase government revenue.

Recommendation 9:
The Smith Family strongly endorses the findings of earlier enquiries in this area and recommends that no changes be made to the present approach other than perhaps to clarify the basis of exemption in such a manner as to prevent the need for repeated review.

5. Conclusion

The design of the tax and transfer system impacts significantly on the distribution of income and opportunity, between different groups in society and between generations. The tax system also has significant impacts for sustainability of non-profit organizations.

The global financial crisis has highlighted the need for a greater role for government. Government spending is essential when private investment is paralysed. To prevent widespread disadvantage and lift Australia's levels of social prosperity, priority should go to the areas of education and support to children, young people and their families. By failing to invest substantively in a new reform agenda and in the critical inputs of economic growth – labor, education and skills – there is a risk that the Australia will not have the human capacity to bounce back when current economic trends shift back to a positive growth cycle.

In redesigning the taxation system, it may be also worthwhile putting some consideration to the tax measures that may complement Government spending in stimulating the economy and supporting business activity, with a focus on education and support to children, young people and their families.

The Smith Family commends the Government's commitment to review Australia's tax and transfer systems and we look forward to the development of a more socially inclusive framework aimed at supporting families and lifelong learning.

APPENDIX I

The Smith Family

The Smith Family is a national, independent social enterprise that provides opportunities for disadvantaged Australian families and communities to create a better future through education. The purpose of The Smith Family's *Learning for Life* suite of inter-connecting programs is twofold: on the one hand, it works to increase the **participation** in society of disadvantaged children and their families through the provision of educational opportunities across the life course (increasing *human* capital); while on the other, it works to increase the **engagement** of those with the time, talent or dollars to support them (increasing *social* capital).

All of the programs within our evidence-based *Learning for Life* suite are built around facilitating children and their families to develop the skills and capacities they need to make successful transitions across the life course; and around enabling the relationships and attributes that support this skills development in the key settings of Family (home), Community, Educational Institutions (which include preschools, primary, secondary and tertiary education) and the Workplace.

Through this agenda, our disadvantaged kids and their families develop the skills or 'literacies' that participation in the 21st century knowledge economy demands, including emergent literacy and numeracy in the early years, comprehension literacy (reading and writing), financial literacy, digital literacy, health literacy, emotional literacy and community literacy.

For more information, see **thesmithfamily.com.au**

APPENDIX II

The Smith Family's Recommendations for Australia's Future Tax System

Recommendation 1:
The Smith Family recommends that the re-design of the tax and transfer systems reduce complexity, and support parents and young people to accurately assess their financial situation and adequately plan for their future and to better balance support for the disadvantaged with incentives for workforce participation.

Recommendation 2:
The Smith Family recommends that families be able to choose whether to receive regular family rebates during the year or to wait for a single end of year rebate.

Recommendation 3:
The Smith Family recommends that the basis and operation of means tests be reviewed to remove perverse incentives for female and youth employment and poverty traps.

Recommendation 4:
The Smith Family recommends that personal income tax levels and benefit withdrawal thresholds continue to be driven by the principle of vertical equity, building on the foundations of social inclusion as the desired outcome of the Australia's tax and transfer systems.

Recommendation 5:
The Smith Family supports a paid parental leave policy with provisions set at minimum wage, for all new mothers with a reasonable attachment to the workforce, to cover a minimum duration of six months. This will allow parents to stay at home and care for their babies without risk of financial strain or disadvantage, and give Australian children the best possible start in life.

Recommendation 6:
The Smith Family recommends that the HECS-HELP scheme be reviewed and redesigned to remove disincentives for low income young people to undertake tertiary studies and to avoid having young people start their full time working life with a substantial debt.

Recommendation 7:
The Smith Family recommends that the parental income test for Youth Allowance be redesigned to increase the levels of payment for young people and achieve greater parity with Newstart.

Recommendation 8:

The Smith Family recommends that tax incentives be provided for businesses that employ longer term unemployed young people, or participate in youth mentoring programs and programs for increasing youth engagement with work.

Recommendation 9:
The Smith Family strongly endorses the findings of earlier enquiries in this area and recommends that no changes be made to the present approach other than perhaps to clarify the basis of exemption in such a manner as to prevent the need for repeated review.