St Vincent de Paul Society

good works

Submission

Australia’s Future Tax System

October, 2008

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Executive summary

The St Vincent de Paul Society ("the Society") notes two policy challenges to Australia's Future Taxation System ("AFTS"): the needs of those in poverty, and the needs of charities supporting those in poverty.

To meets the needs of those in deprivation and poverty, the Society seeks a tax system that goes well beyond standard inequality measures, or poverty line constructs. Significant problems with the present system include the focus on various economic aggregates, the growth of inequality and its failure to promote national well-being by ending capability deprivation. The Society looks to the following key areas of reform:

- Tax relief linked to progress on a Gross Progress Indicator (GPI) or a national well-being indicator (including the impact of effective marginal tax rates on low income Australians);
- Ensuring concessions, rebates and tax credits deliver social and economic objectives (including targeted use of negative gearing); and
- Ensuring trusts are treated in a manner that supports the government's social and economic objectives (including the taxation of discretionary trusts as companies).

Charities seek to effectively, efficiently, personally and innovatively support those in deprivation and poverty. The Society notes the Government's support for this objective through the tax system. Concessions are given to charities so that the benefits may be distributed to those experiencing exclusion, poverty and deprivation. The Society seeks AFTS to have all the features of the present system. The Society also looks at the following areas of reform:

- The indexation of the FBT exemption to average male weekly earnings with relation back to the date the capped threshold was set at $30,000 per employee; and
- Further incentives so as to attract large donations from companies and high wealth individuals.

"*Overcoming poverty is not a gesture of charity. It is an act of justice. It is the protection of a fundamental right to dignity and a decent life."*

- Nelson Mandela, 'Wisdom' 2008

Background

The St. Vincent de Paul Society ("the Society") is a global charity present in Australia since 1854. In 2006-07, the Society in Australia responded to nearly 600,000 calls for financial or material assistance, provided around 2,350 beds a night to people in need of accommodation and served over one million meals[1].

The Society in its works gives priority to the most marginalised Australians. The Society opposes social and economic structures that entrench injustice, inequality, poverty or exclusion.

Introduction

The Australian Government has established a review of Australia's tax system. The Society recognises that the "review will look at the current tax system and make recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century"[2].

In providing its response, the Society will use the 'framing questions' created by the Review Panel. In response to the first 'framing question', the Society suggests two main policy challenges:

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[1] St Vincent de Paul Society National Council of Australia, *Annual Report 2006-07*, Australia 2007.

[2] Treasury Website, taxreview.treasury.gov.au, Accessed: 8 October 2008.

1. A future tax system that meets the needs of those in deprivation and poverty; and
2. A future tax system that is inclusive of charities supporting those in deprivation and poverty.

The Society's submission will be made in two parts addressing both of these major policy challenges and responding to the remaining three 'framing questions' for each of the major policy challenges.

In providing the Society's submission in parts one and two, the Society notes the separate inquiry into the pension by the Review Panel and has made a separate submission to that Review. The Society is also mindful of other inquiries impacting upon the regulation of charities, in particular the Senate Standing Committee on Economics inquiry into disclosure regimes for charities and not-for profit organisations and has made a separate submission to that Inquiry.

Part 1 - A future tax system that meets the needs of those in deprivation and poverty

Introductory comments

The Society holds a vision for a tax system that affords all Australians the opportunity to attain their full economic and social potential, and achieve it in a way that promotes the optimum well being of all citizens or 'the common good'[3]. The Society appreciates that Treasury already understands that it is the Government's responsibility to ensure that all Australians share in the nation's prosperity.

[3] Catechism of the Catholic Church (English Translation) 1994. Homebush: St Paul.

> "From the Treasury perspective, there is far more to sharing prosperity than simply ensuring that income is redistributed in a way that avoids inequality widening over time beyond some arbitrary level. To our minds, the distributional goals of government must relate to a much broader concept of prosperity, or wellbeing; one that goes well beyond standard inequality measures, or poverty line constructs, based on crude statistical measures of dispersion around mean or median income. These traditional income based measures of poverty and disadvantage are just too simplistic for the task. The dispersion of money income is of consequence, to be sure, but it is not enough."[4]

Like Treasury, the Society also seeks a tax system that can conceptualize poverty and the ability to address it. By doing so, the tax system will model the Government's social inclusion agenda.

The Society witnesses families struggling to pay bills or send their children to school adequately resourced to learn, pensioners unable to afford staple foods and suffering the indignity of living with broken dentures, and men and women living on the streets as they are pushed out of the private rental market with inadequate social housing places to accommodate them. The Society lives the experience of deprivation and poverty.

What features should the system have in order to respond to this challenge to meet the needs of those in deprivation and poverty?

Australia's future taxation system should be:

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[4] Henry, K. *Addressing Extreme Disadvantage Through Investment in Capability Development*, Speech to the Australian Institute of Health and Welfare Conference "Australia's Welfare 2007".

- **Equitable** – deliver equal treatment of similarly situated taxpayers and tax unequally situated taxpayers to their ability to pay.
- **Convenient** – a tax that can be readily and easily assessed, collected, and administered.
- **Certain** – the consistency and stability in the prediction of taxpayers' bills and the amount of revenue collected over time.
- **Economical** – compliance and administration of a tax should be minimal in terms of cost.

In addition, a tax system should ensure adequate tax yield, reallocate resources to achieve social and economic objectives, and be neutral in so far as the system does not encourage inefficient allocation of resources by being so extreme that tax payers make counterproductive economic decisions.

What are the problems with the current system in meeting the needs of those in deprivation and poverty?

The current tax system is focussed on various economic aggregates such as consumption, investment, output and the manner in which they increase the Gross Domestic Product (GDP). The automatic assumption of this approach is that rising levels in these aggregates will promote the well-being of all and even when there are delays, the benefits will eventually trickle down. The trickle down effect has long been questioned

There is little argument that the trickle down effect has delivered higher weekly incomes for low economically resourced households; however this has not guaranteed the income can help people out of poverty. The role of income and wealth must to be integrated into a broader and fuller picture of success and deprivation.

The Society has previously noted that the top quintile of households in the 1990’s enjoyed around 50% of Australia’s gross weekly incomes, while the bottom 20% of Australians received less than 4%[5]. The Society has witnessed little positive change in the last 15 years. In fact, the Gini coefficient, a measure of the degree of income inequality, has generally proven gradual increases in inequality[6]. Personal income tax rates greatly effect the distribution of income. If the 2003-04 tax rate had been applied to the 2005-06 incomes, the Gini coefficient would have been 0.303 instead of 0.307, thus retaining the small improvements in income equality gained in 2003-04[7]. When the previous Government decided to allow bracket creep of the highest income brackets in 2005-06, it decided to widen the income inequity in Australia. Lower income households did not have to pay greater tax thus retaining a small overall income growth, but higher income household were given tax relief disproportionally increasing their overall income growth. This defeats the canons of taxation, that a tax system should provide vertical equity and reallocate resources to achieve social and economic objectives. The effect of the changes to the 2005-06 personal income tax rates further pushed many Australians to the margins.

Australian Bureau of Statistics (ABS) Australian Social Trends Data released in 2008 prove that the mean weekly equivalised disposable household income for high income households increased from 2004 to 2006 by 10.2%, while low income households only increased 7.5%[8]. The Society is concerned not only about the growing income inequity, but the fact that so many low economically resourced household are forced to live in poverty and deprivation. The Social

[5] St Vincent de Paul Society National Council of Australia, *Two Australia's - Summary document*, Section 2, Page 2.

[6] Australian Bureau of Statistics, *Year Book Australia 2008*, Pg 277.

[7] Australian Bureau of Statistics, *Year Book Australia 2008*, Pg 277.

[8] Australian Bureau of Statistics, *Australian Social Trends Data (4102.0),* released on 23 July 2008.

Trends Data released in 2007[9], demonstrated that in 2003–04, the mean weekly equivalised disposable household income for low economic resource households was $262, while for the same period, the mean weekly equivalised household expenditure on goods and services for low economic resources households was $309. The Society's experience is that such households operating in a budget deficit have to resort to the sale of assets, reliance on friends and relatives, increased use of credit, non payment of bills and finally financial assistance from charities like the Society. Australia should strive to achieve a social objective where all Australians have the opportunity to enjoy a minimum standard of well-being, which includes housing, education and health, and don't have to suffer such indignities as the Society frequent witnesses. We must understand the deprivation that exists in Australia, so that we can create a future tax system in the wider context of that deprivation. Equally, we must also understand success.

What reforms do we need to meet the needs of those in deprivation and poverty?

To ensure that the tax system understands deprivation and has a social objective of ending capability deprivation, the Society looks to the following key areas of reform:

- Tax relief linked to progress on a Gross Progress Indicator (GPI) or a national well-being indicator (including the impact of effective marginal tax rates on low income Australians);
- Ensuring concessions, rebates and tax credits deliver social and economic objectives; and
- Ensuring trusts are treated in manner that supports the government's social and economic objectives.

[9] Australian Bureau of Statistics, *Australian Social Trends Data (4102.0),* released on 7 August 2007.

Australia need to base future reform around the concept of a national Gross Progress Indicator (GPI) or a national well-being indicator. The Society appreciates that the Treasury has used a well-being index for some time[10]. The Society would like to see the settings of such tool strengthened to protect vulnerable Australians and 'joined up' with the new taxation system to deliver a policy response to eliminating poverty and building national well-being. By linking tax relief with national well-being, the Government might look at lowering effective marginal tax rates for people entering employment. The Society is deeply concerned about the effective marginal rate of tax on the most disadvantaged Australians moving from welfare to work. The Society has estimated the effective marginal tax rate might be as high as 60% or more. It arises when someone moving from welfare to work leaves their welfare benefits and pays tax at a time when they are facing new basic costs such as transportation. The effective marginal tax rate for a person entering the work force is a barrier to participation and works against the social and economic objectives of any progressive government. By recognising employment as a progress indicator, the tax system could work to deliver incentives in the form of tax relief to those that enter employment, particularly low income employment. Some overseas countries address the issue by continuing social security payments, only reducing the payment when the person is entrenched in the workforce. Another option would be to have no or low personal income tax until the person is entrenched in the workforce.

The second main area of reform is ensuring that concessions, rebates and tax credits deliver social and economic objectives. While Australia enjoys a system of social security pensions, underpinning this is a system of concessions, rebates and credits to ensure that Australia meets its social

[10] Treasury 2004 *Policy advice and Treasury's wellbeing framework*, *Economic Roundup*, Winter, pp 1-20.

objectives. Concessions, rebates and credits protect many vulnerable Australians and assist many low income households. However, like any tax system, we must ensure the limited resources achieve the social and economic objectives, and be neutral in so far as the system does not encourage inefficient allocation of resources by being so extreme that tax payers make counterproductive economic decisions. The ability to negative gear is one example of the present system failing to be neutral. Negative gearing can encourage financial losses, investment in unproductive areas and speculation, at the same time it is claimed that negative gearing has increased the supply of rental properties and decreased the rents charged by landlords[11]. Many commentators over time have recommended the abolition of negative gearing, but the Society submits it could be put to greater effect to by linking it with the universal measure of national well-being. Negative gearing should promote future investment in areas of social need, such as social housing, aged and child care and health services.

The Society recognises the legitimacy of trusts in some cases such as family farms or businesses which cannot be "fractionalised" as families grow and develop. The Society however, would like to see a full review of the social and economic contribution of trusts, particularly discretionary trusts. The Board of Taxation's Report on Discretionary Trusts in 2002 noted that the reasons for taxing discretionary trusts include that discretionary trusts are a close substitute for companies, as a matter of principle should be given the same treatment as trusts and that taxing discretionary trusts would reduce tax abuse[12]. The Society submits that discretionary trusts should be taxed like companies.

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[11] Hanegbi R *Negative Gearing Future Directions*[2002] DeakinLR 17

[12] *Taxation of discretionary trusts: A Report to the Treasurer and the Minister for Revenue and Assistant Treasurer* (November 2002) http://www.taxboard.gov.au/content/trusts/index.asp

Part 2 - A future tax system that is inclusive of charities supporting those in deprivation and poverty.

Introductory comments

The Australian community has always recognised the important role of charities, particularly benevolent organisations that provide for the relief of poverty. Charities, like the Society, operate with the support of volunteers providing personalised service delivery. It is this efficient and effective nature of benevolent charities that allow them to respond to new forms of poverty and changes in deprivation in an innovative manner without excessive bureaucracy or corporatization Recognising the important role of providing justice to those living in poverty, charities receive concessions within the present tax system. Concessions are given to charities so that the benefits may be distributed to those experiencing exclusion, poverty and deprivation.

The Society in Australia operates through a number of legal entities recognised as a Public Benevolent Institution and endorsed by the Australian Taxation Office as a 'tax concession charity' with Deductible Gift Recipient (DGR) status. Accordingly, the Society presently receives the following concessions:

- Income tax exemption;
- GST charity concessions;
- FBT exemption – up to $30,000 grossed-up per employee; and
- Receive deductible gifts as a DGR.

Each of these four concessions operates in an important way to benefit the people the Society serves.

The first above-listed concession, income tax exemption, recognises that the surplus of Charitable Institutions and Public Benevolent Institutions are not distributed to shareholders as profit, but to those in need within the Australian community. Any entity could restructure so as to become entitled to a concession. Businesses provide many social and economic advantages to a community, but the fact that shareholders do not request businesses to restructure so as to distribute all income to charitable or benevolent purposes suggests that the present concession does not distort the market. The income tax exemption simply recognises that charities make surpluses, not commercial profits, and exempts charities from paying an income based tax. This way funds can be efficiently and effectively delivered to areas of social need, meeting social and economic objectives.

GST concessions for charities are the second above-listed concession. A full list of the various GST concessions can be found at the Australian Tax Office's (ATO) Website[13]. The Society uses this concession in the delivery of its services, in particular the ability to conduct transfers without GST payable and no credits between entities within the Society through a 'GST religious group' and the ability to operate 'Centres of Charity' by ensuring sales of donated second hand goods are GST-free. Each of these parts of the GST concession provides for a more efficient and effective charity sector. The ability to make transfers within the Society without paying GST and receiving credits provides small administrative savings to the organisation in not having to account to the ATO for such transactions, but more importantly simplifies the overall tax system. The ability not to charge GST on secondhand goods enables the Society to efficiently operate around 636 'Centres of Charity' throughout Australia. Centres of Charity, commonly known as 'Vinnies Shops', are the community base for many of our benevolent actions. By maintaining this important tax exemption the Government recognises that Australians, when they donate second hand goods to a charity are not expecting their generous donation to be used as a means of tax collection.

[13] Australian Taxation Office Website, taxreview.treasury.gov.au, Accessed: 8 October 2008. http://www.ato.gov.au/nonprofit/content.asp?doc=/content/33862.htm

The third concession offered by the Government to Charitable Institutions and Public Benevolent Institutions is an FBT exemption to the grossed up value of $30,000 per employee. The FBT exemption remains to assist Charitable Institutions and Public Benevolent Institutions to attract competent staff and retain a workforce on the limited salaries offered. The ability to attract competent staff allows Charitable Institutions and Public Benevolent Institutions to deliver better social services to the Australian Community. The Society welcomed the efforts of Minister Macklin in protecting charitable sector employees from the adverse impact of FBT changes created by the previous government[14].

The fourth and final concession offered, is the ability to receive tax deductible gifts. As the Society is not just a charity, but a benevolent organisation that promotes the relief of poverty it is able to receive tax deductible gifts through its DGR status. The Society receives tax deductible gifts through its annual winter and Christmas appeals, various door-knocks appeals, workplace giving, via our national website and similar. The Society is pleased by the government's support of community giving. This tax incentive encourages donors to provide funds to charities, which enables the distribution of personal income or wealth directly to the relief of poverty.

The Society promotes a future tax system that recognises the important role of charities in seeking to end poverty. By doing this, the future tax system has clear objective of greater social inclusion. Ideally if economic were stable and the taxation system set correctly to create greater social inclusion, the need for charities would be reduced.

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[14] Macklin, J. "Passage of Bill to protect charitable sector employees", Media Release 26/06/08.

What features should the system have in order to allow charities to support those in deprivation and poverty?

The future tax system should have all the features of the present tax system in so far as they relate to Public Benevolent Institutions and Charitable Institutions.

What are the problems with the current system allowing charities to support those in deprivation and poverty?

There are few problems with the current tax system's treatment of charities. In fact, the Society has always considered favourably the ATO's administration of the present taxation Acts and Regulations as they affect Charitable Institutions and Public Benevolent Institutions. The ATO excels in its responsibility as a regulator of charities and has always been responsive to the special needs of the charitable sectors through its committees and forums.

What reforms will promote charities to support those in deprivation and poverty?

The society promotes two reforms to help promote charities to support those in deprivation and poverty.

The present FBT exemption remains at the capped threshold of $30,000 per employee as set by s.57A of the Fringe Benefits Tax Assessment Act 1986. The indexing of the FBT exemption to average male weekly earnings would be a simple measure to ensure that the FBT exemption kept in line with wage movements. This would meet the government's objective in helping charities to attract competent staff. The indexation should occur with relation back to the date the capped threshold was set at $30,000 per employee.

The Government could also examine ways of increasing giving to organisation endorsed with DGR status through the taxation system. Government should examine incentives in the future tax system to encourage large donations in the area of the relief of poverty, over other causes. Australian charities do not enjoy the level of philanthropic giving and corporate giving that exist in the United States of America. The Society seeks further incentives over and above the marginal tax rate so as to attract large donations from companies and high wealth individuals. The tax system could create incentives such as double deductions for donations to charities that are benevolent. This recognises that the relief of poverty enhances social inclusion, national wellbeing and meets the government's social and economic objectives.

Conclusion

The Society makes the following recommendations, that:

- AFTS be equitable (both vertical and horizontal), convenient, certain and economical;
- AFTS be built around a universal Gross Progress Indicator (GPI), or other form of national well-being indicator;
- tax relief be linked to progress on a Gross Progress Indicator (GPI);
- the effective marginal tax rates on low income Australians entering the workforce be lowered;
- concessions, rebates and tax credits deliver social and economic objectives;
- negative gearing provisions be amended to promote future investment in areas of social need, such as social housing, aged and child care and health services.
- discretionary trusts be taxed like companies;
- concessions provided in the present tax system to Charitable Institutions and Public Benevolent Institutions remain;
- the FBT exemption be indexed to average male weekly earnings with relation back to the date the capped threshold was set at $30,000 per employee; and

- further incentives be provided so as to attract large donations from companies and high wealth individuals to DGR's.