

Chapter 16

Education & Training and the Tax System

INTRODUCTION

The tax system has a substantial effect on investment in education and training. Taxes on income affect the incentives for individuals to obtain education and training, because tax reduces future income, which is in most cases the major return from education. Tax incentives can also reduce the costs of education and training and tax affects the incentives for business and individuals to provide donations and bequests for educational institutions. This chapter explores these issues.

BACKGROUND

Tax and Personal Decisions on Education and Training

One of the main reasons that people undertake post-secondary education and training is to improve their future income although other reasons include undertaking education because it has intrinsic value, because it is enjoyable or because it adds to current quality of life.

Hence, one of the factors influencing an individual's decision to undertake post-secondary education is the income they expect to receive when they enter the labour force. Taxes have a large impact on income, and hence the return to education.

In particular, high marginal tax rates act as a strong disincentive for Australians to spend resources to increase their future income, reducing investment in education and harming Australia's potential growth.

The evidence for this includes:

- Milesi-Ferretti & Roubini (1998)¹ cite a large number of articles showing that labour income taxes reduce growth because they reduce investment in human capital. Their own results confirm this finding.
- Lucas (1990)² shows that income taxation lowers the return to human capital and reduces the incentive to accumulate human capital (ie undertake education and training).
- King and Rebelo (1990)³ and Rebelo (1991)⁴ find that

an increase in the income tax rate decreases human capital accumulation (ie education) and economic growth, assuming that tax revenues are consumed by Government.

High taxes also discourage skilled migration to Australia, and Australians from returning here after they have moved overseas. This was shown in Ueda (2002),⁵ who found that different international tax rates had significant effect on migration decisions and economic welfare. It is clearly unhelpful if the Government spends a large sum on educating Australians to only find them moving overseas and Australia losing the benefits of this education.

Australia's tax system is clearly not competitive when we attempt to attract skilled migrants or encourage expatriate Australians to return home. The 2006 report for the Treasurer, *An International Comparison of Australia's Taxes* (co-authored by ACCI's CEO, Peter Hendy), showed that Australia was uncompetitive, even with the changes in the 2006-07 Budget:

- personal taxes are about 11 percent of GDP, well above the OECD (weighted) average⁶ of 8.1 percent;
- our top tax rate of 46.5 percent is above the OECD average of 44.5 percent;
- the top tax threshold starts at \$125,000 or 2.2 times average wages, which is well below the OECD average threshold of 5.6 times average wages (about \$A287,000); and
- unlike Australia, many of the comparable OECD countries use partial or full indexation of tax thresholds.

Tax Incentives for Investment in Education and Training

In addition to reducing the taxes on the returns to education and training, the Government can provide direct assistance to reduce the costs of education and training.

There have been a number of significant developments in education and training costs in Australia over recent years, including:

- increasing costs for parents in sending their children to school. Over one million children or 32% attend independent and Catholic schools. Annual tuition fees can cost as much as \$14,322 for a year 12 student; and
- recent changes announced by the Federal Government to higher education which allow for universities to increase the level of HECS and also increase the number of full fee paying students from Australia.

Taxation and Philanthropy

Governments provide support for many socially worthwhile services, and many businesses choose to support these services as well. For example, companies donate money to charities, schools, universities and artistic institutions.

Without business philanthropy, the costs to Government would increase substantially or many services would have to be cut back. Therefore, it is important for Government to provide the appropriate level of support for corporate philanthropy, including through the tax system.

However, Australia currently does not have a strong culture of philanthropy. Funding to universities via donations and bequests makes up a small proportion of their revenue, particularly compared to other similar countries.

ACCI seeks to increase this revenue source for universities.

Donations and Bequests to Universities

In announcing an inquiry into the development of a culture of philanthropy towards universities the Minister for Education, Science and Training said donations and bequests represent a very small proportion of Australian higher education revenue (\$171 million or 1.27% of total revenue in 2004).⁷ The Group of Eight has identified that business makes up about 20% of university donors, but accounts for 80% of total donor funds.⁸

In contrast, donations and bequests represent an increasing proportion of income for US universities. Holmes (2002)⁹ noted that:

- the University of Virginia has raised US\$1.4 billion over the past 4 years, and will embark on a 5 year US\$4 billion fund raising program this year;
- the University of Iowa Foundation was formed in 1956, and an endowment of \$US600m and 100,000 donors;

with

- the University of Arkansas has recently received the largest single donation of \$US300m for US state universities.

Harvard University has an endowment of \$US 25.9 billion,¹⁰ the largest endowment in higher education.¹¹

There are a number of reasons for the much larger size of philanthropy in the US. There can be no doubt that there is a much more robust culture of giving in the US. There are lower tax rates in the US, giving taxpayers there more disposable income that they can choose to give away. Another factor is that the US system includes a variety of taxation breaks, including full tax deductibility for property contributions, tax exemptions for charitable remainder trusts, and tax exemptions for retirement funds or life insurance policies that are bequeathed to universities.

Recent Policy Changes

In 1999 and 2001, the Government made a number of changes to increase the incentives for philanthropy which have reduced the differences with the US:

- tax deductions for the market value of donations of property worth more than \$5,000, regardless of when it was purchased or acquired, were introduced. It was estimated that this measure could initially increase donations by around \$45 million per year and by a larger amount over time. At this initial level it was estimated to reduce tax revenue by around \$20 million per year;
- the \$5,000 threshold was removed from pre-existing provisions which allowed for donations of property, such as under the Cultural Gifts Programme, as well as property purchased less than 12 months prior to the donation;
- a capital gains tax exemption for testamentary gifts of property to bodies eligible to receive tax deductible donations was provided. This was expected to assist not-for-profit organisations and donors by increasing donations by around \$15 million a year;
- a new category of private charitable funds was introduced that would meet all the criteria previously required to qualify as a public fund but without the need to seek contributions from the public. The benefit of these funds is that donations to them are tax deductible. This change provided families and individuals with greater

freedom to set up their own trusts for philanthropic purposes without having to seek contributions from others. This measure was expected to increase donations by \$15 million per annum and came at a \$10 million cost to Government revenue; and

- incentives for donations of property to Deductible Gift Recipients were provided. Deductions for donations can now be apportioned over a period of five years. This change encourages donations from donors whose relatively low incomes may otherwise prevent them from fully utilising the deduction for high value gifts of cultural property.

ACCI supported these changes recognising the importance of providing incentives to employers and other individuals through the tax system to contribute to a range of community activities.

CONSIDERATION OF ISSUES

As noted above, high taxes reduce incentives to invest in human capital through education and training. In addition, high taxes cause a large number of other problems, including reducing efficiency, productivity, and growth, encouraging tax minimisation and discouraging innovation, risk taking and entrepreneurship. Higher taxes also leave taxpayers with less money to donate.

Reductions in high tax rates will provide additional benefits to educational institutions, in particular:

- philanthropy will be assisted, because there will be an increase in disposable income of taxpayers, which they could then choose to donate; and
- it will improve incentives for entrepreneurship and innovation, which is often done in collaboration with Australia's universities and other educational institutions.

There is a need to examine the role of the tax system in encouraging individuals and employers to increase their contribution to education and training.

The main areas of potential are:

- increased benefits to parents investing in education plans or scholarship investment programs for their children to meet the costs of private education and post compulsory education (including universities). Some estimates of the total cost of education (including

school fees, uniform costs, equipment, boarding expenses and university or TAFE fees) can be up to \$200,000. Some plans involve parents investing from \$50 to \$300 a month. This idea should be examined and costed by the Australian Government. ACCI, however, thinks the priority should be general personal income tax reductions;

- the introduction of a HECS style system in VET, particularly for fully institutional places; and
- tax benefits for individuals investing in formal accredited skills development activity. Some priority could be given to various categories of people, for example, those with no prior post compulsory qualification (Australia has one of the highest incidence of older workers with no qualification in the OECD).

ACCI supports the continuation of Federal incentives and other employment subsidies for Australian Apprentices. ACCI also advocates the introduction of a Learning Bonus which involves a set amount paid on the completion of a qualification by eligible workers. This was discussed in Chapter 7.

CONCLUSION

The tax system provides both beneficial and detrimental incentives for education and training.

High tax rates discourage investment in human capital, because they reduce the return to this investment, and leave taxpayers with fewer funds for philanthropy.

On the other hand, the tax system can encourage education and training by providing tax incentives for individuals to invest in their own education and for businesses and individuals to donate funds to educational institutions.

Taxation Expenditures

The review of taxation expenditures as part of the reform package is strongly supported to encourage personal responsibility for those in the workforce to increase their skills and to encourage labour mobility to areas of high priority skills shortage. Income tax deductions for self-education expenses could be extended to include education and training expenses undertaken by taxpayers in areas outside of their current occupation. The deduction should be limited to expenses incurred in undertaking accredited training. Consideration could be given to further limiting the scheme, such as to designated qualifications in skills shortage

occupations, which may increase the administrative burden but would limit the cost to the Australian Government.

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¹¹ The Harvard Crimson (2005) “Super-Size Me”, September 28, 2005.

All these policies need further development.

ACCI PROPOSALS

ACCI proposes that:

- the Australian Government reduce high tax rates, particularly the top marginal tax rate, to encourage investment in education and training and increase philanthropy;
- other important tax reforms include reducing the number of tax thresholds to no more than two, indexing tax thresholds, and further reducing the Capital Gains Tax burden;
- the Australian Government investigate and cost increased benefits to parents investing in education plans or scholarship investment programs for their children to meet the costs of private education and post compulsory education (including universities); and
- consideration be given to providing individual tax benefits for investment in formal accredited skills development activity.

¹ G M Milesi-Ferretti & N Roubini (1998) “On the taxation of human and physical capital in models of endogenous growth” *Journal of Public Economics* 70(2), pp237-254.

² R Lucas (1990) “Supply-side economics: an Analytical Review” *Oxford Economic Papers* Vol 42 (April) pp293-316.

³ R G King & S Rebelo (1990) “Public policy and economic growth: developing neoclassical implications” *Journal of Political Economy* Vol 98, pages s126–151.

⁴ S Rebelo (1991) “Long-run policy analysis and long-run growth” *Journal of Political Economy* Vol 99 p500–521.

⁵ Ueda (2002) Implications of Migration on income and welfare IMF Working Paper 215.

⁶ The weighted average is more relevant than the unweighted average, because the unweighted average gives Luxembourg the same weight as the US, which is of limited relevance when the US economy is about 450 times the size of the Luxembourg economy.

⁷ <http://www.dest.gov.au/Ministers/Media/Bishop/2006/09/B001130906.asp>.

⁸ October 2006, *Encouraging Philanthropy in the Australian Higher Education Sector*, <http://www.go8.edu.au/policy/papers/2006/Go8%20on%20Philanthropy%2018.10.06.pdf>.

⁹ Holmes (2002) Higher Education Review Submission 28.

¹⁰ The Harvard Crimson (2005) “Endowment Reaches \$25.9 Billion”,