

Secretary
Joint Standing Committee on Electoral Matters
(By email: jscem@aph.gov.au)

23 April 2008

Dear Secretary,

**Submission to JSCEM's Inquiry into Schedule 1 of the Tax Laws Amendment
(2008 Measures No.1) Bill 2008 - Political Contributions and Gifts***

We thank the committee for the opportunity to make a submission to the above inquiry.

Outline of Schedule 1 of the Bill

Under Division 30-DA of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997), individuals and companies are entitled to a tax deduction in respect to contributions or gifts made to political parties. Prior to 22 June 2006, these deductions were limited to \$100 per annum and deductions were only available to parties registered under Pt XI of the *Commonwealth Electoral Act 1918* (Cth) (CEA) – thereby excluding independent candidates and parties registered under State and Territory legislative regimes. 2006 amendments to the ITAA 1997 increased the maximum deduction to \$1500 per annum and extended deductions to parties registered under relevant State and Territory legislation and independent candidates.¹

Schedule 1 of the Tax Laws Amendment (2008 Measures No.1) Bill 2008 (the Bill) amends provisions of the ITAA 1997 and *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) relating to political donations. Item 3 of the Bill inserts section 26-22 into the ITAA 1997, removing the ability of individuals to claim a tax deduction in respect of party membership. The new sections also prohibit tax deductions being made by individuals and corporations in respect of contributions or gifts made to

* Thanks to Sunita Jogarajan and Miranda Stewart for their help.

¹ Section 30-253 ITAA 1997 as amended by the *Electoral and Referendum Amendment (Electoral Integrity and other Measures) Act 2006* (Cth).

political parties. Item 9 repeals Division 30-DA in its entirety. Under sub-clause (2) of Item 3 employees or office holders are permitted to claim deductions for amounts incurred in earning an assessable income. Items 11 and 12 relate to consequential amendments of the ITAA 1997 and ITAA 1936 to ensure that party fees and contributions cannot form part of the cost base for Capital Gains Tax purposes.

The removal of tax deductions by individuals and corporations in relation to political contributions should be supported

There are three distinct aims that may justify the current provisions. The provisions may be said to:

- encourage small contributions so as to diversify the funding base of parties and, therefore, reduce the influence of ‘big money’;
- promote political participation through party membership; and
- assist in ensuring that parties are adequately funded.

Measured against these aims, however, the current provisions allowing tax deductibility are both *inefficient* and *inequitable*.

They are inefficient, firstly, because neither small contributions nor party membership is a condition for tax deductibility. Specifically, eligibility for tax deduction is cast too wide with large contributions coming within the scope of the current provisions. Second, the money provided from the public purse goes to tax payers rather than the parties.² If these provisions are meant to assist in ensuring that parties are adequately funded, they do so in a rather indirect and limited fashion.

There may also be another reason why tax deductions are an inefficient way to achieve the above aims. Such a system places an incentive to make contributions and to take out membership on the taxpayer much more so than on the parties themselves to solicit contributions and membership. A system of public subsidy that relies more directly on strengthening incentives faced by the parties may very well be more effective.

² For similar sentiments, see Daniel Hays Lowenstein, ‘On Campaign Finance Reform: The Root of All Evil is Deeply Rooted’ (1989) 18 *Hofstra Law Review* 301, 364-5.

We note in this respect that the explanatory memorandum indicates that Schedule 1 of the Bill will have the following revenue implications:³

2009-10	2010-11	2011-12
\$10.1m	\$10.3m	11.0m

These amounts may indicate that the take-up rate is relatively low.

The current provisions are inequitable on several counts. They discriminate against those who do not have to pay tax. Job seekers,⁴ retirees without income, full-time parents and students not engaged in paid work who make small contributions or take out party membership are denied the benefit of the current system.

This leads to a broader point: a system of tax relief disproportionately benefits wealthy sections of society.⁵ This is borne out by the Canadian experience of using tax relief to encourage political contributions. Canadian federal law provides for a Political Contribution Tax Credit (PCTC). Under this scheme, individuals and corporations can deduct a portion of their political contributions from their tax liability. The deductible amounts are based on a sliding scale as depicted in table below.

Amount of contribution	Tax credit
C\$0 to C\$400	75% of contribution, e.g. C\$150 credit for C\$200 contribution
C\$401 to C\$750	C\$300 + 50% of amount of contribution exceeding C\$400, e.g. C\$400 credit for C\$600 contribution
Over C\$750	C\$475 + 33 1/4% of amount of contribution over C\$750 or C\$650, whichever is the lesser amount, e.g. C\$650 credit for C\$1000 contribution

³ Explanatory Memorandum to the Bill, 3.

⁴ See Keith Ewing, *The Funding of Political Parties in Britain* (1987) 139.

⁵ See K D Ewing, *The Cost of Democracy: Party Funding in Modern British Politics* (2007) 194.

In her analysis of the impact of the PCTC, Young, while acknowledging that the scheme may encourage small contributions, observed its unfair operation. Drawing upon a breakdown of tax data for 2000, she said:

The almost half of all Canadian tax filers whose income fall into the lowest bracket comprise only 10 per cent of all PCTC claimants, while the 3 percent of tax filers in the highest bracket make 18 percent of all claims. The pattern is even more skewed when one compares the value of the tax credit for low and high income earners, as the latter are prone to make large contributions. Despite its other merits, then, the PCTC reinforces an inequitable pattern of giving to parties and candidates.⁶

In fact, Young's observations may have greater force now. In 2000, the PCTC allowed tax credits of 75% for contributions only up to C\$200 whereas that limit currently stands at C\$400.⁷

A similar system of tax relief operates in Quebec although at less generous rates.⁸ Nevertheless, the inequity of such a system is apparent. The data for 1997 indicated that while taxpayers earning C\$20 000 or less per annum constituted 54% of all taxpayers, they only constituted 15% of those who claimed a credit under the Quebec system. Those earning C\$50 000 or more, on the other hand, represented 43% of those who claimed the credit while only constituting 10% of all taxpayers.⁹

This brief review of the Canadian evidence indicates that a system of tax relief aimed at encouraging political contributions disproportionately benefits the wealthy for two reasons. First, the rich are more likely to make financial contributions to parties than the less well off. In Massicote's words, such contribution is 'a rather elitist activity'.¹⁰ Second, because the rich are more likely to make larger contributions, the amount of tax relief they can claim is correspondingly increased.¹¹

⁶ Lisa Young, 'Regulating Campaign Finance in Canada: Strengths and Weaknesses' (2004) 3(3) *Election Law Journal* 444, 452.

⁷ *Ibid* 447, 459.

⁸ See Louis Massicotte, 'Financing Parties at the Grass-Roots Level: The Quebec Experience' in K D Ewing and Samuel Issacharoff (eds), *Party Funding and Campaigning Financing in International Perspective* (2006) 151, 159-160.

⁹ *Ibid* 173.

¹⁰ *Ibid* 172.

¹¹ Similar points are made by Ewing: K D Ewing, *Trade Unions, the Labour Party and Political Funding: The next step: reform with restraint* (2002) 39-40.

Such inequity may exacerbate the unfairness of political competition. Under a system of tax relief, inequity amongst citizens translates to inequity amongst the parties. Parties with rich members and supporters will reap significant rewards from this system while the benefit to parties with poorer members and supporters may very well be marginal.

Such inequity is most likely the result of the current provisions. Worse, the risk of such inequity is exacerbated by two features of the current provisions. The threshold of \$1500 is quite high and provides tax relief for political donations that are out of reach of ordinary Australians.

Moreover, the current provisions allow corporations to claim tax deductions for their political contributions. This runs contrary to the aim of reducing the influence of 'big money'. Because corporate money tends to go overwhelmingly to the major parties,¹² subsidising corporate contributions threatens to deepen the financial divide between the major and minor parties.¹³ Most fundamentally, it is far from obvious why public subsidy should facilitate contributions by entities that are clearly not citizens nor organised in a democratic fashion but are rather plutocratic organizations whose general principle is 'one share, one vote'.¹⁴

For all of the above reasons, we *support the provisions of the Bill seeking to remove tax deductions in relation to political contributions by individuals and companies.*

It follows that we do not believe that the exemption in relation to 'employees' and 'office-holders' can be justified. Under income tax law, the term, 'employee', bears its common law meaning¹⁵ while the term, 'office holder', embraces a range of persons engaged by the Commonwealth, State and Territory governments including members of Parliament, members of the Defence Force and public servants.¹⁶ Tax

¹² See Iain McMenamin, 'Business, Politics and Money in Australia: Testing Economic, Political and Ideological Explanations' (2008) 44(3) *Australian Journal of Political Science* (forthcoming).

¹³ For details, see Joo-Cheong Tham and David Grove, 'Public Funding and Expenditure Regulation of Australian Political Parties: Some Reflections' (2004) 32(3) *Federal Law Review* 397-424

¹⁴ R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (2007) 298.

¹⁵ Taxation Ruling TR 2005/16.

¹⁶ Taxation Ruling TR 2002/21.

relief given to these workers in relation to political contributions, even if incurred in earning income, shares the same vices as tax relief for the political contributions of non-workers: it is still inefficient and inequitable.

Moreover, the exception in relation to ‘employees’ opens up the possibility of senior managers and directors claiming fees paid to access and influence political decision-makers in relation to decisions affecting their companies as tax deductions. If the Bill is enacted, companies may not claim payments to the Victorian ALP’s Progressive Business¹⁷ or the NSW Liberal Party’s Millennium Forum¹⁸ as tax deductions but their senior managers and directors may very well be able to do so through the ‘employees’ exception.

It may be said that it is unfair that workers can claim tax deductions in relation to expenses incurred in the course of earning income in relation to other spending but for political contributions. Two things can be said in response. First, this kind of argument of formal parity applies also to corporate tax deductions. Second, arguments of formal parity tell us nothing as to why tax relief should be given for political contributions. If the rationale for tax relief is weak, as we believe it to be, then there is little justification for extending it to anyone or entity.

We, therefore, *recommend the removal of the exceptions for ‘employees’ and ‘office-holders’.*

Possible alternatives

The aims of encouraging small contributions and party membership while assisting the finances of parties remain sound and modest public funding should be devoted to them. The challenge is to devise a system of public funding that is efficient and equitable.

There are two options we wish to flag. First, public funding can be directly provided to parties registered under the CEA based on the number of their party members

¹⁷ See http://www.vic.alp.org.au/index.php?option=com_content&task=view&id=237&Itemid=9#about (accessed on 7 June 2007).

¹⁸ See <http://www.millenniumforum.com.au/> (accessed on 7 June 2007).

(providing there is integrity of membership rolls). For instance, for each member, a registered party could receive \$5. Second, a system of matching funds could be put in place to encourage small contributions. For example, for each contribution of \$50 or less received per annum by candidates and registered parties, public funds could be provided at the amount of 10% of these contributions.

We emphasise that this system of matching funds not only should be limited to small contributions but also should only involve a modest public subsidy in total. Both are necessary in order to alleviate the risk of such a system being biased towards wealthy citizens and parties.

We thank you for reading our submission.

Yours sincerely,

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