

## Introduction

- 1.1 This chapter provides a background to the inquiry and sets out the current arrangements regarding tax deductibility for political donations. A brief history of tax deductibility policy and some of the changes proposed and implemented are presented. Arrangements in other selected jurisdictions are also summarised.

### **Background to the inquiry**

- 1.2 On 19 March 2008 the Senate referred Schedule 1 of the Tax Laws Amendment (2008 Measures No. 1) Bill 2008 to the Joint Standing Committee on Electoral Matters for an advisory report. The Senate resolution required the committee to report by June 2009.<sup>1</sup>
- 1.3 The committee is also currently undertaking an inquiry into the 2007 federal election and related matters, which was referred by the Special Minister of State on 27 February 2008. A later reference from the Senate specifically requested that the committee examine a range of matters relating to the financing of political parties as part of the inquiry.<sup>2</sup> No reporting date was specified in any of these references.
- 1.4 While the committee considered the option of including the review of Schedule 1 of the Tax Laws Amendment Act (2008 Measures No. 1) Bill 2008 as part of its broader 2007 election inquiry, it was decided to

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1 Senate, *Journals of the Senate*, No. 9, Wednesday 19 March 2008, p. 291.

2 Senate, *Journals of the Senate*, No. 5, Wednesday 12 March 2008, p. 210.

conduct the review separately and report to the Senate as soon as practicable.

- 1.5 The committee announced that it would commence the inquiry into Schedule 1 of the Tax Laws Amendment Act (2008 Measures No. 1) Bill 2008 on 28 March 2008 and an advertisement was placed in The Australian newspaper on 2 April 2008. Letters were sent to the major parties and academics with an interest in political finance issues on the same day.
- 1.6 The committee received 10 submissions. A public hearing was conducted on 29 April 2008. All organisations making submissions and the major political parties were given the opportunity to appear at the public hearing.
- 1.7 Details of the submissions and the public hearing are listed in appendix A and B respectively. Full copies of the submissions and public hearing transcript can be found at the committee's website: [www.aph.gov.au/house/committee/em/taxlawbill/index.htm](http://www.aph.gov.au/house/committee/em/taxlawbill/index.htm).
- 1.8 This inquiry is being carried out during a period where there is significant policy debate over the future shape of political party financing more generally. Parliamentary inquiries into campaign financing in several jurisdictions have been announced or are in the process of gathering evidence.<sup>3</sup> Further, the federal government has also announced a program of legislative reform and the initiation of a green paper process to consider broader reforms to political funding and disclosure.<sup>4</sup>
- 1.9 Tax deductibility can be seen as part of the overall framework of political party financing. Alternatively, it can be viewed in isolation of other mechanisms. The committee looks more closely at some of the potential links with other aspects of political party financing in chapter 2.

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3 See NSW Parliament's Legislative Council Select Committee inquiry into electoral and political party funding (<http://www.parliament.nsw.gov.au/partyfunding>), the Victorian Parliament's Electoral Matters Committee inquiry into political donations (<http://www.parliament.vic.gov.au/emc/>) and the Tasmanian Parliament's Working Arrangements of the Parliament Committee inquiry into campaign financing (<http://www.parliament.tas.gov.au/ctee/wparl.htm>).

4 Senator the Hon John Faulkner, Special Minister of State, 'Electoral Reform', media release, 28 March 2008.

## Current arrangements

- 1.10 Individual taxpayers and businesses can currently claim a tax deduction for political contributions and gifts when they complete their tax returns at the end of a financial year.
- 1.11 Contributions and gifts to political parties include payments for political party membership fees and donations. The Treasury explained that:
- A gift has common-law meaning in general. Basically, a gift is where generally there is no expectation of or wanting something in return. 'Contribution' again is an undefined term, so we use its common meaning, which is an amount contributed to or added to the fund and those sorts of things.<sup>5</sup>
- 1.12 There are two methods under which political contributions and gifts to political parties and can be claimed as a tax deduction:
- a general deduction to taxpayers for expenses that are incurred in gaining or producing assessable income. There is no limit applied to the general deduction and it applies to individual taxpayers and businesses;<sup>6</sup> and
  - a specific deduction for certain contributions and gifts to registered political parties, independent candidates and members. Contributions and gifts must be at least \$2 and there is a limit of \$1500 on the total amount deductible in an income year. The specific deduction is available to both individual taxpayers and businesses.<sup>7</sup>
- 1.13 In the case of the specific deduction, the deductibility limit applies separately to political parties and independent candidates, allowing taxpayers to claim up to \$3,000 per income year. Guidelines produced by the Australian Taxation Office provide the following example:
- During the 2006-07 income year, John contributes \$500 and \$1500 respectively to two registered political parties. He also gifts \$200, \$600 and \$1,100 respectively to two independent candidates and one independent member.
- John may claim a tax deduction of \$3,000 in his 2006-07 tax return:

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5 Coles T, The Treasury, transcript, 29 April 2008, p. 7.

6 Income Tax Assessment Act 1997, s. 8-1.

7 Income Tax Assessment Act 1997, s. 30-241.

- \$1500 in relation to the \$2,000 contributed to political parties; and
  - \$1500 in relation to the \$1,900 gifted to the independent candidates and the independent member.<sup>8</sup>
- 1.14 The availability of the specific deduction to individual taxpayers and businesses also means that some taxpayers are able to ‘double dip’. For example, a small business operator may make a contribution or gift to a political party of \$1500 as an individual and \$1500 as a business and claim a tax deduction for each amount.<sup>9</sup>
- 1.15 The underlying tax principle regarding the general deduction is based on a relationship between expenses incurred by a taxpayer and their taxable earnings. The Treasury explained that:
- it is a general concept that, where a person incurs expenditure in the course of gaining and producing their assessable income, those expenditures are deductible, which is the general tenet of section 8.1 of the Income Tax Assessment Act 1997. ... Where those expenses are incurred in gaining and producing the assessable income that that person derives, then the general tenet of taxation policy is that those deductions should be allowable.<sup>10</sup>
- 1.16 While this underlying principle around the general deduction appears to be relatively straightforward, assessing the link between earning assessable income and any contributions to political parties, members and independent candidates can be complex.
- 1.17 The following examples, drawn from guidelines and advice provided by the Australian Taxation Office and The Treasury, illustrate this complexity in practice in relation to direct and indirect contributions to political parties:
- Contributions and gifts that involve entertainment, access to politicians and/or meals – The components relating to meals and entertainment are typically not deductible and the amount over and above these items may be considered as a donation;<sup>11</sup>
  - Payments for goods and services by a business to a political party at above commercial rates – The component relating to the

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8 Australian Taxation Office, Political contributions and gifts – GiftPack, viewed on 26 March 2008 at [www.ato.gov.au/print.asp?doc=content/61195.htm](http://www.ato.gov.au/print.asp?doc=content/61195.htm).

9 Orr G, Democratic Audit of Australia, transcript, 29 April 2008, p. 26.

10 O’Conner M, The Treasury, transcript, 29 April 2008, p. 12.

11 Hardy M, Australian Taxation Office, transcript, 29 April 2008, p. 8.

commercial value of the good or service would generally be deductible as a business expense. Any component above the market value would be deductible within the current ceiling of \$1500 per annum for contributions and gifts.<sup>12</sup>

- Union membership and levies – Periodic subscriptions paid by a person for membership of a trade, business or professional association are deductible where the principal activities of the trade, business or professional association are relevant to the gaining or producing of assessable income by the member, or the carrying on of a business by the member for the purpose of gaining or producing assessable income. However, the following levies, which may be imposed by associations from time to time are *not* tax deductible:
  - ⇒ payments to, or to assist, a political party
  - ⇒ payments to provide overseas relief
  - ⇒ payments to assist families of employees suffering financial difficulties as a result of employees being on strike or having been laid off by their employers
  - ⇒ payments by salaried elected trade union officials into a general fund for the election of union officials.<sup>13</sup>

1.18 While the Australian Taxation Office provides advice to business and individual taxpayers on the deductibility of contributions and gifts to political parties in the form of guidelines and taxation rulings, a definitive interpretation for each taxpayer may require a case by case examination of individual transactions.

- 1.19 When taxpayers complete their tax returns, amounts paid to registered political parties, members and independent candidates need to be claimed under the general deduction (as with other expenses) or under the specific deduction:
- If amounts are claimed as a general deduction, they are included as work-related expenses (for individuals) or an expense (for businesses) on the taxpayer's tax return form. There is no cap on the general deduction;
  - If amounts are claimed under the specific deduction, they are included in the 'Gifts and Donations' category on the taxpayer's tax

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12 Coles T, The Treasury, transcript, 29 April 2008, p. 20.

13 Australian Taxation Office, Taxation Ruling TR 2000/7, Income tax: subscriptions, joining fees, levies and contributions paid to associations by individuals, clauses 6 and 12.

return form. This category also includes gifts and donations to eligible entities endorsed by the Australian Tax Office or listed in the Income Tax Assessment Act. A cap of \$1500 applies to the specific deduction.

- 1.20 The aggregation of contributions and gifts to political parties within broader categories of expenses or donations in tax returns means that there is no administrative data available to determine how many taxpayers claim a deduction, how much they contribute or other characteristics such as their age, gender and postcode. Estimates of the overall cost of the deduction (in terms of potential revenue foregone) are based on other information (see chapter 2).

## Background to existing arrangements

- 1.21 Tax deductibility for expenses related to the earning of assessable income has been a long-standing principle of income tax arrangements, with personal taxpayers able to claim deductions for work-related expenses since 1915.<sup>14</sup> While the tax law explicitly mentions some types of payments for which a deduction cannot be claimed – including bribes to public officials, expenditure relating to illegal activities and recreational club membership expenses<sup>15</sup> – the general deductibility principle applies to those transactions that are related to a taxpayer's income generating activities.
- 1.22 Specific deductibility for a range of causes and organisations, albeit on a more limited scale, has also been part of commonwealth income tax law since 1915.<sup>16</sup> Current tax law provides that donations to more than 15,000 specified organisations across a range of groups including social, recreational, educational and cultural organisations are tax deductible.<sup>17</sup>
- 1.23 Specific deductibility for contributions and gifts to political parties registered under the Commonwealth Electoral Act was introduced in 1991 with significant amendments made in 2006. The issue of tax deductibility for such contributions has been examined by the Joint

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14 Baldry J (1998), 'Abolishing income tax deductions for work-related expenses', *Agenda*, vol 5, no 1, p. 49.

15 See Division 26 of the Income Tax Assessment Act 1997.

16 Income Tax Assessment Act 1915, s. 18.

17 [business.gov.au/abn/lookup/Deductible\\_gift\\_recipients](http://business.gov.au/abn/lookup/Deductible_gift_recipients), viewed on 6 May 2008 at [www.abn.business.gov.au/\(xwjo5z45slyzlx55zz52rr55\)/content.aspx?page=dgrListing](http://www.abn.business.gov.au/(xwjo5z45slyzlx55zz52rr55)/content.aspx?page=dgrListing).

Standing Committee on Electoral Matters on a number of occasions as part of its federal election and other inquiries.

## 1991 introduction of tax deductibility

- 1.24 Specific tax deductibility for donations and gifts to registered political parties was first introduced in 1991 with the passage of the Political Broadcasts and Political Disclosures Bill 1991.
- 1.25 Tax deductibility for donations to political parties was not part of the original bill. After passing through the House of Representatives, the Senate moved amendments to include tax deductibility for contributions to parties registered under the Commonwealth Electoral Act of \$2 or more (moved by the coalition parties) with a further amendment setting a maximum allowable deduction of \$100 (moved by the Democrats).
- 1.26 These amendments in the Senate were made after consideration by a Senate select committee. The committee's report, which also canvassed a wide range of issues included in the Bill such as political advertising, public funding for elections and disclosure of donations, was largely divided along party lines over the issue of tax deductibility for donations to political parties.
- 1.27 The majority report did not include any discussion or recommendations about tax deductibility. The dissenting report by coalition members noted that:

The Majority Report - which is an expression only of the Labor Party's viewpoint - indicates that there is no real intent to level the playing field or it would contain the essential recommendation that ALL political donations be tax deductible.

While we recognise that this in itself will not level the playing field as it relates to unions enjoying tax exempt status, it would tackle one major component of the tax advantage discrepancy between the ALP and other political parties and as such should have been a recommendation of the Committee.<sup>18</sup>

- 1.28 The House of Representatives accepted the Senate amendments and the Bill was carried on 19 December 1991 and received royal assent on

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18 Senate Select Committee on Political Broadcasts and Political Disclosure (1991), *Report*, p. 84.

the same day. Taxpayers were able to claim a deduction for donations made from 1 July 1991.<sup>19</sup>

- 1.29 A ruling by the Commissioner for Taxation in 1992 resolved uncertainty over some of the terms used in the Bill by issuing a determination that:
- ‘contributions’ included membership subscriptions;
  - ‘testamentary’ contributions and gifts, that is, those made under a will, were not deductible; and
  - a ‘contributor’ cannot be a company.<sup>20</sup>
- 1.30 The issue of tax deductibility for political donations had been considered by the Joint Standing Committee on Electoral Matters on several occasions prior to it being included in the (amended) Political Broadcasts and Political Disclosures Bill 1991. A report by the committee in 1989 noted that:

The ALP submission claimed that additional funds raised by political parties with tax deductibility advantage would alleviate any pressure for increased levels of public funding, encourage political parties to continue to seek direct support from the public, and help them more adequately fulfil their necessary social functions. However, the Liberal Party submission expressed the view that tax deductibility of political donations (with a ceiling on deductible donations) is a preferable alternative to the existing system of public funding but could not advocate that tax deductibility should be an addition rather than an alternative to public funding.<sup>21</sup>

## 2006 amendments

- 1.31 There were no changes made to the tax deductibility provisions of political contributions and gifts until 2006, when the government also made a number of other changes to electoral law. Major changes to the tax deductibility provisions introduced with the passage of the Electoral and Referendum Amendment (Electoral Integrity and Other Measures) Bill 2005 included:

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19 Political Broadcasts and Political Disclosures Act 1991, Part 6, s. 38(2).

20 Australian Taxation Office, Taxation determination, 92/114.

21 Joint Standing Committee on Electoral Matters (1989), *Who pays the piper calls the tune*, p. 91.

- lifting the threshold for a tax deduction from \$100 to \$1500;
  - allowing deductibility for contributions made to political parties registered under State and Territory electoral legislation;
  - allowing deductibility for contributions and gifts to members and independent candidates; and
  - extending deductibility for contributions and gifts from companies.<sup>22</sup>
- 1.32 The cost of expanding the coverage of deductibility provisions and increasing the threshold was estimated by the government to be \$4.9 million in 2007-08, \$6.5 million in 2008-09, \$5.4 million in 2009-10 and \$5.7 million in 2010-11.<sup>23</sup>
- 1.33 The Bill became law on 22 June 2006. For the financial year covering the period 1 July 2005 to 30 June 2006, individual taxpayers were able to claim a deduction of \$100 for contributions and gifts to political parties registered under the Commonwealth Electoral Act up to 21 June 2006. For the remaining 8 days of the financial year to 30 June 2006 individual taxpayers and businesses were able to claim contributions and gifts to a wider range of political parties and candidates up to a maximum of \$1500.
- 1.34 While these provisions were not passed by the parliament until 2006, the government made several attempts to include some of the measures in 1998 and 1999.<sup>24</sup> In both cases however, the Bill passed the House of Representatives but lapsed in the Senate.<sup>25</sup>
- 1.35 The Joint Standing Committee on Electoral Matters considered the issue of tax deductibility on numerous occasions in the period between the introduction of tax deductibility in 1992 and the 2006 amendments as part of its reports on federal elections and other inquiries.
- 1.36 The committee's report on the 1996 election included a recommendation that the tax deductibility threshold be lifted to \$1500 and that donations from corporations also be tax deductible. In its

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22 Electoral and Referendum Amendment (Electoral Integrity and Other Measures) Bill 2005, Explanatory Memorandum, p. 16.

23 Electoral and Referendum Amendment (Electoral Integrity and Other Measures) Bill 2005, Explanatory Memorandum, p.3.

24 Parliamentary Library, *Taxation Laws Amendment (Political Donations) Bill 1999*, Bills Digest No. 134 1998-99, p. 1; *Taxation Laws Amendment (Political Donations) Bill 1998*, Bills Digest No. 237 1997-98, p. 1.

25 Senate, Notice Paper, no 194, p. 30; Senate, Notice Paper, no 216, 27 September 2001, p. 8.

submission to the inquiry, the Liberal Party of Australia considered that the tax deductibility threshold should be lifted to \$10,000 while the Australian Labor Party had nominated an increase to \$1500. A recommendation expanding tax deductibility for donations to independent candidates was also included.<sup>26</sup>

- 1.37 While the Liberal Party of Australia's submission to the 1998 election inquiry again supported lifting the threshold to \$10,000, the committee considered that an increase from \$100 was not necessary at the time.<sup>27</sup>
- 1.38 The committee's report on the 2004 election recommended that the tax deductibility threshold should be lifted to \$2000 and adjusted annually for inflation. In its submission, the Liberal Party of Australia argued for a 'significant increase' on the \$100 limit, the Nationals supported an increase and the Australian Labor Party (ALP) opposed any increase.<sup>28</sup> The minority report from the four ALP members noted that:

The Majority recommendation that tax deductibility for political donations be raised from \$100 to \$2000 is an unjustified attempt to transfer private political donations into a taxpayer subsidy. The [ALP] supports public funding for the electoral process which is transparent and reflects the votes gained by political parties. We believe that a general tax-deductibility clause as outlined by the Majority will encourage individuals and other entities to make extensive political contributions, in secret, and at taxpayer expense. The potential to undermine the integrity of the political process under these changes is clear.<sup>29</sup>

- 1.39 The most recent inquiry by the Joint Standing Committee on Electoral Matters to consider tax deductibility was its inquiry into disclosure of donations to political parties. A report for the inquiry was tabled in February 2006. A bill lifting the tax deductibility threshold to \$1500

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26 Joint Standing Committee on Electoral Matters (1997), *The 1996 Federal Election: Report of the Inquiry into the conduct of the 1996 election and matters related thereto*, pp. 103–104.

27 Joint Standing Committee on Electoral Matters (2000), *The 1998 Federal Election: Report of the Inquiry into the conduct of the 1998 election and matters related thereto*, p. 133.

28 Joint Standing Committee on Electoral Matters (2005), *The 2004 Federal Election: Report of the Inquiry into the conduct of the 2004 election and matters related thereto*, p. 340.

29 Joint Standing Committee on Electoral Matters (2005), *The 2004 Federal Election: Report of the Inquiry into the conduct of the 2004 election and matters related thereto*, p. 378.

and broadening deductibility to companies and independent candidates was before the parliament at the time.<sup>30</sup>

- 1.40 The committee's report did not include any specific recommendations on tax deductibility, noting that the committee 'did not find the need to add to the recommendations that it made in its report on the 2004 election'.<sup>31</sup> The Labor members of the committee dissented from the majority report, noting that the ALP platform, as amended at the January 2004 Conference is that 'Labor will abolish the tax deductibility of political donations'.<sup>32</sup>

## Changes proposed by the bill

- 1.41 The policy of removing tax deductibility for political donations was first announced by the Hon Kim Beazley on 3 October 2006 and was included as part of a plan to save \$3 billion from the federal budget released by the Hon Lindsay Tanner on 2 March 2007.<sup>33</sup>
- 1.42 The policy was initially adopted by the Australian Labor Party in its National Platform and Constitution in 2004.<sup>34</sup> The policy to abolish the tax deductibility of political donations was also included as part of the National Platform and Constitution in April 2007.<sup>35</sup>
- 1.43 The overall purpose of Schedule 1 of the Tax Laws Amendment (2008 Measures No. 1) Bill 2008 is to remove tax deductibility for contributions and gifts to political parties, members and candidates.<sup>36</sup>
- 1.44 Introducing the Bill in the House of Representatives, the Assistant Treasurer, the Hon Chris Bowen MP noted that:

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30 The Electoral Matters and Referendum Amendment (Electoral Integrity and Other Measures) Bill 1995 was introduced in the House on 8 December 2005 and passed the House on 11 May 2006. The Bill was introduced in the Senate on 13 June 2006 and passed the Senate on 21 June 2006.

31 Joint Standing Committee on Electoral Matters (2006), *Funding and Disclosure: Inquiry into disclosure of donations to political parties and candidates*, p. 14.

32 Joint Standing Committee on Electoral Matters (2006), *Funding and Disclosure: Inquiry into disclosure of donations to political parties and candidates*, p. 18.

33 Hon Kim C Beazley MP, Leader of the Opposition, 'A nation building role for the public service, *The Don Dunstan Oration*, Adelaide, 3 October 2006; Hon Lindsay Tanner MP, Minister for Finance and Administration, 'Labour's \$3 billion savings plan', media release, 2 March 2007.

34 Australian Labor Party (2004), *National Platform and Constitution 2004*, p. 272.

35 Australian Labor Party, submission 1, p. 2.

36 Tax Laws Amendment (2008 Measures No. 1) Bill 2008, Explanatory Memorandum, p. 3.

this government is honouring its election commitment to remove tax deductibility for donations made to political parties, candidates and members. This commitment was made as part of 'Labor's \$3 Billion Savings Plan', which was announced ... on 2 March 2007.<sup>37</sup>

- 1.45 The government expects that removing tax deductibility for contributions and gifts to political parties, members and candidates will save \$31.4 million over the four years to 2011-12, with savings commencing in 2009-10. The costing methodology for the policy is discussed in chapter 2.
- 1.46 Schedule 1 of the Tax Laws Amendment Act (2008 Measures No. 1) Bill 2008 proposes several amendments to the Income Tax Assessment Act 1997 and the Income Tax Assessment Act 1936.
- 1.47 The proposed amendments remove the ability of all taxpayers – individual taxpayers and business taxpayers – to claim specific deductions for contributions and gifts to registered political parties or independent candidates and members.
- 1.48 The proposed amendments also remove the general deduction available to businesses for donations to political parties, members and independent candidates. The amendments also preclude such contributions and gifts from forming part of the cost base or reduced cost base of any capital gains tax asset.
- 1.49 Individual taxpayers will be able to continue their current practice of claiming contributions and gifts to political parties, members and independent candidates as a tax deduction where it relates to earning their taxable income.
- 1.50 The Bill proposes that these arrangements would apply from the day on which the Bill receives the Royal Assent. If the Bill is passed and given royal assent before 30 June 2008 then these measures would apply to contributions and gifts made on or after 1 July 2008. This would allow the arrangements to apply for the full financial year 2008-09 which is the normal taxation period for most taxpayers.

## Structure of the bill

- 1.51 The most substantive elements of Schedule 1 of the Tax Laws Amendment Bill (2008 Measures No. 1) are found in clauses 3 and 9.
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37 Hon Chris Bowen MP, Assistant Treasurer, House of Representatives Debates, 13 February 2008, p. 207.

The remaining changes proposed by the Bill are largely consequential in nature.

- 1.52 Clause 9 of the Bill proposes to repeal the part of the Income Tax Assessment Act 1997 (subdivision 30DA) that currently includes the specific provisions for political donations. This is the main element of the Bill, with the remaining parts included to: allow the continuation of deductibility for individual taxpayers under the general deduction provision; prevent businesses claiming political donations under the general deduction provision; and amend the capital gains tax provisions to ensure that such expenses do not form part of the cost base or reduced cost base for capital gains purposes.
- 1.53 Clause 3 of the Bill proposes that a new section be inserted in Division 26 of the Income Tax Assessment Act 1997. This division of the Act sets out some amounts that are not deductible, or that are not deductible in full. Examples of payments covered in this section of the Act include amounts payable by way of a penalty under Australian or foreign law, bribes to foreign public officials and expenditure relating to illegal activities.<sup>38</sup>
- 1.54 Clause 3(1) of the Bill, reproduced below, inserts a new section into Division 26 of the Income Tax Assessment Act 1997, that removes the ability of taxpayers to claim as a general deduction political contributions and gifts (including a membership fee):

*You cannot deduct political contributions or gifts*

(1) You cannot deduct under this Act:

- (a) a contribution (including a membership fee) or gift to a political party that is registered under Part XI of the *Commonwealth Electoral Act 1918* or under corresponding State or Territory legislation; or
- (b) a contribution or gift to an individual when the individual is a candidate in an election for members of:
  - (i) an \*Australian legislature; or
  - (ii) a \*local governing body; or
- (c) a contribution or gift to an individual who is a member of:
  - (i) an Australian legislature; or
  - (ii) a local governing body.

- 1.55 Clauses 3(3) and 3(4), reproduced below, relate to this clause 3(1), as they define when an individual becomes a candidate or a member:

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38 Income Tax Assessment Act 1997, Division 26.

*Starting and stopping being a candidate*

- (3) For the purposes of this section, an individual:
- (a) starts being a candidate when the individual's intention to be or attempt to be a candidate for the election is publicly available; and
  - (b) stops being a candidate at the earlier of:
    - (i) the time when the result of the election is declared or otherwise publicly announced by an entity (an *electoral official*) authorised under the relevant electoral legislation; and
    - (ii) the time (if any) when the individual's intention to no longer be a candidate for the election is publicly available.

*Starting being a member*

- (4) An individual who becomes a member as a result of an election (including an election that is later declared void) is taken to start being a member when the individual's election as a member is declared or otherwise publicly announced by an electoral official.

1.56 Clauses 3(2) of the Bill inserts provisions in the same section of the Income Tax Assessment Act 1997 that provides an exception to non-deductibility for individual taxpayers – defined in the tax law as employees or office holders – thereby allowing individual taxpayers to continue to claim a general deduction for contributions and gifts to political parties:

*Exception for employees and office holders*

- (2) However, subsection (1) does not apply to a loss or outgoing incurred in gaining or producing assessable income from which an amount is required to be withheld under section 12-35 or 12-45 in Schedule 1 to the *Taxation Administration Act 1953*.

Note: The provisions of the *Taxation Administration Act 1953* require amounts to be withheld from income of employees and office holders.

1.57 By implication, the lack of an exemption given to business taxpayers in clause 3(2) provides for the discontinuation of the general deduction for donations to political parties, members and independent candidates by business taxpayers that are not part of normal commercial transactions.

- 1.58 The interpretation of what is considered a normal commercial transaction is complex and will be determined by the Australian Taxation Office if the Bill becomes law. The Australian Taxation Office advised the committee that:

It is difficult to give you a definitive answer until we see the final shape of the legislation from an interpretive point of view. In the hypothetical context of a lobbying enterprise being involved in political luncheons, if the tax office had sufficient concern that in fact this was really fundraising and donation work as opposed to legitimate business activity – and that is a terribly fraught interpretive space – we would possibly pursue some questions about the deductibility of some aspects of those expenses. But it is very difficult to answer a hypothetical question on legislation that is not in place.<sup>39</sup>

- 1.59 The capital gains tax provisions are also amended so that such expenses prevented from being deducted by the new section 26-22 do not form part of the cost base or reduced cost base for capital gains tax purposes. This ensures that no capital loss or reduced capital gain can arise from such contributions and gifts.<sup>40</sup> These would be added to a range of existing exclusions including bribes and penalties.<sup>41</sup>

## Examples of changed arrangements

- 1.60 The Explanatory Memorandum prepared for the Bill includes several examples to demonstrate the impact of the proposed amendments on different types of taxpayers for a range of contributions and gifts (table 1.1).

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39 Hardy M, Australian Taxation Office, 29 April 2008, p. 19.

40 Explanatory Memorandum, Tax Laws Amendment (2008 Measures No. 1) Bill 2008, p. 9.

41 Income Tax Assessment Act 1997, s. 110-38.

Table 1.1 Impact of proposed amendments on selected taxpayers and contributions and gifts

<b>Taxpayer type</b>	<b>Example</b>
Individual	Mary wishes to support a registered political party, and consequently makes a \$1,000 gift to the party. The gift is not deductible.
Individual	Bob earns his income by being employed as an engineer and is a member of a political party for which he pays \$50 a year in membership fees. The membership payment is not incurred in earning his assessable income, and is therefore not deductible.
Individual	A Member of Parliament pays a compulsory levy to retain their party membership. This would generally be deductible.
Individual	A Member of Parliament pays for a ticket to attend a fundraising event hosted by their party where a substantial sit-down dinner is provided. The ticket price generally would not be deductible.
Business	XYZ Ltd is a proof reading company specialising in political publications. XYZ Ltd is looking to maintain its corporate profile, and to this end makes contributions to political parties. This amendment ensures that XYZ Ltd is unable to claim these contributions as a loss or outgoing necessarily incurred in carrying on its business or for the purpose of gaining or producing its assessable income.

Source Explanatory Memorandum, *Tax Laws Amendment (2008 Measures No. 1) Bill 2008*, pp. 8–9.

1.61 The Treasury noted the types of individual taxpayers that were likely to be able to continue to claim membership of a political party as a general deduction for income tax purposes would include members of parliament, the staff of members of parliament and party employees.<sup>42</sup>

## International practice

1.62 The use of a tax concession to provide an incentive for taxpayers to contribute to political parties is a feature of some western democracies, including the United States, Canada, Italy and the United Kingdom.<sup>43</sup>

1.63 The type of tax concession varies across countries and can include mechanisms such as tax check offs, tax credits and deductions at source. The choice of which system to use is partly related to the

42 Coles T, The Treasury, transcript, 29 April 2008, p. 15.

43 Committee on Standards in Public Life (1998), *The funding of political parties in the United Kingdom*, Fifth Report of the Committee, vol. 1, pp. 94–95; Sempill S and Tham J, submission 9, pp. 3–4; Thompson N, submission 8, p. 2; Democratic Audit of Australia, submission 6, pp. 2–3.

administrative aspects of a country's tax system including whether they require taxpayers to complete annual tax returns.<sup>44</sup>

- 1.64 Several inquiry participants referred to the use of tax credits in Canada, where individual and corporate taxpayers receive a tax credit for monetary contributions to political parties based on a sliding scale (table 1.2).<sup>45</sup>

Table 1.2 Canadian political contribution tax credit

Amount of contribution	Tax credit
C\$0 to C\$400	75 per cent of contribution. For example, C\$150 credit for \$200 contribution.
C\$401 to C\$750	C\$300 + 50 per cent of amount of contribution exceeding C\$400. For example, C\$400 credit for C\$600 contribution.
Over C\$750	C\$475 + 33 <sup>1</sup> / <sub>3</sub> per cent of amount of contribution over C\$750 or C\$650, whichever is the lesser amount. For example, C\$650 credit for C\$1,000 contribution.

Source Sempill S and Tham J, submission 9, p. 3.

- 1.65 Some of the arguments raised in favour of using tax concessions in a 1998 review in the United Kingdom included:
- That it provides an incentive to political parties to attract a larger number of small donations and therefore broaden political parties' funding base; and
  - That it also offers an incentive to individuals to get involved in politics by contributing to the democratic process. This incentive, it is also argued, may encourage a more active participation in political parties generally.
- 1.66 Some of the arguments against the use of tax relief included:
- That it discriminates between income tax payers and non-taxpayers because a donation by a taxpayer facing a higher marginal tax rate can donate at less net cost to themselves compared to those on lower marginal rates or non-taxpayers;
  - Tax relief favours parties whose members have higher incomes and can therefore afford larger donations;
  - There is an opportunity cost involved in tax concessions whereby the tax which is recovered by political parties represents public

44 Committee on Standards in Public Life (1998), *The funding of political parties in the United Kingdom*, Fifth Report of the Committee, vol. 1, pp. 94-95.

45 Thompson N, submission 8, p. 2; Sempill S and Tham J, submission 9, p. 3; Democratic Audit of Australia, submission 6, p. 3.

money denied elsewhere. Therefore, although individuals using the tax concession scheme are exercising choice, all other individuals would be forced to suffer the consequences of a reduction in the sum total of public revenue; and

- The extension of charitable-type tax relief to political parties could lead to increased pressure for similar tax treatment for non-profit organisations that do not currently qualify for tax relief on their donations because their objects are regarded as 'political' and therefore not exclusively charitable.<sup>46</sup>

1.67 These arguments were re-examined in another review in the United Kingdom in 2004. In this review, a submission to the Electoral Commission noted that poorer supporters of political parties would be disadvantaged, since the scheme would only apply to taxpayers:

It is a form of political participation which is not available to citizens on an equal basis, and it is a form of public funding of the parties which discriminates between parties according to the bank balance of their members and supporters rather than the depth or breadth of their electoral support.<sup>47</sup>

1.68 Nevertheless, the Commission did not believe that the denial of a concession to non-taxpayers' donations was a good reason for not introducing such a scheme. The Commission favoured the introduction of a tax concession scheme that was limited to amounts of less than £200 (or the first £200 of larger donations) and that tax relief should be given on membership subscriptions and cash donations, but not on benefits-in-kind or on payments which involve a potential benefit to the donor.<sup>48</sup> To improve fairness to non-taxpayers, the Commission also considered that any tax relief scheme should be extended to them, through a match-funding system.<sup>49</sup>

1.69 The use of tax concessions in other countries needs to take account of cultural factors and other laws around party finance. For example, in Canada, corporate and union donations are now banned and

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46 Committee on Standards in Public Life (1998), *The funding of political parties in the United Kingdom*, Fifth Report of the Committee, vol. 1, pp. 94-95.

47 UK Electoral Commission (2004), *The funding of political parties: Report and recommendations*, p. 100.

48 UK Electoral Commission (2004), *The funding of political parties: Report and recommendations*, p. 101.

49 UK Electoral Commission (2004), *The funding of political parties: Report and recommendations*, p. 101.

donations from individuals are capped at C\$1100 to a party and its candidates.<sup>50</sup>

- 1.70 The practices and policies in other jurisdictions can offer some guidance to policy makers in Australia. However, appropriate emphasis needs to be placed on the relevant cultural factors, the administrative features of the tax system and political factors that are features of political participation and financing in Australia.

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50 Democratic Audit of Australia, submission 6, p. 3.