Independent Schools Queensland

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Taxing Our Future: Implications of Imposing Extra Taxes on School Education

A discussion paper for Independent Schools Queensland prepared by Dr Mikayla Novak

August 2015

Bethany Lutheran Primary School

Our Schools – Our Future

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Townsville Grammar School

Foreword

Independent Schools Queensland (ISQ) is closely monitoring the current debate regarding the potential for the base of the GST to be broadened to include non-government school education, especially with regard to the recently released Australian Government paper on taxation reform, *Re:Think* – Tax discussion paper.

While understanding the importance of considering how services provided by governments are funded and delivered, ISQ does not support any broadening of the GST base to include household spending on education.

In effect, if GST was applied to household educational expenses — in full and without rebates — then it would amount to a lopsided tax on school choice and a significant increase in school fees. As a result, some parents of non-government schoolchildren would have no choice but to transfer their children to government schools. This would result in increased education costs to governments and a reduction in parental private investment in school education.

Revenue raised through a GST on school fees would be outweighed by the cost of educating more students in the public system, leaving the states and territories about $546 million a year worse off. For Queensland, it would amount to an additional $106 million cost to the Queensland Government.

Extension of the 10% GST to school fees would have a significant effect on the independent schools sector, with the expected loss of enrolments potentially posing challenges, particularly for smaller schools. Many of these schools are in regional, rural and remote locations, or meet specific needs such as for students with disability or in need of social educational assistance. The impact on these schools would impose further pressures upon the State Government school system, not only financially but also on achieving appropriate educational outcomes.

Dr Mikayla Novak is a leading economist. In this paper she has evaluated the financial and social impact of increased taxes on independent schooling.

Her argument that it is highly inappropriate to tax human capital investments which deliver substantial gains to the community is compelling.

I commend *Taxing Our Future: Implications of Imposing Extra Taxes on School Education* to independent schools and public policy makers.

David Robertson
Executive Director
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About the Author

Dr Mikayla Novak is Australia's leading classical-liberal female economist, with a doctorate in economics awarded at RMIT University. Born and raised in Queensland, Novak is presently a senior researcher with the Melbourne-based Institute of Public Affairs (IPA), the world's oldest free market think tank.

Dr Novak is a prolific contributor to Australian public policy debates. She has written over 100 opinion editorial pieces on public finance, government administration, welfare and social policy issues, and is a regular columnist for the Fairfax press. Dr Novak has also contributed to the applied policy and research work of other bodies, including The Centre for Independent Studies (Australia) and The Cato Institute (United States).

Prior to her present appointment with the IPA, Dr Novak worked in the private and public sectors including roles in the Commonwealth Treasury, Productivity Commission, Queensland Treasury, and with the Queensland Chamber of Commerce and Industry.

Dr Novak has long demonstrated a passion for school education policy reform issues, with a focus on school financing and structural diversity within the schooling system. She has previously written policy pieces concerning the implications of charter schooling for Indigenous communities, and the effects of competitively neutral recurrent funding (aka 'voucher') funding regimes.

Disclaimer

Independent Schools Queensland commissioned this paper to promote informed debate on policy issues in school education. The author accepts full responsibility for the views expressed herein. Independent Schools Queensland does not necessarily support all of these views.

About Our Schools – Our Future

Our Schools – Our Future is an Independent Schools Queensland research-based initiative designed to promote informed public policy debate about schooling. Through commissioned research, Our Schools – Our Future explores trends and issues in key areas which determine the nature and performance of our school education systems. While the initiative has a particular focus on the contribution of independent schools to our education provision and outcomes, it examines a range of issues and trends relevant to the development and implementation of effective public policy for schooling. All research reports are available to members on the Independent Schools Queensland website at www.isq.qld.edu.au via ISQhub.


St Pauls Lutheran Primary School

Executive Summary

- In efforts to financially validate excessive public sector expenditures, some groups have advocated new taxes on the Australian school sector and, in particular, on independent schools.
- Taxation burdens on schooling are lower than that borne by many other sectors of the Australian economy, as a consequence of explicit policy measures to exempt the educational services provided by independent, Catholic, and government schools from various direct and indirect taxes.
- Investing in the education and skills development of young people represents a hallmark of a modern, dynamic economy, and so it is highly inappropriate to tax human capital investments which deliver such substantial gains to the community.
- To encourage investment in our young people, GST should not be extended to non-government school tuition fees, whilst school fees and other educational expenses should be deducted from income tax liabilities.
- Non-government schooling of children has become the first option for thousands of Queensland parents, but parental choice would be threatened by extending the GST to school fees.
- Extending the GST would mean non-government schools in Queensland would lose approximately 22,700 student enrolments to government schools, threatening the viability of numerous non-government (including independent) schools across Queensland.
- Extending the GST to school fees would be fiscally counterproductive from Queensland's perspective, since the costs to education budgets from a drift back to government schools would more than offset any extra GST collected from non-government schools across the state.
- Policymakers should resist calls to stymie Queensland's future as a competitive economy and harmonious society through taxing the schooling of its most important resource – its young people.

Introduction

Over the past few years Australian governments at all levels have overextended their budgetary constraints, through spending on operating costs and policy programs at levels in excess of recurrent revenues, leading to persistent budget deficits and significant growth in public sector debts.

The reluctance of governments to substantially reduce their expenditures in response to emerging financial management problems has fostered fresh calls for new and increasing revenue collections, mainly through the taxation system. A clear political target of such demands have been those sectors of the Australian economy perceived as being subject to relatively lower tax burdens, such as school education.

A reasonably representative case among arguments for additional taxes on school education has been proffered by the Australia Institute think tank. Asserting the need to broaden the GST 'without enhancing the burden of the tax on low income households,'[1] the think tank recommended abolishing GST exemptions for non-government school educational services.

According to the Australia Institute, extending the GST to non-government schools would enable the Australian Government to raise an additional $790 million annually – with about 63 percent of this extra GST revenue accrued from the top 40 percent of income earners.[2]

Other groups have made similar calls to increase the burden of taxation upon non-government schooling.

Given the substantial presence of public sector provision and financing in the Queensland and Australian school education landscape, and the already heavy cost pressures faced by families, it is essential that demands for extra taxes on independent schools be intensely scrutinised.

Advocates for higher taxes tend to present overinflated estimates of revenue gains for government, characterising these as effectively a 'free gift' to public consolidated revenue funds. However, what is typically ignored are the potentially adverse consequences of such a policy approach for the accumulation of educational competencies and skills, through formal education supplied by the non-government sector, and the effect of taxes upon the exercise of parental choice in selecting affordable, quality schooling for their children.

When these implications are appropriately factored into an assessment of the efficacy of taxation on schooling, it is found that the recent pro-taxation demands represent little more than veiled efforts to dilute the relative attractiveness of independent schooling through the taxation system.

1 Matt Grudnoff, 2014, *How to extend the GST without hurting the poor*, The Australia Institute, Policy Brief, December, p. 1.
2 Ibid., p. 6.

Brisbane Grammar School

Tax Treatment of School Education in Australia

Tax Treatment in Australia

Each level of government in Australia imposes a multitude of taxes upon activities performed by individuals and businesses, and their use of certain goods and services, mainly for the purpose of raising revenue to finance public sector programs and service delivery.

The impact of Australian taxation will vary by industry in accordance with factors such as policy decisions to statutorily impose taxes, or the economic and financial interaction of a given industry with others which may, or may not, be subjected to tax. In the Australian context, the school education landscape has been critically shaped by policies by successive commonwealth, state, and local governments to treat schooling in relatively advantaged ways for taxation purposes.

Income tax

Australia imposes a corporation income tax of 28.5 percent for small business companies with an aggregate annual turnover less than $2 million, with a 30 percent tax rate applicable to businesses with a turnover of $2 million or above.

Resident companies that are incorporated in Australia, or have their central management and control located in Australia, are subject to company tax on worldwide taxable profits, whereas non-resident companies are only taxed on profits sourced in Australia. Taxable non-profit organisations are generally treated as companies for company tax purposes, whether or not they are incorporated, unless they receive an endorsement from the Australian Taxation Office (ATO) for tax exemption.[3]

Australia also imposes a personal income tax which is withheld from wages and salaries. A progressive tax rate structure applies, with a tax-free threshold for low income earners currently set at $18,200 and with the highest marginal rate for individuals at 47 percent (excluding Medicare Levy of 1.5 percent, NDIS Levy of 0.5 percent, and Medicare Levy Surcharge of up to 1.5 percent for high income earners electing not to purchase private health insurance).

In a longstanding arrangement maintained in Australia, charitable organisations are exempt from paying income taxes. An organisation is deemed to be 'charitable' if conducted on a not-for-profit basis and established to benefit the community, or some section of it, through:

- the relief of poverty or sickness or the needs of the aged
- the advancement of education
- the advancement of religion
- other purposes beneficial to the community.[4]

Schools are defined under the commonwealth *Charities Act 2013* as charities, on account of providing services for the advancement of education in the community on a not-for-profit basis, and are endorsed by the ATO to be therefore exempt from income taxes.[5]

Given their charitable status, independent and other non-government schools rely upon the receipt of income-tax deductible gifts from donors to support the ongoing operations of the school, such as school building funds and scholarship/bursary funds.[6] With regard to schooling infrastructure, the ATO has indicated that funds for acquired, constructed or maintained buildings receiving deductible gift recipient (DGR) status must be used as part of delivering the curriculum of a school.[7]

Consumption tax

The goods and services tax (GST) is a broad-based indirect tax on most goods and services sold or consumed in Australia, introduced on 1 July 2000 as part of a broader package of commonwealth and state taxation reforms. The GST is a multi-stage tax collected at each step along the chain of supply of goods and services. It is applied to the change in value or the value-added at each stage in the supply chain.

A business or other enterprise with a turnover of $75,000 or more per annum ($150,000 or more for non-profit organisations) are obligated to register for the GST. Under the GST the registered business includes the GST in the selling price of goods and services subject to GST, and pays the GST collected from its customers to the Australian Taxation Office (ATO).

3 Australian Taxation Office, 2014, *Tax basics for non profit organisations*, ATO, Canberra, p. 10.
4 Australian Charities and Not-For-Profits Commission, 'Charity subtypes', http://www.acnc.gov.au/ACNC/Register_my_charity/Who_can_register/Typ_char/ACNC/Reg/TypesCharPurp.aspx.

5 Independent Schools Council of Australia, 2015, Submission to Rethink Tax Discussion Paper, June; Australian Taxation Office, 'Taxation Ruling TR 2011/4', Legal Database.
6 ISCA, Ibid.
7 Australian Taxation Office, 'Gifts, Charities and Non profit Organisations', Legal Database.

The registered business can claim a credit (known as a GST credit, or input-tax credit) for GST paid on goods and services included in the price of goods and services purchased from other registered businesses. The provision of this crediting arrangement eliminates any cascading 'tax-on-tax' effects by virtue of GST imposed on intermediate outputs used in the production process.

Numerous goods and services provided by schools in Australia are exempt from GST, or known as 'GST-free.' According to the ATO, the following education related supplies are GST-free:

- supply of an education course includes tuition, facilities and other curriculum related activities and instruction;
- supply of administrative services directly related to the supply of an education course if the administrative services are supplied by the supplier of the course
- supply of course materials for a subject undertaken in an education course
- supply by way of lease or hire of curriculum-related goods to a student by the supplier of a pre-school, primary or secondary course provided the supplier of the course retains ownership of those goods
- supply of a right to receive GST-free education
- supply of an excursion or field trip but only if the excursion or field trip is directly related to the curriculum of an education course and is not predominantly recreational
- supply of student accommodation to students undertaking a primary or secondary course if the supplier of the accommodation also supplies the course
- supply of student accommodation to students undertaking a primary or secondary course if the accommodation is provided in a hostel whose primary purpose is to provide accommodation for students from rural or remote locations who are undertaking such courses
- supply of cleaning and maintenance, electricity, gas, air-conditioning or heating as part of the provision of student accommodation which is GST-free
- supply of telephone, television, radio or any other similar thing as part of the provision of student accommodation which is GST-free.[8]

Educational providers that make GST-free supplies, such as independent schools providing primary and secondary level education services, are entitled to claim input-tax credits for GST paid on goods and services purchased in relation to making their GST-free supplies.

When announcing its tax reform package in 1998, the Howard Government indicated that most educational services would be exempt from GST on account of maintaining some semblance of neutrality in treatment for non-government education providers with their government counterparts:

'education receives significant government assistance. Public primary and secondary education is provided free of charge and significant assistance is given to private schools and tertiary and vocational education. Applying the GST to education would discriminate against private providers.'[9]

It is important to note, however, that not all activities undertaken by schools, and other establishments providing GST-free educational services, are exempt from the GST. As noted in the August 1998 *A New Tax System* statement, activities that are not GST-free include:

- the food component of boarding fees, and food and beverages sold to students in canteens and tuckshops
- school bus services and uniforms
- fees charged for equipment hire (for example, musical instruments)
- the sales of goods and services for fundraising purposes.[10]

Other Australian taxes

Australian state and territory governments levy a range of taxes, including taxes on property, on employers' payrolls, and on the provision and use of goods and services. Independent and other non-government schools are generally exempted from major state taxes (for example, payroll tax, land tax, and stamp duties), on the basis of their status as charitable institutions providing for the advancement of education.

The sole source of taxation revenue for local government in Australia is rates on unimproved property values. Properties used for educational purposes are generally eligible for rates exemptions.

Victory College

8 Australian Taxation Office, 'Goods and Services Tax Ruling GSTR 2000/30', Legal Database.
9 Commonwealth Treasury, 1998, *Tax reform: not a new tax, a new tax system: the Howard Government's plan for a new tax system*, Treasury, Canberra, p. 94.
10 Ibid.

Implications of Tax Increases on School Education for Students

Investing in People: The Basics of Human Capital

As a result of immense contributions of economists – such as Jacob Mincer,[11] Theodore Shultz,[12] Gary Becker,[13] James Heckman,[14] among others – there is now a widespread appreciation of the implications of education and training experiences and skills development (commonly referred to as 'human capital') for long-run economic growth.

In essence, investment in human capital through education tends to increase the productivity of workers by enabling them to work more efficiently (including through the capable use of capital goods such as machinery and equipment), and to think and act more creatively encouraging further technological change and process innovations. These effects help raise the aggregate level of goods and services produced, for a given amount of labour input, and also improve wages and lifetime earnings for educated individuals (*Box 1*).

Box 1: The gains of non-government schooling

The OECD has indicated that people who engage in additional years of formal education are, on average, able to earn greater incomes than those who opt for less education. Specifically, adults with tertiary education earn more than adults with upper secondary or post-secondary non-tertiary education, who, in turn, earn more than adults without upper secondary education.[15]

The Australian education academic Gary Marks has written numerous papers indicating that school sector differences in tertiary entrance in Australia are substantial, with implications for the ability of individuals to enrol in university courses offering potentially higher subsequent career earnings.[16]

In a 2009 study published in the *Australian Journal of Education*, for example, Marks found that, after accounting for the socioeconomic background of students, prior achievement, and various aspects of student learning, non-government schools add value to student performance in the final years of school.[17] Reporting on various model specifications, it is estimated that the tertiary entrance scores of independent school students was between five and 12 score points greater, on average, than for government school students.

More recently, Melbourne Institute researchers Nikhil Jha and Cain Polidano utilised panel data from the HILDA longitudinal survey to assess schooling effects on long-term wage rates, independent of effects on academic achievement (as measured by years of education).[18]

Whilst the focus of this study was on the channels through which Catholic schooling may affect wages through the provision of non-academic skills, it found that people receiving an education within independent schools also provided students with wages over and above those earned by their government school peers.

After 20 years of experience in the workforce, wage rate growth for independent school graduates is, on average, about 12 percent higher than growth for government school graduates (although these results are caveated due, in part, to fewer data observations for independent schools compared with Catholic schools).

11 Jacob Mincer, 1958, 'Investment in Human Capital and Personal Income Distribution', The Journal of Political Economy 66 (4): 281-302; Jacob Mincer, 1974, *Schooling, Experience, and Earnings,* National Bureau of Economic Research, Columbia University, New York; Jacob Mincer, 1981, 'Human Capital and Economic Growth', National Bureau of Economic Research, Working Paper No. 803.

12 Theodore W. Schultz, 1961, 'Investment in Human Capital', *The American Economic Review* 51 (1): 1-17; Theodore W. Schultz, 1963, *The Economic Value of Education*, Columbia University Press, New York.

13 Gary S. Becker, 1964, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education*, National Bureau of Economic Research, Columbia Press, New York; Gary S. Becker, 1996, 'The Economic Way of Looking at Behavior: The Nobel Lecture', Stanford University, Hoover Institution on War, Revolution and Peace, Essays in Public Policy No. 69.

14 James J. Heckman, Lance J. Lochner, Jeffrey Smith and Christopher Taber, 1997, 'The Effects of Government Policy on Human Capital Investment and Wage Inequality', *Chicago Policy Review* 1 (2): 1-40; James J. Heckman, 1999, 'Policies To Foster Human Capital', National Bureau of Economic Research, Working Paper No. 7288.

It is also widely held that greater endowments of human capital within a society are economically beneficial, over and above the direct effects of more and better education upon individual productivity.

The presence of educated labourers in the workplace, for example, can help improve the productivity of other workers through beneficial interactions which produce even more products than would otherwise be the case.

The 'spillover' effects of human capital investment also manifest themselves in the social realm, with an educated community of individuals leading to the likes of reduced crime rates and the pursuit of healthier lifestyles.

Improvements in the stock of human capital, embodied in the accumulated education and skills possessed by an individual, can be conceived of as an investment, much like purchasing buildings, machinery and equipment or even financial assets. This is because the time spent receiving educational services, say, in the classroom, may entail potential losses in income earning opportunities in the short term but be expected to lead to much greater earning capacity, and the other beneficial outcomes as outlined above, in the long run.

Therefore, just like any other investment, more and better education represents the deferral of instant economic gratification for greater benefits into the future.

Optimal Taxation of Human Capital

The ability of young people to attain affordable and high quality independent schooling in this country would be imperilled by policy actions that increase taxation burdens upon education. This is because additional taxes (including higher, and more steeply progressive, rates of taxation) would reduce the returns to human capital, thus distorting investment decisions to accumulate more and better human capital.

In response to heavier educational taxes targeted at non-government schooling provision, parents would, all else being equal, decide to invest less of their own resources in the schooling of their own children. Given the abundant literature pointing to the pro-growth effects of more and better schooling,[19] such policy measures would have dire long term consequences for individual wellbeing, as the profile of expected lifetime earnings are reduced, and our future growth and productivity.

Contrasting the urge expressed in some quarters to increase tax burdens upon independent schools in Australia, the conventional public finance literature suggests that the opposite stance be assumed – that is, school education should, in principle, ideally not be subject to taxation in the interests of promoting a more prosperous economy.

The basic proposition, as outlined by Diamond and Mirrlees in 1971 but subsequently refined and extended by the likes of Kenneth Judd,[20] is that final goods in the economy should be subject to tax, but not intermediate goods.

Whatever the optimal allocation of final goods, it is desirable that the production of those goods be undertaken as efficiently as possible. The taxation of intermediate goods would, however, generate productive inefficiencies, by distorting the allocation of factor inputs – including human capital via education and training – thus reducing the quantum of final goods produced in the economy, compared against a scenario of no intermediate goods taxation.

It may be argued that education embodies both investment and consumption values, since the learning process may enhance income-earning capacities through knowledge and skills acquisition, whilst also proving pleasure and satisfaction for most people. Since education involves such a mix of investment and consumption, it could be conceived as an 'impure' intermediate good with its consumptive elements potentially subject to taxation without unduly compromising efficiency objectives.

One way to consider the issue is to compare financial rates of return on education with alternative investments. If education does indeed have consumptive properties, and by implication would be amenable to taxation, this would be indicated by way of lower returns on education vis-à-vis other forms of investment.

15 Organisation for Economic Co-Operation and Development, 2014, *Education at a Glance 2014: OECD Indicators*, OECD, Paris, p. 132.

16 For example, Gary N. Marks, 2004, 'School sector differences in tertiary entrance: Improving the educational outcomes of government school students', *Australian Social Monitor* 7 (2): 43 47; Gary N. Marks, 2015, 'School Sector Differences in Student Achievement in Australian Primary and Secondary Schools: A Longitudinal Analysis', Journal of School Choice 9 (2): 219-238.

17 Gary Marks, 2009, 'Accounting for school sector differences in university entrance performance', *Australian Journal of Education* 53 (1): 19-38.

18 Nikhil Jha and Cain Polidano, 2013, 'Long-Run Effects of Catholic Schooling on Wages', University of Melbourne, Melbourne Institute of Applied Economic and Social Research, Working Paper No. 39/13.

19 A useful survey of the literature is provided by E. A. Hanushek and L. Woessmann, 2010, 'Education and Economic Growth', in Penelope Peterson, Eva Baker and Barry McGaw, eds., *International Encyclopedia of Education*, Elsevier, Oxford.

20 Peter A. Diamond and James A. Mirrlees, 1971, 'Optimal Taxation and Public Production I: Production Efficiency', *The American Economic Review* 61 (1): 8 27; Kenneth L. Judd, 1985, 'Redistributive taxation in a simple perfect foresight model', *Journal of Public Economics* 28 (1): 59 83; Kenneth L. Judd, 1999, 'Optimal taxation and spending in general competitive growth models', *Journal of Public Economics* 71: 1-26. Also Daron Acemoglu, Aleh Tsyvinski and Mikhail Golosov, 2008, 'Political Economy of Intermediate Goods Taxation', Journal of the European Economic Association 6 (2 3): 353-366.


The Cathedral School of St Anne & St James

There is sufficient evidence garnered from Australian international sources indicating that private returns to schooling exceed those on bonds, and are similar to corporate stock returns.[21]

Andrew Leigh and Chris Ryan estimated the rate of return on schooling in Australia to be in the order of 10 percent, which is similar to rates found in other advanced economies.[22] In a research paper prepared for the Australian Bureau of Statistics, Hui Wei reported high rates of private returns for males and females completing a Year 12 school education.[23]

In an empirical study spanning 56 countries, Psacharopoulos estimated the private rate of return to schooling to be in the order of ten percent.[24] Rates of return to high school education of 11 percent, and 13 percent, have been estimated for the United States and United Kingdom, respectively.[25] Angel de la Fuente and Antonio Ciccone reported average rates of private returns to senior secondary schooling of about 11–12 percent in Europe.[26]

In Australia, and throughout much of the rest of the world, it should also be observed school education is provided compulsorily. In a sense this provides prima facie evidence that schooling, at least from the perspective of education policymakers, is perceived to be an investment in the future productive capacities of individuals with growth implications over time.[27]

Requiring parents to enrol their children in a program of education, the state effectively acts to ensure that investment in a child's education is not diminished by those parents who may not sufficiently value the development of educational experiences for their own children. The positive spillover effects associated with individuals acquiring a minimum degree of literacy and knowledge also rationalises the obligation 'that each child receive a minimum amount of schooling of a specified kind.'[28]

Zero Taxation of Human Capital: Australian Taxation Policy Implications

That school education, including that provided by independent schools in Queensland and Australia, represents a major aspect of the overall investment profile in this country has profound implications from a taxation policy perspective.

Currently, fees paid by parents to independent and other non-government schools for educating their children are not treated as deductions for personal income taxation purposes. The inability to deduct these expenditures associated with accumulating human capital violates the principle, as outlined earlier, that intermediate goods such as investments should not be taxed.

21 Peter A. Diamond, 1999, 'What Stock Market Returns to Expect for The Future?', Boston College, Center for Retirement Research, Issue in Brief No. 2.
22 Andrew Leigh and Chris Ryan, 2008, 'Estimating returns to education using different natural experiment techniques', Economics of Education Review 27: 149-160.
23 Hui Wei, 2010, 'Measuring Economic Returns to Post-School Education in Australia', Australian Bureau of Statistics, Research Paper, cat. no. 1351.0.55.032.
24 George Psacharopoulos, 1994, 'Returns to Investment in Education: A Global Update', *World Development* 22 (9): 1325-1343.
25 Cited in Jim Davies, 2003, 'Empirical Evidence on Human Capital Externalities', University of Western Ontario, Department of Economics, Working Paper No. 2003-11.
26 Angel de la Fuente and Antonio Ciccone, 2002, *Human capital in a global and knowledgebased economy*, European Commission.
27 Zvi Eckstein and Itzhak Zilcha, 1994, 'The effects of compulsory schooling on growth, income distribution and welfare', Journal of Public Economics 54: 339-359.
28 Milton Friedman, [1962] 2002, *Capitalism and Freedom*, University of Chicago Press, Chicago, p. 86.

Further, the current tax treatment of school tuition fees reinforces the disadvantages posed by parents of non-government school children effectively paying twice for school education – in taxes for government school students, and then in direct fees for their own (non-government school) student children.

Introducing tax deductibility for independent and non-government schooling fees would ensure greater tax neutrality between forms of capital investment in a modern, competitive Australian economy.[29]

With regard to personal income taxation matters, it is also well established in the economics literature that progression in the rate structure distorts human capital accumulation decisions by depressing the full extent of greater earnings an individual may receive from engaging in further education. Notwithstanding the compulsory age of schooling imposed in Australia, there is great merit in reducing the progressivity of income taxes to dilute the extent of taxation bias against human capital.

In addition, the inclusion of educational expenditures, such as non government schooling tuition fees, would violate the principle that consumption taxes exclude investment spending from their taxable bases. Rather than an argument for 'protection' of the education sector, as asserted by some,[30] the retention of existing GST arrangements, as they pertain to school education, ensures that the knowledge and skills embodied in human beings make their potentially greatest contribution to robust Australian productivity outcomes into the future.

29 Proposals for tax deductions (a reduction of a person's taxable income) or credits (a dollar for dollar rebate on a person's tax bill) have been canvassed by the likes of former federal Labor Party president Warren Mundine and education expert Jennifer Buckingham. See ABC News Online, 'Mundine seeks tax breaks on private school fees', 5 May 2006; Jennifer Buckingham, 2001, *Families, Freedom and Education: Why School Choice Makes Sense*, Centre for Independent Studies, Policy Monograph No. 52; and Jennifer Buckingham, 2001, 'A tax credit system should be the basis for funding education', The Australian Financial Review, 20 October.
30 Richard Denniss, 2015, 'GST arguments are really about protection', The Australian Financial Review, 13 January.

Citipointe Christian College

Implications of Tax Increases on School Education for Parental Choice

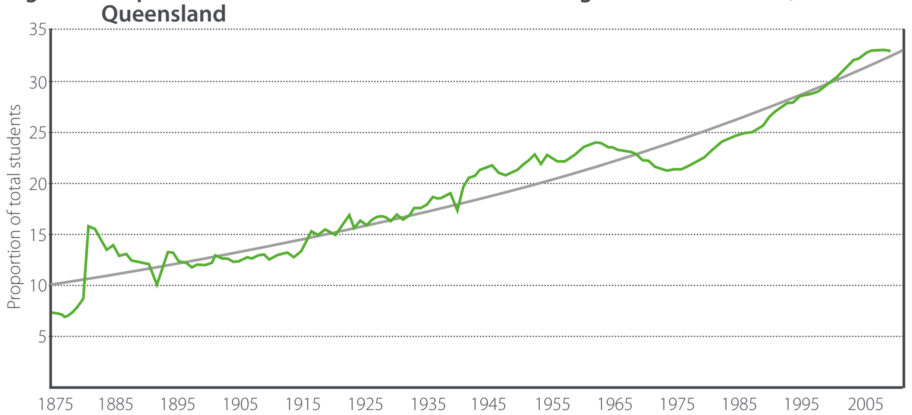
Parental Schooling Choice in Queensland

Non-government schooling of young people has long represented an attractive option for Queensland parents. This is aptly illustrated by the relative 'enrolment drift' in which the share of students in non-government schools have more than tripled since the enactment of the *Education Act 1875* providing 'free, secular, and compulsory education' in the state (*Figure 1).*

Today, Queensland's 195 independent schools have come to be the first school educator of choice for close to 120,000 students – accounting, in turn, for about 15 percent of all school students (20 percent of secondary school students).

Surveys of parental attitudes toward independent schooling suggest a variety of factors influence school choices made by parents on behalf of their student children. Many of these pertain to the perceived quality of educational services provided by independent schools (including in comparison with rival schools in other sectors).

Figure 1: Proportion of school students enrolled in non-government schools, Queensland



Including full time and part time students. Solid line represents a fitted exponential trend.

Source: Australian Bureau of Statistics, Schools, Australia, cat. no. 4221.0; Queensland Government Statistician's Office, Historical tables, society, 1859 to 2008.

According to research by Independent Schools Queensland (ISQ), some of the quality issues for parents choosing an independent school include:

- preparation for the student to fulfil their potential in later life
- good discipline
- encouragement of a responsible attitude to school work
- high quality of teachers
- teaching methods/philosophy.[31]

Whilst the perceived quality premium attached to independent schooling had been frequently cited as an important determinant of demand for education by parents, the price of educational services offered by schools also matters. The ISQ survey reported that 'financial reasons such as fee increases' were the most frequently cited factor for parents with a child who had considered changing school.[32]

Against the background of the clear disparity in taxpayer funding by school sector – about 50 percent of funding to independent schools is derived from commonwealth and state governments; whereas virtually 100 percent of funding for government schools is provided by government – there will be some element of price-sensitivity displayed by parents (especially whose student children are enrolled in low-fee schools) in the event of increasing tuition fees by independent schools.

Estimating the Effects of GST Base Broadening on Parental Choice

As indicated by a recent submission to the federal Tax Discussion Paper process by the national peak body Independent Schools Council of Australia (ISCA), proposals to impose GST on tuition fees would distort parental school choice by encouraging some parents to switch enrolments to government schools.

According to the ISCA analysis, nearly 10 percent of students would be re-enrolled in government schools, but that any GST revenue gains to the states from base broadening would be more than offset by the rising budgetary costs of educating more students in government schools.[33]

This section presents a replication of ISCA's methodology for quantifying the impacts of GST base broadening at a state level, illustrating similarly adverse outcomes for the Queensland school education system.

31 Independent Schools Queensland, 2015, *What Parents Want: An Independent Schools Queensland Survey, Key Findings*, March.

32 Ibid.

33 Independent Schools Council of Australia, 2015, op. cit.

34 This estimate assumes implied growth of 8.2 per cent (five per cent in per capita dollar estimates, plus enrolment growth of 3.2 per cent) in Queensland non government school incomes between 2011 and 2012–13.


Concordia Lutheran College

Assuming a unitary price elasticity of demand for non-government school education services, it is estimated that imposition of a 10 percent GST rate on school fees (and other forms of private income) would have raised about $59 million from Queensland's non-government schools in 2012–13.[34] The additional GST revenues from direct school fees and charges accounted for about 87 percent (or about $51 million) of this total.

The effective increase in non-government fees would be expected to elicit a demand response, in the guise of some parents electing to switch the enrolments of their student children from non-government schools to government schools.

Assuming that the full impact of enrolment switching would be put into effect in the short run, non-government schools across Queensland would have lost approximately 22,700 students to the government school sector in 2012–13 (further details provided in *Appendix A*). As a result of this change, the relative enrolment share of non-government schools would have fallen from about 33 percent to 30 percent. The great likelihood is that the majority of enrolment losses would be likely felt among low-fee schools in high growth catchment areas in Queensland's urban and major regional centres.

As noted by the ISCA submission, the gain in revenue associated with broadening the GST base to school education is not the only budgetary effect of this particular tax-extension proposal.

Extending the GST to school fees and other forms of non government schooling income represents implied expenditure savings to the Australian Government of about $648 million. By contrast the Queensland Government would need to increase its spending by about $1 billion, in order to accommodate the additional 22,700 students seeking a government school education. Overall, the GST base extension would increase fiscal costs by about $361 million in Queensland alone.

This estimate does not include the effects of GST base broadening on the Consumer Price Index (CPI), which would have flow-on effects for CPI-linked government outlays at commonwealth, state, and local government levels.[35]

The extension of consumption taxes upon Australian school education services would almost certainly raise prices charged by independent and other non-government schools, altering parental perceptions of educational value in the presence of heavily subsidised governmental schooling. Indeed, as this study suggests, imposing additional taxes on schooling is likely to engender a significant loss of enrolments threatening the viability of individual schools and, through this, circumventing the availability of diverse school choices for parents.

35 For more details concerning the estimated Australian Government budgetary impact of extending GST, via outlays influenced by price inflation movements, see Independent Schools Council of Australia, 2015, op. cit.

Summary

Human capital is a vital part of the modern Australian economy, and will undoubtedly represent an indispensable part of its future as national and state economies continue to evolve in the face of globalisation, disruptive technologies, and other seismic economic and social changes.

As part of the ongoing efforts in human capital investment, 'expenditure on school education is an essential public interest investment and a fundamental necessity in the operation of a modern society.'[36] The non-government schooling sector, comprised of independent and Catholic schools, is extremely well placed to help optimise the returns on investing in young people, in no uncertain terms, because of the preparedness of many thousands of Australian parents to seek to buy as much schooling for their children as they can reasonably afford.[37]

For the sake of our future economic prosperity and social harmony we need to take even more seriously the task of investing in our young people. For this reason it is advisable that policymakers take even less seriously demands by some groups to further extend the coverage of taxes to school education services, including those provided by independent schools which already save Australian taxpayers considerable sums in potential public expenditures.

As this study has shown, taking human capital investment as seriously as other forms of investment dictates that taxation should not be imposed upon school education services. This would ensure that decisions by parents to invest their own monies into the education of their children are not frustrated by tax impositions, giving their children the best opportunities to become high-wage earners in the highly productive, dynamic Australian economy of the future.

To suggest, as some pro-taxation groups are prone to do, that taxing school education, and thus the critical means through which human capital investment takes place, is appropriate and fair is nothing short of economic irresponsibility of the highest order.

Proposals for new and increased taxes on the school education sector also appear as barely naked attempts to engineer a reversal of the longstanding enrolment drift from government to non-government schools, counteracting the efforts and interests of parents in seeking quality, values-based education for their children, and to further consolidate the influence of public education interests in our educational policy affairs.[38]

This study has also demonstrated that if such efforts to use the taxation system to reduce the relative attractiveness of non-government schooling were to succeed, via a reduction of enrolments in Queensland's non-government schools, this would come at the even greater cost of new spending pressures on public education authorities who must expend more to accommodate the influx of students into government schools.

Should wiser policy heads definitively resist the demands to extend the tax net to independent schooling, the resulting benefits in terms of a more highly educated population, able to confidently meet the opportunities and challenges of the future, would put Queensland and Australia in a most advantageous position in the years and decades ahead.

36 National Council of Independent Schools' Associations, 1998, Taxation and Schools, NCISA Position Paper No. 4.
37 Chris Berg, 2015, 'Why we value the old school tie', The Age, 19 July.
38 Henry Ergas, 2015, 'Extending GST to health and education would boost public sector unions', The Australian, 10 January.

Stuartholme School

Appendicies

Estimating the Impacts of Applying GST to Queensland Non-Government Schools

Appendix A

School Enrolments and Funding in Queensland

According to the latest *Report on Government Services*, produced by the Productivity Commission, there were 252,237 full-time equivalent (FTE) students enrolled in Queensland's non-government schools in 2012–13 (or 33.3 percent of total student enrolments). It is estimated that 505,149 FTE students (66.7 percent of total enrolments) were enrolled in government schools throughout the state.

Estimates of per capita and total recurrent government funding of Queensland's school students in 2012–13 are provided in *Table A1*. The enrolment of a student in a non-government school saved taxpayers, on average, $6,468 in 2012–13 – with funding recurrent costs of educating a student in Queensland non-government schools costing the Australian Government ($4,731) but offset by a larger saving for the Queensland Government ($11,199).

Table A1: Recurrent government funding of schools in Queensland, 2012–13

	Total recurrent expenditure	Per capita funding for government schools	Per capita funding for non-government schools	Implied savings to taxpayers
	$ millions	$	$	$
Australian Government	2,565	1,811	6,542	4,731
Queensland Government	7,572	13,727	2,528	-11,199
Total	10,137	15,538	9,070	-6,468

Source: Steering Committee for the Review of Government Service Provision, 2015, *Report on Government Services 2015*, Productivity Commission, Canberra.

39 According to Treasury the GST benchmark, for the purpose of estimating tax expenditures associated with the GST, comprises: the value of the final supply of all goods and services privately consumed and investment in Australian residential housing as the tax base; the entity making a supply (or receiving a supply in the case of reverse charges) as the tax unit; the existing 10 per cent GST rate as the tax rate; and the financial year as the taxation period. Commonwealth Treasury, 2013, *Tax Expenditures Statement 2012*, Commonwealth of Australia, Canberra, p. 191.

Appendix B

Impact of GST Base Broadening on Government Revenue

Notwithstanding the efficiency and competitive neutrality cases for maintaining GST-free treatment of school education services, the Commonwealth Treasury in its annual *Tax Expenditures Statement* (TES) considers the tax treatment of private education expenses as a concessional departure from the GST benchmark.[39]

As indicated in the TES, Treasury estimates that tax expenditures associated with the GST education exemption was valued at $3.55 billion in 2012–13. This is based on the 'revenue foregone' methodological approach which calculates the benefit to the taxpayer of the tax provision concerned, measured relative to the non-concessional tax benchmark.

When accounting for behavioural changes by taxpayers in response to the removal of a tax concession, Treasury provides a 'revenue gain' tax expenditure estimate. Using this alternative approach, Treasury estimated a gain in revenue of $3.2 billion associated with the hypothetical removal of GST education exemption.

The alternative tax expenditure estimates suggests Treasury assumed a unitary price elasticity of demand for private education expenses. The estimated tax expenditure under the revenue gain approach (again, taking behavioural effects into account) was approximately 10 percent lower than that estimated using the revenue foregone approach. This, in turn, implies a percentage reduction in quantity demanded for private education services by 10 percent. With the removal of the tax expenditure raising private education prices by the full extent of the GST (that is, 10 percent), the assumed (absolute value of the) elasticity is, therefore, one.

The *National Report on Schooling in Australia 2011* report, produced by the intergovernmental Standing Council on School Education and Early Childhood, produced estimates of non-government school incomes and expenditures on a per student capita basis. Information pertaining to non-government schools in Queensland in 2011, and estimates for 2012–13, is outlined in *Table A2*.

The Australian Government could impose GST on non-government school fees and charges, collecting revenue from a total Queensland potential tax base of $561.6 million in 2012–13. Using the revenue foregone methodology, imposition of a 10 percent GST would yield the Australian Government an extra $56.2 million from non-government schools in Queensland.

Assuming that some parents would respond to higher fees and charges, induced by the GST imposition, by enrolling their children in Queensland's government schools would yield a slightly lower GST revenue estimate, of an additional $51.1 million from the non-government school sector. This is because the broadening of the GST to school education would also include the relatively small, but not insignificant, private contributions parents make to government schools.[40]

The government could, instead, apply the broadened GST base to the total private incomes earned by non-government schools (including donations income). If so, this could have yielded a slightly larger amount of GST revenue from Queensland non-government schools in 2012–13 (under the revenue gain approach) of $58.9 million.

GST may also be applied to total recurrent expenditures undertaken by the non-government school sector. Whilst this might potentially yield significantly greater revenue (estimated at about $130 million, under the revenue gain approach, in 2012–13), it is considered an unlikely base to be utilised by the Australian Government for taxation purposes since the imposition of GST on government school expenditures would be politically unpalatable.

Table A2 Queensland non-government school incomes and expenditures

	Income/ expenditure $ per capita 2011	Income/ expenditure[a] $ millions 2011	Income/ expenditure[b] $ millions 2012–13	GST (revenue foregone) $ millions 2012–13	GST (revenue gain) $ millions 2012–13
Fees and charges	4,745	519.0	561.6	56.2	51.1
Private donations and income	727	79.5	86.0		
Total private income	5,472	598.6	647.6	64.8	58.9
State Government grants	2,400	262.5			
Australian Government grants	7,262	794.4			
Total income	15,133	1655.3			
Recurrent expenditure	12,049	1,318.0	1,426.1	142.6	129.8
Capital expenditure	3,072	336.0			
Total expenditure	15,120	1,653.9			

(a) Estimates of absolute figures based on National Report on Schooling estimate of 109,385 total students enrolled in Queensland non-government schools. (b) Estimated private incomes and recurrent expenditures based on assumption of five percent growth in per capita dollar estimates between 2011 and 2012–13, and enrolment growth of 3.2 percent (reflecting difference between National Report on Schooling 2011 estimates and Report on Government Services 2012–13 estimates for non-government school enrolments in Queensland).

Source: Australian Curriculum, Assessment and Reporting Authority, 2013, National Report on Schooling in Australia 2011, ACARA, Sydney.

40 Accounting for the school sectoral consistency in the application of a broader GST, it is effectively assumed that the relative change in private education prices (of nine per cent) is slightly less than the full extent of the GST (of 10 percent).

Appendix C

Impact of GST Base Broadening on School Enrolments

Given the unitary elasticity assumption adopted here, the imposition of the GST would have culminated in a reduction of non-government school enrolments across Queensland to the tune of 22,701 students (FTE basis) in 2012–13. The enrolment share of non-government schools would have fallen from 33.3 percent to 30.3 percent, whereas government school enrolments in Queensland would have increased from 66.7 percent to 69.7 percent (*Table A3*).

Table A3: Full year impact of GST base broadening on Queensland school enrolments, 2012 13

	FTE enrolments (pre-GST)	Enrolment share (pre-GST)	FTE enrolments (post-GST)	Enrolment share (post-GST)	Change in FTE enrolments
Government schools	505,149	66.7	527,850	69.7	22,701
Non-government schools	252,237	33.3	229,536	30.3	-22,701
Total	757,385	100.0	757,375	100.0	

Source: Steering Committee for the Review of Government Service Provision, 2015, *Report on Government Services 2015*, Productivity Commission, Canberra.

Appendix D

Impact of GST Base Broadening on School Funding

Due to policy developments by successive commonwealth and state governments, an implicit division of public sector funding responsibilities for Australia-schooling has emerged. The Australian Government primarily funds the recurrent costs of non-government schools, which are also funded by parents, donors (primarily for capital works), and to a small extent by state governments. On the other hand, the states primarily fund the recurrent (and capital) costs of government schools, with relatively much smaller contributions from the Australian Government and directly by parents.

The effective division of funding responsibilities has important implications from the standpoint of prospective changes to school financing policies, including broadening the GST to school fees or total incomes. As this study has shown, a broader GST is likely to elicit a behavioural response by some parents in the guise of re-enrolling their student children in government schools in an effort to avoid higher non-government school fees.

Table A4 illustrates the potential effects of GST base broadening, leading to a reduction in Queensland non-government student enrolments of 22,701 FTE students, on Australian and Queensland Government budgets.[41] Whilst the enrolment drift toward the state's government schools saves the Australian Government some $648 million in 2012–13, this is more than offset by an increase in state government spending of about $1 billion.

The tax-induced shift in enrolments in Queensland alone costs both levels of government (by extension, taxpayers) at least $361 million,[42] which more than offsets any revenues collected from GST base broadening and would thus be counterproductive from a sound public budgeting perspective.

Table A4: Full year impact of GST base broadening on Queensland school funding, 2012 13

	Total recurrent expenditure (pre-GST) $ millions	Total recurrent expenditure (post-GST) $ millions	Change in expenditure $ millions
Australian Government	2,565	1,917	-648
Queensland Government	7,572	8,580	1,008
Total	10,137	10,498	361

Source: Steering Committee for the Review of Government Service Provision, 2015, *Report on Government Services 2015*, Productivity Commission, Canberra.

41 Excluding the effect on public sector expenditures arising from higher non-government school fees increasing the rate of general price inflation.
42 This estimate does not include the costs posed by additional infrastructure requirements for the accommodation of extra government school student enrolments.

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