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# Weathering the Storm: Tax as a Component of Financial Capability

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# Weathering the Storm: Tax as a Component of Financial Capability

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In a time of global economic uncertainty, maintaining a financial environment where consumers are protected from risk and continue to have opportunities to create wealth should be critical for governments, business and administrators. A financially capable population could therefore be the key to avoiding the crises of the past and getting back to economic prosperity. The Australian Government has recognised that for those with the lowest levels of financial literacy, specific financial literacy programs can equip them with the appropriate financial skills and knowledge to ensure that they can make well informed decisions and be less vulnerable to scams and market risks (Commonwealth Department of Treasury 2006). However, if these programs are to be successful it is imperative that all aspects of financial capability have been considered. This paper will argue that there is a research gap in terms of what components should be considered (and therefore measured) as part of financial capability and specifically that taxation and to a lesser extent, superannuation have largely been excluded in both the measurement and education program aspects. If taxation and superannuation are not seriously considered as important components of financial capability, there could not only be risks to an individual's financial position, but also significant risks to the broader economy, consumer wealth and the revenue base through poor financial capability.

## **Keywords**

Financial literacy; Financial education; Taxation; Financial capability



# Weathering the Storm: Tax as a component of Financial Capability

Toni Chardon<sup>1</sup>,

## Abstract

In a time of global economic uncertainty, maintaining a financial environment where consumers are protected from risk and continue to have opportunities to create wealth should be critical for governments, business and administrators. A financially capable population could therefore be the key to avoiding the crises of the past and getting back to economic prosperity. The Australian Government has recognised that for those with the lowest levels of financial literacy, specific financial literacy programs can equip them with the appropriate financial skills and knowledge to ensure that they can make well informed decisions and be less vulnerable to scams and market risks (Commonwealth Department of Treasury 2006). However, if these programs are to be successful it is imperative that all aspects of financial capability have been considered. This paper will argue that there is a research gap in terms of what components should be considered (and therefore measured) as part of financial capability and specifically that taxation and to a lesser extent, superannuation have largely been excluded in both the measurement and education program aspects. If taxation and superannuation are not seriously considered as important components of financial capability, there could not only be risks to an individual's financial position, but also significant risks to the broader economy, consumer wealth and the revenue base through poor financial capability.

**Keywords:** financial literacy; financial education; taxation; financial capability

**JEL Classification:** D14, I28, M48.

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## Introduction

In a climate where investors have had their life savings and superannuation decimated due to the global economic storms, financial capability needs to be a critical issue. As a specific example of the consequences of poor financial decisions, in January 2009, Australian financial advice firm, Storm Financial were placed into voluntary administration creating a media frenzy which alleged irresponsible financial advice, pressure sales tactics, complicated margin loan arrangements and stories of investors losing not only their whole retirement savings, but also potentially their private homes. Although the intricacies of the Storm Financial collapse may have involved a combination of poor financial capability of participants, a lack of understanding of the specific financial products, targeted sales tactics or even gaps in the regulation of the financial services market, this example as well as the wider global financial crisis, serves to highlight the importance of investor and consumer awareness (of tax issues as well as broader financial consequences) of the financial transactions they enter into.

It has been argued that “financial deregulation, and the resulting increase in competition, and access to financial products, has led to consumers being faced with a “bewildering” array of financial and investment opportunities” (Worthington 2006, p. 59) which are becoming increasingly more complex and sophisticated. Additionally, as a result of shrinking workforces and ageing populations, there is a global trend in western countries toward self-funded retirement (Kelly 2003). A push toward self-funded retirement has also led to complex rules and legislation surrounding superannuation in Australia. These trends are worrying given that surveys measuring adult financial literacy in Australia as well as other academic research (Worthington 2008) suggest that there are certain at-risk?? groups which have low levels of financial literacy particularly in relation to financial products and superannuation.<sup>2</sup> Kempson and Atkinson (2006) also modelled the effect of certain ‘expenditure shocks’ on the UK population and found that an increase in fuel bills (by 40%) would have a disproportionate effect on those households who were already finding it difficult to make ends meet.

In 2003, the Australian Government established the Consumer and Financial Literacy Taskforce with the aim of developing a national strategy. This National Strategy was aimed at reducing poverty, increasing economic opportunity, increasing national savings and creating well-informed consumers. The Australian Government (along with many overseas governments such as the UK, US, Canada and New Zealand) believes improving the financial skills and education of individuals is the key to economic prosperity (Commonwealth Department of Treasury 2006). In its literature, the Government states that it is “committed to helping Australians save for their future and recognises that low levels of financial literacy act as a barrier to consumer awareness and informed participation in the financial system” (Commonwealth Department of Treasury 2006). In making these statements and setting up the Taskforce, the Government is acting upon concerning research<sup>3</sup> which indicates that some groups have particularly low levels of financial literacy and that specific programs can equip

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<sup>2</sup> For example, 42% of survey participants under 65 in the most recent 2008 ANZ Survey of Adult Financial Literacy were not aware that Superannuation was taxed at lower rates than other investments. Additionally, Worthington (2008) undertook more detailed research in relation to findings from the ANZ survey particularly in relation to superannuation. He argues that knowledge of superannuation in Australia is varied with good understanding in some areas and poor understanding in others.

<sup>3</sup> For example, the 2002, 2005 and 2008 ANZ Surveys of Adult Financial Literacy in Australia and the 2004 Commonwealth Bank Foundation survey as well as overseas in the 2006 Baseline Survey undertaken by the Financial Services Authority in the UK.

them with the appropriate financial skills and knowledge to ensure that they can make well-informed decisions and be less vulnerable to scams, rorts and unmanageable levels of debt (Commonwealth Department of Treasury 2006).

Financial capability<sup>4</sup> research both in Australia and overseas has been ad-hoc and there is little academic research which focuses on what elements should form part of measuring a person's level of financial capability. Much of the previous research has focused on measuring the level of financial capability across different demographic groups as well as evaluating financial capability education programs (Coben, Dawes & Lee 2005). Worthington (2006) outlines that literature concerning financial capability can usually be categorised as either; explaining the levels of financial capability in the population or evaluating the effectiveness of financial capability programs. However, he does not identify that any research has explored what should be included as components of financial capability and in fact argues that future research should focus on these components of financial capability to find which are most and least critical to financial success (2006, p75). Kempson (2009, p(ii)) argues that there is "remarkably little robust information" in the area of financial literacy and that because of the ad-hoc nature of the research and surveys already undertaken, it is quite difficult to make international comparisons. Worthington also submitted that future research could focus on how financial capability specifically relates to individual areas such as superannuation (2006, p. 75) and in 2008 published research which explored in detail the level of understanding of superannuation issues in Australia. Highlighting gaps in financial knowledge or misinformation in the market place is critical in ensuring Australian consumers are fit to weather the current and any future financial storms which hit.

This article argues that measurements of financial capability should incorporate all those elements which potentially impact upon a person's financial position and that an understanding of the taxation system should be one of these components. Financial capability as a discipline is not only relatively new, but also complex as it draws from fields such as economics, behavioural economics, finance, psychology and education. This article however, is focused on the components of financial capability as they currently appear and looks at the ways in which the various measurements and surveys of financial capability have informed the development of the components themselves as well as financial capability education programs, and vice versa. The article therefore takes a grounded theory approach which aims to derive propositions from the research, rather than beginning with a particular priori hypotheses or assumption (Leonard & McAdam 2001; Seale 2005).

Taxation is something which impacts with certainty on each individual or business and therefore it also impacts on a person or business's overall financial position. The ability to meet tax liabilities on time, prepare returns accurately, claim all available entitlements and communicate effectively with one's financial or tax advisors would certainly impact on a person's overall financial position. Arguably, the arrival of a substantial tax bill due to being unaware of tax obligations or incorrectly filling in a return could have a similar impact to Kempson and Atkinson's (2006) expenditure shocks as discussed earlier. Given that non-payment of taxation obligations can result in substantial (and unique) penalties, this is certainly an important issue. Therefore, if taxation issues are not seriously considered as important components of financial capability, there could not only be risks to an individual's financial position, but also significant risks to revenue. This is in much the same way there are currently significant risks to the economy and consumer wealth through poor financial capability. The remainder of this paper looks broadly at the concept of Financial Capability and the factors which are currently generally accepted as components of financial capability.

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<sup>4</sup> Defined in this paper as "the ability to make informed judgements and to take effective decisions regarding the use and management of money".

Secondly the paper will discuss recent measures of financial capability in Australia and highlight where there appears to be gaps in relation to taxation or superannuation. Finally the paper will suggest those additional participants who stand to benefit from the inclusion of tax as a component of financial capability.

### Defining Financial Capability

Financial literacy has been defined as “the ability to make informed judgements and to take effective decisions regarding the use and management of money” (Worthington 2006). This is also the definition which was adopted by the Australian Government’s Consumer and Financial Literacy Taskforce and surveys of financial literacy in Australia. However, prior studies have also presented other definitions such as “about people being informed and confident decision makers in all aspects of their budgeting, spending and saving” (Worthington 2006). Worthington (2006) further argues that although policy makers and researchers have attempted to define financial literacy, there is still a question as to whether it should be a broad concept which encompasses many facets such as broader economics or whether it should simply be about basic money management. The research suggests that current surveys and measurements of financial literacy both in Australian and overseas measure a combination of aspects such as day-to-day money management, financial planning, ability to choose appropriate financial products and financial knowledge and understanding (Kempson 2009). However, both the above descriptions imply a financially literate person will behave in a certain way, make better decisions and be more confident. These all describe a set of behaviours or skills rather than mere knowledge about a subject. For this reason, Financial Capability is argued to be a more appropriate term when describing a person’s abilities or skills in relation to financial matters (Hogarth 2002; Vyvyan & Brimble 2007). In fact, Financial Capability is beginning to be adopted as a more valid term, especially in the United Kingdom (Kempson, Collard & Moore 2005) and Australian Government research considers that the terms can be used interchangeably (Financial Literacy Foundation 2007a). More recent work of the Financial Literacy Foundation which is focussed on building confidence, positive attitudes and beliefs and self-efficacy (Financial Literacy Foundation 2007a). This incorporation of behavioural and skills aspects as well as knowledge is also supported by the Organisation for Economic Co-operation and Development (OECD) where they describe financial education as a process incorporating both knowledge and the ability to take such knowledge and make decisions, or take further positive actions (OECD 2005). With such variable definitions of financial capability existing, and little academic research into the components that should form part of a measure of Financial Capability, it is argued that there is scope for broadening the currently measured components of financial literacy to include an understanding of basic taxation issues.

The most widely cited measure of financial literacy in Australia is the ANZ Survey of Adult Financial Literacy. These surveys are underpinned by a financial literacy framework which is largely based on principles established in the UK by the Adult Financial Literacy Advisory Group (Financial Services Authority 2004) and incorporates the variables as described in Table 1 as components of an overall financial literacy score.

**Table 1**  
Variables of an overall financial literacy score

<p><u>Numeracy</u> Basic mathematical operations of addition, subtraction, multiplication, division and percentages.</p> <p><u>Financial Understanding and Competence</u> Attitudes to spending money and saving Understanding of risk and the relationship between risk and return Understanding the main features of basic financial services Understanding of superannuation</p> <p><u>Financial Responsibility</u> Making appropriate life choices about financial issues Understanding consumer rights and responsibilities.</p>
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Source: (ANZ 2008, p. 7 & 179)

It should be noted that these broad categories are quite consistent with the recent findings of Kempson (2009) where she proposed a framework for the measurement of financial capability which would allow international comparisons to be made. This proposal for a consistent framework is also supported in other research which argues that an overarching framework will give greater consistency and clarity for education programs (Fox, Barthololmae & Fox 2005; O'Connell 2007). The proposed international framework (presented as an OECD working paper) broadly categorises financial literacy into four areas; day-to-day money management, financial planning, ability to choose appropriate financial products and financial knowledge and understanding. These broad categories proposed by Kempson, on the whole, appear to be covered by the ones explored in the ANZ survey above, however it could be argued that financial planning (as suggested by Kempson to include attitudes to financial planning, providing for retirement, providing for emergencies) could be explored and measured in more detail in future ANZ surveys in Australia<sup>5</sup>. It is also argued that an understanding of basic taxation issues such as rights and responsibilities of taxpayers and the basic framework of the Australian taxation system could form part of all three of the above variables. The report to the 2008 ANZ survey recognises this argument where it states: "please note that other potential aspects of adult financial literacy (e.g. taxation; understanding of how and why government is financed; awareness and understanding of government benefits; understanding of how fees are calculated and how to minimise them) were agreed upon as being beyond the scope of the current project, and therefore not included in the framework" (The Social Research Centre 2008, p. 182). It is questionable why taxation was considered as outside the scope of the project if it is identified as relevant and useful in determining a person's overall financial literacy score. Given that the Financial Literacy Foundation put forth a media release encouraging teenagers to lodge tax returns (Financial Literacy Foundation 2007) on the basis that "by submitting a tax return you will find out whether you are paying the right amount of tax...you can take control of your tax now if you should be paying more" there appears to be some mixed messages about whether taxation is an important aspect of financial capability or whether it is "outside the scope". To date, understanding taxation issues has never been measured in detail in any Australian survey of financial literacy. This means that there is no data to determine whether this might be an area where people have low levels of literacy or whether there are specific aspects of taxation which need to be focused on or targeted. This targeted and specific approach is particularly important if financial capability education programs are going to include aspects of taxation.

<sup>5</sup> The Financial Literacy Foundation appears to have explored these areas further in their 2007 Report; Australians Understanding Money and this will be discussed later.

This paper will highlight that past surveys of adult financial literacy certainly indicate there are some gaps in terms of taxation and superannuation components which in fact should be included and measured as components of financial literacy.

## Taxation and Financial Literacy

Having discussed broadly the components of financial capability and argued that taxation is considered to be a relevant factor, this paper will now explore the measures of financial capability in Australia broadly, but also highlight where there appears to be gaps (in either measurement of or levels of understanding) in relation to taxation or superannuation issues.

### *Measures of Financial Capability and their Economic Importance*

In 2003, the Commonwealth Bank (CBA) established the Commonwealth Bank Foundation to encourage and fund developments in education, particularly financial literacy. A national telephone survey<sup>6</sup> was conducted with 5000 Australians aged 16-65 in 2004 (Commonwealth Bank 2004). Two key findings of this survey were that the 10% of the population with the lowest financial literacy were more likely to be in one of the following categories; aged 16-20, male, unemployed or students, lower education levels, lower annual personal income, lower annual household income. This finding is consistent with research in the UK which found that financial capability was weakest amongst younger age groups and those with lower annual household incomes (Atkinson et al. 2006; Financial Services Authority 2006). The Commonwealth Bank survey also found that increasing financial literacy by a modest amount amongst this 10% would contribute an additional \$6 billion per year to GDP, and create over 16,000 new jobs (Commonwealth Bank 2004). This is important from an economic and social perspective, but also from a tax perspective. The report argued that these economic benefits would flow from “improved decision making in the workforce, resulting in improved productivity, less capital wastage with improved decisions on starting new businesses and home purchasing, and increased flow of funds to Australia’s more profitable businesses via better saving and investment decisions” (Commonwealth Bank 2004). From a tax perspective this could mean an additional \$6 billion per year in potential revenue base as well as potentially 16,000 new taxpayers. If these efforts to improve financial capability are going to create new taxpayers and increase revenue base, then it would certainly be a risk to revenue to not ensure that these “new market participants” are also educated in how the taxation system works. If an understanding of taxation is not included as part of financial capability education programs (particularly for those on lower incomes or who receive welfare), then when those participants eventually find themselves in a position where they need to engage with the taxation system, they may not have the skills or knowledge to do so effectively. The Financial Literacy Taskforce also modelled “bad” decision making and found that over the course of a person’s life (whose salary was \$36,000 per annum), up to \$790,000 in wealth could be lost (Consumer and Financial Literacy Taskforce 2004). This certainly supports the argument that financial literacy can have an effect on the economy as a whole. From a tax administration perspective, lost wealth could also lead to lost tax revenue.

If only moderate increases in financial capability amongst these vulnerable groups can have such an impact on wealth, then it is important that we understand the most effective types of information to provide in order to bridge this gap and ensure this wealth is not lost. Similarly in terms of taxation, it is important that we understand which aspects of the taxation

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<sup>6</sup> The survey was conducted by the Commonwealth Bank foundation, CommSec Quantitative Research Division, the Centre of Policy Studies at Monash University and Eureka Strategic Research.



system have the potential to impact upon financial capability (and therefore wealth) and the most effective ways to provide this information. Compliance research in the field of taxation has suggested that although correct material was provided to them, many taxpayers found there to be too much information and preferred straightforward and directly relevant material (McKerchar 2002).

Since an understanding of taxation issues has not yet been measured in any detail in previous surveys we are unable to determine which population groups might have low levels of literacy in relation to taxation or which specific aspects of taxation might need targeted education programs. As illustrated by the research undertaken by Worthington (2008) in relation to understanding superannuation, there are many specific dimensions of tax that could be explored in order to draw specific conclusions. It is argued that all those population groups which have been found to have the lowest levels of financial literacy<sup>7</sup> would have at least some contact with the taxation system during their lifetimes, or will eventually need to engage when their financial situations are under control. So, if there is such a potential for people's participation (or non-participation) in the tax system to be effected by their level of financial capability, it is evident that an understanding of basic taxation should form part of measuring financial capability.

## INFORMING PRACTICE, PACKAGES AND PRODUCTS

The Australian Financial Literacy Foundation was formed in 2005<sup>8</sup>. Among the many aims of the foundation, one key aim is to create opportunities for Australians of all ages to learn more about money (Financial Literacy Foundation 2009).

As a result of the establishment of Taskforce and the Foundation, the Ministerial Council for Education, Early Childhood Development and Youth Affairs (MCEECDYA)<sup>9</sup> recommended a framework to state education authorities in relation to how Financial Literacy should be incorporated into the school curricula for years K-9 (Ministerial Council for Education 2005). The framework<sup>10</sup> is to be integrated in curricula and programs across English, Mathematics, Science, Humanities, Business, Commerce, Economics, Technology and Enterprise.

In developing the framework for inclusion in schools, the MCEECDYA defined financial literacy as “the application of knowledge, understandings, skills and values in consumer and financial contexts and the related decisions that impact on self, others, the community and the environment” (Ministerial Council for Education, Training & Youth Affairs (MCETYA) 2005, p1). In their report, they stated that “the world of consumers is becoming increasingly complex (e.g. Superannuation, personal investments, a more complex tax system, and increased applications of new technologies) and research indicates that levels of consumer and financial literacy among adults, parents and young people alike are insufficient to cope with many of these complexities” (MCETYA 2005, p1). Again, it is clear that superannuation and the tax system have been considered at the outset, yet as will be seen, have not been incorporated into the detail.

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<sup>7</sup> Such as those outlined earlier; younger groups, those who are unemployed or receive government payments, those with lower household or personal incomes.

<sup>8</sup> In July 2008, the functions of the Foundation were transferred to the Australian Securities and Investments Commission (ASIC).

<sup>9</sup> MCEETYA made the original recommendations, but was reformed and is now the Ministerial Council for Education, Early Childhood Development and Youth Affairs (MCEECDYA)

<sup>10</sup> Revised in 2009 as a result of the introduction of a national curriculum: Ministerial Council for Education, Early Childhood Development and Youth Affairs

The Australian educational framework for financial literacy draws on financial capability research initially from the U.K, the ANZ Surveys of Adult Financial Literacy, and research on behavioural economics from the Productivity Commission. It also has the broader goal to enhance general capabilities<sup>11</sup> as required as part of the new national curriculum. The framework is based on indications that the most important success factor is the programs' ability to relate financial education to the existing curriculum (as opposed to being an entire course on its own) and provide opportunities to engage in and discuss "real world" financial contexts (MCETYA 2005, p2). This principle would apply to not only school based education strategies but also adult education packages whether they be delivered by way of information package, training seminar or workshop. The Financial Literacy Foundation (2007a) found that in addition to carefully targeted programs, the best program for financial literacy is one that gets people started with an achievable goal and is aimed at building confidence and self-efficacy. However, it is acknowledged that the impact and effectiveness of any financial education program can be limited by its delivery and that many different teaching methods will be used (O'Connell 2007). It is therefore argued that including taxation as a component of a financial capability model would involve much more than providing answers and written information in relation to tax matters (as is currently the method broadly adopted by tax authorities). In a 1999 U.S study it was found that personal finance could be successfully taught and that it had a positive impact on financial behaviour in both students and adults (Worthington 2006). It is therefore argued that teaching the basics of the taxation system could have a positive impact on the behaviour of individuals when participating in the tax system. The framework which incorporates financial literacy into the Australian school curriculum has four dimensions; Knowledge and Understanding, Competence, Enterprise, Responsibility. At the outset, MCEECDYA identified the complex tax system and superannuation as areas which need addressing. However, none of the knowledge and understanding areas included as part of the framework relate specifically to taxation or superannuation (MCEECDYA 2009). Given the arguments put forward in the paper and the fact that the recent Henry Review<sup>12</sup> (Commonwealth Department of Treasury 2010) recommended more education be given in relation to superannuation issues, it seems two important aspects have been excluded. There are some components which touch on tax related matters such as in Year 7; one component includes understanding "that governments provide goods and services to meet consumers' and taxpayers' needs and wants". In Year 9, another Knowledge and Understanding Component includes "understanding how to keep personal financial records and that those records of income, expenses are necessary for income tax purposes." It is clear there is support, that taxation and superannuation issues have a place in financial capability to the extent that they impact upon a person's ability to understand their financial context, meet their legal requirements and their ability to create wealth. So, it is argued that relevant taxation issues should be included as part of the following knowledge and understanding areas as recognised by MCEECDYA.

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<sup>11</sup> As defined by the Australian Curriculum, Assessment and Reporting Authority as; Literacy, Numeracy, ICT skills, Thinking Skills, Creativity, Self-management, Teamwork, Intercultural Understandings, Ethical behaviour and Social competence. See

[http://www.acara.edu.au/development\\_of\\_the\\_australian\\_curriculum.html](http://www.acara.edu.au/development_of_the_australian_curriculum.html)

<sup>12</sup> See recommendation #23 at page 86.

**Table 2**  
Taxation issues that could be included in a National Curriculum

<u>Identified Knowledge and Understanding Area</u> ( <u>Ministerial Council for Education 2009</u> )	<u>Specific Tax Aspect to Incorporate</u>
- money is used to exchange goods and services	- basic GST
- there are different forms of income	- salary vs investment income and tax consequences/differences
- money can be borrowed	- interest and the effects of tax deductibility
- consumer rights and responsibilities	- tax return obligations and financial consequences for non-
- governments provide goods and services to meet consumers and taxpayers needs and wants	- tax policy, types of taxes and their purpose, social welfare and the tax system, superannuation
- how to keep personal financial records	- tax requirements of record keeping and the financial benefits of keeping records
- the use of credit	- tax effects of using credit
- income is derived from a range of sources, including wealth, with different levels of reliability	- types of income (salary, business, investment, share) and tax consequences
- range of consumer and financial advice of varying accuracy and impartiality is available within the community	- responsibility of obtaining accurate advice, cost of obtaining advice.

If taxation issues were included specifically in the framework, by the end of Year 10, a student would have a basic understanding of taxation issues and obligations that would be relevant to them as a now financially literate consumer.

Similarly, it is argued that financial literacy education programs aimed at adults should incorporate those same taxation issues as outlined above. As recognised in the literature, one of the complexities of the discipline is that currently there is no single, widely used financial capability education package for adults (O'Connell 2007). In Australia the current practice is for various interest groups (such as banks, finance organisations, government departments and community groups) to develop education packages or products either broadly covering financial capability or focusing on specific aspects. These packages and products might be internally funded or funded through Government (i.e. The Financial Literacy Foundation) or private grants. Consumers would then be notified of the availability of a product or package through normal advertising or through the Financial Literacy Resources Australia website<sup>13</sup> which maintains a database of education packages and programs. If taxation and superannuation were considered as components of financial capability (and therefore measured as part of financial literacy surveys) then it would be more likely that those aspects would find their way into these somewhat ad-hoc packages and products.

<sup>13</sup> <http://www.understandingmoney.gov.au/Content/>

## MEASURING FINANCIAL LITERACY AND THE TAX ASPECTS

Much of the background in establishing the Financial Literacy Foundation and the subsequent framework for financial literacy in schools was based on recent Australian surveys which aimed to measure the level of financial literacy amongst individuals. It was these surveys (and others like them overseas) which identified the groups which were most vulnerable to low levels of financial literacy and also those specific concepts which had low levels of understanding. In 2002, the ANZ bank conducted the first ‘Survey of Adult Financial Literacy in Australia’ which created a benchmark upon which its full surveys in 2005 and 2008 were compared against. The report to the survey argues that improvements in financial literacy would not only support social inclusion, but also, help people avoid the serious negative consequences associated with financial difficulty<sup>14</sup> (AC Nielsen 2005b). The 2008 survey also involved 3,500 telephone interviews<sup>15</sup>. Some of the key findings of the survey were that although Australians are broadly financially literate, certain groups found were found to not understand or utilise particular financial skills, services and products. Some more specific and important findings of the surveys in 2005 and 2008 were that;

- In 2005, 50% of those with the lowest level of financial literacy were unable to calculate 50% of \$1,400 (not reported in 2008),
- When faced with an investment advertised as having a return ‘well above market rates at no risk’, 48% would have made some level of investment (better than 53% in 2005),
- 33% of adult Australians with investments did not understand that good investments can have short term fluctuations in market value (similar to the result in 2005),
- Of those respondents with investments, 35% said they didn’t consider conflicts of interest in any investment recommendations they received,
- People shopped around more for products like investments (49%), mortgages (48%) and insurance (42%) and less for bank accounts (27%), superannuation products (27%) and financial planners (25%). (ANZ 2005b)

Some points from these findings in relation to taxation are that firstly, the ATO should not expect to protect consumers from complex tax minimisation schemes and therefore protect revenue if 48% of respondents would invest in a scheme marketed as having a return ‘well above market rates at no risk’. As outlined at the outset, in a climate of global economic downturn and corporate collapses, awareness of risk vs. return principles is critical. Secondly, how can the government and the tax administration expect taxpayers to understand their basic tax liability (i.e. marginal rates of tax) if 50% of those with the lowest level of financial literacy were unable to calculate 50% of \$1,400?

Both the 2005 and 2008 ANZ surveys indicated that all population groups found superannuation issues more difficult than basic banking. The questions in the survey relating to superannuation are perhaps the only ones that could broadly be categorised as relating to taxation. In the 2008 survey report it is stated that “although an understanding of certain basic rules relating to superannuation remained very high, there continues to be considerable uncertainty about its tax treatment” The Social Research Centre 2008a, p59). This is

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<sup>14</sup> “Financial difficulty” is defined as referring to both those who, while they have not missed repayments or defaulted on their commitments, nevertheless feel out of control of their finances, and also to those who may have missed repayments or defaulted and feel severely out of control of their financial affairs.

<sup>15</sup> The first full survey was conducted in 2005 and involved telephone interviews with 3,500 Australians.

supported by the fact that 96% of respondents knew that their employers were required to make superannuation contributions on their behalf (down from 97% in 2005). However, only 95% understood that they could make additional contributions. In his further analysis and modelling of the superannuation data from the 2003 survey, Worthington (2008) predicts the percent that know employees have the ability to make additional contributions to be 84%.

Another question posed by the survey was whether the respondent knew if superannuation was taxed at higher, lower or the same rate as other investments. The result was that 58% of respondents, who were under 65 years of age, employed and with superannuation, knew that superannuation was taxed at a lower rate than other investments (up from 56% in 2005). However, 5% thought that superannuation was taxed at a higher rate, 10% thought the same rate of taxation applied and 27% said that they didn't know (in 2005, only 22% were unsure) (AC Nielsen 2005a; The Social Research Centre 2008a). Worthington's (2008) analysis predicts the percent that know that superannuation is taxed at a lower rate to be 63% and interestingly that only 70% had an approximate knowledge of the rate of the compulsory contribution. These findings are particularly relevant given a climate where self-funded retirement is preferred by Government. Further, it is also relevant in a market where many participants have the option of more control over their superannuation through Super Choice<sup>16</sup> and self employed people are more likely to have their own self managed super fund.

In 2006 the Financial Literacy Foundation conducted a telephone survey of 7,500 Australians between the ages of 12 and 75 (Financial Literacy Foundation 2007). This survey is unique in the Australian context because it was not a survey which aimed to measure the level of financial literacy in relation to various products or topics. The aim of the survey was to complement existing surveys (such as the ANZ survey) and focus more on participants self-assessed ability and confidence vs their understanding and their attitudes and behaviours about money (Financial Literacy Foundation 2007). In that respect the survey was more subjective in nature rather than an objective measurement of ability in certain areas (Financial Literacy Foundation 2007). This paper however, will focus on some of the findings in relation to investing, protecting money and obtaining information and advice. In relation to investing, the survey found that although Australians were relatively confident with their ability to invest (69%), this confidence was reported as substantially less than their confidence to budget (90%). Interestingly although this self-assessed confidence to invest was relatively high, the survey found that only 34% of adults would actually consider both risk and return when investing and only a small proportion (6% & 5%) would consider reputation and diversification. This therefore showed a gap between the self-assessed confidence to invest and the indicators of actual confidence. The survey also found that 45% of participants currently invested in either shares or managed funds and 18% had an investment property. In relation to protecting money, Australians reported a high level of confidence in their ability to choose appropriate insurance, understand rights and responsibilities and recognise a scam or investment scheme (all above 80%). However, as the skills required to recognise a scam were considered to be the same as for investing, fewer people actually recognised key aspects of scams and schemes (such as risk and return and understanding financial language) and went ahead with investments despite a lack of confidence or ability. The survey therefore found that people's self-assessed ability to protect income was overstated and therefore they may be at risk of being caught by these investment scams (Financial Literacy Foundation 2007). Considering that purported tax advantages are often used as incentives or sales tactics for many investments (such as for share and rental

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<sup>16</sup> Most employees are able to choose which superannuation fund their employer contributions are made to. Prior to Super Choice, employers chose the superfund that all their employee contributions were made into.

property investments) and particularly for risky investment scams, the fact that there appears to be a lack of understanding of fundamental aspects that should be considered, gives weight to the fact that there needs to be more research on which aspects of taxation lack knowledge and understanding.

In relation to obtaining information and advice, the survey found that 68% of people had used or were likely to use accountants or tax agents to obtain information or advice. The percentage was slightly less (54%) for advice from financial advisors. Further, the most common reason for seeking information or advice was for assistance in completing a tax return. These findings are important because although participants were highly confident in their ability to get information and deal with financial service providers (>80%), only 64% said they had an ability to understand financial language. One of the overall findings of the survey was that people's attitudes and beliefs about money can adversely affect their actual financial literacy and that where it is actual ability that is lacking, effort should be focussed on building confidence and competence (Financial Literacy Foundation 2007).

The results of these surveys in an Australian context should also be of great significance to investment advisors, accountants and financial planners. When explaining superannuation investment strategies to a client or customer one cannot assume that the underlying basic principles are already known. Tax research on compliance has suggested that personal taxpayers are not necessarily confident in the accuracy of their returns even where they used an agent and that complexity may cause misunderstandings between a taxpayer and their tax agent (McKerchar 2002, p. 289). So in order to raise this confidence and limit miscommunications it is critical for tax administrators and advisors to know what their clients already understand, or indeed to have a base knowledge that can be assumed.

As outlined earlier, this focus on financial capability by governments, financial institutions and the education sector has not been limited to Australia. There has been much attention to this area overseas, particularly in the United Kingdom (U.K), the United States (U.S), Canada and New Zealand. In fact, much of the financial capability research in Australia has been based on research in the UK in particular; therefore supporting international research focused on in this paper will come from the UK. In 2005, the 'National Research and Development Centre for Adult literacy and numeracy' issued a research report which concluded that although there was a wide array of adult financial literacy programs being undertaken, further work was needed on the part of government, financial institutions and others on the presentation of financial information to make it more "transparent, accessible and understandable by non-specialists" (Coben et al. 2005, p. 22). Interestingly it was raised that the U.K Treasury Report dealing with the modernisation of Britain's tax and benefit system was an example of what the government was already doing in this area (Coben et al. 2005). It is clear therefore that at least in the U.K, taxation is an area which is seen to be able to be made more transparent, accessible and understandable by the general public. The report also raised questions about the current understanding and research into how financial literacy should be defined stating that there are still questions about the nature of financial literacy education and that further research was necessary in this developing field (Coben et al. 2005, p. 10). Although recent work internationally and by the OECD has assisted in this regard, as this paper has highlighted, there is more work to be done.

Similarly to Australia, the research in the U.K by the Financial Services Authority (FSA<sup>17</sup>) found that financial capability was weakest amongst younger age groups (Financial Services Authority 2006). One of the findings of the survey was that the number and complexity of choices in relation to financial matters has increased dramatically, and that through this, many find it hard to understand the risks associated with these choices

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<sup>17</sup> In the U.K, the FSA is funded by a general levy on the regulated financial services industry.

(Financial Services Authority 2006). The FSA argued if certain groups were to become more financially capable, there would be less need for governments, administrators and financial institutions to intervene because consumers will be less vulnerable in the market (Financial Services Authority 2006). So, following this, it is argued that the ATO could have less need to intervene in tax matters if certain groups were to become more capable in relation to tax matters.

## Conclusions

In such a stormy global financial environment it is important for not only governments, but also industry participants, educators and individuals to be aware of the impact that financial capability can have not just from an individual perspective, but also from a global and economic perspective. If governments are serious about ensuring that individuals are less exposed to investment risks, have adequate opportunities to create wealth and are having a positive experience in participating in the financial environment, then they need to understand what it means to be financially capable, which population groups are less financially capable (in which specific areas) and the best way to go about improving financial capability in a consistent, strategic and successful manner.

This paper has shown that although there is a broadly accepted definition of financial capability, there is not a broadly accepted or consistent model of financial capability. Although some international work has been done, there still appears to be gaps between what stake-holders consider are elements of the complex environment and what is actually included in financial capability surveys and education packages. This paper has focussed on the Australian context and in terms of surveys of Financial Capability (or Literacy) and school curriculum, an understanding of taxation issues was identified as part of the initial context, but in terms of measurement and implementation, has not been considered in any detail, other than in relation to superannuation. The research suggests that increasing financial capability helps to ensure that consumers can make well informed decisions in an increasingly complicated marketplace, and be less vulnerable to scams, rorts and unmanageable levels of debt. It is therefore argued that low levels of tax capability may act as a barrier to informed participation in the taxation system in a similar way.

Research in relation to tax complexity has suggested that non-compliant behaviour was not necessarily intentional and that taxpayers who completed their own tax returns were the most likely to be unintentionally non-compliant (McKerchar 2002). Yet at the same time, this research found that there was “evidence of a high commitment to compliance” (McKerchar 2002, p. 289). Evidence presented in this paper makes it clear that for many individuals, being unintentionally non-compliant in relation to their tax obligations is but one of the many challenges they face in participating in any aspect of their finances. There are groups within the community who lack even basic financial management skills. Given that these individuals have never been taught the basic concepts of taxation, there is little wonder they may be more likely to unintentionally non-comply. The simplification of tax legislation and the move toward Australian Tax Office publications being written in Plain English are both positive ways of reducing the complexity of the taxation system. However, it is argued that simplified legislation and plain English publications will not be of use to a taxpayer unable to perform basic percentage calculations or who isn’t aware that superannuation is taxed at lower rates than other investments. As is the aim of many financial capability training packages, certain groups and individuals need targeted and relevant information in a “real world” setting. This means capability or skills based training rather than written material. This is supported by the Australian Financial Literacy Foundation which suggested that although there is a raft of information available to people, they need targeted training in

the relevant context (Financial Literacy Foundation 2007). If educators, the Australian Taxation Office, financial planners, accountants or advisors want to provide useful and informative information to taxpayers, clients or students, they need to understand the specific aspects of the taxation system where there might be low levels of literacy or capability. Therefore, being aware of the persons likely tax base knowledge would be an advantage. Whether in the role of a teacher, advisor or administrator, one of the keys to successfully delivering a message is to tailor your presentation, training package or publication to the type of audience. It has been suggested that when it comes to financial matters people are often not interested in learning until a crisis (Brotherhood of St Lawrence 2004). So, from a taxation perspective, one could argue that people will not be interested in learning about tax until they are suddenly obliged to engage with a system they know nothing about, or even worse, audited or targeted for non-lodgement.

This paper has argued that not only is there a need for further research into what should be considered the components of financial capability but also that there may already be gaps in the areas of taxation and superannuation. Research currently being conducted will therefore focus on gaining a better understanding of not only how much taxpayers need to know about taxation to be better “participants” in the system, but also what they already know. Earlier it was submitted that increasing financial capability by a modest amount amongst the 10% with the lowest levels of financial capability could contribute and additional \$6 billion per year to GDP, and create over 16,000 new jobs. If any current or proposed financial capability programs are indeed successful, there will be no choice but to ensure that an understanding of the taxation system forms part of the program. The government and the tax administrators would certainly want to ensure that revenue is collected on this newly created wealth from a now financially capable population.

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