THE TAX INSTITUTE

29 May 2014

Dr Kathleen Dermody
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Dr Dermody,

Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014 and related bills

The Tax Institute is pleased to have the opportunity to make a submission to the Senate Economics Legislation Committee (Committee) in relation to the Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014 and related bills (**the Bills**).

Introduction

On 28 May 2014 the Bills to enact the temporary budget repair levy passed the House of Representatives, without amendment. The Bills now move to the Senate.

The Bills will enact a three-year progressive budget repair levy (**the Levy**) in the primary form of additional income tax on Australian resident and foreign resident individuals commencing in the 2014-15 financial year.

The Levy is payable at a rate of 2% of each dollar of a taxpayer's annual taxable income over $180,000. The Levy is payable where the taxpayer has a taxable income of $180,000 or less except in cases where a tax law integrity rule applies the top personal marginal tax rate as a flat rate to certain types of income.

The Tax Institute supports a more simple, efficient and equitable tax system. Our submission focusses on specific technical aspects of the Bills which impact on these aspects of the tax system.

Complexity

The Institute is concerned that the Bills add unnecessary complexity to the tax system. Paying the levy is not as simple as increasing the highest marginal tax rate by 2%.

Section 4-10 of the *Income Tax Assessment Act 1997* (**the Tax Act**) works out how much tax you must pay, and the calculation consists of four steps. Three additional steps are required to the calculation in order implement the Levy   The Levy is not included in calculating the taxpayer's basic income tax liability under Step 2 of the method statement in section 4-10(3) of the Tax Act. Instead a further 3 Steps are required to adjust the calculation in the method statement in order to take into account the Levy: see section 4-11(3) inserted by Item 2 of *Tax Laws Amendment (Temporary Budget Repair Levy) Bill* 2014. A note to section 4-10(3) is to be inserted to remind the relevant taxpayers that they must pay the Levy in addition to the income tax liability that they have calculated under section 4-10(3).

The rationale behind treating the Levy as a further adjustment to the section 4-10(3) calculation is to ensure that the Levy cannot be offset by non-refundable tax offsets except the foreign income tax offset: Explanatory Memorandum at para 1.14. We would expect that the number of non-refundable tax offsets available to those earning taxable income exceeding $180,000 would be limited. If there is no substantial increase in the tax collected, we question the practical utility of adding this complexity to the calculation of the individual's income tax liability under section 4-10(3).

In another example, the increase in the top rate of tax appears to apply inconsistently. Amendments to the Income Tax Rates Act 1986 (**the Rates Act**) in Items 35 and 36 *Income Tax Rates Amendment (Temporary Budget Repair Levy) Bill 2014* increase references to 45% in certain provisions of the *Rates Act* by 2%. These Items do not include a reference section 12(1) and Schedule 7 of the Rates Act. This has the effect that the rate of tax on superannuation remainders and employment termination remainders under section 1(a) and (aa) of Schedule 7 of the *Rates Act* remain at 45%. The rationale for this discrepancy is not explained in the Explanatory Memorandum.

Fringe Benefits

The increase in the FBT rate corresponding to the increase in the Levy, applies in respect of all employees, not only those employees earning taxable income over $180,000. If this is the policy intent, we would suggest that it be made clear either in a note to the Bills or an additional paragraph in the Explanatory Memorandum.

The adjustment in Item 1 of Schedule 2 of the *Tax Laws Amendment (Temporary Budget Repair Levy) Bill* 2014 will permanently decrease the FBT rate from the current 48% to 47% from 1 April 2017 once the Levy expires. This appears to be the policy intent based on para 1.53 of the Explanatory Memorandum, however we are concerned that this permanent rebate reduction for rebateable organisations such as charities is being included in the Bills as a measure related to the Levy.

Superannuation

The 2% increase also applies to various income tax rates relevant to superannuation funds which will affect taxpayers who are not on the highest marginal tax rate. Although the FBT rate change discussed above also affects taxpayers who are not on the highest marginal tax rate, those changes have a clearer basis in maintaining the integrity of the Levy than the changes applicable to income tax rates applicable to superannuation funds.

Amendments in the *Superannuation (Excess Non-concessional Contributions Tax) Amendment (Temporary Budget Repair Levy) Bill* 2014 and paragraphs 1.70 to 1.72 of the Explanatory Memorandum indicate that tax rate applying to excess non-concessional contributions tax will increase from 47 to 49 per cent of an individual's excess non-concessional contributions for a financial year. The Tax Institute is concerned that this will result in inequity, particularly for members of Defined Benefit Funds. Employees in some funds routinely exceed the cap through no fault of their own as they have no control over what is paid in by their employer by reason of an award. Those in Defined Benefit Funds are unable to have the sum returned to them to avoid the excess and therefore cannot take advantage of the amendment announced in the 2014-15 Budget whereby those non-concessional contributions withdrawn from a fund can be taxed at the individual's marginal rate. Instead, members of Defined Benefit Funds, (whose may not be on the highest marginal tax rate) would be taxed at 49% on these deemed excess contributions which they might never receive.

The rate of tax on non-complying superannuation funds will increase from 45 per cent to 47 per cent, as will the rate of tax on the non-arm's length component of the taxable income of a superannuation fund. As with the rate change to Excess Non-Concessional Contributions Tax, this will impact taxpayers who are not on the highest marginal rate of tax.

The rationale for these increases appear to be that those income tax rates are aligned with the top personal marginal tax rate and therefore should incorporate the levy: Explanatory Memorandum at 1.45. While the Tax Institute supports the use of consistent rates throughout the Tax Act, we are concerned that these increases in respect of the Levy do not apply across the board (as discussed in relation to the rate of tax on superannuation remainders and employee termination remainders above). Further, consistency in the rates used in the Tax Acts should not be at the expense of equity in the tax system. As explained above the 2% increase in respect of various rates used for the superannuation funds is at odds with the rationale that the Levy and associated changes "*will ensure that those with a greater capacity to pay make a larger contribution to reducing the budget deficit*" (Explanatory Memorandum at page 4).

If you would like to discuss this matter, please contact me or Tax Counsel, Thilini Wickramasuriya

Yours sincerely

Michael Flynn
President