THE PROPOSED 'TEMPORARY BUDGET REPAIR LEVY'

Submission to the Senate Economics Legislation Committee

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The 2014-15 Budget imposes a 'temporary' 2 pc pt 'deficit levy' on taxpayers currently subject to the highest marginal income tax rate, which is payable on incomes in excess of $180,000 pa. This levy will take the top personal income tax rate from 45% to 47% - or to 49% including the Medicare levy (which, as announced in last year's Budget, rises from 1.5% to 2.0% from 1 July in order to fund the National Disability Insurance Scheme).

The intent of this levy is entirely political – in the words of the Treasurer's Budget Speech, "to ensure that high income earners make an appropriate contribution to the task of fixing the Budget". Precisely because it is temporary, it does not make any lasting contribution to "fixing the Budget" in a structural sense.

I completely support the notion that the 'burden' of restoring Australia's public finances to a sustainable condition should be (and should be seen to be) 'fairly shared' as between different stakeholders. And given that most government spending programs are directed primarily towards lower- and middle-income households (or to businesses), the only way that higher-income households can be made to bear an 'appropriate' share of this 'burden' is through changes to the tax system.

However, I do not believe that increasing the top rate of income tax is the *best* way to achieve this goal. That *isn't* because I think it will have a significant negative impact on economic activity – fewer than 4% of all taxpayers will be affected by the measure, and at least some of their increased tax payments will be absorbed by lower saving on their part, rather than lower spending. Nor do I believe that this increase in the top income tax rate will have any material adverse impact on the labour force participation rates of those affected by it

I do, however, believe that it will encourage at least some higher-income households to take more active steps to engage in tax-minimization or avoidance activities, including by making greater use of the myriad provisions in the income tax system which offer preferential or concessional treatment for particular types of income, forms of business organization or categories of investment vehicles. The resulting distortion of investment decisions detracts from overall economic efficiency – if only at the margin – and further undermines the integrity and equity of the income tax system.

The Budget's 2 pc pt increase in the top income tax rate will result in Australia having one of the higher top income tax rates among countries whose taxation systems and political traditions are similar to Australia's, cutting in at threshold which is low by those countries' standards – as shown in Table 1 on page 2 (New Zealand is an 'outlier' here, with a very low top tax rate of 33% cutting in at a relatively low income threshold). This isn't really consistent with the Government's assertion that Australia is "open for business".

In my view, the Government could achieve the same political objective, of ensuring that high-income households made an appropriate contribution to the task of budget repair – but in a lasting way, and without any of the adverse consequences of a higher marginal tax rate – by broadening the base of the personal income tax system, that is, by curtailing or limiting the various opportunities which the income tax system currently provides for taxpayers to reduce or defer their income tax liabilities, opportunities which are for the most part availed of primarily by high-income households.

Table 2 (on page 3) shows that the 293,475 taxpayers (2.3% of the total) who were in the top income tax bracket in the 2011-12 financial year paid 26.5% of the total net amount of income tax collected in that year – as might be expected given that they earned 15.0% of total taxable income and that the income tax system is intended to be 'progressive'. Similarly, the 32,450 taxpayers (0.3%) of the total who earned 5.0% of total taxable income in 2011-12 paid 10.1% of total net income tax.

Table 1: Top income tax rates and thresholds in Australia and other selected countries

	Top tax rate (%)			*Threshhold (b)*	
	National	*Other (a)*	*Total*	*Local currency*	*A$ (c)*
Australia(d)	49.0		49.0	180,000	180,000
Comparable countries -					
Canada					
Toronto	29.0	9.2	38.2	C$ 514,090	503,912
Montreal	29.0	25.8	54.8	C$ 136,270	133,572
Vancouver	29.0	16.8	45.8	C$ 150,000	147,030
New Zealand	33.0		33.0	NZ$ 70,001	64,400
United Kingdom (e)	45.0		45.0	£ 150,000	269,990
United States (e)					
New York City	39.6	12.6	52.2	US$ 500,000	534,074
Los Angeles	39.6	10.6	50.2	US$ 1,000,000	1,068,148
Chicago	39.6	3.0	42.6	US$ 406,750	434,469
Philadelphia	39.6	3.1	42.7	US$ 406,750	434,469
Houston	39.6	0.0	39.6	US$ 406,750	434,469
Other selected countries -					
France	45.0		45.0	€ 70,830	104,089
Germany	50.5		50.5	€ 250,731	368,464
Japan	40.8	10.0	40.8	¥ 18,000,000	188,755
Netherlands	52.0		52.0	€ 56,532	83,077
Norway	47.2		47.2	Nkr 857,300	154,905
Singapore	20.0		20.0	S$ 320,000	273,632
Spain	52.0		52.0	€ 300,000	440,867
Sweden	57.0		57.0	Skr 602,600	97,923
Switzerland					
Zurich	11.5	13.0	24.5	SwFr 755,200	910,046
Geneva	11.5	19.0	30.5	SwFr 755,200	910,046
Bern	11.5	6.5	18.0	SwFr 755,200	910,046

Notes: (a) Includes State, Provincial, prefectural, or cantonal and city, municipal or communal income taxes where appropriate; in many cases the thresholds for these taxes are different from those for national income taxes. (b) Thresholds are for single taxpayers with no dependents. Some countries (eg the US, Germany and France) have different thresholds for different types of household situations. (c) Foreign currency amounts converted to A$ using exchange rates as at 9th May 2014. (d) Includes Medicate and National Disability Insurance levies. (e) Does not include National Insurance Contributions (UK) or Social Security taxes (US) which are payable on incomes up to a ceiling which is below the top tax threshold in each of these cases.

Sources: Australian Government, *2014-15 Budget Paper No. 1,* Statement 5; KPMG, *Individual income tax rates* (www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/individual-income-tax-rates-table.aspx); Canada Revenue Agency (www.cra-arc.gc.ca/tx/ndvdls/fq/txrts-eng.html); Tonya Moreno, State Income Tax Rates (http://taxes.about.com/od/statetaxes/a/highest-state-income-tax-rates.htm); and Swiss Federal Tax Administration, *Federal, Cantonal and Communal Taxes* 2014.

Table 2 also shows, however, that top-bracket taxpayers contributed an availed themselves of the favourable tax treatment afforded particular categories of income, particular savings vehicles or forms of business organization, to a much greater extent than taxpayers in lower tax brackets, and accounted for a much larger share of the income in these categories:

Table 2: Taxable income, tax paid and income from selected sources by taxpayers in the top and other income tax brackets, 2011-12

	% of taxpayers in income group			*% of total number of taxpayers*			*% of total $*		
	Up to $180,000	*Over $180,000*	*Over $500,000*	*Up to $180,000*	*Over $180,000*	*Over $500,000*	*Up to $180,000*	*Over $180,000*	*Over $500,000*
Taxable income				97.7	2.3	0.3	85.0	15.0	5.0
Gross tax paid				97.5	2.5	0.3	74.9	25.1	9.6
Net tax paid				97.0	3.0	0.3	73.8	26.2	10.1
Employer superannuation contributions	9.2	28.3	27.4	93.2	6.8	0.7	88.3	11.7	1.6
Personal superannuation contributions	1.3	8.5	19.2	86.6	13.4	3.4	79.9	20.1	5.2
Net distributions from partnerships & trusts	14.5	35.6	51.0	94.5	5.5	0.9	66.9	33.1	15.4
Income from capital gains	3.1	12.4	19.4	91.4	8.6	1.5	49.1	50.9	34.0
Net rental property losses	7.9	19.8	22.0	94.4	5.6	0.7	88.2	11.8	2.7
Termination payment tax offset	1.2	9.0	7.3	85.5	14.5	1.3	43.3	56.7	10.2
Reportable fringe benefits	5.7	21.7	24.9	91.8	8.2	1.0	89.7	10.3	2.1
Employee share scheme discounts	0.4	10.1	15.1	60.3	39.7	6.6	10.6	89.4	65.8
Dividend franking credits	22.4	51.7	64.4	94.8	5.2	0.7	53.8	46.2	24.2

Sources: Australian Taxation Office, *Taxation Statistics 2011-12* (www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2011-12/), Individuals Tax Table 3; BofA Merrill Lynch Global Research

- 35.6% of taxpayers in the top tax bracket – and, within this group, 51% of taxpayers with incomes in excess of $500,000 – received net distributions from partnerships and trusts in 2011-12 (compared with 14.5% of taxpayers in lower tax brackets), and they accounted for 33.1% of all income received in this way;

- 12.4% of top bracket taxpayers reported receiving income in the form of capital gains in 2011-12 (cf. 3.1% of other taxpayers), accounting for 50.9% of the total value of capital gains received by all taxpayers;

- 28.3% of taxpayers in the top tax bracket received or made (concessionally taxed) 'reportable' employer superannuation contributions (ie, contributions in excess of the compulsory 9%) in the 2011-12 financial year (cf. just 9.2% of other taxpayers), and accounted for 6.8% of the number of taxpayers receiving such contributions (as against their 2.3% share of the total number of taxpayers) and 11.7% of the total dollar value of such contributions received by all taxpayers;

- 8.5% of top bracket also made personal super contributions (cf.1.3% of other taxpayers) accounting for 20.1% of the total dollar value of such contributions; and

- 19.8% of taxpayers in the top tax bracket reported 'net rental property losses' (ie, had 'negatively geared' property investments), compared with 7.9% of other taxpayers, and those losses accounted for 11.8% of the total net rental losses reported by all taxpayers.

Table 2 suggests that the relatively favourable tax treatment accorded other types of income – such as termination payments, fringe benefits, employee share schemes and dividends – also disproportionately benefits high-income taxpayers.

It would have been preferable, in my view, if the Government had, instead of increasing the top marginal income tax rate (even temporarily), had, for example:

- sought to reduce the generosity of tax concessions for superannuation contributions (as the previous Government had planned to do);

- reversed the 2006 decision to exempt superannuation payments to people aged 60 and over from income tax;

- moved to curtail the use of trusts to divert taxable income to members of households facing lower tax rates (as Joe Hockey advocated shortly after becoming Shadow Treasurer in 1999);

- reduced the discount on capital gains for tax purposes from 50% to 40% (as recommended by the Henry Review);

- gone ahead with the previous Government's proposed measures to reduce the concessionality of the tax treatment of employer-provided motor vehicles;

- or moved to eliminate curtail the extent of 'negative gearing'.

Each or all of these measures would have enhanced the neutrality, efficiency and equity of the income tax system to a much greater extent than the 'temporary deficit repair levy'.

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