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INQUIRY INTO TREASURY LAWS AMENDMENT (PERSONAL INCOME TAX PLAN) BILL 2018

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About the author

Daniel Wild is a Research Fellow at the Institute of Public Affairs. He specialises in red tape, regulation, economic policy, the philosophy of free enterprise, and criminal justice. Daniel has authored research papers on economic policy, environmental regulation, and criminal justice reform. Daniel frequently appears in the media, and has published a number of opinion pieces in The Australian, The Daily Telegraph, The Sydney Morning Herald, The Courier Mail, and The Spectator. Daniel has also made a number of radio and television appearances, including on 2GB, 3AW, Sky News, and Channel 7 News.

Daniel previously worked at the Commonwealth Department of the Prime Minister and Cabinet where he analysed global and domestic macroeconomic policy. Prior to that he worked at the Commonwealth Department of Finance where he worked on regulatory reform. Daniel holds an honours qualification in economics and a degree in international studies from the University of Adelaide.

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Contents

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Introduction

The IPA welcomes the government's endeavour to reduce the tax burden on Australian workers, families, and businesses compared with the status quo. The two major components of the income tax plan put forward in the 2018-19 Budget - increasing the top threshold of the 32.5 per cent bracket from $87,000 to $120,000 from 2022 and removing the 37 per cent tax bracket from 2024-25 – present the most substantial changes to the tax system in years and will benefit every Australian worker. However, the implementation of these changes are deferred too far into the future. The IPA recommends that the government implement these changes from this coming financial year, 2018-19.

Further, we note that, despite endeavours to cut taxes, taxes (along with spending and debt) will continue to rise under this Budget. In particular, the Budget figures show that real taxes per capita, which controls for population growth and the effects of inflation, will increase by 4.6 per cent over the next four years. The government's proposed tax cuts will simply mean that taxes will continue to rise, but at a slower rate than under the status quo. This is welcomed, but it would be technically incorrect to refer to the changes as a tax cut.

Moreover, the government's proposed changes to the income tax system represent yet another missed opportunity to engage in deep, structural reform of the tax and transfer system. There are two realities that are not being acknowledged: that until spending is cut in absolute terms, taxes will continue to rise; and that Australia's tax system is terribly inefficient. Indeed, there are a number of reforms that should be pursued which could be revenue neutral but would provide a boost to investment, income, and growth. These reform would include reducing Australia's reliance on the most destructive taxes, such as the corporate tax and progressive income taxes, and increasing its reliance on less destructive taxes such as the GST.

Recommendations:

The IPA recommends that

- The implementation dates of the two major changes to the income tax system - increasing the top threshold of the 32.5 per cent bracket from $87,000 to $120,000, and removing the 37 per cent tax bracket – should be brought forward to the 2018-19 financial year.
- The income level for the top marginal tax rate be increased to around $400,000, which would result in the top-marginal-tax-rate-to-average-income ratio being around the same in Australia as the OECD average by 2024-25.
- The government pursue a flat income tax as a long term strategy for improving the income tax system.

The Major Changes to the Income Tax System are Welcomed

The government is proposing two major changes to the income tax system in the 2018-19 Budget: increasing the top threshold of the 32.5 per cent bracket from $87,000 to $120,000 from 2022 and removing the 37 per cent tax bracket from 2024-25. These are the most substantial proposed changes to the income tax system in years. According to the government's figures, the proportion of taxpayers who would face a top marginal tax rate of 32.5 per cent or less will increase from 63 per cent to 94 per cent in 2024-25.[1] Taken together, these changes would provide tax relief for millions of Australian workers, compared with the status quo.

However, the delayed and drawn out implementation time frame for these major changes is concerning and raises questions about how serious the government is about implementing them. The implementation date should be brought forward to the coming financial years, 2018-19, to ensure that Australian workers are more likely to receive the full benefits of the government's proposed income tax plan.

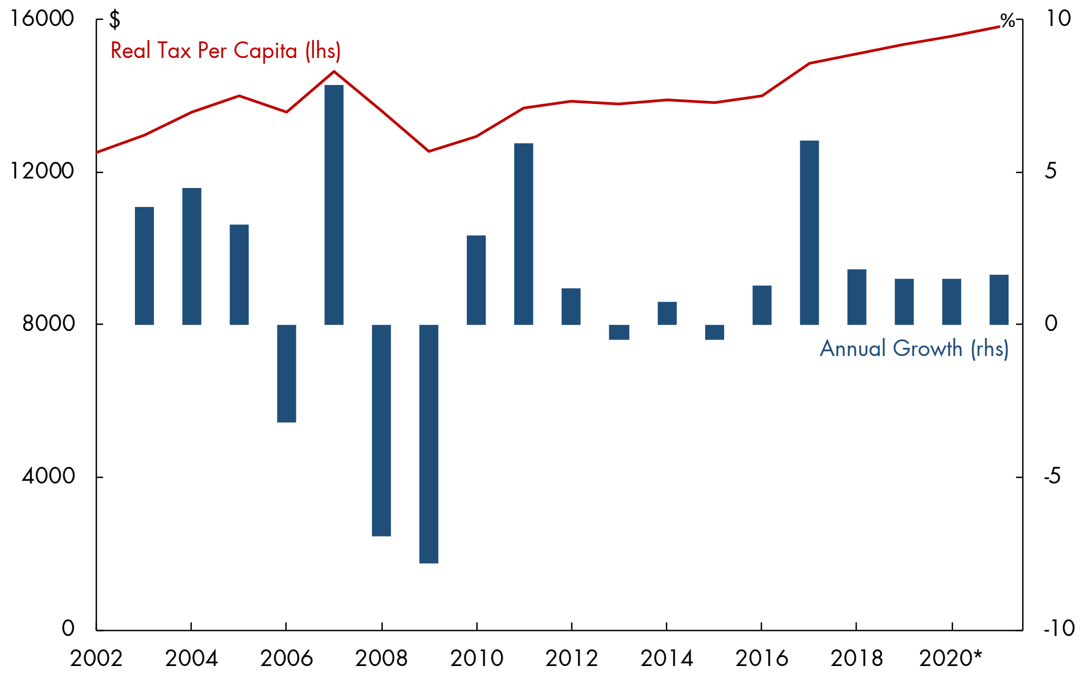
Taxes Will Continue to Rise Under the Government's 2018-19 Budget

The government has claimed it will be cutting taxes under its 2018-19 Budget. However, the government's own figures show taxes will continue to rise over the forward estimates. Total government receipts are set to rise from $473 billion in 2018-19 to $537 billion in 2021-22 - a 17 per cent increase, or 4 per cent per year – more than twice the rate of growth to inflation and wages. Some of this increase can be attributed to growth to the working age population. But taxes will still rise even when controlling for population growth. In other words, the average total tax take per capita will continue to rise over the forward estimates. Table 11 of the Budget Paper no.1 shows tax per capita to increase from $15,100 in 2018-19 to $15,800 in 2021-22, an increase of 4.6 per cent in real terms.[2]

1 Commonwealth Government, "Budget 2018-19: Stronger growth to create more jobs", Canberra, Australia, (2018)

2 Commonwealth Government, "2018-19 Commonwealth Budget", Budget Paper No.1, Table 11

Chart 1: Real Tax Per Capita



The key factor driving higher taxes is higher spending. Spending growth continues unabated over the forward estimates. In 2018-19 spending is expected to grow by around 3 per cent in real terms, and then slowing to 0.2 per cent, 1.1 per cent, and 1.9 per cent over the following three years. Insofar as spending continues to rise, so too will taxes. Every dollar of extra spending must be paid back via higher taxes, either now or in the future. The only way to cut taxes is to cut spending. Until spending cuts, in real terms, takes place, it will not be possible for the government to deliver permanent cuts to taxation. Alternatively stated, without real spending cuts, the only way taxes can be cut is by increasing debt which means increasing taxes in the future. This is best understood as a tax deferral, rather than a tax cut.

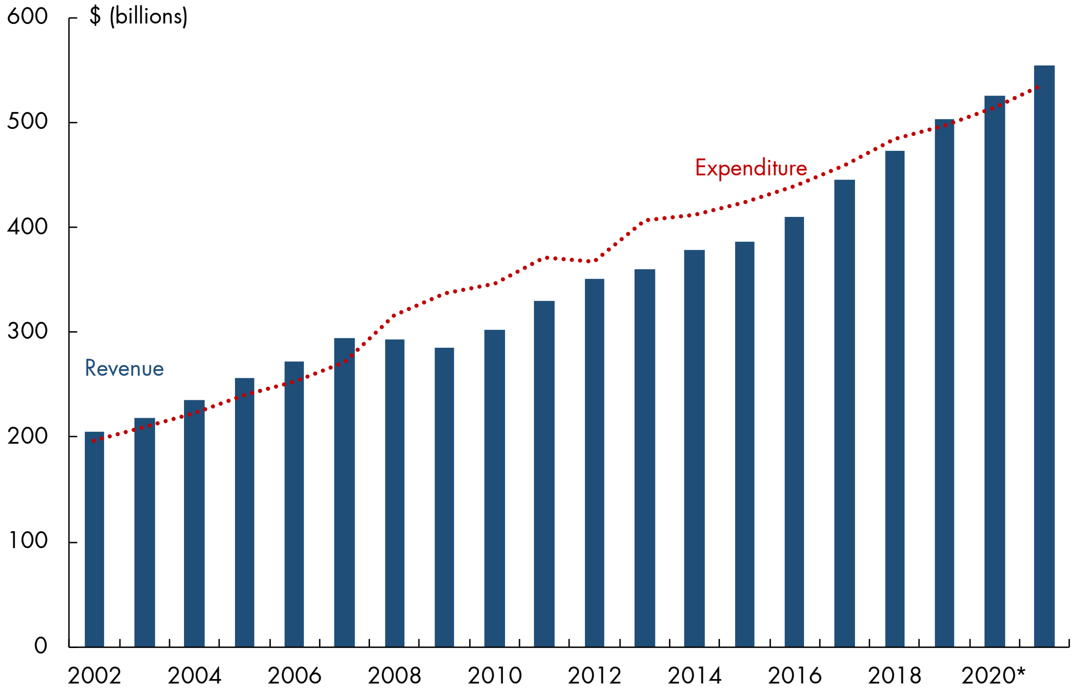
Gross government debt is also expected to continue to grow over the forward estimates, from $561 billion in 2018-19 to $578 billion by 2021-22. This represents a tax hike on young Australians who will be responsible for paying back this debt. Encouragingly, though, gross government debt as a percentage of GDP is expected to decline moderately, from 29.5 per cent in 2018-19 to 26.6 per cent of GDP in 2021-22. However, this forecast decline to government debt, as with all forecasts, is based on certain assumptions around economic growth which, if they do not hold, will undermine the expected decline. Indeed, each year since 2008-09, gross government debt has increased both in absolute terms and as a percentage of GDP – over the past decade gross government debt has increased by some 390 per cent.

The immutable law of public finance is that all government spending must be financed via taxes. Those taxes can be levied at the same time as spending is undertaken, or they can be deferred into the future via the accumulation of government debt. Public debt (plus interest) and tax are equivalent. This means all of the $578 billion in expected gross debt by 2021-22 will need to be paid back with higher taxes in the future. The primary burden of this will be incurred by today's young Australians. In other words, any budget which features positive gross national debt is committing to higher future taxes.

All of the reduction to the deficit is attained through a higher tax take

The government is projecting that the Budget will return to surplus by 2020-21. However, it is worth noting that all of the reduction to the deficit, and projected return to surplus, is attained through higher tax receipts, rather than lower spending. For the past fifteen years, expenditure has been driving tax hikes. And until spending is reduced, taxes will continue to rise.

Chart 2: Expenditure and Revenue Growth



The Top Marginal Tax Rate is Too High and Commences at a Relatively Low Income Level

Disappointingly, the government's plan maintains the high top marginal tax rate of 47 per cent (including the Medicare levy). And even under the government's proposed plan, this top rate will commence at $200,000, which is low by international standards. As noted in the government's Budget, "Australia's top marginal tax rate cuts in at around 2.2 times average full-time earnings, compared with four times in Canada and the UK, and eight times in the US."[3] Under the government's proposed changes, this will become even worse, with the ratio dropping to 1.9. This is less bad than the status quo where the ratio is expected to decrease to 1.7, but it is still an unacceptably low ratio.

To address this, the income threshold for the top marginal tax rate should be increased to around $400,000, from the current value of $180,000 and proposed value of $200,000. This wold result in the ratio being closer to the OECD average of 4.4.[4] Alternatively, the government could maintain the top proposed income of $180,000 or $200,000, but lower the top marginal rate to around 30 per cent to 35 per cent. This would follow an approach similar to New Zealand where the top marginal rate applies at a low income level – just $70,000 NZD – but it also has a top marginal tax rate of just 33 per cent.

3 Commonwealth Government, "Budget 2018-19: Stronger growth to create more jobs", Canberra, Australia, (2018)

4 OECD, "OECD Stat: Table I.7. Top Statutory personal income tax rate and top marginal tax rates for employees", Paris, France, (2018)

A Flat Income Tax is the Best Way to Increase Opportunity and Prosperity for the Next Generation of Australians.

It is a welcome development that the Government's proposed income tax plan will deliver a flatter income tax schedule. However, the proposed measures do not go far enough in flattening the income tax schedule. Rather, the income tax system will continue to impose a higher penalty on those who earn a higher income. According to analysis by Deloitte, the top 20 per cent of income earners in Australia will see their share of all personal tax grow from 78 per cent in 2017-18 to 81 per cent in 2024-25. Conversely, those in the 40 per cent to 80 per cent bracket of all income earners will see their share of income tax decline from 21 per cent to 19 per cent.[5] Moreover, economist Judith Sloan recently calculated that, under the government's plans, someone earning $200,000 would be earning five times that of someone on $41,000, yet would be paying thirteen times more tax.[6]

A so-called "progressive" income tax system has a number of drawbacks. Firstly, it discriminates against Australians by income. Other forms of discrimination, such as by skin colour, race, or ethnicity, are rightly abhorred, yet the income tax system openly discriminates against people by income. Secondly, it discourages upward economic mobility. By confiscating a greater share of income as income increases, "progressive" income taxes discourage upward economic mobility. The effect of this is likely to be more concentrated amongst low income households. This is because as well as having a greater share of their income confiscated as they move up the income scale, low income households also lose welfare benefits. This results in an extremely high effective marginal tax rate. In this sense, progressive income taxes are regressive: they provide powerful incentives to keep poor people poor.

Thirdly, and in addition to the aforementioned effect, progressive income taxes do not benefit low income households. Confiscating a greater share of income from higher income households does not benefit low income households. It just damages high income households. Any concerns about the material circumstances of low income households should addressed through welfare transfers, rather than progressive taxes.

5 Greber, Jacob, "Both tax plans hit the rich, says Deloitte", *Australian Financial Review*, (21 May 2018)

6 Sloan, Judith, "Ill-informed tax debate clouds benefits of reform", *The Australian*, (19 May, 2018)

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