SUBMISSION TO THE SENATE STANDING COMMITTEES ON ECONOMICS - INQUIRY INTO AUSTRALIA'S TAXATION SYSTEM

THE SOCIAL AND ECONOMIC IMPACT OF TAXING PEOPLE WHO EARN LESS THAN THE COST OF LIVING

Overview of Australia's Tax System

Australia's tax system is a complex mix of federal, state, and local taxes. The federal government collects the majority of tax revenue, primarily through income tax and the Goods and Services Tax (GST)[2]. Key aspects include:

- Progressive income tax rates for individuals, with higher earners paying a larger percentage of their income in tax[1][2].
- A 10% GST on most goods and services[2].
- Various other taxes like company tax, capital gains tax, and state-level taxes such as stamp duty and payroll tax[2].

Taxation of Low-Income Earners

The impact of taxation on low-income earners is a significant concern:

1. Tax-Free Threshold: Australia has a tax-free threshold of $18,200, meaning individuals earning below this amount do not pay income tax[1][4]. This helps protect very low-income earners from income tax.

2. Low Income Tax Offset (LITO): The LITO provides additional tax relief for low to middle-income earners, with a maximum benefit of $700 for those earning up to $37,500[6].

3. Medicare Levy: Most residents pay a 2% Medicare levy, but low-income earners may be exempt or pay a reduced rate[4][6].

Social and Economic Impacts

The taxation of low-income earners has several notable impacts:

1. Progressivity: Australia's tax and transfer systems are highly progressive, which supports fairness[1]. However, this can create high effective marginal tax rates for some groups, potentially discouraging workforce participation[1].

2. Cost of Living Pressures: For those earning just above the tax-free threshold, even small tax burdens can significantly impact their ability to meet basic living costs[3][5].

3. Bracket Creep: Over time, inflation pushes incomes into higher tax brackets, potentially reducing real disposable income for low and middle-income earners[1][4].

4. Gender Impact: The current tax system, particularly the Stage 3 tax cuts, tends to benefit higher income earners more, with only about one-third of the benefits going to women[5].

5. Compliance Costs: The complexity of the tax system imposes significant compliance costs, estimated at around $40 billion per year[1]. This can be particularly burdensome for low-income earners.

Recent and Proposed Changes

The Australian government has proposed several changes to address these issues:

1. Tax Cuts: From July 1, 2024, the government plans to reduce the 19% tax rate to 16% for incomes between $18,200 and $45,000, aiming to provide relief to low and middle-income earners[4].

2. Medicare Levy Thresholds: The government will increase the Medicare levy low-income thresholds, benefiting over a million low-income Australians[4].

3. Debate on Stage 3 Tax Cuts: There is ongoing debate about the fairness and economic impact of the Stage 3 tax cuts, which primarily benefit higher income earners[5].

Alternative Approaches

Some organizations and experts suggest alternative approaches to support low-income earners:

1. Increasing Income Support: ACOSS recommends lifting all income support payments to at least $70 a day and indexing them to wages as well as prices[5].

2. Housing Support: Proposals include increasing Commonwealth Rent Assistance and investing in social housing to address housing affordability[5].

3. Energy Efficiency: Investments in energy efficiency for low-income homes could help reduce living costs and create jobs[5].

4. Jobs and Training Guarantee: A flexible program for long-term unemployed individuals could help connect them to suitable jobs and training opportunities[5].

In conclusion, while Australia's tax system aims to be progressive and fair, there are ongoing challenges in balancing the need for revenue with the impact on low-income earners. Recent and proposed changes attempt to address some of these issues, but debate continues on the most effective ways to support those earning less than the cost of living while maintaining a robust tax base for essential services.

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THE TAX ARBITRAGE BETWEEN ONSHORE AND OFFSHORE PROFITS THAT ENCOURAGE DOMESTIC PROFITS TO BE TRANSFERRED OFFSHORE RATHER THAN RETAINED IN AUSTRALIA

Overview of Australia's Tax System

Australia has a complex tax system administered at federal, state, and local government levels[1]. The federal government collects the majority of tax revenue (around 81%), primarily through income taxes on individuals and corporations[4].

Reliance on Income Taxes

Australia relies heavily on individual and corporate income taxes compared to other developed countries[4]. This reliance has remained relatively unchanged since the 1950s, despite significant economic changes. Projections indicate this dependence is likely to increase further due to wage growth and bracket creep.

Corporate Tax and Profit Shifting

The corporate tax rate in Australia is relatively high by international standards, which can create incentives for multinational corporations to engage in profit shifting[4][5]. This involves artificially moving profits to low-tax jurisdictions to minimize overall tax liability.

Tax Arbitrage Concerns

There are growing concerns about tax arbitrage between onshore and offshore profits[6]. This practice can:

1. Encourage domestic profits to be transferred offshore rather than retained in Australia
2. Put companies domiciled in Australia at a competitive disadvantage compared to those domiciled offshore

Compliance Risks for Large Corporate Groups

The Australian Taxation Office (ATO) has identified several key compliance risks related to multinational enterprises and profit shifting[5]:

1. Inappropriate recognition of profits in Australia
2. Transfer mispricing
3. Re-characterization of income from trading enterprises to concessionally-taxed passive income flows

Example: Inbound Supply Chains

The ATO provides an example of how they assess whether appropriate profits are being recognized in Australia for multinational companies[5]. They consider factors such as:

- Margin on local costs

- Profitability of local operations compared to the entire supply chain
- Implied commission on goods
- Motivation to engage in transfer mispricing

Legislative Measures

To address these issues, Australia has implemented several legislative measures[5]:

1. Applying a 30% withholding tax on trading income converted to passive income via stapled structures
2. Amending thin capitalization rules to prevent double gearing structures
3. Limiting tax exemptions for foreign pension funds and sovereign wealth funds

Ongoing Concerns and Inquiries

There are ongoing discussions and inquiries into various aspects of the tax system, including[6]:

1. The social and economic impact of taxing low-income earners
2. Assumptions used in modeling income tax cuts
3. The abolition of tax loopholes favoring special interest groups
4. The actual net company tax rate after franking credits
5. Capital gains tax concessions and their impact on capital allocation

In conclusion, while Australia has taken steps to address tax arbitrage and profit shifting, it remains an ongoing challenge. The complex interplay between domestic and international tax systems continues to create opportunities for multinational corporations to minimize their tax liabilities, potentially at the expense of domestic revenue and competitiveness.

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THE TAX ARBITRAGE BETWEEN ONSHORE AND OFFSHORE PROFITS THAT PUTS COMPANIES DOMICILED IN AUSTRALIA AT A COMPETITIVE DISADVANTAGE TO COMPANIES DOMICILED OFFSHORE

Overview of Australia's Tax System

Australia has a complex tax system with multiple layers:

- Federal taxes (e.g. income tax, GST)
- State taxes (e.g. stamp duty, payroll tax)
- Local government taxes (e.g. council rates)[3]

The federal government has jurisdiction to tax Australian residents on worldwide income, while non-residents are taxed only on Australian-sourced income[6].

Corporate Tax Rates and Structure

- The standard corporate tax rate in Australia is 30%[6]
- A lower 25% rate applies to companies with annual turnover under $50 million[6]
- Australia uses a dividend imputation system to prevent double taxation of corporate profits[6]

Tax Arbitrage Issues

There are concerns about multinational companies using offshore structures to minimize their Australian tax liabilities:

- Profit shifting to low-tax jurisdictions is estimated to cost Australia billions in lost tax revenue annually[4]
- Common tactics include transfer pricing, thin capitalization, and use of tax havens[4][9]
- This can put Australian-based companies at a competitive disadvantage compared to foreign multinationals[2]

Government Responses

Australia has taken several steps to address these issues:

1. Implementing a Diverted Profits Tax of 40% on large multinationals that artificially divert profits offshore[4]

2. Strengthening transfer pricing rules and thin capitalization limits[9]

3. Introducing a Multinational Anti-Avoidance Law to prevent artificial avoidance of permanent establishment status[4]

4. Committing to implement the OECD's global minimum tax of 15% from 2024[4]

5. Increasing tax transparency requirements for large corporations[8]

6. Extending the Tax Avoidance Taskforce to strengthen compliance efforts[8]

Challenges and Limitations

Despite these measures, challenges remain:

- The global minimum tax may raise limited revenue for Australia ($210 million in 2024)[4]
- Multinationals may find new ways to work around tax rules[4]
- Australia's high corporate tax rate relative to other countries creates incentives for profit shifting[6]

Potential Solutions

Some experts suggest more fundamental reforms may be needed:

- Taxing multinationals as single global entities rather than separate subsidiaries[4]
- Allocating taxing rights based on where economic activity occurs rather than legal structures[4]
- Further international cooperation to close loopholes in the global tax system[4]

In conclusion, while Australia has taken significant steps to address tax arbitrage and profit shifting by multinationals, it remains an ongoing challenge that puts pressure on the competitiveness of Australian-based companies. Continued policy development and international cooperation will likely be needed to fully address these issues.

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THE ABOLITION OF NUMEROUS TAX LOOPHOLES THAT FAVOUR SPECIAL INTEREST GROUPS, IN PARTICULAR FOREIGN INTERESTS

Current State of Australia's Tax System

Australia's tax system faces several key challenges:

1. Heavy reliance on income tax[8]
2. Complexity due to numerous tax concessions and loopholes[8]
3. High progressivity, with top earners paying a large share[8]
4. Ongoing issues with bracket creep[8]
5. Anachronistic elements that have not kept pace with economic changes[8]

Major Loopholes and Avoidance Strategies

Some of the most significant tax loopholes and avoidance methods include:

1. Use of trusts for income splitting and tax minimization[6]
2. Multinational profit shifting to low-tax jurisdictions[9]
3. Exploitation of dividend imputation system[1]
4. Negative gearing on property investments[3]
5. Capital gains tax concessions[5]
6. Superannuation tax concessions[8]

Proposed Reforms

Experts and policymakers have suggested several reforms to close loopholes and improve the system:

1. Strengthen thin capitalization rules to limit debt deductions[4]
2. Implement a 15% global minimum tax on multinationals[4]
3. Expand the general anti-avoidance rule for income tax[2]
4. Reform the taxation of trusts, potentially taxing them as companies[6]
5. Establish a public register of trusts for transparency[6]
6. Tighten rules around foreign resident capital gains tax[5]
7. Broaden the tax base by reducing concessions and loopholes[10]
8. Consider a tax mix switch to more efficient taxes like land tax or GST[10]

Challenges to Reform

Despite widespread agreement on the need for reform, several factors impede progress:

1. Political resistance due to vested interests[10]
2. Complexity of the tax system making changes difficult[10]
3. Short-term focus on budget impacts rather than long-term efficiency[10]
4. Public skepticism about tax changes[3]
5. Difficulty in accurately modeling economic impacts of reforms[10]

Potential Benefits of Reform

Successful tax reform could yield significant benefits:

1. Increased economic efficiency and productivity[8]
2. Improved budget sustainability[10]
3. Greater fairness and equity in the tax system[3]
4. Simplified compliance for taxpayers and businesses[10]
5. Reduced opportunities for tax avoidance and evasion[9]

Conclusion

While Australia's tax system has many strengths, it also contains numerous loopholes that benefit special interests and reduce overall efficiency. Comprehensive reform to close these loopholes and modernize the system could yield substantial economic and social benefits.

However, such reform faces significant political and practical challenges that will require careful navigation and sustained effort to overcome.

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