Business Council of Australia

SUBMISSION

Submission to Treasury Laws Amendment (Income Tax Relief) Bill 2016

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Contents

The Business Council of Australia is a forum for the chief executives of Australia's largest companies to promote economic and social progress in the national interest.

Business Council of Australia supports efforts to curtail bracket creep

This is the Business Council of Australia's submission to the Senate Economics Legislation Committee inquiry into the Treasury Laws Amendment (Income Tax Relief) Bill 2016.

The Business Council recommends the Senate to pass this Bill without amendment for the following reasons:

- It will begin the process of addressing bracket creep by keeping 500,000 people out of the third tax bracket. Over 3 million taxpayers are expected to benefit overall.
- If we do not begin to tackle bracket creep, it will actually make the personal tax system less progressive, hurting lower- and middle-income earners.
- Australia's personal tax system will need to be competitive with other advanced economies as workers become increasingly mobile. Attracting the best talent is critical to improving productivity and economic growth.
- With an ageing population and reduced labour force participation, it will be imperative that the personal tax system does not discourage people from entering the workforce or taking on more hours.

The Treasury Laws Amendment (Income Tax Relief) Bill 2016 is the first step to curtailing bracket creep

The Business Council strongly supports increasing the third tax threshold from $80,000 to $87,000 to limit bracket creep over the next few years.

This aligns with the Business Council's proposals for personal taxes that better reward effort in *Realising Our Full Potential: Tax Directions for a Transitioning Economy* (attached), which outlined a three-stage transformative tax package.

The Business Council supports the government's commitment to ensuring the proposed tax changes are revenue neutral over the next four years. Any further income tax changes should also be implemented alongside sensible offsetting revenue measures or through better value for money in government services.

The Bill is the first step to curtailing the effects of bracket creep on the economy. Many people have not received any income tax relief since changes in 2012-13. The bottom line is that Australia's tax settings are unnecessarily hindering wealth and job creation.

The benefits of the Bill are clear – around 500,000 people with an average full-time income will not move into the third tax bracket until 2019-20. More broadly, increasing the threshold for the start of the 37 per cent bracket is expected to benefit 3.1 million taxpayers overall (Australian Government, 2016).

Left unchecked, bracket creep will steadily make the personal tax system less progressive. Bracket creep increases taxes by stealth through inflation. It disproportionately and unfairly hurts lower- and middle-income earners. Bracket creep is regressive and hidden.

Bracket creep means that workers face ever-higher average and marginal tax rates even though their real pre-tax wage hasn't changed. This reduces the rewards for effort, creates a disincentive to work and gradually reduces the progressivity of the tax system.

For example, over the next three years, a person currently earning $150,000 will be paying 12 per cent more tax. A person earning $36,000 will pay 31 per cent more just because their wage increases to keep up with the cost of living (Business Council calculation).

Further changes to the personal income tax system, in the context of broader tax reform, remain important

The Business Council's *Realising Our Full Potential: Tax Directions for a Transitioning Economy* highlighted possible future changes to the personal income tax system including:

- Increasing the second tax threshold from $37,000 to $40,000 to compensate personal taxpayers for bracket creep since 2012-13. This is estimated to cost around $4 billion in 2016-17.
- Increasing Australia's relatively low top tax threshold. Australia's top tax threshold of $180,000 has been at this level since 2008-09, despite wages having grown around 30 per cent over this period. This threshold could be increased to $250,000, or around three times average earnings. That is, retain the rate but change the threshold to restore its relationship with average earnings.

Without broader change, people on lower incomes will be left worse off after tax, simply because their wage keeps pace with inflation.

Further context

Personal income tax settings are out of kilter with Australia's emerging challenges

The Australian economy is facing immediate and long-term challenges and uncertainties from its ageing population and an increasingly globalised labour market.

An ageing population and declining participation

Like many industrialised countries, our population is ageing. An older population will drive increased government spending while reducing labour force participation and thus the capacity to pay. By 2055 there will be only 2.7 workers for every person over 65, compared with 4.5 today (Australian Government, 2015).

The personal income tax base will narrow further – if income tax maintains its current share of total taxes (and the overall tax burden is not significantly lower), this will mean a significantly increased burden on future income earners.

With an ageing population, we cannot afford a tax system that discourages working. High effective marginal tax rates (reflecting the interaction of the tax and transfer systems) particularly discourage workforce participation by low and secondary income earners and older workers.

Australia needs to be competitive in a global labour market

Workers, particularly highly skilled ones, have become increasingly mobile over recent decades. Immigration can increase the size of the workforce, and also bring in new skills, ideas and connections that can ultimately improve productivity and economic growth.

As labour mobility increases, tax differentials increasingly influence worker decisions about where to locate (Akcigit et al., 2015). In Australia's case, the top marginal tax rate starts at around 2.3 times the average wage, making us less attractive compared with other OECD countries. For example, the UK and Germany have top rates that cut in at 4 and 6 times average earnings respectively (OECD, 2015).

High personal income taxes discourage people from entering the workforce, working additional hours and working in Australia

Personal taxes influence decisions to work, save and invest. The personal income tax system influences decisions to move from welfare to work, to work additional hours or seek promotion, and to work in Australia or overseas.

High personal tax rates that cut in at relatively low income thresholds mean that people may choose not to work overtime or seek promotion.

Effective marginal personal income tax rates can exceed 80 cents in the dollar because of the withdrawal of benefits as incomes increase, creating a barrier to people wanting to enter the workforce.

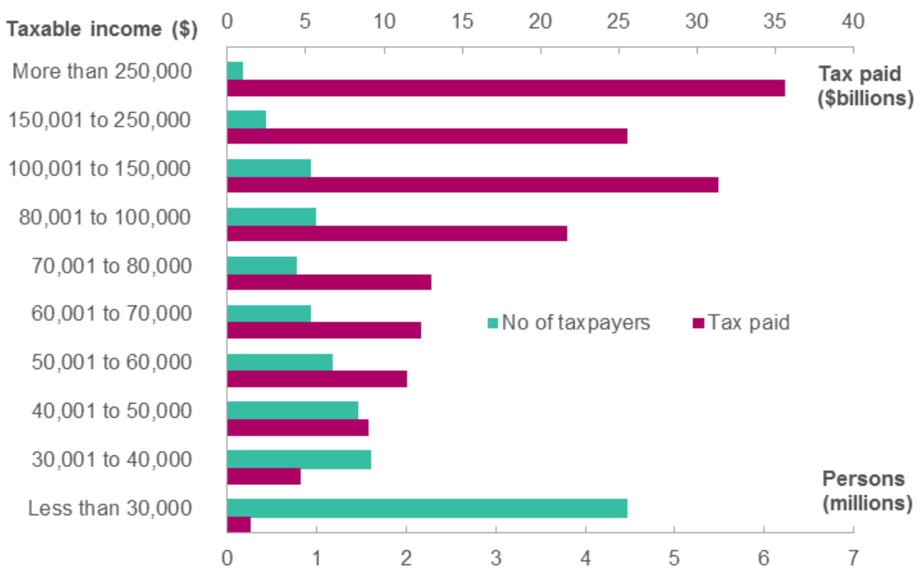
Australia's top marginal income tax rate is nudging 50 per cent with the Temporary Budget Repair Levy. The average top rate in Asia is around 30 per cent (OECD, 2015).

High marginal rates of income tax discourage some people from investing in skills improvement if they do not consider the eventual rewards from higher paid jobs are worth the effort. People will be reluctant to incur the cost of studying (the fees and forgone income) if they consider that the after-tax rewards are inadequate. High marginal tax rates also encourage tax planning – that is, people seek out ways to reduce their taxable income.

Australia's tax system is highly progressive, but unchecked bracket creep will be regressive

Australia's tax system is highly progressive, meaning the burden of taxation increases with income. For example, the top 3 per cent of taxpayers account for 30 per cent of personal tax revenue. By comparison, these taxpayers account for 18 per cent of taxable income (ATO, 2015).

Figure 1: The income tax system is highly progressive



Source: ATO, Taxation Statistics 2013-14, 2016.

Similarly, the transfer system is highly targeted, with the ratio of benefits received by households in the bottom quintile relative to the top quintile the highest in the OECD (Whiteford, 2010). The bottom quintile receives 42 per cent of welfare spending, while the top quintile receives 4 per cent. Almost 80 per cent of all benefit spending is means-tested. This is high relative to other OECD countries and more than four times the OECD average (OECD, 2014).

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Income tax changes are one part of a transformative tax package

Australia needs to move to a more modern, sensible mix of taxes that will best promote the wellbeing of the Australian community and support the creation of jobs for the future. It’s not about one tax. It’s about the combination of taxes and setting an overall tax mix that is most able to achieve the goal of growing the economy and creating jobs.

The overarching objective of tax reform over the medium term must be to redesign and improve the tax system by shifting from less efficient taxes to more efficient ones, so that the average economic burden of raising each dollar of revenue falls.

This requires a tax package that overall reduces the tax burden on investment, working and other highly valuable and productive activities.

While a tax system that promotes economic growth must be the primary objective of reform, the tax system as a whole must also be equitable, have integrity, provide a stable revenue base and be as simple as possible. Fortunately, these objectives are often mutually reinforcing.

The Business Council has proposed a three-staged approach to achieve structural tax reform by 2025. But this staged approach is not a convenient excuse to defer or cherry-pick necessary changes.

Each and every step will need to be demonstrably consistent with delivering the objectives and directions for growth-enhancing tax reform outlined in *Realising Our Full Potential: Tax Directions for a Transitioning Economy*.

An illustrative proposal for sequenced tax reform

The precise timing and detail of possible tax measures proposed in the Business Council’s three-staged approach, in practice, will depend on many factors. The pace and scale of change will have to be carefully calibrated according to fiscal and global economic circumstances.

Horizon 1

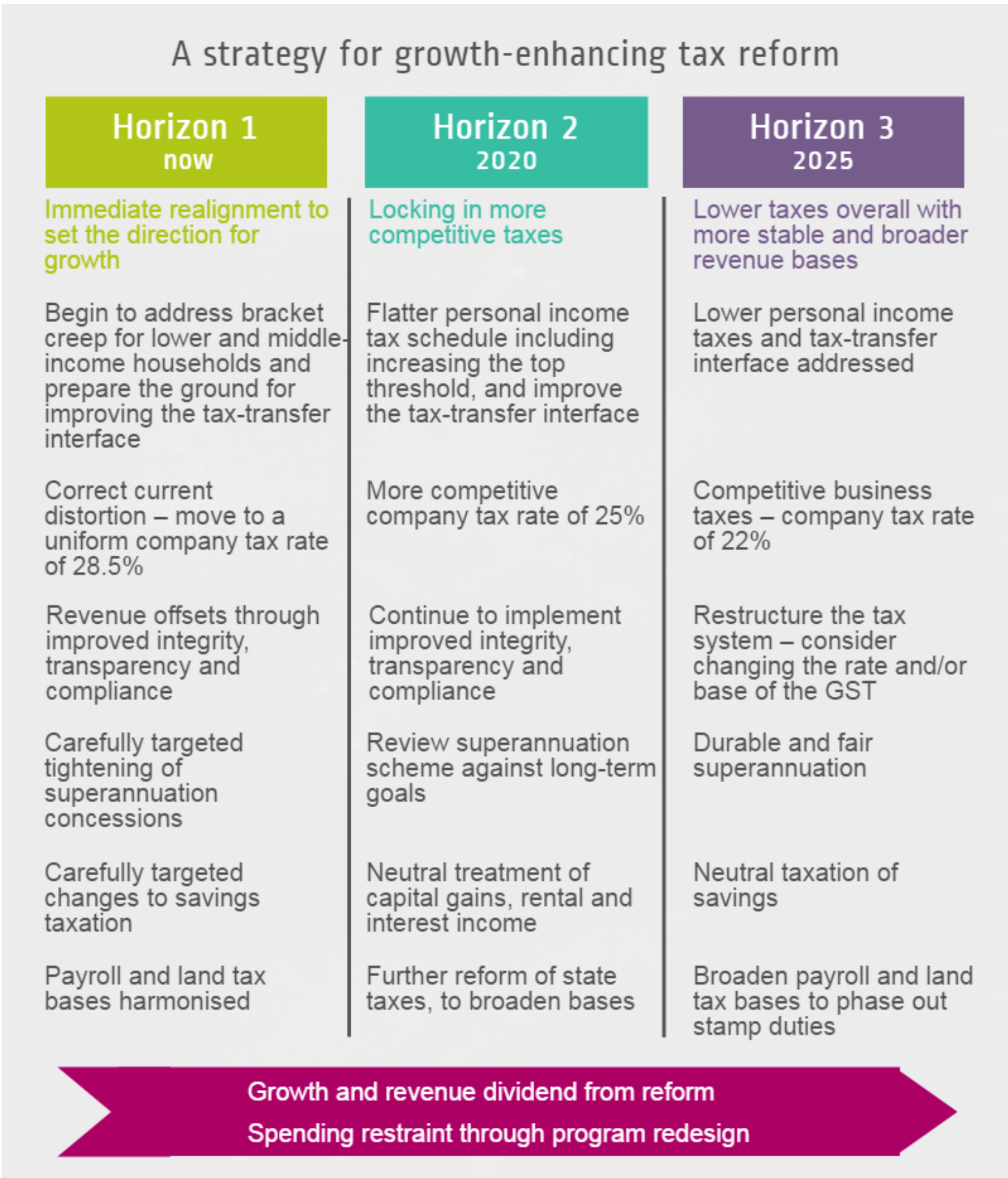
- Revenue-neutral tax reforms including slowing the impacts of bracket creep for lower- and middle-income earners and a uniform company tax rate for all businesses of 28.5 per cent.
- Offsetting revenue measures to be explored include several business and personal tax integrity measures as well as targeted changes to taxation of superannuation consistent with promoting the objectives of the superannuation system.
- The groundwork should also be laid for reforms of state taxes, a better interface between the tax and transfer systems (as set out by the McClure review) and lower tax compliance costs.
- Structural redesign of major expenditure programs should continue.

Horizon 2

- By 2020 there would be further income tax cuts (including, for example, increasing the top threshold from around 2.3 to at least 3 times average earnings) and a reduction in the company tax to 25 per cent to bring the rate into line with the OECD average.
- Funding would come from a combination of reduced spending, the full effects of revenue measures and revenue dividends from tax and other growth-enhancing reforms.

Horizon 3

- By 2025, overall tax revenue should be lower as a proportion of GDP and consistent with long-term fiscal rules to contain the size of government.
- Company taxes should be further reduced to 22 per cent, bringing Australia in line with our Asian competitors. There should be more neutral taxation of savings income, and more stable and broader revenue bases at the national and state levels. Depending on economic performance and pressures on various tax bases, changes to the GST could be considered (in other words, do not take this off the menu) within this horizon.



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