

The Senate

Economics
Legislation Committee

Treasury Laws Amendment (Income Tax
Relief) Bill 2016 [Provisions]

October 2016

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Senate Economics Legislation Committee

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Chapter 1

Introduction

1.1 On 1 September 2016, the Treasury Laws Amendment (Income Tax Relief) Bill 2016 was introduced by the Government into the House of Representatives. On 15 September 2016, the Senate referred the provisions of the bill to the Economics Legislation Committee for inquiry and report by 10 October 2016.¹

Conduct of the inquiry

1.2 The committee advertised the inquiry on its website and on Twitter. It also wrote to relevant stakeholders and interested parties inviting submissions by 23 September 2016. The committee received seven submissions, which are listed at Appendix 1.

1.3 The committee thanks all of the organisations that contributed to this inquiry.

Overview of the bill

1.4 The bill amends the *Income Tax Rates Act 1986* (ITRA 1986) to increase the third personal income tax threshold applying to personal income taxpayers. Taxpayers earning above \$80 000 will now face a lower rate of tax from \$80 001 to \$87 000.²

1.5 The bill also amends the non-resident tax schedule to increase the first income tax bracket to \$87 000.³

1.6 As outlined by the Treasurer:

Under existing law a marginal tax rate of 32.5 per cent applies to taxable incomes between \$37,001 and \$80,000. Incomes above \$80,001 then have a marginal rate of 37 cents, not including the two per cent Medicare Levy.⁴

1.7 The bill will extend the marginal tax rate of 32.5 per cent from \$80 000 to \$87 000 from 1 July 2016.⁵

1.8 This measure is part of a suite of measures announced by the Government in the 2016-17 budget that aim to boost the economy and make 'a start on personal income tax relief'.⁶

1 *Journals of the Senate*, 2015-16, no. 7 (15 September 2016), p. 211.

2 Explanatory Memorandum, p. 3.

3 Explanatory Memorandum, p. 3.

4 The Hon Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 1 September 2016, p. 14.

5 The Hon Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 1 September 2016, p. 14.

6 The Hon Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 1 September 2016, p. 14.

1.9 It is estimated that the amendments will benefit approximately 3.1 million taxpayers in 2016-17 and will provide a maximum tax cut of \$315 per annum for incomes of \$87 000 and above.⁷

1.10 The Treasurer explained how the bill will reward hardworking Australians:

As a down payment towards further tax relief for working Australians this bill will particularly assist those earning average full-time ordinary wages in Australia by preventing them from going into the second highest tax bracket of 37 cents in the dollar in 2016-17.

These mum and dad workers, these middle-income Australians, are bearing a growing burden under our tax system. This bill will provide modest but genuine relief, demonstrating the government's commitment to action on reducing that burden.⁸

1.11 The amendments made by the bill will reduce the tax burden of taxpayers and contribute to achieving a better tax system that supports Australians to work, save and invest.⁹

7 Explanatory Memorandum, p. 6.

8 The Hon Scott Morrison MP, Treasurer, *House of Representatives Hansard*, 1 September 2016, p. 14.

9 Explanatory Memorandum, p. 3.

Chapter 2

Views on the bill

Bracket creep

2.1 The majority of submitters expressed their general support for the bill, commenting that the proposed amendments are a step in the right direction to addressing the effects of bracket creep on the Australian economy.¹

2.2 Bracket creep is the effect of inflation pushing taxpayers into higher income tax brackets. Deloitte provided the committee with an explanation of the nominal and real components of bracket creep and their differential impact on taxpayer income:

Overall revenue gains from bracket creep can be divided into two components:

- A nominal component which occurs as wages rise with price inflation, thereby increasing average tax rates even if real wages are going nowhere.
- A real component, which occurs when wage rises outpace price inflation, shifting taxpayers even further into higher tax brackets. This type of bracket creep is a natural feature of a progressive income tax system.

The first form of bracket creep generates a cut in real disposable income over time, whereas the second form of bracket creep involves a sharing of real wage growth between taxpayers and governments.²

2.3 Not accounting for the measures in the bill, an individual earning an average fulltime ordinary wage (\$1516 per week³, just under \$80 000 per annum) would soon be pushed into the second highest marginal tax rate (from 32.5 to 37 per cent).⁴ This increase in the average earner's tax burden has the effect of reducing their purchasing power and diminishing productivity by discouraging participation in the economy.⁵

2.4 The Business Council of Australia commented on this effect:

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

1 See, for example, The Tax Institute, *Submission 1*, p. 2; Business Council of Australia, *Submission 7*, p. 1.

2 Deloitte, *Submission 2*, p. 3.

3 Australian Bureau of Statistics, *6302.0 - Average Weekly Earnings, Australia, May 2016*, <http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0> (accessed 5 October 2016).

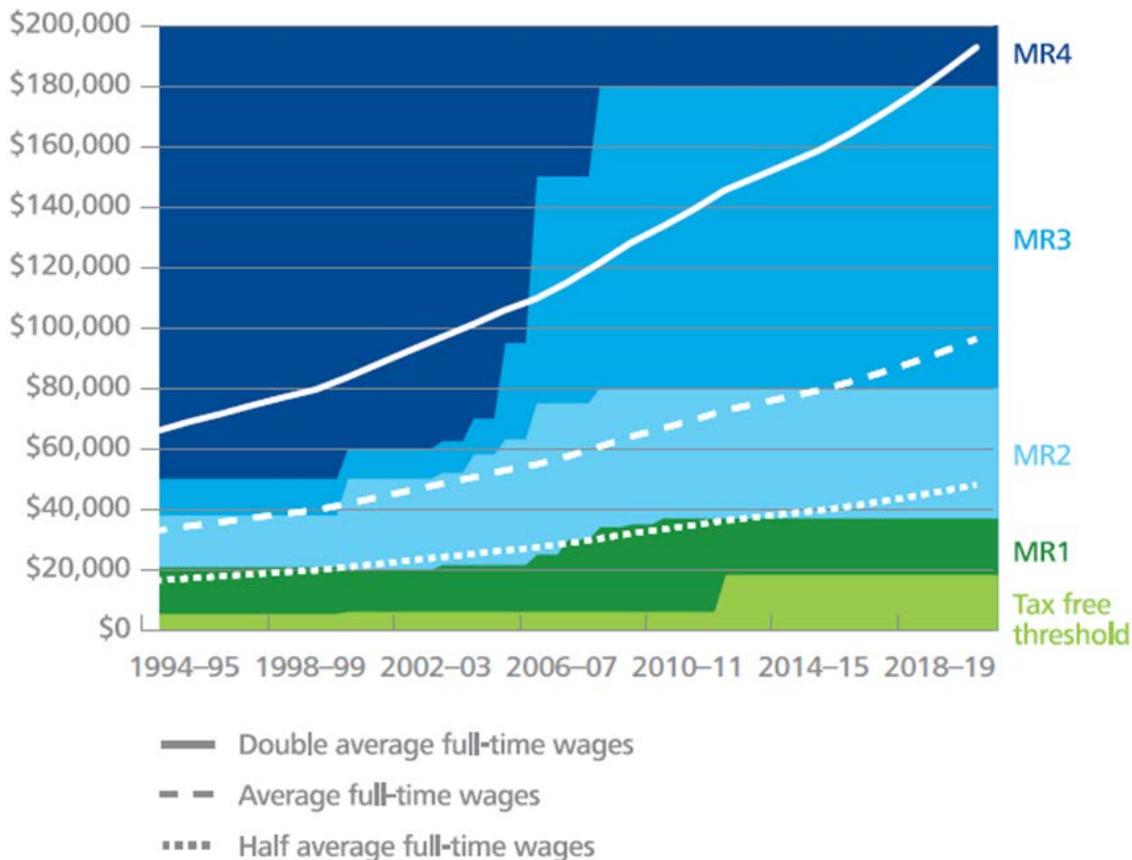
4 Deloitte, *Submission 2*, p. 4; Chartered Accountants Australia and New Zealand, *Submission 6*, p. 2.

5 The Tax Institute, *Submission 1*, p. 1; Business Council of Australia; *Submission 7*, p. 4.

thresholds mean that people may choose not to work overtime or seek promotion.⁶

2.5 Figure 2.1 illustrates the imminent shift into the next tax bracket that would affect average fulltime ordinary wage earners in the absence of the amendments proposed in the bill.

Figure 2.1—Marginal tax rate paid at different levels of income⁷



2.6 In addition to the detrimental effects on workforce productivity, high marginal tax rates on personal income encourage the use of tax planning arrangements as individuals seek ways to reduce their taxable income.⁸

Skewed benefits

2.7 A number of submitters expressed concern that the greatest benefits derived from the proposed amendments will be delivered to high income earners.⁹ For

6 Business Council of Australia, *Submission 7*, p. 4.

7 Deloitte, *Submission 2*, p. 4.

8 Chartered Accountants Australia and New Zealand, *Submission 6*, p. 3; Business Council of Australia; *Submission 7*, p. 5.

9 See, for example, Australian Council of Social Service, *Submission 3*, p. 1; Australian Council of Trade Unions, *Submission 4*, p. 11.

example, the Australian Council of Social Service commented that the proposed tax relief is 'targeted towards individuals in the top 20% of taxpayers'.¹⁰

2.8 Moreover, some submitters argued that high effective and marginal tax rates disproportionately hurt low and middle income earners.¹¹ This is due to the interaction between the tax and transfer systems and its effect on take-home income. Taxpayers on lower incomes are expected to experience greater challenges as a result of bracket creep, with those on incomes between \$30 000 and \$37 000 affected the most.¹² The Business Council of Australia emphasised this issue:

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.¹³

2.9 Some submitters also raised concerns that the proposed measures may be funded by spending cuts to social security payments and services on which low and middle income earners rely, exposing these groups to further disadvantage.¹⁴ The Australian Council of Trade Unions highlighted this concern:

If the government proposes to fund personal tax cuts by cutting expenditure on services such as health and education, families on low and middle incomes will lose out – receiving only a 'sandwich and a milkshake' tax cut in exchange for poorer services and higher out-of-pocket costs for health and education.¹⁵

2.10 The committee notes the concerns raised with regard to the scope of the amendments in the bill. However, the committee reiterates that the proposed amendments are part of a suite of measures aimed at boosting the economy for the ultimate benefit of all Australians.

Need for more holistic tax reform

2.11 While generally supportive of the personal tax relief that the proposed measures will bring, most submitters also promoted a need for a more holistic approach to tax reform.¹⁶

2.12 Submitters advocated for bracket creep to be addressed more broadly, suggesting that any changes to marginal tax rates should take into consideration their

10 Australian Council of Social Service, *Submission 3*, p. 1.

11 Deloitte, *Submission 2*, p. 4; Australian Council of Trade Unions, *Submission 4*, p. 12.

12 Deloitte, *Submission 2*, pp. 1 and 4.

13 Business Council of Australia; *Submission 7*, p. 4.

14 See, for example, Australian Council of Social Service, *Submission 3*, p. 3; Australian Council of Trade Unions, *Submission 4*, p. 11.

15 Australian Council of Trade Unions, *Submission 4*, p. 12.

16 See, for example, KPMG, *Submission 5*, p. 1; Business Council of Australia; *Submission 7*, p. 3.

overall interaction with the transfer system.¹⁷ The Business Council of Australia underlined this view, arguing that 'without broader change, people on lower incomes will be left worse off after tax, simply because their wage keeps pace with inflation'.¹⁸

2.13 The Australian Council of Social Service proposed that more holistic reform could also be achieved by:

...closing shelters and loopholes in the personal tax system, as has been done in the past. This would improve fairness because more people would actually pay tax at their legislated tax rate. Under the present system 'the many' have to pay more to offset revenue losses from the tax avoidance activities of 'the few'.¹⁹

Preparing the economy for future challenges

2.14 Stakeholders also highlighted that the Australian economy is facing a number of emerging challenges that pose an imminent risk to the effectiveness of Australia's tax system. An aging population is one such challenge. The Business Council of Australia emphasised this point in their submission:

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.

...

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.²⁰

2.15 The Business Council of Australia identified Australia's increasingly globalised labour market as a further challenge to Australia's economy:

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.²¹

17 Deloitte, *Submission 2*, p. 2; KPMG, *Submission 5*, p. 1.

18 Business Council of Australia, *Submission 7*, p. 3.

19 Australian Council of Social Service, *Submission 3*, p. 1.

20 Business Council of Australia, *Submission 7*, p. 4.

21 Business Council of Australia, *Submission 7*, p. 4, citing Akcigit, U., Baslandze, S. & Stantcheva, S. (2015) Taxation and the International Mobility of Inventors. Working Paper 21024. Massachusetts: National Bureau of Economic Research.

2.16 The committee is mindful of these challenges facing the Australian economy and is confident that the proposed measures will contribute to curtailing the risks posed by these factors.

Committee view

2.17 Overall, the committee notes that the majority of submissions supported the income tax relief measures proposed in the bill, commenting that the amendments are a step in the right direction to addressing the effects of bracket creep on the Australian economy.

2.18 While acknowledging the particular concerns raised by submitters, the committee considers the proposed amendments to be a necessary step toward providing further tax relief for working Australians.

2.19 As well as maintaining the progressivity of the tax system, the committee is confident that the bill will positively influence taxpayer decisions to work, save and invest by offering rewards for effort and creating better incentives to work. The committee is also confident that the bill will better align the tax system with the emerging challenges Australia's economy will face in the years to come.

2.20 The committee does recognise, however, that bracket creep affects taxpayers at all levels of income and that future tax relief measures may benefit from broader consideration of this issue.

Recommendation 1

2.21 The committee recommends the Senate should pass the bill.

Senator Jane Hume
Chair

Appendix 1

Submissions received

No.	Submitter
1	The Tax Institute
2	Deloitte
3	Australian Council of Social Service
4	Australian Council of Trade Unions
5	KPMG
6	Chartered Accountants Australia and New Zealand
7	Business Council of Australia

Correspondence received

- 1 Correspondence received from the Australian Manufacturing Workers' Union on 27 September 2016.

