Chapter 2
Views on the bill

2.1 This chapter explores the views stakeholders expressed regarding the proposed personal income tax plan.

General views on the bill

2.2 There was a broad level of support for lowering the personal income tax burden, both through the low and middle income tax offsets and reducing personal income tax rates generally.

2.3 The Business Council of Australia (BCA) urged the Senate to pass the bill without amendment:

> The Business Council supports the three-stage personal income tax plan, which will reduce the tax burden faced by individuals. It will deliver a more competitive personal tax system that improves incentives to work and save. It achieves this while maintaining a highly progressive tax and transfer system.[1]

2.4 Ernst and Young also supported the bill as it provides appropriate incentives for individuals to participate in the workforce and increases the relative competitiveness of Australia for individuals with skills that are attractive internationally.[2]

2.5 PwC concluded from its own modelling that:

> …the Government's proposed PITP [Personal Income Tax Plan] provides much-needed relief from the pressures of bracket creep to Australian taxpayers and it does so in a way which retains the central character of progressivity in Australia's income tax system. For these reasons, we support the PITP as an appropriate response to these issues.[3]

2.6 The Council of Small Business Organisations Australia (COSBOA) supported the simplification and flatting of the tax system under the personal income tax plan, and also noted that tax relief would provide a boost for small business activity:

> The other issue for small business people is that we quite often just pay ourselves a small amount of money until the business gets going. When we have a good year, we often have a really good year, and we pay an awful lot of tax in that year. This is something that says to a small business person there's a bit more certainty about planning as well. When you have a great year, you can plan on that.
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> …

1 Business Council of Australia, *Submission 7*, p. 1.

2 Ernst and Young, *Submission 8*, p. 1.

3 PwC, *Submission 20*, p. 11.

> More money means more spending and people in hospitality and retail, et cetera, will be happier, and hopefully they'll see their share of it. But the big win for us, when I talk to my members, is that removal of the complexity and the fear people have of moving into tax brackets…[4]

2.7 Other stakeholders were more qualified in their support for the personal income tax plan.

2.8 The Centre for Independent Studies (CIS) supported the 'main thrust' of the personal income tax plan but considered that it could be improved to better promote economic efficiency. The CIS was also concerned that the introduction of the Low and Middle Income Tax Offset (LMITO) would increase the complexity of the income tax system in the short term and increase effective marginal tax rates.[5]

2.9 The Institute of Public Affairs (IPA) welcomed the government's endeavour to reduce the tax burden on Australian workers:

> 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.[6]

2.10 While supporting the proposed changes, the IPA was critical that the government had not engaged in 'deep, structural reform of the tax and transfer system'.[7]

2.11 The Tax Institute also advocated for broad tax reform:

> While the measures in the 'Personal Income Tax Plan' (Plan) are a 'step in the right direction', they fall short of a holistic solution to the revenue reliance on personal taxes and the issues associated with the personal tax rate regime.[8]

2.12 However, not all stakeholders supported the proposed personal income tax plan. These concerns mainly centred on not seeing tax relief as a priority when they believe the revenue is needed for social and community services. For this reason, the Tax Justice Network-Australia (TJN-Aus) concluded that:

> …in Schedule 1 the TJN-Aus opposes the tax offset for those on incomes above $90,000 per year. Similarly TJN-Aus opposes the reduction in the rate of personal income tax proposed in the Bill for those with salaries greater than $90,000 per year. [9]

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4 Mr Peter Strong, Council of Small Business Organisations Australia, *Committee Hansard*, 6 June 2018, p. 48.

5 Centre for Independent Studies, *Submission 2*, [pp. 3, 8 and 9].

6 Institute of Public Affairs, *Submission 1*¸ p. 3.

7 Institute of Public Affairs, *Submission 1*¸ p. 3.

8 The Tax Institute, *Submission 10*, p. 1.

9 Tax Justice Network Australia, *Submission 6*, p. 1.

2.13 The Australian Council of Social Services (ACOSS) and the Community and Public Sector Union (CPSU) went further and submitted that the government needed to increase revenue, not provide tax cuts as proposed under the personal income tax plan.[10]

Timing of the plan

2.14 A number of stakeholders advocated for the personal income tax plan to be fully implemented sooner than proposed.

2.15 The IPA recommended that the government implement the entire plan from the start of the 2018–19 financial year:

> …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.[11]

2.16 Although not as extreme in its position, the CIS advocated for an earlier introduction on the grounds of greater public credibility:

> Credibility would be enhanced by an earlier introduction, such as full implementation within the life of the next parliament and within the four-year forward estimates horizon for the 2018–19 Budget. This would imply full implementation by 1 July 2021 rather than 2024.[12]

2.17 Mr John Daley from the Grattan Institute raised concerns about legislating for tax cuts too far into the future:

> … if you legislate for tax cuts that are future dated and then the world changes, you can be left in a budgetary position that is not really one that you would choose and politically it tends to be very hard to unwind the tax cuts that have already been legislated.[13]

2.18 Similarly, Mr Matt Grudnoff from The Australia Institute considered that:

> I don't think that we should be legislating out beyond the forward estimates; but certainly the government could announce that this is where they intend to go, and, as we get closer to that time, they can then legislate, having a better idea of what the economy is doing and where the economy is going.[14]

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10 Australian Council for Social Services, *Submission 4*; Community and Public Sector Union, *Submission 18*.

11 Institute of Public Affairs, *Submission 1*¸ p. 4.

12 Centre for Independent Studies, *Submission 2*, [p. 10].

13 Mr John Daley, Grattan Institute, *Committee Hansard*, 6 June 2018, p. 4.

14 Mr Matt Grudnoff, The Australia Institute, *Committee Hansard*, 6 June 2018, p. 25.

2.19 However, Mr Strong, CEO of COSBOA, considered that it was prudent to have a long term plan. Mr Strong noted that successful large businesses have long term plans.[15]

Distributional impacts

2.20 Various stakeholders highlighted that the tax system will continue to be progressive under the government's personal income tax plan.[16] For example, analysis undertaken by the Grattan Institute confirmed that progressivity does not change significantly under the personal income tax plan.

2.21 Further, Treasury's analysis also showed effective marginal tax rates do not materially worsen under the government's personal income tax plan.[17]

2.22 Information provided by The Tax Institute highlighted the difference between marginal tax rates and average tax rates. For example, in 2024–25 under the personal income tax plan, while a $41,000 income earner would face the same marginal tax rate as a $200,000 income earner their average tax rates would be substantially different. An income earner on $200,000 would pay around thirteen times more tax than the person on $41,000 and their average tax rate would be around three times higher.[18]

2.23 The Grattan Institute also highlighted that high income earners, such as those on the top marginal tax rate, would continue to pay a similar proportion of overall personal income tax collections under the government's plan compared to the current system.[19]

2.24 Modelling by PwC showed:

> The amount of tax paid by the top 20 per cent of taxpayers increases year-on-year during the period of the PITP, as would be expected from a system that maintains progressive tax rates for taxpayers on high incomes.
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> …
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> …we note that the highest earning taxpayers in Australia will pay a top marginal rate of tax which is high relative to other comparable nations (45 per cent for taxable incomes exceeding $200,000). For example, Australia's rate is equal top in the following list of federal taxes for individuals
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> - Australia 45% (proposed)
> - United Kingdom 45%
> - United States 37%
> - New Zealand 33%

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15 Mr Peter Strong, Council of Small Business Organisations Australia, *Committee Hansard*, 6 June 2018, p. 49.

16 See PwC, *Submission 20*; Ernst and Young, *Submission 8*.

17 Treasury, *Submission 12*, p. 10.

18 The Tax Institute, *Submission 10*, Appendix B, p. 5

19 Grattan Institute, *Submission 14*, p. 7.

- Canada 33%.[20]

2.25 Other stakeholders raised concerns that lower income earners received less tax relief. For example, Professor Miranda Stewart and Emily Millane argued that:

> …the removal of the third rate in the progressive rate structure is unnecessary and a retrograde step. It is a permanent change to the personal income tax rate structure that will make the income tax less progressive. It undermines the fundamental principle of our progressive income tax which aims to tax on the basis of ability to pay...It is appropriate to maintain progressivity across the middle and upper middle of the wage distribution.[21]

2.26 The Australia Institute concluded that low income earners (50 per cent of all taxpayers) would only receive seven per cent of the benefits.[22] While the ACTU commented that:

> This personal income tax plan is targeted at those in the higher income deciles. A staggering 62% of the income tax plan will go to high earners.[23]

2.27 The Grattan Institute highlighted that:

> …while the components of the Tax Plan will be introduced in a staggered way, their impact will be permanent and ongoing. So although the last tranche comprises only 29 per cent of the cost of the package over eleven years, it will cost approximately 40 per cent in each year thereafter.[24]

2.28 Associate Professor Jinjing Li from the National Centre for Social and Economic Modelling (NATSEM) outlined the distributional effects between urban and regional areas:

> Geographically, people who live in the central part of the capital cities are more likely to benefit from the proposed changes when they're fully implemented due to the distribution of the income spatially.[25]

2.29 However, Treasury pointed out that this assessment did not look at the whole picture. Treasury explained that as low income earners pay less tax, and, in proportional terms, benefit considerably more from tax relief under the government's personal income tax plan. Under the personal income tax plan over the period 2018–19 to 2024–25, a person on a taxable income of $50,000 would receive cumulative tax relief of 6.25 per cent, compared to a person on $90,000 receiving cumulative tax relief of 2.94 per cent and a person on $200,000 receiving cumulative tax relief of 2.51 per cent. Further, a person on $50,000 would pay cumulative tax of

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20 PwC, *Submission 20*, pp. 2 and 11.

21 Professor Miranda Stewart and Emily Millane, *Submission 16*, p. 9.

22 The Australia Institute, *Submission 13*, p. 8.

23 Australian Council of Trade Unions, *Submission 11*, p. 14.

24 Grattan Institute, *Submission 14*, p. 6.

25 Associate Professor Jinjing Li, National Centre for Social and Economic Modelling, *Committee Hansard*, 6 June 2018, p. 10.

$56,089 over this period, a person on $90,000 cumulative tax of $154,439 and a person on $200,000 cumulative tax of $458,809.[26]

2.30 The Australia Institute drew attention to the gender distributional split caused by the proposed personal income tax cuts:

> The over representation of men at higher income levels coupled with the fact that the tax cuts favour high income earners means that men get a larger proportion of the tax cuts than women. Men get twice the tax cut compared to women.[27]

2.31 Professor Miranda Stewart and Emily Millane discussed alternatives to the personal income tax plan, such as universal family payments, to improve incentives for second household income earners. They concluded that:

> …the government has alternatives available to it that would more directly respond to concerns of lower and middle earners while continuing to deliver equity and efficiency in the personal income tax system.[28]

2.32 Treasury noted that the personal income tax system was currently gender neutral and would continue to be so under the government's personal income tax plan.[29]

Bracket creep

2.33 One of the main reasons cited by the government for introducing the personal income tax plan was to address bracket creep.

2.34 Bracket creep, often referred to as 'fiscal drag', occurs when an individual's income increases over time and a higher tax rate starts to apply, but tax thresholds are held steady. Bracket creep reduces progressivity of the individual's income tax scales over time. This is because the tax increase for individuals with lower incomes is greater as a proportion of their income than for those at higher incomes.[30]

2.35 The BCA explained the effects of bracket creep:

> 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.[31]

2.36 Ernst and Young suggested that the reforms in the Bill help to address bracket creep.

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26 Treasury, answers to questions on notice, 6 June 2018 (received 14 June 2018), p. 4.

27 The Australia Institute, *Submission 13*, p. 10.

28 Professor Miranda Stewart and Emily Millane, *Submission 16*, p. 5.

29 Mr John Fraser, Treasury, *Estimates Committee Hansard*, Senate Economics Legislation Committee, 29 May 2018, p. 26.

30 Australian Government, 'Individuals income tax', *Re:think*, http://bettertax.gov.au/our-tax-system/individuals-income-tax/bracket-creep/ (accessed 13 June 2018).

31 Business Council of Australia, *Submission 7*, p. 2.

> In our view, the bracket creep and its layering additional tax burdens onto Australia's working age population is not good policy. It:
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> - Creates disincentives to work
> - Creates incentives to tax structuring rather than to work to grow Australia
> - And the incentives to tax structuring are greater, the greater the divergence between personal tax and corporate tax rates.
>
> The bill addresses all of these challenges.[32]

2.37 The ANU Centre for Social Research and Methods considered, after undertaking its own analysis of the plan, that:

> The bracket creep analysis shows that the tax cuts are significant but they do not entirely remove bracket creep and average tax rates increase across low, middle and high income households. They return to taxpayers some, but not all, of the fiscal drag being generated by the non-indexation of tax thresholds.[33]

2.38 The BCA concluded that:

> The Bill does not fully eliminate bracket creep, which requires constant recalibration or indexation of tax thresholds, but the changes are a positive step and provide the foundation for broader reform. High personal tax rates that cut in at relatively low income thresholds mean that people may choose not to work overtime or seek promotion.[34]

2.39 Indeed, Mr John Daley from the Grattan Institute concluded that:

> So the net impact of the tax is it will give back all of bracket creep, pretty much, to those in the top 10 percent but nothing like all of the bracket creep to those who are further down the distribution.
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> …
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> The key facts are that bracket creep will reduce the progressivity of the system over the next 10 years, and the tax plan doesn't materially unwind it.[35]

2.40 Similarly, Per Capita commented that:

> The simplest and most effective way to deal with bracket creep is to index tax bracket thresholds to inflation (including the tax-free threshold)… Simple indexation would mean that addressing bracket creep could no longer be falsely labelled as tax reform or tax cuts and that personal income tax changes that erode the progressivity of the tax system could not be sold as if they are simply addressing bracket creep.

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32 Ernst and Young, *Submission 8*, p. 3.

33 ANU Centre for Social Research and Methods, *Submission 3*, p. 12.

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

35 Mr John Daley, Grattan Institute, *Committee Hansard*, 6 June 2018, pp. 1 and 3.

> It's also worth noting that moving from below the tax-free threshold into the lowest tax bracket is also bracket creep and no effort has been made to address this in the Bill.[36]

2.41 The CIS advocated for ongoing indexation of income tax thresholds to address bracket creep:

> The CIS believes that the government's current tax proposal should be enhanced by formally indexing income tax thresholds once the proposed discretionary increases in thresholds are fully implemented.[37]

Committee view

2.42 The committee acknowledges that decisions to implement significant changes to the personal tax and transfer system often invoke highly charged responses to which reasonable minds can differ. In this context, the committee welcomes the various views put forward by stakeholders throughout this inquiry in the spirit of a balanced public debate.

2.43 That said, the committee considers that measures outlined in the bill will provide certainty to taxpayers for the next seven years and will help households manage the budget pressures they face. Permanent tax relief as proposed in the bill will leave more of Australian's hard earned income in their pockets and ensure that the personal tax system continues to reward effort and foster aspiration.

2.44 Changes to the tax and transfer system are not mutually exclusive and the committee acknowledges the work of the government to encourage greater workforce participation by providing more support to low and middle income families through the new Child Care Subsidy.

2.45 While recognising the different views of stakeholders, the committee is comforted by Treasury's assurance that there will probably be very little change to the overall progressivity of the tax system arising from the implementation of the personal income tax plan.

2.46 Accordingly, the committee considers that the personal income tax plan should be passed so as to deliver a personal income tax system that is simpler and fairer.

Recommendation 1

2.47 The committee recommends that the Senate should pass the bill.

Senator Jane Hume

Chair

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36 Per Capita, *Submission 17*, p. 2

37 Centre for Independent Studies, *Submission 2*, [p. 8].