Policy priorities for the next Australian government

PUBLIC REVENUE FOR ESSENTIAL SERVICES

March 2019

Introduction

Australia is the eighth-lowest taxing country among 39 OECD nations (at 39.4% of GDP), ahead of only Mexico, Chile, the Czech Republic, Ireland, the United States, Switzerland and Korea.[1]

While the government predicts a small surplus in its budget for 2019-20, pressures on the budget will build as the cost of providing essential health, aged care and disability services, is expected to cost $21 billion higher per year in a decade's time.[2] This is before necessary action is taken to close gaps in our social security system and essential services. Such action includes addressing poverty and unemployment among people relying on our lowest social security payments, as well as increasing access to dental and mental health services, and affordable housing (see the social security, health and housing statements).

In the recent past, we have seen how eight successive income tax cuts created pressure for harsh cutbacks in essential services and social security payments in the 2014 budget. An arbitrary cap on tax revenue of 23.9% of Gross Domestic Product, as proposed by the government, would repeat this mistake, as would legislated income tax cuts for high income-earners costing at least $20 billion per year by 2024.

At the same time, major gaps in the income tax system that enable people with high incomes to avoid contributing their fair share remain in place, including:

+ Overly generous tax breaks for superannuation post-retirement, which, along with tax offsets for older people, exempt 84% of people over 64 years from income tax;
+ Weaknesses in the Medicare Levy;
+ The use of private trusts and companies to avoid tax;
+ Negative gearing and the 50% Capital Gains Tax 'discount'.

One of the main reasons that Australia recently recorded the highest housing costs in the OECD is that our tax system favours property speculation. Negative gearing, together with the generous tax breaks for capital gains (a 50% discount), encourage people to go heavily into debt to bet on property prices, driving up home prices and household debt. A better way to stimulate new affordable housing construction is to invest directly in social housing, coupled with a new private investment incentive to build new homes rented at below-market rates.

Business tax reform should remove harmful distortions and inconsistencies that are costly to revenue and favour some industries over others. Further, weaknesses in the taxation of companies that operate internationally have allowed many corporations operating profitably in Australia to contribute little or no tax.

Taxes can be used to meet social objectives, as with alcohol and tobacco excise. There are two major gaps in our tax treatment of products that are harmful to health: sugary drinks are lightly taxed, and alcohol is inconsistently taxed (with cheap wines and ciders taxed at lower rates than other drinks).

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[1] OECD (2017): Revenue Statistics. Public revenue from all levels of government in 2015.

[2] Parliamentary Budget Office (2018), 'Medium term budget projections 2018-19', Report 3/2018, Canberra.

Policy proposals

Improving fairness in the tax system and easing future budget pressures

To improve fairness in the tax system and ease future pressures on the budget, tax cuts legislated to commence from 2023 should be removed and personal tax shelters closed.

Despite future pressures on the Budget, regressive ('Stage 2 and 3') income tax cuts costing at least $20 billion per year by 2024 have been legislated. These tax cuts mainly benefit the top 20% of taxpayers earning $90,000 or more (who will gain at least $160 a week). The top 3% of taxpayers with $200,000 or more will gain $227 a week.

High income-earners with 'smart' advice can readily avoid paying income tax at their proper marginal rate, and often pay tax at a lower marginal rate than the average worker. Tax shelters used for this purpose include private trusts and companies.

Recommendation 1 The progressive personal income tax base and revenue for essential services should be strengthened by:

(1) Withdrawing the personal income tax cuts that were legislated to be introduced from July 2022, with the savings devoted to essential services; (Saving: $20,000 million in 2024-25)

(2) Funding any new tax cuts by closing income tax shelters and loopholes (including excessive work-related deductions and tax breaks for company cars);

(3) Curbing tax avoidance and evasion by high-wealth individuals using private trusts by:

+ Tightening the tax treatment of capital gains within discretionary trusts; (Saving: $1,500 million)
+ A public register of express trusts, including settlors, trustees, beneficiaries, and annual income and expenditure (where the trustee makes a family trust election, details of beneficiaries could be held confidentially by the ATO).

(4) Curbing the use of private companies to shelter personal income, especially passive investment income. (Revenue: $1,400 million)

Properly funding essential health, aged care and disability services

To properly fund essential health, aged care and disability services, tax concessions for well-off retirees should be reduced and the Medicare Levy strengthened.

Due to the overly generous tax treatment of superannuation, and other special tax breaks for older people, only 16% of people over 64 years pays income tax, despite the fact that this cohort is now the wealthiest of all age groups (with an average net wealth of $1.3 million, of which half is from their home). As more people retire, tax revenues will fall while the cost of the health and aged care they need will rise. This is not sustainable.

Superannuation fund earnings and benefits after retirement are tax free, and the tax free threshold for all *other* income of a retired couple is almost $60,000. Tax concessions for superannuation now cost more each year ($40 billion in 2017-18) than the Age Pension. At the same time, retired people are rightly concerned that will be not be able to afford nursing home deposits and essential medical services when they grow old. This is neither fair nor sustainable.

In addition, the Medicare Levy should be strengthened so that high income earners cannot use tax shelters to avoid paying.

Recommendation 2 The next government should guarantee affordable access to essential health, aged care and disability services, and implement tax reforms to finance it, including:

(1) Extending the 15% tax on fund earnings in the accumulation phase of superannuation to the pension phase; (Savings: $1,500 million)

(2) Removing refunds for dividend imputation credits above a fixed annual level, for example, $2,000; (Savings: $5,600 million)

(3) Curbing the use of ‘re-investment strategies’ to avoid taxation of income from superannuation and the diversion of assets to super to avoid Capital Gains Tax;

(4) Replacing existing complex and inequitable tax concessions for superannuation contributions (including the 15% and 30% flat taxes on employer contributions, deductions for personal contributions) with a capped two-tier rebate (with rates of 100% and 20%) based on the principle that all should receive the same tax benefit per dollar contributed;[3]

[3] As in the present system, deductable contributions should be capped. People with income below the tax free threshold should receive the rebate as a tax credit or co-contribution. A modest level of contributions (for example $500 a year) should attract a dollar-for-dollar tax credit or co-contribution to boost superannuation savings of people with low incomes. This reform would be revenue-neutral.

(5) Only considering an increase in the Superannuation Guarantee on the basis that:

+ The tax treatment of superannuation contributions is fair and sustainable;
+ People with low and modest incomes benefit (the increase takes into account the effect on their lifetime incomes);
+ People have reasonable access to part of their superannuation savings for purposes other than retirement, when needed;

(6) Restricting the Seniors and Pensioners Tax Offset (SAPTO) to pensioners, as well as re-designing it to exempt from tax the Age Pension and any income within the 'free area' of the pension income test; (Savings: $700 million)

(7) Broadening the income definition for the Medicare Levy to apply to the Medicare Levy Surcharge, and removing the exemption for the Medicare high-income surcharge for individuals with private health insurance. (Savings: $1,200 million)

Overall savings: $9,000 million

Making housing more affordable through tax reform

Home prices rose by 50% over the five years to 2017 and by 400% over 25 years. They have fallen slightly, by a national average of 5%, over the two years since they peaked. This modest decline in prices helps first home buyers and tenants and does not pose a risk to economic growth unless price falls accelerate.

Housing affordability can be improved over the medium term, and a sharp reduction in housing commencements avoided, through reforms in the tax treatment of housing combined with direct investment in social housing outlined in the Housing section of this statement.

Recommendation 3 The tax treatment of housing should be reformed to discourage speculation in asset prices and directly encourage new investment in social and affordable housing by institutions and individuals, by:

(1) Introducing a two-tier incentive (tax or direct payment) to encourage investment in affordable and social housing by individuals and institutions:

+ This would be linked to the cost of construction of new dwellings held for rent at affordable rates (less than a fixed fraction of median rents) for at least 10 years; and paid at a much higher rate for new social housing dwellings for low income-earners.

(2) Reducing the 50% discount for personal taxes on capital gains to 25% (without grand-fathering), over a five year period; (Savings: $300 million)[4]

(3) Quarantining losses from passive investment in assets yielding capital gains (such as property and shares, including newly-constructed housing) to income from that class of assets (that is, disallow 'negative gearing'), while 'grand-fathering' existing 'negatively geared' assets, subject to anti-avoidance tests to prevent the owners from prolonging 'losses' by re-financing; (Savings: $600 million)

(4) Encouraging State and Territory Governments to progressively replace housing Stamp Duties with a broad-based Land Tax (including owner-occupied housing), with deferred payment arrangements for people with low incomes.

Removing inefficient business tax concessions and curbing international profit-shifting

Many business tax concessions benefit particular industries without meeting a clear public purpose. In doing so they indirectly disadvantage other industries, including emerging sectors. For example, the fuel tax offset for off-road use, together with immediate deductions for mining exploration costs, disproportionately benefit the mining industry. In a modern economy, fuel taxation is a mechanism for generating general government revenue and reducing our reliance on environmentally harmful fossil fuels, not just for funding roads.

Governments are finally working together to prevent harmful and unfair tax avoidance and evasion by companies operating across national borders.[5] The Australian government has implemented welcome reforms, including the introduction of a Diverted Profits Tax and a Multinational Anti-Avoidance Law (MAAL), but much more needs to be done.

Recommendation 4 Tax avoidance and evasion by companies operating internationally should be curbed by:

(1) Tightening thin capitalisation rules so that allowable debt deductions are based on a company's global debt-equity ratio;

(2) Requiring the Australian Taxation Office publicly release 'high level reports' under the OECD 'country-by-country reporting' initiative in regard to companies and trusts with turnover above $750 million;

(3) Applying special withholding taxes on transfers of funds to 'secrecy jurisdictions' (tax havens) that do not provide sufficient information to enforce international treaties.

Savings: $500 million

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[4] These are estimated savings for the first full year of this policy. Savings would increase substantially as it is phased in.

[5] OECD (2013): Addressing Base Erosion and Profit Shifting, Paris.

Recommendation 5 Fuel tax credits for off-road use (outside agriculture) and the immediate deduction for mining exploration should be removed.

Savings: $2,300 million

Reducing harms from overuse of alcohol and sugary drinks

There are two major gaps in our tax treatment of products that are harmful to health: sugary drinks are lightly taxed and alcohol is inconsistently taxed (with cheap wines and ciders taxed at lower rates than other drinks).

Recommendation 6 The tax treatment of alcoholic and other sugary drinks should be tightened to discourage over-consumption and bring in revenue and improve public health, by:

(1) Introducing uniform taxation of alcoholic drinks by alcohol content and volume (lifting tax rates on cheaper wines and ciders); (Savings: $2,300 million)

(2) Introducing a tax on sugary drinks; (Savings: $500 million)

(3) Earmarking revenues from the above to health promotion and illness prevention expenditures.

More information on our public revenue policies can be found at:

Income tax cuts

https://www.acoss.org.au/wp-content/uploads/2018/05/ACOSS-submission-to-Personal-Income-Tax-Plan-Bill-2018.pdf

Medicare Levy

https://www.acoss.org.au/wp-content/uploads/2017/09/ACOSS_medicare-levy-FINAL.pdf

Housing

https://www.acoss.org.au/wp-content/uploads/2016/04/Fuel_on_the_fire_ACOSS.pdf

Superannuation and retirement incomes

https://www.acoss.org.au/wp-content/uploads/2015/08/ACOSS-submission-to-retirement-incomes-review_Tax-Talks-4_Final.pdf

Trusts

https://www.acoss.org.au/ending-tax-avoidance-evasion-and-money-laundering-through-private-trusts/