POSITION STATEMENT

Business
Coalition for
Tax
Reform

BCTR Position Statement on Personal Tax Reform Options

The Henry Tax Review (HTR) proposes radical but broadly sensible changes to the taxation of personal income. These include taxing all forms of labour income/remuneration as wages and salaries, a separate and lower system of taxation of most forms of capital income, a simplified tax rate schedule which removes the Medicare Levy (ML) and the various tax offsets, and moves to greater simplification. If adopted, the proposals would make important steps to a simpler, fairer and more efficient system of taxation of personal income.

Proposed streamlined Personal Income Tax (PIT) rate scale

The HTR recommends a major rationalisation and simplification of the personal income tax rate schedule via a high tax-free threshold with a constant marginal rate for most people to provide greater transparency and simplicity, while maintaining progressive tax collections.

In particular, the HTR has suggested a three-step schedule with a tax free threshold of $25,000 a year, then a 35% rate to apply to an estimated 97% of taxpayers, and a top rate of 45% for income above $180,000 a year.

This proposed reform would also be coupled with the removal of the existing Medicare Levy and the various structural tax offsets such as the low income, senior Australians, pensioner and beneficiary tax offsets.

It is also recommended that that the various concessional offsets be removed, standardised or replaced by outlays. Examples include dependency offsets, zone tax offset, mature age worker, employment termination payment, overseas civilian, entrepreneurs' tax offset, notional tax offset, overseas forces tax offset and averaging tax offsets for primary producers.

In relation to medical expenses, it is proposed that the existing tax offset be removed and that the Medicare Levy surcharge and assistance (rebates) for private health insurance be reviewed.

It is also recommended that all forms of wages/salaries for Australian resident taxpayers be taxable on an equivalent basis and without exemptions including private education payments, foreign employment income and relevant defence forces payments.

Many of the changes proposed to the current PIT rate scale would enhance the simplicity and transparency of the existing personal tax regime as well as reducing some very high effective marginal tax rates (EMTRs), particularly when the ML and tax offsets are recaptured or phased out. In turn, the lower tax rates would provide more attractive incentives for workforce participation, particularly for single parents, married women with young children, and the mature aged.

The BCTR endorses the thrust of the of the proposed personal rate scale with a $25,000 tax free threshold. Determining the main rate will need further analysis once the associated modelling is released.

We also believe that the modelling underlying the proposed new scale should be released soon as practicable so that all groups can examine the effects.

Fringe benefits tax (FBT)

The HTR recommends that fringe benefits that can be easily valued and attributable to employees should be taxed in their hands. Certain other benefits, such as those incidental to an individual's employment, would be taxed to the employer at the top marginal rate of tax.

BCTR broadly supports this approach as it would generally be consistent with the regimes adopted in other OECD countries, but we note that some additional complexity could arise from some benefits still being taxed to the employer. Further clarification would be useful in respect to which benefits might still be taxed in the hands of the employer.

Treatment of capital income

For capital income, or the returns on household savings, the HTR proposes quite radical reforms in some instances aimed at reducing, but not eliminating, the different effective tax rates on different savings options.

The current prepaid consumption tax treatment of investment in owner occupied housing is to be retained (namely invest after tax income with no further tax on imputed rent or capital gains, but no deductions for expenses such as mortgage interest and rates). This is justified on the need to encourage long-term savings and to ameliorate the impact of the taxation of inflationary gains.

While the BCTR broadly supports this position, we believe that further work needs to be done on some personal tax/state tax interaction issues, eg:

- the major tax subsidy to housing and the apparent incentive this has provided for the states to impose their own inefficient duties on property transactions;

- possible opportunity to provide the states with some access to the personal income tax in return for the abolition of their current inefficient duty arrangements.

Note that more detailed comments on state taxes are contained in a separate BCTR submission on this topic.

In the case of superannuation, the HTR approach would involve replacing the current flat rate 15% tax on all employer contributions in the fund, regardless of income level, with the usual marginal rates under the personal tax rate scale but subject to a uniform concession in the form of a flat rate refundable tax offset on contributions up to an annual indexed cap of $25,000 (but doubled for people aged 50 years or older). The offset would be set so the majority of taxpayers do not pay more than 15% tax on their contributions.

While we note that the government has not yet indicated its position on the abovementioned proposal, we believe that further work on the interaction between personal income tax and superannuation is warranted to determine the most appropriate approach in this area.

Other changes in the superannuation/retirement income area would include halving the tax on fund earnings to 7.5% (but applicable also to funds in the pension phase) and the government promotion of annuity type products to facilitate the management of longevity risk by retirees.

In relation to other forms of capital income, including interest on bank and other financial deposits/instruments, returns on rental property investments and capital gains generally, the HTR proposes a 40% discount on the relevant personal income tax rate for such investments. The discount is to remove from taxation returns which offset the effects of inflation, so that tax is only applied to real income. We understand that the discount rate assumes an average market or nominal rate of return (to cover the eroding effect of inflation plus the real return for deferring consumption) of 6% and the Reserve Bank's target inflation rate of around 2-3% per annum. In the case of property investments, most of the current arbitrage opportunity between the immediate deduction of expenses, including debt interest, and the deferred payment of CGT on discounted (50%) realised capital gains would be largely removed since both the expenses and the related income would be reduced by 40%.

The imputation system for company dividends is to be retained for the present (pending possible review in the event of a general move by other countries to different forms of company taxation) but these and other shorter term savings options will still be taxed more heavily than saving via owner occupied homes and superannuation with longer term provision of retirement income objectives, but the gap would be reduced.

More radical options to place all household savings on a neutral tax footing, such as via a dual tax system now operating in a number of Nordic countries, was considered too ambitious without substantial further analysis by the HTR.

We broadly support the AFTS proposals to obtain more consistent treatment of capital income to ensure that the choice of particular investment/savings vehicles is based primarily on risk/return rather than tax considerations. Nevertheless, the BCTR believes that implementation of a dual tax system would provide a simpler and more comprehensive solution to the existing differential treatment of capital income and that this should be the appropriate medium to long-term objective in this area.

Personal tax/transfer system interaction

Income support (including family assistance and other government payments akin to income support) and supplementary payments should be tax exempt to ameliorate existing EMTR problems.

The BCTR supports this approach as it should assist in reducing EMTRs.

Simplifying capital gains tax (CGT)

The HTR has proposed that the CGT regime be simplified by:

- increasing the exemption threshold for collectables and exempting all personal use assets;

- rationalising and streamlining the small business CGT concessions by removing various tests and concessions, and

- removing the pre-CGT concessions and replacing them with a market value cost basis.

The BCTR broadly supports these proposals as they would go some way to simplifying the existing CGT rules.

Tax on bequests

The HTR recommended that the possibility of introducing a tax on bequests should be explored. The BCTR supports this approach on the grounds that such a tax, if properly designed, would enhance the overall efficiency of the Australian tax system. While we note that the government has already ruled this out, we believe that it warrants further consideration, particularly given that such taxes are common in other comparable countries.

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