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It’s the revenue stupid

Ideas for a brighter budget

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TAI

Policy Brief

The Australia Institute
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Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

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The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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Acknowledgment

This research paper was commissioned by together with previous papers:

Top Gears: How negative gearing and the capital gains tax discount benefit the top 10 per cent and drive up house prices.

Who's getting negative? The benefits of negative gearing by federal electorate

Closing the tax loopholes: A Buffett rule for Australia

The author would also like to thank David Richardson for his help with the Bank super profits tax and the Estate tax.

Also thanks to Cameron Amos for his work on the financial transaction tax.

Summary

The budget

The government's single minded focus of cutting spending primarily to low income households in order to reduce the budget deficit has been rejected by economists, rejected by voters and rejected by the senate. It has been branded unfair and the government has been thrown into confusion and chaos as it searches for an alternative budget plan. But almost all of the alternative budget policies it puts up seemingly point back to spending cuts.

The budget currently has a revenue problem not a spending problem. Revenue is down 2.2 per cent of GDP when compared to the average of the 12 years before the GFC. Spending, after adjusting for unusual government transfers, is running at 0.9 per cent above the average for the same period. This means that 70 per cent of the budget deficit is caused by a fall in revenue and 30 per cent by an increase in spending. In other words the budget is not collecting enough tax, while increased spending is only impacting on the budget in a relatively minor way.

The government has claimed there are no alternatives to its budget vision and called on the senate crossbenchers to stop blocking its budget measures or find alternatives that stack up. This paper aims to do just that.

In order to help the government out and shift debate back to good budgetary policy, The Australia Institute has made eight policy suggestions that will;

- reduce the budget deficit by billions
- make savings progressively with those with the most ability to pay paying the most
- make savings efficiently, minimising market distortions and in some cases correcting distortions already in the market

Modelled and costed budget polices

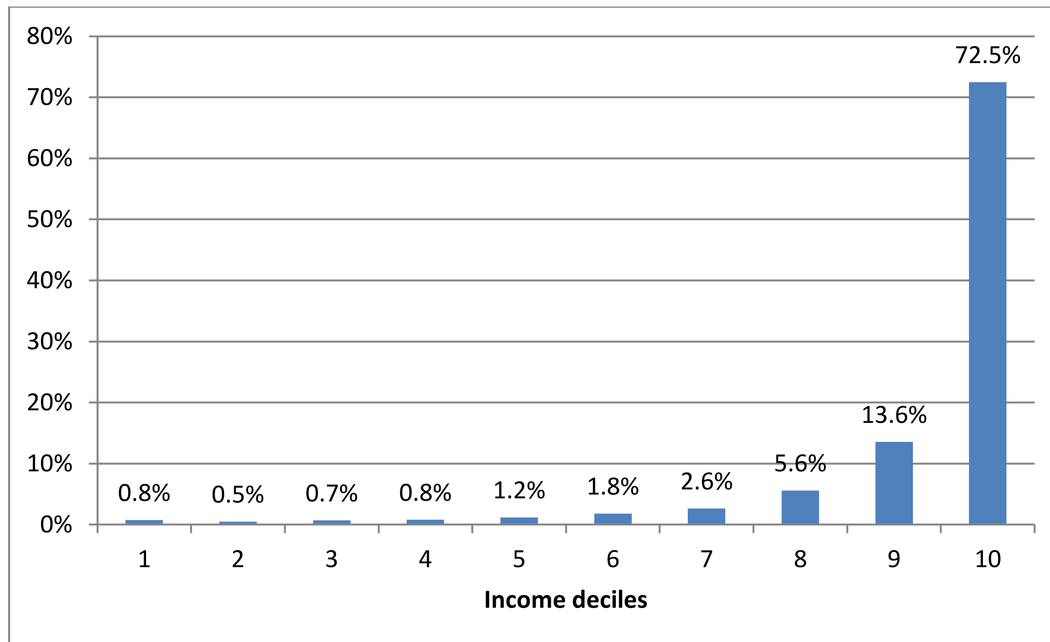
The Australia Institute has had four budget policies modelled and costed. These policies and their revenue impacts are set out in table 1.

Table 1 – Modelled policies and revenue impact

Revenue measures	Estimate of revenue raised ($m)
Super tax concessions	$9,616
Restrictions on negative gearing	$3,491
Scrapping the capital gains tax discount	$4,039
Introducing a Buffet rule	$2,492

These policies are worth $19.5 billion per year. When we look at the distribution of the impact these policies would have by household income we find that they will disproportionately affect high income households. The impact by decile is shown in Figure 1.

Figure 1 – Income distribution of budget savings of four modelled policies



Source: NATSEM modelling

Almost three quarters of the savings come from the top 10 per cent while 86 per cent come from the top 20 per cent. By comparison only four per cent come from the bottom half.

Super tax concessions

Super tax concessions are increasingly being used by high income earners as a way of minimising their tax. This is not their original purpose. They were designed to encourage people to save for their retirement so they would be more self-reliant and less dependent on taxpayers.

80 per cent of those who are of eligible age are on the age pension or part pension and this is predicted to still be the case in 2050. It would seem that super tax concessions are not working. Worse, almost $18 billion (60 per cent) of super tax concessions are going to the top 20 per cent of income earners. These are the people most likely to be a part of the 20 per cent not receiving an age pension. There is no economic justification for taxpayer's money being spent on enlarging the super balances of those that are not likely to ever claim a pension. This means that about $18 billion is being wasted each year on unnecessary tax concessions.

Reform of super tax concessions is long overdue and should start from the principle that the only justification for using taxpayer's money is if it reduces long term impacts on the budget. Otherwise the benefit of the tax concession is entirely private.

The proposed reform would see super tax rates rise with income so that the benefit was greatest for low and middle income households. Growing the super balances of these households is likely to have the largest long term impact on the budget by reducing their reliance on the age pension. High income households would see a smaller super tax concession as they are less likely to need an age pension. The new super tax rates are set out in table 2.

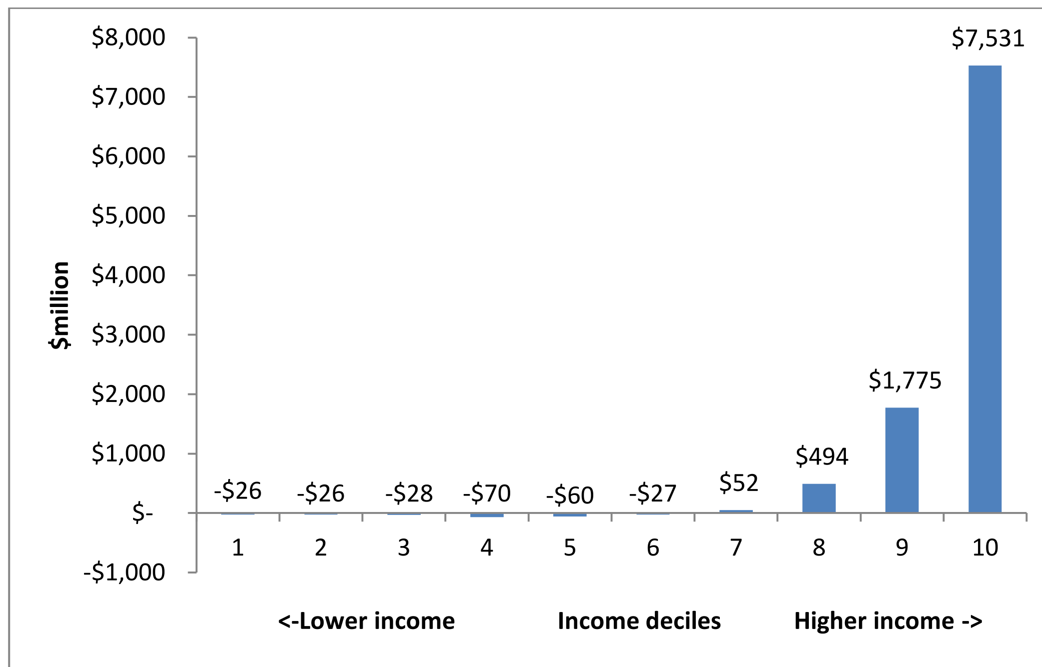
Table 2 – Proposed super tax rates

Annual Income	New tax rate	Old tax rate	Difference
$0 to $37,000	0%	15%	+15%
$37,001 to $80,000	10%	15%	+5%
$80,001 to $180,000	22%	15%	-7%
More than $180,000	45%	15%	-30%

These new super tax rates will reduce the distortion in tax policy where the tax concession is going predominately to high income people for a dubious long term benefit to the budget.

The new super tax rates will also see 60 per cent of households paying less tax on their super. High income households will see less super tax concessions and overall the policy will reduce super tax concessions by $9.6 billion. The income distribution of impacts of changes to super tax concessions are shown in Figure 2.

Figure 2 - Distribution of impacts of changes to super tax concessions by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

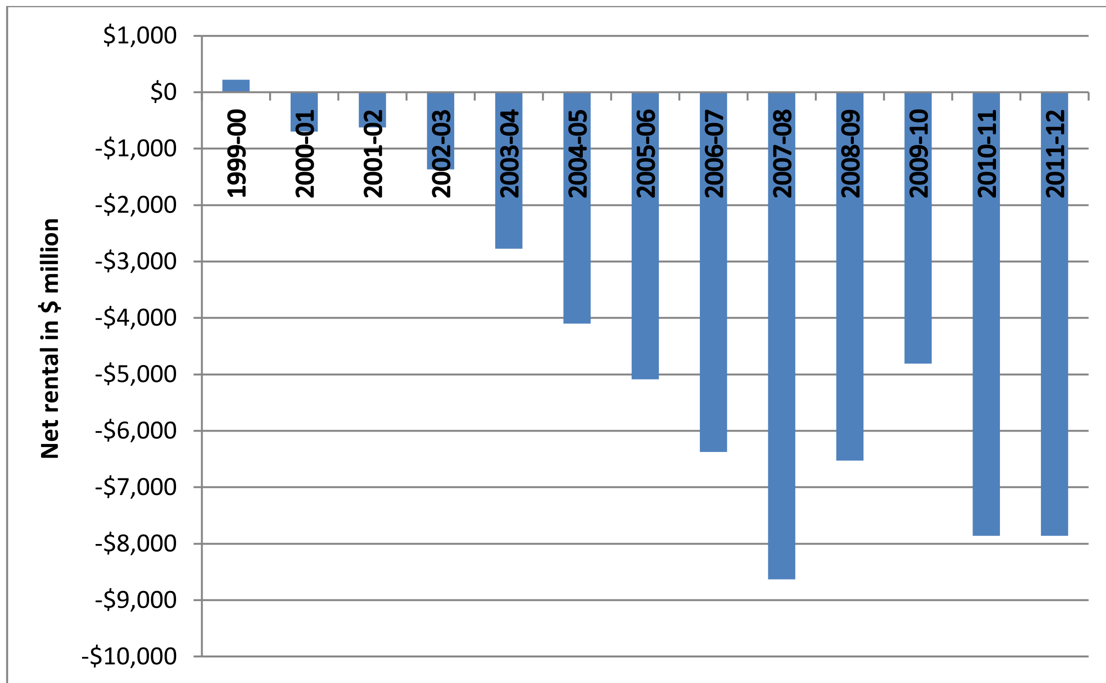
Negative gearing and the capital gains tax discount

Negative gearing and the CGT discount are distorting the housing market and costing the budget $7.7 billion per year. The proportion of investment loans is rising, owner occupied loans are falling and rates of home ownership are falling. People are being forced to rent in greater numbers as a growing number of houses are bought by property investors.

Investment in residential property is unique in that objective for many investors seems to be to make a loss. Net rental loss has rapidly expanded in Australia since the introduction of the

CGT discount. Figure 3 shows net rental loss since 1999-2000 when the CGT discount was introduced.

Figure 3 – Net rental loss over time



Source: ATO (2014) *Taxation Statistics 2011-12*, Individual tables, Table 13

Residential property investors are content to make a loss over time, which is tax deductable, in the hope that they will make their loss back in capital gain when the property is sold. Investment only for the purposes of capital gain is speculative investment and distorts investment decisions.

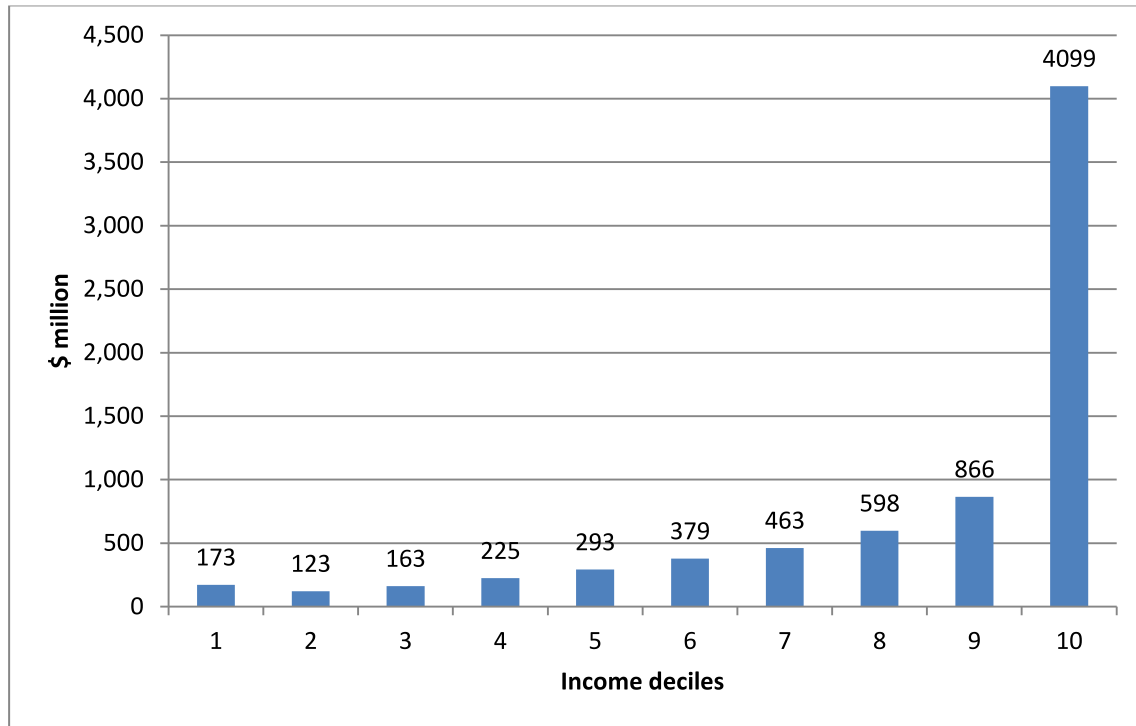
In a market dominated by speculators the return on the asset is of less concern, with the main focus on the capital gain. This means that rising property prices, which have the effect of reducing investment returns, do not discourage buyers but rather attract them. Rising property prices means larger capital gains. This has the effect of making the residential property market more susceptible to bubbles.

The interaction between negative gearing and the CGT discount is important in encouraging speculation. Negative gearing means that taxpayers help by paying for some of the losses the investor makes while the CGT discount means less capital gain is required in order to make a profit when the property is sold.

While some have claimed that negative gearing encourages the building of new rental properties and so helps lower rents, this impact is overstated. The vast majority of investor housing finance, 94 per cent, is for existing houses.

The budget proposal is to restrict negative gearing to new residential property investment and scrap the CGT discount. This would save the budget $7.4 billion per year. As these tax shelters are primarily used by high income households, most of the savings impact on high income households.

Figure 4 - Distribution of impacts of changes to negative gearing and the CGT discount



Source: NATSEM

Buffet rule

The idea of a Buffett rule is to ensure that very high income earners are not able engage in aggressive tax minimisation. A Buffett rule would create an average minimum rate of tax that high income earners could not go below. It acts like a tax floor for people earning more than $300,000 per year, the top one per cent of taxpayers. The tax rate would be set at 35 per cent, just below the average tax rate paid by someone on $300,000 a year.

Aggressive tax minimisation undermines the progressive nature of the income tax system. Very high income earners pay large sums of money to tax advisors to find them tax loopholes. This is a sensible from their individual point of view as the tax advisor can save them more money than they charge in fees. It is not efficient from the point of view of the economy as resources are being wasted circumventing the tax system.

It is also inequitable since lower income households cannot restructure their incomes to take advantage of the tax loopholes and do not have the funds to pay for the advice.

The Buffett rule does not change the deductions that very high income earners can make. Instead it simply puts a limit on how low very high income earners can reduce their taxable income. It would have the effect of reducing the value of tax advice as additional deductions after a certain point are worthless.

NATSEM modelling revealed that if a Buffett rule was set on people with an income above $300,000 and set at a rate of 35 per cent then it would raise $2.5 billion per year, all from very high income earners.

Other revenue measures

The question of how to find revenue measures that can be levied in an equitable, moderate manner is one with no shortage of solutions. The preceding proposals merely scratch the surface of worthwhile alternatives to the government's preferred austerity measures.

This paper includes a range of complementary measures. These need not be read as either/or proposals; rather, the measures in Table 3 are best considered a menu of potential revenue-raisers. Like the rest of the report's content, these options are progressive, revenue-raising measures that will collect billions for Treasury without hurting low-income Australians. They are measures that are efficient as they will not distort the economy.

Table 3 – Other revenue measures

Revenue measures	Estimate of revenue raised ($m)
Bank Super Profits Tax	$5,700
Financial transaction Tax	$1,000 to $1,400
Estate Tax	$5,000
Restricting fossil fuel subsidies	$11,517

There are many solutions to reducing the government's budget deficit apart from cutting spending. The government just needs to have the courage to defy special interest groups and pick some of them.

Introduction

The Abbott government's first budget was grim news for low income earners and was viewed as unfair. While the government has repeatedly said that spending cuts are the only solution to reducing the budget deficit, this is simply not the case. The government has many options for a brighter budget.

Government spending predominately goes to low income households. Similarly, income tax is only paid by those with an income stream to tax, of course, and in a progressive income tax system, a greater fraction of each dollar earned is paid in tax as you earn more and more.

The result of this is that attempts to reduce the deficit by decreasing spending will disproportionately impact on low income households, while attempts to reduce the budget by increasing revenue will impact on higher income households.

When the Abbott government, in response to claims of overreach, proclaimed that there are no alternatives to its budget vision, it threw down a gauntlet.[1] If you accept that the budget is not in great shape, it said, what would do to resolve it? It is impossible to rein in spending without hurting the poorest, but the government says we are without any alternatives. This report seeks to correct that assertion.

In fact, it is entirely possible to raise billions in revenue that can be used to assist disadvantaged communities, without relying on punitive and austere spending cuts. What's more, if the government wishes to ensure everyone is enlisted to do the budget's "heavy lifting", then identifying progressive revenue-raising opportunities is the most efficient means to do so.

The real budget problem

The Abbott government's 2014-15 budget said to Australia that spending was too high. The government threatened that if nothing changed spending would become unsustainable and we would all be made worse off.

At the same time that the government is claiming that spending is too high it has also announced that revenue is substantially lower than predicted. The Mid-Year Economic and Fiscal Outlook (MYEFO) for 2014-15 announced that over the forward estimates expected revenue had fallen $31.6 billion dollars.[2] Perhaps the government's sole focus on spending is not giving it the complete picture.

If you look at government spending and taxing as a percentage of Gross Domestic Product (GDP), which is the well-established way of looking at it, then the government's sole focus on spending is more difficult to understand. According to the budget papers the government has a revenue problem. In other words it is not collecting enough tax. Increased spending has only impacted on the budget in a relatively minor way.

Spending is up as a percentage of GDP. This is not surprising given the economy is slowing and unemployment is rising. When the economy grows at below trend then government spending tends to rise as welfare payments including unemployment benefits and family payments rise. MYEFO notes that unemployment payments are expected to rise by $966

[1] Murphy (2014) *Tony Abbott: budget will pass because no one has 'credible alternative'*

[2] Commonwealth of Australia (2014c) *Mid-Year Economic and Fiscal Outlook*

million over the forward estimates while family tax benefits are expected to rise $3.2 billion over the same period.[3]

If we look at the 12 years before the Global Financial Crisis (GFC) average spending was 24.1 per cent of GDP. Last year spending was 25.7 per cent of GDP. So spending is running above that average by 1.6 per cent.

In the Abbott government's first budget there were a number of unusual changes that have had the effect of inflating the spending figures by $11 billion. The largest of these was an unasked for $8.8 billion grant to the Reserve Bank (RBA). It is unusual to record this as an expense. The RBA is owned by the government and as such it is really just transferring money from its right pocket to its left pocket. After the transaction the government still has exactly the same amount of money which makes it very strange that it has recorded it as an expense.

The way the government recorded this transaction was also unusual. It should have been recorded as a below the line financing transaction which would not have appeared in the budget deficit. In fact the RBA recorded the $8.8 billion as a new deposit and the money simply moved from government deposits to other deposits so that it remained hidden.

If you take out the unusual spending items' then spending falls to 25 per cent of GDP. This means that currently spending is running at 0.9 percent above the average. With a slowing economy this is not that unusual.

The average revenue to GDP ratio during the 12 years before the GFC was 25 per cent but last year it was 22.8 per cent of GDP. Government revenue is therefore running 2.2 per cent below the average. Again it is important to note that the economy is slowing. During a slowing economy we would expect tax revenue to decrease.

This means that taxation is down substantially more than tax revenue is up. About 70 per cent of the current budget deficit is being caused by a drop in taxation and about 30 per cent is being caused by a rise in spending. This is why the budget has a revenue problem and not a spending problem.

While the revenue problem seems clear, the government's approach to reducing the budget deficit has been primarily to reduce spending. In doing so, the government is trying to match spending to unusually low levels of tax revenue and as a result it is being forced to make extremely unpopular cuts to services. Some of these measures are cuts to pensions, higher education and the introduction of a Medicare co-payment. Many people view these as an attack on universal education and health care. A survey by the Australia Institute found that only 19 per cent of people supported cutting spending if access to universal education and health was reduced, while 58 per cent were opposed to such cuts.[4]

The Abbott government has attempted to reduce the budget deficit primarily by targeting spending. This has meant that the savings proposed by the government have mainly impacted on lower income earners who are more reliant on the government services than higher income earners.

Various studies that have been done of the budget have shown that lower income households have been forced to bear more of the savings than higher income households. In fact high income households might actually be better off because of last year's budget, primarily because of the removal of the carbon price. NATSEM modelling of the budget

[3] Commonwealth of Australia (2014c)

[4] TAI (2015) *Australia Institute Survey - March*

shows that by 2017-18 the bottom 20 per cent of households would lose 2.2 per cent of their disposable income while the top 20 per cent of households would increase their disposable income by 0.2 per cent.[5]

A further break down showed that in 2017-18 the bottom 20 per cent of single parent households would lose almost 11 per cent of their disposable income and the bottom 20 percent of couple-with-children households would lose almost seven per cent of their disposable income.

Another analysis by Peter Whiteford and Daniel Nethery of the ANU showed that a 23 year old on Newstart would lose 18.3 per cent of their disposable income.[6] A single parent on Newstart with a child aged 8 would lose 12.2 per cent of their income.

The result was a budget that was labelled 'unfair' by the general public and major savings were stalled and rejected by the senate. In frustration the Prime Minister asked senators for alternative savings.[7]

The solutions

We have taken the up the Prime Minister's offer and this paper puts forward two different types of revenue proposals. The first are fully modelled and costed policy changes. They include;

- Changes to super tax concessions
- Restrictions on negative gearing
- Scrapping the capital gains tax discount
- Introducing a Buffet rule (minimum average tax rate on high income earners)

The second are revenue measures that have not been modelled. They include;

- Banking super profits tax
- Financial transactions tax
- Estate tax
- Restricting fossil fuel subsidies

With the previous budget being attacked mainly for being unfair, any future attempts by the government to reduce the budget deficit is more likely to succeed if it does not target low and middle income households.

The four modelled policies are not only designed to raise revenue in a progressive way but are also designed to remove distortions in the taxation system.

The changes to superannuation are designed to make super tax concessions work in the way they were originally designed to, as a way to make people more reliant on their own savings and less reliant on the government in retirement.

The changes to negative gearing and the scrapping of the capital gains tax discount are designed to end the distortion in the housing market that is making housing less affordable for low and middle income households.

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[5] NATSEM (2014) *NATSEM Budget 2014-15 Analysis*

[6] Whiteford et al (2014) *Sharing the budget pain*

[7] Griffiths (2014) *Prime Minister Tony Abbott signals budget compromise, calls on crossbenchers to offer alternatives*

The Buffett rule is designed to stop very high income earners from avoiding the progressive nature of the income taxation system by aggressively minimising their tax. It ends the cat and mouse game where people seek out and exploit loopholes in the taxation system.

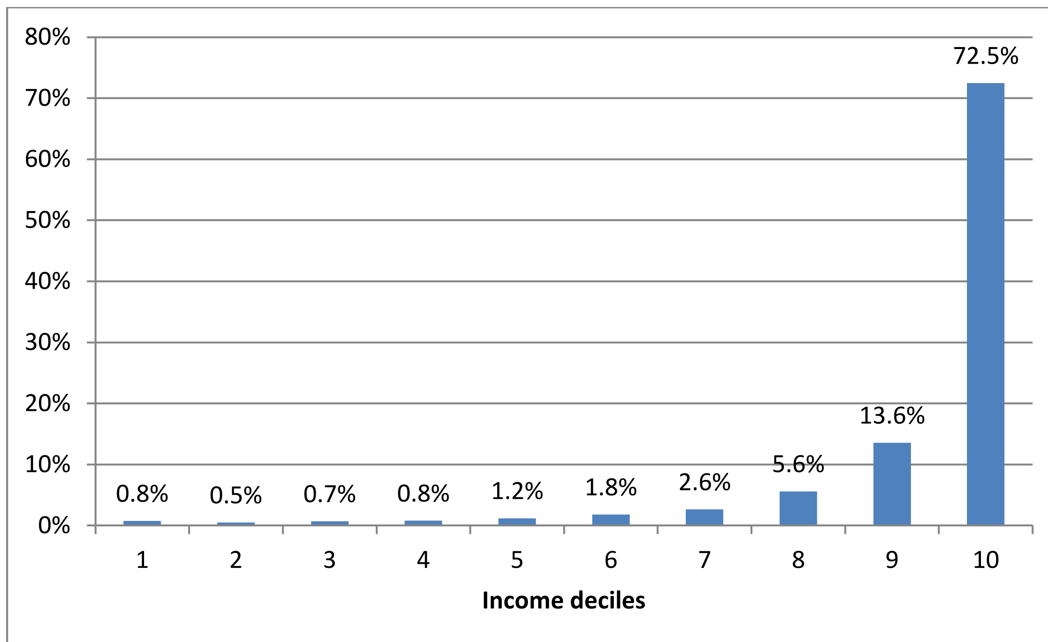
Each of the four policies and the amount of revenue they would raise are listed in table 4.

Table 4 – Modelled policies and revenue impact

Revenue measures	Estimate of revenue raised ($m)
Super tax concessions	$9,616
Restrictions on negative gearing	$3,491
Scrapping the capital gains tax discount	$4,039
Introducing a Buffet rule	$2,492

If these four policies were introduced they could raise up to $19.5 billion dollars a year,[8] the majority of which would come from high income households. The income distribution of all four policies is shown in figure 5.

Figure 5 – Income distribution of budget savings of four modelled policies



Source: NATSEM modelling

[8] It should be noted that the budget is not likely to raise the full $19.5 billion. This is because the policy changes do not include behavioural responses. As tax loopholes for high income households are closed these same households are likely to seek out other tax shelters. For example the Commonwealth Treasury estimates an eight per cent difference between the cost to the budget of super tax concessions on contributions and the revenue it would raise. If all four policies were introduced then it is likely to close many of these tax loopholes reducing any possible behavioural response.

Figure 5 shows that almost three quarters of the savings, $14.1 billion, comes from the top 10 per cent of households by income. The top 20 per cent make up 86 per cent of the savings. The bottom half of households only make up four per cent of the savings. The result is that the government can raise substantial amounts of revenue, correct distortions in the tax system and have a very limited impact on low and middle income households.

Beyond the modelled policies the government has other ways that it could raise revenue without distorting the economy. We have included four measures that the government could choose if it wanted to further reduce the budget deficit. These measures have not been modelled to the same extent as the policies listed above but are likely to be progressive and efficient.

These four measures are presented in Table 5.

Table 5 – Other revenue measures

Revenue measures	Estimate of revenue raised ($m)
Bank Super Profits Tax	$5,700
Financial transaction Tax	$1,000 to $1,400
Estate Tax	$5,000
Restricting fossil fuel subsidies	$11,517

There are many solutions to reducing the government's budget deficit apart from cutting spending. The government just needs to have the courage to defy special interest groups and pick some of them.

Superannuation tax concessions

Introduction

Australia's superannuation system was designed to help Australians save for retirement and be less reliant on the age pension and thereby take pressure off the federal budget. To encourage contributions to superannuation savings, lower levels of tax apply to aspects of the super system – superannuation tax concessions.

Superannuation tax concessions mean the tax rate that applies to "super" is a flat rate of 15 per cent. Contributions to super funds and the earning from super funds are both taxed at a flat 15 per cent. Contributions include the 9.5 per cent of wages that are paid into super funds as well as any additional salary sacrificed contributions.

For the vast majority of people this represents a lower tax rate than they would normally be charged. Only those earning $18,200 or less a year, who face a tax rate of zero, pay more tax on their super than on their other income.[9]

Super tax concessions mean that the government forgoes tax revenue they would otherwise collect. The granting of these tax concessions means that more tax must be raised in other ways and that these taxpayers are assisting people accumulating money for their retirement. There is a real cost in granting super tax concessions in the form of increased taxation in other areas or forgone government services. This is particularly important at a time when the government is cutting health, education and the social safety net in order to reduce the budget deficit.

At present, the main super tax concessions represent foregone revenue of $29.7 billion in 2014-15.[10] Treasury expects this to grow to $49.5 billion by 2017-18.[11] The concession on contributions is valued at $16.3 billion in 2014-15,[12] while the concession on super fund earnings is worth $13.4 billion.[13]

The size of the concessions, the foregone revenue, is growing three times faster than spending on the age pension. That's an annual growth rate of 13.6 per cent. By comparison Treasury expects the age pension to grow at a far slower rate of 4.5 per cent over the same period.[14]

At this growth rate the value of super tax concession for contributions and fund earnings will exceed the cost of the age pension in 2018-19.[15] This is important since the justification for super tax concessions is to reduce people's reliance on pensions. This means the very policy that is supposed to reduce the cost of the age pension will soon cost more than the age pension itself.

[9] At the moment the government offsets the additional tax paid through the low income super contribution. The low income super contribution has been repealed and is set to end in 2017-18. After this time some low income earners will pay more tax on their super than if they had earned it as income. That is they will face a negative super tax concession.

[10] Superannuation tax concessions on contributions and fund earnings represented 87 per cent of all superannuation tax concessions in 2014-15. Other superannuation tax concessions available at Commonwealth of Australia (2015) *Tax Expenditure Statement*

[11] Commonwealth of Australia (2014a) *Budget Papers: Appendix B: Tax Expenditures*

[12] Commonwealth of Australia (2015)

[13] Commonwealth of Australia (2015)

[14] Commonwealth of Australia (2014a)

[15] If all superannuation tax concessions are considered then they exceed the pension a year earlier in 2017-18

Rather than taking pressure off the federal budget, super tax concessions and the revenue they forego are becoming a burden on the budget. The Australia Institute has long argued that changing Australia's super tax concessions is important for the future of the federal budget.[16]

The inequity of super tax concessions

Not only are super tax concessions becoming a burden on the budget, but it is clear that they are being used more and more as a way for high income households to avoid tax rather than as a retirement income support measure.

Super tax concessions are a flat rate of 15 per for everyone earning below $300,000 per year. For those above $300,000 they are taxed at 30 per cent. This means that people on higher incomes are given larger tax concessions since income tax rates are progressive. Someone earning $250,000 per year is on the top marginal tax rate of 49 per cent[17] pays only 15 per cent tax on their super and so gets a tax concession of 34 per cent. A low-income earner on the minimum full time wage has a marginal tax rate of 21 per cent[18], but also pays 15 per cent tax on their super. They therefore get a tax concession of just six per cent. Annual incomes and the rate of super tax concession are shown in table 6.

Table 6 – Super tax concession by income

Annual Income	Super tax concession
$0 to $18,200	-15%
$18,201 to $37,000	6%
$37,001 to $80,000	19.5%
$80,001 to $180,000	24%
$180,001 to $300,000	34%
Above $300,000	19%

The Australia Institute commissioned the National Centre for Social and Economic Modelling (NATSEM) to assess the distribution of the current superannuation tax concessions by household income.[19] NATSEM made these estimates with its extensive data on households combined with:

- Australian Tax Office (ATO) statistics from 2011-12, updated to reflect 2014-15.
- ABS Employment Arrangements and Superannuation Confidentialised Unit Record File (CURF).

According to NATSEM's estimates, most of the benefit of super tax concessions is going to high income earners as shown in Figure 6 below:

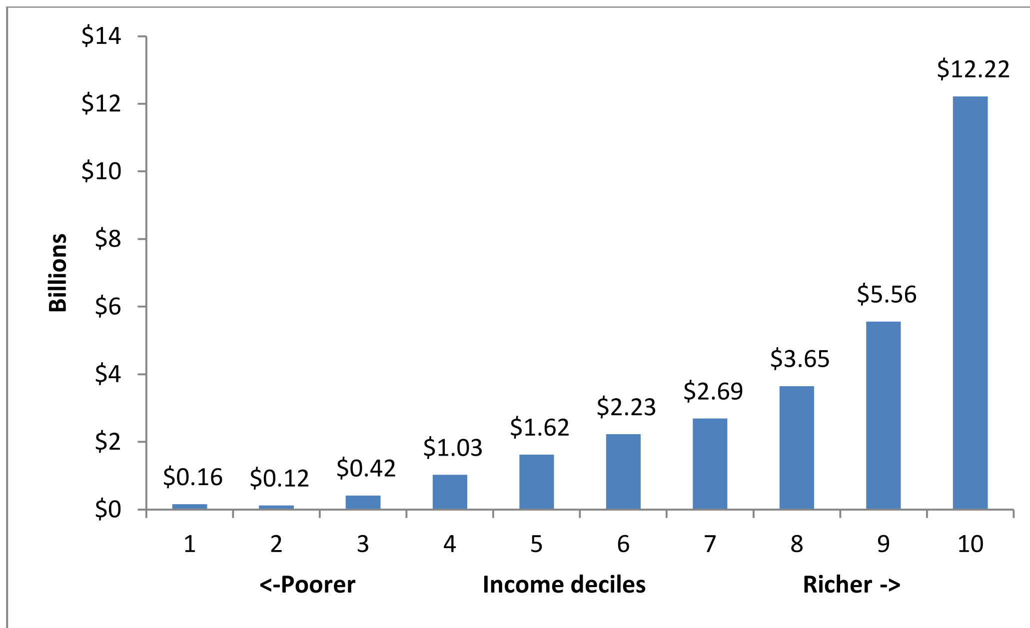
[16] Dennis et al (2011) *What price dignity?*, Dennis et al (2012) *Can the taxpayer afford self-funded retirement?*, Dennis (2013a) *Super for some*, Dennis (2013b) *Time to get engaged with super?*, Ingles (2009) *The great superannuation tax concession rort*, Ingles et al (2014) *Sustaining us all in retirement*

[17] This includes a 45 per cent tax rate plus 2 per cent medicare levy and 2 per cent temporary budget repair levy

[18] This includes a 19 per cent tax rate plus 2 per cent medicare levy

[19] Further information on the methodology used in the modelling can be found in Appendix A

Figure 6 – Distribution of super tax concession benefits by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

The benefits of super tax concessions are mainly accruing to the top 10 per cent of households, who claim 41 per cent of the tax concessions, worth $12.2 billion. The top 20 per cent of households receive 60 per cent of the tax concessions, worth $17.8 billion. This is compared to the bottom 50 per cent of households who only get 11 per cent of the tax concessions, worth $3.35 billion.

Furthermore, 20 per cent of the eligible population do not currently receive any age pension and this is predicted to continue for the next 35 years.[20] The top 20 per cent of households by income are likely to be heavily represented in the 20 per cent of people who will not claim a pension in the future. These are the households that are claiming the majority of super tax concessions at a current cost of almost $18 billion. In other words, most of the $18 billion in tax breaks designed to help people get off the age pension is being gained by people who would not be able to claim the pension anyway. These concessions are having no impact on reducing the future cost of the age pension.[21]

While the government is trying to push through unpopular spending cuts that mainly impact on low income earners,[22] cutting super tax concessions to high income earners seem to be a much fairer, more popular, and more economically responsible option. A survey by The Australia Institute found that 59 per cent of people were in favour of cutting super tax concessions to high income earners, with only 19 per cent opposed.[23]

[20] Commonwealth of Australia (2014b) *Towards Responsible Government: Phase One*

[21] It should be noted that if super tax concessions were removed the increase in government revenue would not be as large as the current value of the tax concessions. This is because people are currently using super tax concessions as a vehicle to reduce the amount of tax they pay. Some of the money flowing to super would flow to other low tax vehicles. Treasury do estimate the revenue gained and this works out at $27.3 billion for contributions and fund earnings. This is about 8 per cent lower than their current estimated cost.

[22] NATSEM (2014) *NATSEM Budget 2014-15 Analysis*

[23] TAI (2015) *Australia Institute Survey - March*

Super tax concessions – rationale and reform

In general, tax concessions should only be granted if they bring a societal or budgetary benefit. An example of a societal benefit that gains a tax concession is the tax exempt status of not for profit hospitals and other benevolent institutions. These institutions are considered to provide public goods and to encourage such organisations the government exempts them from paying tax.

An example of a tax concession that has a budgetary benefit is the exemption from the GST for private importation of goods worth less than $1,000. The cost of collecting the tax is believed to be more than the amount of tax collected. It is therefore a net gain to the budget to have this tax concession.

Super tax concessions are difficult to justify on the basis of a societal benefit. Increasing the amount of money that someone has in their super fund for the purposes of retirement, which is what the tax concessions do, is largely a private benefit.

Some argue that super tax concessions could provide a budgetary benefit. If people have more money in their super accounts when they retire they may no longer be eligible for an age pension or they may be eligible for a smaller part pension. Super tax concessions are effectively the taxpayer putting money into people's super accounts. This is justified if it reduces people's later reliance on taxpayer support through the age pension.

However, there is no evidence that this is occurring. Currently about 80 per cent of Australians who are old enough to qualify claim an age pension, with about 50 per cent on full pension and 30 per cent on a part pension.[24] The National Commission of Audit predicts by 2050, 35 years from now, the proportion of people on the age pension is expected to still be 80 per cent with full pensions dropping to 30 per cent and part pensions increasing to 50 per cent. While there may be an increase in the proportion of people on part pensions, there is expected to be no decrease in the proportion of people who receive an age pension.

Super tax concessions need to be reformed so they better fit the purpose of encouraging Australians to rely more on their savings in retirement and less on the taxpayer. For this to happen there needs to be less super tax concessions flowing to those who are unlikely to ever need an age pension and more flowing to those who are likely to be on a part pension. At the moment the reverse is true. Reforms targeted in this way will take pressure off the age pension.

Proposed reforms

The Australia Institute proposes reform to charge rates of tax on super contributions and fund earnings depending on the amount of income earned. Super tax concessions should be aimed at people who are most likely to require a full or part age pension. Concessions should not provide benefit to those who are unlikely to require taxpayer support in retirement. This is achieved by increasing the rate of taxation on super contributions and fund earnings as people's income rises. Our proposed super tax rates are set out in Table 7.

[24] Commonwealth of Australia (2014b)

Table 7 – Proposed super tax rates

Annual Income	New tax rate	Old tax rate	Difference
$0 to $37,000	0%	15%	+15%
$37,001 to $80,000	10%	15%	+5%
$80,001 to $180,000	22%	15%	-7%
$180,001 to $300,000	45%	15%	-30%
Above $300,000	45%	30%	-15%

Our proposal would remove all taxation on contributions and fund earnings for people who earn up to $37,000 per year. For middle income earners there is still a strong case for super tax concessions as providing them will push people onto smaller part pensions. The reform proposal sets the super tax rate on contributions for those earning between $37,001 and $80,000 at 10 per cent which is a lower rate than the current 15 per cent that they pay.

For those between $80,001 and $180,000 the super tax rate is increased from 15 per cent to 22 per cent. Individuals on $80,000 per year are just in the top 20 per cent of income earners and so the benefit of super tax concessions is reduced.[25] Cutting super tax concessions to them completely may well push some of them onto a part pension particularly at the lower part of the income range, so there is some justification for a super tax concession, but a lesser one than is currently given.

Those on more than $180,000 are in the top two per cent of income earners and are unlikely to qualify for an age pension. There is no justification for granting any super tax concessions. The super tax rate should be set at 45 per cent.

The Australia Institute commissioned NATSEM to estimate the tax revenue that would be raised by these changes. NATSEM made these estimates with its extensive data on households combined with:

- Australian Tax Office (ATO) statistics from 2011-12, updated to reflect 2014-15
- ABS Employment Arrangements and Superannuation CURF

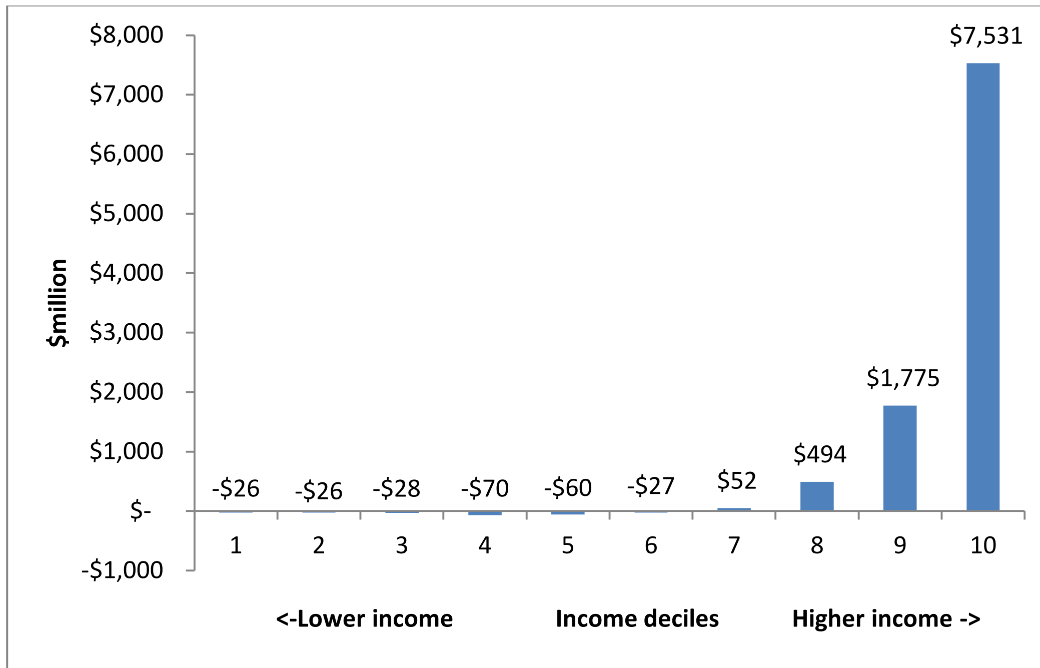
Distribution of super tax concessions

NATSEM estimates that this change to super tax concession rates would raise $9.6 billion in revenue. This policy change would see 60 per cent of households paying less tax on their super. They would reduce super tax concessions that go to those who do not need it and increase the benefit to those who do need it. A larger super balance for these households has the biggest chance of reducing pressure on the age pension.

The distributional impacts of these reforms by decile are shown in Figure 7 below:

[25] ATO (2014) *Taxation Statistics: Individual tax Table 14*

Figure 7 - Distribution of impacts of changes to super tax concessions by household income



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

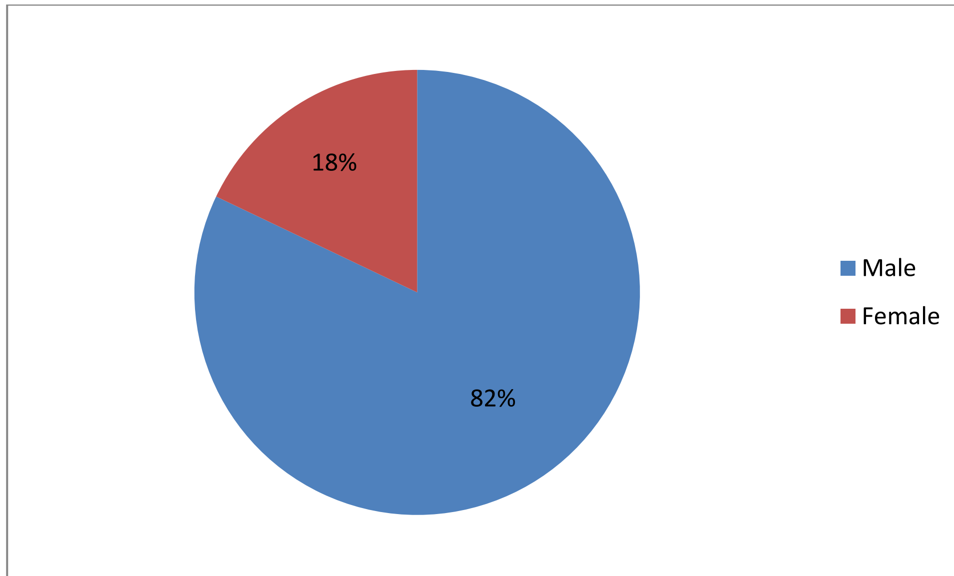
Figure 7 shows that most households (60 per cent) will be better off under these reforms. That is they will pay less tax on their super. Almost three quarters of the savings (74 per cent) come from the top 10 per cent of households. The top 20 per cent, who are least likely to be eligible for an age pension, make up 91 per cent of the savings.

Distributional impact by gender and age

NATSEM's modelling also looked at how the impacts of the proposed changes would be distributed by gender and age.

Figure 8 shows the gender distribution. It shows that over 80 per cent of the savings will come from males.

Figure 8 – Distribution of impacts of changes to super tax concessions by gender



Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

Males are over represented among high income earners while females are over represented among low income earners. Males are also likely to have significantly higher super balances than females. The very high proportion of savings coming from males highlights these disparities.

Table 8 shows the age distribution of super tax concession savings. It shows that those under 30 will actually be better off because of these changes. More super in someone's account at a younger age means a larger balance later in life because the money has been used for longer and compounds to a larger amount.

Table 8 - Distribution of impacts of changes to super tax concessions by age group

Age group	Proportion of total savings
Less than 30	-0.7%
30-39	12.6%
40-49	25.8%
50-59	27.7%
60-69	31.9%
70 or more	2.8%

Source: NATSEM, ABS Employment Arrangements and Superannuation CURF, 2007

Table 8 shows that the savings come mainly from higher age groups as workers move into higher paying jobs. Savings then rapidly decrease as people retire and stop contributing to their super accounts.

The case for superannuation tax concession reform

Any reform of super tax concessions should be focused on getting better value from taxpayer's money. It is clear that at the moment far too much of the concession is going to high income earners with a dubious long term benefit to the budget.

The purpose of superannuation has been subverted by the current concession arrangements. It is no longer just a system for improving the retirement earnings of Australians but is increasingly being used for estate planning and tax avoidance by high income earners.

A research paper from The Association of Superannuation Funds of Australia (ASFA) highlights the size and extent to which those with large superannuation balances are able to access tax free incomes.[26]

The ASFA report looks at data obtained from self-managed super funds (SMSFs). The report shows that there are 24,000 people in pension mode[27] that have account balances in excess of $2 million. These 24,000 people are effectively receiving a tax free income of $5.2 billion per year (an average income of $217,000). There are 75,700 people in pension mode with balances of a $1 million or more who receive tax free income of $10.1 billion per year (an average income of $133,000). All the remaining accounts in pension mode, 232,000 accounts, receive just $8.9 billion in income per year (an average income of $38,000).

The wealthiest super funds see 475 people whose funds are in pension mode that have account balances of more than $10 million. On average these people are receiving a tax free income stream of $1.5 million each.

The ASFA report goes on to say;

> *Income streams approaching or in excess of $1 million a year appear to be more related to tax planning and estate planning than for reasonable retirement expenditure needs.*[28]

It is clear that a substantial part of super tax concessions are being used for purposes other than to move people from publically funded pensions to privately funded retirement. The super system is now costing taxpayers substantial sums of money for little public benefit.

The focus of any government reform should not just be about reducing the large and growing size of super tax concessions going to high income earners. It should also focus on those on lower income households who are most likely to be on the pension.

Super tax concessions to lower income households are likely to give taxpayers far more value for money since increasing these super accounts will give more long term relief to the age pension. At the moment the bottom half of households get only 11 per cent of the value of super tax concessions.

After 2017-18 the situation will get even worse. This is when the Low Income Super Contribution Scheme will be abolished.[29] This scheme was set up because people under the tax free threshold paid no tax on their income but were still paying 15 per cent on their super contributions and fund earnings. Put simply they were paying more tax on their super than on

[26] Clare (2015) *Superannuation and high account balances*

[27] Pension mode is when the superannuation account is now paying out a stream of income.

[28] Clare (2015)

[29] Power (2014b) *Super tax refund for lower-income earners available until 2016/2017 year*

their income and so were getting a negative tax concession. The low income super contribution refunded the extra tax and payed it into their super fund.

When this scheme is abolished, those who are most likely to rely on the taxpayer in retirement will be penalised by super tax concessions. This will make them even more likely to require a pension in retirement. Such a situation makes no policy sense.

The principles of super tax concession reform

Some reform was started by the previous Labor government when it increased the tax on superannuation contributions and fund earnings for people on incomes above $300,000 from 15 per cent to 30 per cent.[30] More recently the now Labor opposition has proposed taxing superannuation incomes above $75,000 per year at 15 per cent and lowering the threshold for the 30 per cent tax rate on contributions and fund earnings from $300,000 to $250,000.[31]

These reforms are simply tinkering around the edges and will still see billions of dollars go to households that are unlikely to ever claim an age pension. A larger reform of super tax concessions is needed if taxpayers are to get better value for money.

Any reform of tax concessions should focus on the purpose of super tax concessions. Looked at this way super tax concessions are useful if they can reduce people's reliance on the age pension. Their purpose is not to grow the retirement incomes of those who would not claim a pension in the absence of any concessions. Its purpose is certainly not to allow high income households to minimise their taxation.

Conclusion

Reform of super tax concessions is overdue. Reform is required to get better value for taxpayer's money. The current system not only results in billions of dollars in tax revenue foregone every year, but fails to reduce the budgetary cost of the age pension. High income earners are unlikely to ever claim an age pension receive almost all of the benefit of the current tax breaks. At the same time more is needed to increase the super balances of middle and low income earners to move them onto smaller part pensions and off the pension completely.

The current tax arrangements for super contributions and fund earnings encourage high income earners to use super as a means of minimising tax. Changes made by the previous Labor government and proposed by the current Labor oppositions are little more than tinkering and will not reform the system the extent required.

Super tax rates should be based on the likelihood of those who receive them requiring an age pension. A flat rate of tax is inconsistent with this and gives more benefit to high income earners. It also encourages high income earners to use superannuation as a means to minimise their tax.

Super tax concessions were never meant as a means of tax minimisation and estate planning. It is time to reform superannuation so that it can be used in the way it was intended, as a means to make people more self-reliant in retirement.

[30] Power (2014a) *Double contributions tax for high-income earners*

[31] Australian Labor Party (2015) *Fact Sheet - Labors Plan for Fair Sustainable Super*

Negative gearing and the Capital Gains Tax discount

This section is taken from an Australia Institute paper released in April called *Top Gears*.[32]

What is the problem?

Negative gearing is the tax minimisation process where losses made on investments can be deducted from taxable income derived from other sources. In the instance of property, which is the target of the majority of Australia's negatively-geared investment, an investor borrows money to buy an investment property and rents the property out. If the rent being paid is less than expenses relating to the property, then this loss can be deducted from other taxable income.

Importantly, while the investor is making a loss on their property in cash terms and deducting this loss from their taxable income, the property itself is usually increasing in value. When the investor sells their investment property it is (hopefully for the investor) worth more than they paid for it. As the property is now more valuable, the investor has experienced a "capital gain".

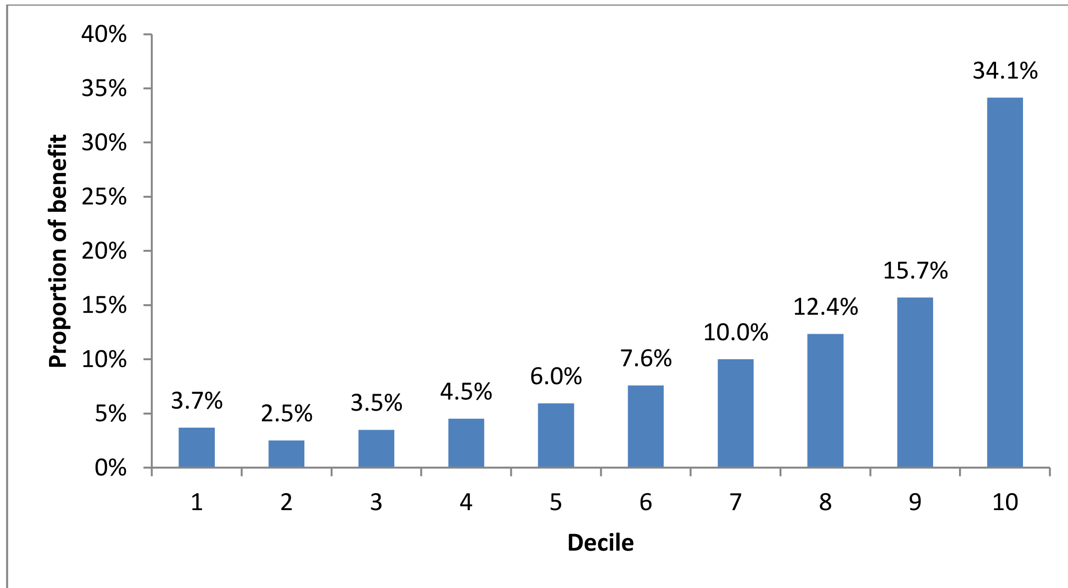
Capital gains are subject to capital gains tax (CGT). CGT is paid when an asset is sold for more than it was purchased for, minus some deductions. Since 1999, Australia has a 50 per cent discount on CGT if the asset was held for more than 12 months by individuals or trusts. The discount means that only half the capital gain on an investment property is subject to tax. So, for example, if a $100,000 capital gain was recorded, only $50,000 is taxed.

The combination of negative gearing and the capital gains tax discount is distorting the Australian residential property market, encouraging speculative behaviour and being used by predominately high income households as a tax shelter. These two policies combined result in significant forgone tax revenue for the Australian Government.

NATSEM estimates that negative gearing of residential investment property is currently reducing tax revenue by $3.7 billion per year. This tax discount is not evenly distributed. Half of the tax break flows to the top 20 per cent of households, while the lower half of Australian households receives only 20 per cent of the benefit of negative gearing.

[32] This section is a summary of Grudnoff (2015b) *Top Gears*

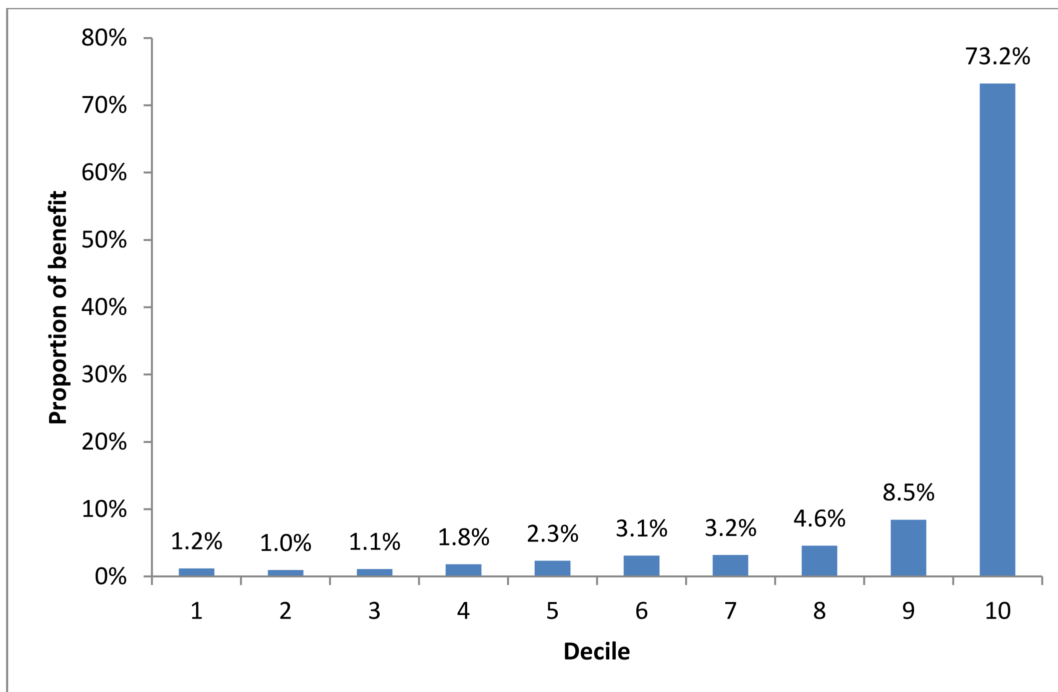
Figure 9: Distribution of negative gearing benefits by household income



Source: NATSEM, ATO (2014) *Taxation Statistics 2011-12*, updated to 2014-15

In regards to capital gains tax discounts, the skewed distribution of benefits is more pronounced, with the lower half of Australian households receiving 13 per cent of the benefits.

Figure 10: Distribution of the CGT discount benefits by household income



Source: NATSEM, ATO (2014) *Taxation Statistics 2011-12*, updated to 2014-15

The modelling shows that the majority of the benefits of negative gearing and the CGT discount, taken together, are not going to middle Australia (as is sometimes contended) but

rather to high income earners. 56 per cent goes to the top 10 per cent of income households and 67 per cent goes to the top 20 per cent.

By comparison, relatively little flows to low income households with just four per cent going to the bottom 20 per cent of households.

Together with the discounted capital gains tax rate, NATSEM found that these two tax perks are costing taxpayers $7.7 billion per year.

Proposal

The Australia Institute commissioned modelling from NATSEM to assess the distribution of benefits from negative gearing and the CGT discount, as well as how changes to these tax breaks would affect households of different income levels and age groups.

NATSEM calculated the changes to negative gearing and the CGT discount using data on households combined with the most recent Australian Tax Office (ATO) statistics from 2011-12, updated to 2014-15.

To understand how a reform of these policies might affect government revenue and different Australian households, NATSEM modelled a change to current policy of:

- Ending the CGT discount.
- Changing negative gearing on residential investment property to
    - Only apply to newly built housing
    - Only be deductible for 10 years after purchase of new housing
    - Grandfather existing negative gearing for five years.

The CGT discount was introduced by the Howard Government in 1999. It replaced the existing system that reduced any capital gain by the consumer price index. This was an attempt to remove inflation from the value of the capital gain. Introducing the CGT discount was a simpler method.

Removing inflation from capital gains tax means that income from capital gains is treated differently from other sources of income. Income earned from interest is taxed at its nominal rate (that is, the rate that includes inflation). There is no justification for why income from capital gain should be taxed differently to other forms of income.

In taxing capital gains differently we are preferencing those who earn income from capital over those who earn it from other sources, such as interest earned on bank deposits. The proposal then is to end the CGT discount and tax capital gains in the same way as all other sources of income.

The proposed policy change for negative gearing is only for residential investment properties and does not include negative gearing for other purposes. Losses from share market trading and commercial property could still be negatively geared.

Results

NATSEM estimates these changes would increase government revenue by $7.4 billion. The distribution of the impact of the policy change is shown in Table 9. It shows that more than half (56 per cent) of the revenue would come from the top 10 per cent of households, with 67 per cent from the top 20 per cent. Only 13 per cent of the revenue raised comes from the bottom half of households.

Table 9 – Distribution of impacts of suggested policy change by household income

Household income decile	Annual revenue increase from changes to Negative Gearing and the CGT discount ($m)	Proportion of total households
1	$173	2.3%
2	$123	1.7%
3	$163	2.2%
4	$225	3.0%
5	$293	4.0%
6	$379	5.1%
7	$463	6.3%
8	$598	8.1%
9	$866	11.7%
10	$4,099	55.5%
Total	$7,382	100.0

Source: NATSEM, ATO (2014) *Taxation Statistics 2011-12*, updated to 2014-15

NATSEM's modelling assumes that negative gearing applies to 10 per cent of residential properties that are newly built and have been held by their owners for less than 10 years. This is a conservative assumption since only six per cent of current residential investment loans are for new housing. It also factors in some possible behavioural change, as the amount of new housing being negatively geared is expected to increase if changes are made so that only new housing can be negatively geared.

The change in policy is likely to have a positive impact on the building of new housing, the intended purpose of the policy. Under modelled changes, people wanting to invest their money in residential property will find that buying new housing stock has a bigger tax advantage than buying existing housing stock. This could increase the current low rates of investment in new housing for rental.

When considering taxation policy a government should consider issues of efficiency and equity. Negative gearing and the CGT discount fail on both those criteria. It is time for the government to make significant changes to negative gearing and the CGT discount. There is a lot to be gained and very little to be lost.

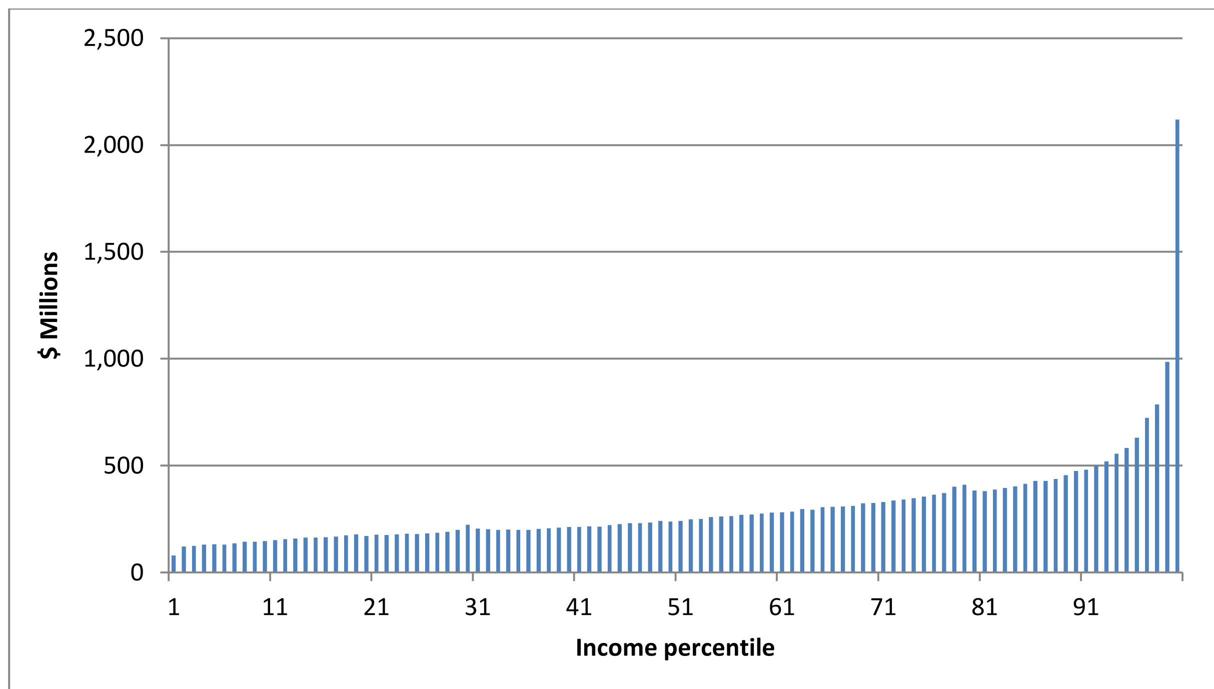
The Buffett Rule

This section is taken from an Australia Institute paper released in April called *Closing the tax loopholes: A Buffett rule for Australia.*[33]

Some very high income earners are undermining the progressive nature of Australia's income tax system by aggressively minimising their tax through deductions. Many deductions are complex and relate to investment income from shares, real estate and superannuation funds. Because many deductions relate to investments, the people who benefit from them are those who can afford such investments – namely, high-income earners.

The extent to which tax deductions accrue to high income earners is clear from Australia's taxation statistics. Figure 11 below shows the amount of money claimed through income tax deductions for each income group in Australia.

Figure 11 – Deductions at income percentiles[34]



Source: ATO (2014)

Figure 11 shows that deductions claimed rise steadily with income through low and middle income earners, but then increase exponentially for taxpayers with high incomes. The top one per cent of income earners, people earning about $300,000 per year, claimed over $2 billion worth of tax deductions – the same amount as the bottom 16 per cent.

In fact, Australian Tax Office statistics show that 75 individuals earned more than $1 million in 2011-12, but paid no income tax at all. They did this by finding tax deductions that reduced their taxable incomes to levels below the income tax threshold. In total, these 75 people had pre-tax income of $195 million, but reduced their taxable income to a mere $82.

[33] This section is a summary of Grudnoff (2015a) *Closing the tax loopholes: A Buffett rule for Australia*

[34] Income percentiles groups tax payers into 100 groups based on their taxable income. The 1st percentile is the group with the lowest taxable income while the 100th percentile is the group with the highest taxable income.

Each of these individuals earned more than a million dollars for the year but had an average taxable income of just $1.09.

Reducing taxable income does not come cheap. The Australian Tax Office statistics show that these 75 people paid, on average, almost $860,000 each to manage their tax affairs. Paying this money makes sense for high income earners - the tax saved is greater than the cost of saving it. But from the point of view of society it represents a flow of income away from the government and towards millionaires and tax advisors. Tax saved by these people increases the burden for less-wealthy taxpayers required to fund infrastructure and services.

The idea of the Buffett Rule

US billionaire investor, Warren Buffett, once said that he did not think it was fair that his secretary paid a higher effective tax rate than he did. He compiled a spreadsheet of his office staff, their income and effective tax rates, finding that although he was, unsurprisingly, the highest income earner, he also paid the lowest rate of tax. His principle of fair income taxation coined the phrase the "Buffett rule".

The Buffett rule suggests implementing a conditional floor on the average rate of tax people pay, which is triggered when their gross income puts them in the top marginal tax bracket. This creates a minimum average rate of tax for very high income households based on their total, pre-deduction income. This would mean that if very high income households are able to make large deductions to reduce their taxable income, they would not be able to fall below a certain threshold of average tax paid: this way, a billionaire cannot spend money on tax advice to lower their taxable income beneath that of their secretary.

Proposal

The Buffett rule requires a tax rate to be paid on total income. People earning exactly $300,000 per year with no deductions, the minimum income that the new tax would apply to, would pay an average rate of tax of 36 per cent. The Buffet rule tax rate should be set just below this rate, at perhaps 35 per cent. It is also important to note that this tax acts as a floor on the amount of tax paid. This tax would not apply to someone earning $300,000 or more who paid an average rate of tax above 35 per cent. Many high income earners do not aggressively minimise the amount of tax they pay; for them, this new rate of tax will not apply.

It should be noted that there are sound policy reasons for some tax deductions and this rule would not prevent them. It merely places a limit, so that high income earners can't end up paying a lower average rate of tax than middle income earners.

To estimate the revenue that might be collected by an Australian Buffet rule, The Australia Institute commissioned modelling from NATSEM. NATSEM used STINMOD, their economic model, to calculate the revenue and distributional effects of implementing such a tax.

Results

NATSEM estimated that a Buffett rule, with the parameters discussed above, would raise an additional $2.5 billion per year for the government.

Table 10 – Revenue from an Australian Buffett rule

Revenue raised (pa)	Number of households affected	Average impact of affected households
$2,492 million	31,524	$79,053

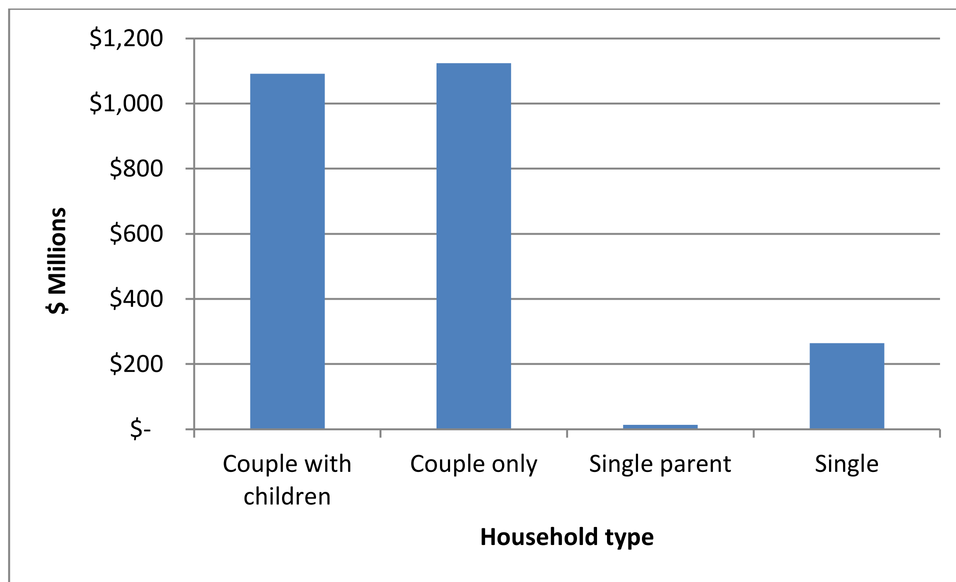
Source: NATSEM

In addition to revenue, the modelling of the distributional results reveals the policy's progressive impacts on a number of fronts.

This tax change would apply only to very high income earners. This tax simply allows Australia's progressive income taxation system to operate in the way in which it was intended; that is, taxing high income earners at higher rates than low income earners. All the revenue is raised from those in the top 10 per cent of households by income.

Single parents contribute only one per cent of the revenue raised by the modelled Buffett rule, which is important as it does not decrease the after-tax income of families or households most prone to financial stress.

Figure 12 – Impact of an Australian Buffett rule by household type



Source: NATSEM

Estimates of the gender distribution of impacts of a Buffett rule reveal that the overwhelming majority of those subject to the rule are men. Females contribute 10 per cent of revenue raised by the Buffett rule, compared with 90 per cent contributed by males.

Table 11 – Impact of an Australian Buffett rule by gender

Gender	Revenue raised (pa)	Proportion of revenue raised
Male	$2,241 million	90%
Female	$251 million	10%

Source: NATSEM

While it is important for governments to continue to close tax loopholes, a Buffett rule reduces the value to very high income households of pursuing these tax loopholes.

NATSEM modelling commissioned by The Australia Institute estimates that $2.5 billion per year would be raised from a Buffet rule tax arrangement in Australia, in a progressive, equitable manner. A Buffett rule simply allows Australia's progressive income taxation system to operate in the way in which it was intended, by reducing the incentive for the wealthiest Australians to minimise their taxable income, thereby increasing government revenue by supporting the integrity of Australia's personal income tax system.

Other revenue measures

Introduction

The question of how to find revenue measures that can be levied in an equitable, moderate manner is one with no shortage of solutions. The preceding proposals merely scratch the surface of worthwhile alternatives to the government's preferred austerity measures.

Below, we introduce a range of complementary measures. These need not be read as either/or proposals; rather, the following are best considered a menu of potential revenue-raisers. Like the rest of the report's content, these options are progressive, revenue-raising measures that will collect billions for Treasury without hurting low-income Australians. They are measures that are efficient as they will not distort the economy. These revenue measures are listed in table 12.

Table 12 – Other revenue measures

Revenue measures	Estimate of revenue raised ($m)
Bank Super Profits Tax	$5,700
Financial transaction Tax	$1,000 to $1,400
Estate Tax	$5,000
Restricting fossil fuel subsidies	$11,517

These options have not been modelled to the same degree of detail as policy options such as negative gearing and capital gains tax, superannuation tax concessions, and the Buffett rule. As such, these are offered not as fully-costed policies but as an illustration of the wide range of options available to Treasury, each of which must be preferred to spending cuts on services disproportionately relied-upon by low-income households.

Indicative estimates of revenue generated from each option are provided below, along with descriptions of their design and their benefits. These policy options are consistent with progressive tax principles, where those most able to pay are asked to pay most. They serve as fair, reasonable opportunities for the government to reduce the budget deficit, and should be the first place the government turns.

Bank super profits tax

According to IMF figures which give the share of the market accounted for by the top four banks in each country examined, Australia has the most concentrated banking industry among the developed economies of the world.[35] The latest figures show that the big four banks account for 80 per cent of bank assets in Australia.[36] Recent profit figures for each of the big four are given in table 13.

[35] IMF (2012) *Australia: Financial system stability report*

[36] APRA (2015) *Monthly banking statistics, January*

Table 13 – Profit of the big four banks in Australia

Bank	After tax ($m)	Before tax ($m)
ANZ	$7,283	$10,308
Commonwealth Bank	$8,650	$11,997
National Australia Bank	$6,802	$7,955
Westpac	$7,625	$10,740
Total	$30,360	$41,000

Source: Annual reports

Big banks act as a sort of tax collector by overcharging for access to the payments system which is basically a utility. In addition banks tend to charge whatever the market will bear. Economies of scale, technology and other innate advantages of the big banks are used for their own advantage rather than passing cost savings on to their customers.[37] In addition the fact that banks are owned by the same institutions suggests they may not act as independent companies.

As a result the big four banks earn pre-tax profits of $41 billion or an average return on equity of well over 20 per cent.[38] This is well over the profitability that would occur in a competitive industry and is reflected in the fact that bank stocks trade at a substantial multiple of their book value or the value of shareholders' funds. Super profits worth some $18 billion are generated by the big four banks.

For the mining industry super profits were defined as a return equal to the 10 year bond rate plus seven per cent. At the moment that would imply a rate of less than 10 per cent. This reflects the abnormally low interest rates at the moment. On the other hand a seven per cent premium seems a bit high for what is effectively a utility with predicable cash flows from year to year. Hence 12 per cent seems a justifiable figure and certainly includes a good conservative allowance in favour of the banks.

As a tax on the super profits earned by banks there is no reason for the banks to change their behaviour in any way and that will be reinforced by the limited competition big banks get from the smaller banks. As such a super profits tax is favoured by economists as it does not change behaviour or distort the market.

A tax surcharge of 30 per cent on all profits of the big four banks above a threshold 12 per cent pre-tax rate of return on equity would have raised $5.7 billion in 2013-14 and can be expected to increase substantially in years to come.

Financial Transaction Tax[39]

How are things working at the moment?

High-frequency traders (HFTs) use powerful computers to trade large volumes of assets at very high speeds, completing transactions in a fraction of a second. High-frequency trading (HFT) involves the buying and selling of large volumes of securities such as stocks or

[37] See Richardson (2010) A Licence to Print Money: Bank profits in Australia, and Richardson (2012) The rise and rise of the big banks: Concentration of ownership

[38] All figures are calculated by TAI based on data in the annual reports of the banks for 2013-14.

[39] This section is a summary of Amos (2015) *Australia's Tobin Tax: Arguments and evidence*

derivatives for very short periods of time - often for only fractions of a second. HFT uses sophisticated computers and mathematical algorithms designed to capitalise on millisecond-long discrepancies in stock prices. HFTs are able to buy up the shares that normal investors have ordered, pushing up the price, before selling at the higher price to normal investors, who are unable to process their orders at such speeds.

How would this proposal fix it?

A Tobin tax (also known as a Financial Transactions Tax, or FTT) would reduce the volatility of capital markets that HFT creates, as incentives to trade large volumes exacerbating minor markets movements are reduced by the tax. A Tobin tax could also work to keep more investors on public exchanges and away from less transparent "dark pools". This would improve transparency and the price formation function of capital markets. In doing so, a FTT similarly raises revenue, improves average investor returns, and lowers the risk associated with excess liquidity.

What revenue would it raise?

Using conservative estimates using conservative assumptions on tax elasticity, regulatory cost impositions and evasion rates, The Australia Institute has estimated a tax levied at rates between 0.01 and 0.4 per cent depending on the instrument would raise $1 billion to $1.4 billion a year. Its design is based on a similar structure to that proposed by the European Commission. Crucially, this would also dampen speculation and reduce the prevalence of "front-running" in the capital markets, allowing longer-term institutional investors and self-managed super funds greater access to market information, increasing profitability and eliminating financial scalping by up to $1.9 billion a year.

Estate tax

Estate duties can perform important functions in addition to raising revenue. Estate duties support the progressivity of the tax system as a whole by way of a levy on wealth at least once a generation. They also limit the growth of large accumulations of wealth that reflect the often arbitrary and occasionally criminal circumstances of the deceased. The latter is particularly important given the need to address the worsening inequality with undesirable consequences for social cohesion in Australia.

During 2014 the world was alerted to increasing income inequality by the influential work of Thomas Piketty.[40] Piketty explained too that nothing was inevitable and the increasing inequality could be addressed with appropriate fiscal policies. While Piketty suggested addressing accumulations of wealth with an annual wealth tax, estate duties have the advantage that the tax applies at the time when the deceased's affairs need to be managed and re-ordered. In addition, estate duties raise the revenue before the wealth is passed on to beneficiaries.

Previous estate tax

In 1966-67 Australia's estate and gift duties at both the state and federal levels raised $155.8 million or 0.6 per cent of GDP according to the 1975 Taxation Review Committee.[41] The equivalent today would be approximately $10 billion per annum by 2015-16. Just prior to the abolition of the estate and gift duties the estate duty rates, at the Commonwealth level, started at a relatively low rate (3 per cent) and began at a relatively low threshold ($20,000 or

[40] Piketty (2014) *Capital in the twenty-first century*, Cambridge Mass: Harvard University Press,

[41] Taxation Review Committee (1975) *Full report*

$232,000 in today's prices). However, after $1 million ($11.6 million today) the tax rate increased to 27.9 per cent at the federal level.

At the time the estate duties were known to lack integrity and estate planning had been playing havoc with the revenue. We cannot put an estimate on the value of the tax avoided; however, we would expect it to be a very large proportion of the amount actually collected. The Taxation Review Committee said that it was virtually only paid by those 'who died unexpectedly or who had failed to attend to their affairs with proper skill'. The tax was largely regarded as voluntary.

Results

Rejigging the rates and thresholds to exempt everything up to $2 million and imposing rates of 20 per cent thereafter and 30 per cent above $10 million should again raise something of the order of $5 billion or around 0.3 per cent of GDP as a conservative estimate – about the same as European countries that operate such a tax.

These estimates are necessarily subject to a good deal of uncertainty. However, we think that exemptions for family farms should be consistent with this estimate given that the value of the agricultural net capital stock is only three per cent of the aggregate net capital stock of Australia (excluding that in public administration which is allocated to the public sector).

Fossil fuel subsidies

The Abbott government has cracked down on some cash subsidies to industry. The most notable was to the car industry and the canned fruit manufacturer SPC. These cut backs represent the most obvious of government subsidies but there are larger subsidies that are less well known.

The biggest of these are tax concessions. Tax concessions are where the government lets you legally pay less tax. While cash subsidies from the government attract attention because there is a formal transfer of funds, tax concessions attracts less attention because there is no transfer of funds. Instead each year the firm or individual pays less tax.

In terms of direct benefits there is no difference between a $1 million cash transfer from the government and a $1 million tax concession. There are however less tangible benefits from receiving a tax concession over a direct transfer.

While tax concessions tend to attract less scrutiny than direct transfers, some argue that tax concessions are not real subsidies. They argue that even though the main source for figures on tax concessions is the Commonwealth Treasury, that the figures are unreliable.

Business lobby groups generally try to down play the importance of tax concessions. It is not hard to see why given the size of some of these tax concessions. If the government wants to reduce the budget deficit then it could do so by reigning in some of these tax concessions.

The tax concessions being targeted are set out in table 14. These concessions are worth $11.5 billion to the firms who claim them.

Table 14 - Selected tax concessions

Subsidy	Year	Subsidy amount ($m)
Fuel tax credits	2015-16	$6,822
Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	2015-16	$1,310
Excise concession on 'alternative fuels'	2015-16	$450
Statutory effective life caps	2015-16	$1,930
Capital works expenditure deductions	2015-16	$1,005
Total		$11,517

Source: Commonwealth of Australia (2015) *Tax Expenditure Statement* and Commonwealth of Australia (2014a) *Budget Papers: Appendix B: Tax Expenditures*

They can be broken into two groups. Concessions which encourage the use of fossil fuels and concessions that allows firms to write off the value of their assets more quickly.

Fossil fuel subsidies encourage the use of fossil fuels. With the government set to spend billions of dollars on direct action in order to reduce greenhouse gas emissions it is highly inefficient for the government to be encouraging businesses to use more fossil fuels.

There are good economic reasons to impose taxes on fossil fuel given the consumption of these fuels produces what economists call negative externalities. This means that the free market will over supply these goods to the detriment of society. The solution that economists put forward is to tax these goods.

The fuel tax credit scheme allows some businesses to get a large discount on how much tax they pay on the diesel they use.

Concessional rates of excise levied on aviation gasoline and aviation turbines means that this form of fossil fuel pays a lower rate of tax than other fossil fuels.

Excise concessions for 'alternative fuels' means that some fuels such as liquefied petroleum gas, liquefied natural gas and compressed natural gas get a 50 per cent discount on the tax that other fossil fuels pay.

These fossil fuel subsidies add up to $8.6 billion every year.

The second group are tax concessions that increase the rate of deprecation. Deprecation is where the value of capital equipment goes down over time as it gets used up. The Australian Tax Office (ATO) lists all capital equipment and the rate at which they deprecate. Businesses who own capital equipment can write off the value of the depreciation against their income.

Statutory effective life caps allow firms to increase the rate of depreciation above that of the ATO. This means that firms who own these assets can claim a larger tax concession each year. The assets that increased rates of depreciation apply to include aircraft, trucks, truck trailers, buses, tractors and harvesters. These are assets that primarily use fossil fuels.

The other depreciation concession is capital works expenditure deductions. This allows firms to increase the rate of depreciation on capital works expenditure. This is a faster rate than that set out by the ATO.

The fossil fuel subsidies combined with faster depreciation add up to $11.5 billion each year.

The government has targeted industry subsidies arguing that businesses should stand or fall without money from the taxpayer. So far only a relatively small amount of money has been saved by cutting some industry subsidies. The government could collect far more revenue if it targeted industry tax concessions.

Conclusion

Reducing the budget deficit does not have to be about cutting government spending to low income households. The majority of the deficit is caused by too little tax revenue rather than too much spending. This means that trying to reduce the deficit by only cutting spending will simply mean smaller government and a reduction in services that the public have come to expect should be supplied by government.

If the government's aim is to reduce the size of government then they should do away with the rhetoric of the budget being 'unsustainable' and instead sell their ideal of smaller government as a reason for the cuts. Then the voting public can decide if they want smaller government or they want high quality education that is universally available. They can decide if they want high quality health care that is based on need. They can judge each of the government's prosed cuts against any desire they may have for smaller government.

If on the other hand the government is truly concerned about the budget deficit and have no wider ideological agenda then there are many budget measures the government could introduce that will not disproportionately impact low income households. This paper has suggested many measures that would reduce the budget deficit by billions of dollars. The revenue would be raised in a progressive way, impacting those who can afford to pay more and doing so in an economically efficient way that would not distort the economy. In many cases the measures would actually reduce distortions that currently exist.

If the Abbott Government takes seriously the concerns about its previous budget being unfair then it needs to look wider than simply slashing spending. If it does then it will see there are plenty of options for a brighter budget.

Appendix A - Modelling methodologies

There were four measures in this paper that were modelled by NATSEM. This appendix will briefly describe the modelling methodology.

All the modelling was done on a 'day after' basis. That is the model is static as it does not assess its dependent variables across more than one period. This means it does not take into consideration behavioural change, and instead gives 'day after' impacts of a change to the government's system of tax and transfers. In other words, the model's primary focus is on the initial change, rather than change on change.

Superannuation tax concessions

Super tax concessions were estimated using an updated version of the ABS Employment and Superannuation survey from 2007. NATSEM updated income, superannuation balances and contributions and age group populations in line with known growth rates to December 2014.

The two taxation concessions modelled were investment incomes and contribution concessions. Concessions were estimated by comparing tax currently paid under the existing legislation compared with a range of alternative policy setting. To estimate 'tax concessions' NATSEM compared the existing superannuation taxation arrangements with the existing personal income taxation scales. Some minor adjustments were made to align the overall value of tax concessions to that of the latest estimate for tax expenditure by The Treasury.

Negative gearing and capital gains tax discount

NATSEM calculated the changes to negative gearing and the CGT discount using NATSEM's extensive data on households combined with the most recent Australian Tax Office (ATO) statistics from 2011-12, updated to 2014-15.

Buffet rule

The Buffett rule used NATSEM's STINMOD to model changes in tax policy.

STINMOD, or the Static Income Model, is a microsimulation economic model developed by the NATSEM, which is used to simulate the effects of changes to policy on Australian household incomes. The model allows for detailed assessment of changes to differing levels of specificity, ranging from a population, to a cohort, to a group of individuals, to a household, and to individuals.

The model is static as it does not assess its dependent variables across more than one period. This means it does not take into consideration behavioural change, and instead gives 'day after' impacts of a change to the government's system of tax and transfers. In other words, the model's primary focus is on the initial change, rather than change on change.

The model's database is based on data from the Australian Bureau of Statistics, in particular the Household Income and Expenditure Survey and other related catalogues. STINMOD categorises its base files into demographic, income and household composition, which allows the modeller to simulate multivariate impacts of policy change. The model is regularly updated for income and population changes, and the parameter datasets of income source are adjusted with policy changes.

The model simulates the adjusted household income in response to exogenous changes, or shocks, in both entitlement and liability, which produces outputs that give indications to the

topline and distributional effects of that change on the population. Because of the microsimulation foundations of the economic model, STINMOD can granulate the results to focus on "cameos", or effects on targeted specific groups, as well as estimating broader effects.

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