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## 1. Introduction

This submission considers 'Individuals' and 'Savings' including bank accounts, investment in shares and property, and superannuation.

Presently taxation of each of these saving types, except superannuation, is based on individual income tax rates.

## 2. Income tax

In 2011-12, the distribution of income tax paid according to income level was;

| Taxable income band | No. individuals '000 | Av. Tax per individual | Total income tax - $B | Total income tax - % |
|---|---|---|---|---|
| **0 to $16K** | 2,308 | Nil | Nil | Nil |
| **$16K to $37K** | 3,453 | $1,536 | $5.3B | 3.7% |
| **$37K to $80K** | 4,746 | $9,987 | $47.4B | 32.8% |
| **$80K to $180K** | 1,836 | $29,411 | $54.0B | 37.4% |
| **Over $180K** | 292 | $128,888 | $37.7B | 26.1% |
| **Total** | 12,636 | $11,396 | $144.4B | 100% |

Individuals in the first two income bands ( ˜ 6 million) paid little or no income tax.

Individuals in the subsequent three income bands ( ˜ 7 million) contributed more than 96% of total income tax paid.

Current (2014-15) individual income tax rates are;

| Taxable income band | Marginal rate | MR + Medicare | + Budget Repair Levy |
|---|---|---|---|
| **0 to $18.2K** | Nil | | |
| **$18.2K to $37K** | 19% | 19% + 2% | |
| **$37K to $80K** | 32.5% | 32.5% + 2% | |
| **$80K to $180K** | 37% | 37% + 2% | |
| **Over $180K** | 45% | 45% + 2% | 45% + 2% + 2% |

The 2014-15 tax rate settings generate the following income tax payment levels;

| Individual | Income | Marginal rate | Tax Paid | Average tax rate |
|---|---|---|---|---|
| **Av. Earnings – All employees(1)** | $59,000 | 32.5+2% | $11,900 | 20.2% |
| **Av. Earnings - F/T employees(1)** | $77,000 | 32.5+2% | $18,100 | 23.5% |
| **Higher earnings** | $130,000 | 37.5+2% | $38,600 | 29.7% |

(1) Source- ABS November 2014

Individuals on average earnings have a marginal income tax rate of 34.5% and an effective or average income tax rate well in excess of 20%. An individual earning at the mid-point of the second highest marginal rate bracket ($130,000) pays nearly 30% of earnings by way of income tax.

The above data confirms that middle and higher income earners suffer a disproportionate level of income tax burden due to the nature of the marginal tax rate system.

High marginal tax rates apply to average income levels. The current marginal tax rate levels are counterproductive and act as a disincentive. PAYG earners would be better motivated to increase productivity and earnings by moderating the present highly progressive income tax system. The lack of inflation adjustment to marginal tax rates and subsequent bracket creep further aggravates this situation. Review of the marginal tax rate system in harmony with reform of savings taxation would be desirable objectives, as would less reliance on personal income tax revenue in general.

## 3. Savings

Cash - consider the return of a bank account using real data over a ten year period:

Period: FY 2005 to 2014.

Annual Cash Rate: Source - JANA Investments

Average CPI: 2.7% pa

| Tax Rate + Medicare Levy | Cash – ROR after tax | Cash - ROR after tax and inflation |
|---|---|---|
| **0** | 5.0% | 2.3% |
| **19% + 2%** | 4.0% | 1.3% |
| **32.5% + 2%** | 3.3% | **0.6%** |
| **37% + 2%** | 3.0% | 0.3% |
| **45% + 2%** | 2.7% | Nil |

The net annual cash rate of return over this ten year period for an individual on average earnings was **0.6%** after tax and inflation. Most savers - and investors - would consider this to be a very poor net rate of return and a disincentive to saving. Note that the average gross rate of return (before tax and inflation) for this period was 5.0%. Of course at the present time pre-tax cash returns are substantially lower than the period considered above.

So is it fair to apply a marginal rate income tax to interest from after-tax funds held in a personal bank account? An objective assessment concludes it is not reasonable to do so.

A fair, consistent and efficient system for the taxation of bank account interest for all individuals is proposed in the table below;

| Cash Rate (CR) % | CR% less CPI% | Tax Rate on interest |
|---|---|---|
| **0-5%** | | **0** |
| **5-10%** | **<5%** | **0** |
| **5-10%** | **>5%** | **15%** |
| **Over 10%** | | **15%** |

For example: If CR = 7% and CPI = 3%, the difference is 4% (<5%) and no tax is payable.

If CR = 8% and CPI = 2%, the difference is 6% (>5%) and tax is payable.

A more consistent approach across all saving (cash, fixed interest, superannuation) and investment (property and shares) categories is imperative. This will improve fairness, simplicity and efficiency in the taxation of our savings and investments. Tinkering and inconsistent taxation treatment of asset classes leads to complexity, high administrative cost, unintended consequences, depression of investment activity and ultimately lower taxation income.

Capital Gains Tax –

> Reintroduction of CGT on undiscounted net capital gain (i.e. after expenses and inflation) for investment property and shares. A taxation rate of 15% applies.

Dividends –

> Maintain the dividend imputation system as this precludes the double taxation of (Australian) company profits which is equitable. Otherwise a taxation rate of 15% applies. Individuals choose a savings/investment strategy taking into account numerous factors such as perceived risk/return as well as potential taxation treatment. Australian investors would do well to consider greater involvement in foreign equity markets however varying taxation regimes should not be the motivation for doing do.

Negative gearing –

> May apply to expenses involved in producing income such as investment property and share investments. Personal income tax relief when investment asset expenses exceed asset income should be set at 15%. To be consistent and fair to all taxpayers, when childcare expenses are incurred to facilitate income production then this should be treated as an expense - in the same manner as all other forms of income production.

Superannuation –

> In the accumulation phase, super contributions (subject to certain limits) and earnings are taxed at 15%. In the retirement phase there is no tax paid on earnings or withdrawals which is consistent with the untaxed status of the age pension. Currently around 30% of retirees receive no age pension, 28% receive a part-pension and 42% receive a full pension. The proportion of part-pension recipients to full pension recipients is expected to increase with the maturation of the superannuation guarantee system commenced in 1992. Even though Treasury demographic projections show the proportion of over 65s will increase from around 15% (2014-15) to 22% (2054-55), the outlay on age pensions is expected to decrease from 2.9% GDP (2014-15) to 2.7% GDP (2054-55).

Therefore, despite the aging population, the current super system is working effectively toward reducing the reliance on age pensions for retirees and a lower proportion of GDP expenditure.
There is justification to place an upper limit on the untaxed retirement super account balance. A deemed income equal to average earnings (say $60,000) based on the conservative balanced fund (50% growth/50% defensive assets) benchmark return may be reasonable. Deemed income exceeding this level would be taxed at 15%.

## 4. Conclusion

By necessity this is a brief document which does not attempt to consider policy aspects of the proposed changes or modelling of outcomes. Reform of taxation in the area of personal saving and investment must be considered as part of reform to the wider tax system. To ensure consistency, fairness and efficiency, tax on consumption (GST) and tax on production (company tax) may require realignment. If reform is not undertaken in a properly balanced manner then the costs of running the system will remain whereas income will inevitably be lower than forecast.

We should avoid the use of terms such as budget 'winners and losers' or 'high income earners' as they are divisive and too often used by interest groups and those seeking to get someone else to subsidize others. Many appear to have been brainwashed into accepting that 'high income earners' are the solution to every tax or budgetary challenge whereas of course they are not and already make a substantial contribution. The highly progressive nature of personal income tax means that barely half of the working population contributes nearly all of the country's income tax.

We need to focus on attracting and retaining high calibre individuals and organizations and a competitive, consistent taxation system is fundamental to achieving this objective. Otherwise the high cost of living and doing business in Australia will continue to dampen sustained growth and development of a versatile economy.

The taxation system is the income generator of our economy and we could observe a few simple principles - hopefully self-evident but unfortunately not often apparent - to safeguard our economic viability and ensure the nation's future prosperity.

- Spend less than your earn
- Inconsistency causes unintended outcomes and complexity, creating high costs
- Growth is not the solution, more often it causes the problem
- Exceptions contribute to inefficiency, creating high costs
- Lower tax rates means more tax collected