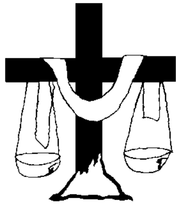

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Submission to the Review of Australia's Future Tax System

The Catholic Social Justice Commission ('the Commission') supports the Archdiocese of Canberra and Goulburn in advancing social justice and enhancing the dignity of every individual in accordance with the social doctrine of the Catholic Church.

Core principles

The Commission considers that two broad principles should guide the conclusions of the tax review. One is the 'common good'. The other is a 'preferential option for the poor'.

The principle of the common good is not held exclusively by the Catholic Church. In one form or another, it is widely accepted by people of all faiths and of none. In essence it is saying that the encouragement of narrow self-interest is not of itself an adequate basis for the formulation of public policy. The needs of society as a whole are fundamental.

The principle of a preferential option for the poor is more specific. Put simply, it is saying that the interests of society's most disadvantaged members are paramount. Again, the Catholic Church is not alone in holding this view. In one form or another, the principle is widely shared across the religious, social and political spectrum. It underpins the very existence of social security and progressive income tax.

Neither principle is an argument for absolute equality of income and wealth. Work and savings effort will vary from one individual and business to another. Economic returns should take some account of these differences.

Both principles, however, present a strong case for avoiding extremes of wealth and poverty. They also imply high levels of employment. Unemployment goes hand in hand with poverty, and is inconsistent with human dignity.

Practical application of these principles

It is one thing to state these principles in the abstract. It is quite another to make practical judgements of how best to advance them in concrete policy. Their realisation depends not just on the direct impact of particular measures but also on the indirect consequences:

- Such measures influence decisions to work, save and invest
- They can make it easier or harder for people and families to improve their own situations by their own efforts
- The revenue gains or losses from specific measures vitally affect governments' capacity to fund programs for the disadvantaged
- Tax initiatives can interact with social security, housing and other systems - often in subtle ways that can have unintended impacts.

To take one example, it might seem that removing eligibility for Family Tax Benefit from families above (say) $100,000 would make perfectly good sense – it would free resources for much needed use elsewhere by taking money from the relatively well-off. In reality, however, things are not so simple. Such a measure would involve a form of means testing that could take the effective rate of tax up to levels higher than are

good for incentives to work, save and invest. Those most affected might be families on lower incomes, whose capacity to improve their situation by their own efforts could thus be compromised.

To take another example, indexing the nominal scale of income tax rates might seem an unattractive proposition in that each instance of indexation gives the greatest gains to higher-income taxpayers. Without indexation, however, 'bracket creep' has the eventual effect of dragging people on lower incomes into paying tax at rates originally intended for people in a much better financial position.

The Commission has no fixed position on the rights and wrongs of tightening access to Family Tax Benefits or indexing the income tax rates scales. It is simply making the point that the immediate impact of a given initiative may not adequately reflect the longer-term outcome, and that policy decisions should have an eye to both.

Evaluating the taxation system

How can options for changes in the tax system be evaluated against the principles of the common good and a preferential option for the poor? The Commission suggests that the review should ask the following questions when considering proposals:

- Who stands to gain and lose from the immediate impact?
- If the immediate gains flow predominantly to those on high incomes and/or with substantial assets, can it be shown that the measure's flow-on effects ultimately will benefit low-income and low-asset individuals or prevent people from falling into deprivation?
- How will they influence aggregate levels of employment?
- Do the measures widen or narrow the dispersion of incomes and wealth (in both the short and the long term)?
- Are people in similar circumstances treated alike?
- Will the tax system become simpler or more complex, and will compliance costs increase or decrease for people with limited incomes and assets?
- Are the effects of family responsibilities on taxable capacity adequately taken into account?
- Will the impact of revenue gains and losses on the Government's ability to fund its social programs for the disadvantaged be adequately recognised?
- How will incentives to work, save and invest – and therefore the tax base - be affected?

The Commission is not in a position to offer a comprehensive analysis of the tax system against these criteria, but notes the following:

- Recent changes to income tax scales have benefited people across most of the income spectrum, but by far the largest gains have been made by people at the top of the range The changes have done little to simplify the system. They have cost large sums of revenue. There is little evidence to suggest that they have generated employment or other economic outcomes in a way that would benefit those on low incomes.
- Superannuation, which is essentially a form of tax-sheltered saving, gives by far the greatest benefits to individuals on high incomes while giving little or nothing to those at the lowest end of the income distribution – and the 2007-08 Budget changes have aggravated the situation by exempting superannuation benefits paid to people aged 60 and over. The net impact on national savings appears to be minimal. Longer-term forecasts indicate that the aged will continue to be heavily reliant on age pensions well into the future.
- Lump-sum grants to taxpayers give nothing to people whose incomes are too low to attract tax.
- Almost alone among developed countries, Australia has no death duties or capital transfer taxes. The capital gains tax and the tax on superannuation benefits paid to 'non-dependants' go some way to filling the gap but their incidence is erratic and the latter is easily avoided.
- The income tax and social security systems can interact to produce effective marginal tax rates that can take as much as two-thirds to three-quarters of income earned in part-time employment

- The immense complexity of the income tax system allows opportunities for those on high incomes to avoid tax by taking advantage of loopholes available only to people who can afford costly professional advice.

Recommendations

The Commission offers the following proposals to address these issues:

Recommendation 1: that the tax concessions for superannuation be tightened, and that consideration be given to their complete abolition in the accumulation phase

This issue is partly to do with retirement incomes, and the review's terms of reference preclude changing the tax-free status of superannuation payments to people aged 60 and over. For all that, the concessions in the accumulation phase have impacts that need to be considered in a broader context than just retirement income. Among other things, they erode the revenue base and force government to look for revenue elsewhere.

Given the remarkable generosity of the 'over 60' concessions, the Commission sees little case for retaining any concessions in the accumulation phase – they act as little more than tax-avoidance devices for the relatively well-off. The Commission notes that the cost of superannuation concessions, even in the present economic climate, is almost equivalent to the total cost of age pensions and in more prosperous times has greatly exceeded the cost of age pensions. The benefits of the concessions are disproportionately concentrated at the upper ranges of income.

Less dramatic options to cut concessions in the accumulation phase include:

- Greatly reducing the annual limits on concessional and non-concessional contributions – the present limits of $50,000 and $150,000 are way beyond anything that can be regarded as reasonable
- Limiting to 15 cents in the dollar the tax advantages of concessional contributions
- Removing the tax benefits attached to the practice of recontributions.

The tax exemption in the retirement phase could also be made fairer if it were achieved by using tax offsets rather than completely disregarding superannuation. Under this system, tax liability for superannuants would be set by calculating tax on total income (including superannuation) and then subtracting tax payable on the superannuation component.

Recommendation 2: that the income at which the 45 per cent marginal rate of tax comes into effect be reduced from $180,000 to $150,000 and that a 47 per cent rate apply to income in excess of $200,000

Adoption of this recommendation would reverse some of the immense gains high-income taxpayers have made in recent years. The Commission recognises that it is unrealistic to expect a more comprehensive reversal of recent years' changes, at least for now.

Recommendation 3: that lump-sum grants to taxpayers no longer be made

These grants are regressive in that they preclude people at low levels of income. They are also highly arbitrary – a person with $1 of tax liability received $900 in the recent round while a person with no tax liability received nothing. The Commission considers that it would be fairer to focus further initiatives on increasing fortnightly benefits to pensioners and unemployed people.

Recommendation 4: that the review considers the introduction of taxation on capital transfers, including a succession or estate tax

The present taxes on capital gains (and on superannuation paid to non-dependants) go some of the way to achieving a measure of equity in capital taxation. They do not apply, however, to the total amount of

property transferred and still permit transfers of substantial wealth between generations. The Commission does not have the technical expertise to suggest the precise form that taxes on capital transfers should take. It simply notes that it should apply only to substantial transfers, particularly in the case of deceased estates.

Recommendation 5: that rates of benefit withdrawal under the means tests applying to Centrelink benefits for unemployed people be reduced

At the present time withdrawal rates are set at 50 and 60 cents in the dollar, depending on the amount of non-benefit income derived. This is above the rate of 40 cents that applies to pensions and even exceeds the highest rate of income tax. When tax is added to the withdrawal rate, people who qualify for Centrelink payments may find that they keep as little as one in every three or one in every four dollars that they earn for themselves. The Commission's recognises that the issues here are complex, but suggests that as a starting point the withdrawal rate of 60 cents in the dollar be reduced to 50.

Recommendation 6: that taxation, especially on income, be simplified

The Commission is conscious of how complex it is to disentangle complexity. It also is not in a position to propose specific measures to address this issue. It does, nevertheless, see it as a priority. Complexity is costly, creates loopholes for those who have the means and advisers to take advantage of it, and creates compliance burdens that people on low incomes can find onerous.

Conclusion

This submission highlights just a few areas where the tax system is failing to deliver, and it makes a limited number of proposals for change. It has focused largely on how the system affects people and families on low incomes and with limited assets, recognising in this context that longer-term outcomes are not always reflected in immediate effects.

The Commission acknowledges that it has not covered other issues of vital importance, notably the use of taxation to achieve environmental outcomes. With the exception of its proposals to ease the income test on payments to unemployed people, it has also not explored how extra revenue from adoption of its proposals might be used to fund new expenditure or to reduce taxes elsewhere in the system. It notes, however, that the proposals' total impact depends on how the extra revenue is used.