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Tax reform: where to focus?

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John Curtin Institute of Public Policy
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Tax reform: where to focus

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What problem are we trying to solve?

- Economic growth
- Budget repair
- Inequality
- Housing affordability
- Federalism
- In what sequence?

What are the big rocks?

- Property: stamp duty; Land Tax; property taxes
- Asset taxes
- Superannuation (still)
- Corporate tax: rate; base; international
- Trusts
- Income / consumption taxes

Tax reform is a (relatively) big lever for economic growth

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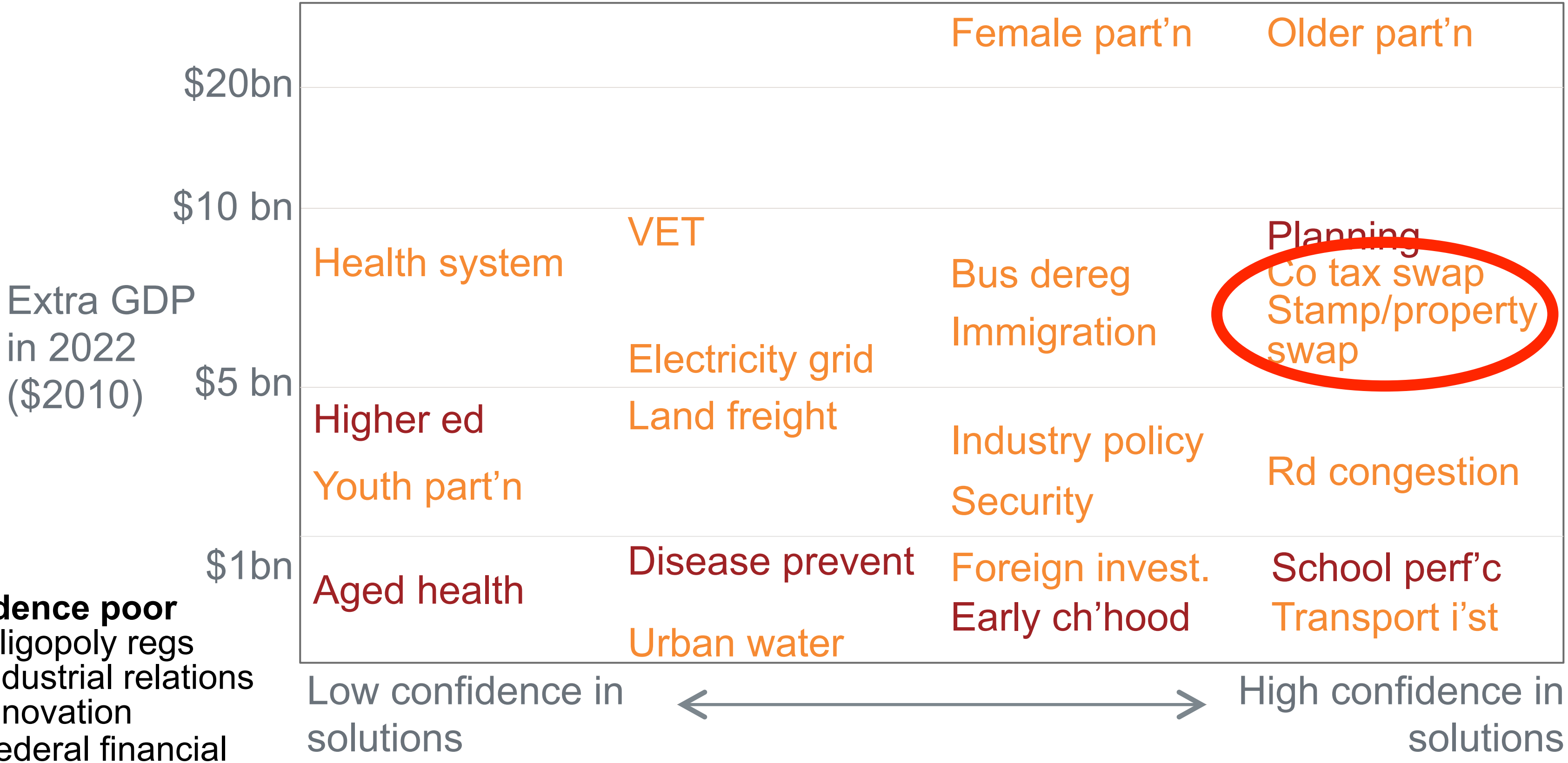

Evidence poor
- Oligopoly regs
- Industrial relations
- Innovation
- Federal financial

Note: Figures are approximate estimates of annual impact on GDP or budget, at full implementation in ten years, in 2011 dollars.
Source: Grattan Institute, *Game-changers*

The Commonwealth budget balance is at least heading in the right direction

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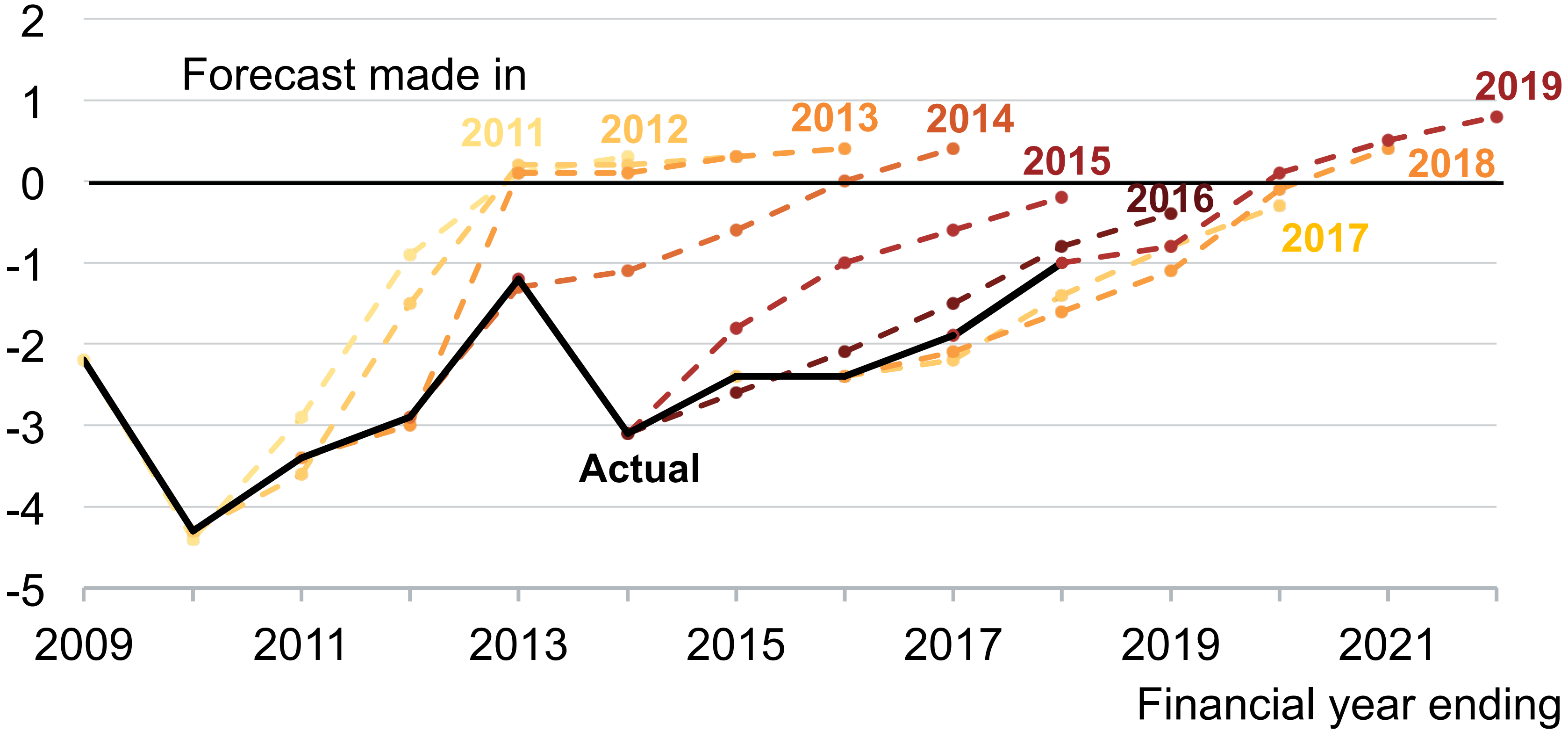
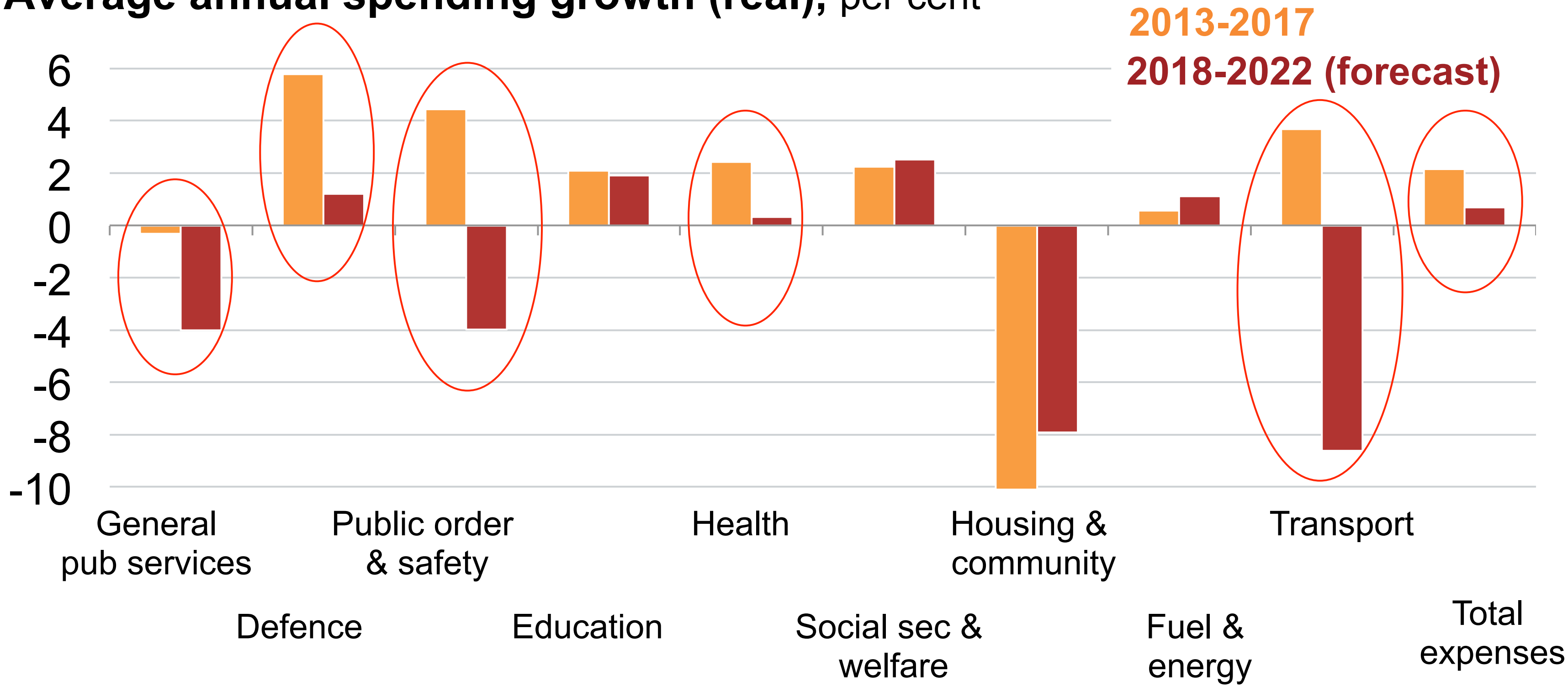
Actual and forecast Commonwealth underlying cash balance, % of GDP



Source: Grattan analysis of Commonwealth Budget Papers 2010-11 to 2016-17

… assuming unusual spending restraint

Average annual spending growth (real), per cent



Notes: Excludes some of the smaller functions and expenses for ‘other purposes’ (largely GST payments to the states). Total expenses growth is also calculated excluding ‘other purposes’.
Sources: Commonwealth Budget Papers, 2018-19; Grattan analysis.

Incomes have risen across the board; less so after housing costs; wealth is unequal

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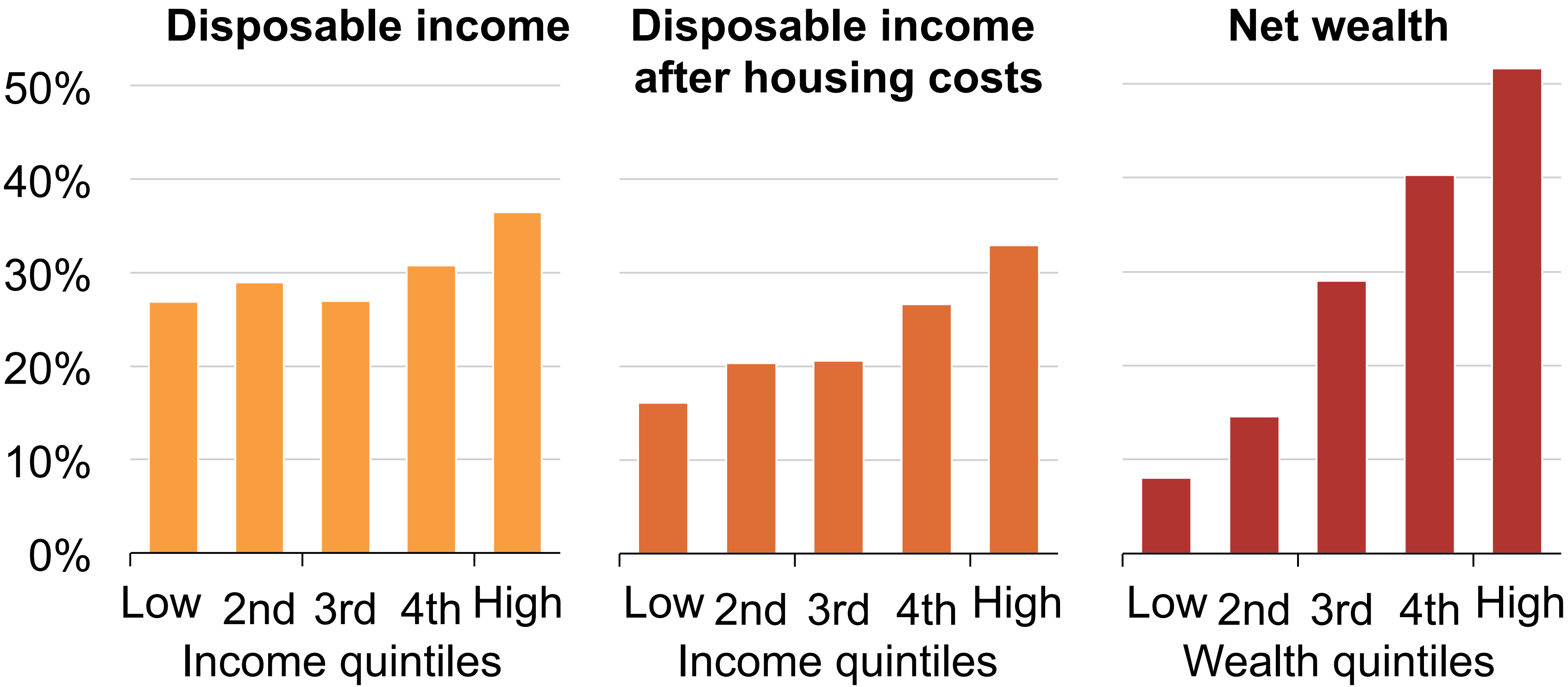
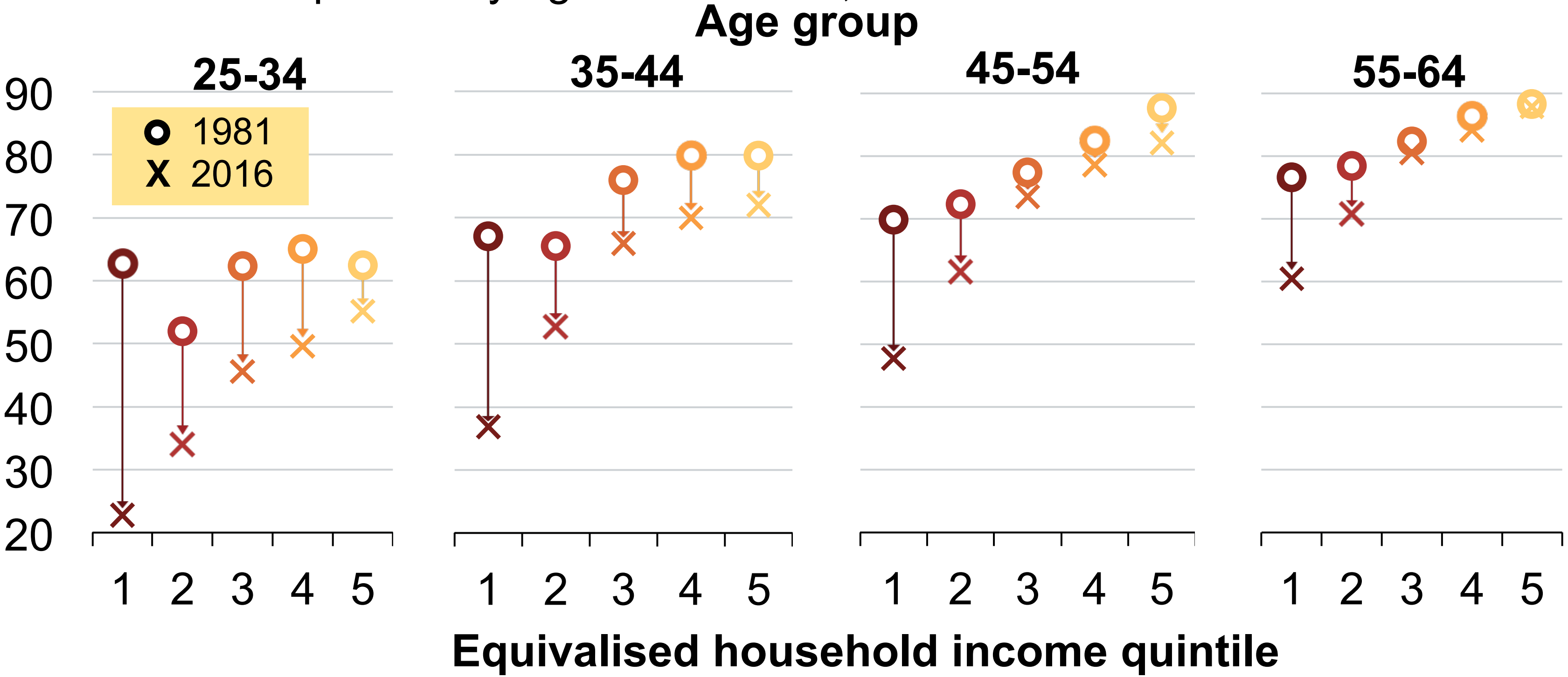
Real growth from 2003-04 to 2015-16 per equivalised household



Notes: Income estimates for 2003–04 onwards are not perfectly comparable with estimates for 2015-16 due to improvements in measuring income introduced in the 2007–08 cycle.
Source: Grattan Institute, *Housing affordability*

Home ownership is falling particularly fast among younger low-income earners

Home ownership rates by age and income, 1981 and 2016



Notes: Updates Burke et al 2014 using Census data obtained from the ABS. Limitations in Census calculations of household incomes means that estimates of ownership rates are imprecise. Excludes households with tenancy not stated (for 2016) and incomes not stated. Uses age of household reference person and equivalised household income quintiles.
Source: Grattan Institute, *Housing affordability*

Older households gained from one-off asset appreciation

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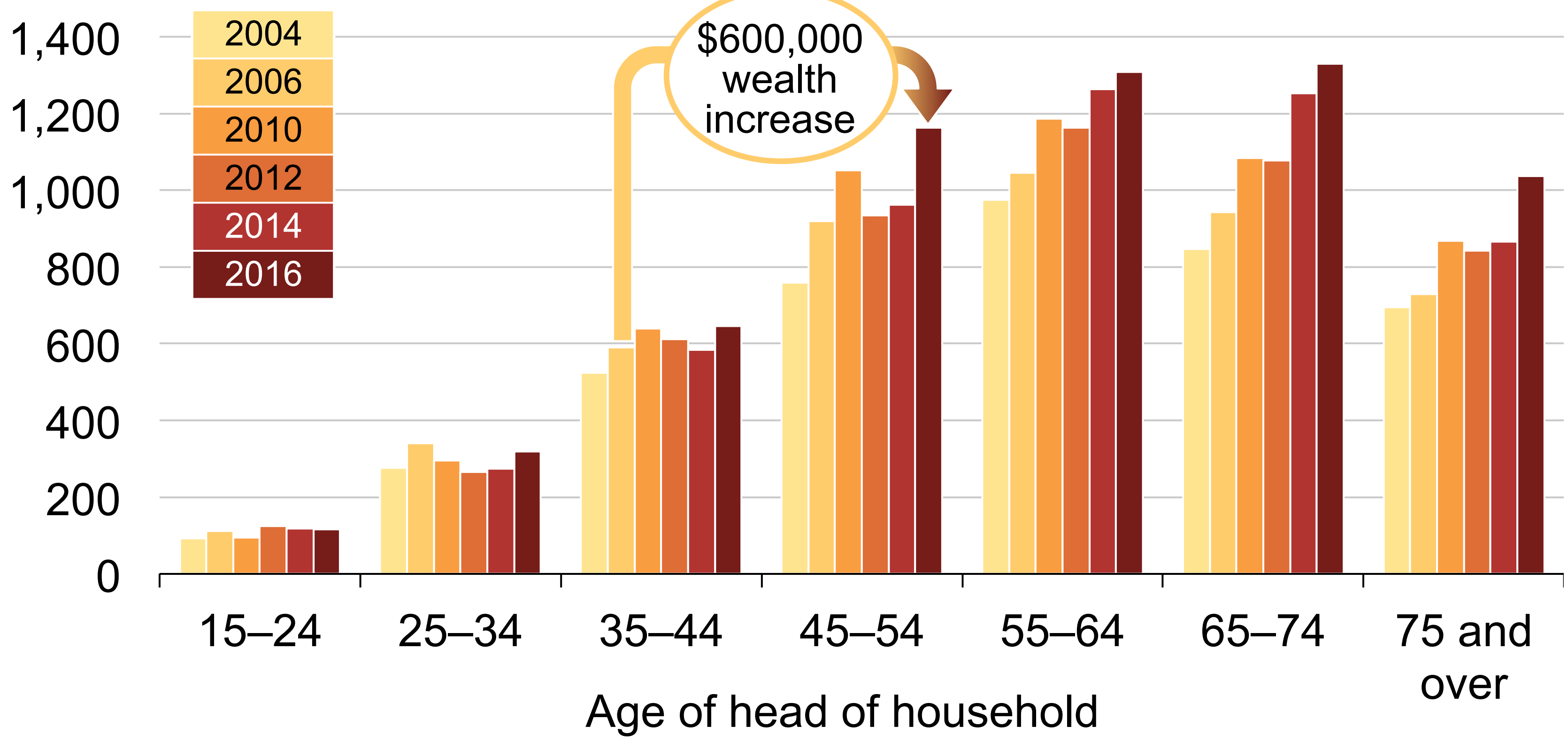
Mean wealth by age of head of household, $2015-16, thousands



Source: Grattan Institute, *The Wealth of Generations*

The young will pay back debts due to higher spending and lower taxes for the old

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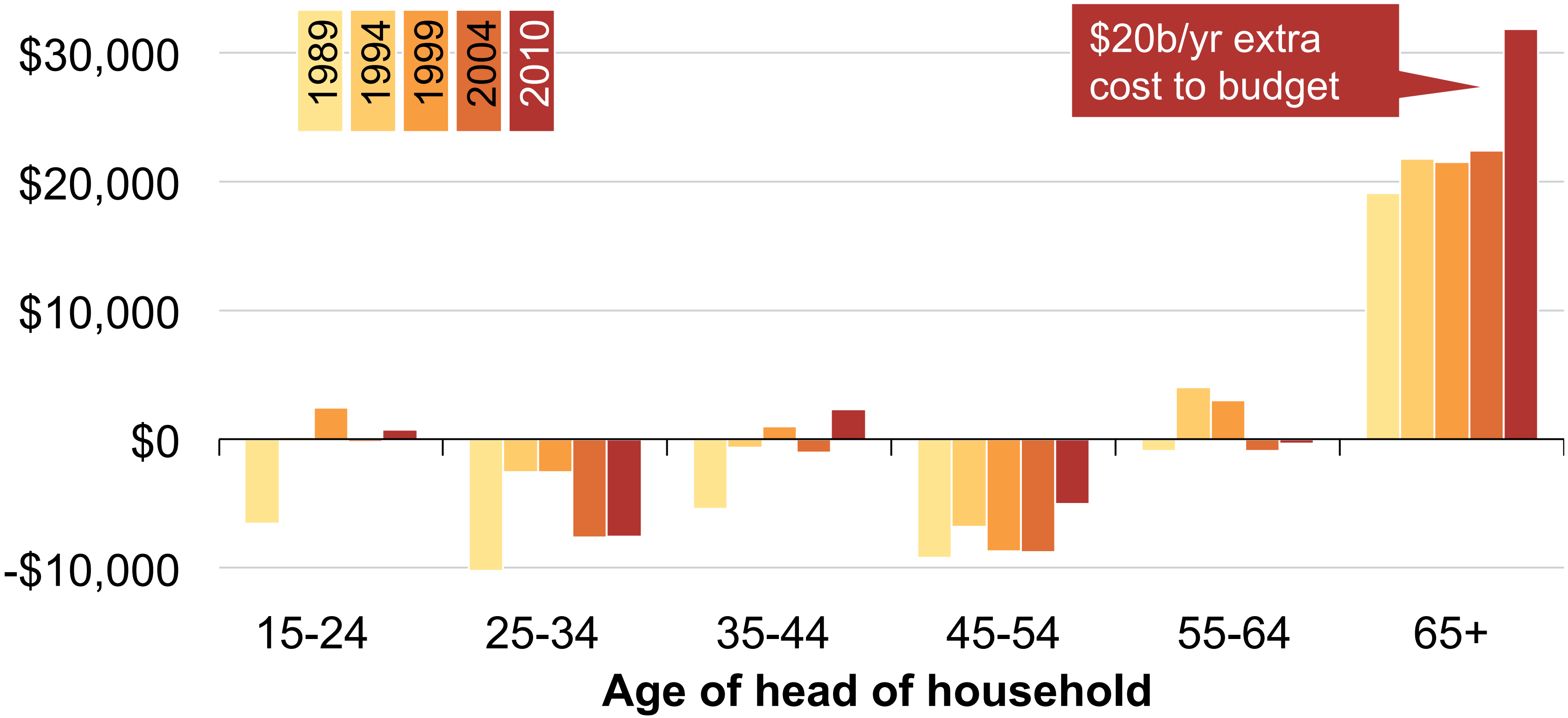
Net benefits per household (government payments, less tax), 2010$



Source: Grattan Institute, *Wealth of Generations*

Grattan has released a series of reports on budgetary sustainability and revenue repair

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Fiscal challenges for Australia

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A better super system: assessing the 2016 tax reforms

Tax reform: where to focus

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An overview of tax reform

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Negative gearing / CGT	↓ housing over-invest & lev'g	+$2-6b	High wealth	Don't exaggerate	Rent impact?
Super	Minimal	+$1-4b	Top 10%	Inter-generational	Savings impact?
Corporate (rate)	+ Foreign investment	-$12b for 5%	+ Foreign owners		Investment v GNI?
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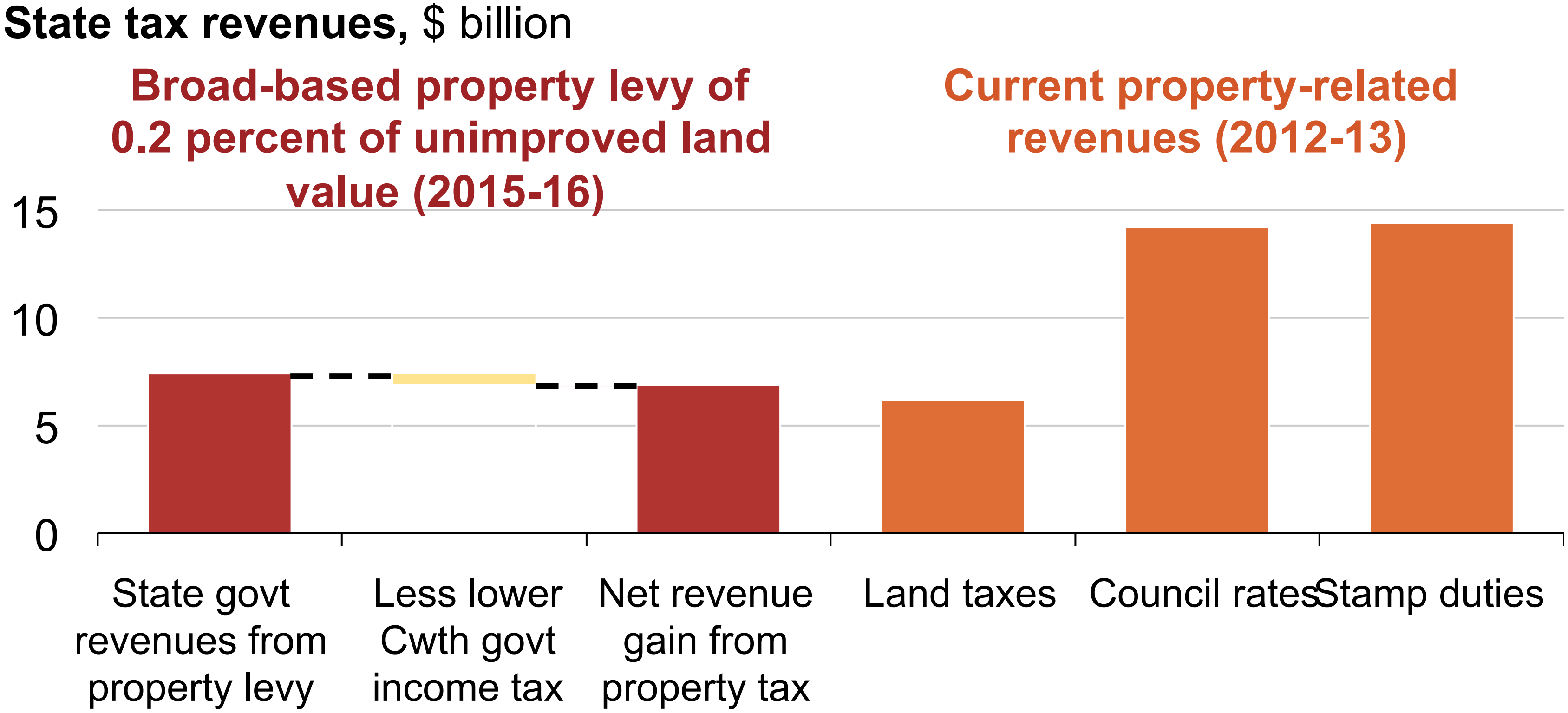
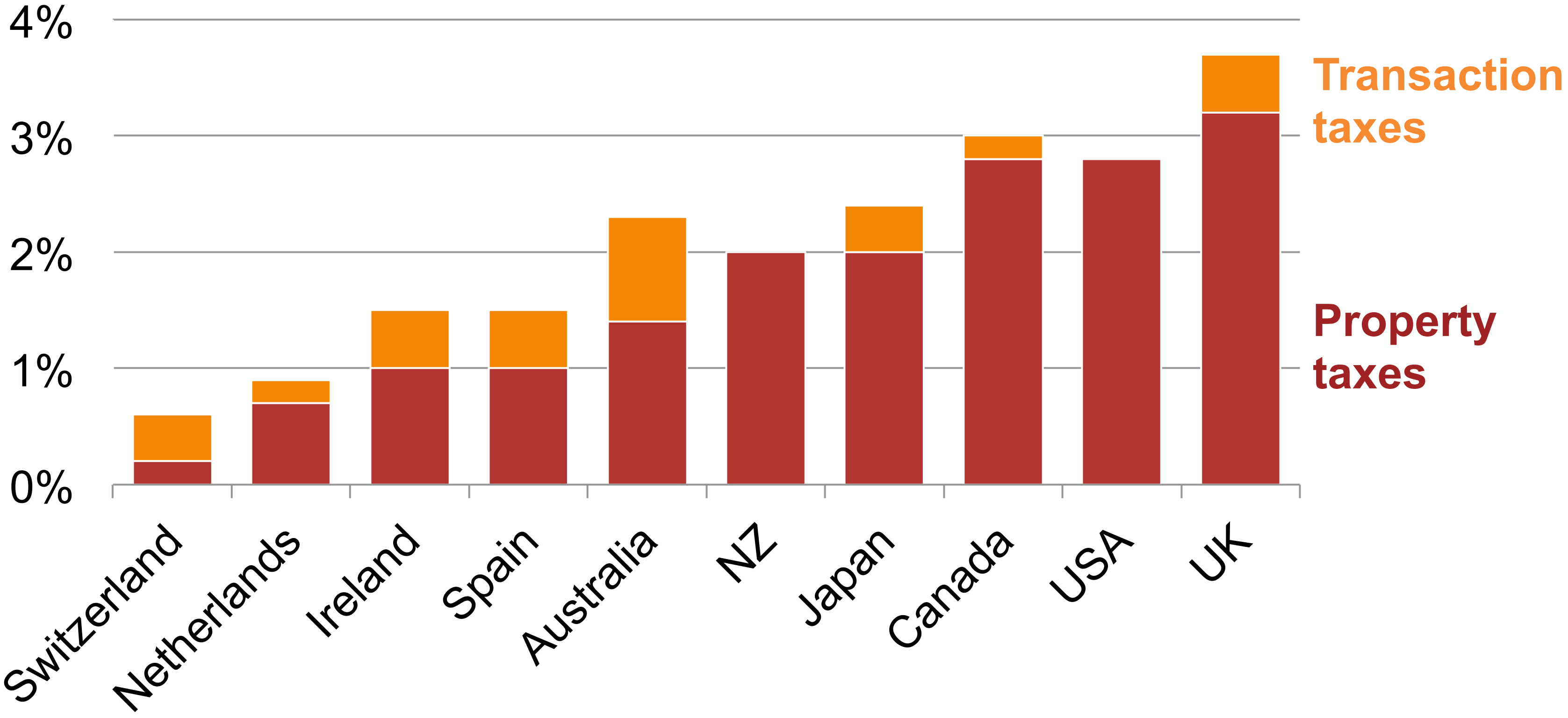
Property taxes could be a material revenue source even at lower rates



Source: Grattan Institute, *Property taxes*

Australia has lower property tax revenues than some comparable countries

Taxes on property and transactions, per cent of GDP



Source: OECD (2014), *Revenue statistics*, updating Grattan Institute, *Property taxes*

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Tackle the hard arguments: how do taxes affect savings rates?

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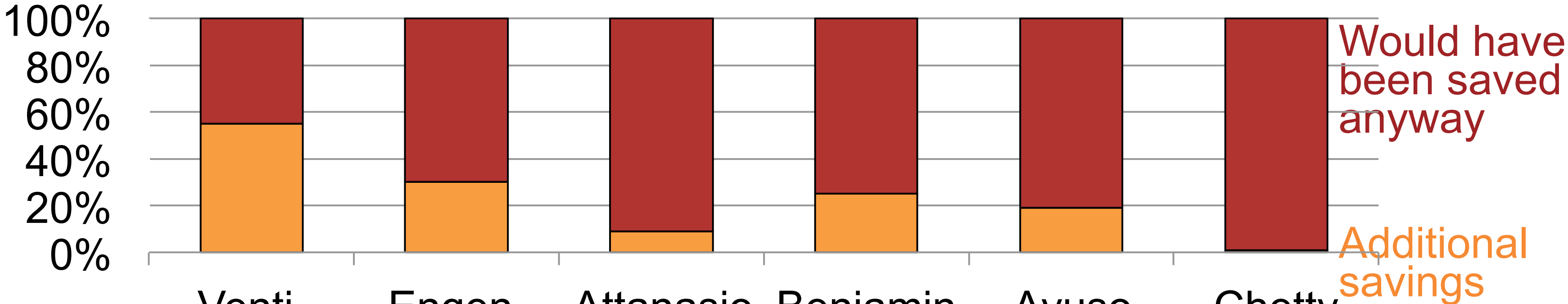
Where do the extra contributions into tax advantaged vehicles come from?



Venti	Engen	Attanasio	Benjamin	Ayuso	Chetty
New savings from tax advantaged US retirement savings plans (IRAs/401ks)	New savings from 401ks across earnings groups. Estimates range 0-30%.	New savings from IRAs by comparing consumption new and existing contributors	New savings from 401ks. Better controls for savings propensity across households.	New savings from tax-favoured retirement plans in Spain	Change in savings after reduction in tax break for high income earners in Danish retirement accounts
Biased result - imperfect controls for savings preferences between contributors and non-contributors	New savings come from low income participants. Those on high incomes mainly “reshuffle”	Most savings in IRAs come from tax benefit or money “reshuffled” from taxable savings vehicles	Those that save the most in 401ks mainly would have saved anyway	Amongst near retirees that contributed most, almost all contributions reshuffling from other savings	Most savers “passive” do not respond tax rates. Active savers, save anyway, just choose most tax effective vehicle

→ Study reliability

Notes: Additional savings is new savings from reduced consumption and/or increased labour effort. If taxes on savings are lower, the ultimate value of those savings will be higher. For Venti we report the mid-point estimate for new savings across a number of studies. For others, we report the maximum estimate for new savings. Source: *Super tax targeting*, p.21

The tax system significantly distorts investment choices

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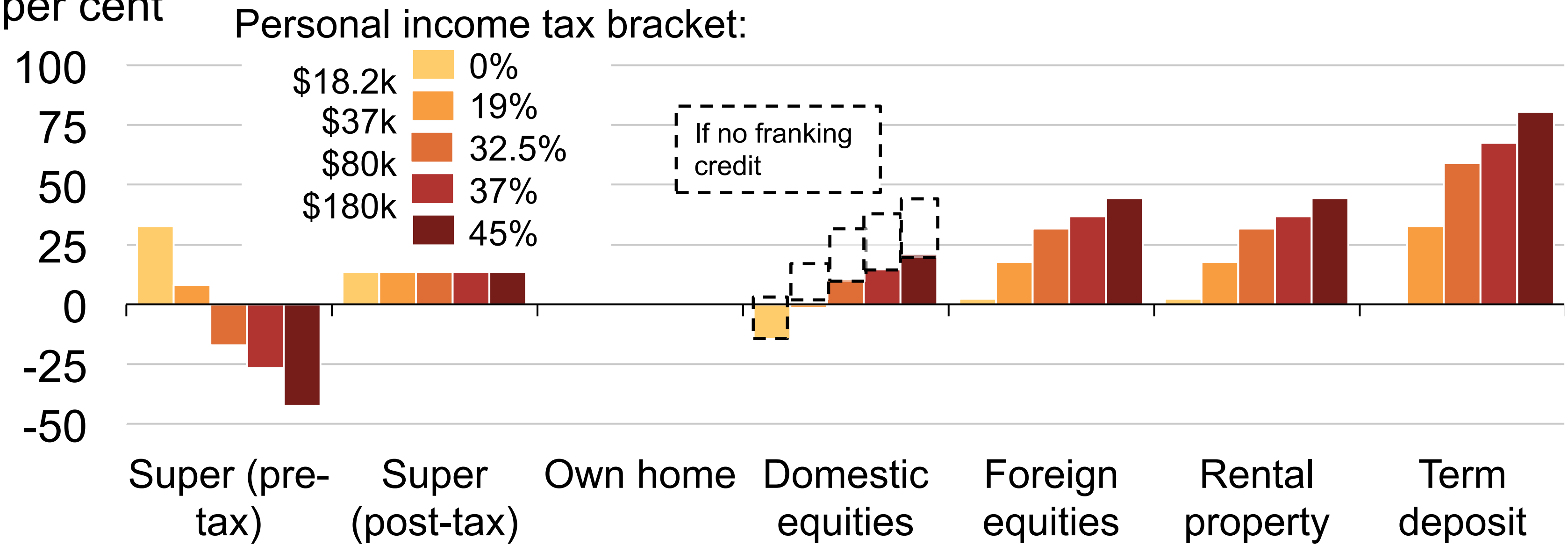
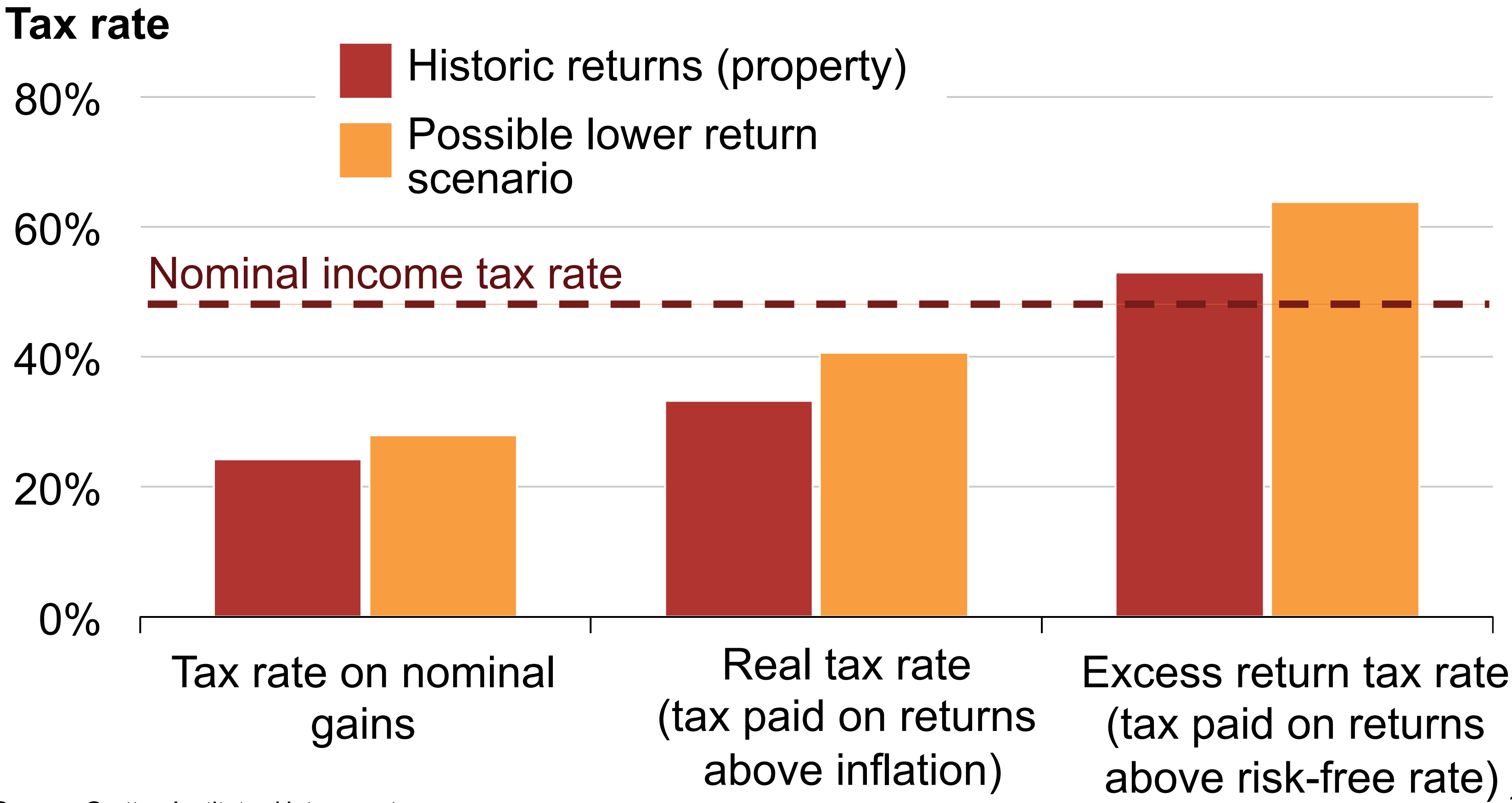
Real effective tax rate on long-term savings, relative to TEE benchmark, per cent



Notes: Real effective marginal tax rate (EMTR) on saving defined as the income foregone due to tax, as a proportion of the pre-tax return (net of inflation). EMTR presented relative to a pre-paid expenditure tax (i.e. TEE) benchmark, consistent with the Henry Review approach. Assumes super earnings taxed at average effective rate of 8% in the fund, reflecting capital gains taxed at 10% and dividend imputation for domestic equities investments. Assumes 6% nominal return; 2.5% inflation; all investments held for 25 years; for property and equities capital gains tax is only crystallised and paid at the end of 25 years; for property and equities, 50% returns attributed to capital gain, 50% `to rental or dividend income; dividends on domestic equities are fully franked unless noted.

Source: Grattan Institute *Super tax targeting*, p.18

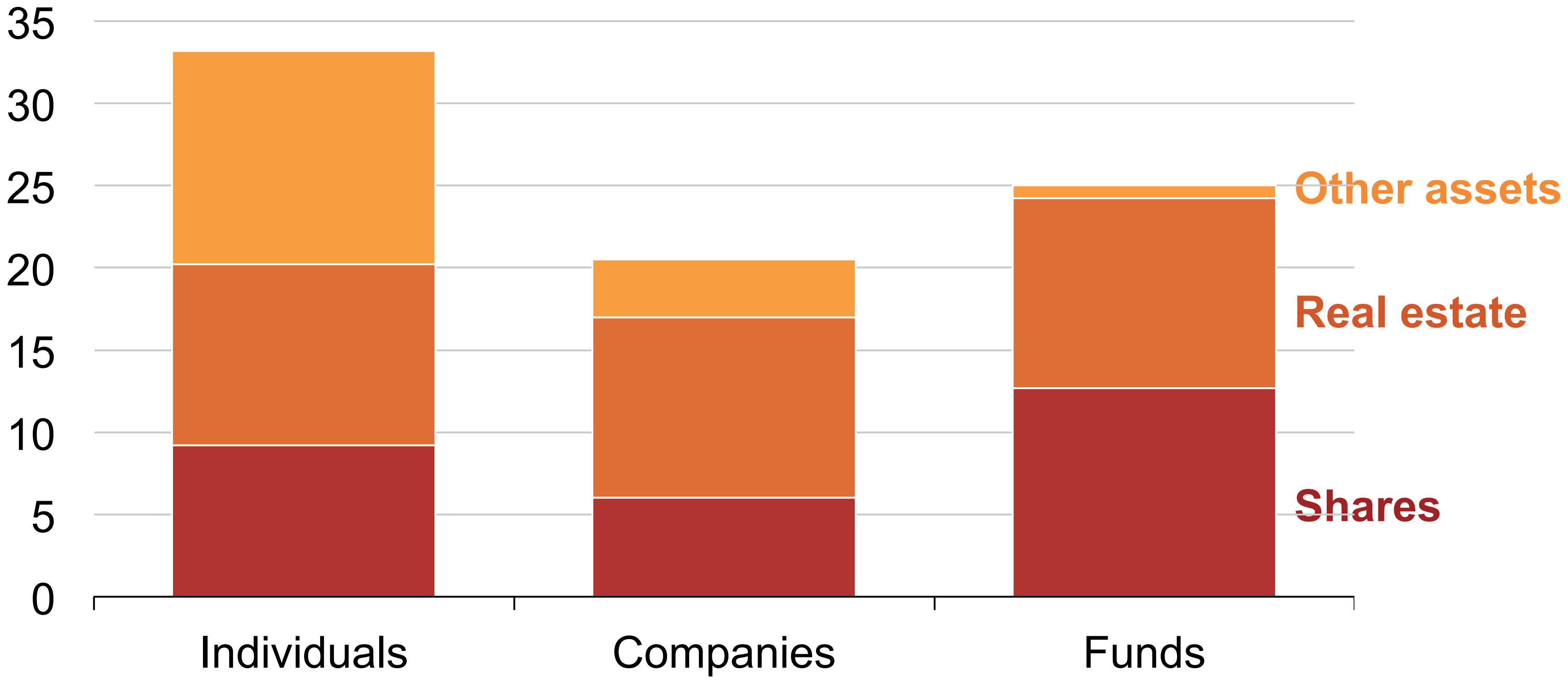
Excess returns have only been taxed marginally above nominal income tax rates



Source: Grattan Institute, *Hot property*

The majority of capital gains are earned by individuals through real estate and shares

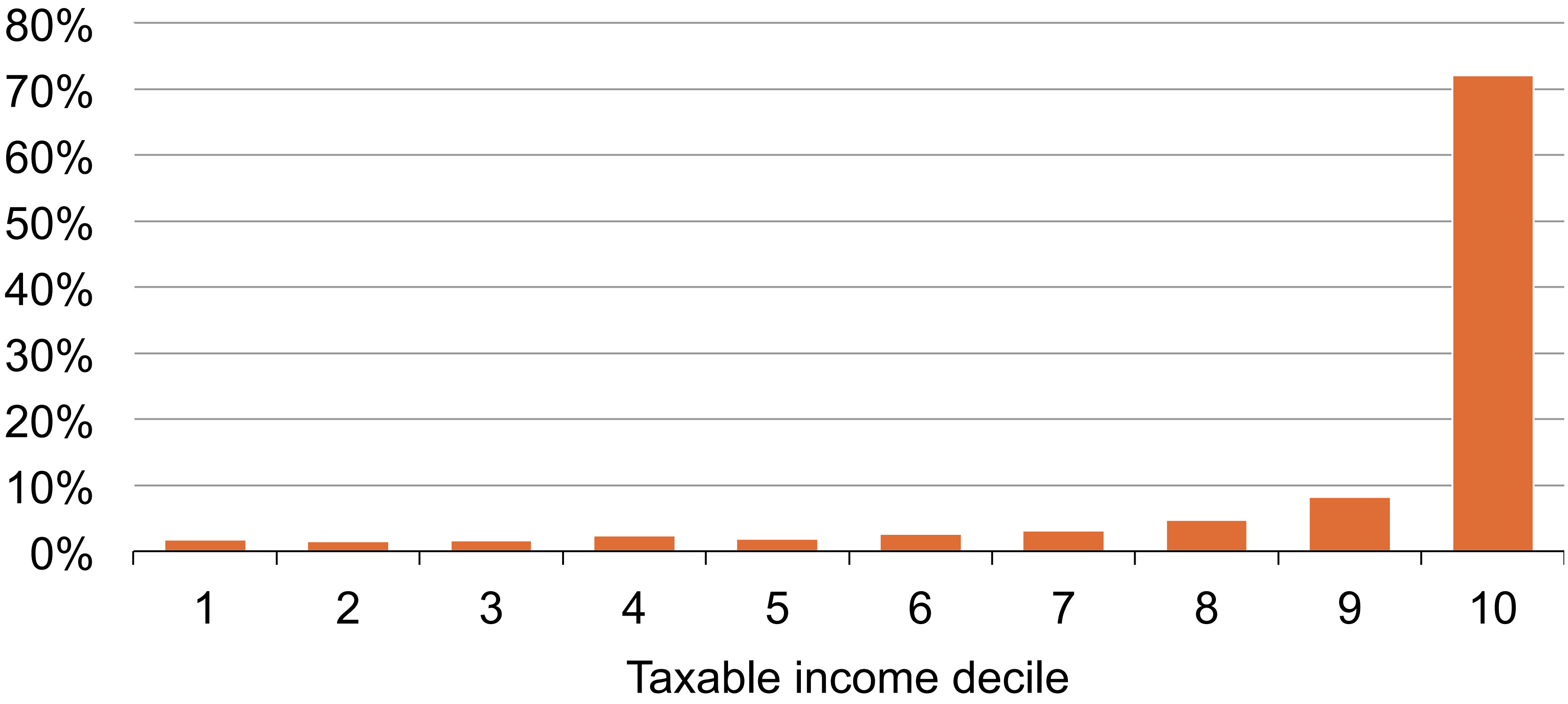
Realised capital gains 2013-14, $ billions



Source: Grattan Institute, *Hot property*

High income earners receive the most in capital gains

Proportion of net capital gains by income decile, 2013-14



Source: Grattan Institute, *Hot property*

Since 2000, most additional investment property owners have been negatively geared

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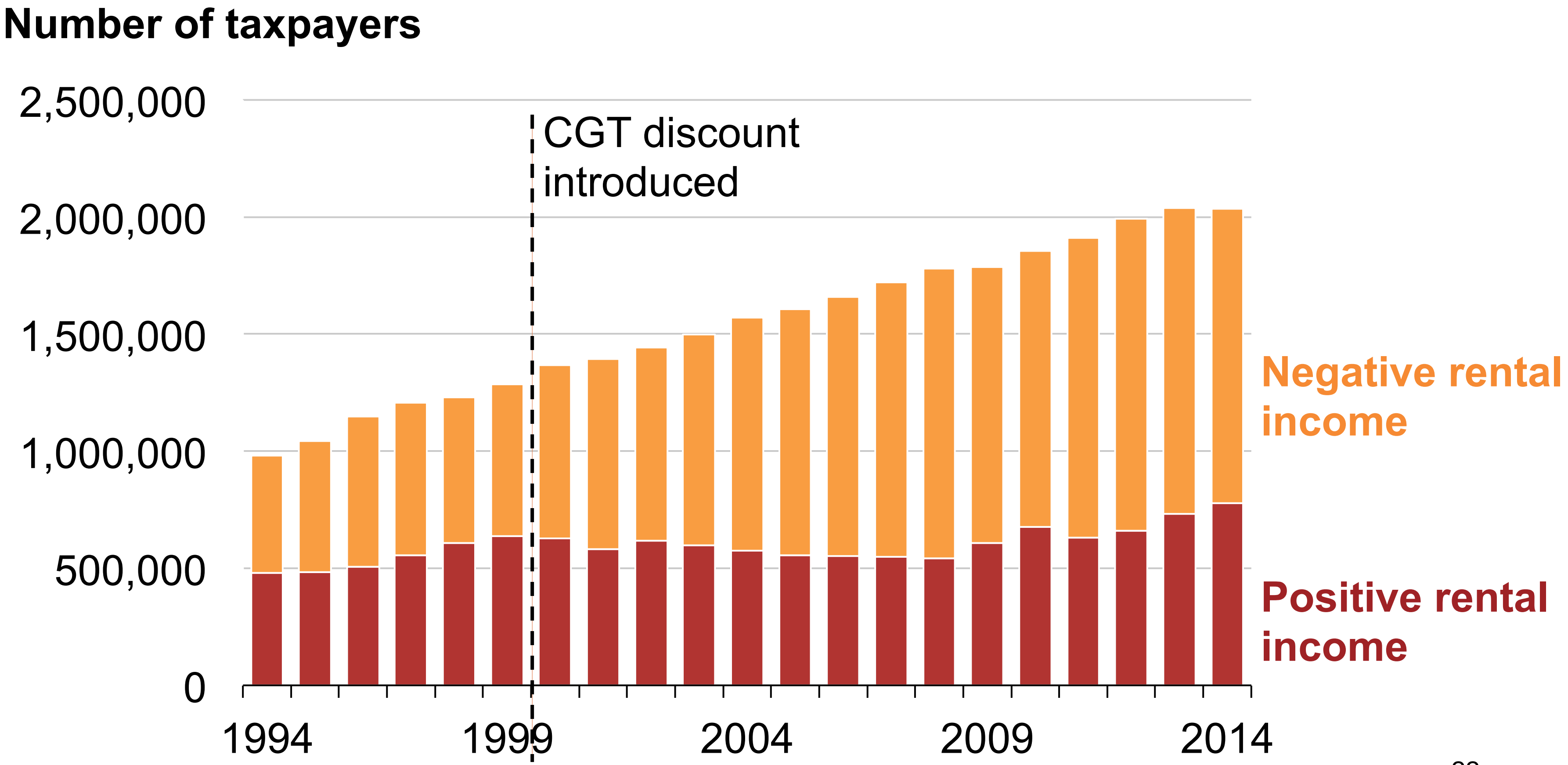
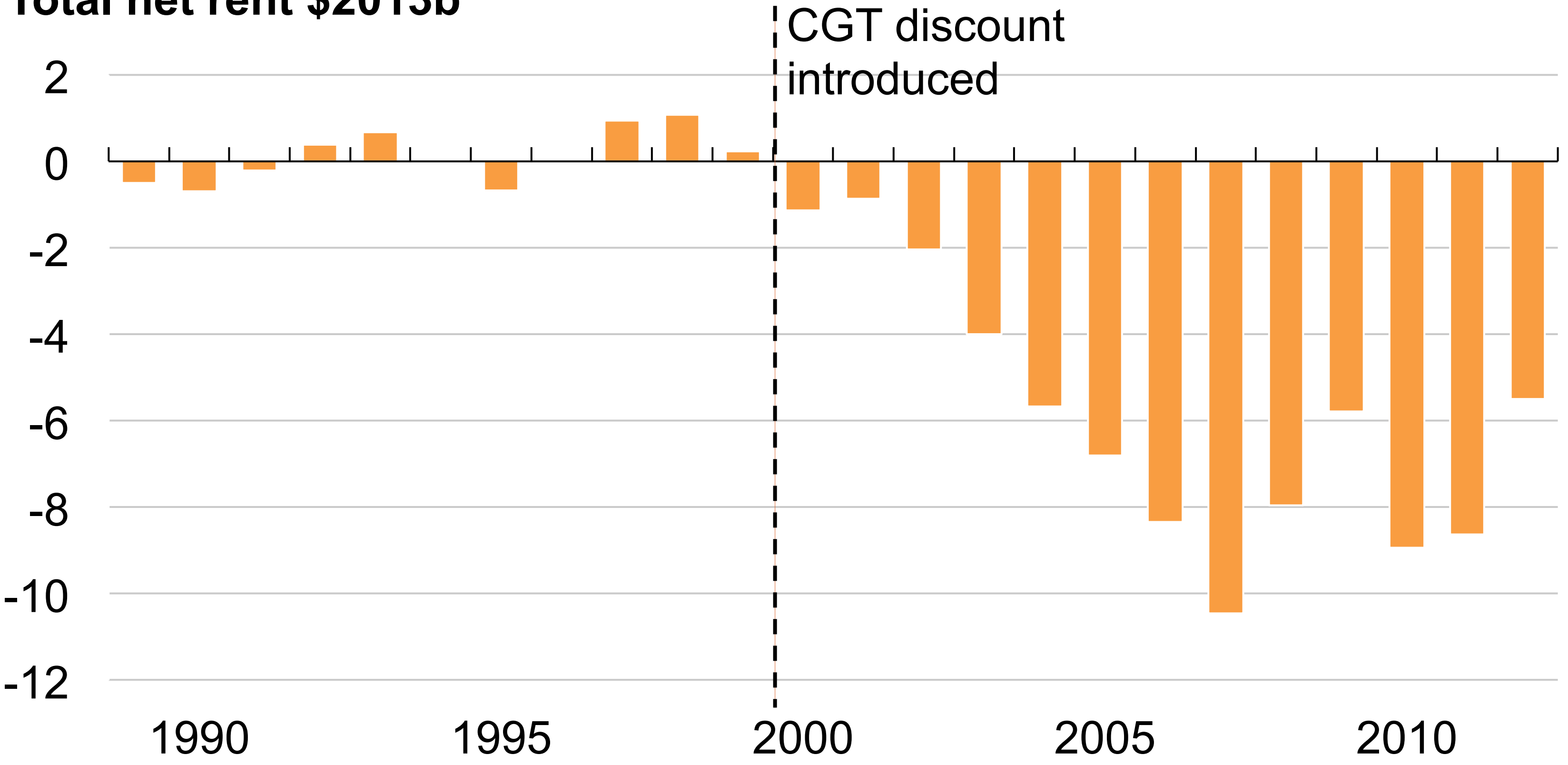


Source: Grattan Institute, *Hot property*

CGT discount and negative gearing are increasing leverage

Total net rent $2013b



Source: Grattan Institute, *Hot property*

Quarantining salary income from investment losses redistributes less than existing system

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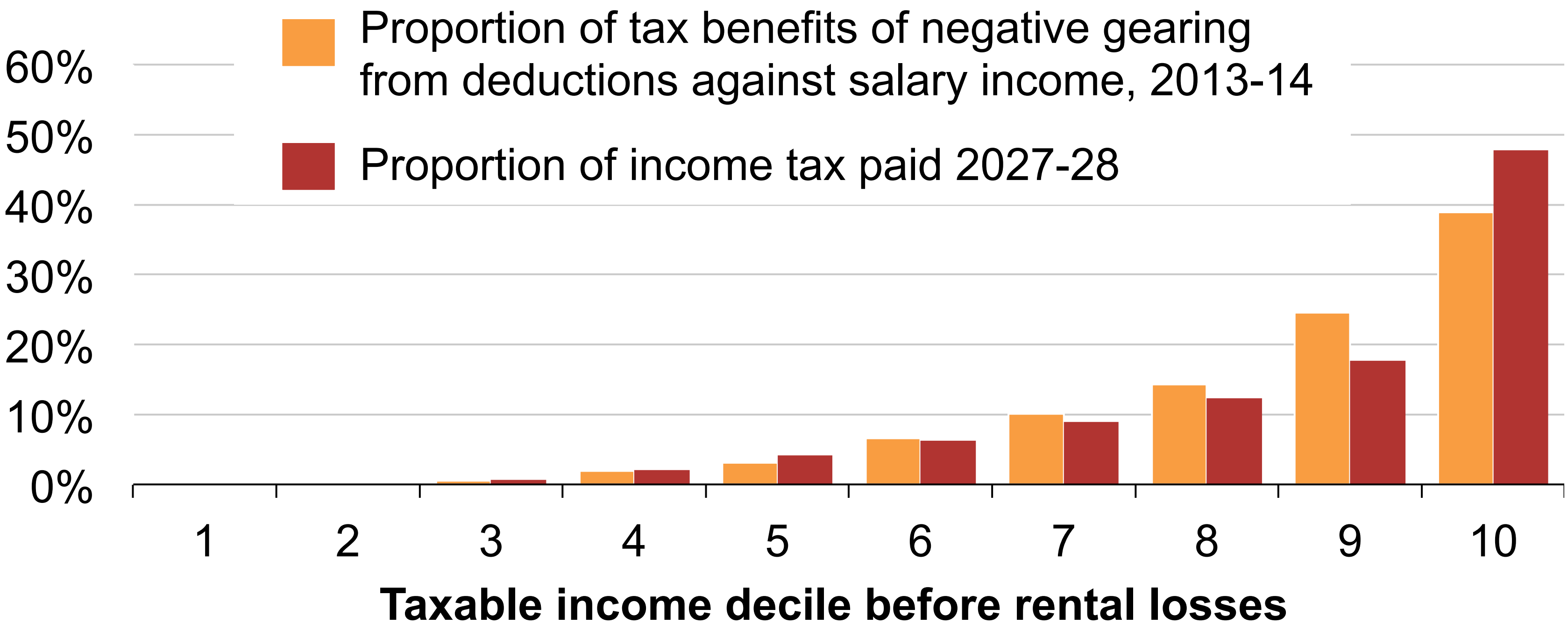
Proportion of tax



Notes: Tax benefits are the reduction in tax paid because of rental losses. Non-salary income is all other income such as investment earnings and business income. Income tax includes the Medicare levy, but not the Seniors and Pensioners Tax Offset.

Source: ATO, Grattan analysis, updating Grattan Institute, *Hot property*

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Post-tax voluntary contributions primarily benefit the wealthy

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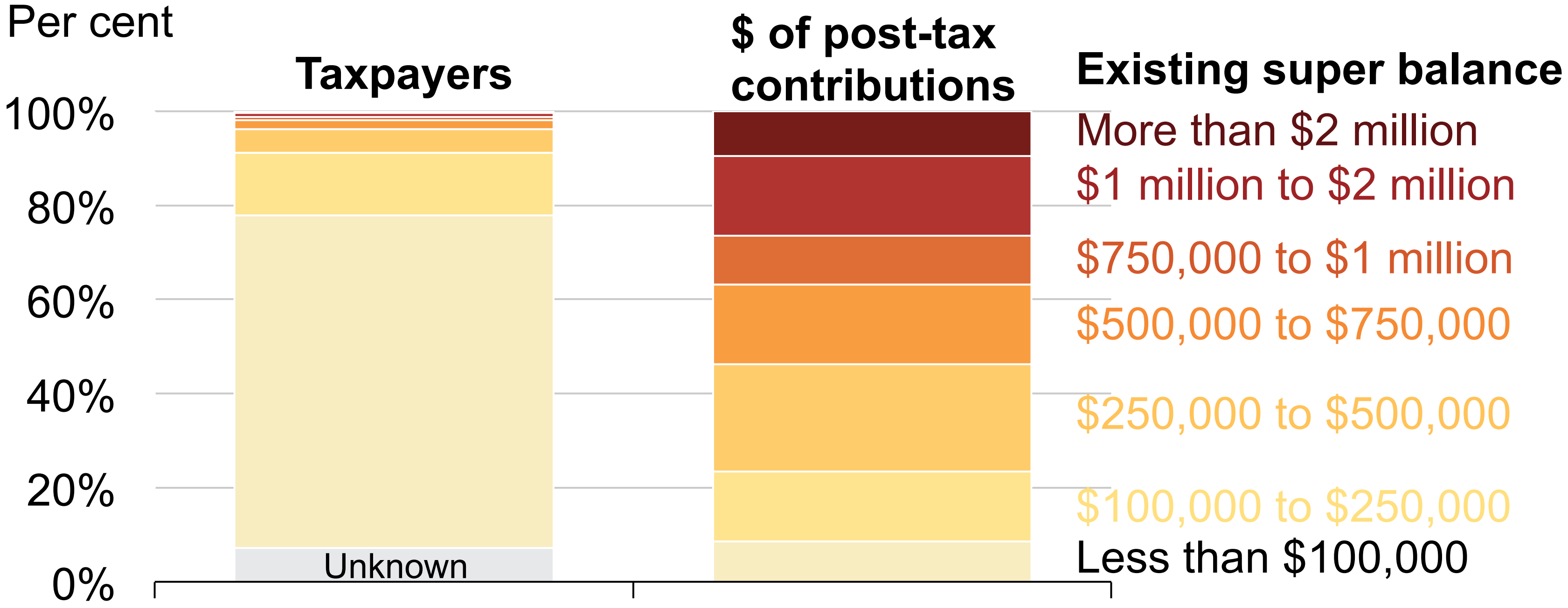
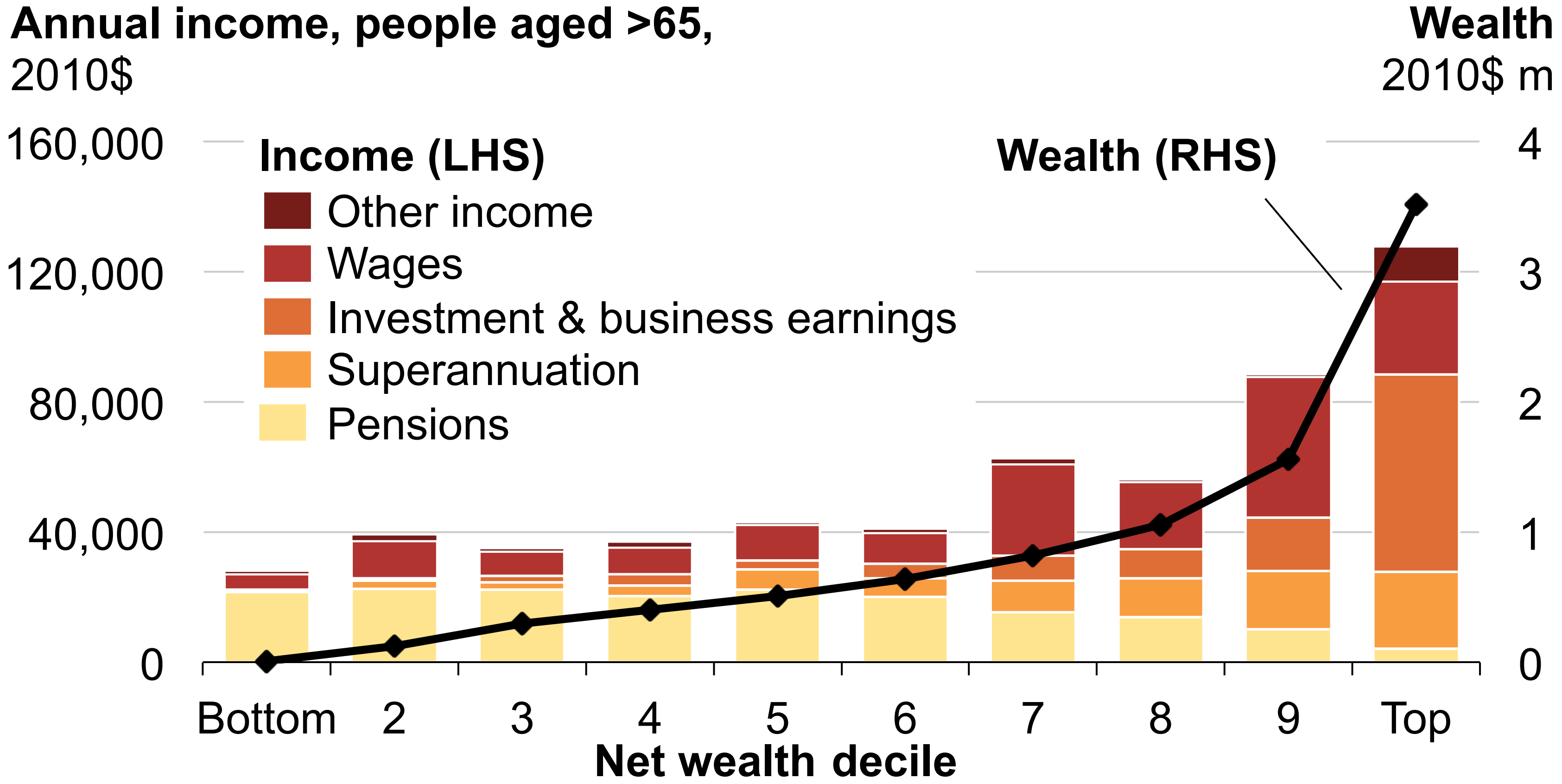
Share of taxpayers and post-tax contributions by existing super balance



Notes: Excludes those taxpayers and post-tax contributions where the ATO is unable to identify their account balances. The statistics for the 2012–13 income year were sourced from 2013 individual income tax returns processed by 31 October 2014 and member contributions statements received before 29 October 2015. The super fund balance is the sum of all member account balance values reported for a single individual where the Member Contributions Statement had a Tax File Number. Age is as at 30 June 2013 and is based on the date of birth reported by the individual on their income tax return. Where this date of birth is not populated ATO registration information is used.

Source: *Super tax targeting*, p.55

The top 20% of income earners aren't relying on the pension – or on super

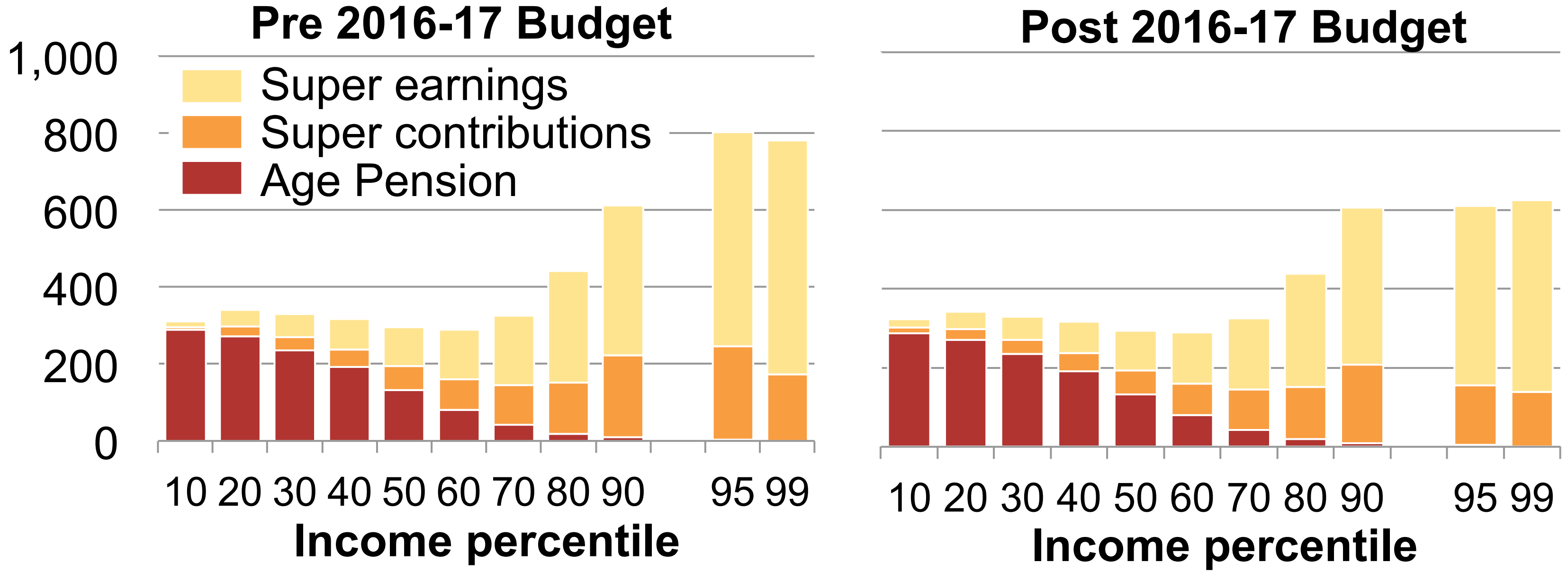


Notes: 'Superannuation' includes other private pensions, which account for only a small share of income across all households.
Source: *Super tax targeting*, p.28

While a step in the right direction, super changes don't go far enough

Net present value of lifetime government support for retirement

$2016 thousands

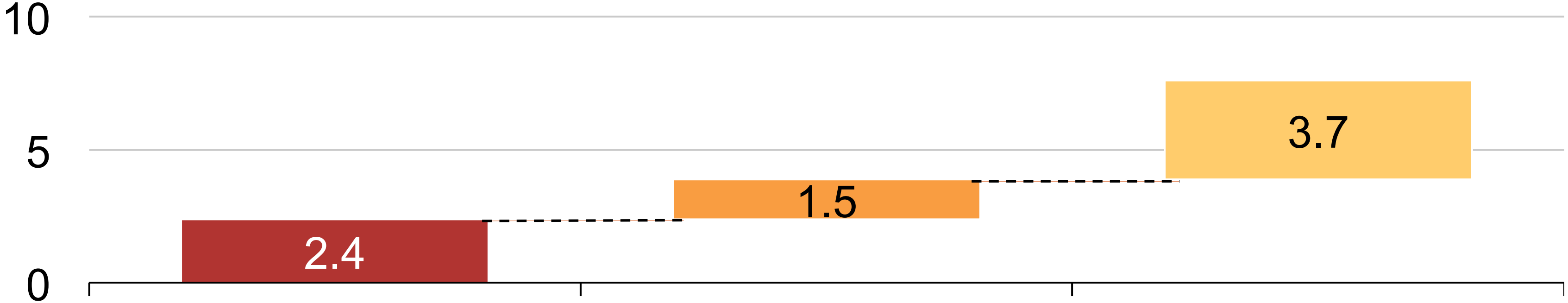


Note: Individuals are assumed to commence work in 2016 at age 30 and work until age 70, with a predicted life expectancy of 92. Accumulated superannuation benefits are invested in an account based pension and individuals are assumed to draw down their assets at the current age based minimum drawdown rates. The level of tax assistance and Age Pension entitlements are discounted by 5 per cent per annum to give a net present value in 2016 dollars. Annual incomes are calculated for each percentile based on the distribution of earners at each single year of age. Assumes no non-concessional contributions

Source: 2016-17 Budget factsheet.

Half of the available savings from super tax targeting are already in view

Annual budget impact of superannuation tax reforms, 2019$b per year



Passed in 2017

- Cap pre-tax contributions at $25k/yr
- Tax contributions at 30% if income >$250k
- Cap lifetime post-tax contributions at $500k
- Tax earnings at 15% on balances over $1.6m

Proposed by ALP

- Prevent carry-forward of unused pre-tax cap
- Tax contributions at 30% if income >$200k
- Only allow wage-earners to contribute pre-tax

Grattan additional

- Cap pre-tax contributions at $11k/yr
- Tax contributions at 30% if income >$115k
- Tax earnings at 15% on all balances in retirement

Note: May not capture all overlap effects
Source: Grattan Institute, *A better super system*

Superannuation won't produce net annual budget savings until about 2060

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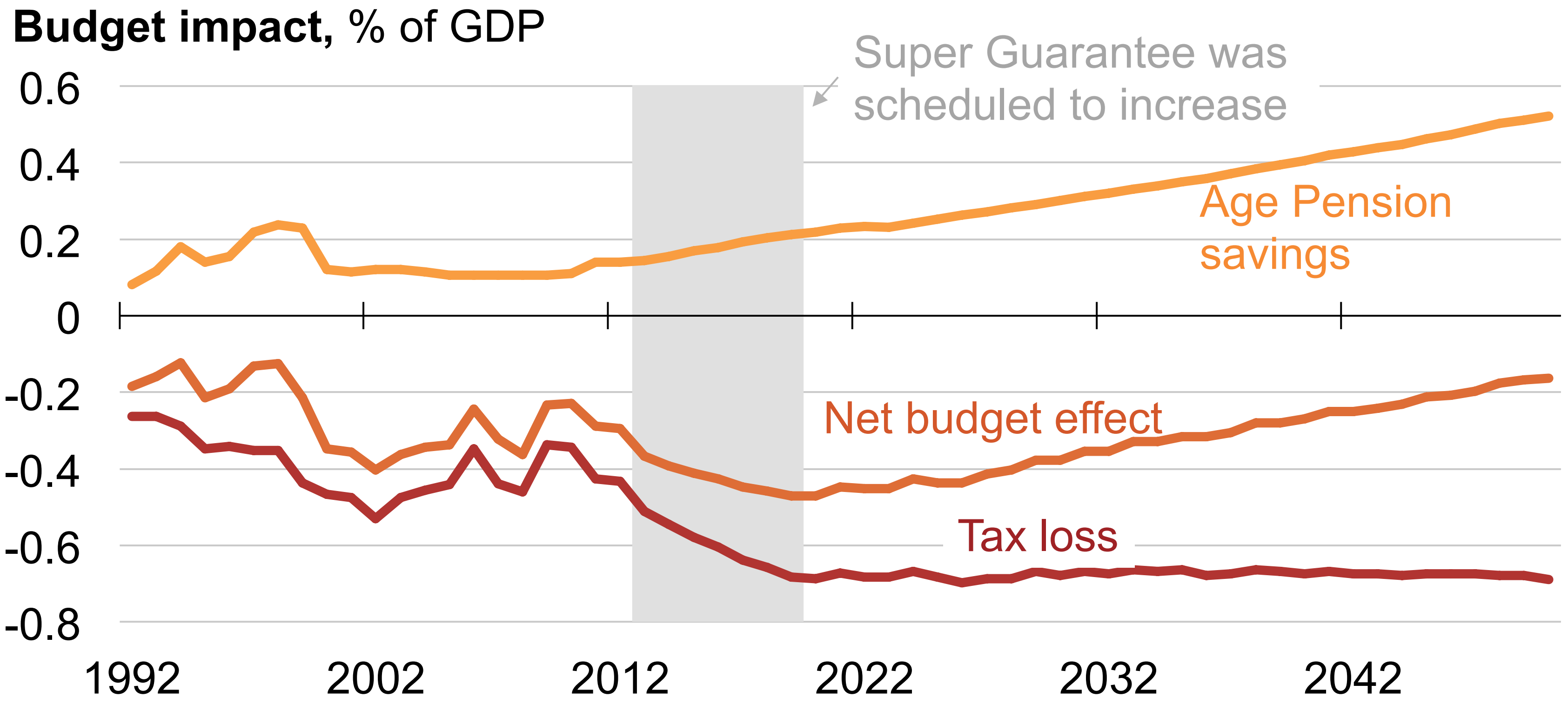

Notes: The 2010-11 Budget predicted that increasing the Super Guarantee by 0.25 ppt would cost the Budget $240m in 2013-14. The 2014-15 Budget predicted that not increasing the Super Guarantee by the previous Government's policy of 0.5 ppt would save $440m in 2017-18. These cost estimates were done before recent policy changes: a higher pension assets test taper rate and tightening of super tax breaks. These changes will add up to a fiscal saving of ~0.1 per cent of GDP in 2018-19 (higher tape rate ~$1b, super tax changes ~$0.7b). Shaded area indicates 2010-11 Budget policy.
Sources: The Treasury Charter Group 2013; Budget papers; Grattan analysis

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The company tax cuts are likely to boost incomes by no more than 0.6 per cent

Expected long-term boost to GDP and GNI from a cut in the company tax rate from 30 per cent to 25 per cent, Per cent of GDP and GNI

Note: Based on Treasury analysis of the 2016-17 Budget changes. “Boost to GDP” assumes company tax cut is funded by a hypothetical, non-distorting tax; assumes flat increase to personal income tax.
Source: Treasury (2016), *Economy-wide modelling for the 2016-17 Budget*, Table 3; Grattan analysis.

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Many wealthy over-65s have low taxable incomes

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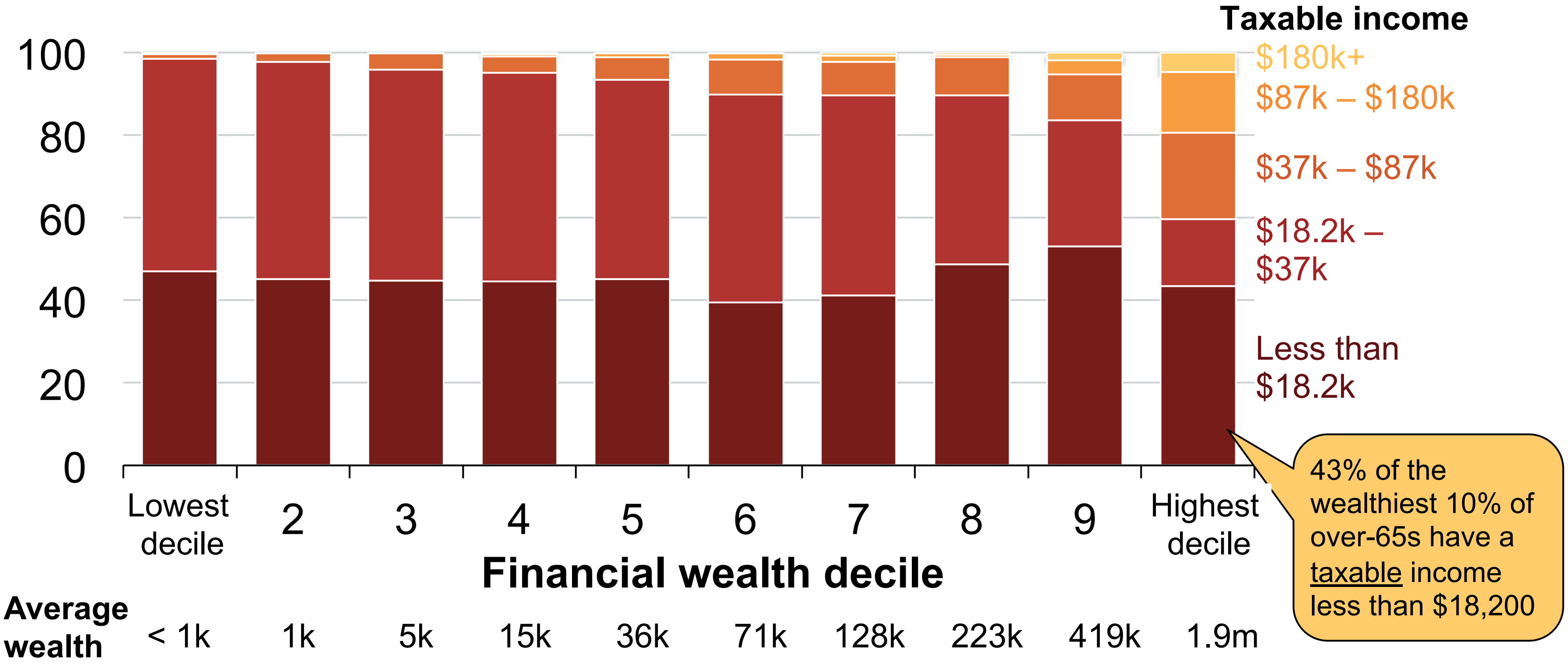
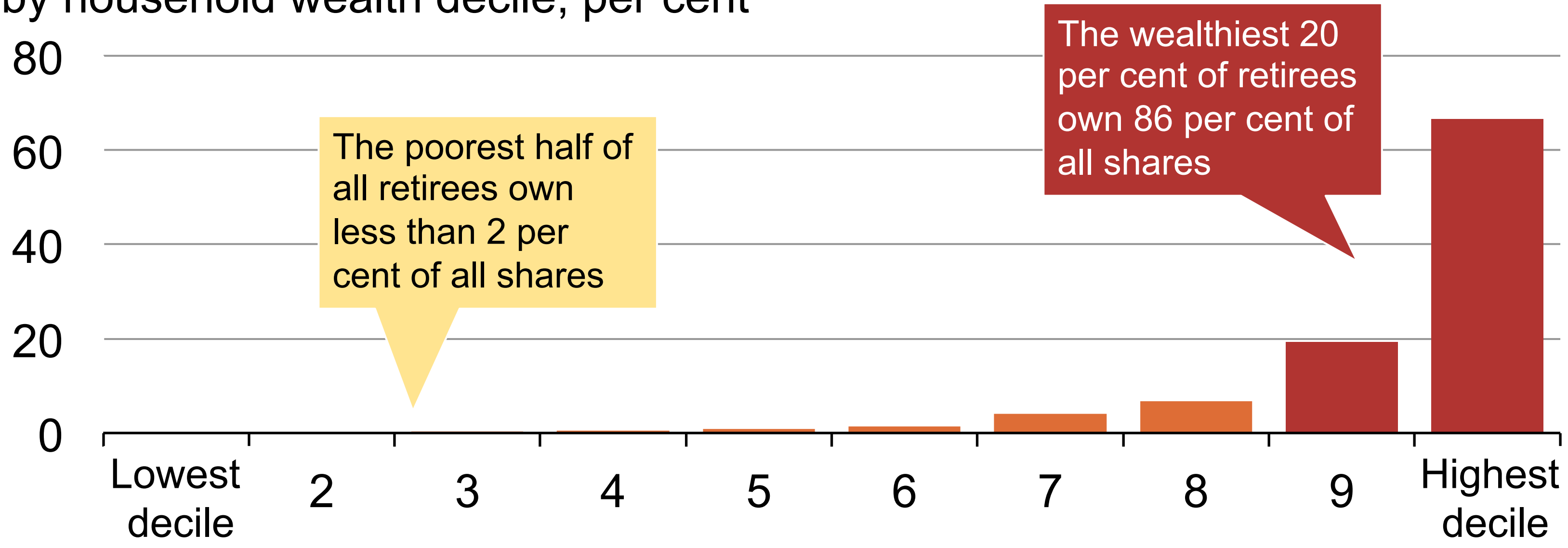
Non-super income of people aged 65+, % of each financial wealth decile



Notes: Financial wealth includes superannuation, bank accounts, bonds, debentures, business assets, trusts, partnerships, shares and other, but excludes all property assets and personal effects and motor vehicles. Income is total income less superannuation withdrawals.
Source: Survey of Income and Housing 2015-16; Grattan analysis.

Most shares are owned by wealthier retirees, with higher incomes

Proportion of direct shareholdings by over-65s, by household wealth decile, per cent



Average income	$29k	$37k	$35k	$39k	$40k	$44k	$57k	$57k	$74k	$161k

Note: Total income includes superannuation withdrawals but excludes superannuation earnings.
Source: Survey of Income and Housing 2015-16; Grattan analysis.

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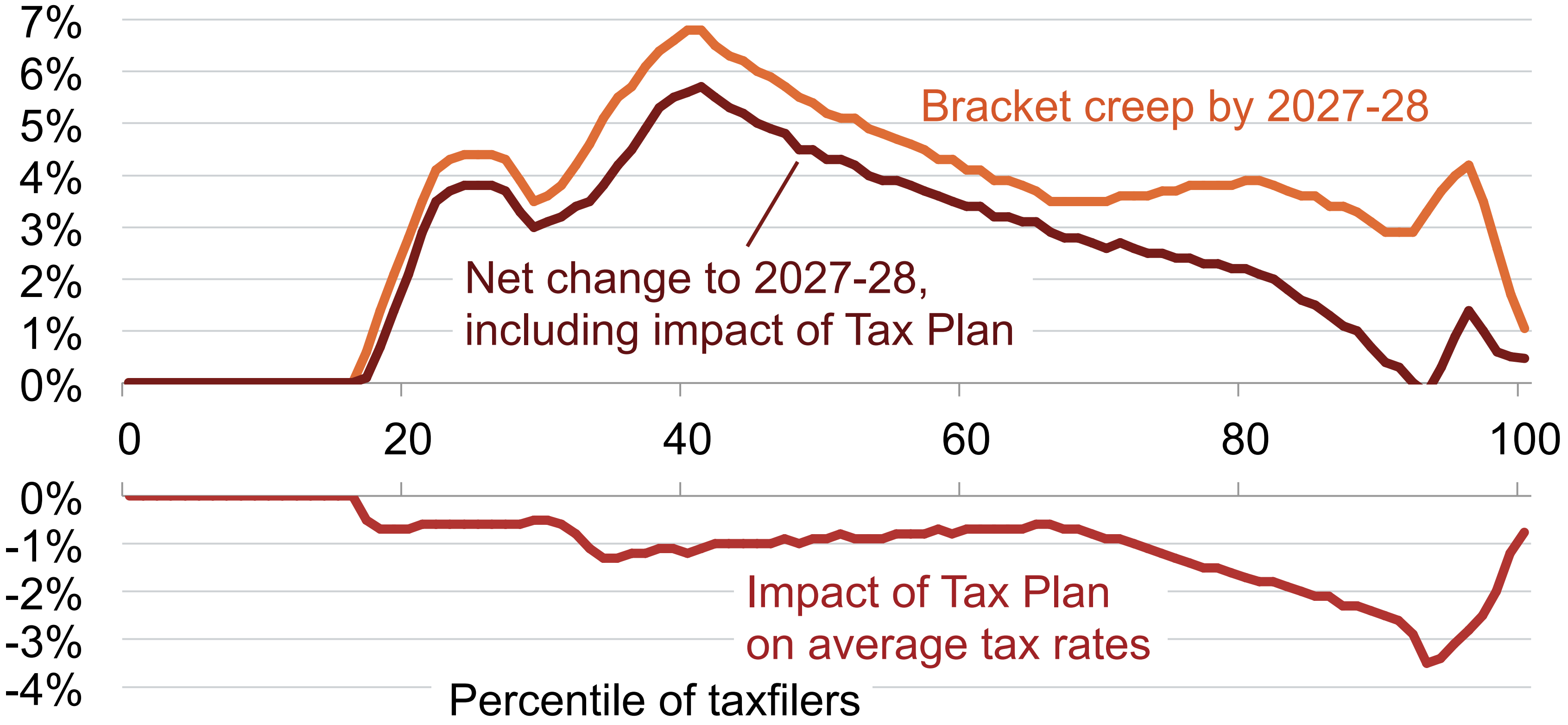
Bracket creep hurts middle incomes most; Tax Plan helps top 20% more

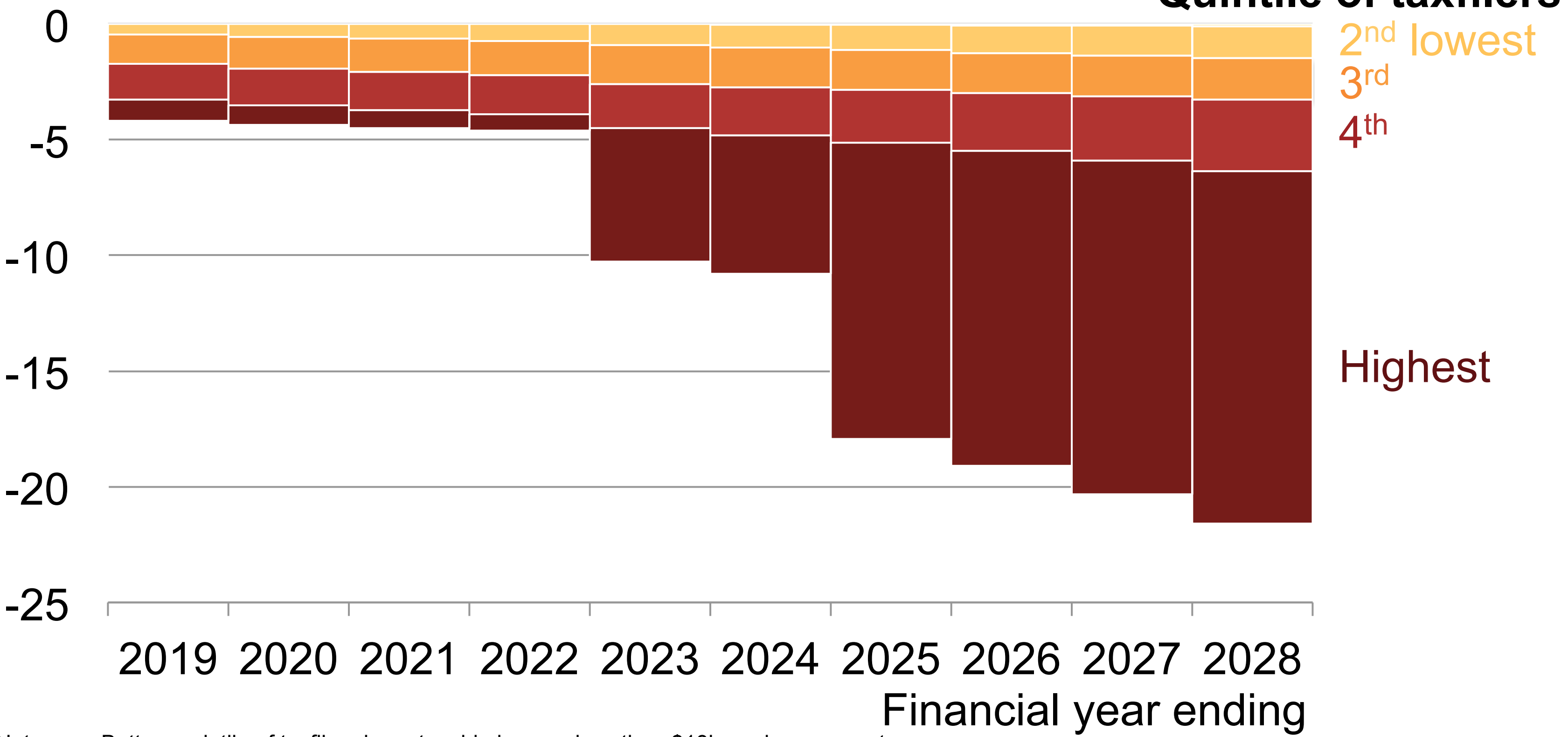
Change in average tax rates by taxable income percentile, %



Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16.

Top 20% of income earners get 60% of revenue foregone under the Tax Plan

Budgetary impact of 2018 tax cuts, $b



Note: Bottom quintile of taxfilers have taxable income less than $18k, and so pay no tax

Source: Commonwealth Budget Papers, 2018-19; Grattan analysis ATO Taxation Statistics 2015-16

Overall share of tax paid by higher income earners falls a little under 2018 tax changes

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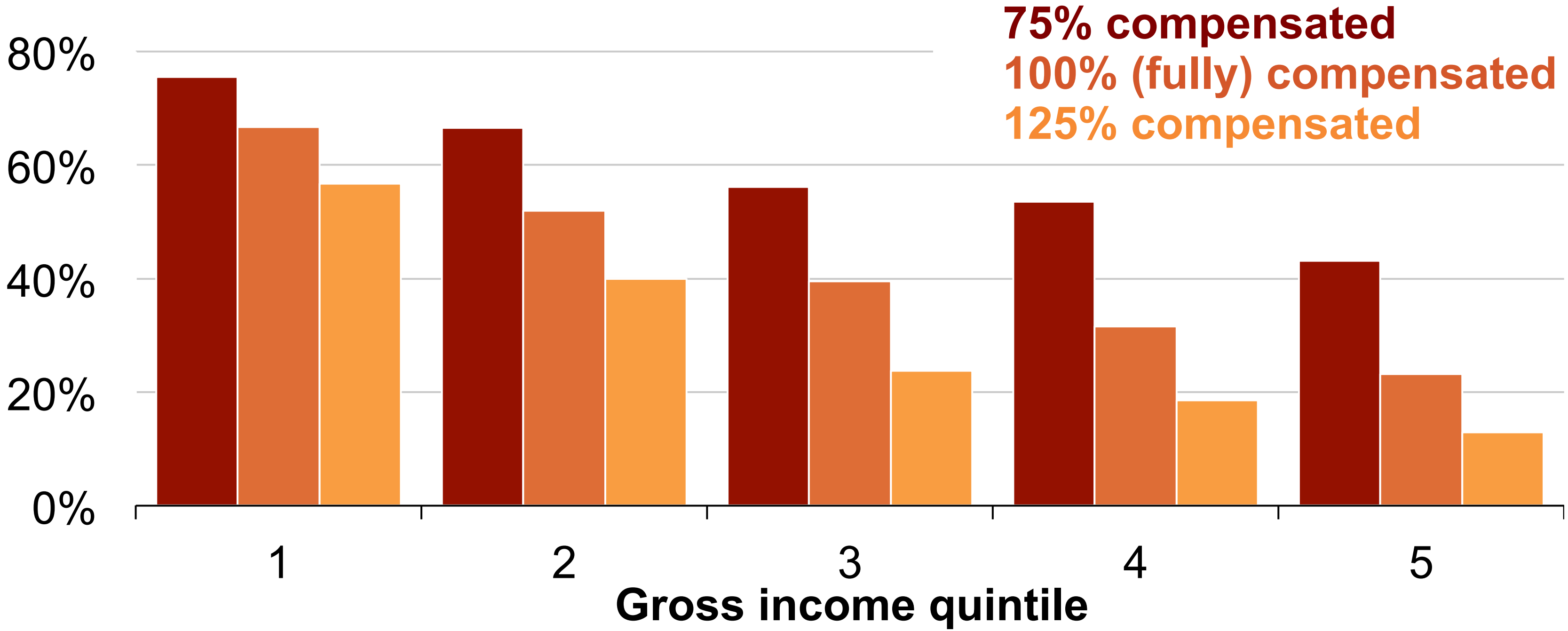
Percentile	Share of income	Share of income tax		
		2017-18	2027-28 (no change to tax rates)	2027-28 tax changes
1-10	0.4%	0%	0.0%	0.0%
11-20	2.2%	0%	0.0%	0.0%
21-30	3.6%	0.4%	0.8%	0.7%
31-40	5.0%	1.6%	2.2%	2.1%
41-50	6.5%	3.4%	4.2%	4.2%
51-60	8.0%	5.8%	6.2%	6.3%
61-70	9.8%	8.5%	8.6%	8.9%
71-80	12.2%	12.1%	12.1%	12.3%
81-90	15.7%	17.8%	17.8%	17.7%
91-99	26.5%	32.9%	32.3%	31.5%
Top 1%	9.9%	17.5%	15.8%	16.3%

GST reform package could improve incomes for most in the bottom half

Percentage of each quintile at least compensated by the amount shown after higher GST, higher welfare payments and tax cuts



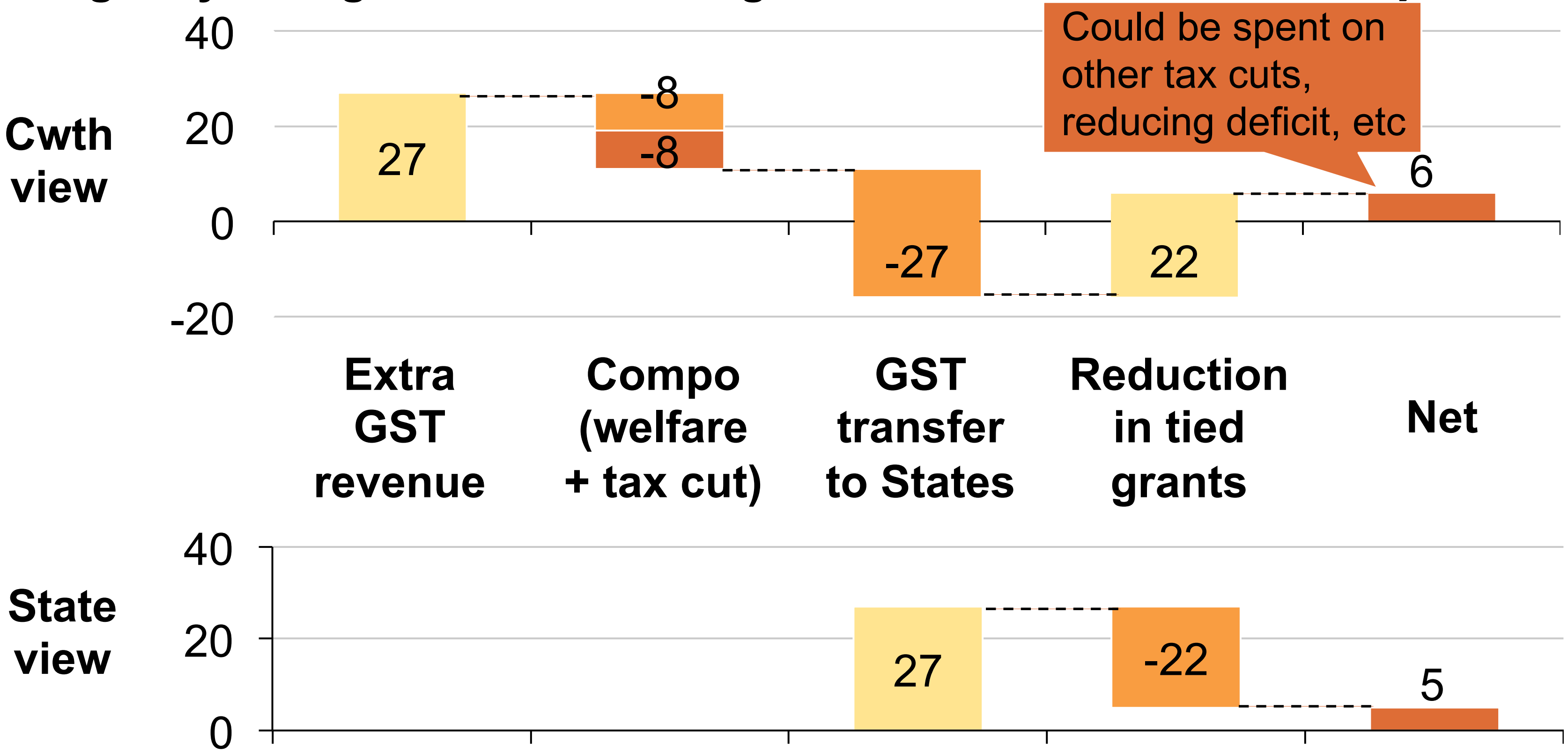
Note: Assumes that 30 per cent of the additional revenue from increasing the GST to 15 per cent is spent on higher welfare payments and 30 per cent is spent on tax cuts of approximately 2pp for tax brackets under $80k.

Source: Grattan Institute, *A GST reform package*

A GST reform package can be progressive, and attractive

GRATTAN Institute

Budgetary changes from increasing GST to 15%, 2014-15, $billion/yr



Source: Grattan Institute, *A GST reform package*

An overview of tax reform

	Economy	Budget	Inequality	Housing	Consensus
Property tax swap	Improves housing alloc'n	swap	High wealth	Helps downsizing	Near unanimity
Negative gearing / CGT	↓ housing over-invest & lev'g	+$2-6b	High wealth	Don't exaggerate	Rent impact?
Super	Minimal	+$1-4b	Top 10%	Inter-generational	Savings impact?
Corporate (rate)	+ Foreign investment	-$12b for 5%	+ Foreign owners		Investment v GNI?
Corporate (internat)	Positive GNI	+$1-2b	- Foreign owners		Technical
Trusts	Reduces tax planning	+$1-2b	Top only	Inter-generational	Technical
Dividend cash refunds	Distorts super, ↑ planning	+$6b	Mostly high wealth	Inter-generational	2nd best to super reform
Income / consumption	Distorted spending	+$7b	Depends		Work impact?
Resource rents	Distorted investment	? large	Mostly top & foreign		Design issues

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- Rigorous
- Practical

Analysis of Australian domestic public policy

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