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SPECIAL BUDGET UPDATE

Welcome to TaxWatch's Special Budget Update, providing an overview of the effects of the 2011-2012 federal budget on Australia's tax system. This is the first of two special budget updates, the second one which will follow shortly will include a selection of comment from other sources. (Julian Disney, Convenor, TaxWatch)

KEY TAX MEASURES IN THE 2011-12 COMMONWEALTH BUDGET

Comments by Prof Julian Disney

WHAT'S IN THE BUDGET ?

> **The Dependent Spouse Tax Offset will be phased out for most people under 40 years old (saves $755 million over 4 years)**

Comment: This is a long-overdue reform, although it will increase the incentive to exploit the larger and more damaging income-splitting loophole which is available through the use of trusts. That loophole should have been addressed directly in this Budget.

> **The portion of Low Income Tax Offset (LITO) which can be received fortnightly will be increased from 50% to 70% (costs $1.25 billion over 4 years).**

Comment: This is a very modest but desirable benefit for low-income people. Improvements to the LITO are generally preferable to increasing the tax-free threshold or cutting the lowest marginal rate, both of which flow on excessively to high-earners.

> **The LITO will not apply to minors who get income from other sources rather than earning it themselves (saves $740 million over 4 years).**

Comment: This is a good reform, addressing a loophole which had escaped the attention of many reformers but not of inveterate tax avoiders on high incomes. It will reduce to a significant extent the attractiveness of using trusts to split income with children although there will remain scope for tax avoidance through transfers to children which purport to be earned income.

> **The Fringe Benefits Tax on company cars will be at a flat rate of 20% irrespective of usage (saves $970 million over 4 years).**

Comment: This is a useful but flawed reform to reduce excessive car usage, inequity and erosion of revenue. It desirably reduces the previous incentive to drive very long distances but regrettably increases the incentive to drive shorter distances rather than, for example, use public transport. It also suffers from the inherent weakness of the basic FBT regime being based on the top marginal rate rather than a more progressive structure. There will be some scope for abuse of the preserved right to base claims on log books.

> **The Family Tax Benefit A will be increased very substantially for parents of people aged 16-19 years who are in full-time secondary education (costs $770 million over 4 years).**

Comment: This increase should be accompanied by much better availability of secondary education that meets the interests and aptitudes of people seeking employment opportunities which do not require tertiary education.

> **The freeze of indexation of thresholds and rates which affect payments of Family Tax Benefit A to high-earners will be continued for two more years (saves $1.2 billion over 4 years). The freeze will also apply to indexation of Family Tax Benefit supplements (saves $800 million over 4 years).**

Comment: The modest reductions in payments to wealthy families are justifiable savings to help achieve a tight budget.

> **The Child Care Rebate will be claimable on a weekly to fortnightly basis and can be paid directly to the provider.**

Comment: The Rebate should have been merged in to the Child Care Benefit (as recommended by the Henry Review) or means-tested more tightly.

> **The Education Tax Rebate will be increased considerably to help pay for school uniforms.**

Comment: An increase of this kind is of dubious merit when the rebate is not means-tested and the educational uses to which it can be put are so limited.

> **The Entrepreneur's Tax Offset will be replaced by the previously announced cut in the corporate income tax rate and by other tax concessions for small business (net cost or saving is undisclosed)**

Comment: These changes are generally appropriate, although the cut in the corporate income tax rate should not exceed 1-2% at most (rather than the foreshadowed cut of 5%).

- **The annual caps on concessional superannuation contributions for people over 50 who already have accumulated benefits of $500,000 will be set at $25,000 and one-off relief from penalty rates for excess contributions will be provided.**

  Comment: These changes modestly improve the scheme.

- **The tax treatment of losses on Infrastructure Australia's priority projects will be more generous.**

  Comment: This change is broadly acceptable.

- **Charities will be taxed on profits from unrelated commercial activities and their GST and FBT concessions will not be available for those activities.**

  Comment: These changes are sound in principle but raise great difficulties of interpretation in practice. The associated promise to define charity by statute could be useful but must not swing from being too permissive to too restrictive.

WHAT SHOULD HAVE BEEN IN THE BUDGET ?

- **Trusts should be taxed on the same basis as companies (including the equivalent of dividend imputation) or taxed in the hands of the controller.**

  Special arrangements could be made for legitimate concerns affecting rural land holdings.

- **Negative gearing should be restricted by allowing expenses to be deductible only against income from investment, not other sources such as wages and salaries.**

  Alternatively, it could have been restricted by reducing the CGT discount and deductibility of expenses along the lines proposed by the Henry Review.

- **The superannuation tax concessions for high-earners should be reduced substantially, as recommended by the Henry Review.**

  This could have helped fund, amongst other things, the relaxation of the income test for age pensioners which is promised in the Budget.

- **The previously foreshadowed cut in the corporate income tax rate to 28% should have been abandoned or delayed further and the longer-term goal of a 25% rate should have been abandoned.**

  The corporate income tax rate is not very high by the standards of comparable OECD countries, and the overall tax on corporate incomes and payrolls is extremely low by OECD standards. In addition, we have about the most generous system of dividend imputation for shareholders.

WHAT ARE THE EFFECTS ON GENERAL LEVELS OF TAXATION ?

- **The overall level of taxation in 2011-12 is estimated by the Government to be about $27 billion less than in the final year of the Howard Government (when expressed as a percentage of GDP) – see table below.**

  The Government's projected figure for 2014-15 is about $10 billion less than in the final year of the Howard Government.

- **The overall level of Commonwealth and State taxation in 2011-12 will be about $75 billion lower than the average level in comparable OECD countries (when expressed as a percentage of GDP).**

	2006-7 (% of GDP)	2011-12 (% of GDP)	2014-15 (% of GDP)
Personal income tax (including FBT)	10.9	10.3	11.2
Corporate income tax (including RRT)	6.1	5.6	5.8
Indirect tax (including GST)	6.5	5.8	5.8
Total tax receipts	**23.6**	**21.8**	**22.9**

(Source: Budget paper No 1, Table C4)

GOVERNMENT LINKS

- Australian Government Budget website
- Transcript of Budget Press Conference
- Treasury Portfolio Budget Statements
- Govt Press Release: Making Australia's Tax System Simpler and Fairer
- Govt Press Release: FBT on Company Cars
- Govt Press Release: Low Income Tax Offset
- Govt Press Release: Dependent Spouse Tax Offset
- Govt Press Release: Special Disability Trusts Income Tax Impediments

COMMENT BY OTHER SOURCES

Community/Industry:

- **Old economy wins while new economy loses**
  The Greens, 11 May 2011
- **Progress on subsidies, but federal budget falls short on environment**
  Australian Conservation Foundation, 11 May 2011
- **Cautious Budget does not paint the full picture**
  CPA Australia, 10 May 2011
- **Relief from unfair superannuation tax welcomed**
  Taxation Institute of Australia, 10 May 2011
- **Weekly Tax Bulletin: Special Budget Report**
  (A technical summary of all tax-related changes)
  Thomson Reuters, 10 May 2011

Media:

- **Tax, women and the Henry Review**
  Miranda Stewart, The Conversation, 11 May 2011
- **The tax devil is on the indirect side**
  George Megalogenis, The Australian, 11 May 2011
- **The taxman giveth and taketh away**
  Max Newnham, Sydney Morning Herald, 11 May 2011
- **Budget a first instalment in tax reform**
  Business Spectator, 11 May 2011
- **Honk your horn, the fringe benefits tax is changing**
  Chris Reidy, The Conversation, 11 May 2011
- **Luck keeps us on the right track**
  Saul Eslake, The Age, 11 May 2011
- **Deep cuts may inoculate against future pain**
  Ross Gittins, Sydney Morning Herald, 11 May 2011

TaxWatch is an independent research and information service based at the University of New South Wales and Monash University.

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