

## **PERSONAL INCOME**

*[This Note summarises a number of problems and options for action which have been identified by tax experts, leading community sector organisations and other analysts as needing attention in the Henry report. TaxWatch itself does not express policy views.]*

### **INCOME TAX SCALES**

#### **Some key problems**

Income tax liabilities for most high-income people have fallen substantially over the last decade or so. People on very low incomes have benefited from increases in the Low-Income Tax Offset (LITO) as have people with children through increases in Family Tax Benefits. But tax cuts have been much less for many full-time workers on low or modest wages who do not have dependent children.

This inequity can be counter-productive as it reduces the net gains of entry into full-time work. Many people on below-average wage rates face effective marginal tax rates which are higher than for people earning three or four times as much, even without taking account of any loss of means-tested benefits. The imbalance could be reduced considerably by giving them access to an expanded LITO and abolishing the general tax-free threshold.

#### **Options for Action**

- Substantially increase the Low-Income Tax Offset and abolish the general tax-free threshold.
- Adopt a principle that no-one should face effective marginal tax rates above the top marginal rate (or, preferably, the second highest rate).
- Index the LITO, and perhaps the 30% tax rate threshold, to allow for price inflation or adjust for average wage increases.

### **WORK BENEFITS AND EXPENSES**

#### **Some key problems**

The Fringe Benefits Tax (FBT) concessions for fringe benefits in the form of private motor vehicles are unfair and wasteful, especially as they are more readily available and valuable to high income-earners and they encourage excessive use of vehicles in order to qualify for lower tax rates. They discriminate against public transport users and against people whose employers are unable or unwilling to structure the necessary remuneration packages.

The system of claiming tax deductions for work-related expenses is unfair and inefficient because, without good reason, it favours some kinds of expenses rather than others. For example, education expenses are claimable by people if they are in work but not if unemployed. The system is also a major reason why such a large proportion of taxpayers seek professional assistance with their tax returns. Abolition of deductibility, however, would be unfair to workers who cannot get their employees to meet the expenses and it would increase the attraction of pretending to be an independent contractor so that all expenses could be claimed (see below).

Many people, usually relatively high-earners, now engage in extensive tax avoidance through the device of salary sacrifice which is often not available to people of more modest means or working in smaller businesses. Adverse consequences include unfairness, economic distortions, complex administration and loss of public revenue. These problems would be lessened, but not eradicated, by reducing the hugely generous tax concessions for fringe benefits and superannuation.

#### **Options for Action**

- Abolish or reduce the FBT concessions, especially for motor vehicles.
- Restrict the concessions for superannuation (see section on Superannuation).
- Provide a flat-rate tax credit for work-related expenses (including for jobseekers) with additional claims allowable only on very limited grounds.
- Reduce the excessively generous tax treatment of "golden handshake" payments.

## **INDEPENDENT CONTRACTORS**

#### **Some key problems**

Many employees are being pressured or even required by their employers to operate as if they are independent contractors, thereby enabling the employers to avoid having to pay payroll tax, compulsory superannuation and other worker entitlements. The attractions of this arrangement for some employees include being able to set themselves up as a trust or company so that they can income-split or pay tax at the lower corporate rate. They may also have more scope to claim tax deductions for work-related expenses.

This situation unfairly deprives employees of rights and governments of revenue. It also creates considerable complexity and expense for the employers and employees in establishing the requisite arrangements and for the Taxation Office in monitoring and enforcing compliance.

#### **Options for Action**

- Strengthen enforcement of current restrictions on the creation of independent contractor status, income-splitting arrangements such as trusts, and claims for work-related expenses.
- Tighten those restrictions.
- Tax the undistributed profits of private companies at the top marginal rate for personal income.