

[1] TAX POLICY & AUSTRALIAN TAXATION SYSTEM

Why do we have taxes? Why does the government need money?

<ul style="list-style-type: none"> • Revenue goal • Build roads, hospitals etc.

What options are available?

1	<i>Commandeer resources</i>	Take land
2	<i>Government enterprise</i>	e.g. Singapore
3	<i>Print money</i>	Inflation
4	<i>Borrow</i>	Not sustainable
5	<i>Taxation</i>	If properly designed, it is the fairest and least disruptive

Alternative tax bases:

<p><i>Basis upon which the government determines how much each taxpayer must pay</i></p> <ul style="list-style-type: none"> • Income • Consumption (GST, tax on vices) • Wealth (land tax, total wealth) • Head tax (\$100 per head) (uncommon) • A mix of taxes
<ul style="list-style-type: none"> • Income = consumption + Δ wealth • Generally, tax on ability to pay

Australia's tax mix:

<ul style="list-style-type: none"> • Misapprehension regarding Australia's high income tax • We do not have social security tax, which is a large part of the tax mix in US • Our income tax is used to fund programs paid for by social security levies overseas
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Goals in designing a tax system (difficult to maximise all 3):

<i>Fairness/equity</i>	<p><i>Who should we tax, whom should we tax, how much, how should we tax?</i></p> <p><i>Horizontal equity</i></p> <ul style="list-style-type: none"> • Taxpayers in like economic positions are treated alike • Hard to measure similarity • e.g. Is \$100 trust fund vs. \$100 labour same economic position? <p><i>Vertical equity</i></p> <ul style="list-style-type: none"> • Taxpayers in better financial positions should pay more tax • Due to greater ability to pay (controversial)
<i>Efficiency</i>	<p><i>Neutrality</i></p> <ul style="list-style-type: none"> • Taxes should not influence/disrupt individual choices <p><i>Elasticity</i></p> <ul style="list-style-type: none"> • How strongly people react to a change in tax policy • Reflected in consumption tax (GST)

<i>Efficiency</i>	<p><i>Incidence vs. burden (of the tax)</i></p> <ul style="list-style-type: none"> • Person with the incidence of tax does not always bear the burden • <i>e.g. Corporate tax</i> <ul style="list-style-type: none"> ○ Incidence is on the corporation ○ Burden is not on the corporation ○ Burden is no the staff, customers etc. <p><i>Deadweight loss</i></p> <ul style="list-style-type: none"> • Loss of economic efficiency that can occur when equilibrium for a good/service is not achieved/is not achievable • When you do impact a person's behaviour, the loss in happiness will always be > gain in profit
<i>Simplicity (administrability)</i>	<ul style="list-style-type: none"> • For taxpayers and administrators • Taxpayers must understand to be able to comply with the system • <i>Need a comprehensive tax base</i> <ul style="list-style-type: none"> ○ If there is a tax on labour but not capital, people will try to disguise \$ so it falls within the tax-free area (distortion)
	<ul style="list-style-type: none"> • Almost everyone complains that the tax system is complex. Why does tax law continue to become ever more complex if everyone agrees that it is too complex? • What does all this have to do with tax evasion, avoidance?

Example:

<ul style="list-style-type: none"> • What is the fairest way to raise \$25? • What else would you like to know? Type of tax (e.g. disability) 				
A	B	C	D	E
\$7	\$12	\$17	\$23	\$41

<i>Tax</i>	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>	<i>E</i>	<i>Explanation</i>
Head	\$5	\$5	\$5	\$5	\$5	Regressive tax (earn more, pay less)
Flat (25%)	\$2	\$3	\$4	\$6	\$10	Appearance of fairness but regressive in effect
Progressive	\$0	\$1	\$3	\$5	\$15	Australia

Individual income tax rates:

<ul style="list-style-type: none"> • These rates apply to individuals who are Australian residents for tax purposes
<ul style="list-style-type: none"> • <i>Tax year</i> <ul style="list-style-type: none"> ○ 1 July – 30 June
<ul style="list-style-type: none"> • <i>Marginal tax rate</i> <ul style="list-style-type: none"> ○ Tax rates do not apply to entire taxable income, but to each additional dollar ○ (cf Overall tax rate)

- *Progressivity*
 - Rates progressively get higher as you earn more
 - Complex
 - Tax planning (to make it look like you are in a lower tax bracket)
 - Less efficient
 - Unfair

Sch 7, ITRA – tax rates 2015-16 (apply from 1 July 2015)

<i>Taxable income</i>	<i>Tax rate</i>	<i>Tax payable</i>
\$0 – \$18,200	0%	\$0
\$18,201 – \$37,000	19%	19c for each \$1 over \$18,200
\$37,001 – \$80,000	32.5%	\$3,572 + 32.5c for each \$1 over \$37,000
\$80,001 – \$180,000	37%	\$17,547 + 37c for each \$1 over \$80,000
\$180,001 and over	45%	\$54,547 + 45c for each \$1 over \$180,000

The above rates do NOT include

- Medicare levy of 2% (there is a tax free threshold)
- Temporary budget repair levy of 2% (for taxable incomes over \$180k)

Example:

	<u>2011</u>	<u>2012</u>
<i>Taxable income (TI)</i>	\$37,000	\$37,000
<i>Marginal tax rate (MTR)</i>	15%	19%
<i>Tax payable</i>	\$4,650	\$3,572
	<ul style="list-style-type: none"> • \$0 – \$6k = 0 • \$6,001 – \$37k = 15% • (\$37k - \$6k) * 0.15 	<ul style="list-style-type: none"> • \$0 – \$18,200 = 0 • \$18,201 – \$37k = 19% • (\$37k - \$18,200) * 0.19
<i>Average tax rate (ATR)</i>	12.6%	9.7%
	<ul style="list-style-type: none"> • \$4,650/\$37k 	<ul style="list-style-type: none"> • \$3,572/\$37k

- Bigger tax free threshold in 2012, paying less tax
- MTR increased in 2012 (if earning in 2nd bracket), but ATR decreased

Example:

<i>TI</i>	<i>2011 tax</i>	<i>2012 tax</i>
<i>15k</i>	\$1,350	\$0
	<ul style="list-style-type: none"> • (15k - 6k) * 0.15 	
<i>80k</i>	\$17,550	\$17,547
	<ul style="list-style-type: none"> • (37k - 6k) * 0.15 = \$4,650 • \$37,001 – \$80k = 30% • (\$80k – \$37k) * 0.30 = \$12,900 • \$4,650 + \$12,900 	<ul style="list-style-type: none"> • (37k – 18.2k) * 0.19 = \$3,572 • (80k – 37k) * 0.325 = \$13,975 • \$3,572 + \$13,975

Example:

- Taxable income - tax + family benefit

Assume that the taxpayer is entitled to \$3,000 of family benefit, but that for each dollar of income over \$40,000 the family benefit is reduced by 25c

What is the MTR and ATR when the taxpayer goes from \$37,000 to \$37,001 of TI?

<i>Income</i>	<i>Tax</i>	<i>Family benefit</i>	<i>Total</i>	<i>Effective/EMTR</i>
\$37,000	\$3,572	\$3k	\$36,428	32.5%
\$37,001	\$3,572 + 0.325c	\$3k	\$36,428.675	

From \$40,000 to \$40,001?

<i>Income</i>	<i>Tax</i>	<i>Family benefit</i>	<i>Total</i>	<i>Effective/EMTR MTR</i>
\$40,000	\$3,572 + \$975	\$3k	\$38,453	(32.5% + 25%) = 57.5%
\$40,001	\$3,572 + \$975.33	\$2,999.75	\$38,453.43	

Tax design system:

<i>Schedular system</i>	<i>Global system</i>
<p><i>Income is divided into categories and each is taxed separately (different rate)</i></p> <ul style="list-style-type: none"> • Labour income • Investment income • Business income 	<p><i>All income goes into one pile</i></p> <ul style="list-style-type: none"> • Not differentiate between income earned

Australia has a mix (global system with scheduler element)

- Law is stated in a global way,
- But the components that go into taxable income are treated differently

Different rules for different types of income:

- Salary
- Business (through company)
- Royalties
- Annuity/insurance
- Capital gains
- Trust income (interest)
- Everything paid for
- Gift
- Lottery win

Income Tax Legislation:

- *Income Tax Act 1986*
- *Income Tax Assessment Act 1936* (dashes e.g. s 4-10)
- *Income Tax Assessment Act 1997* (no dashes)
- *Income Tax Rates Act 1986*
- *Fringe Benefits Tax Act 1986*
- *Fringe Benefits Tax Assessment Act 1986*

What is a tax?

Roy Morgan Research

Decision	Superannuation guarantee (collected from employer) = tax
Principle	<u><i>A compulsory exaction of money by a public authority for public purposes, enforceable by law</i></u> <ul style="list-style-type: none">• <i>Okay if it regulates activity</i><ul style="list-style-type: none">○ Tax on a vice (tobacco) can change behaviour• <i>Okay if it does not raise revenue/raises minimal revenue</i>• <i>Part of government's general revenue</i>• <i>Cth can regulate in areas of State power</i><ul style="list-style-type: none">○ Cth cannot regulate in relation to area x○ But, can impose a tax in relation to behaviour related to area x
NOT	<ul style="list-style-type: none">• Not a fee for service/penalty• Not arbitrary/variable/discriminatory

Concepts of income – structure of income tax:

s 4-1 ITAA 1997 – who must pay income tax?

Income tax is payable by each **individual** and **company**, and by **some other entities**

s 4-10(1) ITAA – tax period

You must pay income tax for each **financial year (1 July – 30 June)**

s 4-10(3) ITAA – tax payable

Income tax payable = (taxable income * rate) – offsets

- Only assessable income goes into the calculation
- Offsets = a reduction in amount of tax you need to pay
- e.g. Low income tax offset
- Some offsets are refundable, others are not