

# Income Tax

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## AUSTRALIAN DEMOCRATS ACTION PLAN INCOME TAX TAXATION, FINANCE & CORPORATE AFFAIRS

*The key message for income tax is that the Australian Democrats propose a structured tax reform plan based on five key priorities which are: raising the tax-free threshold, indexing the rates, broadening the tax base, addressing negative tax-welfare intercepts and finally, delivering sustainable tax cuts. This is the Australian Democrats five pillars agenda for taxation reform. The current income tax system is complex and highly inefficient due to significant 'churning' effects and unnecessary tax concessions. Democrat policy aims to improve measures of equity, simplicity and efficiency within the Australian taxation system.*

*"The Democrats propose a five pillars agenda for taxation reform to improve measures of equity, simplicity and efficiency in the Australian taxation system."*

**Senator Andrew Murray**  
Spokesperson on  
Taxation, Finance and  
Corporate Affairs

## Our Action Plan

- To increase the tax-free threshold so that the lowest earners are not taxed;
- To index income tax rate thresholds to maintain their present value;
- To broaden the income tax base;
- Reform intersection of tax and social security to encourage welfare-to-work;
- Sustainable reductions in income tax by lowering tax rates and/or increasing tax thresholds;
- Harmonising the taxation treatment of trusts, partnerships and companies;
- To reform negative gearing, see Negative Gearing Action Plan; and
- To reform the Capital Gains Tax system – see Capital Gains Tax Action Plan.

## Democrats Five Pillars taxation reform plan

Australia's income tax system is in need of a comprehensive structural overhaul that fosters the development of a modern civil society, stimulates growth competition jobs and investment, and is equitable efficient and inclusive. The Australian Democrat's five pillars agenda for taxation reform focuses on:

1. raising the tax-free threshold;
2. indexing tax rate thresholds;
3. broadening the taxation base;
4. reviewing and addressing negative tax-welfare interactions; and,
5. lowering taxation rates and raising taxation thresholds.



Other ACTION PLANS are available online at  
[www.democrats.org.au](http://www.democrats.org.au)

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## Issue One: Raising the Tax-free threshold

The Australian Democrats propose a phased increase over a number of years in the tax-free threshold from \$6 000 (which is less than half the OECD average) to \$20 000. People cannot live on \$6 000 a year. Australia's welfare floor is presently around \$13 000, the minimum income required for basic subsistence. There is no justification for income taxing someone earning less than this amount.

In addition, by continuing to tax individuals at an absolute rather than indexed value, this social inequality is magnified each year. Taxes from low income earners are returned as tax rebates or welfare benefits. What is the point of paying tax as a low income earner when that tax is ultimately returned in the form of a rebate?

By raising the tax-free threshold to \$20 000, around 2 million low income earners are removed from the taxation system – a significant equity efficiency and welfare gain. These gains will cost an estimated \$20 billion, which would necessitate a phased introduction. However taking millions of Australians out of the income tax system provides some revenue savings opportunities. Tax deductions cannot be claimed if your total income is below the threshold. As an example, taxpayers earning less than \$20 000 claimed well over \$1 billion in work-related expenses.

There are at least four advantages offered by a higher tax-free threshold. There are practical, psychological, immediacy and administrative benefits. From a practical perspective, excluding low income earners makes sense, from a personal equity and efficiency point of view. For a tax-free threshold to be socially effective it needs to affect a large aggregate, meaning a high tax-free threshold therefore.

The psychology of knowing what proportion of your income is entirely yours to keep has high utility. It is an intrinsic good. For obvious reasons, that utility is not satisfied nor is it effective when a tax-free threshold is too low.

'Churning' means tax paid every pay-day is rebated back to the tax-payer up to 18 months later. Immediacy has great attractions. Money earned and received within a week or two of work done is better regarded than any time lag in receiving compensating rebates, credits, or welfare adjustments.

Administration has two components – the private and the public. A high percentage of low income earners have poor administrative skills, and the self-assessed income tax return is often a chore that has its own cost in anxiety and lost opportunities, and quite frequently requires the aid of a tax agent. At the public level is the cost of being part of the tax system, calculated as tax system complexity and compliance costs. Tax rebates and offsets also complicate the tax system and are administratively costly.

## Issue Two: Indexing tax rate thresholds

The second pillar of Australian Democrats' taxation reform is an easily justified concept, that of maintaining, not raising the value of taxation thresholds. For every year that taxation thresholds remain fixed, Government benefits at our expense. There is widespread support in the professions, business and the community for the



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indexation of tax rates to maintain the present value of tax thresholds and to minimise the effects of bracket creep.

Bracket creep is the impact of inflation related salary increases on the static progressive marginal tax rates. Why should Australians have to bear withering tax thresholds whilst Government coffers are lined through the effect of bracket creep?

The Democrats have long supported indexing all income tax thresholds, but if there is insufficient funding to support that reform in one hit, a phased introduction is required. Priority must be given to where the impact will be greatest, namely, low-income earners must be supported first. This means indexing the tax-free threshold of \$6 000 before other tax bands. The tax-free threshold has not been adjusted since 2000. In that time its value, due to the effects of inflation, has depreciated by over 20%. All wage earners benefit from indexing the tax-free threshold at an equal rate. Preserving the value of the tax-free threshold has a far greater proportional benefit to a low income earner than to a high income earner.

## Issue Three: Broadening the tax base

The Democrats' third pillar of tax reform proposes broadening the tax base to remove unnecessary tax concessions, reduce tax loopholes, simplify Australia's taxation system and to pay for structural reforms. A broad tax base will preserve taxation revenue, reduce tax evasion, lower rates and simplify the tax system.

A number of studies have concluded that many billions can be saved by income tax base broadening. ACOSS for instance have calculated ending tax concessions that would produce over \$7 billion in savings.

Base-broadening measures the Democrats have considered include reductions in a number of claimable tax-deductions and concessions such as FBT concessions for company cars, CGT discounts and negative gearing deductions. These three measures alone account for in excess of \$5 billion per annum in taxation revenue forgone and amongst others, represent significant potential tax savings that might fund structural tax reform.

## Issue Four: Tax-Welfare Intercepts

Reviewing and improving negative tax-welfare interactions is the fourth pillar of structural reform which targets unacceptably high effective marginal tax rates (EMTRs) faced by many low-income families. It is a vital reform to move Australians from welfare-to-work. As low income earners seek to increase their earnings, they face the loss of welfare as they gain greater income which in turn is more progressively taxed. This loss of welfare and gain of taxable income is described by the EMTR.

Low and lower income Australians struggle with a tax threshold that kicks in at a ridiculously low level of \$6 000, and they struggle with the highest EMTRs of all because as they earn more, welfare benefits reduce. The Coalition Government has improved incentives to work, through reducing taper rates on welfare payments (i.e. cutting EMTRs), lowering tax on low-income earners, and raising the low-income tax offset. However, with EMTRs as high as 60%, there are still disincentives for



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low income earners to progress from welfare to work. This perpetuates structural poverty in a society of plenty.

Tax rates for low income earners cannot be addressed without sympathetic adjustments to welfare rates. To get people off welfare and into work the tax and welfare intersects must be targeted with further reform. This will require a thorough review.

There is also a strong interplay between the level of the tax-free threshold, the dependency on welfare and stimuli for engaging with the workforce. There are over 2 million Australians paid less than \$20 000 a year. They could all be taken out of the tax system. Many of these are casual and part-time workers, particularly women, who need not pay income tax at all, which would be great for struggling families and mothers, among others.

Combined with welfare reform the aim should be to lower EMTRs for low and middle income earners. Significant equity and efficiency gains would result in this simplified system, particularly for lower income Australians.

## Issue Five: Lower tax rates

The fifth and final pillar of taxation reform is a long-term goal of the Australian Democrats - that of reducing income tax rates and/or increasing tax thresholds in a sustainable fashion. By implementing a re-structured, broad-based income tax system, that is more efficient and simpler to both administer and use, all Australian's stand to gain through an efficient and simpler tax system that can afford lower income tax rates indexed to inflation.

Recent Government income tax policy changes have increased tax thresholds as described in the table below. The Democrats have argued against improvements for higher income earners until low income earners needs are met. Our focus on prioritising the tax-free threshold before changes to the top tax threshold is well documented. Democrat legislative amendments have attempted to oppose the tax threshold changes to the top two tax bands whilst proposing indexing the tax-free threshold as an alternative – funded by savings from the opposed top tax threshold changes and a proportion from current and projected future budget surpluses.

Rate	Previous Thresholds	New Thresholds (1/7/07)	New Thresholds (1/7/08)
%	\$	\$	\$
0	0-6,000	0-6,000	0-6,000
17	6,000 – 25,000	6,000 – <b>30,000</b>	6,000 – 30,000
30	25,001 – 75,000	<b>30,001</b> – 75,000	30,001 – <b>80,000</b>
40	75,001 – 150,000	75,001 – 150,000	<b>80,001 – 180,000</b>
45	150,001+	150,001+	<b>180,001+</b>

The Democrats are not opposed to the notion of reducing the top tax rate or increasing the top tax threshold. Indeed, we have long campaigned for a staged



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and prioritised reform of the Australian income taxation system, which includes measures to reduce high income tax. However, any attention to reform for high-income earners should be subsequent to reform for low-income earners.

## Issue Six: Other issues

Another income tax priority for the Democrats is to harmonise the taxation treatment of businesses using different legal structures such as trusts, partnerships and companies so that trusts, in particular, cannot be used to pay less tax than companies. The principle is a simple one, one that the Coalition has baulked at. The Democrats say that regardless of the entity and legal structure a business uses, business activities should be taxed on a common basis.

Similarly, negative gearing has historically been targeted by the Democrats as an excessive tax avoidance practice. Moreover, negative gearing has led to the magnification of the national housing affordability crisis through investor residential property ownership that oftentimes is driven more by the attractiveness of negative gearing tax concessions and capital gains than the underlying value of the asset.

Negative gearing costs Australia well over \$2 billion a year. The Democrats propose that losses should be claimable against income from the related investment, but not against other earned income.

Negative gearing feeds into capital gains tax problems. The generous 100% deduction for negative gearing is compounded by a low capital gains tax (CGT). There is a tax arbitrage effect due to the conversion of capital to income.

Apart from tax minimisation techniques, the Democrats believe very large tax avoidance occurs with CGT. With respect to many asset purchases (like property) the transactions records are frequently held in state registries. These State systems are not easily accessible by the ATO, because there is no unique identifier in the state registries. It is therefore very difficult for the ATO to check on capital gains. Consequently there is large scale tax avoidance.

CGT is part of the income tax system. Many oppose it. The Democrats support it, but believe it should be highest for speculative gains, and should be concessionally rated for long term productive investment.



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