



TAX FORUM

4-5 October 2011

STATEMENT OF REFORM PRIORITIES

PARTICIPANT NAME AND POSITION

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ORGANISATION

The National Centre for Social and Economic Modelling (NATSEM) is one of Australia's leading economic and social policy research institutes, and is regarded as an international centre of excellence for microsimulation, economic modelling and policy evaluation. NATSEM undertakes independent and impartial research, and aims to be a key contributor to social and economic policy debate and analysis in Australia and throughout the world through economic modelling of the highest quality, and supplying consultancy services to commercial, government and not-for-profit clients.

NATSEM does not have corporate views on policy. Recommendations in this position statement are informed by evidence from NATSEM's own analysis and published research.

STATEMENT OF PRIORITIES

1. What are your priority reform directions for the tax and transfer system?

I. Simplification and transparency

A number of the recommendations in the 2010 Report to the Treasurer on *Australia's Future Tax System* (the "Henry Tax Review") provide sensible measures to promote greater transparency and simplicity in the Australian tax and payment system. NATSEM analysis shows there to be a strong rationale to:

- implement the recommendations of the Henry Tax Review through a simplified personal tax system with a single rate applicable for the majority of taxpayers;
- exempt income support and transfer payments from tax, and removing the low income, beneficiary, pensioner and senior Australians tax offsets;
- explore the scope for the comprehensive means testing of payments, incorporating 'deemed' income from assets;
- review the basis for separate indexing of aged pension (indexed by average weekly earnings, AWE) and other payments (indexed by the consumer price index, CPI), noting that AWE has grown at almost double the rate of CPI over the past 10 years (61% compared with 35%).



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II. Delivering work incentives through the Australian tax and payments system

There remains a tension between the adequacy of family payments in providing support to families with children, and the potential employment disincentives created by high effective marginal tax rates (EMTRs) that apply to those receiving support. NATSEM research reflects other findings in identifying single parent households and secondary earners in families with dependent children as two groups for whom high EMTRs are most prevalent under the current system¹.

To what extent does the Australian tax and transfer system throw up high EMTRs and participation disincentives through the “stacking” of payment tapers and tax rates, and which payments create most issues in terms of negative work incentives? Those who principally face high EMTRs are (i) recipients of Newstart Allowance, Parenting Payment, Youth Allowance and Sickness Allowance (particularly those on the higher 60% rate of withdrawal); (ii) recipients of Family Tax Benefit Parts A and B combined; and (iii) recipients of FTB and Child Care Benefit combined.

We support an integrated assessment of taxes and payments in Australia to explore what scope exists to align rates and structures within the existing system to alleviate the worst disincentives. Elements of this assessment should include an examination of the following (separately and, importantly, in combination):

- A simplification of the current system of Family Tax Benefit Parts A and B into single payment with a unified income test and a taper rate set to reduce the highest EMTRs faced by secondary earners and single parent families in particular;
- Reduce the higher taper for Newstart Allowance, Youth Allowance and Sickness Allowance, harmonising to a single rate of 50%;
- Simplification and integration of CCB and CCR into a single payment (for which, more below).

A lower FTB taper for FTB would bring more families into receipt of the payment, leading to increased EMTRs for higher income families and higher FTB costs. There may be scope to combine these changes with some adjustment to the income threshold for FTB receipt to control FTB costs. Microsimulation models such as NATSEM’s own STINMOD are well placed to undertake such distributional modelling.

There has been some discussion of the benefits of a working tax credit or employment-conditional benefit program to overcome negative employment incentives and to “make work pay”? Evidence from the US, UK and Europe highlight positive effects on workforce participation from payments targeted at low-income working households. Such effects are dependent on a host of critical design considerations – the level of payment, the threshold and tapers for withdrawal of payment, the conditions of entitlement, the unit of assessment (family or individual) and the period of assessment and payment (pay-as-you-go, or in arrears). However, introducing some form of employment-contingent benefit to existing taxes and payments in Australia can serve to add complexity to an already complicated system.

¹ Harding, A. Payne, A., Vu, Q.N. and Percival, R. (2006), *Interactions between Wages and the Tax-Transfer System*, Report commissioned by the Australian Fair Pay Commission, 2006.



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III Support for childcare

There is a general consensus that the delivery of child care support in Australia through a combination of Child Care Benefit (CCB) and Child Care Rebate (CCR) is unusually complex and non-transparent. CCB is paid at an hourly rate per session of approved care (up to 50 hours per week for working families) with a maximum weekly benefit (MWB) that depends on type of care and number of children. CCB is means tested on taxable family income, with restricted eligibility for non-working families. The rate of CCR is paid as a percentage of the 'out-of-pocket' costs of child care (net of CCB) to a threshold (50% of child care expenses to a cap of \$7,500 in 2010/11).

In combination, CCB and CCR present a complex and administratively challenging system. The income means test for CCB is complicated, the rate of CCR depends on CCB entitlement, and the combination of the two elements potentially obscure the positive employment incentives that should be derived from support for child care costs².

The Henry Tax Review provided a compelling argument to simplify childcare support in Australia and improve its efficiency through the integration of CCB and CCR into a single benefit assessed on gross childcare costs and means tested on private income. The balance between universal and targeted support can be established through the retention of a maximum subsidy and a basic level of support. Any redesign should consider carefully the likely welfare and incentive impacts of change in existing support arrangements. For example, if women with higher family incomes were to get less under proposed system, how much less, how many women, and what might be effects on labour force participation? Other design features could include special provision for at-risk children, and a consideration of support for women not (or not always) in paid work.

IV. Housing and Taxation

Over the past decade housing affordability deteriorated throughout Australia. The ratio of house prices to income grew from around 4.5 during the 1990s to over 7 by 2011³, driven principally by a doubling of house prices through the last decade. The increase in the ratio is a boon for home owners who enjoy tax free capital gains but locks out low income renters from entering the market. The reasons for the sharp rise in house prices are complex and beyond the scope of the Tax Forum. However, taxation arrangements are an important element of price determination.

Australia's current tax regime tends to support home owners (those already in the market) as opposed to those attempting to gain access to the market. The regime does this by favourable treatment for the family home including no capital gains tax and not including the family home in asset testing

² Duncan, A., Vu, Q.N., McNamara, J. and Cassells, R. (2010), 'Child care assistance reform proposals in the Henry Tax Review'. Women and Tax: The impact of the Henry Tax Review Workshop, University of Sydney, July 30th 2010.

³ Phillips, B (2011), *The Great Australian Dream – Just a Dream?* AMP-NATSEM Income and Wealth Report, Issue 29 July, Sydney AMP.



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arrangements for government pensions and allowances. Both these arrangements encourage over-investment in housing and therefore place upward pressure on house prices. Those entering the market face the impost of stamp duties (admittedly often concessional for first home buyers) and if purchasing a new property, GST and the pass-through of the up-front infrastructure cost.

Housing stress is most prominent amongst low income renters (Phillips, 2011). Commonwealth Rent Assistance (CRA) provides a moderate income boost to low income households to assist in rent payments. NATSEM's research supports the proposals in the Henry Tax Review for better targeting CRA and indexing CRA payments to rent CPI. The costs of extending CRA could be offset by targeting the first home buyers grant to low and middle income families only.

The Henry Tax Review detailed the broad efficiency arguments for housing taxation policy change but NATSEM suggests further research is required into the distributional impacts of current and alternative housing taxation arrangements. NATSEM also acknowledges the strength of argument in the Henry Tax Review for a broad-based land tax to replace stamp duty, but notes that much of the supporting research to date concentrates on broad outcomes and efficiency arguments. We would support detailed analysis both of its implementation, and the distributional impact on different household groups. NATSEM would also support further research into the tax and benefit treatment of the family home.

2. How are your proposals financed over the short and longer term?

Where feasible, NATSEM will publish costings of specific recommendations through NATSEM's Tax Forum online resources, at www.natsem.com.au/taxforum (forthcoming).

LIST OF ATTACHMENTS

Supporting documentation is available through NATSEM's Tax Forum online resources, at www.natsem.com.au/taxforum (forthcoming).