



Policy costing

Liberal Democrats' tax policy	
Person/party requesting the costing:	Senator David Leyonhjelm, Liberal Democratic Party
Date costing completed:	12 September 2018
Expiry date of the costing:	Release of the next economic and fiscal outlook report.
Status at time of request:	Submitted outside the caretaker period <input checked="" type="checkbox"/> Confidential <input type="checkbox"/> Not confidential
<p>Summary of proposal:</p> <p>The proposal would make the following changes.</p> <ul style="list-style-type: none"> • Change personal income tax by: <ul style="list-style-type: none"> – abolishing the Medicare levy (but not the Medicare levy surcharge), the low income tax offset, and the low and middle income tax offset – increasing the tax-free threshold to \$40,000 – reducing the marginal tax rate for taxable income above the tax-free threshold to 20 per cent. • Reduce the fringe benefits tax (FBT) rate to 20 per cent. • Set the company tax rate for all entities, including trustees and life insurers, to 20 per cent. • Abolish the following indirect taxes: <ul style="list-style-type: none"> – tobacco, alcohol and fuel excise – customs duties – passenger movement charge – wine equalisation tax – luxury car tax – major bank levy. <p>All changes, except those to FBT, would have effect from 1 July 2019. The changes to FBT would have effect from 1 April 2020. The policy would be announced on 1 July 2019.</p>	

Costing overview

The proposal would decrease the fiscal balance and the underlying cash balance by \$622,760 million over the 2018-19 Budget forward estimates period. The fiscal balance impact reflects a decrease in revenue of \$661,000 million and a decrease in expenses of \$38,240 million over this period.

Sensitive

The proposal would have an ongoing impact beyond the 2018-19 Budget forward estimates period. A breakdown of the financial implications over the period to 2028-29 is provided at Attachment A.

The proposal would be expected to decrease departmental expenses by \$240 million over the 2018-19 Budget forward estimates period and this decrease would be ongoing. This decrease reflects the initial expenses in 2018-19 required to implement the proposal, including system changes and information campaigns, and a subsequent decrease in the ongoing costs to administer the programs to be abolished under this proposal.

There is a difference between the fiscal and underlying cash balance impact as there is a timing difference between when liabilities for goods and service tax (GST) revenue, fuel tax credit expenses and refundable research and development tax offset expenses are recognised and when these payments are made.

On 22 August 2018, the Commonwealth Government announced that they will not proceed with the unlegislated portions of the 2016-17 Budget measure *Ten Year Enterprise Tax Plan - reduce the company tax rate to 25 per cent.*¹ This change does not form part of the current budget baseline, and would be expected to be included in the budget baseline at the release of the next economic and fiscal update. In the absence of any offsetting tax measures, this proposal would be expected to result in a larger reduction in the fiscal and underlying cash balances after the next economic and fiscal update than shown in this costing.

Estimates of this proposal have a very significant impact on a number of different revenue heads and expense programs.

- The impact on personal income tax revenue includes the changes to personal income tax, the reduction to the FBT rate and the effect of the reduction in company tax rate on franking credits to individuals.
- The impact on company tax revenue includes the reduction in the company tax rate, the effect of this reduction on refunds of franking credits to charities, and the increase in company tax due to the flow-on impact to fuel tax credits due to the abolition of fuel excise.
- The impact on other indirect tax revenue includes the effects of the abolition of tobacco, alcohol and fuel excise, customs duties, the passenger movement charge, the wine equalisation tax, the luxury car tax, and the major bank levy.
- The GST revenue impact reflects the reduction to the retail price of goods whose retail prices include the cost of indirect taxes abolished under the proposal.
- The impact on superannuation tax revenue is due to the effect of the reduction in the company tax rate on refunds of franking credits to superannuation funds.
- The GST expense impact reflects the reduction in payments of GST revenue to the states and territories.
- The fuel tax credit expense impact is due to the abolition of fuel taxes removing eligibility for this program.
- The refundable research and development tax offset expense impact is due to the linkage of this rate with the corporate tax rate.

¹ <https://www.financeminister.gov.au/media-release/2018/08/22/labor-abandons-australian-businesses-and-workers>

This costing does not include any allowance for broader economic impacts from decreasing taxes. While the 2016-17 Budget Papers note that a reduction in the company tax rate is expected to increase the level of gross domestic product over time, the costing presented in the 2016-17 Budget did not include this effect. A further decrease in the company tax rate would be expected to have a positive impact on business investment and the total level of economic activity. This impact would otherwise be expected to result in higher revenues from other taxes such as personal income tax, and lower payments for programs such as working age benefits. However the magnitude and timing of these impacts is too uncertain to estimate, including because it depends on how the reduction to tax revenue is to be funded.

The costing is subject to uncertainties around the key economic parameters.² Given the magnitude and scale of the proposed change in tax rates there is also substantial uncertainty around the behavioural responses to the proposal. Changes to these assumptions could significantly alter the costing estimates.

Table 1: Liberal Democrats' tax policy – Financial implications (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	Total to 2021–22
Fiscal balance	-100	-186,890	-214,890	-221,890	-622,760
Underlying cash balance	-100	-187,980	-214,890	-220,890	-622,760

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.

(b) Figures may not sum to totals due to rounding.

Key assumptions

The Parliamentary Budget Office has made the following assumptions.

General

- As the proposal would be announced and have effect from the same day, there would be no behavioural response by individuals or entities in relation to the start date.

Changes to personal income taxes

- A behavioural response has been included to account for changes in investment decisions and tax planning arrangements by high-income earners.
 - Individuals with incomes in excess of \$180,000 are assumed to have a taxable income elasticity of 0.2.³ Individuals with taxable incomes in excess of \$1 million are expected to have a taxable income elasticity of 0.35.⁴

² There are inherent uncertainties in all policy costings, regardless of who produces them. For a more detailed discussion of the nature and sources of these uncertainties, see PBO information paper no. 01/2017, *Factors influencing the reliability of policy proposal costings*.

³ A taxable income elasticity is a measure of the responsiveness of taxable income to changes in tax rates. It measures the proportional change in declared taxable income resulting from a proportional change in the net-of-tax rate (one minus the marginal tax rate). An elasticity of 0.2 means that if an increase in a marginal tax rate leads to a 1 per cent decrease in the net of tax rate, there will be a 0.2 per cent decrease in taxable income.

Sensitive

- The behavioural response has been adjusted to reflect that the ability of individuals to increase their taxable income is likely to be limited, and diminishes as marginal tax rates reduce. The elasticities are assumed to reduce to zero for marginal tax rates less than 30 per cent.
 - ♦ Lower-income earners are likely to have less scope to realise additional income in response to lower marginal tax rates. As a result, any behavioural response from these individuals is not expected to be significant.

Company tax rate reduction

- Companies with foreign operations would not seek to increase their taxable incomes in response to the proposed decrease in company tax rate by recognising more profits in Australia, as the rate under this proposal is not lower than that in many existing low-tax jurisdictions.
- Company income, deductions and offsets will grow in line with estimated growth in gross operating surplus for all companies.
- The number of companies liable to pay company tax in Australia will increase in line with historical growth in the number of companies liable to pay company tax in Australia.
- Companies will continue to pay the same proportion of their after-tax income as dividends.

Abolition of indirect taxes

- The retail prices for products for which customs, excises and other indirect taxes are included will be reduced by the full amount of customs, excises and other indirect taxes currently applied, leading to a commensurate reduction in GST revenue and expenses.

Methodology

Changes to personal income taxes

The costing was estimated using a 16 per cent sample of de-identified personal income tax and superannuation returns for 2014-15 provided by the Australian Taxation Office (ATO). The data was used to estimate the change in tax payable under each option. Behavioural responses were incorporated, reflecting the assumptions above.

Company tax rate reduction

The impact of the proposal on company tax, dividend payments, imputation credits and refundable tax offset expenses was calculated using a microsimulation model of company tax as at the 2018-19 Budget, developed by the PBO. This model estimated the company tax liabilities for all companies over the period to 2028-29 under the current and proposed settings, based on company tax data for the 2015-16 financial year (including benchmarking to aggregate company tax revenue estimates), growth in gross operating surplus, and taking into account the effect of the imputation system. The estimates take account of a 'clawback' of tax from resident shareholders as a result of a

⁴ These elasticities are applied consistently across PBO personal income tax costings. The values are consistent with the wider empirical literature across advanced economies, where the average estimate of taxable income elasticities is close to 0.2, with higher elasticities estimated for higher income earners; see for instance, Klemm, A, Liu, L, Mylonas, V. and Wingender, P., 2018, *Are Elasticities of Taxable Income Rising?*, International Monetary Fund.

reduction in the value of imputation credits arising from a lower company tax rate. This clawback is included in the 'personal income taxes' and 'superannuation fund taxes' revenue lines in Attachment A.

Abolition of indirect taxes

The amount of forgone indirect taxation revenue and the resultant reduction in fuel tax credit scheme expenses was estimated based on 2018-19 Budget estimates. Departmental savings reflect the estimated ongoing savings from the abolition of these taxes and include the estimated costs of winding down these programs.

The change in GST revenue and expense due to abolishing excise and import duties was estimated based on the estimated change in consumption expenditure.

General

The modelling has taken into account the timing of tax collections and expense payments.

Revenue and administered expense estimates have been rounded to the nearest \$1,000 million. Departmental expense estimates have been rounded to the nearest \$10 million.

Data sources

The ATO provided a 16 per cent sample of personal income tax and superannuation returns from the 2014-15 tax year and de-identified company tax return data for the 2015-16 financial year.

Treasury provided economic forecasts for the personal income, company, superannuation and indirect taxes as at the 2018-19 Budget.

Senator the Hon Mathias Cormann, 2018. *Labor Abandons Australian Businesses and Workers*.

Australian Taxation Office, 2018. *Taxation Statistics 2015-16*, Canberra: Commonwealth of Australia.

Attachment A – Liberal Democrats’ tax policy – financial implications

Table A1: Liberal Democrats’ tax policy – Fiscal balance (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	Total to 2021–22	Total to 2028–29
Revenue													
<i>Personal income taxes</i>	-	-128,000	-147,000	-152,000	-151,000	-160,000	-164,000	-171,000	-181,000	-193,000	-205,000	-426,000	-1,651,000
<i>Company tax</i>		-18,000	-30,000	-31,000	-31,000	-30,000	-30,000	-28,000	-26,000	-27,000	-29,000	-79,000	-280,000
<i>GST revenue</i>		-5,000	-4,000	-5,000	-5,000	-5,000	-5,000	-6,000	-6,000	-6,000	-6,000	-14,000	-53,000
<i>Other indirect tax</i>	-	-48,000	-48,000	-50,000	-52,000	-54,000	-57,000	-59,000	-62,000	-65,000	-68,000	-146,000	-563,000
<i>Superannuation fund taxes</i>	-	-	1,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	4,000	18,000
Total – revenue	-	-199,000	-228,000	-236,000	-237,000	-247,000	-254,000	-262,000	-273,000	-289,000	-306,000	-661,000	-2,529,000
Expenses													
<i>Administered</i>													
<i>GST expense</i>	-	4,000	4,000	5,000	5,000	5,000	5,000	6,000	6,000	6,000	6,000	13,000	52,000
<i>Fuel tax credit</i>	-	7,000	8,000	8,000	9,000	9,000	10,000	10,000	11,000	12,000	12,000	23,000	96,000
<i>Research and development refundable tax offset</i>	-	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	2,000	6,000
Total – administered	-	12,000	13,000	14,000	15,000	15,000	16,000	17,000	18,000	19,000	19,000	38,000	154,000
<i>Departmental</i>													
<i>Australian Taxation Office</i>	-60	60	60	60	60	60	60	60	60	60	60	130	570
<i>Department of Home Affairs</i>	-40	50	50	50	50	50	50	50	50	40	40	110	430
Total – departmental	-100	110	110	110	110	110	110	110	110	100	100	240	1,000
Total – expenses	-100	12,110	13,110	14,110	15,110	15,110	16,110	17,110	18,110	19,100	19,100	38,240	155,000
Total	-100	-186,890	-214,890	-221,890	-221,890	-231,890	-237,890	-244,890	-254,890	-269,900	-286,900	-622,760	-2,374,000

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.

(b) Figures may not sum to totals due to rounding.

- Indicates nil.

Table A2: Liberal Democrats' tax policy – Underlying cash balance (\$m)^{(a)(b)}

	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	Total to 2021–22	Total to 2028–29
Receipts													
<i>Personal income taxes</i>	-	-128,000	-147,000	-152,000	-151,000	-160,000	-164,000	-171,000	-181,000	-193,000	-205,000	-426,000	-1,651,000
<i>Company tax</i>	-	-18,000	-30,000	-31,000	-31,000	-30,000	-30,000	-28,000	-26,000	-27,000	-29,000	-79,000	-280,000
<i>GST receipts</i>	-	-4,000	-4,000	-5,000	-5,000	-5,000	-5,000	-6,000	-6,000	-6,000	-6,000	-13,000	-52,000
<i>Other indirect tax</i>	-	-48,000	-48,000	-49,000	-52,000	-54,000	-57,000	-59,000	-62,000	-65,000	-68,000	-145,000	-562,000
<i>Superannuation fund taxes</i>	-	-	1,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	4,000	18,000
Total – receipts	-	-198,000	-228,000	-235,000	-237,000	-247,000	-254,000	-262,000	-273,000	-289,000	-306,000	-659,000	-2,527,000
Payments													
<i>Administered</i>													
<i>GST expense</i>	-	4,000	4,000	5,000	5,000	5,000	5,000	6,000	6,000	6,000	6,000	13,000	52,000
<i>Fuel tax credit</i>	-	6,000	8,000	8,000	9,000	9,000	10,000	10,000	11,000	12,000	12,000	22,000	94,000
<i>Research and development refundable tax offset</i>	-	..	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	6,000
Total – administered	-	10,000	13,000	14,000	15,000	15,000	16,000	17,000	18,000	19,000	19,000	36,000	152,000
<i>Departmental</i>													
<i>Australian Taxation Office</i>	-60	60	60	60	60	60	60	60	60	60	60	130	570
<i>Department of Home Affairs</i>	-40	50	50	50	50	50	50	50	50	40	40	110	430
Total – departmental	-100	110	110	110	110	110	110	110	110	100	100	240	1,000
Total – payments	-100	10,110	13,110	14,110	15,110	15,110	16,110	17,110	18,110	19,100	19,100	36,240	153,000
Total	-100	-187,890	-214,890	-220,890	-221,890	-231,890	-237,890	-244,890	-254,890	-269,900	-286,900	-622,760	-2,374,000

(a) A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

.. Not zero but rounded to zero.

- Indicates nil.