Parliamentary Budget Office

Policy costing

Introduce a 35 per cent minimum tax rate on incomes above $300,000 and make the deficit levy permanent	
Party:	Australian Greens

Summary of proposal:

The proposal has two components:

- Component 1: Permanently reinstate the deficit levy at 2 per cent for taxable incomes greater than $180,000. The fringe benefits tax rate would also increase to 49 per cent.
- Component 2: Implement a minimum tax liability (also known as a 'Buffett Rule') for individuals with total income above $300,000.
  - Total income would consist of assessable income, net investment losses, exempt foreign employment income, reportable superannuation contributions and reportable fringe benefits. Net (rather than gross) business and investment income would also be included in the calculation of total income. Franking credits would not be included as part of total income.
  - The minimum tax liability would be calculated as 35 per cent of total income.
  - The minimum tax liability would be assessed against gross tax, the application of refundable and non-refundable offsets (including franking credits), and the Medicare levy, but not the Medicare levy surcharge.
  - The $300,000 threshold would be indexed every two years in line with male total average weekly earnings.

The proposal would have effect from 1 July 2019 (for the personal income tax changes) and 1 April 2019 (for the fringe benefits tax changes).

Costing overview

Policy background

Personal income tax is levied on taxable income, which includes income from salary and wages, investment income from rent, interest and dividends, capital gains from shares or property, and a number of other sources. Individuals are also able to reduce their taxable income by claiming certain deductions that are directly related to earning income, such as expenses incurred in employment, or in earning investment income.

Under Component 2 of this proposal, individuals with a total income above $300,000 (before most deductions are applied) would be liable to pay a minimum tax liability of at least 35 per cent of their total income.

This would primarily affect individuals with total incomes above $300,000 who have significant deductions such that their average tax rate is below 35 per cent.[1] Individuals with total incomes above the $300,000 threshold would not be affected by the proposal if they have only a small amount of deductions, or if their total income is sufficiently high such that their average tax rate already exceeds 35 per cent.[2]

Financial impact

The proposal would be expected to increase the fiscal balance and underlying cash balance by $14,388 million over the 2019-20 Budget forward estimates period. This reflects an increase in revenue of $14,400 million, partly offset by an increase in departmental expenses of $12 million for the Australian Taxation Office (ATO) over this period.

The proposal would be expected to have an impact that extends beyond the 2019-20 Budget forward estimates period. Detailed financial implications of the proposal over the period to 2029-30 are provided at Attachment A.

Table 1: Financial implications ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	1,194	4,196	4,499	4,499	**14,388**
Underlying cash balance	1,194	4,196	4,499	4,499	**14,388**

(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.

Component 2 is estimated to raise the majority of the revenue over the 2019-20 Budget forward estimates period. When implemented as a package, the total revenue raised would be expected to be less than the revenue raised from implementing the components separately. This is because Component 1 increases average tax rates, meaning that the minimum tax liability would have less of an impact on some individuals.

Component 2 would be expected to involve an increase in departmental expenses for the ATO, as the cost of monitoring these changes to the taxation system would be significant. Component 1 would not be expected to involve any change in departmental expenses as it would not change the administrative complexity of the system.

Uncertainties

The costing is subject to significant uncertainties surrounding income and population growth rates, as well as behavioural responses to the proposal. The costing does not account for changes to labour supply as a result of the proposal. Studies indicate that some individuals may reduce their working hours in response to higher marginal tax rates, while others may choose to work more as a result of

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[1] For example, an individual with $400,000 in total income and $200,000 in deductions would be affected by this proposal in 2019-20. Under current policy settings, in 2019-20 this individual would have a tax liability of $67,097. Under the proposal, this individual would have a minimum tax liability of $140,000.

[2] For example, an individual with $400,000 in total income and $40,000 in deductions would not be affected by this proposal in 2019-20. Under current policy settings, in 2019-20 this individual would have a tax liability of $142,297, which is greater than the minimum tax liability of $140,000 they would have under the proposal.

the decrease in after-tax income.[3] There are also uncertainties surrounding the broader macroeconomic implications of the proposal, which have not been accounted for in this costing. For instance, Component 2 would have the effect of removing tax deductibility for certain expenses for affected individuals, which would increase the after-tax cost of these goods and services. This may result in reduced expenditure on these goods or services, with possible flow on effects to the budget.

Key assumptions

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

Behavioural responses

- Component 1: Some high income earners would respond to the proposal by adjusting their taxable income in order to reduce the impact of the deficit levy.
  - Individuals with taxable incomes in excess of $180,000 are assumed to have a taxable income elasticity of 0.2.[4] In the absence of this behavioural response, the estimated financial implications of this component would be around 60 per cent higher over the period to 2029-30.
  - Individuals subject to the deficit levy in 2019-20 would bring forward 5 per cent of their income from 2019-20 to 2018-19. In the absence of this behavioural response, the estimated financial implications of this component would be around $75 million higher over the period to 2029-30.
  - Discretionary income that individuals are able to bring forward from 2019-20 to 2018-19 is unlikely to be withheld in the 2018-19 year. As such, the revenue impact from the income brought forward would not arise until individuals lodge their 2018-19 personal income tax return, which occurs from the 2019-20 financial year.
- Component 2: Some individuals with total income above the $300,000 threshold would make changes to their financial affairs in order to mitigate the impact of the proposal.
  - Individuals could redirect income distributed from partnerships, trusts or companies to other entities so that their total income is reduced to below the threshold.
  - Individuals could defer the realisation of capital gains in order to avoid exceeding the threshold in a particular year.[5]
  - Some individuals may bring forward income and/or deductions prior to the proposal's implementation date of 1 July 2019.

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[3] See for instance, HM Revenue and Customs, 2012. *The Exchequer effect of the 50 per cent additional rate of income tax,* London: HM Revenue and Customs.

[4] 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 the marginal tax rate leads to a 1 per cent decrease in the net-of-tax, there will be a 0.2 per cent decrease in taxable income. The value is consistent with the wider empirical literature across advanced economies, where the average estimate of taxable income elasticities is close to 0.2; see, for instance, Klemm, A., Liu, L., Mylonas, V. and Wingender, P., 2018. *Are Elasticities of Taxable Income Rising?,* International Monetary Fund.

[5] This component is similar to the original 'Buffett Rule' that was contemplated in the United States. That proposal would have applied a minimum tax rate of 30 per cent on individuals making more than $1 million a year. In costing the proposal, the Joint Committee on Taxation in the United States also assumed that high-income taxpayers would defer the realisation of capital gains to fall beneath the 'Buffett Rule' threshold in a particular year.

- In the absence of these behavioural responses, the estimated financial implications of this component would be around 40 per cent higher over the period to 2029-30.

Timing of revenue

- The first quarter of fringe benefits tax revenue in 2019-20 would not be collected, as 1 April 2019 has passed. As such, the fringe benefits tax rate is assumed to be increased from 1 July 2019.
- Any additional tax payable under the minimum tax liability would be collected on assessment (when individuals lodge their tax returns). There would be no change to pay-as-you-go arrangements.

Methodology

- The financial implications of the proposal were estimated using a 16 per cent sample of de-identified personal income tax and superannuation returns for 2016-17 provided by the ATO. The data were used to estimate the change in tax payable for each component.
- Behavioural responses were incorporated, reflecting the assumptions above.
- The modelling has taken into account the timing of tax collections.
- Revenue estimates have been rounded to the nearest $100 million. Departmental expenses have been rounded to the nearest $1 million. The interaction between the two components has been rounded to the nearest $10 million.

Data sources

The ATO provided:

- a 16 per cent sample of de-identified personal income tax and superannuation returns for the 2016-17 tax year
- a 100 per cent file of de-identified personal income tax and superannuation returns for the 2015-16 and 2016-17 tax years.

The Treasury provided economic forecasts for personal income and superannuation tax as at the 2019 Pre-election Economic and Fiscal Outlook.

HM Revenue and Customs, 2012. *The Exchequer effect of the 50 per cent additional rate of income tax*, London: HM Revenue and Customs.

Klemm, A., Liu, L., Mylonas, V. and Wingender, P., 2018. *Are Elasticities of Taxable Income Rising?,* International Monetary Fund.

United States Congress Joint Committee on Taxation, 2012. *Memo on Buffett Rule*, Washington: United States Congress Joint Committee on Taxation.

Attachment A – Introduce a 35 per cent minimum tax rate on incomes above $300,000 and make the deficit levy permanent

Table A1: Introduce a 35 per cent minimum tax rate on incomes above $300,000 and make the deficit levy permanent – Fiscal and underlying cash balances ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	**Total to 2022–23**	**Total to 2029–30**
Revenue													
Component 1 – Permanent deficit levy	*1,100*	*1,500*	*1,700*	*1,800*	*2,000*	*2,000*	*2,100*	*2,300*	*2,500*	*2,700*	*2,900*	***6,300***	***22,700***
Component 2 – Minimum tax liability	-	*3,000*	*3,300*	*3,200*	*3,600*	*3,600*	*4,500*	*4,300*	*4,700*	*4,600*	*4,900*	***9,500***	***39,700***
Interaction	*100*	*-300*	*-500*	*-500*	*-600*	*-600*	*-700*	*-700*	*-800*	*-800*	*-800*	***-1,400***	***-6,300***
Total – revenue	**1,200**	**4,200**	**4,500**	**4,500**	**5,000**	**5,000**	**5,900**	**5,900**	**6,400**	**6,500**	**7,000**	**14,400**	**56,100**
Expenses													
Departmental													
Component 2 – Minimum tax liability	*-6*	*-4*	*-1*	*-1*	*-1*	*-1*	*-1*	*-1*	*-1*	*-1*	*-1*	***-12***	***-19***
Total – expenses	**-6**	**-4**	**-1**	**-1**	**-1**	**-1**	**-1**	**-1**	**-1**	**-1**	**-1**	**-12**	**-19**
Total	**1,194**	**4,196**	**4,499**	**4,499**	**4,999**	**4,999**	**5,899**	**5,899**	**6,399**	**6,499**	**6,999**	**14,388**	**56,081**

(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.
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.

\- Indicates nil.