

Education Policy Brief

Government Has A Massive Potential Revenue Pool to Fund Gonski

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Summary

The \$7 billion needed for the Federal Government to fund the last two years of the Gonski plan can be easily financed. The Government has a potential revenue pool of at least \$34 billion a year by reducing several tax concessions to high income earners and by clamping down on rampant tax evasion by high income earners and large Australian and multinational corporations.

The only thing stopping this is the unwillingness of the Government to challenge the privileges of the wealthy and big business.

The potential revenue gains per year are:

High income earners (top 20%)

Superannuation: \$16.3 billion

Capital gains: \$4.7 billion

Negative gearing: \$2 billion

Family trusts: Not quantified

Overseas tax havens: Not quantified

Total: \$23 billion

Corporate tax evasion

Large Australian public companies: \$4.2 billion (50% of Tax Justice Network estimate)

Overseas companies: \$2 billion (scaling up of International Centre for Tax and Development estimate)

Total: \$6.2 billion

Other tax concessions

Refund of unused dividend franking credits: \$4.6 billion

Grand total: \$33.8 billion

Even a partial claw-back of revenue lost through these tax concessions and corporate tax evasion would fund Gonski. The funding needed to finance the average \$3.5 billion a year for each of the last two years of Gonski is only 10% of the total tax revenue forgone annually. In addition, there are many more tax shelters that provide significant benefits to high income earners and corporations.

The Turnbull Government should stop using the Budget deficit as an excuse not to fund the last two years of Gonski. Labor should stop dithering about committing to the plan it devised while in government.

The fundamental question is whether the Turnbull Government (and the Labor Opposition) is prepared to make the rich and big business pay their fair share of tax and invest it in reducing disadvantage in education to improve the lives of the low income students, improve workforce skills and participation and increase productivity.

If the Prime Minister really believes in the need to develop an innovative, agile, knowledge-based economy it should be a straightforward choice. A high performing education system with minimum levels of disadvantage means a high performing economy.

Government Has a Massive Potential Revenue Pool to Fund Gonski

The Federal Government claims that the Budget deficit precludes fully funding the last two years of the Gonski plan. Labor is dithering on Gonski because it fears being seen as spendthrift when there is a large deficit.

However, full implementation of Gonski could be easily financed. The Federal Government has a potential savings pool of at least \$34 billion a year to fund the \$7 billion originally planned for the last two years of Gonski.

These savings could be realised by reducing personal income tax concessions for the rich and clamping down on rampant individual and corporate tax evasion. The only thing stopping this is the unwillingness of the Government to challenge the privileges of the wealthy and big business.

Personal income tax concessions

High income earners in Australia benefit enormously from several tax shelters, the most significant of which are tax concessions for superannuation, capital gains, negative gearing and family trusts. Many high income earners also salt money away in overseas tax havens.

Superannuation contributions, and earnings on investment in super, receive concessional tax treatment compared to tax imposed at personal marginal tax rates. A flat 15% tax rate applies to employer and deductible personal contributions to superannuation, except for those earning over \$300,000 per annum. This encourages high income earners to divert income into superannuation. For example, the marginal tax rate of 45% for those who earn \$180,000 or more is reduced to 15% on contributions to superannuation up to a limit of \$30,000. Superannuation benefits paid as an income stream in retirement are generally exempt from income tax for those over 60.

[The 2014 Tax Expenditure Statement](#) issued by the Treasury estimates the cost of superannuation taxation concessions in 2014-15 at \$29.7 billion or \$27.3 billion depending on which method is used to estimate the cost [Table 1.1, p.7]. [The latest Mid-Year Economic and Fiscal Outlook \(MYEFO\)](#) report estimates that the cost of these concessions will blow out to over \$50 billion by 2018-19.

The large part of these tax benefits go to the top income earners. [The Financial System Inquiry \(Murray\) report](#) published in December 2014 estimates that about 55% of superannuation tax concessions went to the top 20% of income earners [p.138]. That is, the top 20% of income earners received \$16.3 billion in superannuation tax concessions a year based on the upper estimate from the tax expenditure statement or \$15 billion using the lower estimate. The report further showed that the top 30% of income earners received about 68% of the total tax concessions – that is, \$20.2 billion or \$18.6 billion depending on which cost estimate is used.

Even if only a part of superannuation tax concessions was reduced it would still deliver a large amount of revenue to the government annually. For example, the 2013 Tax Expenditure Statement shows that under an expenditure tax benchmark, whereby contributions are taxed at marginal rates while earnings and benefits are exempt from tax, the revenue forgone in 2014-15 would be \$12.3 billion (p. 193).

Capital gains from the disposal of assets is taxed as income. However, Australian residents and trusts can discount any capital gain from an asset by 50% if the asset has been owned for at least 12 months. The discount means that only half the capital gain made on an investment is subject to tax. The Tax Expenditure Statement shows that the revenue forgone from the capital gains tax discount in 2014-15 was \$5.8 billion [Table 1.1, p.7]. The MYEFO report estimates this will grow to \$8.6 billion by 2018-19.

The discount goes mostly to the very wealthy. [The National Centre for Social and Economic Modelling \(NATSEM\)](#) has estimated that the top 20% of income earners account for 81% of the benefit flowing from the capital gains discount, or \$4.7 billion, while the top 30% of income earners account for 86% of the benefit.

Negative gearing allows losses made on investments to be deducted from taxable income derived from all sources. In Australia, negative gearing is mostly associated with investments in real estate. An investor borrows money to buy an investment property which is rented out. If the rent being received is less than expenses relating to the property – which include interest on money borrowed to make the investment, depreciation and maintenance - this loss can be deducted from all other taxable income. The investor usually records a tax loss on their income from the property, but can achieve a significant reduction in tax they pay from their total income. This is very valuable to high income earners on the top marginal rate, and they get a capital gains concession when they sell the property.

NATSEM has estimated that the negative gearing of residential investment property is currently reducing tax revenue by \$3.7 billion per year. Half of this benefit flows to the top 20% of income earners. [The Grattan Institute has estimated](#) the cost of tax concessions for negative gearing cost at \$4 billion a year.

High income earners can also reduce taxation through family trusts. The trust earnings can be allocated to family members who have low income from other sources so that the taxable income attracts the lowest rate of tax possible. For example, a high proportion of the trust income can be allocated to adult family members who work part-time so as to take advantage of the tax-free threshold applying to them. In some circumstances it is possible to reduce the tax bill to almost zero. Estimates of the tax revenue lost through this rort are difficult to come by, but certainly high income earners can reduce their tax payments by tens of thousands of dollars a year.

These tax concessions are key forms of what are called tax expenditures. They include tax exemptions, tax deductions, tax offsets, concessional tax rates and deferrals of tax liability. They have the effect of reducing budget revenue. Because Australia has a progressive tax system — the marginal rate of tax gets higher as income goes up — most tax expenditures deliver a higher rate of subsidy to the more affluent.

[According to the International Monetary Fund](#), Australia has one of the highest tax expenditures in the world. It tops the list of 16 OECD countries with tax expenditures amounting to 8.5% of GDP.

Apart from benefitting from a myriad of special tax concessions, many of the wealthy avoid tax by transferring funds to bank accounts in overseas tax havens. The revenue loss to government is difficult to estimate.

The Australian Tax Office (ATO) has made some progress in getting some of the income and assets hidden tax havens returned to Australia to meet their taxation obligations. For example, [a tax amnesty by the ATO last year](#) to encourage disclosure of offshore income resulted in more than 5,800 Australians disclosing \$5.4 billion in assets and \$600 million in income held overseas. It resulted in \$240 million in additional tax liabilities

[Last December, the ATO announced](#) that that it is investigating more than 100 Australian parents with children at 60 elite private schools who paid school fees of \$100,000 a year from overseas bank accounts. The ATO is concerned that the offshore accounts that are being used to pay the private school fees may be concealing much larger amounts of money amounting to millions of dollars.

Corporate tax evasion

In addition to reducing tax concessions for the wealthy, much more tax revenue could be raised by clamping down on tax avoidance by big business. [The first tax transparency report published by the ATO](#) in December 2015 shows that 38% of the largest Australian and foreign-owned corporate entities did not pay any tax in 2013-14. The 579 companies that paid no tax had a combined turnover of over \$400 billion and a taxable income of \$4 billion. It also showed that 101 companies had a turnover over \$1 billion but paid no tax. Two companies with a turnover of over \$10 billion paid no tax.

[A report published last September by the Tax Justice Network](#) found that the 200 largest publicly listed companies in Australia avoid up to \$8.4 billion a year in corporate tax. Nearly one third have an average effective tax rate of 10% or less compared to the statutory corporate tax rate of 30%.

The companies have hundreds of subsidiaries in tax havens such as Singapore, Hong Kong, British Virgin Islands, Cayman Islands, Mauritius, Luxembourg, Switzerland and the Channel Islands of Jersey and Guernsey. The report shows that 113 of the top 200 companies have over 1000 subsidiaries in tax havens.

Many subsidiaries of large multinational corporations in Australia pay little tax on their operations by shifting profits offshore through inflated interest payments to head office and transfer pricing. A research study published last November by [the International Centre for Tax and Development](#) found that US corporations avoid an estimated \$US 1.45 billion (A\$2.1 billion) of tax in Australia each year by shifting their profits to low or no tax countries.

[An investigation by the Australian Financial Review](#) found that Australian companies sent almost \$60 billion to tax havens in 2012. For example, it found that Apple shifted an estimated \$8.9 billion in untaxed profits from its Australian operations to a tax haven structure in Ireland in the last decade.

Other reports have revealed massive tax avoidance by large Australian companies. For example, [an academic analysis](#) found that Westfield paid an "effective corporate tax rate" of just eight cents in the dollar over nine years between 2005 and 2013, far below the official 30% rate. It paid an average annual tax of just \$140 million on pre-tax profits of \$1.7 billion. The report estimated that the tax forgone amounted to \$2.6 billion over the nine years. Westfield has more than 50 entities registered in tax havens such as Jersey, Luxembourg and Singapore.

[Australia's largest coalminer, Glencore](#), paid almost zero tax on an income of \$15 billion over three years to 2014. [The oil giant Chevron](#) had an operating income of \$3.2 billion in 2014 but paid no tax. [Another academic analysis](#) showed that News Corp paid a rate of just 4.8 per cent in income tax on its \$6.8 billion in operating cash flows over ten years to 2014.

Other tax shelters

High income earners and companies also benefit from numerous other tax loopholes. One particularly generous measure is refunding unused dividend imputation credits.

Under Australia's dividend imputation system, shareholders receive a credit (called a franking credit) against their tax liability for the taxes paid by the company in which they have shares. Dividend recipients who have no income tax liability, due to either their other deductions or retirement status are given a 'refund' by the government for the company's profits tax that has already been paid on their dividends. Australia is one of only a small group of OECD countries that operate a full dividend imputation system and it is the only country in the world that refunds unused franking credits.

[The tax discussion paper](#) published by the Treasury in March last year estimates the total value of imputation credits at nearly \$30 billion a year, with about \$19 billion claimed by individuals, superannuation funds and charities and about \$10 billion claimed by other Australian companies. Refunding unused franking credits cost taxpayers \$4.6 billion a year.

[NATSEM has estimated](#) that franking credits to households were worth \$9.9 billion in 2014-15 and that they flowed overwhelmingly to high income households. The top 10% of income earners received \$7.4 billion, or 75% of the total credits to households, and the top 20% of income earners got 84%.

Clearly then, the very large part of the tax refund for unused franking credits is paid to high income earners. [The Chanticleer financial columnist](#) for the *Australian Financial Review* has described it as "a rort that needs to be skewered in the interests of equity".

There are also numerous other tax shelters not covered here that provide significant benefits to high income earners and corporations. The revenue forgone for a large proportion of these is not quantifiable. [The 2013 Tax Expenditure Statement](#) said that estimates are not available for around 43 per cent of tax expenditures (p. 9).

Australia has a revenue problem

Contrary to the claims of the Treasurer, Scott Morrison, Australia has a revenue problem not an expenditure problem. Tax evasion by the wealthy and large Australian and overseas corporations is rampant. It is costing the taxpayer many billions of dollars annually. The Government is not raising enough revenue to cover necessary social expenditure. As [Liberal Senator Bill Heffernan has said](#):

If you're willing to turn a blind eye to billions of dollars going out the door and offshore, you're doomed in terms of providing what people expect from government: roads, schools and hospitals.

He said that tax avoidance is "the greatest financial challenge" facing Australia.

The [former Labor Government Treasurer, Wayne Swan, has made the same point](#):

...tax avoidance or evasion on such a grand scale impoverishes us all. When companies fail to pay their fair share of tax, revenue must be found elsewhere – from other businesses or individual taxpayers. The billions of dollars extracted are forever lost to health or education or infrastructure investment that improves the lives of people across the community...

There is much capacity to raise more revenue by reducing tax concessions for the wealthy and stamping out tax avoidance by Australian and multinational companies. Australia is a low tax country. [Taxation statistics published in December by the OECD](#) show that Australia is ranked 29th out of 34 OECD countries in terms of the tax to GDP ratio in 2013 (the latest year for which tax revenue data is available for all OECD countries). Australia had a tax to GDP ratio of 27.5% compared with the OECD average of 34.2%. [The Government's own Tax White Paper discussion paper](#) concedes that Australia is a low tax country (p. 16).

Reducing tax concessions to high income earners (the top 20%) alone could deliver about an extra \$27.6 billion a year (including the refund for unused franking credits) even ignoring the tax loss associated with the use of tax havens by the wealthy. Clamping down on corporate and multinational tax avoidance could deliver several more billions. It could amount to over \$6 billion a year, based on half the tax avoided by Australian publicly listed companies estimated by the Tax Justice Network (\$4.2 billion) and scaling up the loss incurred by US corporations to include other multinational companies (say \$2 billion).

The total revenue pool available from reducing these concessions considered above amounts to about \$34 billion a year. It would easily fund the last two years of the Gonski funding plan, as well as other social and community needs, and still reduce the Federal budget deficit. Even a partial reduction of these concessions would fund Gonski. It is simply a test of will for the Government (and the Labor Opposition).

The fundamental question is whether the Turnbull Government is willing to make the rich and big business pay their fair share of tax and invest it in reducing disadvantage in education to improve the lives of the low income students, improve workforce skills and participation and increase productivity. If the Prime Minister really believes in the need to develop an innovative, agile, knowledge-based economy it should be a straightforward choice. A high performing education system with minimum levels of disadvantage means a high performing economy.