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Labor could make all super earnings taxable but that would require political honesty

HENRY ERGAS THE AUSTRALIAN 12:00AM March 23, 2018

After a week of taxation claim and counterclaim, 10 propositions are essentially uncontested.

First, Labor's elimination of the full reimbursement of imputation credits will replace a system where dividends received by Australian residents are taxed at their personal income tax rates by one in which all dividends are taxed at no less than 30 per cent, even if that rate is well above the rate which would apply to any other taxable income that taxpayer might receive.

Second, the direct effect of that change will be to dramatically increase the weighted average tax rate on dividends, lifting it by up to 10 percentage points.

Third, while it is controversial how much impact that increase will have on large firms, whose cost of capital is set in world financial markets, it will make raising capital substantially more expensive for smaller firms, reducing their investment levels.

Labor's other proposed tax hikes — including the increase in capital gains tax, the clampdown on family trusts and the elimination of negative gearing on shares — will merely compound that effect.

Fourth, as well as increasing the overall tax rate on savings, removing the full refunding of franking credits will increase the difference in effective tax rates between the various forms of saving, aggravating already severe distortions in the allocation of savings.

Fifth, as a result of the higher tax rate on dividends, two taxpayers with exactly the same, low, taxable income will be taxed at different rates, with the one who has made the greatest effort to save — and who consequently has a higher share of income that comes from investments in shares — being taxed more heavily.

At the same time, that taxpayer may be taxed at a higher rate than a better-off taxpayer who has saved less and hence has a lower proportion of income from dividends.

The tax system will therefore be both less progressive in its treatment of taxable income and less consistent with the principle that taxpayers with the same taxable income should be taxed equally.

Sixth, those effects are contrary to the recommendations of the Ralph review of business taxation, the Henry review of Australia's future tax system, and Labor's Business Tax Working Group. They are also contrary to tax reform internationally, which has recently seen moves to significantly lower tax rates on savings and make them more uniform in countries as different as the US and France.

Seventh, in addition to their impacts on the efficiency of the tax system, Labor's proposed changes will alter the relative competitiveness of the larger retail and industry funds on the one hand, and the self-managed funds on the other, thus affecting the functioning of the retirement income system.

In particular, the larger funds are taxed on a consolidated basis; they therefore always have tax liabilities that can be offset against any imputation credits. As a result, Labor's changes will not alter their headline tax rates, but will increase those of the smaller self-managed funds, many of which will see their refunds cut.

Eighth, the immediate effect will be to encourage the transfer to the larger funds of some of the self-managed funds, increasing the fees the larger funds earn. The greater and more durable effect, however, will be on the extent of competition.

Thus, according to a recent study by the ASX, "30 per cent of Australian adults that do not currently use an SMSF plan to set one up in the future", threatening the larger funds' revenue base. But Labor's changes will decrease any benefit to smaller savers from opting out, thereby weakening the competitive constraint the ability to manage one's own savings now imposes. With that competition stymied, the major funds will have even greater market power.

Ninth, the Murray report found that the major funds had not reduced their fees by anywhere near as much as the cost savings from increased scale should have permitted. With fewer rivals to worry about, and the competitive threat from the self-managed funds reduced if not eliminated, the pressures to give savers a good deal will be even more muted.

Prices will therefore rise, and quality fall, for all savers, with the exception of those who are so wealthy as to readily afford the costs of opting out.

Tenth and last, while it is impossible to predict exactly who will derive the greatest benefit from the changes in industry structure, there are good reasons to think it will be the industry super funds, as they are the ones that have suffered the most direct revenue erosion from the smaller self-managed funds.

In short, Labor's proposed change will damage both our tax system and our system of retirement incomes. Yet Labor could achieve its stated objective — of preventing wealthy retirees from paying no tax on multimillion-dollar share portfolios — at much lower cost to this country's long-term prosperity.

It could, in particular, simply make all superannuation earnings taxable. That would hardly be economically efficient; but it would be less harmful than the serious distortions listed here.

Because the tax would be applied to a much wider base, it could secure the same revenue with a lower, essentially non-discriminatory, rate; and it would also be harder to avoid, as all forms of earnings would be taxed equally.

But that is not Labor's way, for two reasons: it would deliver nothing to the industry super funds, which are a rapidly growing source of payments to the unions and hence to the ALP; and convincing voters to accept such a direct and transparent tax increase would require more than mere appeals to the rhetoric of envy.

Rather, it would demand political honesty. In this Corbynite, post-truth age, who would even dream of that?