Centre for International Finance and Regulation

Towards Financial System Integrity

CIFR Submission:

The Australian Tax White Paper Task Force

June 2015

AUSTRALIAN UNIVERSITY PARTNERS

GOVERNMENT PARTNERS

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Disclaimer: The views in this submission represent the combined views of the professional and scholarly staff of the Centre for International Finance and Regulation (CIFR), several of the participants at CIFR's FSI III Workshop, held in Sydney on 11 March 2015, and various sources of academic and professional commentary on Australia's finance sector. They do not include or represent the views of any member of the Consortium that funds and supports CIFR.

Foreword from CIFR's Chairman

The 2015 Intergenerational Report reminds us that Australians enjoy some of the highest living standards in the world. This is testament to the ingenuity and application over many years of Australians from all walks of life.

As the Report reminds us, productivity growth and greater workforce participation will be pivotal factors in determining future growth outcomes. The recommendations made in this submission focus on the 'big picture'. Some are contentious, all require more work before they can be implemented. Some of this work should be done by academics, some by industry, and some by the regulators.

It is incumbent on us to make sure that we keep the pressure on industry practitioners, policy makers and politicians to ensure that we either advance the best and most effective recommendations or dismiss them. These decisions should be based on a rigorous analysis of relevant and high-quality evidence. It is in the best interests of all of us to take the initiative.

It is important to recognise that academia has a significant role to play and, as we have seen at CIFR, can make a major public policy contribution. With this role comes an obligation to ensure that the research work is first class in terms of its academic rigour and its practical application.

To date, CIFR and its consortium members have invested over $22 million in sponsoring 70 academic research projects. Many of these are now coming to fruition. There has been some first class work done by our researchers and we are working with them to deliver high quality, relevant outputs to stakeholders. One of our key objectives is to translate academic work, with a view to achieving the broadest possible dissemination. Specifically, our aim is to have this work published in academic journals and, more importantly, to ensure it is accessible to a wider, non-academic audience of policy makers, regulators and industry.

This submission encapsulates the views of some of CIFR's academic scholars and professional staff, several of the industry practitioners who participated in CIFR's third Financial System Inquiry Workshop on 11 March 2015, and a number of leading thinkers in the fields of economics and finance.

Peter Mason AM

Chairman, CIFR

Introduction from CIFR's Chief Executive Officer

The volume of Australia's Income Tax Assessment Act (1936) has grown exponentially since its enactment, due to ad hoc annual amendments over many decades. However, the substantive nature of the Act has changed little over the years. The breadth and extent of the changes that have taken place in the financial sphere, and more broadly in Australian society since that time, lead to the conclusion that **Australia's income tax regime is no longer fit for purpose.** Australia has grown and developed to become an important, dynamic and vibrant member (e.g. Organisation for Economic Cooperation and Development (OECD) of the global community. To ensure Australia retains its strong position in this increasingly inter-connected world, it is vital that we reform our tax system with a view to maintaining and enhancing our international competitiveness. Realising this goal necessitates a bi-partisan approach, with an unwavering focus on promoting the national interest.

Addressing the tax system – a broad-brush approach

The Henry Tax Review of 2009 showed that meaningful tax reform cannot be restricted to selected isolated areas. A broad-brush and systematic approach is instead required. A worthwhile first step towards designing a best-practice tax system would be an empirical examination of different taxation regimes elsewhere in the world, and their applicability in an Australian context. A number of the ideas outlined in this submission certainly warrant further empirical investigation and modelling by Commonwealth Treasury, and we encourage the Tax White Paper process to invest the resources into modelling these and other avenues proposed in other submissions.

Unfortunately, the tax debate in Australia appears to have fallen victim to the cut and thrust of federal politics and, to some extent, the welfare lobby. It is time to raise the debate above political and other vested interests, and focus on Australia's national interest. We also recognise that the Federal model governing the way that the Commonwealth and States operate, cannot be excised from this debate. A genuine and meaningful review should and must consider taxation and welfare reforms collaboratively along with a review of Australia's Federated system of government.

Compliance

Unsurprisingly, the ballooning volume of tax-related legislation over recent years has led to a corresponding blowout in the inefficiency cost of tax collection. The Re:think Tax Discussion Paper

(2015) indicates that tax compliance costs presently amount to $40 billion per year. The magnitude of this sum indicates that a 'free kick' in the reform process is available if this figure could be reduced by a quarter, or perhaps even by half. Furthermore, reforms that lead to a less complicated collection process correspondingly reduce the propensity for tax fraud.

It could also be argued that the structure of the tax system, and the compliance obligations of individual taxpayers, unnecessarily burdens too many of these individuals, who collectively contribute a significant proportion of Australia's total tax revenue.

The Tax White Paper Task Force should give serious consideration to significantly lessening the compliance burden on individual taxpayers. Those with simple Pay As You Go (PAYG)-type tax obligations should either not be required to submit an annual tax return, or should be provided with a simple and time-efficient mechanism for achieving tax compliance. Substantial efficiency gains are available if these individuals are absolved from filing a detailed tax return, or are permitted to file a simplified online return.

Desirable outcomes of tax reform

In addition to promoting greater compliance, the reform process must promote confidence in the tax system. Certainty and continuity of policy are essential in this regard, and it follows that, in order to build confidence, we need to move away from having substantial changes to tax policy as an annual feature of the Federal Budget. It could also be argued that political cycles of three years at Federal level, coupled with four-year periods used by Treasury to calculate the Forward Estimates, are far too short-term focused.

Another step in this direction of addressing short-termism may involve government moving away from a piecemeal approach and taking a whole-of-life tax perspective for individuals. This includes aspects of their lives such as health and aged care and higher education. A significant aspect of such a perspective entails ensuring that appropriate incentives are in place to encourage unemployed people into the workforce, and move them away from long-term dependence on the welfare system. This is critically important to promote inclusiveness in an egalitarian society.

Fiscal policy – an independent approach

Given the paucity of policy innovation that has resulted from the political process, the time has come to separate politics from fiscal policy. Such a move is not without precedent. Before their liberalization, foreign exchange rate and monetary policy used to fall within the domain of government. The free market mechanism now takes care of foreign exchange, while the Reserve Bank of Australia operates under a legislated mandate to independently determine monetary policy.

There is no reason why a similarly constituted body could not operate in a similarly independent manner to determine and implement fiscal policy for the common good. This suggestion is somewhat contestable, perhaps even contentious. It is nevertheless a new idea that is worthy of serious debate in terms of its merits and drawbacks.

With regard to the historically sizable budget deficit, it is clear that, although Australia is not in imminent danger of experiencing extreme fiscal stress, we are currently on an unsustainable debt path. The use of debt to bolster public finances is not bad policy, provided the debt load remains modest, and is paid down during cyclical upswings. If debt is allowed to persist throughout the course of the cycle, it risks becoming a structural feature of the economy and eroding intergenerational equity. Australia presently faces this risk.

Composition and share of the tax burden

The Australian Tax Office taxation statistics for 2012-13 highlight the extent of the tax system's reliance on individuals. Over the five income years covered by the statistics, the income tax paid by individuals has grown from less than $120 billion to almost $160 billion. However, this comes about not through active and deliberate policy, but rather as a result of a passive reliance on bracket creep. Accordingly, a proposal to increase tax on high-income earners as a means of reducing the budget deficit begs the question as to whether this is a justifiable policy option, or whether it is simply politically expedient. Irrespective of the proposal's underlying rationale, it is not viable as there are too few high-income earners relative to the size of the problem. This is evident in the fact that, at present, only 20% of all individual taxpayers earn more than $80,000 per annum.

The Henry Tax Review divides potential sources of tax revenue into four main areas: capital, labour, land, and consumption. In our globalised and interconnected world, capital is highly mobile. Calls for large multi-national companies to pay their 'fair share' of tax grab headlines, but they run the risk of prompting these companies to simply shift their domicile to more accommodative tax jurisdictions.

With regard to labour, lower paid workers are typically not as internationally mobile as multi-national companies. However, high earners tend to be particularly internationally mobile. Accordingly, if their tax burdens become excessive, they may easily move elsewhere, taking their earning power and skills with them. This potentially increases the 'brain drain' risk for Australia.

A land tax would similarly be unlikely to prove successful, despite land being immobile. It would be hard to make a 'fair' case to ask people who may have lived in their home for 30 years to now make a cash payment based on the home's current value. Furthermore, such a scheme may provide a powerful disincentive for older Australians to remain in their homes. This, in turn, may have a detrimental impact on their wellbeing. Studies conducted by the Australian Housing and Urban Research Institute emphasise the critical role that housing ownership plays in ensuring the wellbeing of older Australians in the retirement phase of their lives.

Accordingly, the time has come to revisit the way Australia taxes consumption. In the national interest, we should rise above political self-interest and engage in a mature conversation regarding both the rate and base of the GST. Collection of GST is very efficient, providing the tax is broadly based, with few exemptions. Cherry-picking items to exclude from the GST base should be minimised, with rebates provided in only the most necessary and justifiable cases.

A frequently cited argument against broadening the GST base is that it unfairly targets low-income earners, who would face a higher tax bill on their food and everyday living purchases. In isolation, this would be so. However, if this measure were to accompany an increase in the tax-free threshold, or a reduction in the bottom marginal tax rate, then low-income earners could be left in at least a tax-neutral position, or perhaps even be left better off.

Superannuation

Confidence is an essential pre-requisite for individuals' greater engagement with the superannuation system. Given that the accumulation of the capital necessary to fund retirement is by nature a long-term process, it follows that any changes made to the superannuation system should be similarly long term in nature. Accordingly, it would be desirable to frame superannuation regulation and policy independently of the annual Federal Budget cycle. Again, this could, and should, be done independent of government.

The ageing of the Australian population serves to highlight the importance of having people accumulate sufficient funds during their working lives to pay for their retirement. Accordingly, it makes sense to ensure that superannuation is as attractive as possible from a tax perspective during the accumulation phase. Tax that is foregone during this phase can be recouped during the retirement phase, either in the form of a tax on investment returns, or a tax on spending.

The 2015 Intergenerational Report draws attention to the fact that Australia's population is ageing, noting that the number of Australians aged 65 and over is projected to more than double by 2054-55 compared to today.

It follows that if superannuation is going to be the preferred means of funding this cohort then saving and superannuation need to be actively promoted to today's younger Australians. In addition, government should consider whether the Sole Purpose Test in the context of superannuation savings is optimal. Superannuation savings pools should be more significantly oriented around how retirement incomes can be best designed, as well as other needs that retirees will have in relation to health and aged care. Current policy seems to be lacking in assisting retirees with what they need to self-fund their retirements across a spectrum of living and health care needs. We encourage the Government to follow through with the reforms and suggestions outlined on retirement incomes policy by the recent Murray Inquiry into the Financial System.

A jointly funded study by CIFR and The University of Melbourne into attitudes towards superannuation among young adults in Australia shows the scale of the task involved in promoting superannuation to the younger generation.

Specifically, the study finds that, among the 25-34 year old age bracket:

- Superannuation is not widely regarded as a major priority;
- Short term financial goals take clear precedence over retirement planning; and
- Frustration, a lack of control, and insufficient knowledge are significant contributing factors to the reported difficulty in planning for retirement.

The issue of lump sum withdrawals from superannuation tends to generate a marked polarity of views. On the one hand, the ability to make a lump sum withdrawal has been seen as an opportunity for wasteful extravagance, leading to subsequent reliance on the age pension. Conversely, it has been held that because individuals are given a choice in how to invest their money, they should similarly be given a choice in how they spend it. The optimal solution most probably lies somewhere in the middle. It would nevertheless be advisable to limit the amount that can be drawn down as a lump sum over a particular period, with limitations placed on the uses to which these funds can be put.

Estate taxes

A disproportionately high rate of consumption has been a defining characteristic of the 'baby boomers' as they have moved through the various stages of their lives. With this generation now increasingly represented in retirement, it would appear fair and equitable for society to ask for a return on the resources expended to satisfy this consumption.

If the state has contributed to the support of a pensioner in their retirement, it seems fair, from a social equity perspective, that the state be partially recompensed. Specifically, an estate tax could be levied on the sale or transfer of the pensioner's assets. The revenue raised from such a tax could be distributed among the states to fund general operating expenditure.

Higher Education Contribution Scheme (HECS)

HECS has attracted widespread criticism and debate since its introduction. Consideration should be given to removing this tax, and replacing it with a levy on people that have received publicly-funded university degrees, and who now earn an income in excess of a minimum repayment threshold. This 'HECS Levy' would be calculated as a percentage of income, in a similar manner to the Medicare levy. It should be used to invest in further developing our publicly-funded higher education institutions to enable them to provide world class education and compete globally. From a taxpayer's respective, it would effectively represent a repayment in later life for opportunities granted during the career formation stage. The scheme should not apply to those who attended private universities or who earned their degrees offshore before returning to Australia.

We recognise that public university education was fee-free from 1974 to 1989, and that fees have steadily increased since their reintroduction, and that some people have repaid some or all of their HECS debt, while others have not. This would need to be taken into account when formulating the HECS Levy.

We also advocate addressing the problem of 'mature age' students accessing a HECS Levy opportunity in undertaking university study when there is little chance that they will earn sufficient income to enable them to pay for their education. We contend that these people should be required to pay for their education on enrolment. This would help address the current problem of having a large and growing portion of HECS debt that will never be repaid.

Negative gearing

The resilience in demand for housing finance correspondingly shows the need for the creation of further housing stock. However, it is open to debate as to whether negative gearing has contributed to the creation of this stock, or whether it has simply been used as a vehicle for tax planning. At the very least, negative gearing represents a distortion in the housing market, and its use should be addressed in a mature manner, with a focus on the national interest. Reflecting its size and systemic importance, the housing market should be the subject of further empirical research.

Corporate tax

The present corporate tax regime uses net profit as the basis of calculation for tax liability. However, across many industries, there are a wide range of expenses and deductions that may be legitimately claimed against income. It follows that this simply encourages aggressive tax planning to the point where expenses that are claimed from tax may be regarded as dubious at best. A government inquiry into tax planning may prove an effective mechanism to examine the tax planning sector in a transparent manner. If the present regime of paying corporate tax on the basis of revenue less allowable expenses were to be replaced with a tax on top line revenues, then the opportunity for many aggressive tax planning practices would be removed. To ensure international competitiveness, a rebate mechanism could then be applied, returning revenues collected according to a suitably defined framework. The benefit of a top-of-the-line revenue tax shifts the role of the ATO to that of a fund-returning agency, rather than using the courts to demand payment of funds by corporate taxpayers. This could increase efficiencies and cash flow certainty for the ATO.

Tax equity

No two individuals are identical. Similarly, their respective contributions to society differ in terms of extent and value. However, social contributions play no role in the tax system, where tax liability is calculated solely on the basis of earnings. A case can be made for the tax calculation to reflect the value to society of particular employee groups. Several occupations fall into this category, however the most important are police and defence personnel, nurses and other emergency workers, and school teachers.

The importance of the respective contributions these people make to the lives of those they serve cannot be overstated, and society's debt of gratitude should be acknowledged in the tax system. One idea could be to provide tax scale discounts reflective of their broader contribution and importance to a civil society.

Taxation structures

In the context of non-corporate entities, the Australian tax system is centred on the individual, in contrast to the welfare system, which is centred on the family or 'household'. Given the nature of our society, where most people live in a family-type arrangement, it would seem logical to define an individual taxpayer in terms of a family unit, as opposed to a single person. There is a serious inequity in the tax system for sole-income breadwinners supporting dependents within their household, and who are therefore only able to claim a sole tax-free threshold. This is in contrast to double-income households that enjoy the benefits of two tax-free thresholds. Consideration could also be given to the tax scales applicable for those supporting households dependent on a single, versus a dual, income.

An immediate benefit of a move to household tax arrangements would be the achievement of greater cohesion between the tax and welfare systems. Aside from the definition of an individual tax-paying entity, there should be a policy commitment to apply tax on income regardless of the legal entity or structure that individuals or incorporated bodies may create for tax purposes. Any such policy commitment should recognise the degree of uniformity in the taxation affairs of individuals who work as salaried employees.

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Towards Financial System Integrity

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Challenges for Australia's Tax System

- The ageing of the Australian population is one of the key findings of the 2015 Intergenerational Report. As the baby boomers retire, there will be a corresponding decline in the percentage of the population that is of working age. This is significant in that there will be a declining pool of taxpayers to fund the entitlements of an expanding cohort that is moving from the accumulation phase of their lives, where their superannuation investments are taxed at 15%, to the retirement phase, where these investments are presently tax free. Reflecting this demographic shift, accountants KPMG anticipate that government expenditures will exceed receipts over the next 10 years.
- Commonwealth Government revenues should nevertheless be significantly bolstered by the impact of bracket creep. The respective taxation statistics for 2009-10 and 2012-13 illustrate the progressive revenue gathering power of bracket creep. In 2009-10, net tax receipts from individual taxpayers amounted to $120 billion. By 2012-13, this amount had grown by 28% to $154 billion. It is projected that in the next year, the average full-time employee will attain the second-highest marginal tax rate of 39%. However, bracket creep disadvantages those on average to lower salary rates, who typically do not have the ability to structure their affairs in a tax efficient manner. It could be described as a 'lazy' way to increase tax, in that the responsibility for raising additional revenue is passively delegated to inflation. Raising additional revenue in this manner may serve to undermine individual initiative.
- The 2015 Intergenerational Report highlights the challenge for government expenditure projections posed by the ageing of the Australian population. The challenge will manifest itself broadly, but will be particularly evident in areas such as healthcare. In the absence of any national reforms, expenditure in this area is projected to grow uninterrupted past 2050.
- Accordingly, although there is popular support for social initiatives such as the Gonski educational reforms and the National Disability Insurance Scheme (NDIS), a public conversation is necessary to ensure a broad and clear understanding of how such initiatives will be paid for.

Overview of Australia's Tax System

- Traditionally, there has been a 10- to 12-year cycle of tax reform in Australia. The *Australia's Future Tax System Review (AFTSR)*, chaired by now former Treasury Secretary Ken Henry, was released in 2010, and it could therefore be argued we are early in the review cycle. However, given that only one of the AFTSR's recommendations was fully enacted, with another enacted in part, we could more appropriately be described as being late in the cycle, with comprehensive changes to our tax system long overdue.
- Notwithstanding the existence of complications in the tax legislation provisions, there is a further layer of complexity in terms of tax collection. The Re:think Tax Discussion Paper (2015) indicates that compliance costs presently amount to $40 billion per year. Accordingly, there is clearly scope for a review of the red tape within the collection system. Increased use of technology would be an ideal starting point for a broader move towards streamlining the

submission of returns. It follows that a more streamlined collection process would also reduce the scope of opportunity for those who seek to take advantage of the system's complexity by committing tax fraud.

- Australia is more reliant on company tax receipts, and particularly those from a small number of large corporate taxpayers, than our peers in the OECD. Furthermore, relative to the same universe, Australia is overweight in its reliance on direct taxation, and underweight in its reliance on indirect taxation.
- There is scope for improvement in the taxation treatment of health insurance. Present policy provides a private health insurance rebate to help Australians cover the cost of their private health insurance premiums. The standard rebate of 27.82% currently applies to those aged under 65 years. With a view to encouraging younger people to enter the private health system at an earlier age, and so contribute to the building up of insurers' financial reserves, consideration should be given to the introduction of a further rebate for those under the age of 30 years.
- Our tax system has become excessively politicised. An excessive focus on politics mitigates against policy innovation and international competitiveness. There ought to be a primary focus on the national interest, as opposed to vested, or party political interests.
- Retaining taxation within the realm of political debate has stifled policy innovation. It would be appropriate to consider separating politics from fiscal policy. There is precedent for this step, in that the same approach has been applied to foreign exchange rates and monetary policy. Both used to fall within the domain of the Federal Government, before a progressive liberalisation of their respective methods of operation. The floating of the Australian dollar led to the market mechanism assuming responsibility for determining the dollar's exchange rate, while monetary policy now falls within the ambit of the Reserve Bank of Australia, whose operational independence is enshrined in legislation.
- There is very little empirical evidence comparing the various taxation regimes in operation around the world. It would make sense for Australia to undertake such a study, with the aim of developing a tax system that incorporates the best aspects of those in existence elsewhere.
- The Australian tax system is too heavily centred on the individual. By comparison, the welfare system is centred on the family. Given the nature of our society, where most people live in a family-type arrangement, a case can be made for greater alignment of the tax and welfare systems, with a view to achieving increased synergies in revenue and outgoings.
- At a minimum, all taxpayers at both the corporate and individual levels need to have confidence in the tax system. Confidence rests on two pillars of policy, namely certainty and continuity. Accordingly, it stands to reason that the annual changes in tax policy and legislation that typically accompany the annual Federal Budget serve to undermine the confidence of taxpayers at all levels.
- At present, individuals' involvement with the tax system starts when they begin their working lives. It may be worth considering the merits of government instead taking a **whole-of-life perspective on tax**. This would entail a greater involvement of the taxation system in aspects of peoples' lives such as health care and higher education. This may involve

spreading their tax contributions more broadly over the course of their entire lives, as opposed to only their working lives.

- Pursuant to the notion of individuals having a broader engagement with the tax system, there needs to be a greater incentive for those who are unemployed to seek work, and move away from long-term dependence on the welfare system. The increased social involvement that accompanies active workforce participation is conducive to individuals becoming more engaged in their communities, which, in turn, leads to a strengthening of the broader social contract.
- With a view to taxing savings and income more evenly over the course of individuals' lives, consideration should be given to adjusting the points at which tax is applied. The tax payable on savings and investment gains may be reduced during the accumulation phase, to be later recouped with a tax on the income drawn from these savings during retirement.
- Current debate in the area of tax reform is largely focused on ways and means of raising additional revenue. Very little is said about spending, apart from calls to maintain existing expenditure levels. This needs to change. It is nevertheless acknowledged that there is significant political difficulty in implementing meaningful change within a system in which there is a steadily growing proportion of those who are net beneficiaries of the system, and a corresponding decline in those who are net contributors to the system. More broadly, it stands to reason that it is not conducive to the longer-term health of a democracy to have progressively fewer taxpayers increasingly footing the welfare bills of a large and growing group of recipients.
- Former Federal Treasurer Peter Costello makes the valid point that government spends no money of its own. It simply re-distributes the money it has taken from its citizens. People accept that part of their earnings will be taken from them by way of tax. Part of this tax is effectively donated to less affluent citizens, who are net recipients of the welfare system. Welfare payments are accepted by modern society as being 'fair', as they aim to ensure that the vulnerable are not left behind or excluded. However, this begs the question of whether it is equally 'fair' to those who provide these donations to deny them any opportunity to examine, or even discuss, how their donations are allocated.
- The use of borrowings to fund public expenditure does not necessarily constitute bad policy. As long as deficits are kept within modest limits, they can be used to smooth the impact of revenue shortfalls at the bottom of the economic cycle. Moreover, increased public spending at such times can shorten the period spent at the bottom of the cycle, and hasten the onset of the revival process. However, there is a caution attached to the use of debt. It must be capable of being largely repaid during cyclical upturns. If it is not, it risks becoming a permanent structural feature of the economy. This risk is shown in World Bank data covering the period from 2005 to 2012. Specifically in the case of Greece, the level of central government debt as a percentage of gross domestic product (GDP) has risen from 121.6% to 163.6%. By comparison, Australia's debt load appears far more manageable, having risen from 22.5% to 40.5% over the same period. It is nevertheless on a deteriorating trend, in common with the other OECD nations where the average government debt to GDP ratio has risen from 44.5% to 67.9%.

Individuals

- The tax-free capital gains status of the family home has encouraged the popularity of housing investment. The associated capital gains in property prices have prompted the view that prices in several Australian capital city markets are reaching unsustainable levels. Indeed, ASIC's chairman, Greg Medcraft, has warned of a 'bubble', in part due to very low interest rates.
- The inequitable taxation treatment of various forms of savings is reflected in the allocation of investment capital. For example, non-resident investors are incentivised to provide debt finance, rather than equity finance, because the withholding tax rate applicable to interest income is significantly lower than the company tax rate.
- The Income Tax Assessment Act (1997) provides that where a business raises debt finance from non-residents, the interest payable, which is a deduction for the business, attracts a withholding tax of between zero and 10%, depending on the bilateral tax treaty. The Act further provides that, where non-resident investment takes the form of equity in an Australian company, the company tax rate is payable on earnings and no further withholding tax applies. If a company pays unfranked dividends, the Act stipulates that these are paid to a foreign investor minus withholding tax of between zero and 15%, depending on the applicable tax treaty. In common with their local counterparts, foreign investors make their investment decisions on the basis of their assessment of the underlying merits of the business or security, and the respective tax consequences of structuring their investment in the form of debt or equity. It follows that any proposed changes to the taxation of investment structures should be carefully considered from the point of view of the likely response of investors.

Savings

- The intention behind the introduction of the Superannuation Guarantee (SG) system is to achieve an increase in the proportion of individuals who are able to fund themselves in retirement. To better reflect the universal nature of this goal, the SG regime should be expanded beyond salaried workers to include those who are self-employed.
- The SG mechanism has been designed on the expectation that individuals will maintain a steady and uninterrupted pattern of employment over the course of their working lives. However, given the nature of the modern business environment, this is frequently not the case. Accordingly, the SG regime should be supplemented with a catch-up mechanism for individuals who have interrupted or irregular work histories.
- There have been calls for the removal of the tax distortion on deposit income. This includes income from bank interest and fixed interest securities, and essentially mirrors the Henry Review proposal advocating a 40% tax discount on household savings income. The question that arises in relation to this proposal is whether a bank deposit is a savings or transaction account. Furthermore, if fixed interest income is allowed a 40% tax discount, a similar argument can be made for property or infrastructure investments.

- Australia's tax treatment of negative gearing is out of step with the rest of the world. Negative gearing and the Capital Gains Tax (CGT) discount on assets held for more than twelve months have exacerbated the recent sharp rise in house prices. These measures have also served to reduce tax revenue. The CGT discount should be reviewed, with a view to examining the ongoing merit of its contribution to the tax system.

Superannuation

- The total cost of superannuation tax concessions for the 2014/15 financial year was $30 billion.
- The Henry Review suggested addressing the issue of the cost of superannuation via the introduction of a rebate system. The argument was put forward that if Australia has a progressive tax system where greater amounts of income get taxed at a higher rate, there should correspondingly be a deduction available at the marginal rate for income channelled into superannuation. Predicated on the purpose of the superannuation system being to reduce the cost to the government of providing the age pension, it follows that the cost of superannuation tax concessions should not exceed the cost of the age pension. In other words, the amount contributed to a superannuation fund should limit the tax concessions that can be taken out of it.
- Earnings on superannuation investments are taxed at 15%, which makes superannuation a better investment option for savers than a bank deposit, but not as attractive as an investment in the family home.
- Superannuation tax concessions, by the very nature of the tax system, disproportionately favour high income earners. These concessions should instead provide broad encouragement for people to use their own savings to fund the cost of their retirement. This would reduce the cost to the public purse of funding the age pension.
- A relatively high top marginal tax rate applies in Australia. Data from KPMG shows that, over the period from 2006 to 2015, Australia's top individual income tax rate has remained almost unchanged at 45%. This is higher than the OECD average (41.78%) and the global average (31.12%). However, effective tax rates for Australians are substantially reduced by measures such as superannuation tax concessions, and the CGT discount. Predicated on government revenue pressures necessitating tightening of provisions relating to tax concessions, consideration could be given to an accompanying re-alignment of progressive tax rate structures. It would also be worth considering narrowing the gap between the corporate tax rate and the top personal tax rate. This would create greater alignment within the tax system, and avoid the encouragement of fund flows to one part of the system at the expense of the other.
- The current annual caps on pre-tax contributions to superannuation appear reasonable for those with consistent income. However, an issue arises in how to deal with those who earn irregular income, or those who start with limited contributions but want to make up for this later in life. Potential solutions to address this issue include a lifetime cap on contributions, or the linking of contribution caps to the amount already accumulated.

- It is important to remain mindful that the reason that superannuation is taxed at a concessional rate in the accumulation phase is to ensure there is an accumulated sum available to provide retirement income in the future. It follows that additional tax levied during the accumulation phase has a negative compound impact on the final pool of funds available to provide retirement income.
- Given the widely recognised tendency for people to underestimate the amount of money they need to sustain themselves in retirement, there is a need to promote incentives for young people to make more than the mandatory minimum contribution to superannuation. Fostering a greater willingness to contribute to superannuation is conducive to ensuing that people have enough funding to sustain themselves in retirement. Furthermore, at the point of retirement, prospective superannuants may be gaining access to a sum of money far larger than that with which they previously may have dealt. It would make good sense to make financial education programs available to these people, with a view to assisting them in obtaining the maximum benefit from their investments.
- There should be greater consistency in the regulation of superannuation. For example, it appears incongruous that small business owners may use their superannuation to buy commercial property, yet wage earners may not access their superannuation to fund the purchase of their first home. There is an opportunity for politicians to show leadership in the context of accessing accumulated superannuation benefits. In preference to the present regime whereby politicians may access their benefits on retirement from parliament, they could instead defer this until they reach retirement age.
- It would be advisable to simultaneously examine the superannuation and age pension systems, with a view to eliminating inconsistencies between the two. For example, there is an inconsistency in the age at which superannuation (60 years) and the age pension (67 years) can presently be accessed. A case can be made for flexibility in the age at which superannuation can be accessed. Not everyone retires at the same age, and people need the assurance that they will be able to access their superannuation savings when they are required to fund their retirement.

Dividend Imputation

- Australia and New Zealand are the only two jurisdictions currently operating an imputation system. It was trialled to a limited extent in a number of other countries, but has since been removed. Australia is further unique in that a refundable imputation regime applies for Australian resident taxpayers.
- Four main arguments have been put forward in support of the view that the imputation system should be abolished:
    1. If the corporate tax rate were to be lowered, the problem of tax being paid at the corporate rate, and then again at the shareholder level would be reduced.
    2. Imputation distorts the relative appeal of corporate funding sources. However, it must be acknowledged that part of the original intention behind the imputation

system was to encourage the use by Australian companies of domestically sourced funding.

3. The bias created by imputation makes foreign funding less competitive. However, it could be argued that Australian shareholders are being asked to shoulder a greater tax burden to assist the competitive positions of foreign funding sources.
4. Investors, such as superannuation funds, who are subject to low tax rates, may generate imputation credits in excess of their tax payable, with negative consequences for government revenue. However, this argument appears to overlook the aim of the imputation system, which is to remove the double-taxation of corporate distributions.

- Removing dividend imputation would benefit foreign investors, who do not benefit from imputation credits, at the expense of Australian investors, who do. Furthermore, it would remove an incentive for Australian companies to maximise the repatriation of foreign-sourced revenues for tax purposes, rather than paying the tax overseas. Removal of the imputation system would also encourage increased use of debt financing, in preference to lower-risk equity financing. This was found to be the case in the US.

GST and State Taxes

- State-based taxes and duties are a source of complication for the business sector, because tax rates and calculation methodologies tend to differ between the States.
- The arrangement between the Commonwealth and the States with regard to the collection and distribution of tax requires a comprehensive review. The current model is simply not assisting the States in addressing the needs of their citizens.
- The rate of GST levied in Australia is low, relative to our OECD peers. Any review of the Australian taxation system should consider the GST, from both a rate and base perspective.
- Australia's OECD peers tax consumption at almost double our current GST rate of 10%. And they apply it to a wider range of goods.
- The argument frequently cited against a broadening of the GST is that it unfairly targets low-income earners and welfare recipients, who would face a higher tax bill on their food purchases. In isolation, this would be so. However, if this were to accompany an increase in the tax-free threshold, or a reduction in the bottom marginal tax rate, then low-income earners could be left in at least a tax-neutral position, or perhaps even be better off. This has been the experience in New Zealand, where raising the country's consumption tax rate has been done in concert with other measures to the benefit of most taxpayers. In 2010, the GST was increased from 12.5% to 15% as part of a package of measures. These included lowering both the corporate tax rate and personal marginal rates.
- A common negotiating stance for special interest or advocacy groups is to call for the GST to be shifted away from their areas of interest. However, these calls contrast with the experience of New Zealand, where a broadening of the GST base has facilitated lower taxes for individuals and companies. The OECD measures the breadth of a consumption tax by what it terms the 'VAT revenue ratio'. The current average VRR across its member countries

is approximately 0.5, indicating that half of all goods sold are subject to a consumption tax. New Zealand is well ahead of this average, with a ratio of 0.96, while Australia is fractionally below the average.

- Collection costs further merit a review of the operation of the GST. Anecdotal evidence suggests that the compliance burden of completing a GST return is greatly complicated by the range of apparently similar goods that may or may not fall within the ambit of the GST. In contrast, New Zealand business owners report that the cost and effort associated with their GST reporting is relatively minor.
- A further complication regarding the calculation of GST liability in Australia is the fact that the tax may not necessarily apply to all inputs and to all stages of a product's production process.
- The issue of tax mobility is a further reason to revisit the current GST regime. The Henry review identifies four main sources of tax revenue: labour, capital, land and consumption. In terms of mobility, in other words the risk of the source relocating to another jurisdiction, labour represents a moderate risk. Low-paid workers are typically immobile. However, their higher paid counterparts are particularly mobile. If such people permanently leave the country, there is a loss to the tax system, but perhaps the greater loss is the skills they take with them. Capital is highly mobile. Companies, particularly larger entities with multi-national operations, find it relatively easy to relocate their domicile for reporting or tax purposes. Accordingly, popular campaigns, such as the **'Google tax'**, that aim to increase the tax burden on large corporations run a similar risk to those that target high-income earners. The intended target may simply relocate overseas. In contrast to labour and capital, land and consumption are immobile sources of tax. By definition, land cannot be moved. However, moves to introduce a land tax on the family home would encounter strong opposition on the basis of fairness. Specifically, it would be hard to make a 'fair' case to ask people who may have lived in their home for 30 years to now make a cash payment based on the home's current value. Consumption is a similarly immobile tax. A great many of consumers' regular outlays are non-discretionary, and therefore the tax revenues associated with this expenditure are similarly certain.
- With regard to duties on insurance policies, the removal of these would do away with a regressive tax and address the significant problem of underinsurance in Australia.