

Bettertax Submission

Attached is a personal submission relating to tax reform, together with references to the transfer system as the impact of taxes and the transfer system are inseparable. Many changes need to be packaged together, as unless this is done it is impossible to make headway and vested interests will selectively and wilfully undermine any reform.

The submission is structured in terms of:

- some background about myself and why I am making this submission and have a particular interest the topic;
- an executive summary of my proposals and commentary on implementation strategy; and
- observations and commentary on the discussion paper, combined with related major changes I propose.

I would like to thank CPA Australia for their helpful material on GST reform which was recently published. The tax reform discussion paper is helpful, and will inform (and hopefully drown out the prejudiced, ignorant and obstructive nonsense of some).

Disclosure – Given that most advocates propose changes that they personally benefit from, I disclose that most of the changes I propose that are personally detrimental, in particular the superannuation taxation and capital gains changes.

Background

I am an economist and accountant by training, and I have health policy, and company director qualifications. My economics studies included labour economics, public finance and agricultural economics. I have worked for the ATO as a tax assessor, and internal and external auditor of various commonwealth agencies including the ATO, customs (dealing with primary industry levies and excise collections), health etc. I have been an elected member of local government and also involved with various boards or committees including a community legal service, a men's centre and a diabetes education body. I have worked as a public servant in a variety of agencies including ATO (auditing emissions trading taxation policy issues), Defence, ATSIC, Health and Ageing (having exposure to the extent of out of pocket health expenses) and the Therapeutic Goods Administration.

As an adviser I dealt with seniors and means testing issues (and many issues relating to women, child care, youth allowance, payments, legislation, fraud and gambling) in the now Social Security portfolio, and tax reform in during the 1998 to 2001 period. This period was instructive to me of the extent of perverse regressive policy in all manner of areas (apart from tax), such as tertiary education and superannuation taxation.

I have long being critical of the overly generous treatment of superannuation taxation, gross feed-in tariffs for electricity. I have a particular high regard for the likes of late former Finance Minister Peter Walsh who was critical of the regressive impact of free or subsidised tertiary education and many other programs. I have being encouraged by the recent interest of the opposition to apparently support (in vague terms) tax reform changes. This contrasts with the 1991 -2001 period. It is easier to run a fear campaign and oppose than propose. It should be noted that whilst the year 2000 reforms were large, GST was only a small part of it and whereas in most of the OECD GST/VAT has in fact being introduced and certainly expanded by affiliated parties of the Australian Labor Party. So the objections or reservations of that party seem very opportunistic or peculiar from an ideological perspective.

There have been discussions about leaving the GST alone and that it is a mature tax and that the difficulty in changing its base or rate and resultant compensation makes the exercise barely worth it. Whatever the truth of this, the alternative of the states being able to impose an income tax surcharge instead is also fraught with difficulties. The surcharge would need to be imposed centrally through the ATO, the thought of going back to a pre-1942 model (with separate state and federal tax administrations) is just too awful to contemplate. Each state or territory has very different capacity to raise revenue from income taxation. Tasmania for one would have a much greater difficulty in revenue raising due to it low income levels and on the other hand New South Wales and Western Australia could reap considerable revenue due to higher income levels.

Executive Summary

These are my recommended ways forward. The principal thing that must happen is that the major parties must put aside the short term political game-playing and like in New Zealand with its tax reforms of the 1980's work together to make it work. Just disregard the vested interests and whingers and just put the package on a fait accompli basis, no changes no concession and no backsliding. Otherwise nothing of consequence will happen. New Zealand has never looked back from its changes (which were cathartic), nor should we.

Disclosure – Given that most advocates propose changes that they personally benefit from, I disclose that most of the changes I propose that are personally detrimental, in particular the superannuation taxation and capital gains changes.

I have not proposed a reduction in the rate of individual tax or that of companies, although both should be possible if a series of changes are made in respect, of means testing, superannuation taxation, FBT reform, excises and so on.

Proposals

1. To improve our place in the world make greater use of GST revenue in place of consumption taxes, and continue aggressive maintenance activity in relation to international taxation. (The changing world).
2. Phasing out stupid federal, state and territory taxes and applying the GST makes sense in our tax system and also in our place in the world, a 15% or 20% rate may be in order. (Australia's tax system).
3. To improve the situation of low income earners the use of tax offsets (page 30) can be helpful, an expansion for low income earners of workforce age may help with the benefits/low wage interface. (Australia's tax system).

4. A tightening of the means testing for pensions is required to reduce outlays and to fit with the increased taxation (and targeting and sustainability) of superannuation contributions, earnings and income. (Australia's tax system).
5. The tightening of the means testing of pensions and benefits should include the progressive inclusion of the value of the family home, with a phase in period of say 20 years, and with adjustments to the assets test thresholds. (Australia's tax system)'
6. The Medicare Levy should either be absorbed into the tax rate structure with no exemptions, or set at meaningful rate to cover at least Commonwealth health outlays (including the NDIS), with no exemptions. The Medicare Levy Surcharge could be maintained in either event, by adding the necessary percentage to marginal rates. (Individuals).
7. The FBT regime needs reworking removing concessional valuation rules, concession and exemptions. Motor vehicle leasing rorts promoted by a parasite industry must be stamped out; and the inequitable concessional FBT treatment of employer provided child care must be ended. (Individuals).
8. With the current \$17,000 and \$30,000 FBT concessional limits, under no circumstances should these limits be increased. Inflation will reduce their real value. (Individuals).
9. Work incentives for young people can be enhanced via tax offsets and tweaks to Youth Allowance – the situation described in Box 3.4 should not arise as a matter of equity. (Individuals).
10. Work incentives for families can be improved by increasing child care availability and affordability. (Individuals).
11. Women's superannuation outcomes can be improved by paying superannuation during the period of Paid Parental Leave. (Individuals).
12. End many tax planning opportunities and providing equity for low income earners requires the following:
 - a. Restoring the 12% superannuation target progression;
 - b. Providing a rebate to funds to ensure that low income earners receive at least a 15% superannuation contributions benefit;
 - c. Taxation on income paid from superannuation funds should be restored for those over 60 years of age and this should have a short phase in period.
 - d. Changes to the pre and post tax contributions limits should be made to ensure superannuation is not rorted.
 - e. Capital gains taxation should be changed back to an indexation basis, and the generous arrangements for superannuation funds and individuals ended.
 - f. Avoid grandfathering provisions as they would just make things complicated again. (Individuals)
13. To help curtail tax expenditure outlays on superannuation a higher tax rate should apply to an individual's superannuation fund earnings above an unindexed \$50,000 amount (or less and certainly considerably less than \$100,000 as originally proposed). (Savings)
14. The Mutual Recognition of Australian and New Zealand Dividends should be pursued as part of the integration our economies despite its revenue implications. (General business tax issues).
15. The continued tax concession for large commercial like clubs (with large holdings of poker machines) should be reconsidered as they are vastly different to the type of club the concessional mutuality taxation basis is intended to benefit. (Not-for-profit sector)
16. The base broadening of the GST should include financial services as taxable as opposed to the current input tax basis, realising some \$4B per annum. (The Goods and Services Tax and state taxes).

17. The base broadening of the GST should apply input taxing to more sectors that are currently the case, health, education, child care, water sewerage and drainage (the last category may want to be subject to GST so as to recover cost though). This expanded base will considerably redress the potential for base decline. (The Goods and Services Tax and state taxes).
18. Online sales should be subject to GST. (The Goods and Services Tax and state taxes).
19. The Commonwealth may need to be active in the area of ensuring online revenue leakage from the gambling revenue (and GST) base is managed effectively. (The Goods and Services Tax and state taxes).
20. Australia should reintroduce a Resource Rent tax on all mineral resources. (The Goods and Services Tax and state taxes).
21. The cessation of indexation of excise should not be undertaken as a matter of policy. (Indirect taxes).
22. The excise taxation of alcohol of public health and safety reasons should be taxed on a volumetric basis of alcohol content rather than the mess it is currently taxed at. (Indirect taxes).
23. The excise indexation regime that the social 'bad' tobacco is subject to of AWE should be extended to the social 'bad' of alcohol. (Indirect taxes).
24. The Commonwealth should consider corrective taxes on the sugar contents or drinks and foods. (Indirect taxes).
25. If a carbon tax is revisited it needs to be designed to influence behaviour but not have a large impact on industry competitiveness, household budgets and actually encourage/support energy conservation. (Indirect taxes)

Commentary

The format of my comments follows the discussion paper structure with occasional references to page numbers.

The changing world

At page 8 the discussion paper talks of the changing world and this is useful and puts in context the reality that changes occur. I will refer to two European countries that have gone on opposite paths despite being neighbours. I favour the German approach using GST to raise revenue, and not relying so much on taxes on employment as the French have done. The economic performance of the nations is stark in terms of unemployment, trade balance, economic growth and overall tax take. Germany has gone the right path and is booming relative to France

There is a low level (truly pitiful) of public awareness of the impact and interaction of taxation, regulation, and bureaucratic process on productivity, jobs, trade, tax, growth, intra-company supply chains that span the globe and opportunities. There is little understanding that the world changes and usually to your detriment if you do not adapt to it. The decay of the GST base is not surprising and reflects what happened to the Wholesale Sales Tax (effectively a tax on manufacturing) before it. GST is most important for international competitiveness, which others will use to their benefit if we don't at least neutralise the impact of domestic taxes.

The recent United Voice foray into the tax reform debate shows that if there is an opportunity to wreck – there is always someone there willing to play on ignorance, prejudice and obstruct. It reflects something that has been observed - the best tax is one that someone else pays!

With TNC's intangible assets are an issue, transfer pricing as is thin capitalisation. Arrangements with other revenue organisations and the client companies need to be worked upon and agreed and compliance encouraged. It is not high profile work, but maintenance work and needs to be undertaken all the time. It's not a witch-hunt but there should be no doubt about paying tax.

Proposals

- To improve our place in the world make greater use of GST revenue in place of consumption taxes, and continue aggressive maintenance activity in relation to international taxation.

Australia's tax system

At page 13 the discussion paper correctly highlights the fact that Australia's tax transfer system is highly progressive, but I would point out (from advising experience) that correcting poverty traps (even minor changes) can involve considerable outlays increases for little benefit. This progressivity is a major plus in putting Australia in a better fiscal position than many other countries. Whilst we are more income tax reliant we also don't have social security tax imposts which can be negative in employment terms.

I favour minimising numbers of taxes, as I see it replacing various state and territory taxes with a higher GST makes a lot of sense. If 45% of states revenue is from GST or grants, and 31% is from their own revenue raising, a 15% GST would eliminate the need for almost all state taxes, payroll tax and stamp duties and so on are cumbersome and that related to conveyancing quite a burden on individuals, particularly young homebuyers. GST in place of payroll tax would make our exports much more competitive too, which is part of the reason Germany as I have referred to above is doing well relative to France. A 20% rate could eliminate all state and territory taxes and maximise the competitive advantage for Australian industry.

Phasing out stupid federal, state and territory taxes and applying the GST makes sense in our tax system and also in our place in the world.

The high level of property taxes would decline slightly if GST applied in place of stamp duties, but municipal rates are a fair revenue measure and should be kept. Whilst consumption taxes are low, a shift to greater reliance on GST could raise the consumption tax portion, whilst improving competitiveness of Australian industries relative to now.

As noted at page 21 the shift to income taxes over six decades has been marked.

The reality of a 'no change scenario' will be an inevitable reliance on bracket creep to raise revenue. Something opponents seem to little appreciate. It is also a relatively regressive way to deal with revenue.

The incentives impact of bracket creep is overstated. The highest effective marginal tax rates (EMTR) are faced by those in the social security system, and child care. The interaction of withdrawal rates, tax, and in particular unemployment payments and the low end of the labour market can seem like 'jumping out of a well' is involved, particularly if it is part time, insecure, or minimum wage employment (the secondary labour market). Higher unemployment payments may actually exacerbate this problem (this is not an argument not to increase the payment), as the incentive to work would be reduced, which for those on higher incomes may seem hard to understand, but the interaction with the minimum wage is real.

To improve the situation of low income earners the use of tax offsets (page 30) can be helpful, an expansion for low income earners of workforce age may help with the benefits/low wage interface.

The discussion of tax offsets refers in particular to pensions which are the subject of discussion about cost of late. Indexation changes are simply unpopular, and in a very roundabout way there has been a realisation that tightening means testing is the answer. The parallel I would cite is the 2009 'increase' in pensions. The word increase is in inverted commas as the changed means testing in time will eliminate the cost of this increase by reducing or eliminating payments to hundreds of thousands of potential pensioners.

A tightening of the means testing for pensions is required to reduce outlays and to fit with the increased taxation (and targeting and sustainability) of superannuation contributions, earnings and income.

The exclusion of the family home from the social security means test has not always been the case. When the age pension was first provided by the Deakin Government it had a uniform qualifying age for men and women of 65, and an income and asset test and also included the family home. The subsequent Fisher Labor Government removed the family home and reduced the qualifying age for women. Nearly a century later the qualifying age was equalised (again). However having gone through a period where means tests were absurdly (in hindsight) removed by the Whitlam Government and reversed by subsequent Coalition and Labor Governments, the home is still ignored.

A solution would be to progressively include the home value in the assets test, and make adjustments to the assets test simultaneously. The disparity in the value of homes around Australia is enormous. Some regional localities see home values of a fraction of metropolitan markets prices. A phase in period of perhaps 20 years would remove this inequity and reflect the fact that the home which is sheltered unlike other investments the owners could have invested in. The current blanket exemption is very unfair.

The discussion at page 26 about the incidence of taxes is useful, however it is a point that the public at large would not appreciate. There is a belief that a tax on companies (particularly foreign ones) is overwhelmingly good and should be increased, 'prejudice peddling' is alive and well and as the United Voice foray reveals ignorance and prejudice has both a voice and an audience.

The downward trend in international corporate taxation rates is unmistakable (page 27), and when other nations have lower rates of tax, an impact on business decisions and resource allocation of a TNC must take this into account. This also applies to Australian TNC's that operate overseas. If tax compliance costs are around \$40B pa it is about 2.5% of GDP which is an astonishingly large cost. In large part the cost of running a tax system is outsourced to the accounting profession, it's impractical to do it any other way.

Proposals

- Phasing out stupid federal, state and territory taxes and applying the GST makes sense in our tax system and also in our place in the world, a 15% or 20% rate may be in order.
- To improve the situation of low income earners the use of tax offsets (page 30) can be helpful, an expansion for low income earners of workforce age may help with the benefits/low wage interface.

- A tightening of the means testing for pensions and benefits is required to reduce outlays and to fit with the increased taxation (and targeting and sustainability) of superannuation contributions, earnings and income.
- The tightening of the means testing of pensions and benefits should include the progressive inclusion of the value of the family home, with a phase in period of say 20 years, and with adjustments to the assets test thresholds.

Individuals

I have spoken of the situation of low income and pensions changes above. Essentially superannuation concessions need to be reined in and some tweaking of offsets etc for low income earners to reduce disincentives for low income earners.

A levy such as the Medicare Levy has no meaning. It is barely half of Medicare Benefit Schedule (MBS) outlays, less than one sixth of Commonwealth health outlays, and about one fifteenth of national health outlays. With the addition of the National Disability Insurance Scheme which will rival the MBS outlays annually, the levy is completely pointless.

If there must be a levy as an indicator of health costs, then set the levy at a cost which reflects health outlays, this would be educative for the public and take away the misleading impression that the Medicare Levy covers the cost of health care. If the levy was about 10% (combined with a 8% reduction in marginal tax rates), it would reflect Commonwealth health outlays; at about 15% (combined with a 13% reduction in marginal tax rates) it would reflect Commonwealth health outlays and the cost of the National Disability Insurance Scheme.

The exemptions from paying the Medicare Levy should be removed (currently the military and some others). The pointlessness of the levy itself is one reason, the other if the levy is absorbed into the tax rate the exemptions become irrelevant. The Medicare Levy Surcharge could be maintained in either event, by adding the necessary percentage to marginal rates.

Residency issues are not as big an issue as evidenced by the fact the ATO considers it so marginal a risk, that it does not conduct any checks on it in tax returns. The number of foreign residents that received stimulus payments in the aftermath of the Global Financial Crisis tends to highlight this ATO and compliance deficiency.

I would maintain the existing individual basis on taxation and avoid any changes to household, or couple based regimes. (Page 40). To change it would open up more issues than it solved.

The Chart 3.2 is very instructive about the contributors to income taxation and how dependent it is on the 2.3% of income earners on \$180,001 plus (26.1% of revenue). The public's general misconceptions of tax burden on themselves might surprise them too, particularly if offsets, child care and social security assistance such as parenting payments are factored in. The number of net taxpayers is in the order of half the total adult population (or less).

In relation to Fringe Benefits Tax (FBT) its structure of imposing the administrative and financial burden on employers was largely driven by partisan political logic (as it was in New Zealand, unlike the rest of the developed world), and reinforced by the delays of many years in bringing fringe benefits into welfare and other taxation calculations. The FBT is prone to rorting not so much by employers but by a parasite industry that has grown up around exploiting the systems valuation rules, concession and exemptions. Motor vehicle leasing sees about a \$1B pa of foregone tax benefit for what is overwhelmingly private use.

The not for profit sector discussion (page 123) refers to the FBT regime, and the FBT concession such as for on-site employer provided child care which is regressive in its impact (page 56). The concessional treatment of items must be stamped out.

I hold particularly strong views about the abuse of FBT from my experience of the so-called Not For Profit sector during the tax reforms during 1998-2001 period. The widespread abuse of the uncapped fringe benefits by the sector was disgraceful, as were the self-interested advocacy by this sectors advocates. The current \$17,000 and \$30,000 FBT concessional limits are a compromise as a result of opportunistic opposition at the time. Under no circumstances should these limits be increased. Inflation will reduce their real value.

The discussion from page 44-46 refers to women participation and work incentives. One needs to consider various categories of people, the two largest are:

- young people in the transition from school to full time work transition though part time and casual work, part and full time study, and whilst Youth Allowance the significant reform it is possibly weak on meeting accommodation costs;
- families, be they sole or couple parents, face a range of issues around means testing, availability and cost of child care, women particurely miss out on superannuation by absences from the paid workforce.

For young people simple solutions to reduce the tax impact are the use of tax offsets, noting that Box 3.4 describes a situation that should not arise where a student and worker on identical incomes see the worker worse off. For families expanded child care availability and cost assistance must be priorities. Superannuation needs to be provided as part of the Paid Parental Leave (PPL) scheme. The omission of superannuation whilst on parental leave for women was clearly a savings measure, that compounds the disadvantage that women have in the way superannuation works.

The first paid parental leave scheme was introduced in Germany in 1883. Many nations had schemes by the time of World War One. Of the 163 schemes in place in the world today, based on the level of replacement of average income in the respective countries, Australia's is one of the worst. Australia by changing some aspects of child care access and affordability, paying superannuation during parental leave, will improve the work incentives for women and families, improve the superannuation position of women, and the status of women in our country. It would be a great leap forward.

At page 48 onwards there is a discussion of tax planning issues. A good indication of what is wrong in our taxation and transfer systems is evident when you can get well informed financial advice that recommends superannuation and negative gearing (or more specifically using the concessional treatment of CGT). I have being able to access generous superannuation schemes as a Commonwealth Public Servant and also make good use of salary sacrifice in superannuation, you would be foolish not to. The welfare industry criticisms against negative gearing really miss the point. The concessional treatment of capital gains is the key issue, not that people incur losses, which is a fact of life in many business cycles.

Most Australians will not for decades have serious amounts of money in superannuation. The 12% contribution target can easily be met by salary sacrifice. The 12% target is foregone wages, and over time wage settlements factor in superannuation contributions as part of the overall remuneration package. In recent times the sluggish state of the economy has seen low wage settlements be further impacted by increased superannuation contributions. Low income earners are particularly poorly served by the entire current superannuation taxation system. Bearing in mind the taxation structure was set up by a supposedly worker friendly political party, the system provides the smallest benefits for low income earners, and the biggest to high income earners. Anyone that contributes via salary sacrifice or after tax contributions is on a winner, with concessional contributions, earnings and payments.

Continuation of the movement to the 12% superannuation target should continue and it can be afforded if superannuation tax concessions are reined in. The minimal benefit of the existing system for low income earners needs redressing, a rebate for low income earners to their funds should provide at least a 15% concession. In respect of capital gains they are too concessionaly treated and this is the case in superannuation funds or individual hands. With negative gearing, the greatest single benefit derives the current and previous concessional treatment of capital gains. The solutions are:

- Restoring the 12% superannuation target progression;
- Providing a rebate to funds to ensure that low income earners receive at least a 15% superannuation contributions benefit;
- Taxation on income paid from superannuation funds for those over 60 years of age should be restored and this should have a short phase in period.
- Changes to the pre and post tax contributions limits should be made to ensure superannuation is not rorted.
- Capital gains taxation should be changed back to an indexation basis, and the generous arrangements for superannuation funds and individuals ended.
- Avoid grandfathering provisions as they would just make things complicated again.

At page 53 there is a discussion of zone and medical expense offsets. The zone offsets if they are retained should be frozen. Remote areas are disadvantaged.

With net medical expenses I am inclined to favour its retention. My view is informed by my experience with the Department of Health and Ageing examining out of pocket medical expenses, and also my time with the ATO as a tax assessor. The level of out of pocket expenses can be large and the safety nets only partly redress the problems. As a tax assessor I encountered a claim for medical expenses that was greater than my then annual income for a person undertaking gender reassignment surgery. The income testing arrangements introduced do save money but with a sensible threshold and no income test would help people with large outlays. Large outlays can be generated by medical appliances e.g. hearing aids which may cost up to \$5,000 (and considerably more), wheel chairs and so on. Private health insurance is helpful but does not meet a large part of the outlays.

At page 54 the discussion of work related expenses was interesting. I had worked with the ATO when it was contemplating self assessment, this involved a major cultural change in the way tax was managed, and a major rethink about the trustworthiness of taxpayers and plausible risk. Now it hard to imagine tax assessor wading through literally piles of paper, but about a quarter of a century ago that was how it was done. A simplified tax form has merit, and for many people (38%) a \$500 limit was sufficient. Given that \$300 is the substantiation limit that could also be used.

Proposals

- The Medicare Levy should either be absorbed into the tax rate structure with no exemptions, or set at meaningful rate to cover at least Commonwealth health outlays (including the NDIS), with no exemptions. The Medicare Levy Surcharge could be maintained in either event, by adding the necessary percentage to marginal rates.
- The FBT regime needs reworking removing concessional valuation rules, concession and exemptions. Motor vehicle leasing rorts promoted by a parasite industry must be stamped out; and the inequitable concessional FBT treatment of employer provided child care must be ended.
- With the current \$17,000 and \$30,000 FBT concessional limits, under no circumstances should these limits be increased. Inflation will reduce their real value.
- Work incentives for young people can be enhanced via tax offsets and tweaks to Youth Allowance – the situation described in Box 3.4 should not arise as a matter of equity.
- Work incentives for families can be improved by increasing child care availability and affordability.
- Women superannuation outcomes can be improved by paying superannuation during the period of Paid Parental Leave.
- End many tax planning opportunities and providing equity for low income earners requires the following:
 - Restoring the 12% superannuation target progression;
 - Providing a rebate to funds to ensure that low income earners receive at least a 15% superannuation contributions benefit;
 - Taxation on income paid from superannuation funds for those over 60 years of age should be restored and this should have a short phase in period.
 - Changes to the pre and post tax contributions limits should be made to ensure superannuation is not rorted.
 - Capital gains taxation should be changed back to an indexation basis, and the generous arrangements for superannuation funds and individuals ended.
 - Avoid grandfathering provisions as they would just make things complicated again.
- The net medical expenses offset should not be subject to an income test to provide assistance with high out of pocket medical expenses (which are often medical appliance related).
- A simplified tax return for taxpayers with low deductions should be contemplated.

Savings

With savings vehicles the first principle is there should be minimal differences in the treatment of various vehicles. I propose a modest reform agenda of minimising differences and removing the worst features of the existing treatments of various vehicles. With savings if people use interest bearing vehicles, the income is taxed, there is no issue here. The purpose of dividend imputation was to encourage share ownership and investment in companies and productive economic assets, and underwrite the growth of superannuation. The family home is favourably treated, it is not taxed for capital gains, but all of the ownership costs are private expenses and not deductible either.

The problem areas of capital gains as I have suggested above be subject to tax on the real gain (i.e. revert to the previous indexation regime). This is concessional relative to use of historical costs, but an improvement on the existing concession in terms of fairness. It would raise hundreds of millions of dollars annually in the near future and billions a year in not so distant future. This change to CGT will significantly remove the attractiveness of negative gearing. I don't expect a significant impact on investor housing investment, and if there is it will be beneficial to home buyers anyway.

With superannuation which is greatest problem area and will continue to expand unaffordability in terms of tax expenditures (i.e. revenue losses). The growth of the lost revenue must be reined in, and the biggest problem area is the concessional treatment of fund earnings. The growth is unsustainable and must be ended. The scale of the problem is as follows:

Year	2014-15	2015-16	2016-17	2017-18	
<u>Cost of concessional dedications</u>					
	17.8B	19.15B	20.7B	22.3B	26.3% growth
Increase from base year					
		1.35B	2.9B	4.5B	3 yr total \$8.75B
<u>Cost of concessional taxation of fund earnings</u>					
	18.45B	21.7B	24.1B	26.95B	46.1% growth
Increase from base year					
		3.25B	5.65B	8.5B	3 yr total \$17.4B

I have proposed (above) the taxation of superannuation payments for those over the age of 60. Consideration should be given to increasing the rate of taxation on earnings of superannuation funds. The recent Labor Government had proposed an increase in tax for in fund superannuation income of over \$100,000 a year. This is a useful first start and is a bit high to have a meaningful effect at this time. However if the amount was not indexed in time it would be effective. But it must not be indexed to be effective. A lower level of in fund earnings a year of \$50,000 might be a better starting point. Most people will not be affected by it, but it must not be indexed to be effective. In time the growth of superannuation balances will see actual superannuation tax revenues rise, and with it equity amongst contributors and beneficiaries.

My earlier proposal to ensure that low income earners received a rebate (into their superannuation balance) so as to ensure they got a serious benefit from superannuation combined with a higher tax impost on large superannuation earnings will improve the equity of the superannuation system. The other changes are with means testing in the social security system referred to elsewhere.

Self-Managed Superannuation Funds also need attention and should not escape the increased taxation proposed here.

In relation to wealth and estate taxes (page 72); Australia has tended to make heavy use of taxes on land and municipal rates, as well as stamp duties. Australia is high taxer on land and understanding the likely estate planning impulse such taxes would generate it is a tax area of limited scope, particularly as it will simply promote tax planning via trusts and other such vehicles.

The taxation of trusts as companies is often proposed this would curtail advantages of income tax splitting, I am not sure that if there is dividend imputation this is necessarily the case, but it is not without merit.

- To help curtail tax expenditure outlays on superannuation a higher tax rate should apply to an individual's superannuation fund earnings above an unindexed \$50,000 amount (or less and certainly considerably less than \$100,000 as originally proposed).

General business tax issues

The tax position of Australia in terms of corporate rates of tax (page 76) and the strong upward trend in such revenues put a lie to the claims of rampant tax avoidance. At 19% of tax revenues versus 9% for the OECD we have become heavily dependent on this revenue source. This does imply no action is needed but the hysteria in this area is a beat-up. Page 81 is helpful in seeing Australia's actions on tax avoidance and base erosion.

The integrity aspects of the imputation system like GST is not generally appreciated. If both parties do not have an interest in declaring transactions or seeking to claim back tax paid the tax system would be much weaker.

Page 87 and the discussion of Mutual Recognition of dividends and imputation credits between Australia and New Zealand despite its revenue cost would be an economic measure that would complement the existing integration of our economies. New Zealand (with due respect to our Tasman neighbours) is like a seventh state of Australia and we should do everything to enhance this market.

The Mutual Recognition of Australian and New Zealand Dividends should be pursued as part of the integration of our economies despite its revenue implications.

The discussion of business issues was interesting ranging across depreciation, losses, intangible assets, inbound and outbound investments, transfer pricing, financing, specialised industries, tax and accounting income definitions, research and development, and employee share schemes. I have long had an interest in employee share schemes and I support the proposed change to the taxation point for employee share schemes.

Proposals

- The Mutual Recognition of Australian and New Zealand Dividends should be pursued as part of the integration of our economies despite its revenue implications.

Small business

The changing structure of business and issues with trusts are not new. Page 114 details some of the concessional treatments afforded small businesses, in respect of cash turnover and delayed GST remittances. The capital gains concessions for small business are generous and should not be expanded. A \$2m dollar turnover or \$6m of assets exclusion is generous and should not be changed.

Primary producers are provided with any concessional income tax deductions which are capital in nature, true income averaging can be highly beneficial as are Farm Management Deposits which are fortunately capped at \$400,000.

The discussion about the UK experience with concessional tax rates for small business was instructive, and should not be replicated here, as it would add to complexity which is at odds with the purpose of this review.

Not-for-profit sector

The information at pages 123-125 are instructive about the scale of some NFP entities. The term NFP is misleading, many of the largest NFP's rival commercial entities and are bigger than many small businesses. A practical example is the use of this term with the regulation of therapeutic goods and 'for profit' entities (which may be relatively small) are charged audit costs, but NFP's which may be major hospitals (with billion dollar budgets) are not so charged. There was no logic in it and the only reason was that the enabling legislation made this distinction with huge implications of cost on similar entities and cross subsidisation for others.

The concessional treatment of NFP attracts sufficient advantage already, with gifts and tax concessions. The clubs sector benefits from the taxation based on the mutuality principle. The chasm between genuine local community clubs and huge turnover commercial-like poker machine venues is becoming starker, the imposition of income taxation on the latter should be considered.

- The continued tax concession for large commercial like clubs (with large holdings of poker machines) should be reconsidered as they are vastly different to the type of club the concessional mutuality taxation basis is intended to benefit.

The Goods and Services Tax and state taxes

I indicated (above) support for an expansion of the base for GST it increase to cover more items and to replace a raft of existing state (and territory) taxes. The shrinkage of the GST base (from 56% to 47% of consumption) is not surprising as it exempts items with growth to income growth (positive income elasticity of demand), as well as the decline of mining related investment.

The initial base enhancing measures should include financial services which were excluded initially. This would also have a fairness impact too as higher income households benefit to a greater extent from this concession. This would increase revenue about \$4B per annum. The current rental arrangements should remain, input taxation for residential rents is fair. The comparative bases of average OECD 55% and New Zealand of 96% is instructive. Regrettably the New Zealand experience may remain unique as such coverage would come with so much opposition.

The exclusion of health, education, child care, water sewerage and drainage from GST had in part it logic the cost impact on the federal (and state and territory) budgets apart from competitive issues. This should be changed so that these sectors are input taxed, this is not a perfect solution but would considerably expand the base and revenue without massive public resistance.

Fresh food has been a sticking point and it is not surprising the distribution of benefits are greatest (in absolute dollar terms for high income households) and for that matter the other currently exempt items above. The pizza roll example cited at Box 8.1 is eerily like the issues that arose with Wholesales Sales Tax.

The digital economy is a major threat to the GST base and for that matter the income tax base. Online sales should be subject to GST (cost may be an issue but it must be tackled).

I refer to the level of state and territory taxes above (and here at pages 142-3) and note that taxes such as payroll tax, insurance tax, stamp duty, land tax all undermine the competitiveness of Australian goods and services in the marketplace in Australia and also overseas. The high level of reliance on stamp duty (page 145) is striking. The ACT reforms in relation to reducing conveyancing stamp duty and increases rates have considerable merit, but the annual impact in rates at the end of 20 years will be considerable (as evidenced with the extension of the phase in period from 10 to 20 years).

The discussion about municipal rates (page 149) was interesting. The problem for councils is the rate base and capacity of people to pay. This is particularly an issue for rural councils, and also fast growing urban edge councils. The demand for infrastructure is considerable but the capacity to tax residents limited.

Gambling tax like any state and territory taxes is driven by the crude need to raise revenue, many are highly regressive. In the past the states and territories and federal government raised revenue on entertainment and racing in particular. These days it is heavily reliant on poker machine taxation and there are large clubs are 'community supporting' only in name. They are in large part a tax favoured and powerful vested interest that exploits the mutuality principal. The Commonwealth may need to be active in the area of ensuring online revenue leakage from the gambling revenue (income and GST) base are managed effectively.

Royalties are correctly noted as not been a tax but an impost on property i.e. minerals which vest in the state). Given that royalties are 22% of Western Australia's revenues it is unlikely they will want to change that anytime soon. I favour a Resource Rent Tax (RRT) and am on public record as such. The original 2010 proposals were close to an ideal regime of resource taxation (although including quarries was a major mistake, along with some bizarre subsidy arrangements). The replacement and now defunct minerals tax on coal, oil and gas and Iron ore, and ignoring all other minerals made no sense as other than a political fix. Given the low level of minerals prices a RRT would not raise much revenue, but it is to be desired as a sensible tax on economic rents from all the exploiting of all mineral resources. Nations such as Norway make effective use of RRT and so should Australia.

Proposals

- The base broadening of the GST should include financial services as taxable as opposed to the current input tax basis, realising some \$4B per annum.
- The base broadening of the GST should apply input taxing to more sectors that are currently the case, health, education, child care, water sewerage and drainage (the last category may want to be subject to GST so as to recover cost though). This expanded base will considerably redress the potential for base decline.
- Online sales should be subject to GST.
- The Commonwealth may need to be active in the area of ensuring online revenue leakage from the gambling revenue (and GST) base are managed effectively.
- Australia should reintroduce a Resource Rent tax on all mineral resources.

Issues in the Federation

The discussion paper canvasses a range of interesting topics. I have proposed the replacement of most (and ideally all) state and territory taxes with the GST.

As noted above gambling tax like any state and territory taxes is driven by the crude need to raise revenue, many are highly regressive.

Indirect taxes

The discussion of the history and complexity of indirect taxes is interesting. The restoration of fuel excise in 2014 is long overdue. The failure to index the excise from 2001 was a mistake and at 17 cents a litre loss the revenue impact is large. The hysterical claims made about the impact of the restoration of the excise are just absurd and political nonsense. The campaign in part waged by the party that introduced the 1983 six monthly indexation of the excise and periodic ad-hoc increases should be embarrassed by this sort of rank opportunism, as should the party that claims to be environmentally concerned/motivated. A less than 1 cent a year increase on an already 38 cents a litre impost is tiny. The exclusion for off-road use and partial for on-road heavy vehicle use activity strikes a reasonable balance and is not a subsidy as is falsely claimed by some. The absence of this concession would inflate freight cost and also undermine the competitiveness of Australian exports and import competing industries.

Alcohol taxation in Australia is a mess. From a public health perspective I cannot believe that we treat alcohol content of various drinks so differently. There is no logic to it and certainly a tax on the volume of alcohol would make sense from a health and public safety perspective. The price impact of all of this would not be significant and application of the excise on the volume of alcohol would at least make sense (compared with the current system). Wine Equalisation Tax can probably be done away with also. Chile and Mexico at least have a sane approach to the taxation of alcohol, and so should we.

The example of the taxation of ginger beer at Box 9.1 demonstrates the nonsensical basis of taxation of alcohol products on other than a volumetric basis.

The indexation regime for fuel is CPI, that for alcohol is CPI but for tobacco AWE, perhaps fuel whilst it is a necessary 'evil' should be indexed to the CPI but alcohol is not a necessary evil, and perhaps like tobacco should be indexed to AWE?

I have no particular views on the Luxury Car Tax (LCT). But it may need some modification.

Agricultural levies are imposed at the request of the relevant primary industry. As an auditor I was involved with an audit of such levies. In the intervening years they have been improved, which is pleasing as some had some peculiar features in the past. I have nothing else to add.

Tariff revenue is expected to continue to decline in importance. From an economic perspective this a good thing. I have nothing to add to this discussion.

Financial transaction taxes. I have indicated a preference that reliance on such taxes be reduced and replaced with GST. I have nothing further to add to this discussion.

'Corrective' taxes – this is a messy area. Often the motivations have moral purposes and non-objective bases. Having a health policy/health economics background I am sensitive to argue that taxation may be useful means to discourage certain activities. A consequence of a higher living standard is a desire to consume more of certain services, travel, education and health but there are aspects of obesity and diabetes. In part the increased consumption of sugar products combined with overeating and insufficient exercise are taking a public health toll. The imposition of a tax on sugar content of drinks and breakfast cereals in particular has health merit. A tax or some description of sugar content should be examined, adding that a health related tax is more likely to succeed legislatively as there is a clear purpose and consequence of the tax. To add to this discussion awareness of calorie content has prompted food and drink venues to promote the calorie content as a selling point. Awareness of calorie content is actually a good thing from a public health perspective.

A 'corrective' tax to deal with market failures is well established. Many European nations had pollution taxes for many decades as a means of forcing environmental remediation. Similarly Australia's carbon tax in part was based on this logic. The carbon tax involved a huge amount of churn in terms of tax on energy, and a huge compensatory regime which for many people meant they were actually better off; this was not a particularly sensible position – in fact it is completely absurd. An impost on additional energy use (on a national basis) would have probably have avoided this huge churn and public angst (Professor Warwick McGibbin had made proposals like this).

A major problem with the carbon tax was its impact on Australian competitiveness, which seems to not ever been adequately dealt with, and merely shifted industries to other parts of the world, with no net change in emissions. Related to the carbon tax were many features of subsidies for installation of energy saving and other 'direct action' items, something that seemed incongruous in light of how public debate went. The takeaway lesson is that 'corrective' taxes are more likely to succeed if the burden is confined and small in an overall personal budget, and largely discretionary, whereas if it large in impact on a personal budget and on a largely non-discretionary way (which power, light, fuel and so on are largely not), that success is less likely. As an internal auditor at the ATO I participated in an audit of the ATO input into emissions trading, and from an ATO tax policy development perspective this process was entirely satisfactory.

Proposals

- The cessation of indexation of excise should not be undertaken as a matter of policy.
- The excise taxation of alcohol of public health and safety reasons should be taxed on a volumetric basis of alcohol content rather than the mess it is currently taxed at.
- The excise indexation regime that the social 'bad' tobacco is subject to of AWE should be extended to the social 'bad' of alcohol.
- The Commonwealth should consider corrective taxes on the sugar contents or drinks and foods.
- If a carbon tax is revisited it needs to be designed to influence behaviour but not have a large impact on industry competitiveness, household budgets and actually encourage/support energy conservation.

Complexity and administration

The discussion is quite valuable. The reality is that the tax system is complex and 'patches' are commonplace to deal with problems.

The discussion about the ATO is interesting. I have worked at the ATO on three separate occasions. In different capacities. It is one of the most dysfunctional government organisations anyone could work for. For some inexplicable reason it has only begun to accept credit card payments in recent years, decades after other mainstream organisations. The reason may exist but it may only make sense in a ATO sort of way.

Tax system governance

The discussion of how tax works and is managed in Australia was interesting. Tax is arcane and bureaucratic and the ATO certainly so.

Martin Gordon

20/4/2015