How to Raise the Public Revenue Australia Needs

By Graham Ihlein, graham.ihlein@optusnet.com.au, 0400 598 705, July 2015

For many years I have been thinking about how we can better fund government services and investments. This paper presents my personal views on tax changes that Australia needs in the medium term (10 to 30 years).

The paper proposes that:

- **That increased tax revenue is required;**

- **That the main criteria for judging how best to raise extra revenue should be to promote more economic growth and jobs, promote greater fairness and promote a sustainable tax system;**

- **That the extra revenue should come mainly from income tax and expanded property taxes – and not from increased consumption taxes; and**

- **That in election campaigns political leaders should say that they will seek to in a fair, long term way fix the Budget and provide for future services and development that our country needs – and specifically not to promise anything like low taxes, no tax increases or a cap on taxes.**

In its final submission on the Abbott Government's 2015 Tax Discussion Paper, ACOSS put the core argument for tax reform very well:

"In the absence of comprehensive tax and budget reform, social and political conflict over scarce public resources will only intensify. Governments will be trapped in a vicious cycle of austerity and recrimination."[1]

Why do we need more Tax Revenue?

Gross Domestic Product (GDP) in Australia is now close to $1,600 billion. Tax revenue of all governments across Australia totals about $440 billion[2]. Hence, our taxes are about 27.5% of our Gross Domestic Product (GDP).

In the medium term it is estimated that Australia will need to find an extra $150 billion per year in 2015 dollars[3] for recurrent spending.

This $150 billion includes $60 billion per year to overcome the current overall shortfall in the budgets of Australian governments[4], plus $90 billion per year for new recurrent spending.

All this goes beyond just extension of existing programs to more people. For example, our growing and aging population will bring massive demands for infrastructure (particularly in transport, urban renewal and decentralisation) and for more and different services (particularly in health).

In 2010 the Australian Treasury estimated Australia's spending needs would rise over the next 30 years by a net 4.5% of our GDP. That's equivalent to about $90 billion per year. Treasury based their estimate on rising expectations for public services, our aging population and technological enhancements (especially increasing health costs). This 2010 estimate may prove to be on the low side, with extra recurrent funding needed for the Gonski education reforms, the NDIS and people facing poverty and disadvantage.

We can and should meet some of these demands by reorganising some spending[5]. We can and should also use extra borrowing and private equity to invest in more major capital infrastructure projects[6].

But there will still be a requirement for real increases in public tax revenue - estimated to be about $A60 billion dollars per year (in 2015 dollars) or about 14% extra revenue.

Would this raise taxes in Australia to higher than most other developed economies? No. Taxation revenue in Australia is about 27.5% of our GDP - well below the tax average for OECD countries of 33.7% of their GDP (See Figure 1).

From 1965 to 2007 tax in Australia was, as a percentage of GDP, 4.8% below the OECD average. Since 2008 Australia has averaged 6.8% below the OECD.[7]

To raise an extra net $60 billion tax revenue per year in current dollars equals nearly 14% more tax revenue (or an extra 3.75% of our GDP).

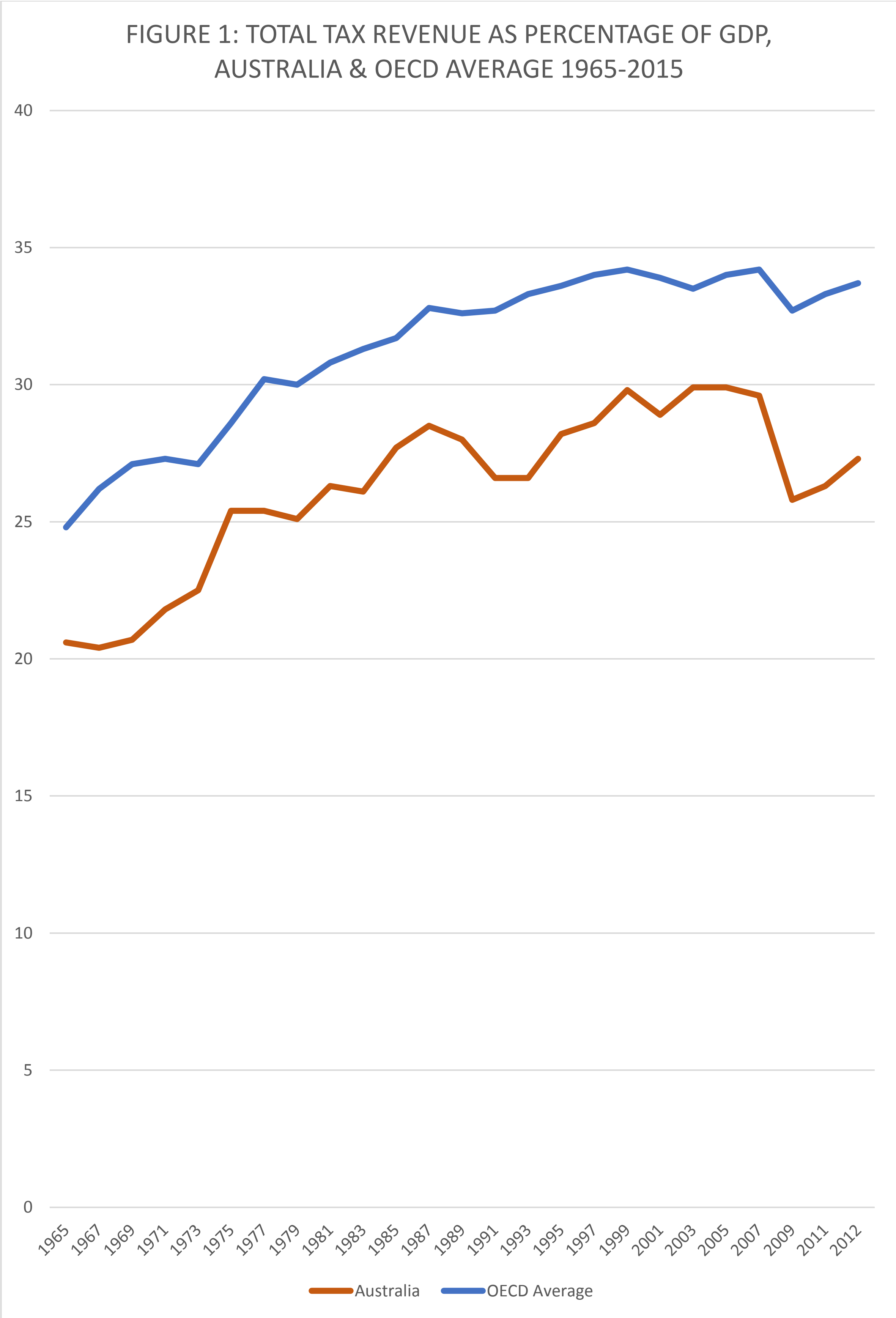
FIGURE 1: TOTAL TAX REVENUE AS PERCENTAGE OF GDP, AUSTRALIA & OECD AVERAGE 1965-2015
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Australia
OECD Average

Why not go further to bring our taxation up to the OECD average, or go even further to raise Australia to the taxation levels of the Scandinavian countries?

The main reasons are:

a) It's hard to push up taxes;
b) National income and wages are likely to grow less than past averages;
c) Unlike many other countries our culture and economy are not ready to go further; and
d) We have to spread the funding task across taxation, spending cuts, borrowing and private investment to avoid excessive shock in one area.

Last year I visited the Scandinavian countries of Denmark, Sweden and Norway. It was striking how people in the street were openly proud about their good services and infrastructure, which had to be paid for with high taxes.

I was lucky to be in Sweden a few weeks before their election day. They have all their national, county and local elections on the one day, with all being by proportional representation and each level gets a set share of revenues to carry out complete areas of service. In the event of conflict between levels of government, then the policy determined by the national parliament applies. It was interesting that the main policy commitment given by each of the major parties was popular – that they would **not** cut taxation (because that would mean reduced services).

The Scandinavian countries have enjoyed a high degree of co-operation over a long period. There is little pressure or scare campaigns to reduce tax and services, although international economic pressures are now increasing. These countries have a very high standard of living – materially and socially.

The key is that to develop that culture in Australia would take a long time and lots of steady changes.

Criteria for judging tax reform options

So, if Australia is to raise some extra tax revenue, what is the best way to do this? This paper applies three main criteria for judging tax reform options:

1) Tax reforms should promote more **jobs and income -** by reducing excessive inequality in income and wealth, and by using taxes which encourage and finance productive development;

2) Tax reforms should promote greater **fairness –** by making the total tax system more progressive, so that those on low incomes pay a total of 24% of their income (as now); those on average incomes paying 28% (up three points); and those on high incomes paying 35% (up seven points).

3) Tax reforms should promote a **sustainable tax system** - which the public respects, which raises required revenue at minimum cost (and increasing at least in line with GDP).

A more detailed explanation of these criteria is given in Attachment One.

Which Tax Reforms should provide the extra Tax Revenue?

The revenue-raising taxes across Australia can be grouped as[8]:

- Personal income tax (now 41% of all revenue-raising tax revenues)[9],
- Land and resources taxes (11%)[10],
- Corporate taxes (22%)[11], and
- Consumption taxes (26%)[12] .

This paper proposes a package to over 10 to 30 years increase Personal Income Tax by 25% (plus $46 billion per year) and increase Land and Resources Taxes by 25% (plus $12.5 billion per year). There would be little change in net revenues from Corporate and Consumption Taxes, although some shifts within these taxes are proposed.

This would provide the extra public tax revenue needed and be consistent with the criteria given above for tax reforms – to promote jobs and income, fairness and tax sustainability.

Personal Income Tax

Income has been the cornerstone of Australia's tax system and this should remain so. Australia collects a higher proportion of its revenues from income tax than most other countries. This is understandable – Australia is physically isolated, so it's harder for lots of people to shift to a neighbouring country to avoid income tax.

This paper proposes that personal income tax revenue be raised by 25% or $46 billion per year over the next 10 to 30 years. $26 billion per year would come from higher income tax rates (including a more progressive scale). Limits on four income tax concessions (on superannuation, negative gearing and capital gains, franked dividends, and income splitting through trusts and companies) and a new "Buffet Rule" would raise a further $20 billion per year.

These income tax reforms would make a significant contribution to a more progressive overall tax system in three ways – by increasing the proportion of total tax coming from a progressive tax[13]; by making the income tax scale more progressive; and by reducing the disproportionate benefits given to those on higher incomes from income tax concessions.

I agree with the comment by former Secretary of the Departments of Finance and Prime Minister and Cabinet, Michael Keating that *"Maybe we would be better off if our government(s) just came clean and acknowledged that we will not be able to pay for what we want in the way of future public services without a modest upward adjustment of the income tax rates."*[14]

Higher income tax rates should provide 14% extra income tax revenue (or $26 billion) by:

- An extra annual income tax revenue of about 9% could be achieved 30 years from now by adjusting tax rates from time to time to return to taxpayers nine tenths of bracket creep[15];

- A further 2.5% increase in income tax revenue could be raised by increasing the Medicare Levy from 2% to 3%[16]; and

- A further 2.5% increase in income tax revenue could be raised by raising income tax rates for those on high incomes[17].

Details of the extra $20 billion per year to be saved by reducing four income tax concessions and introducing a "Buffet Rule" are as follows:

i. Reduce superannuation income tax concessions (saving net $8 billion)[18] - in the contributions phase half of contributions above $8,000pa should be taxed as normal income and in the retirement phase payouts less the first $40,000pa should be taxed as income [19];

ii. Reduce Capital Gains and Negative Gearing income tax concessions (saving $5 billion)[20] by:

   a) Fully tax any asset, acquired from now, if it is sold within 2 years (up from current 1 year);
   b) Increase the amount of other capital gains to be included in taxable income in stages from 50% to 75%;[21]
   c) Except for losses of up to $10,000pa (on properties now held and future new constructions), abolish negative gearing so capital and borrowing losses could only be offset against capital gains (not wage income).

iii. Reduce income splitting through trusts by requiring that trusts be taxed as companies (saving $3 billion in personal income tax)[22].

iv. Reduce the franking (dividend imputation) concession (saving $2 billion in personal income tax)[23] by requiring that the dividend must be paid within a year of the profit and reducing the franking credit in stages from 100% to 75%.

v. Introduce a "Buffet Rule", as recently proposed by the Australia Institute, to set a minimum average income tax rate of 35% of gross income where gross annual income is $300,000 or more (saving $2 billion[24]).

Land and Resources Taxes

This paper proposes that revenue from Land and Resources Taxes be increased by a net 25% (net +$12.5 billion per year) - replacing most stamp duties. The net revenue to be gained from revamping and increasing land tax would deliver an extra $10 billion per year, after replacing most stamp duties. $2.5 billion per year would be raised from an effective Mineral Resource Rents Tax.

Property taxes provide significant revenues, are mostly progressive and enable state governments to retrieve some of their planning and development costs.

In 2013 the levies on fire insurance policies which paid for part of the cost of fire authorities in Victoria were replaced by a land rate collected for the state government by local councils. This model could be used to extend land tax, equitably reflecting land values across the country.

Local Government Rates are in most cases applied progressively to capital improved land values. Unlike local council rates, land taxes exclude owner-occupied dwellings. Land tax is a limited and fairly effective wealth tax. It could be extended to apply to the capital improved value of all properties. It could replace most stamp duties and be a stable, long-term tax base. It could be collected annually and charges could attach to the property to be met at sale or transfer (or as death duty).

Further, if the argument can be won to include the home in all assets then, as technology advances, a wealth tax taking into account all assets could become a significant part of the tax mix. Differences in accumulated wealth grow several times greater than annual income variations, so there is potential for very progressive and targeted taxation. Wealth taxes can also assess all asset holdings. However, pressure to exclude many productive assets (such as farmland) can be irresistible. Overseas experience is that wealth taxes do not raise great revenue (generally 1% or less of total tax revenue), because they can be easily avoided (by gifts, use of companies etc.), they are complicated and they have high collection costs.[25]

Stamp duties on property transfers also provide substantial revenue and can be progressive. However, they are a volatile source of state government revenue, dependent on a buoyant property market. They also discourage some home owners, especially older people, from selling their home to free up savings in retirement. This disincentive to sell also limits housing supply.

Corporate Taxes

This includes federal company tax and state payroll taxes. This paper proposes to maintain revenue from Corporate Taxes by Company Tax by 10% ($14 billion), and using this to halve Payroll Tax (-$14 billion).

Company Tax: There has been extensive publicity recently about huge tax avoidance by companies using low-tax countries, transfer pricing etc. and this applies to both Australian companies on their Australian and international operations and foreign companies on their activities in Australia. [26]

Revenue from Company Tax could be increased by $14 billion per year by:

1. Legislation and enforcement action to reduce tax avoidance by Australian companies and international companies operating in Australia (saving $9.5 billion), including taxing sales where avoidance/evasion is suspected;

2. Reduce the franking (dividend imputation) income tax concessions by requiring that the dividend must be paid out within 12 months of profit and franking and reducing the franking credit by one quarter from current provisions (saving $0.5 billion in company tax);

3. Treat Trusts as companies for tax purposes (saving $2 billion);

4. Treat the commercial business enterprises of Charities as separate taxable companies (saving $1 billion); and

5. Raise the 15% tax on Superannuation fund earnings to 20% (except for investments in the Australian Infrastructure Fund designed to build major public infrastructure) (saving $1 billion).

State Payroll Taxes raise substantial revenue for state governments, are straightforward and easy and cheap to collect. Payroll taxes are only collected from medium to large businesses, so they can be slightly progressive.

However, Payroll Taxes are limited to the input of wages, so they discriminate against employees. They also discourage small businesses from growing and encourage artificial use of independent contractors over employees. As well as reducing harm to jobs, cutting payroll taxes could facilitate negotiations to raise employer superannuation contributions to 12% and long-term to 15%.[27]

Business has been pushing to reduce the company tax rate. They argue that capital is mobile and a low tax rate can attract more foreign investment. They also argue that the cost of Company Tax is ultimately not borne by companies or their shareholders – because they'll shift investments or pass on the costs to consumers (by higher prices) and employees (by lower wages and less jobs). There is scant logic or evidence to support these extreme economic theories.

Company profit is a sound and fair tax base. Profit broadly reflects how well-off they are to contribute tax – in contrast to turnover. And company tax is essential to limit income tax avoidance by individuals.

Other relevant factors to consider on the company tax rate include:

- Australia's headline Company Tax rate is in line with advanced countries and lower than the USA, but very close to the average for OECD countries and for countries of our size and in our region. Also, Australia's dividend imputation system makes our effective tax rates for Australian investors much lower than many other countries.

- To follow other countries in reducing company tax rates is likely to be a self-defeating race to the bottom – the benefits to economic growth are arguable, the main beneficiaries would be foreign investors (especially in our mining giants), the short-term effects are to reduce revenue and optimistic assessments would return (by more growth) half of the revenue levels only after 10 years.

- Attracting funds is not now a problem (with low interest rates and few alternative investment options)28 - there are more factors than just the tax rate.
- The disparity between the Company Tax rate and the top individual marginal income tax rate has caused tax avoidance problems. Until 1988 the Company Tax rate was aligned to the top individual marginal income tax rate. The Company Tax rate was reduced several times and to the current rate of 30% in 2000.

- Of the 800,000 companies in Australia, just 2,000 pay two-thirds of company tax. It's reasonable, as Labor did in 2010, to say to business wanting a company tax cut that they should put forward offsetting savings in benefits and concessions going to the business sector.

Consumption Taxes

This includes GST, federal excise and custom duties, and state vehicle, gambling and insurance taxes.

This paper proposes that total consumption taxes be increased by a small net 1% (net + $1.5 billion per year). This includes reducing Fuel Excise Credits (which go to miners and farmers) and increasing GST enforcement (on Google etc.). This would offset the decline in GST relative to GDP.

Fuel excise tax credits to farmers and miners now cost the Australian budget over $7 billion per year. Whilst a strong case can be put to abolish these special benefits, only some of the perceived cost could be recovered.

GST is collected by the Australian Government for the States. The proportion of consumption of goods and services covered by the GST fell from 56% in 2005-6 to 47% in 2012. Revenue from GST has been growing much more slowly than other tax revenues.[29] This is due to widespread GST avoidance/evasion, the rate of saving increasing and GST-free consumption expanding faster than GST-taxed consumption. The main categories that are GST-free are fresh food, health, education, childcare and water, sewerage and drainage services.

Financial services and residential rent are covered only to the extent that inputs are taxed - sales are tax-free. The Abbott Government's Tax Discussion Paper estimated that the current treatment of financial supplies is worth over $4 billion in forgone revenue in 2014-15 (this mainly applies to banking, because insurance is subject to a 10% stamp duty in most states).

The Tax Discussion Paper also says that higher-income households contribute a smaller proportion of their income on GST than low-income households because they divert more of their income into savings.

Some indirect taxes can be progressive – such as the luxury car tax and some stamp duties if confined to or having a higher rate for expensive properties.

The following claims have been put in support of extending the GST to all items and raising the GST from 10% to 15%, plus higher welfare benefits to offset the regressive effects on those on lower incomes:

- That this would be an easy way to raise revenue- extending the GST to all items and raising it to 15% would raise a net $60 billion ($140 billion less $80 billion compensation)[30];

- That this would create a more balanced tax spread with taxes on consumption in line with the OECD average; and

- That those on high incomes spend a greater proportion of their incomes on some items now excluded from the GST, notably education and child care, than do those on low incomes – so extending the GST to these items would not be regressive[31].

The arguments against extending and raising the GST are:

- That this change would not be easy as some of the extensions (such as on financial services) would be very complex;

- The real agenda of the proponents is not to expand services and infrastructure, but to use the funds to cut taxation on capital (corporate and income tax cuts);

- In most areas GST extension would particularly hurt those on low incomes, requiring great compensation that could be whittled away over time - either the net revenue would be minimal or those on low incomes would be hurt;

- No net revenue would be gained from extending the GST to education and child care because governments would be forced to fully recompense parents;

- Wage earners (as consumers) would see a further real reduction in the value of their wages; and

- The incentive for avoidance/evasion would increase.

The Real Agenda of the Abbott Government

In my view the Abbott Government is trying to defraud public debate on taxation in Australia. They say they are for lower taxes, but they are doing very little about tax, except for allowing income tax bracket creep. They refuse to discuss higher public revenues.

The Abbott Government's Tax Discussion Paper put forward three claims to support higher consumption taxes and lower income and corporate taxes:

i. That many other countries gain a greater share of their taxation revenue from consumption taxes and less from income and corporate taxes than Australia does;

ii. That "indirect taxes" (like GST) distort economic behaviour less than do "direct taxes" (like income and corporate taxes); and

iii. That economic modelling by KPMG Econtech[32] shows that taxes which have a more immobile and broader tax base (such as all goods and services) distort economic behaviour less than do mobile and narrow-based taxes (such as those on capital).

But the facts don't support these claims.

Take company tax – our headline rate of 30% is below many other countries, but it's right on the average of the 10 largest economies and our real tax rate is much lower because we are almost alone in allowing a tax deduction for franked dividends.

As Fairfax Media Economist Ross Gittins pointed out:

"when you add compulsory social security contributions (Australia: none) and payroll taxes (Australia: low) to get a like-with-like comparison between countries, we raise 63 per cent of total taxation through "direct" taxes, compared with the OECD average of 61 per cent. Oh."

There's also scant evidence to show that avoidance behaviour is less with an indirect tax than it is with a direct tax.

Further, the KPMG Econtech "economic modelling" was flawed. The assumptions were made at the outset that the most efficient taxes are less mobile and have a broad tax base. Modelling was then done (and a lot of words), which concluded that capital taxes are less efficient than broadly-based consumption taxes (mainly because capital is mobile and all goods and services is a broad base). Disturbingly, the modelling was circular, self-fulfilling and proved nothing.

Finally, the Abbott Government, through its tax and federation plans, is really aiming to squeeze the States and leave it to them to handle the problems.

I agree with the conclusion of Ross Gittins:

"The discussion paper makes no recommendations, but add up all its arguments and the conclusion we're led to is clear: to reform our tax system to cope with the globalised 21st century, we need to make changes that cause high-income earners and foreign investors to pay less tax, but the rest of us to pay more. Purely coincidentally, of course. In the unlikely event anything much is done about {the unfair huge tax concessions enjoyed by the top 20 per cent-odd of taxpayers], the saving will be used to help pay for tax cuts for companies and high-income earners, not to help reduce the deficit."

CONCLUSION

It's not an option to just sit and hope that income tax bracket creep and a bit of tinkering with some spending will fix budgets. [33]

Without remedial action, our future public revenues look difficult. Existing taxes are under pressure due to less economic growth[34], lower export prices, a growing industry of tax-dodging by well-off companies and individuals, and an unsustainable system of tax concessions.

I fear that if we don't stand up and put forward clear, positive plans, then the Abbott Government will do bad things to spending and State services. It will be disastrous if we just shove the problems down the line onto State and local governments and pretend the problems are fixed.

My package can be applied to give a better breakup of revenues and responsibilities between levels of government. We need to view these needs of all our governments as a whole – and preferably develop a formula to share revenue and responsibilities across the different levels of government. – including the federal, state and local breakup.

And over the next 30 plus years we need to reform spending and borrowing and private investment for major capital projects – and fairly increase public revenues from our taxes.

Attachment One: Criteria for judging tax reform options

Tax reforms should promote Jobs and Income

Within a reasonable range, lower or higher taxes do not increase or reduce jobs, economic growth or national income. Most OECD countries with lower taxation as a percentage of their GDP do not have better economic performance[35] than countries with higher taxation.

However, there are two main ways in which taxes can lead to more jobs, growth and national income – by reducing excessive inequality in income and wealth, and by using taxes which encourage and finance productive development. Both of these will be examined more closely.

Tax measures to reduce inequality of income and wealth can lead to more jobs, growth and national income. This applies especially in cases where inequality has increased or the public believes inequality is excessive or unfair.

Most Australians are very well off by world standards in terms of income and wealth. However, we are now a relatively unequal society and the gaps are getting wider. Inequality of income is higher in Australia than the average of OECD countries, although it is still considerably lower than in the USA and the UK. Inequality of wealth is also very high in Australia. A range of studies have confirmed that gaps in incomes and wealth in Australia are large and growing[36].

An excellent study released by ACOSS in June 2015 found:

"A person in the top 20% income group receives around five times as much income as a person in the bottom 20%. A person in the top 20% wealth group has a staggering 70 times as much wealth as a person in the bottom 20%."[37]

The ACOSS study showed that inequality in Australia has increased greatly:

- From 1985 to 2010, real wages increased 72% for the top ninetieth percentile, 50% on average and 14% at the bottom tenth percentile[38];
- Investment income for the top tenth doubled between 2004 and 2010;
- The wealth of the top fifth wealth group increased 28% over the period 2004 to 2012, whilst the wealth of the bottom fifth increased just 3%.

How does excessive inequality harm the growth of jobs and national income in Australia? The ACOSS study put the case succinctly:

"Excessive inequality is bad for the economy. When resources are concentrated in fewer hands, there is a reduction of economic activity. Fewer people are starting up businesses, buying houses, and purchasing goods and services. More people become dependent on government intervention … The risks of rising inequality are becoming increasingly recognised around the globe. In a report published in May 2015, the OECD found that rising income inequality reduced economic growth by an average of around 5% across OECD countries over the two decades to 2010. The main reason for this is that, by widening the rungs in the income ladder, it closes off opportunities for people at the bottom of the distribution. By holding people back from realising their potential, especially through employment, it stunts their contribution to the economy."

Specific taxes can encourage productive behaviour or discourage unproductive behaviour. Revenue can help fund investment in productive infrastructure or increased skills – to increase labour and capital productivity, increase workforce participation and reduce discrimination against jobs. [39]

<u>Tax reforms should promote Fairness</u>

Most people say that they want a "fair" tax system and for fairness to have a large and significant role in our tax system. This generally involves some redistribution of income and wealth. The underlying rationale is that taxes should reflect capacity to pay and benefits (including tax concessions) should go to assist those in need or to deliver clear net public benefits.

However, when you dig further there seem to be talking about three somewhat different things.

The first and widest view looks towards a social contract to achieve a **better society**. Supporters argue that there is a social contract between society and people to contribute together to a better and fairer society. In this view we are humanity and more than selfish economic units. We want to see our society progress in a civilised way – it can be inspirational, give people hope and simply feel good. This was put well in a recent ABC television program when a member of the public interviewed in the street said[40]:

"We all have a moral obligation to society. You pay tax not just for yourself and your family, but you pay tax to improve the society that you live in."

This can also relate to our instinct to pass on something better to future generations. In 2012 Michelle Obama said[41]:

"When you've walked through that doorway of opportunity, you do not slam it shut behind you. You reach back, and you give other folks the same chances that helped you succeed."

'Better society' supporters look beyond just some sort of social safety net to help people avoid dire poverty – they want to give people substantial opportunities to develop and succeed, especially in areas such as education. Amongst 'better society' supporters opinions will vary as to how far the system of taxes and benefits should go to redistribute income from the better off to those who have the least, but they all support at least some redistribution.

The second broad **capacity to pay** approach is to say that in a "fair" tax system, taxpayers contribute in line with their capacity to pay and rorts should be removed. Tax scales could be either proportional or slightly progressive - with some redistribution from those better off to those who have the least.

The third broad **efficiency** approach defines "fairness" very narrowly. This approach would effectively strip the term of any meaning by treating it merely as 'efficiency'[42]. Supporters of this very narrow approach say that in a free and fair market taxes should be kept to a minimum and cover competing things equally so that there are minimum costs and changes in behaviour for those paying taxes. Another variant of this approach is to argue that the tax system should only seek to collect revenue (as efficiently as possible) and any assistance to people of lesser means should be through payments only (limited to a small social safety net to help people avoid dire poverty).

However, whilst transfer payments must play the main role in reducing inequalities, if taxes do not share in creating fairness then much more revenue would be required to achieve an overall fair outcome.

Research by ACOSS has shown that overall Australia's tax system is relatively flat[43] - those on higher incomes pay a similar proportion of their income in income tax and consumption taxes as those on lower incomes. The ACOSS research (based on ABS 2009/10 data) showed that in Australia total income, consumption and other indirect taxes paid were:

- For those households on the lowest fifth of incomes total 24% of their income (or $129pw)[44];

- For those on average incomes total around 25% of their income; and

- For those on the highest fifth of incomes 28% of their income (or $1006pw)[45].

It would be desirable that, over the next 30 years, the progressiveness of the total tax system be increased. This paper suggests the following:

- Those on low incomes paying a total of 24% of their income (as now);
- Those on average incomes paying 28% (up three points); and
- Those on high incomes paying 35% (up seven points).

This would be consistent with the wider meaning of **"fairness"** - that people pay taxes as part of a social contract in order to positively contribute to a better society and there is a more progressive overall tax system which reflects capacity to pay without major rorts.

Tax reforms should promote Tax Sustainability

A sustainable tax system is one which the public respects and which raises required revenue at minimum cost (and increasing at least in line with GDP).

Over a long period the public has wanted more spending (mainly on health, schools and infrastructure) ahead of tax cuts. Opinion polls have shown an increasing majority (over 80%) in favour[46].

Measures which would assist public acceptance of the package include:

- It's important to talk early about the big picture and general principles and to phase in changes with a mandate.

- Identifying tax changes with important spending and investment (by hypothecation or otherwise) can be very beneficial.

- The focus should be on removing rorts and small taxes (e.g. privatising agricultural levies) and be publicly seen to minimise public sector waste and be frugal with politician benefits.

- Tax plan details should highlight the promotion of jobs (and minimise discrimination against jobs or fairness).

- Tax plan details should also highlight measures apart from tax to increase equality.

Sustainable revenue-raising taxes will rise at least in line with GDP, attract high revenue for each dollar of collection costs and avoid volatility.

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1 "Tax Talks 3: Re-think, Re-engage, Re-design : Response to the Federal Government Tax Discussion Paper 2015", page 4.

2 Almost all the total tax revenue collected by Australian Governments is derived from just 10 taxes and a small number of supporting measures. Whilst there are at least 125 different taxes in Australia, only a handful are to raise significant revenue. Most are not separate revenue-raisers (67 are agricultural levies collected for and given to industry) and many others are licence fees or have mainly social or environmental objectives or are designed to close off avoidance of the main taxes. The Australian Government also gets about $25billion (1.6% of GDP) from receipts from operating activities and sales of non-financial assets. In 2014-15 Commonwealth Government Securities (borrowings) were $360billion or 22.1% of GDP and interest of $14billion was paid.

3 All references from here on will be to 2015 dollars.

4 This is called the "structural imbalance or structural deficit" and is the deficit that would exist with current taxes and spending programs when the economy is at its average across the business cycle (that is, average performance).

5 Much government spending is fixed grants, payments and services. However, some changes can be made by productivity improvements, trimming plans and reviewing spending priorities. It would be reasonable over 10 to 30 years to redeploy about 15-20% of government budgets (that is, about $90 billion per year).

6 Private equity can fund much increased infrastructure investment. However, governments should contribute, with borrowing spread over the life of each project and interest met from the budget. It is important that major projects only be undertaken after through cost-benefit analysis and public discussion, plus rigorous, independent assessment to ensure that there are widespread public and substantially positive net benefits. This includes investment in hard infrastructure such as transport networks and urban redevelopment, as well as soft infrastructure such as skills development (both for new residents and workers requiring retraining for new industries) and research and development. Continued population growth will be particularly significant, with bursting pressures on our cities. We will need investment to increase jobs in new and developing industries, to help our cities and regional areas adjust, and to expand our resource and skill bases. In addition, the Abbott Government is now making commitments to hugely increase defence capital spending.

7 The increased margin coincided with massive tax cuts and concessions brought in by the Howard Government in 2006 and the growing effect of earlier unsustainable concessions.
8 This grouping was suggested by the 2010 Henry Tax Review. Revenues from small fees, levied for reasons other than to collect significant revenue, are excluded.

9 Including $4billion Fringe Benefits Tax

10 Including $31billion state land tax and stamp duties, $15billion local government rates and $1billion federal petroleum resource rent tax. There is a related issue of mining super-profits. Note that the tax system does not treat royalties (such as mining royalties) as tax revenue.

11 Including $68billion company tax; $6billion tax on super fund earnings and $25billion state payroll taxes. There are related issues re dividend imputation and trusts. After the GFC in 2007 the revenue from Company Tax fell from 23% to 19% of total income tax in Australia.

12 Includes $54billion GST, $34billion federal excise & custom duties and $25billion state vehicle, gambling & insurance taxes. Federal fuel excise credits to farmers and miners cost revenue $7billion pa.

13 Analysis by ACOSS ("Tax: Are we paying our fair share?" ACOSS, January 2015) concluded: *"The greater the role for personal income taxes in the overall tax mix, the greater the reduction in household income inequality from the tax system as a whole".*

14 Blogs on the website of John Menadue, July 2014

15 The scales would also need to be adjusted from time to time to ensure equity. Analysis by the Grattan Institute ("Fiscal Challenges for Australia", July 2015 at page 6) using Treasury and ATO data shows that unadjusted bracket creep (or "fiscal drag") from 2015 to 2019 would increase the percentage point rate of tax for those on incomes from $20,000 to $70,000 by considerably more than those on higher incomes. The biggest point increase would be for those on $50-60,000 incomes – six times the increase for those on $100,000 plus.

16 The levy could be absorbed into the tax scales (whilst retaining a tag highlighting its contribution to health). The Medicare Levy now raises about $13billion a year. Total Australian Government expenditure on health is about $20billion.

17 This would include making the current temporary levy on higher income levels permanent and adding a higher marginal tax rate for incomes above $250,000. It should be understood that in 2004/05 13% of tax payers were in the top income tax bracket, but just 3% are today. In 1951, income tax cut in at an income of $300 a year, at a rate of 1%, and rose in 21 steps to a top rate of 65% on income above $30,000 a year. Today, income tax starts at $18,200 a year, at a **marginal** rate of 21% (including the 2% Medicare levy) and proceeds in just four steps to a top rate of 49% (including the Medicare levy and the temporary budget repair levy of 2%) on income above $180,000 a year. The **average** income tax rate for a taxable income of $40,000 is about 10%, $80,000 is about 25%, $120,000 is about 28%, $160,000 is about 33% and $200,000 is about 37%.

18 Some superannuation concessions are necessary. Superannuation guarantee contributions are a form of forced and inaccessible saving and Australia needs to increase superannuation guarantee contributions (from the current 9.5% up to 12%, then up to 15%)

to provide full retirement incomes for most people. It's also desirable to reduce the worries of many retirees about how many years they will need to spread their superannuation payouts (e.g. by guarantees or strongly encouraging annuities). Super concessions occur in three stages – in the contributions phase income tax does not apply and only 15% superannuation tax is payable at all income levels; in the accumulation phase super funds pay only 15% tax on their earnings (compared with 30% by companies on their profits) and there are further generous capital gains and franked dividend concessions; and in the payout phase there are almost no taxes payable. The concessions are huge, unfair and unsustainable and benefits go disproportionately to those on high incomes. Current super concessions cost revenue $35 billion a year and this is growing about $2 billion a year such that the total cost will soon exceed the total cost of pensions. The tax benefits for saving through superannuation vastly exceed the benefits through other savings forms (e.g. all of bank interest is taxed as income). In early April this year Federal Treasurer Joe Hockey said "Anybody who deals with the numbers in this area knows the super system is not sustainable. The overall system costs a fortune, we can do better, the Government knows it, it's the community debate that has to reach that view." Mr Hockey has now reneged from that view.

19 A $90,000 income per year would give 9% superannuation guarantee contributions of $8,000. A $40,000 per year tax-free superannuation payout (on top of the $20,000 threshold that applies before income tax commences) would be generous and give a comfortable retirement to a person owning their home.

20 Negative Gearing and Capital Gains concessions apply extensively for property landlords and also for borrowings for share trading. Primarily the negative gearing concessions allow individuals whose rental or dividend income is less than their borrowing costs to deduct that "loss" from their salary income. Total deductions claimed for rental properties in Australia now exceed total gross rents. In addition, in terms share trading, in 2011-12 about 285,000 individuals deducted nearly $1.4billion for expenses (mostly borrowing costs) in earning dividend income. Once property or shares are sold, half the capital gain is excluded for income tax assessment. The beneficiary gains from the deferral and deduction.

21 In 2001 the Howard Government reduced tax on capital gains so that only half of gains to individuals and trusts would be taxed. A rate of 75% would be a simple way to deduct inflation of 2.5% per year over 9 years.

22 Trusts and companies are a tax avoidance measure widely used by those on high incomes to split their income (often amongst children) and to delay payouts so as to avoid full income tax rates (up to 49% marginal rate). Trusts are also used to avoid company tax (30% of profits).

23 Franked Dividend concessions (also called dividend imputation) applies to the dividends paid by Australian companies which have paid company tax (30%) on their profits. The receiver of the dividend is allowed a credit of the tax paid. For high taxable income earners it means a reduced rate of tax and for "low" taxable income earners it can mean a payment back from the Government. A high proportion of this concession in fact goes to high income

earners, super funds and companies and reduces the income and company taxes collected. Last year the Parliamentary Budget Office found that franking credits led to $6billion less in earnings tax. Countries have moved away from dividend imputation and the 2010 Henry Review reported that by then the only OECD countries with imputation systems were Australia and NZ.

24 Savings would be well over $3 billion if the other income tax saving measures were not introduced.

25 Tax Discussion Paper 2015 p.72; OECD Revenue Statistics 2014

26 An ATO document revealed in March this year showed that the 900 biggest companies in Australia reduced their tax bills by a combined $25 billion via deductions, exemptions and other concessions. In 2012-13 companies shifted over $300 billion from their Australian arms to overseas parent or subsidiary companies. The Tax Commissioner has said there was evidence corporations had moved about $60 billion from Australia to related parties in offshore tax havens such as Singapore. A Senate Enquiry into Corporate Tax Avoidance is due to report in June. Another issue has been the tax concessions for 50,000 accredited charities and religious organisations and 25,000 deductible gift recipients in Australia. The cost of these concessions is not known, but issues arise particularly around profitable commercial enterprises and land tax exemptions.

27 The treatment of Research and Development tax deductions and the possibility of switching to grants for proven incidence and value could also be examined.

28 Many countries now have negative yields on their government bonds well into the future – including Switzerland, Germany, Belgium, Finland, Austria, Netherlands, France, Denmark and Sweden.

29 In the 4 years to 2012-13 the Federal Government's tax revenues (excluding GST) increased by 30% (to $288 billion), whilst State & Local Government revenues (plus GST) increased by only 13% (to $128 billion; GST increased by only 8%).

30 It is claimed that increasing the current GST to 15% would raise a net $15 billion ($35 billion less $20 billion compensation). If the GST were extended to all items at 10% this would raise a net $30 billion ($70 billion less $40 billion compensation.

31 If the GST were extended to education consumption (mainly private education providers) at 10% this would raise a net $1billion ($3billion less $2billion compensation).

32 KPMG Econtech Report to the Australian Treasury "CGE Analysis of the Current Australian Tax System", 26 March 2010

33 Bracket creep is going to be a lot less than in the past because wages (and inflation) are rising very slowly and the increase in taxes of lowest-income people would be greatest. Further, the Abbott Government's Intergenerational Report estimated that average annual

growth in per capita real GDP will slow to 1.5% over the next 40 years compared to the average over the last 40 years of 1.9%.

34 About two thirds of Australia's budget deterioration in the last 8 years has been on the revenue side. The Abbott Government's Intergenerational report estimated average annual growth in per capita real GDP will slow from 1.9% in the last 30 years to 1.5% in the next 30 years.

35 In terms of economic growth, employment, GDP and national income.

36 See "Focus on: Top Incomes and Taxation in OECD Countries: Was the Crisis a game changer?" OECD Report 2014; "In it together: Why less Inequality benefits us all", OECD report 2015; "Battlers and Billionaires: The Story of Inequality in Australia", by Andrew Leigh 2013; "Inequality in Australia – A Nation Divided", ACOSS June 2015.

37 ACOSS June 2015 p.8 (using ABS data).

38 A recent Per Capita study found that the share of national income in Australia going to wages fell from 65.5% in 2000 to 59.7% in 2012, whilst the share going to capital increased from 34.5% to 40.3% ("Paradise Lost? The race to maintain Australian living standards").

39 Tax should not discriminate against labour. Whilst Payroll Tax is cheap to collect and easy to administer, in the long run it discriminates against jobs. The tax system also discriminates against employees by fully taxing income from working but only taxing half of capital gains.

40 Moral Compass program ABC television, 28 June 2015

41 Speech to 2012 US Democratic National Convention

42 This approach was effectively adopted in the Abbott Government's recent "Tax Discussion Paper".

43 "Tax: Are we paying our fair share?" ACOSS, January 2015 pages 7 and 13-15. Australia's tax system used to be more progressive - over the last 30 years and the last decade those on high incomes gained from income tax cuts way beyond adjusting for inflation and very generous tax concessions. These were proportionally much greater than the benefits for low and middle income earners.

44 This included income tax 3% + GST 7% + other indirect taxes 14% = 24% total

45 This included income tax 20% + GST 3% + other indirect taxes 5% = 28% total

46 Conservative sceptics doubt the polls, saying that the results are distorted by the "halo effect" – the claim that people tend to answer with the sympathetic response they think is respectable rather than reveal their selfish preferences. This dismissal is patronising, lazy and unfair. It's also disproved by the evidence that the majority opinion has been increasing

over time. See for example, 2004 study “After the Tax Revolt” by Shaun Wilson and Trevor Breusch of ANU.