Tax Reform for Australia

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This paper recommends a radical and complete re-think of how taxation works in Australia with consideration for an ageing population and changing technology in an increasingly global world.

An ageing population means a reducing work force paying income tax. Reducing personal tax rates, and a general reliance on personal taxes, would result in increasing the disposable income of employees, which should lead to an economy wide increase in consumption spending and personal savings.

Changing the focus of tax revenue to company taxes must be done in a way that supports and encourages investment and productivity growth, which would ensure a sustainable and reliable tax revenue stream.

Taxation legislation has become bloated over the years, and has become confused between a government revenue stream and a political document reflecting changing ideologies.

Suggested reforms

Personal Taxes

Introducing a low taxation rate reduces the incentive to find or create elaborate tax minimisation schemes.

A tax-free threshold assists those on lower wages. Aligning a tax-free threshold to the average male wage removes any political manipulation of affordability for those on low or minimum income.

If the taxation rate was to be set at 10-15% with a tax-free threshold of $18,000 or one-third of the average male wage there would no longer be a need for the notion of “assessable income” and “allowable deductions” as the focus would be purely on the income stream.

Income would continue to be taxed at the source, with annual tax returns effectively becoming declarations of income received and tax paid.

Company Taxes

Currently the company tax rate is applied against a company’s profit adjusted for a variety of legislated allowable tax deductions. This effectively means that the Government is being treated as an owner receiving a distribution from a company’s profits.

Business should consider taxation as an expense of running a business, just the same as products, services and wages, rather than something that is paid after everything else.

By removing the focus on expenses the complexity of the taxation system is immediately reduced. Reducing complexity reduces the potential for loopholes and therefore the associated costs to the economy.

Taxing income earned in Australia, whether over the counter or Internet means that local and international companies would be paying tax before paying/distributing money to overseas associated entities.

With the introduction of GST and the regular BAS returns all businesses now have systems that record and report on their income and purchases.

Changing to a system where tax is paid on operating profit (income); that is, sales revenue less cost of goods sold, the tax rate could be lowered to 10-15% of ex GST revenue. To provide some fairness for small businesses (companies) and start-ups a tax-free threshold of say $80,000 or 1.5 times the average male wage. This would give them additional funds to support borrowings, inventory and capital investment.

The monthly tax paid could be based on the prior year's assessed taxable income so as to minimise seasonal fluctuations.

By having a higher tax-free threshold than personal taxation this encourages the establishment and development of proper business practices and structures. Any distribution of wages or profits would be taxed in the hands of the recipient meaning that this would not encourage tax-avoidance or minimisation.

Negative Gearing

Changing to a taxation system that is focussed on income means that there is no longer a need to provide tax advantages for negative gearing. Removing negative gearing allows landlords to focus on their cash flow rather than structuring investments for purely tax reasons.

If the government wants to encourage investment in housing, one option is to allow all home owners, that is investors and owner-occupiers, a deduction from their rental income or personal income, respectively, for loan interest adjusted to an interest rate published by the ATO being an average of the RBA cash rate. This lower interest rate will discourage investors from risky loans with high interest.

The focus should not only be on supporting first home buyers because inevitably an government measure to give access to more funds simply increases the purchase price, as shown time and time again.

Superannuation

The most important thing is not to make too many changes to Superannuation to ensure that people have confidence in their retirement investment. With a reduction in personal taxes to 10-15% there is no need to change the current rate.

Following the theme of only taxing income, contributions made as part of the Superannuation Guarantee Levy should only be taxed once the amount exceeds the levy multiplied by 1.5 times the average male wage and the rate should remain at 15%; similar to the above treatment for companies/businesses.

All contributions in excess of the Guarantee Levy rate, including salary sacrificed amounts, and all Superannuation investment income should also be taxed at 15%, with no tax-free threshold. This is to remove any incentive for excessive transfers from personal wealth into superannuation.

Franked Dividends

Notwithstanding the economic discussions on the long term benefits of franked dividends, the purely tax viewpoint could be that with tax paid on a company's income a franking credit of the same tax rate could be applied against any dividends paid.

Not-For Profit Organisations

By their very nature not-for profits (NFPs) do not distribute any surplus from operations but re-invest in themselves. The income they generate is used to support any government grants or philanthropic contributions. As such, the current income tax exemptions and "deductible gift recipient" (DGR) arrangements should continue.

Fringe Benefits Tax (FBT)

The changes proposed above would result in a re-think on the nature and design of FBT as companies, businesses and individuals would no longer be claiming deductions for expenses.

That said, many not-for-profit businesses and organisations use the benefits of salary packaging to attract potential employees, as they do not have the capacity for the higher cash salaries payable by corporates, and so the FBT regime should be retained in some form.

Salary packaging within the current cap could be taxed at a concessional rate. For example, 50% of the grossed up benefit taxed at the personal tax rate.

However there would need to be changes to the types of benefits that are available.

- Most expense benefits would be removed as expenses are no longer deductible to reduce tax as tax is based on income only
- Concessional benefits, like motor vehicles would remain, as it is popular and also good for the economy.
- Mortgage repayments help with cash flow, and maybe for a "first home buyer" the cap could be increased for one or two years as this incentive is hidden from the property market and therefore less likely to result in an increase in new home prices.

Conclusion

To achieve real structural change the government needs to move away from tinkering with the edges of the current tax system, and instead tear it down and start again using some of the good ideas of our tax system but in a different way to prepare the country and people for a demographically and technologically different future.