

# Principles for Improvements to the Australian Taxation System

## Introduction

This document will outline some key principles that I feel are imperative in designing an effective tax system. I will also outline some key principles in relation to the functions of government, as taxation is necessary for the funding of these functions and the proper organization of these functions will help minimize the requirements for collecting funds through taxation. I will also outline some basic budgeting principles and how I feel they should apply to not only individuals and businesses but also to government.

## Taxation Principle 1: Keep it simple

The system of taxation should be as simple as possible with as few types of taxes as possible. Apart from user pays charges and specific purpose charges to be covered in the 2<sup>nd</sup> and 3<sup>rd</sup> principles I would have only three types of taxes, one for each level of government.

At the federal level I would have income tax. This is sometimes called company tax when applied to companies. At the state level I would have a consumption tax. At the local government level I would have land rates.

Each level would be responsible for setting the level of taxation for their jurisdiction. I know this would mean that the level of consumption tax would be different for each state but this occurs in the US and doesn't impact unduly on interstate commerce. We already have different levels of rates for local government areas.

## Taxation Principle 2: User Pays where appropriate

In some cases the government may wish to have users of a service directly contribute to the funding of the service. This is, in many cases not the full cost of the service, but set at a level to send a volume usage signal to the customers to discourage unnecessary usage. The balance of the funding would come from the primary taxation source as outlined in principle one.

There are some cases where it may be considered appropriate for the user pays charge to cover the full or most of the funding requirements. This is particularly the case if the service is not considered an essential basic service. In these circumstances the question must be asked why is the government providing this service and not leaving it to other providers. If it is not an essential basic service customers will pay for it if they want it. Businesses can meet this requirement.

Let governments stick to what needs to be done. See Government Functions Principle 1 below.

### Taxation Principle 3: Specific purpose charges

There are some circumstances where the government may wish to levy charges to achieve certain social objectives such as discouraging certain behaviour. Examples could be fines for trying to bring dangerous goods into the country or levies on smoking. Again the principle should be to set these at the appropriate level to send the signal. They should not be viewed as a primary source of revenue.

### Taxation Principle 4: Structure primary taxes based on ability to pay but don't stifle motivation

Some people are much better off than others and those on lower income levels should not be expected to make the same level of contribution by way of taxation payments as those on higher income levels. For income tax at the federal level there are a number of different methods that could be used. An ascending step block method, similar to what is currently in place, would probably be best. It would also probably be the method most easily understood by the taxpayer. I would however recommend two changes from what is currently in place.

Firstly I would expand the concept of deemed income on assets to all taxpayers, not just retirees. Wealth can be structured to avoid income and therefore taxation. This change would mean all those who are better off make a higher contribution. As an extension on this I would also apply a limit on the exemption value allowed for the family home. I would not apply this asset test to companies as it is applied to individual shareholders through their shareholding.

Secondly I would have a much flatter scale with the differential between the rates for the different tiers much lower than it is. There is already a significant volume based penalty for higher earners so the higher tiers don't need to be at the levels of approaching 50 cents in the dollar. Setting the levels too high for the upper tiers stifles motivation. The extra tax from the expansion of the asset test will allow the rates to be kept lower.

### Taxation Principle 5: Flat level for the consumption tax and no exemptions

The level for the consumption tax can, as it currently is, be set at the one flat level, even though this is done at the state level and may vary between states. The individuals impacted already pay a penalty based on wealth through the federal income based tax and the volume base penalty here is probably enough.

All the current exemptions to the consumption tax should be removed. They make it too complex to administer and only succeed in lining the pockets of the

accounting and legal professions. If protection from the impact is to be given to lower income earners then this should be done explicitly through a welfare-based payment and not by distorting the tax.

### Government Functions Principle 1: Stick to what is essential

Government's should as a general rule stick to providing those services that are essential. This should be viewed both in terms of functionality and in terms of quality.

The legislature and the judiciary are two of the three arms of government and the core of these functions should be left to the government. The third arm of government is the administration. This will include oversight, coordination, regulation and in some cases service delivery.

Oversight, coordination and regulation are key functions of government however in the case of service delivery the government should stick to what is essential. There are some basic essentials of life that the public needs such as security and access to the basics such as adequate food, water, shelter, clothing and health services.

If the public wants services outside these areas they will be willing to pay for them and they would be best left to business to provide.

Also in terms of quality the government should stick to the basic level of provision of these essential services. Again if some members of the public want a higher level of service other providers can in many cases supply this. An example is private schooling.

This should not be confused with the public generally wanting a higher level of basic service. This would need to be funded by taxation but the public need to understand the resultant increase in taxes.

### Government Functions Principle 2: Stick to services that can't be done better by others

Even when it is a basic level of essential service the government should examine to see if other providers, other than the public service, could better carry out provision of the service. The primary source of funding would be taxation but the service would be delivered by commercial or not for profit providers. Aged care services are a good example of this.

The government can still maintain control over the level of the service through regulation. It is just a matter of commercial and not for profit providers being in many cases more efficient.

### Government Functions Principle 3: Someone, but only one is responsible for each function of government.

Before we can even begin to talk about the taxation system we need to sort out the mess left by the constitution on who is responsible for what. The constitution needs to clearly define what the responsibilities of each of the three levels of government are. It should clearly state what the federal government, the state governments and the local governments are responsible for.

Only one level of government should be responsible for each function. The wastage caused by duplication is beyond a joke. The problems caused by buck passing are considerable and this impacts on funding and therefore taxation. Those functions that require national coordination in delivery such as defence and immigration should be a federal responsibility. Those that require detailed local knowledge such as land use planning and provision of basic recreation facilities should be local. Those that require significant infrastructure but don't need to be fully coordinated to work should be left to the states. This would include things such as schooling and police.

Remember the old adage that if no one person is responsible then no one is responsible.

### Government Functions Principle 4: Accept responsibility for your own funding.

Each level of government should be responsible for raising the funds for the functions they are responsible for. The practice of the federal government raising more funds than they need and then using tied grants to control state functions is a joke. It places too much burden on federal taxation and allows the state governments to constantly abdicate fiscal responsibility. Both the state and federal levels repeat this same mistake when dealing with local government.

If you aren't responsible for the fund raising for your functions then the incentive to be efficient in providing the services is not as strong. The taxpayers at each level should be able to see a clear connection between the level of taxes they are paying and the quantity and quality of services they are receiving.

### Budgeting Principle 1: Live within your means

Budgeting at a government level should not be any different from that for individuals or businesses in that over the long term you must live within your means. You cannot continue to spend more than you earn without getting into serious trouble. Yes the length of time a government can get away with over spending may be longer than individuals but the end result will be the same. Look at the current situation with Greece.

Living beyond your means is an intergenerational funding issue. The increasing levels of debt and the resultant increase in interest payments will result in lower service levels and/or quality for future generations.

Politicians make decisions that have long term impacts and must get past the three-year mentality. Decision makers in non-government organisations also have to do this.

### Budgeting Principle 2: Only use debt for infrastructure

The use of debt by governments for infrastructure is appropriate. The length of the term of the loan should reflect the asset life with the time period never exceeding the asset life. It can however be shorter and remembering that assets usually need to be replaced the loans need to be repaid.

What is not appropriate is the use of debt to fund day-to-day operating expenditure. No individual, business or government can survive financially if they continue to do this.

### Budgeting Principle 3: Make a clear link between taxation levels and service levels and quality

At the time of setting each budget each government should make the clear link between the level of the taxation and the level and quality of the services provided.

Although fiscal illiteracy of the general public is a significant problem in this country, and dealing with it a passion of mine, the public are capable of understanding the basic principle that you have to pay for what you get.