Businessday 150407 Taxing times now there are no excuses (The one big piece version)

Dear Joe,

Thanks for the invitation to take part in “an open and constructive conversation” on the tax system. With the benefit of a long flight to read your oddly-titled “Re:think” discussion paper, let’s start with the bleeding obvious and then to move on to a few specifics.

First I’ll carp on a minor point and the politics of it: if your paper just contained the stuff that wasn’t comprehensively covered in the Henry review finished in December, 2009, it would be a very slim volume indeed – vastly less than its 203 pages. But, what the heck, that’s politics for you. Henry was some other government’s baby that you studiously ignored in opposition, so the “Not Invented Here” principle applies.

That said, you’re now over half way through your electoral cycle. You’re promising an options paper in the second half of this year after the “discussion” and then a policy white paper to take to the 2016 election – presumably with the more politically difficult options scrapped. Without respected leadership capable of carefully communicating brave policy, that won’t leave many options at all.

I gather that, having promised not to rule anything out of the conversation, you’ve already ruled some things out, specifically anything to do with the family home. See the last sentence of the previous paragraph.

But you’re already running your 2016 three-word slogan hard in the discussion paper: “Lower, Simpler, Fairer”. It crops up plenty of times in your paper, starting with a big promise in the foreword: “the development of a tax system to build jobs, growth and opportunity — a better tax system to deliver taxes that are lower, simpler, fairer.”

There are two problems with that.

We’re over inane three-word slogans. Like hula-hoops and blokes wearing kaftans, they’ve had their day and we’ve moved on. For something as complicated as improving the tax system, slogans won’t do it. It’s that respected leadership capable of communicating thing again.

And there’s the matter that it’s a crock to start with. Barring another economic miracle of the likes of the resources boom, your own (admittedly debased) intergenerational report makes it rather obvious that the shrinking dependency ratio (the ratio of workers to non-workers) means it’s highly unlikely taxes will be lower. We have to tax smarter just to avoid them being substantially higher down the track.

Unless, unless, you’re playing with the weasel words there – that by “lower” you just mean “lower than they otherwise would be”. Perhaps that would be explained after the election.

But let’s look past the usual shoddy and self-defeating politics and communication we’ve come to expect from you and seize on a good bit:

The discussion rightly points out the vast complexity and contradictory arguments involved in changing most of our taxes. There’s a shining exception though. It was clear in the Henry review and this rehash has made it even clearer: a nice broad land tax ticks all the boxes, starting with efficiency.

There’s sweet Chart 2.9 that shows the “marginal excess burden” of land tax/municipal rates was below zero while the other taxes ranged up to stupidly high (stamp duties on conveyancing). There’s no better example of how the system could be smarter than replacing the “bad” stamp duties with the “good” land tax. (I note stamp duties on insurance policies wasn’t included on the chart – maybe it because it would be off the chart.)

If you want to know how land tax can have negative marginal excess burden, read the following quote, otherwise skip to the next par:

“Modelling also suggests that broad-based land taxes, such as municipal rates, have a low economic cost. This is because land is immobile (unlike other capital) and cannot be moved or varied to avoid tax. The model applies this assumption to both domestic and foreign ownership of land. Land taxes paid by foreign and domestic landowners are only redistributed to the domestic households, providing a benefit to Australian households and generating a negative marginal excess burden for a broad-based land tax shown in the chart.”

Ah, but you’ve already ruled out touching the family home, as has the Labor Party, so there goes that one. And both the coalition and Labor use the excuse of stamp duties and land tax being matters for the states and therefore beyond your federal control – you claim the stupidity isn’t your fault.

I reckon that’s a cop out. If you were game to try to do the right thing, the fiscal force is with you to make/facilitate the states changing their iniquitous ways. As the discussion paper mentions, the Australian Capital Territory administration is already in the process of doing so, phasing it in over 20 years.

Re the sacrosanct family home, even the discussion paper ruled out a couple of possibilities: “Given the central importance of the home for Australian families, there is a strong consensus that it would not be appropriate to tax either the imputed rent on owner-occupied housing or capital gains derived from it.”

That was despite the paper pointing out the huge tax advantage of the owner-occupied dwelling being exempt from capital gains tax.

Interesting then that the paper left land tax on the table. Call it “municipal rates” and the family home is already being taxed. Do as Henry suggested and make it universal, with a threshold square metre rate to allow for low-value farm land and it would encourage more efficient use of land as well. A win-win.

After that, it all becomes harder. There’s plenty of stuff about the problem of bracket creep, a popular line of yours that can be used to segue neatly into the election chant, but the paper manages not to let everyone in on the little secret that bracket creep has already eaten up most of those income tax cuts we had for eight years in a row. If you’re not to quietly treat those Costello and Swan cuts as an unfortunate mistake, you’d been running hard now to catch up with bracket creep past and present, never mind bracket creep yet to come. But if you don’t tell them, I won’t either.

The corporate tax rate and dividend imputation get a good going over, along with the promise of package of favours for small business. Messy, that lot.

You’re putting a lot of effort into softening up the public for a reduction in the corporate tax, relying on: “Treasury research estimates that each additional $1 collected by way of company income tax reduces the living standards of Australian households by around 50 cents in the long run because of reduced investment.”

Well, as a discussion point, maybe, maybe not. I suspect there are too many variables to rely on it. It would depend of course on what that $1 of corporate income tax was spent. Invest it in education and crucial infrastructure and you might well find it increases living standards. And if the un-collected $1 of corporate tax was instead spent on a sponsoring the chairman’s favourite footy team or funding a big dud takeover (as most takeovers are) to increase the CEO’s salary, there’s nothing happening there for our living standards.

Yes, our corporate tax rate needs to be reasonably competitive to attract investment – but being a growing, developed and developing nation offering investment opportunities means we don’t have to try as hard some of the corporate cheer squad would have us believe.

Corporate tax segues into dividend imputation. The “official family” doesn’t like it. The legion of domestic Australian investors love it.

Treasury and the Reserve Bank basically believe it’s a terrible thing because it encourages Australian companies to pay out profits in dividends instead of retaining that money to invest in stuff. Private sector investment right now is our economy’s missing ingredient, what’s forcing the RBA to cut rates more than it would really like to.

There’s also the idea that franking credits encourage Australians to invest too much in Australia – which is a funny complaint given the line pushed about the need for a lower corporate tax rate being necessary to encourage foreigners to invest here. And we do have our literal national treasure: $1.95 trillion and rising in superannuation savings.

Before giving the RBA and Treasury what they want though, there’s a little contradiction to deal with: companies that pay decent dividends tend to outperform over time. The economic theory of not retaining most of the profits fails the reality test. There’s even a study that suggests paying out a high level of dividends results in better corporate investment decisions that add more value – management is wiser when it has less to play with, is less likely to burn capital and less likely to make those aforementioned dud takeovers.

And dividend imputation was brought in to solve the problem of the double taxation of corporate profits. It’s not a bad principle in its own right. As AMP chief economist Shane Oliver has put it:

“Sure it biases Australian investors into Australian shares but this is no reason to return to taxing dividends twice. Doing so would only encourage firms to retain more earnings which all the evidence suggests is negative for capital allocation in the economy and bad news for long term share-holder returns. If there is a better way to achieve the same as dividend imputation then let’s move to that but I doubt there is.”

Never mind though – I don’t think you’ll be game to take on the SMSF Army (self-managed super funds).

Talking of armies with political sway, the Liberal heartland that is small business wants more and you’re promising to give it to them, even before this tax and federation review process is over.

And assisting small business by making life simpler would indeed be a good thing, cutting the rainbow of tape that governments of all stripe and level keep producing.

Specific tax breaks though, adding to the jungle of concessions for mates, are dangerous things. The best thing for the economy is to encourage small businesses to become larger, not to provide financial incentives for them to stay small – to stay below the payroll tax threshold, for example. It might play well at branch meetings, but it’s dumb.

Ah, concessions – that’s a whole other area that the discussion paper seems a little suspiciously light on. “Tax expenditures” can be a very hot item if highlighted the right way, but it looks like your paper chooses not to.

For example, I’ve previously held out the salary packaging industry in general and the motor vehicle novated lease lurk in particular as a quick test of the government’s integrity. (<http://www.smh.com.au/business/the-economy/car-leasing-tax-break-a-yardstick-for-governments-fiscal-integrity-20150217-13hccz.html> ) It’s hard to find a clearer example of bad economics and politics. It’s also something that the now-government cynically exploited during the last election campaign.

Do a search for concessional motor vehicle FBT in this discussion paper and you find just one passing mention. There’s more detail about the FBT treatment of employer-provided child care.

If the process is to be taken seriously, if people are to see it’s fair and support the necessary change and pain, such blatant failures have to be dealt with, the last election’s mistakes admitted.

And there is pain and change ahead.

The paper is right to point out that, for all the attacks from the Left about the well-off rorting the system, the top 2 per cent still pay 26 per cent of all personal income tax. The bottom 40 per cent are, collectively, net tax receivers rather than payers, thanks to our transfer system.

So the well-off think the system is unfair because they’re all of the lifting. And the not-so-well-off think the system is unfair because the well-off benefit most from the tax lurks. It’s rather obvious that you can’t benefit from a tax avoidance scheme if you’re not paying tax in the first place.

But there’s also the reassuring truth that “Australia’s overall tax burden is relatively low compared to other developed countries”.

That’s nice. We can still do better if we try harder, if we are seen to be fairer and smarter. And we need to if we only want to tax a little higher.

For example, the delights of the family or discretionary trust for income splitting are explained, but the complexity of trust law would make reform very brave indeed.

And it’s really not fare that the tax system treats different forms of saving so differently, ranging from a zero tax rate for saving by investing in the family home to full marginal rates for savings held as financial deposits.

The questions about the great onshore tax haven for the rich, alias our superannuation system, have been well aired, so I’ll just make my contribution about how to solve the problem:

The super tax break is around the wrong way. Instead of concessional contributions and earnings within the fund being taxed at 15 per cent and eventual super payments being tax free, they should all be taxed at a 15% discount to the individual’s marginal rate, but not beyond zero.

Still sounds like a good deal to me. You might even say it was simpler and fairer, but not lower. Two out of three ain’t bad.

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