AUSTRALIAN TAXATION SYSTEM WHITE PAPER MARCH 2015

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General

I have downloaded the paper referenced above, which bears the title "Re: Think Tax Discussion Paper March 2015". It covers a wide range of Tax issues over 196 pages.

I have read all of the sections listed in detail and have formed a number of broad conclusions which I will attempt to qualify and quantify. This document is an attempt to cover a meta view of what is contained in the White Paper with its implications for Australia's Tax system –and its possibilities for reform.

References will be made to specific pages in the cited document, which has been referenced as "Source – The Australian Government the Treasury"

Overview

The document is a most comprehensive listing of all of the applicable taxes currently in force in Australia at this time. As such it serves as a valuable compendium in that regard, as this has been a most difficult task for taxpayers, and tax professionals, to ascertain. It is admitted in the document (WP) that the task is further complicated as there are two distinct tax Acts in current operation - the 1936 Act, and the 1997 Act (page 176). This should surely be the first point of reform – to produce one unified and integral Act, appropriately "reformed" as to other aspects which I will attempt to indicate.

The word **"complexity"** is perhaps the most common word, followed by **"fairness**" used in the WP discussions. This appears to be the excuse , and rationale for incremental attempts to satisfy the major proponents for amendments, to suit a particular lobby, but possibly to the detriment of others. It appears to be a situation where those who complain the most, get the most – regardless of principles and "equity". A list of the "buzz words" used in the document has been prepared as an appendix. These words are emotive, and in many cases meaningless in support of the arguments advanced, but add a "buzz" to the presentation. The word "**productivity**" is also used extensively – as the saver of the economy – and more will be said on this issue later.

The document is full of **"Economic Paternalism – we know best, we look at all things through the economist's eyes and the efficiency of the tax system operation".** Liberal and literal use is made of overseas practices and policies as being appropriate to Australia. The OECD is mentioned frequently. The OECD has not been an outstanding success in its home territory, Europe, and its advice for Australia may need further examination.

There is a prevailing theme which is disturbing – that the income earner is a captive of the state, and must be taxed in every which way possible to extract the maximum amount of tax from him/her. All avenues of tax evasion must be closed off, and tax paid – according to that determined by the Tax Authority – even if the complexity of the assessment is such that the taxpayer does not understand nor has the wherewithal to challenge. Uncertainty, the rapid change in tax policy, and too many retrospective tax laws disadvantage the taxpayer (page 182).

While there is a plethora of taxes applicable to Australian taxpayers, there are a number which are relatively obscure and not of relevance to the mainstream taxpayer (Luxury Car Tax etc). **The main thrust of the overall Australian Taxation system would appear to be to raise as much revenue as possible, and distribute it – via the Transfer system – to as many worthy individuals as possible - the mendicants. Democracy is a marvellous concept –one person one vote – but when the mendicants outnumber the taxpayers then some perversion of the concept occurs.**

The Progressive Tax principle is defended, on the basis of the "rich has the ability to pay". This has been the cornerstone of most of the Western countries taxation systems. While this principle has historical significance, and is implemented widely, it should of itself redress any and all of the differentials which are alleged to exist between high income earners, and low income earners. **However this "distinction" is carried on and on, in different forms – such as "means tests", and concessions throughout the whole system of income redistribution under the Transfer system. The "rich" are targeted wherever a distribution of a transfer wealth occurs. Is this equitable? Is this fair?**

The equity of accessability to transfer payments has reached a high discussion point in Australian public affairs. **One issue of high profile is the Aged Pension, and the Means test applicable – to prevent "rich" applicants access to part or all of the Age pension benefits**. At present, a couple who fully satisfy the Assets and Income criteria are entitled to an Age pension of $33,000 per year. Assuming that they take up the (indexed CPI) pension at age 65, and have 20 years on the pension, they receive a tax free bounty of $660,000 in present value terms ((20 x $33,000 @CPI) discounted @CPI)). Have they contributed $660,000 in tax during their working life? Looking at Migrant Family reunions, Mums and Dads only need to have been residents for 10 years to gain Age pension eligibility. **How much have they contributed towards their pensions? Is it fair?**

This is an illustration of the weakness of the current Tax system**. It does not consider Contributions towards the aged pension benefit** – apart from the relatively new Superannuation provisions. **The Australian Government Accounting "system" is the main problem. For too long, the Consolidated Revenue Account has been a grab bag in which the main revenue collections have been placed without distinction**. There has been no attempt to provide a distinction between collections which are relevant to future commitments – such as the Aged Pension, and current outgoings. Both the USA, and the UK have specific accounts for aged pensions contributions accumulation, tied to the individual contributor. **His/her lifetime contributions are matched to their ultimate benefit. In essence, the User Pays**. There is no mention in the White Paper of such a principle or any consideration of it.

Recent events have seen a lowering of the amount of the assets test for the aged pension, which will eliminate some of the "rich" from the aged pension. Already the "fight back" has commenced, with the "rich" spending the excess, and /or enhancing the Family Home – which is means test exempt. As Kerry Packer said at a Tax Inquiry –"any person who does not take advantage of the law as it stands is foolish". Changes to eligibility will only be effective for a short time. This brings in the matter of the Taxability of the Family Home – to be discussed later.

Nonetheless, there is a tacit admission within the current Tax provisions that "**User Pays"** is a valid principle – for some. All personal income earners (above a low cutoff point) are required to pay the Medicare Levy, currently @ 2% of assessed income. This entitles any taxpayer to Medicare services at a Public Hospital without charge – regardless of any means test. In essence, the user pays. Why does this principle not apply to the Age Pension. After all, the ATO has very good records of how much tax each taxpayer has paid over their lifetime.

Possibly the answer to this riddle is simply –**" it would cost too much, and the Age Pension is not specifically "Funded""**. This appears to be the excuse, and an "accepted principle" for modern tax law reform. The UK system pays a pension according to the person's accumulated contributions balance, which is funded by a deduction from earnings from the day the person started work, and is held by a Government Fund. This is added to any private Superannuation the person may have personally contributed for, and taxed in total accordingly. **This provides an incentive for workers to personally save for their retirement and they receive according to their contribution**. **It is a contradiction in the Australian system (now) that workers who have not saved a cent for their retirement can immediately move to an Aged pension worth $660,000 in present value terms, yet self funded retirees are means tested if they have saved that amount**. It also raises the question – how much would a self funded retiree need to have invested at 3%, to receive $33,000 (CPI indexed) tax free. The answer is $1.1 million – yes they need to be millionaires, but they would be excluded from the Age Pension. **Is that fair?**

There are many problems of equity and fairness which are not covered by the White Paper. The word "**incentive"-** to save for retirement, never appears, yet it is the key to guiding all taxpayers to self provision for retirement. In addition, there is no mention of a "sunset clause" on paying tax. Persons who have paid tax continuously for over 60 years should be rewarded for their diligence. Persons who have lived off their own retirement savings for more than 15 years after retirement should be eligible for the aged pension without means test**. Self funded retirees must see a "light at the end of the end of the tunnel" after paying tax for almost a lifetime, otherwise they will arrange their affairs accordingly.**

Specifics

The two present Tax Acts are a conglomeration of amendments on amendments – almost ad infinitum. They are published on the Internet, they are badly organised and indexed, and for the non astute – including CPA Accountants who are not tax practitioners- a labyrinth of confusion. The fact that a 100 page information booklet had to accompany every (paper) Tax Return form – for the ordinary TaxPayer – was an indictation that the process had got out of control – hence the introduction of

Electronic lodgement. The fact that over 70 % of all tax returns are now lodged by Tax Agents indicates a system that is too complex and in need of radical surgery.

Australia has over 100 different taxes (page 15). In 2012-13, over 80% of Federal Government tax was collected from taxes levied on individuals and corporations. This information should lead to a first step in rationalisation of the objective of the White Paper **– of simplification**. Elsewhere, under the topic "**Imputation"**, the distinction is made that Corporations are considered to be only intermediaries in the income flow to the ultimate receiver – in essence the shareholders own the company. (tell that to Google and Microsoft) **All tax must therefore fall on the personal – and individual- taxpayer.** One of the "dirty tricks" inflicted by the ATO is **Bracket Creep**, which is admitted (page 10) as a "sin", but there is no positive recommendation to fix it. **Surely in this day of computers, a suitable formula can be devised to provide a "smooth curve" charging system, instead of steps in the income brackets.**

The theme that the individual taxpayer is the unit of taxability is the rationale for the non allowance of income splitting between couples. This may be a sound principle of taxation, but is undone when a couple is the unit for means testing for aged pension (and other) purposes. A further contradiction is found in the tax treatment of Trusts. It would appear that the Trustee can decide who gets what, and can move tax liability amongst beneficiaries (page 107) – which seems contrary to mainstream principles. It is evident that there are RULES and rules, arbitrarily decided at the time and rarely reviewed.

There is a need for a process called "**Zero Base Budgeting**", which was introduced in the USA during the Kennedy era, by McNamara. In brief, all Budget items have a currency of only one year. Before they are adopted for continuity into the next year, they must be evaluated and justified, and their relative priorities reassessed. This process ensures that there are no "roll ons". **Projects which have an accepted life beyond a year are stated as such at inception, but must face the test for continuity when their stated life has expired**. **This process should be applied to all concessions, rebates and subsidies applied as part of the Transfer process**.

As well as the Zero Base Budgeting approach, there must be a Full Accounting Statement of all revenues, and concessions, rebates and subsidies. This equates to the conventional Accounting Statement called "Source and Application of Funds", which shows where all the revenue came from in total, and where it was spent. The Net approach followed at present hides the usages of the funds, and does not provide sufficient information to decision makers - and the Taxpayer –as to the effectiveness of the concessions in achieving sound equitable results. One case in point is Childcare payments – made so it is said to encourage more women into the workforce. It would seem that there are a significant number of women using childcare who are not in the workforce, and have no intention of going into the workforce. The best approach would be to grant tax deductions for childcare to women who are earning assessable income, and at their marginal rate. The complaint would be that lowly paid workers would get less deduction than the highly paid worker - who is paying a higher tax. **Social equity issues such as this blur the overall objective, which as said earlier, is to get more women back in the**

workforce. The test is "how many women have entered the workforce as a result of the incentive, and how many have rorted the system".

There are 66 Transfer (Social Security Payments, comprised of 22 Income support payments, and 44 Supplementary Assistance payments. These are NOT listed in the Tax White Paper, but can be found in a very useful document "A Stocktake of the Tax System and Directions for Reform" by the Crawford School of Public Policy, page 32. It gives names to the bewildering array of concessions and hand outs that have accumulated over the years **to make Australia a truly Socialist State**. How to rein this largesse in painlessly, yet achieve the desired result is like being in the middle of a thorny blackberry bush and having to get out. This example is symptomatic of the problems which surround other major areas of concessions et al.

There are grounds to say that "all is not lost just yet". **The Goods and Services Tax** came out of the air – prompted by numerous instances of its application in many countries around the world. Adopted in year 2000 it has turned out to be a valuable source of income for the States, while under the management of the Commonwealth. However the Economists have been long in its criticism – for NOT encompassing all aspects of commercial activity. **It only covers less than 50 % of the total goods and services tax potential**. Education and Health are two notable exceptions. There is some complexity in deciding what is taxable and how much – John Hewson ran into this problem in the 1990's and it still exists. **It raises the simple yet important question – why tax consumption? The burden falls more closely on low income earners. Is this fair?**

The Henry Report 2010 has been the frontrunner in the White paper and has laid down the trail to follow. **The following gives some indication of the flavour. "The personal and transfer system aims to achieve redistribution outcomes that broadly reflect commitment to Australia's values of fairness and support for those who are disadvantaged" (Henry 2010a, 59.)** Indeed Henry did a monumental job in trailblazing the economic wilderness, but with a direction which appeared to aim towards the policy flavor of the Labor Government of the Day.

The GST did dramatically cut through the complexity of the old Wholesale Tax. As such it provides some precedent to attempt to follow the same approach with other complex sections of the range of taxes at present in force. However it did introduce its own complexities, and it did deviate from the New Zealand model which was administratively simpler. **The present Australian Tax "System" is a huge Gordian Knot, which gets tighter and tighter every year, and the only way it can be remedied is to cut through it completely. What Government will attempt that task?**

Remediation

The size and complexity of the current two Tax Acts, with their attendant rules and regulations, precedents, secret tax rulings , procedures, and practices represents at least 10,000 man years of effort – probably a lot more. To overhaul that amount of knowledge and work is a monumental task. While the task gets bigger as the years increase, there must be some starting point determined, and principles laid down which will move the task forwards towards a simpler and more understandable result.

Tax is an essential part of the governance of a modern first world country such as Australia. It must be paid by all users of the facilities of the country, unless they are appropriately deemed to be a mendicant. There should be sound principles of taxation which are fair and equitable, and accepted as such by all sectors of the community, especially the tax paying sectors.
Taxes should identify their rationale and purpose, which should be in the public interest, and/or have a stated objective. The taxes on Tobacco and alcohol are of this nature, and are in the Public interest to reduce unhealthy excess consumption (and raise a lot of money). The GST does not have this Public Interest intent, apart from raising a lot of money.

While on the subject of the GST, it was "sold" on returning to each of the States the money which was collected within them. Unfortunately a "means test" was applied to the distribution amongst the states, and there are "Mendicant States" which get more GST grants than they collect. Also Mendicant States receive Grants in addition which help balance their Budgets (and reduce the equitable shares of the larger States). It would seem that there are no "pure" taxes, and all are subject to rules, regulations, means testing and arbitrary allocation, despite their innocent and inspiring stated purposes.

Taxes should be collected into specific nominated Funds and used for the purpose of those Funds. (Note. The Term "Fund" is used in the accounting sense, which indicates that specific Assets are held, such as money in the bank, to the value of the Fund denoted). As an example, NSW introduced an extra tax on petrol under the then Government of 4 cents per litre, in order to improve roads. The money went into Consolidated revenue, was spent on other general items, and the roads are still under repair 30 years later.

Taxes should provide a "Carrot and Prod" approach to taxpayers, and should NOT inhibit "free market activities" excessively. The States have taxes on large transactions, such as Stamp Duties on Property transfers, Insurance Policies, Motor Vehicle transfers etc. In addition States levy Land Taxes, and Local Government levies Rates which are partly a Land Tax. There are many more minor taxes. The most significant of these taxes is Stamp Duty on property transfers, which inhibits the operation of property sales, and adds to the cost of moving. Stamp duty on Home and contents insurance is another "drag" on free market, and public policy activity, with a significant number of people not insuring. Land Tax, introduced in the 1950's in NSW, was stated as being for "breaking up the large landholdings" but ended up ensnaring the modest holiday home of workers. Tax Creep is as sneaky as "Bracket Creep".

Taxes should be simple in their application, and should be readily understandable by the entity being taxed. The reason for the tax should be plainly stated and should be defendable on a number of criteria, including Public Interest, and importance in the national interest. As mentioned previously, the tax collected should be accounted for into the specific nominated Fund and a "Collections and Disbursements" statement should be published at regular intervals. Any significant surplus in collections/disbursements should lead to a re evaluation of the tax.

Taxes should be divided into their Expense content, and their Capital content. The Expense content would cover the amount of tax (possibly as a percentage) of the total tax which will be spent during the financial year. The Capital content will cover the amount which represents an "investment", which may earn income and/or be recoverable over a number of years. A good example is the HECS (education) loans which are repayable by University students when they reach a stated level of income after graduation. In brief, the Education Budget item should be divided into yearly Expense and, Capital Investments. (it should also state the amounts written off as irrecoverable).

Taxes should be seen to be a useful and necessary part of Government Administration. Few citizens would challenge the need for Defence spending, Medicare has become an entrenched part of Australian expectations, yet it is vastly more costly than the specific tax levy of 2 percent. Unfortunately Medicare has become an enshrined "freebie" of the Mendicant class – who represent a substantial – and non contributing- group of voters who will change Governments if necessary to ensure its continuance as a free/almost free service.

Concessions and subsidies must be justified and regularly reviewed, with sunset clauses. They should contain the right of repayment/review at some future time when the circumstances of the recipient change for the better. An example is public housing tenants who have had 3 bedroom houses for over 40 years and which are now in prime locations.

Concessions, subsidies and other Problems to be Solved

The foregoing list of Tax Principles is by no means exhaustive. Assuming that a tax satisfies these principles, it then has to run the gauntlet of Concessions and other "exceptions" which grow like barnacles on the Tax "ship" as it proceeds through the "sea" of tax lobbists seeking concessions and exemptions. Possibly the most visible is the Capital Gains Tax**. The most prominent of the Capital Gains Tax (CGT) applications is "Negative Gearing", usually used in Rental Property Investments.**

Negative Gearing is viewed by a number of Taxpayers as a legitimate avenue of investment, and as such it also **enjoys the support of the White Paper (page 64).** It is viewed as NOT being a distortion of the Taxation System, but merely a normal operation of any financial investment decision**. Where it "gets off the rails" is the concessional allowance of 50 percent deduction of the gain (when sold), after 12 months have elapsed**. It could be argued that properties financed under negative gearing provide scarce rental accommodation for those in need of housing. However the allowance of a deduction of 50 percent of the gain on sale is not defendable unless it is an incentive for the investor as "icing on the cake" to cover perhaps a low net return on rental income.

The presence and declaration of Negative Gearing as a legitimate vehicle of investment introduces the next problem in concessions. **This is the (Non) Taxability of the Family Home, which has been raised along with the Assets Test for eligibility for the Aged Pension**. At present the Family Home represents a store of wealth which is increasing at a rate -above the RBA declared cash rate-, and this represents a gain in capital value for the owner**. How to tax this gain is the next great challenge for the Taxation Authorities. The majority of the mendicants and their representatives are in favour of such a tax, but the devil is in the detail.**

If such a tax were to be considered **then the Homeowner would be an Investor in his own property, and as such should be treated in the same way as a Negative Gearing Investor – with allowance for deductions for maintenance, Interest on mortgage, depreciation etc.** The increase in capital value from year 1 to year 2 would be the value received for "owning" his own home, and would represent the revenue against which the expenses would be deducted. Any surplus/deficit would be paid from normal PAYE deductions. **As Capital Gains have been accounted for annually, there would be no capital gains tax payable on death**.

There have been representations made by Renters who view the exemption for the ownership of a family dwelling as discriminatory against people who rent and /or have to rent. These persons are of two types. There are those who choose to retain their capital for use in more profitable ventures, such as share trading, and there are those who do not have enough funds and/or income to finance home ownership. For this latter group**, a tax deduction for the rent paid would offer one avenue of equity balancing**. However as it would reduce the tax base significantly, it would not be favoured by the Tax reformers.

Other countries such as the USA have provisions for the deductibility of mortgage interest on family homes from yearly tax assessment. However this concession is ultimately recovered on sale or death inheritance. **This gives rise to another Principle of Taxation – what has been given away as a concession now will be recovered in the future.**

The UK, and USA levy Death Duties on estates of a relatively low value of assets. Death Duties have already been tried in Australia, in each State, and also by the Commonwealth. **This is the next untrodden area in which Government may be tempted to enter**. In its hey- day, each State had its own rules and rates. It was eventually undone in the 1970's by Queensland abolishing its death duties, with a consequent stampede by residents of other states to establish their fortunes in Queensland investments – hence the Gold Coast.

The present Capital Gains Tax operates in a Death Duties role, with its steadily increasing effect on assets acquired since 1985 (the date of its inception). CGT on transfers either by sale or on death, on assets acquired since 1985 are bringing more and more revenue into the coffers, and will continue to do so. With its tax treatment of the gain as an addition to the person's normal taxable income in the year of receipt, it achieves a high marginal rate of tax payable, and this far exceeds the old Death Duties rates which were generally around 6 percent of the estate. Capital Gains Tax, even with its 50 percent concession in some cases, is a giant slowing emerging from the depths, and will become a big surprise Tax achiever. **The normal taxpayer only runs into CGT possibly once in their life, but it will be long remembered.**

Reform of the Current Tax System

There is both Bad News and Good News in this regard. The Bad News is that the current Tax "System" is not a system at all, but a collection of arbitrary rules and regulations which at times are contradictory, and are at best patches on patches – ad infinitum. Before any progress can be made towards computerisation of the tax system – which is the only way that the system can be moved forward- the labyrinth of the rules and regulations, secret tax decisions, and workplace practices (to name but a few of the impediments) must be closely examined and the path straightened. This in my estimate (as a long standing Information Technology practitioner) will take at least five years. It will be a worthwhile exercise for the long term operation of a tax system which is truly 21st Century. Consequently my recommendation is to embark on what will have to be a manually performed rationalisation of the many, many terms, clauses, provisions, and legislation. This should be done with the objective of unification, uniformity and integration of all aspects of taxation. I would term this the Systems Analysis Phase.

Concurrently with the Systems Analysis Phase, the Systems Requirements Phase can be formulated.

The Systems Requirements Phase

A conceptual model of what the new Tax System must deliver should be formulated. This must include the present requirements, together with a forward projection of the business and political environments in which it will operate. The cost of tax collection – as it affects both the Tax Authority, and the Taxpayers- must be closely considered. Ideally tax collection should be transparent and effortless for both parties. This could be accomplished by having a "Tax Authority Standard Chart of Accounts" which would be adoptable by all businesses. This would permit electronic transfer of "raw" accounting data to the Tax Authority in a uniform format – without the need to formally lodge a Tax Return.

The Systems Requirements must include the following:

1. **The system must be computable. This means that it must be capable of being programmed for a computer to operate in an efficient and "hands off" mode to process all tax related data and transactions.**
2. **The system must be auditable. This means that it must produce audit trails of all assessements, and be regularly audited by appropriate computer audit software.**
3. **The system must be secure. This means that the system must have appropriate physical and software protection against external intrusions, and also protection against unauthorised internal intrusions.**
4. **The system must be readily maintainable. Problems of the past such as many months delay in changing the wording of a simple letter must be avoided**
5. **The system should operate in "Cloud" mode. The system will need a Private Cloud based in Australia, operated under Government control.**

6. **The system should integrate with other relevant Government systems, such as Medicare, Centre Link, and AFP.**
7. **Provision should be made for "as required" system links with the various States systems such as Courts, Prisons, Child Welfare, Family Courts etc. These will be Cloud based systems in the near future. Records must be kept of accesses and results.**

The above list is a "starter" and is by no means complete. It has been provided to indicate the scope of the considerations necessary in designing a new system.

In brief, the Bad News is that the existing Tax System is broke and cannot be fixed. Money spent on any attempt to fix it will not help, and will be wasted. The Good News is that a new system can be created – from the ashes of the old system – if the appropriate effort, and money, are put into creating a new fully computerised and integrated system. In this way the money will be better spent. It will take five years, and in the interim, the Systems Analysis Phase can be carried out, with some of the interim rationalisations being implemented.

The Task is large, and some difficult decisions will be needed to be made which will go against currently accepted "wisdom". All new computerised systems suffer from this dilemma. The ultimate decision has to be made by the Government of the day in the political climate existing at that time.

Conclusion

The task of a total reform of the current Australian Taxation System is monumental in size. It will require as a first step, bipartisan support in both Houses of Parliament. In the present political climate this is unlikely to be achieved. In practical terms, the present exercise will most likely end up as a "camel" with only the edges trimmed and a few contradictions resolved. I realise that much of what I have proposed is beyond current practicality. However I have felt it desirable , as a citizen and taxpayer, to provide my expertise in this short treatise of what needs to be done. I hope it will be of some use, but I doubt it.

Philip Stanley
27th. May 2015