



AustralianDoctorsFund  
Keeping Patients and Doctors Together

## Tax White Paper Submission

### Core Values

Australia today could be described as a **liberal democracy**—namely a nation whose institutions respect, uphold and value civil liberty, a limited role for government, the rule of law, equality of opportunity, religious toleration, peace and security. In the Australian vernacular, a **fair go for all**.

Classical Liberals also assert that **private property rights** are not only **foundational to other liberties** but **essential for human flourishing** and a peaceful and prosperous society.

Economist F. A. Hayek stressed the **importance of the rule of law** (which he defined as “*rules fixed and announced beforehand – rules which make it possible to foresee with **fair certainty** how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge*”<sup>1</sup>) as a necessary check on any tendency by government to exercise power arbitrarily.

A **key indicator** of a free society is the **value it places on its institutions**, including what has been called **the learned professions**<sup>2</sup>. **In a society that values freedom, these professions will flourish and make a considerable contribution to the welfare and security of all citizens**. There is clear evidence that **Australia values its professions** and in turn has benefited from their contribution. In the case of the medical profession, its contribution has helped deliver the second highest life expectancy in the world.

### Lower, Simpler, Fairer Taxes

The Australian Doctors’ Fund (ADF) asserts that **a tax system cannot be divorced from the expectations of citizens** as to the quantum of taxpayer-funded services provided. **Where expectations and demands on the treasury are high, taxation will be higher.**<sup>3</sup> **With higher taxation comes growing complexity** and regulation, since an increase in the tax burden is also likely to generate an increase in demands for exemptions, deductions, rebates, offsets and subsidies. Higher taxation will also **generate an incentive to exit the taxable economy** and join the cash-only society,

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<sup>1</sup> F.A. Hayek (1944), *The Road to Serfdom*, Routledge, page 54.

<sup>2</sup> Historically medicine, law and divinity, but now much broader. Professions are defined by Dahrendorf as “private bodies with public functions”. Dahrendorf, Ralf (1984) In defence of the English professions, *Journal of the Royal Society of Medicine* Volume 77 March 1984, p178.

<sup>3</sup> Winston Churchill is quoted as saying, “A government trying to promote prosperity by increasing taxes is like a man standing in a bucket and then trying to lift himself up by the handle.”

estimated by the Australian Taxation Office to involve at least 275,000 businesses.<sup>4</sup> The Australian Bureau of Statistics has estimated the size of underground economic activity at \$20.772 billion.<sup>5</sup>

## History of Taxation in Australia

The **first taxes in the colonies were simple duties on goods**. In 1884, some 96 years after the founding of New South Wales, the **first income tax** (a land tax and income tax) was introduced in South Australia at a rate of **1.25% of income on personal exertion**, 2.5% on income from property, and 0.2% on land holdings. The justification of the Federal government's **introduction of an income tax in 1915 was "a war measure designed to meet present circumstances"**. This saw income from personal exertion taxed at progressive rates from 1.25% to 13% for amounts below £7,600 [equivalent to \$732,491.64 in 2014] and 25% thereafter.<sup>6</sup> There was a company tax of 7.5% and property taxes up to 25%.<sup>7</sup>

## The Definition of Income

A **major factor in the complexity of the Australian tax system is the challenge of defining 'income'**. The 10th edition of Australian Tax Law spends 70 pages explaining 'assessable income – general principles', and a further 44 pages explaining income from personal exertion. Explanations on income from property take up 50 pages, income from business, 86 pages, and exempt income, 18 pages. Furthermore, there are **judicial and economic concepts of income** and "these concepts have continually **jostled for recognition in Australian tax jurisprudence**".<sup>8</sup> Hence, **income is often described rather than defined** in the various Acts and regulations governing tax, and the context of meaning is interpreted from case law. As a result, complexity around the definition of income is a significant contributor to the demand for tax advice as is the size of the income tax Acts themselves. The ADF notes that the two major **Commonwealth tax Acts run over 18 volumes and 7,273 pages** (Income Tax Assessment Act 1936: 7 volumes, 2,150 pages; Income Tax Assessment Act 1997 11 volumes, 5,123 pages). Obviously, few individuals have the sufficient expertise to navigate let alone understand the legislation governing their tax obligations. The ADF believes that reducing high compliance costs borne by the taxpayer should be a priority in simplifying the tax system.

## Taxation and the Political Process

In Australia, the debate about the role and size of government, on any particular issue, including the level and incidence of taxation, is played out in a **competitive political process between two predominant political philosophies**—one that emphasises **more government intervention**, and one that emphasises **less**. Furthermore, within any defined political grouping the **'more government' and 'less government' positions can vary** depending on the issue. The **political compromise** that accommodates this tension **is likely to produce further complexity**. The introduction of the GST is a good example. In the area of health, medical services with a Medicare rebate are GST exempt as are prescription drugs. However women's sanitary items and over-the-counter pain killers are not.

<sup>4</sup> Nassim Khadem, "ATO cracks down on cash economy", *Australian Financial Review*, 22 Aug 2014

<sup>5</sup> Estimate for year 2010-11 in the chapter 'Measuring Underground Production' ABS, *Information Paper: The Non-Observed Economy and Australia's GDP, 2012*, 5204.0.55.008, 12 September 2013

<sup>6</sup> According to the Reserve Bank Inflation Calculator, a basket of goods and services valued at £7,600 in 1915 would cost \$732,491.64 in the year 2014.

<sup>7</sup> Woellner, Barkoczy & Murphy (1999), *Australian Taxation Law*, 10<sup>th</sup> Edition, CCH Australia

<sup>8</sup> Ibid, page 307.

Feeding into this process will be political perceptions of public opinion (past, present and future) and the subsequent realignment of policy platforms to maximise electoral support.

In summary, whilst it is **generally accepted that “a better tax system that delivers taxes that are lower, simpler, fairer”<sup>9</sup>** will help improve productivity and hence economic growth, reform is not easily achieved. **Community expectations of government and a competitive political process mean that any progress towards this goal is likely to be slow at best.**

### Principles of an Ideal Taxation System

The US Tax Foundation has identified 6 principles of sound tax policy:

1. **simplicity** (low administrative cost),
2. **transparency** (based on sound legislative procedures),
3. **neutrality** (neither encouraging nor discouraging certain economic decisions),
4. **stability** (the avoidance of short term measures),
5. **no retroactivity** (reliance on the law as it is at the time the tax is assessed), and
6. **broad bases and low rates** (the avoidance of targeted deductions, rebates and exclusions).

The Tax Foundation also asserts that **good tax policy should “promote economic growth by focusing on raising revenue in the least distortive manner possible”**. The Tax White Paper lists **equity, efficiency and simplicity** as three key principles, noting that the Henry Tax Review had emphasised **sustainability and consistency**.<sup>10</sup> Whilst much has been written on taxation theory, in reality, **the political process makes the taxation system less principled and more complex.**

### The Australian Taxation System Defined

The Australian tax system, with more than 100 different taxes<sup>11</sup>, could be described as **a progressive income tax based system, with a cluster of supporting taxes designed to cut off escape routes**. The major supporting taxes include: Fringe Benefits Tax, Capital Gains Tax, Company Tax, Goods and Services Tax, tax on undistributed trust income, and tax on the unearned income of minors of up to 66%. In 2013-14, income tax delivered 50% of total tax revenue, corporate income taxes 22%, GST 15% and indirect tax (excluding GST) 13%.<sup>12</sup>

**Significant reliance on income as a tax base largely reflects its reliability as a relatively fixed target**, particularly compared to the transferability of business assets (which can be liquidated and the proceeds used to purchase assets overseas), shares (which can be sold and repurchased), and liquid funds (transferred electronically overseas in days).

The ability of progressive income tax to deliver **higher taxation revenue without public announcements** of tax increases through the **process of bracket creep**, also **adds to its political attractiveness**, despite its constant **erosion of the incentive for greater workforce participation and entrepreneurial activity**. As the incentive to earn extra income in the ‘official economy’ is diminished, the **incentive to join the non-taxable cash economy increases**, and the cost of enforcing

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<sup>9</sup> Tax White Paper, page iii.

<sup>10</sup> Tax White Paper, page 14

<sup>11</sup> Tax White Paper, page 15

<sup>12</sup> Tax White Paper, page 21

the tax law grows. The ADF believes that personal income tax brackets should be indexed to average weekly earnings in order to prevent bracket creep and reduce incentive to work.

## **GST and Health**

As a result of a **political compromise to facilitate the introduction of the GST** (introduced to remove the complexities of the Wholesale Sales Tax it replaced), many health transactions are GST free but some are not, leaving the Australian Taxation Office (ATO) the difficult job of explaining the difference. Despite these anomalies, it would appear that those working in the health sector have become familiar enough with the classifications and contradictions of the system. Given that any change to the GST on health transactions will most likely trigger greater uncertainty and generate new claims for exemptions, inclusions or compensation, the ADF does not advocate any change in the current GST treatment of health related transactions, albeit, the ADF appreciates the arguments in favour of a broader base and lower rate of GST.

## **Use of the Taxation System to Deter Unhealthy Behaviour**

The use of the tax system as an agent for behavioural change is often advocated and sometimes implemented. High profile taxes on cigarettes, alcohol and gambling are supported by strong advocacy groups as part of a battery of deterrents which also includes prohibitions on advertising, merchandising, selling and public use.

However, **the use of tax to promote healthier behaviour has its limits**. Despite the widespread consensus that taxing tobacco products is fair and justifiable (as a cost recovery for medical treatment and hospital care caused by smoking and subsidised by taxpayers, as well as a preventive health strategy), Australian Customs states that it seized **147 million illegal cigarettes in 2014**<sup>13</sup>, giving some indication of the size of the illegal tobacco market.

For this reason, it is important that where taxes are used to achieve better health outcomes, the case be fully researched to **ensure as far as possible that the health objectives of the tax can be achieved and not avoided by substitution and inability to effectively enforce the law**. The implementation of the tax must also take into account any negative effects on vulnerable families and how these will be dealt with including ample provision for support and counselling.

Finally, it is important that once the tax is introduced, its purpose as a driver of better health outcomes not be lost or sublimated to revenue raising objectives. This will require adequate budgets for effective health promotion and anti-avoidance enforcement. The ADF supports programs (including taxes on alcohol and tobacco) which are effective deterrents to preventable unhealthy behaviour when those programs are based on sound research, including detailed consultation with the Australian medical profession.

## **Failure of the Medicare Levy to Cover Costs**

The current Medicare Levy of 2% on taxable income was increased from 1.5% by the Gillard Government using the National Disability Insurance Scheme (NDIS) as justification. Hence, **it could be argued that the 'Medicare Levy' should be renamed the Medicare/NDIS Levy**. This levy (tax)

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<sup>13</sup> Australian Customs and Border Protection Service Annual Report 2013-14, page 26.

generated \$10.3 billion in 2013-14 or about 16% of total federal health outlays (\$64 billion). Furthermore, given that the NDIS is estimated to cost \$22 billion p.a. (\$8 billion federal) when fully operational in 2018-19<sup>14</sup>, any pretence that this levy is making anything other than a minority contribution to Hospital Medicare (\$43.9 billion p.a.) and Medical Medicare (MBS+PBS) (\$36.1 billion p.a.) or the future cost of the NDIS (\$22 billion) is misguided.

To improve transparency, the ADF proposes that the Medicare Levy be renamed the Public Hospital Insurance Levy and provision be made for a direct financial contribution to a public hospital by a taxpayer to be eligible as an offset against the levy. This proposal is in line with the ADF's belief that public hospitals work best when they maximise local community involvement, including local boards of management. Having a contribution pathway from the taxpayer to the public asset is one way of building that involvement.

### **The Cycle of Lifetime Earnings**

**Australians who excel in their profession (or any lawful endeavour) should have the opportunity to reap the financial rewards** that come with hard work and dedication in a very competitive professional environment. In medicine, that includes accepting direct professional, legal and ethical responsibility for the health and well-being of patients. In any profession however, **peak earnings come only after a substantial lead time of education and training.** In medicine, this can be 20 years. Provided everything goes well in terms of health and opportunity, these professionals will experience around 15 years of peak earnings before exiting the profession or stepping down to end-stage career activities and hopefully a long and healthy retirement. It is often convenient when quoting professional incomes to ignore the long lead up of limited income, high training and operational costs and in the case of self-employed professionals, the need to provide for a reasonable standard of retirement income including building an adequate level of superannuation.

It is therefore **important that the taxation system does not deter the best and brightest Australians from undertaking their profession** by eroding the reward for hard work and diligence which includes lifelong education and compliance with the highest standards of medical education and training.

In 2013, the then Federal Treasurer, the Hon. Wayne Swan, announced a change to self-education expense deductions that would have impacted negatively on doctors (and in particular junior doctors) given their high initial and ongoing training costs. On examination, Treasury decided not to proceed with the proposal. The ADF supports that decision (not to proceed) and believes that existing tax law is sufficient to ensure that the taxpayer's interests are represented in the application of this deduction. There is no doubt that the proposed changes were unfair and unprincipled. They would (if implemented) have imposed an arbitrary limit on legitimate tax deductions for one group only, and were contrary to the established principle of tax deductibility of expenses incurred in the process of generating income.

In summary, the ADF asserts that a fair tax system will continue to allow the costs of medical training to remain deductible. Furthermore, that consideration be given for an option for training costs to be capitalised, indexed and deducted over a five year period.

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<sup>14</sup> Andrew Baker, NDIS cost blowout has begun, Centre for Independent Studies, 15 Feb 2013

## Superannuation and Tax

The ADF does not support any increase in superannuation taxation (including retrospective or retroactive changes) and maintains that such actions will only contribute to greater uncertainty for all superannuation contributors. **There is no guarantee that a change in superannuation tax rules will generate the revenue expected<sup>15</sup> since investment behaviour reacts to adverse change.** If the tax fails to achieve revenue projections, there is further uncertainty of further tax increases to cover the shortfall. Furthermore, when any tax meets revenue expectations, there will be pressure to revisit specific source when under pressure to meet an ever increasing demand for public funding, stimulated by a competitive political process.

## Health Savings Accounts

The ADF is a supporter of **incentives that encourage Australians to save where they can for future healthcare costs** whilst maintaining a safety net through public healthcare financing and the encouragement of private health fund membership. A limited tax free Health Savings Account with defined expenses for specified medical and dental treatment<sup>16</sup> would complement the existing financing arrangements and could be readily administered through the current superannuation structure. The ADF believes the policy option of Health Savings Accounts should be implemented.

## Dividend Imputation

The ADF notes tax white paper's statement that dividend imputation "provides a more neutral tax treatment of incorporated and unincorporated businesses and reduces the bias towards debt (rather than equity) in company financing choices."<sup>17</sup> **Any proposal to remove dividend imputation would therefore reintroduce double taxation on company profits paid as dividends at very high rates.** Such a proposal would be contrary to fairness. The ADF supports the retention of the current dividend imputation system.

## Summary of Recommendations

1. Reduce the high compliance costs borne by the taxpayer as a priority in simplifying the tax system.
2. Index personal income tax brackets to average weekly earnings in order to prevent bracket creep.
3. No change be made to the current GST treatment of health related transactions.
4. Continue programs (including taxes on alcohol and tobacco) which are effective deterrents to preventable unhealthy behaviour when those programs are based on sound research, including detailed consultation with the Australian medical profession.
5. Change the name of the Medicare Levy to the Public Hospital Insurance Levy and make provision for a direct financial contribution to a public hospital by a taxpayer to be eligible as an offset against the levy.

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<sup>15</sup> Robert Carling (2015) *Right or wrong? Dissecting Australia's tax concessions*, Centre for Independent Studies, April 2015, pp. 14-17

<sup>16</sup> A suitable starting point may be those services which currently attract an MBS rebate plus specified dental and orthodontic treatment.

<sup>17</sup> Tax White Paper, p. 83

6. Continue to allow the costs of medical training to be deductible. Give consideration to an option for training costs to be capitalised, indexed and deducted over a five year period.
7. No increase in superannuation taxation (including retrospective or retroactive changes).
8. Implement the policy option of Health Savings Accounts using the current superannuation structure.
9. Retain the current dividend imputation system.

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