



UniTax

Simple, Fair & Efficient

Progressive Income Tax

Collected at a

Flat Rate

on

Expenditure

FOREWORD

This paper has been prepared in response to the Government's [Re:Think Tax Discussion White Paper](#). It takes for granted the case for change made out in the White Paper and proposes a radical new tax system: UniTax.

It is based on the philosophy that to encourage the production of goods and services, we should not tax the creation of 'value', but its consumption - as we spend our incomes.

By using the banking system to collect tax on expenditure, different rates can be applied for different jurisdictions (Local, State and Federal), depending upon each taxpayer's place of residence. With this flexibility, the tax can replace most other taxes (company, personal, payroll, stamp duty, etc)... hence the name.

It is extremely simple in design, with no exceptions, yet it is fully progressive. It achieves this seemingly impossible challenge by paying a system of rebates, including a general weekly rebate to every Resident over age 15.

It also suggests a novel way to fund the general rebate in the form of a 'National Dividend' – paid out of money created to recognise our collective capacity to make more with fewer and fewer people in the process. How this can be achieved is discussed in [Appendix I](#).

Such a radical new system will have a significant impact on all tax professionals in both the public and private sectors; whose livelihoods depend upon the complexity of the current system. For this reason, it is suggested that the only way to implement the change is to take a long term view.

The earliest the new system could reasonably be enacted is at least 5 years. In order for all stakeholders to have sufficient time to adjust, a further 10 years could be allowed before the system is fully switched over. Initially, the rate of UniTax could be set to replace the GST only. This would enable development of a collection history, as the basis for setting the rates for each jurisdiction to replace most other taxes.

To further assist the transition, it is proposed that the first 10 years of administration and compliance savings (following its full implementation) be used to pay generous redundancy benefits to those impacted, including for loss of goodwill related to tax advice businesses.

This provides a 25 year time scale before the full value of the new scheme would be realised, but the future savings will continue indefinitely. As well, even from implementation (15 years hence), the indirect benefits arising from the new system will be in the \$billions pa based on the reduced complexity in all decision making.

The paper is not a standalone document. The details set out are mainly to demonstrate the depth underlying the development of UniTax. A full understanding will require a much greater level of analysis (issue by issue).

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[The Australian Government has called for a 'Re:Think of Tax'.](#)

1 **Imagine if...**

- Tax was simple to understand. Perhaps 200 pages all up (instead of 26,000)!
- Every dollar you earned (first to last) attracted the same marginal rate of tax, so...
- There was no disincentive to give, work, invest or trade (buy or sell), yet...
- The first \$20,000 was tax free, with the rate increasing smoothly to 25% tops*, and...
- All Gains (including capital gains) were only ever taxed once - all at the same rate.
- All gains were adjusted for inflation and taxed only as they were realised and spent
- You never had to put in a tax return
- No business had to expense tax, or put in a return other than their normal accounts.
- Tax ceased to be a factor in any decision making between alternate expenditures
- Everyone paid their fair share, because tax was difficult to evade and penalties high
- Compliance costs were virtually zero, because the whole system was automated
- The States and the Federal Government could each set their own rates of tax
- Cross-subsidies between States were still achievable based on agreed guidelines
- No bracket creep, yet tax would grow as the economy grew - without a rate change
- Levies/Charges still applied where they directly linked to the activity being managed
- After the law was enacted, everyone was given 10 years to get ready for the change.
- Tax specialists (in both the public and private sectors) supported the change because they were generously compensated for loss of income and business value - paid from the savings to be derived from the new system.

*indicative based on total tax share of GDP

2 **Criteria for Tax**

There are ten main criteria we have to consider in any major change to the Tax System:

1. Equity - fairness across income levels; no tax on tax; all gains treated the same.
2. Efficiency - so as to have the lowest possible cost over and above the revenue that is raised
3. Simplicity - easy to understand and simple to comply with; and hard to avoid... or evade.
4. Productivity - the creation of value/wealth should not be taxed; to maximise production
5. Competition – all business profits should be distributed tax-free; to attract investment
6. Inflation - only *real* gains to be taxed; and tax *rate* increases should not cause inflation
7. Distortion - tax should not be a factor in decision making by business or individuals
8. Incentive - imposition of tax should not be a disincentive to give, work, invest or trade
9. Honesty - all gains assumed to be derived in good faith (absence contrary evidence).
10. Stakeholders - the interests of each group to be balanced (including vested interests)

UniTax is aimed at meeting all of these criteria. It has been in development for over 30 years and is designed to tackle not only current problems, but the emerging issues of: a) tax collection on international trading, b) on-line sales, and c) the rise of digital currencies.

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3 Overview of UniTax

UniTax is based on the philosophy that we should not tax the creation of value; but its consumption. So no business would expense tax; and all profits would be paid out tax-free. It is an All-encompassing Progressive Income/Capital Gains Tax, constructed in four parts:

1. All income/*real* gains paid/received 'tax-free'
2. a set *percentage* tax that is paid on *all expenditure*.
3. a flat *amount rebated weekly* to every Resident over 15
4. a *system of rebates* for tax paid: a) by business, b) on all assets and loans, and c) on all payments made for no consideration - all adjusted for inflation.

In this way, it is possible to ensure each person pays a *progressive tax on all income and real capital gains - without any double taxation, or avoidance - as they spend their incomes*. Evasion would still be possible, but to a much lesser extent than under the current system.

Section 5 details how it can be achieved with very little administration, or cost- using the *banking system* as the collection agency (instead of business).

Data from the Re:Think Tax paper suggests that an all-encompassing income/capital gains tax rate of 25% would be sufficient to support all current government services now paid out of tax, after saving on tax compliance. *This equates to 33.3% on expenditure, as below:*

Table 1 Tax Table showing the link between: Income and Expenditure Rates, a Flat Rebate and Net Tax Paid

Amount/ Rate	ANNUAL INCOME LEVEL				
	Zero	Breakeven	Low	Median	High
Annual Earned Income	0	20,000	40,000	100,000	1,000,000
Annual Flat Rebate (paid in weekly instalments) 6,667	6,667	6,667	6,667	6,667	6,667
Disposable Income	6,667	26,667	46,667	106,667	1,006,667
Tax on Total (as spent)	1,667	6,667	11,667	26,667	251,667
Expenditure	5,000	20,000	35,000	80,000	755,000
Net Tax Paid on Income	-5,000	0	5,000	20,000	245,000
Tax Rate on:					
- Disposable Income 25.00%	25.00%	25.00%	25.00%	25.00%	25.00%
- Expenditure 33.33%	33.33%	33.33%	33.33%	33.33%	33.33%
Net Tax Rate on Income	n/a	0.00%	12.50%	20.00%	24.50%

As the table shows, everyone would pay the *same percentage tax rate on all expenditure*, and be rebated the *same flat amount* each week. *As every dollar earned would attract the same marginal tax rate: 25%* - there would be no disincentive to give, work, invest or trade.

Yet, the *net tax rate* would vary smoothly from zero at \$20,000 pa, up towards 25% of income (the higher the income)... *with a net contribution to anyone earning less than \$20,000 pa*. That is, UniTax is fully *progressive*.

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4 Philosophy of UniTax

4.1 *The Taxman must assume all Earnings are derived in Good Faith*

Money paid for work, investment or trade represents a 'gain' to *society*. It recognises the *value* (in the form of new assets, goods or services) that the recipient of the income has helped to create by providing their labour, wit and/or money.

In levying tax, we must assume that all gains represent each person's fair share of the value created - as determined in the market. As a rule, your income allows you to 'take out what you put in'. Great wealth is derived from adding great value... and not consuming it.

This of course ignores the problems of market power, fraud and theft, including financial fraud; and also tradesmen doing shoddy work, or office workers spending time on Facebook instead of their job, etc. Unfortunately, there is no 'prima facie' way for the taxman to know whether any earnings have been derived in good faith, or not. As such, we have to leave those questions to our other systems of justice, as circumstances arise.

4.2 *Tax should not be a Disincentive to Work or Invest; Buy or Sell (Trade)*

We want people to create value in the form of assets and goods and services (public and private) to meet our individual and collective needs. Tax should not be a disincentive.

This condition will be met if all income (eg. wages, fees, rent, royalties, interest, sole-trader profits, dividends and capital gains, etc.) is *received* tax-free by individuals.

What about business? Businesses are social and legal constructs designed to add value to our natural, human and technological resources by transforming them into new assets and goods and services, when and where they are needed. By the same logic as individuals, businesses (including sole traders) should not expense tax on the value they create.

And, as with individuals, we should not try to use the *general* tax system to correct market anomalies and externalities. Where these exist, they need to be managed via regulation and prosecuted via the judicial system; and/or via specific levies (and subsidies) aimed at altering behaviour. These objectives are outside the scope of this proposal which is looking at how to improve the system of *general taxation*.

4.3 *Why Pay Tax?*

If the creators of value never pay tax, the money they receive (in recognition of the value they create) would allow them to consume all that they produce – as they spend their money. This is expressed in economic terms as: $\text{Income} = \text{Total Output} = \text{Expenditure}$.

Expressed colloquially, it means: "you get to take out what you put in". This sound's fair enough; except there are social needs: not least infrastructure; and health and education services; as well as the creation of property rights, and the administration of law to regulate behaviour – criminal, civil and corporate (eg to control pollution and food and drug safety,

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as well as the operation of companies, banks, and insurers, etc); and for defence and emergency services; and the management of natural resources; and much else besides.

All these 'social services' enable us to securely earn income and live our lives in much better ways than are possible in countries without good governance. Tax is how we pay for them.

Importantly, tax is also required to support those who are 'outside' the production system – those who cannot earn to support themselves (and who have no other means): the young, old, disabled, *and their unpaid carers*, as well as those without the skills required by the market.

From a philosophical viewpoint, sharing certainly helps those who cannot help themselves - providing the moral imperative... but it also helps the rich in very practical ways.

Money flows up much faster than it trickles down. As soon as most people receive money, they spend it on their immediate needs. This spending flows into business and up the chain, encouraging investment and increasing growth. That is, money paid in tax by the rich soon comes back to them in the form of extra sales and profits - supporting a real and sustainable rise in asset values across the broad economy. As well, with less poverty, there is less crime and less ill-health, requiring less need for police, hospitals and medical services; enabling the money saved to be spent on better resources for the remaining support services and/or lower taxes. It is a virtuous circle.

Viewed from this perspective, tax is only a temporary cash flow problem for the rich. If you own the factors of production, the more money people have to spend (bureaucrats, welfare recipients and everyone else), the more your business and/or investments can grow... increasing their value in real terms - while making society safer and better for everyone.

The old adage is true: money goes round.

4.4 Tax should be Progressive without creating 'Second-class Citizens'

As a general rule, the more value a person adds, the higher their income... the more they are able to share, and still meet their needs. This economic reality enables some form of progressive taxation - to ensure no one lives in 'poverty'.

Poverty is a relative concept. During most of human history it did not exist - everyone in the tribe was looked after, based on the standards of the time.

The poor in a modern city may be materially better off than everyone 1,000 years ago. However, that's not the issue. It's the differential between them and the rest of the population that makes them 'poor'; and [today the differential is greater than it has ever been](#), and also more apparent through TV, film and the Internet.

In the case of Australia, most of the population have 'good quality' health and dental care; education; housing, heating and cooling; water, food and clothing; communication tools and the means to get to work; as well as care if you are young, aged or disabled.

But millions don't.

Despite being [one of the wealthiest countries in the world on a per capita basis](#), [Australia still has over 2.5 million people living in poverty](#) - with many more living a precarious existence from week to week. This percentage has remained stubbornly persistent through time. With the threat of automation now looming ever larger... some believe poverty could increase, as people lose their jobs to computer programs and robots. Which would be ridiculous - given automation ought to mean *more for everyone with less work!*

Growth and Productivity Improvements cannot be the answer - else poverty in Australia would have been eliminated long ago.

Nor can poverty in Australia be due to a lack of resources or money.

Today we have more natural, human and technological resources available than ever before; while the global supply of money has escalated into the \$trillions... far outpacing economic growth.

Who doubts that if we were suddenly forced by aliens to achieve a 'good life' for everyone in our community - we could do it in less than a decade. In the process, as activity ramped up, we would increase everyone's wealth – as happens in preparation for war. Of course, we would have to do it in ways that ensure our natural resources are not stripped bare... but that is another topic.

Clearly, 'poverty' is a system problem.

Of course there are many personal reasons that push people into poverty. The key is to tackle the systemic causes that underlie most of them.

From an economic viewpoint, the crux of poverty is not that the rich have too much money; it is that the poor have too little to signal their needs... so the market cannot respond.

We know from personal experience: with money, we can share in society's bounty; without it, we are literally destitute. *How much money anyone else has is irrelevant.*

However, history has also shown that *taxing the rich (or even charity) to give to the poor* is not the ideal answer either. It creates a disincentive to work and perhaps a sense of entitlement on the one hand; and a feeling of resentment on the other, leading to 'second-class citizens'. It also requires a huge bureaucracy to manage the payments - to decide who should get how much.

Section 5 shows how UniTax helps to address this lack of money in the hands of the poor - without creating inflation, the disincentive to work, second-class citizens, or a huge bureaucracy.

Appendix I also shows how we can mitigate poverty *without taking money from the rich (or anyone else)* - even while *UniTax remains 'progressive' at its heart.*

4.5 Better to Pay Tax based on Income, but Collect it on Expenditure

To be progressive, the tax *rate* must increase with a person's income.

However, to ensure there is no disincentive to give, work, invest or trade, and to remove tax from business decision making, it is best *not to tax the creation of value* (that is the earning of income), but to *tax the consumption of value* - as we spend our incomes.

It is also much simpler and more efficient to collect tax in this way - as expenditure is readily identified and tax collected via transactions. And it is more difficult to avoid.

If tax is levied on *all* expenditure (without exception) *at the same rate*, it also ceases to be a factor in decision making when money is spent.

The key problems are then how to make it 'progressive' (without creating 'second-class citizens'), and how to avoid 'double taxation'. Other problems include how to capture on-line purchases from overseas, as well as the transfer of income between countries. These issues will be discussed in section 5 which details how UniTax would work.

4.6 All Real Gains (after Inflation) should be Taxed the Same

If a person makes a real gain (after inflation), the gain represents value that has been added by their labour, wit and/or money - through deferral of consumption. When they come to consume that value, the tax treatment should be the same regardless of how it was created (earned) – *or when it is consumed*.

That is, both income and *real* capital gains should be treated the same for tax purposes.

This can be achieved, without creating a disincentive to work, invest or trade, if no tax is paid on the creation of value (ie earning). And, if all expenditure attracts the same rate of tax, there can be no disincentive to spend (based on tax).

4.7 No Double Taxation

Tax should only be paid once on any amount of income or capital gain - as the money is spent to consume resources.

As businesses (including sole traders) and investments are designed to add value to our resources (by providing labour, wit and/or money), this requires that all tax paid in the process of creating value be *rebated* upon the sale of assets and goods and services.

This enables the full profit (representing the value added) to be passed to the ultimate owners/investors tax-free. Tax is then paid finally only as the proceeds from the business/investment are spent by the owners/investors to consume resources. It also means that tax paid on losses are rebated in full as any losses are incurred.

Also, any payments that are not made for consideration should be made tax-free... so tax is only paid once: as the payees spend the proceeds to consume resources.

4.8 No Bracket Creep but Tax should move in line with GDP

Tax should move in line with GDP without the need for a rate change. Tax rates for individuals and business should only change by decree, based on announced changes in policy and/or activity.

4.9 Total Amount of Tax and Government Expenditure

How much tax in total should be collected and for what purposes it is raised, and how well it is spent, are outside the scope of this paper; which is aimed at simplifying the system of collection. However, as a matter of philosophy, we should recognise that there are different expenditures that need to be accounted and paid for in different ways.

General Tax (the subject of this paper) should pay for:

- Policy Development and Government Administration.
- Government Services that cannot be charged in full to the user (eg Regulation and Administration of Justice, Police, Basic Research, Defence, Health, Education, etc)
- Transfer Payments to Individuals and Subsidies/Grants to Business
- Interest and Capital repayments on Borrowings to fund Capital Works
- Maintenance on Capital Works

Capital Works (infrastructure and government buildings, etc) should all be funded from borrowings over the useful life of the asset – to ensure future generations (that benefit from the works) continue to pay their share of the cost to create them.

Ideally, monies raised as levies to modify behaviour should only be spent on activities aimed at eliminating, and mitigating the effects of the behaviour – to avoid dependence on the revenue. This would include for cigarettes, drugs, alcohol, gambling, pollution, etc.

Where Government delivers services than can be directly charged to the users of the service, those charges should continue to apply. However, they should be provided at cost, so there is no incentive to artificially inflate revenue to create sources of income for other uses.

General Taxation alone should pay for all services that are not directly chargeable to users – so it is clear to the electorate what the different services cost before any cross-subsidy.

5 Operation of UniTax

5.1 Paying and Expensing UniTax, and Submitting Tax Returns

Under UniTax, ALL income and real capital gains would be remitted to the earner without tax deduction (ie all payments would be made gross).

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If you have 'money in the bank', this unspent income represents value that you have helped to create, that you have not consumed. If you have created value and not consumed it, there is no justification for taxing the money while it remains unspent.

In keeping with this philosophy, UniTax would be *paid only on expenditure* (without exception).

To ensure business *expenses* no tax (to avoid double taxation), all tax paid on expenditure by business would be fully rebated against its cost of sales (like GST). See section 5.12. Effectively, business would *expense* no tax at all... a significant competitive advantage – the best that any 'tax haven' could hope to offer.

Only individuals would *expense* tax as the final consumers of our natural, human and technological resources, and they would never again have to put in a tax return... though they may have to apply for rebates (using automated processes). See sections 5.10, 5.12 and 5.14.

The following sections describe the process and impacts. The principal rules are set out in section 5.20. Evasion is discussed in section 5.25

5.2 Australian Deposit Taking Institutions (ADTI) to Collect UniTax

Unlike GST (which is collected by business), Australian Deposit Taking Institutions (ADTI) would be charged with, and compensated for, collecting UniTax for the community - as money was withdrawn from any Australian Deposit Account (ADA).

The tax would be paid by both business and individuals whenever a *withdrawal was made for any purposes*... making tax deduction automatic.

As such, the ADTI's would not be required to pry into individual affairs... making *collection* simple, certain and virtually costless.

5.3 Different Rates can apply to Different Jurisdictions.

With UniTax deducted from ADA's, it is possible for the Federal Government to set a national tax rate, with each State (and even Local Government) separately setting their own rates - *based on the place of residence of each taxpayer*. Cross subsidies for smaller States (and even down to municipalities) could still apply via the Federal Government (taking account of other income the States/Local Governments may receive, eg. mineral royalties).

This makes it possible for UniTax to replace most other forms of taxation (including GST, income, company and payroll tax and stamp duty, tax on super funds, etc.)... hence, the name.

5.4 Residents' Australian Income

Individuals and businesses would be required to pay all Australian sourced income 'tax-free' (ie gross) into an ADA. If not, the tax payable by the payee would have to be deducted by

the payer and remitted to the Tax Office in the name of the payee - split by the various jurisdictions. While this could be done via the bank-tax system when the payments were made, it would be a more onerous process; and would encourage tax-free payment into an Australian Deposit Account (ADA).

5.5 Residents' Non-Australian Income

Individuals and businesses would need to make special arrangements with the Tax Office to pay/recover tax in keeping with international treaties.

5.6 Non-Residents' Australian Income

Individuals and businesses would need to make special arrangements with their Australian Bank or Payer to legally avoid or recoup tax in keeping with international treaties.

5.7 Prices for Assets, Goods and Services

All prices for assets and goods and services would be quoted and paid 'ex-tax'... greatly simplifying business; and *also eliminating tax increases as a cause of inflation*.

Foreign visitors and exporters would also greatly benefit from 'ex-tax' pricing.

5.8 Tax Paid regardless of the Manner of Payment

A person could still pay with cash, but to get cash they would have to withdraw it from their ADA (bank) account - at which time the tax would be paid. The same would happen when money was withdrawn to pay by direct debit, or when withdrawing money to pay off a credit card, or for any other purpose.

5.9 Tax Paid regardless of the Source of Goods or Services

It would not matter if the assets, goods or services being purchased are local or imported; real or virtual; delivered physically, or over the net. Tax would be deducted from the purchaser's account and paid regardless - as and when the money was withdrawn to pay for them.

5.10 Treatment of Gains and Losses on Assets Acquired by Individuals

Real gains (ie adjusted for inflation) in Asset Values are just like any other income. Under UniTax, such *gains are subject to tax as they are realised and spent to consume resources*.

Tax paid on assets (and associated costs) would be rebated upon re-sale - *to avoid double taxation*. The rebates would be based on a formula that ensures all realised gains (after inflation) continue to be taxed when the money is spent. The calculation is the lesser of:

- tax paid on original purchase and maint. (adjusted for inflation while owned), and
- the expenditure tax rate times the net re-sale price.

The rebate ensures the vendor is able to spend the proceeds of sale without paying tax twice; while paying tax on any *real* gain (when spent).

In the case of business, all costs associated with ownership of the asset (inc. maintenance and depreciation) would be taken into account in adjusting the amount to be rebated, as the tax associated with these charges would be deducted against income as sales were made. This avoids paying a 'double rebate'.

Capital losses *by individuals on depreciating assets* would diminish the rebate. This is the appropriate outcome as a 'capital loss' represents consumption of the asset. When the asset has no value it would be regarded as fully consumed and no rebate would be paid.

Table 2 (page 17) *shows that the cash result is the same* for all *real* capital gains and losses – whether they are taxed as income; or they are taxed under the UniTax system on expenditure (with rebates).

5.11 Negative Gearing and Property Ownership

Under UniTax, 'negative gearing' would cease to be an issue.

In the first instance, tax would be paid by all purchasers on the purchase price and related costs, eg: legal, maintenance costs, interest and selling costs related to the property. Upon sale, the tax paid would be adjusted for inflation and rebated to the vendor.

This system of rebates ensures only *real* gains (based on the total cost of ownership) are taxed when *realised and spent*. In effect, the tax you pay on any property becomes an asset (like the property) – because you get its full value back (adjusted for inflation) when the property is re-sold.

For example, if you have made \$100,000 *net real* gain (after all expenses) from the time of purchase to re-sale, tax would be paid on this gain - only as and when it is spent.

There would be no difference in tax treatment between an owner, investor or developer. The tax paid and rebated would be the same since all are engaged in the same activity: creating and/or owning, maintaining and ultimately selling a property. However, because the tax is only paid when the property is sold and the proceeds spent, no-one can be forced out of their home to pay tax.

Special transition arrangements need to be made to ensure existing asset owners are not prejudiced when UniTax is introduced. See Section 5.28

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Table 2 Comparison of Tax paid on Income vs. Tax collected on Expenditure - for Real Gains and Losses on Assets

		LOSS	BREAKEVEN	PROFIT
TAX PAID ON INCOME				
Income		1,000	1,000	1,000
Income Tax Rate and Tax Paid	25.00%	250	250	250
Money in Bank at the Start		750	750	750
PURCHASE of ASSET out of AFTER-TAX INCOME				
Original Purchase Price		750	750	750
TAX ON MONEY GAIN/LOSS ON RE-SALE				
Re-sale Price		500	750	1,750
Profit/(Loss) on Original Purchase Price		(\$250)	\$0	\$1,000
Tax Payable on Money Gain	25.00%	0	0	250
NET CASH POSITION				
After-tax Gain on re-sale		(\$250)	\$0	\$750
Money in Bank at Start		750	750	750
Money in Bank at End (Re-sale Price less Tax)		500	750	1,500
TAX ON REAL/LOSS GAIN ON RE-SALE				
Inflation over period during which asset is held	10.00%			
Original Purchase Price adjusted for Inflation		825	825	825
Re-sale Price		500	750	1,750
Real Profit/(Loss)		(\$325)	(\$75)	\$925
Tax Payable	25.00%	0	0	231
NET CASH POSITION - ADJUSTED FOR INFLATION				
Proceeds of Sale		500	750	1,750
Less Money at Start		750	750	750
Less Tax Paid		0	0	231
After Tax Gain		(\$250)	\$0	\$769
Money in Bank at Start		750	750	750
Net Available Expenditure at End (after Inflation)		500	750	1,519
Money in Bank at End (No Inflation Adjustment)		500	750	1,500
Extra 19 represents the saving from adjusting the original price by inflation to calculate tax on the <i>real</i> gain		0	0	19

To keep it simple, this example does not show the impacts of interest and other costs related to the asset.

NOTE: Tax is calculated on the 'money' gain (shown shaded above) only to illustrate the difference between tax paid on a 'money' gain vs. tax paid that is adjusted for inflation.

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		LOSS	BREAKEVEN	PROFIT
TAX PAID ON EXPENDITURE				
Income (paid Gross)		1,000	1,000	1,000
Money in Bank at the Start		1,000	1,000	1,000
PURCHASE of ASSET out of PRE-TAX INCOME				
Original Purchase Price		750	750	750
Tax Paid upon Purchase	33.33%	250	250	250
Re-Sale Price		500	750	1,750
TAX REBATE				
- Rebate calculated based on tax paid (adjusted by inflation)	10.00%	275	275	275
- Rebate calculated by applying the rate to re-sale proceeds	33.33%	167	250	583
Tax Rebate Paid (Lesser of the two rebate calculations)		167	250	275
NET PROCEEDS AND REBATE – WHEN SPENT				
Proceeds from Re-sale		500	750	1,750
Tax Rebate		167	250	275
Gross Proceeds from Sale and Rebate (Money in Bank)		667	1,000	2,025
Tax payable on Expenditure	33.33%	167	250	506
Net Available Expenditure at End (after Inflation)		500	750	1,519

THE NET EXPENDITURE IS THE SAME AS AFTER-TAX CASH AT BANK WHERE TAX IS PAID ON INCOME

5.12 Treatment of Business Income and Expenditure

All Income and Sales Proceeds would be received tax-free into the business bank accounts.

Business would pay tax on all expenditure (including wages, fees and interest) as the money was withdrawn from their accounts. They would not expense the tax - as businesses are designed to add value, not consume value. That is, all tax would be capitalised as an asset.

Business (including sole traders) would recoup tax paid on its cost of sales based on their normal trading accounts (similar to GST, but adjusted for inflation). Tax paid (adjusted for inflation) in respect of losses would be immediately re-couped based on the cost of sales. All remaining tax would be recouped upon liquidation of the business (adjusted for inflation – to maintain its real value).

As now, business would be required to comply with the law to ensure no illegitimate rebates were claimed to evade tax payable by individuals associated with the business. Business accounts would be subject to tax audit for this purpose.

5.13 Treatment of Payments that are not for Consideration

Gifts or bequests of money, as well as share subscriptions and dividends and profit distributions, and any part of superannuation contributions and insurance premiums that

represent 'saving', and all superannuation and insurance payouts, and any other *payments that are not for consideration* also need to be adjusted. The reason is that such payments do not represent consumption of a resource, but merely transfer of purchasing power.

Double taxation could be avoided by simply allowing a payer to make the payment tax-free; enabling the payee to pay tax when the proceeds of the payment are spent. The difficulties with this approach are that: a) it would create an 'exception' to the rule that tax is payable when money is withdrawn from a bank account, and b) the different tax rates of the parties involved (where their place of residence is different) would complicate the payment.

The consistent solution is for the payer to pay tax (at their rate) on the payment as normal when the money is withdrawn, and for the payee to receive a tax credit (at their rate) when the advance is banked. This has the same effect as if the payment was tax-free. The *payee* would then pay tax (at their rate) - as they withdrew the money from their ADA to pay for assets, goods and services.

The aim would be to integrate any rebate into the payments system using a simple 'code' to make rebates easy to identify, process, and audit. See section 5.24.9

5.14 Treatment of Tax on Loans and Borrowings

The following explanation is illustrated in Table 3 on page 20. When a person makes a loan, they are not consuming resources. They are simply transferring purchasing power to the borrower. Consumption takes place when the borrower spends the proceeds, so it is the borrower who should pay the tax as they spend, and not the lender. Repayment of capital should be tax-free for the same reason.

However, if the loan (and repayments) were to be made tax-free; in the move to UniTax, adjustments would have to be made to both the principal and the interest rate. This would be required to ensure neither the lender nor the borrower were disadvantaged in the process. This would be impossible to manage given the global financial market.

As with other payments that are not for consideration; it is simpler and more consistent for the lender to pay tax (at their rate), by having the tax withdrawn from their account at the same time as they make the loan; and for the borrower to be given a credit for tax (at their rate) upon receipt of the proceeds. This is the same as if the loan was made tax free.

The borrower would receive the rebate whether or not the lender was an Australian Resident. They would then pay tax as the proceeds were withdrawn for spending. The borrower would also pay tax (at their rate) on any repayment of capital.

As the loan principal is repaid, an Australian lender would get a credit on the tax equal to the repayment times their expenditure tax rate. So, when the loan was fully repaid, the lender would get their capital *and tax* returned in full. This is appropriate as, in making the loan; they have not consumed any resources. It makes no difference if an Australian lender

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makes a loan to an Australian Resident or to a Non-resident; they would pay tax as the loan is made from their bank account; and receive a credit for tax on any repayments.

An overseas lender would advance the loan net of tax also. A foreign lender would get no tax credit on capital repayments unless they paid tax in Australia. Overseas borrowers would receive the net proceeds from an Australian Lender; and no tax credit – as now.

This approach allows for different tax rates (or none at all) to be applied to the lender and the borrower, depending upon their place of residence (including overseas), both in making the loan and in making repayments of capital.

Interest would be taxable as normal income for the lender, and as a normal expense for the borrower – with all tax applying only as money is withdrawn from a bank account.

Withholding Tax (at the UniTax rate) would apply to interest earned by overseas entities.

Table 3 Comparison of Tax paid on Income vs. Tax paid on Expenditure for Loans and Borrowings

		Borrower Investor/Business	Borrower Individual
TAX PAID ON INCOME			
AUSTRALIAN LENDER			
Income of Lender (Before Interest on New Loan)		2,400	2,400
Tax on Income	25.00%	600	600
Cash at Bank Pre-loan		1,800	1,800
Loan		1,800	1,800
Cash at Bank Post-loan		\$0	\$0
Interest on Loan for One Year			
	10.00		
	%		
Interest on Loan for One Year		180	180
Tax on Income	25.00%	45	45
Net Income of Lender		135	135
Capital Repayment at the end of Year		100	100
After-tax Cash at End of Year		235	235
AUSTRALIAN BORROWER			
Loan from Lender		1,800	1,800
Net Expenditure by Borrower		1,800	1,800
Net Cash After Spending		\$0	\$0
Income of Borrower (Pre-interest)		1,180	1,180
Less Interest for Investor/Business Loan		180	0
Taxable Income of Borrower		1,000	1,180
Tax on Income of Borrower		250	295
Net Income (for Individual)			885
Less Interest (for Individual)			180
Net Income of Borrower After Tax		750	705
Less Capital Repayment		100	100
Net Cash at End of Year		650	605

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		Borrower Investor/Busines s		Borrower Individual
TAX PAID ON EXPENDITURE				
AUSTRALIAN LENDER				
Income of Lender (Before Interest on New Loan)		2,400		2,400
Tax paid when Loan Made (as % of Loan)	33.33%	600		600
Disposable Cash at Bank		1,800		1,800
Loan		1,800		1,800
Cash at Bank Post-loan		\$0		\$0
	10.00			
Gross Interest on Loan for One Year	%	180	#	180
Tax on Interest when spent by Lender	33.33%	45		45
Net Income of Lender (after spending)		135		135
Capital Repayment at the end of Year		100	#	100
Tax Rebate on Capital Repayment	33.33%	33	#	33
Gross Cash (Gross Interest + Capital + Rebate)#		313	#	313
Tax when spent	33.33%	78		78
After-tax Cash at End of Year		235		235
AUSTRALIAN BORROWER				
Loan from Lender		1,800		1,800
Tax Rebate on Loan	33.33%	600		600
Total Available to Spend		2,400		2,400
Tax Payable on Expenditure	33.33%	600		600
Net Expenditure by Borrower		1,800		1,800
Net Cash After Spending		\$0		\$0
Income of Borrower (Pre-interest)		1,180		1,180
Less Interest		180		180
Less Tax on Interest	33.33%	60		60
Sub-Total		940		940
Plus Business Rebate of Tax on Interest		60		0
Less Capital Repayment (^ not inc in sales cost)		100	^	100
Less Tax on Repayment (^ 'rebate' given upfront)	33.33%	33	^	33
Gross Cash After Capital Repayment and Interest		867		807
Tax on Expenditure	33.33%	217		202
Net Cash at End of Year		650		605

The coloured rows compare the same line item under the different scenarios: a) Tax paid on Income, and b) Tax paid on Expenditure, showing the results are identical.

5.15 Transfer of Assets without Consideration also Tax-free

When an asset is transferred to another party without consideration (in the form of a gift or bequest); the donor would be able to transfer (to the donee) any entitlement to the tax they paid when they (the donor) acquired the asset (as well as the date of purchase). If the donee later sold the asset, they would be entitled to recover the same tax (as if the donor had sold it). Again, this avoids double taxation, while ensuring any real gains on the asset (since it was acquired by the *donor*) are taxed when realised and spent.

5.16 Charitable Donations may be made Tax-free

Under section 5.13, charities may receive gifts and donations tax-free from the donor. This is the same as making such gifts deductible in the current system.

5.17 Certain Charitable Expenditure may also be made Tax-free

In addition, a charity could have a specific ADA made tax-free. This would mean no tax was paid whenever money was withdrawn from the account. This would require close audit to ensure the monies were only spent for defined 'charitable' purposes. For example, the law should ensure that money spent on a lavish lifestyle for the 'administrators' would not be exempt and would have to be paid from a normal taxed account.

This would provide improved control over charities.

While making an account tax-free for charity is possible, it represents a subsidy by taxpayers to the objects of the charity. The relevant proportion of the subsidy should be reported as such in each government's accounts - so everyone can see the nature of the activities that are being supported.

5.18 Foreigners would pay no Tax on Australian Goods and Services

Foreigners would benefit from all prices being ex-tax... a boon for tourism and export.

However, foreigners buying appreciating assets (such as property, or collectibles and interests in Australian based businesses) would have to register with the Tax Office and have the details of the purchase recorded. This is to ensure Australian Tax is withheld on any real gain upon re-sale – subject to international treaties.

5.19 Tax no longer a Factor in Decision Making.

As UniTax would be applicable equally to all expenditure (including for assets) with rebates to avoid double taxation and to adjust for inflation; UniTax would no longer be a factor in decision making by individuals or business to give, invest, trade or work.

5.20 Some Other Levies and Direct Charges would continue to apply.

These include levies and excise designed to alter buying patterns for social reasons (eg to limit alcohol consumption, smoking, gambling, etc). Ideally, the levies should reflect the true social, economic and environmental costs arising from the behaviour; with the levy only going to pay for mitigation of the adverse effects of the targeted behaviour.

As well, other levies would be appropriate for national superannuation, health and disability insurance.

Fees could also be charged for government services (eg. land or port administration); as well as royalties and licence fees for access to national resources (eg. rights to minerals, water and telecommunications spectrum, etc.); regulatory charges (eg. companies and banking, etc.); fines (eg. speeding); and tariffs... *or any other charges where there is a direct link with the activity being managed.*

5.21 Universal Rebate

This Rebate would be paid in weekly instalments into the nominated ADA for every Australian Resident over 15. Its purpose is to turn the flat rate of tax paid on expenditure into a progressive tax on income – as per Table 1 on page 4.

Because it would be payable regardless of any other circumstances, and because the same rate of tax would apply to every extra dollar earned (25% of Income = 33.33% of Expenditure), there would be no disincentive to give, work, invest or trade.

See also Appendix I (section 10) which details a novel way to fund the rebate as a 'National Dividend'. Essentially, it is similar to Quantitative Easing. But, instead of creating new money to buy securities, new money would be created to recognise the additional value inherent in our collective capability to produce more with fewer people in the process - as computers and robots automate the supply chain. The Appendix shows how this additional value can be unlocked without impacting inflation, or creating labour shortages.

UniTax does not depend upon payment of a National Dividend. The weekly rebate could be funded via the tax system, though it would require a higher rate or lower rebate.

5.22 Role of Local, State and Federal Treasuries, Tax Offices and ADTI's

Each Local, State and Federal Treasury would set their own rates to raise the revenue they require based on transactions made by their residents.

The Federal Tax Office would set the rules for rebates based on UniTax philosophy and operating procedures. It would also operate the whole system on behalf of the States and Local Government – like the GST. This will ensure common administrative processes.

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ADTI's would act as the collection and payment agents. Each ADTI would automatically deduct and remit Tax to the Tax Office in each jurisdiction based on their customers' place of residence in accord with the rates specified by the relevant jurisdictions.

Any rebates calculated to be due to a taxpayer would be remitted by the Federal Tax Office to the taxpayer's ADA and charged to the relevant jurisdictions, based on their respective tax rates.

This would standardise the collection process and streamline administration, while leaving each Treasury in control of the amount raised on their behalf – unlike the GST.

5.23 Tax Audit

The Audit function would be much more effective and less costly than now:

- the rules would be very simple, and would apply across all jurisdictions
- all transactions would go through the one bank-tax system, with only 2 exceptions
- the exceptions would be cash and foreign transactions
- there would be no need to audit individuals (apart from rebates claimed), and
- all business would be audited on the basis of normal trading accounts

The primary focus of the audit would be *rebates* claimed, for:

- Business: On all Inputs charged against Sales
- Asset Sales: Appreciating and Non-Appreciating
- Loans: Advances and Principal Repayments
- Payments not for Consideration

As well, audits would be carried out on cash and foreign transactions; including making 'test' cash transactions to confirm a tax receipt is issued and reported to the Tax Office (refer section 5.24.10).

The Federal Tax Office could outsource its audit function to the States and Local Governments concerned. This would ensure the jurisdictions remained connected with their taxpayer base.

5.24 UniTax Rules

To give effect to UniTax, certain rules would need to be enacted. The following list is not exhaustive. It covers the principal requirements only. They are listed to illustrate the scope of legislation required, which is a fraction of the tax regimes it would replace. The actual rules will need to be set by the taskforce charged with UniTax's implementation. The final rules will need to be closely reviewed for internal consistency; and to ensure the system is as simple as possible.

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5.24.1 General

1. All prices to be quoted ex-UniTax.
2. Each Jurisdiction (Local, State and Federal) to nominate the tax rate applicable to their constituents.
3. Place of Residence of each Resident to be determined on the facts.

Governments are currently looking to improve National Addressing. It would be ideal to have single place where your current details can be securely held, which then allows you to give access to everyone who needs it. Perhaps the bank could be the place that also holds your address? So when you move, you can just tick the organizations and people you want to be automatically notified of your change of address... as happens in Denmark. This would ensure correct tax was deducted based on your place of residence whenever you move – with very little administration.

4. All other taxes to be scrapped, except for levies and charges where there is a direct link with the service being delivered (eg port administration), or activity being managed (eg alcohol consumption).

5.24.2 Australian Deposit Taking Institutions

5. Identify all Australian organizations into which payments must be made for UniTax, namely: [Australian Deposit Taking Institutions \(ADTI\)](#).

5.24.3 Australian Deposit Accounts (ADA)

6. Every Resident to have at least two associated ADAs into which all payments due to them must be made: one representing disposable income; and one from which tax is paid and rebates received. Payments received to be split between ADA's based on income tax rate. Tax rebates to be paid into the tax ADA.

Having two accounts simply makes it easy to know how much you have to spend on assets, goods and services, without needing to work out your net cash position.

7. Each business to have at least two ADA's in each State where they operate - one for spending, and the other for payment and recovery of tax. The reason is to ensure that trade in each State is correctly accounted; so the correct tax is paid within each Jurisdiction.

Business accounts must be separate from private accounts.

8. No ADA can be set up without the tax number of the resident, non-resident, or business being registered - to ensure each account is associated with a unique taxpayer.

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9. A taxpayer may have many accounts - so long as their tax number is associated with each account.
10. Taxpayers who have joint accounts, but reside in different jurisdictions, would have tax deducted depending upon which of the joint account holders instructed the payment to be made.

5.24.4 Government Bank Accounts

11. All government bank accounts (Local, State and Federal) would be tax-free

5.24.5 Charities Bank Accounts

12. Designated accounts would be tax-free

5.24.6 Payments and Receipts via Australian Deposit Accounts

13. Unless paid in cash (dollar notes or coins), or via credit, or to foreign entities; all Australian sourced payments are to be paid by the payer from their own ADA into the ADA of the payee via the bank-tax system.
14. All payments *into* ADAs to be made gross. This includes sales proceeds, sole trader profit, wages, fees, rent, royalties, interest, dividends, proceeds of asset sales, insurance payouts, superannuation benefits, gifts, etc.

5.24.7 Payment of UniTax

15. All ADTI's would be obliged to deduct UniTax (at the expenditure tax rate) from a 'tax holding' ADA upon *any withdrawal* from a related 'disposable' ADA, as and when made.
16. The tax deductible from each account to be the sum of the rates of the applicable jurisdictions (Local, State and Federal).
17. The ADTI to immediately remit UniTax deducted, to each jurisdiction based on their specified tax rates.
18. Residents to make arrangements with the Tax Office to ensure that tax is paid on non-Australian income in accord with international treaties and their specific circumstances.
19. Non-residents to make arrangements with the Tax Office to ensure that tax withheld on Australian income, or deducted on expenditure in Australia; is adjusted in accord with international treaties and their specific circumstances.

5.24.8 Business UniTax

20. All businesses to lodge their full trading accounts with the Tax Office showing sales and cost of sales and tax paid and recovered - by State - reconciled to their bank accounts and to their balance sheet. The more accounting is automated (especially in the cloud) the easier this will become... as the tax rules are simple and clear.
21. A business would be able to transfer gross income from the business (tax-free) to the owner who could then spend it (and pay expenditure tax on it like everyone else).
22. Tax paid on losses would be rebated as the loss is incurred. As an example, say I create \$100 value and spend \$75 on inputs and pay \$25 tax. If I subsequently get nothing for my \$75 investment, it means I have lost \$75 value. So, over the period, I will have added only \$25 (100-75). If I have added \$25, I should be able to spend \$18.75 and pay tax of \$6.25. This will happen automatically if I get a full rebate of the tax paid in the business as the loss is incurred. Under this rule, the timing of the profits and losses is irrelevant for offset. It could be a week or years.

UniTax is designed to take into account the *net* value accumulated over the whole life of the business – whatever the timeframe. The period only becomes relevant in terms of calculating the impact of inflation on the rebate... to ensure the *real* value of the tax paid is recovered - as sales are made, or the business is liquidated.

23. Based on current experience x industry sector, the Tax Office may specify amounts considered to be drawings by the owner (eg food taken from a restaurant) – just as they do now. These ‘drawings’ would be treated as purchases by the owner and no tax rebate would be made to the business.

Without a rebate, the tax paid by the business would become tax paid by the owner. It would be as if the business had distributed the income tax-free, and the owner had purchased the goods at cost and paid their own tax.

24. A business could provide a discount (down to cost) for people associated with the business in relation to goods and services supplied to them. Tax would be payable by the purchaser on the discounted price. Below cost, no tax would be rebatable to the business.
25. Auditors and all concerned in the management of the affairs of an operating trust, or company, or sole trader, or any other business, must satisfy themselves that:
 - Appropriate tax had been paid and rebated based on the company’s accounts and in accord with the Tax Act.
 - All assets are being utilised solely for the benefit of the business; and no assets are being utilised at under market value by third parties/associates of the business

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- That all goods and services are sold or performed at market rates – except for staff discounts that must not be below cost.
- No rebates are claimed on 'expenses of a private nature' charged to the business
- All transactions reportable for tax purposes are reported to the Tax Office and where appropriate tax remitted, eg in the case of cash payments, or sales on extended terms, or foreign transactions, etc.

5.24.9 Rebate Codes for Tax paid on: Assets, Loans and Payments 'Not for Consideration'

26. The main codes to be defined for:-

- A = Appreciating Asset
- N = Non-appreciating Asset
- L = Loan
- R = Repayment of Capital
- G = Not paid in Consideration

Additional detail to be decided. This could include:

For Appreciating Assets: P = Property, C = Collectible, B = Goodwill, S = Securities

For Non-Appreciating Asset: E = Expendable Consumer Good, V = Vehicle

For Non-Consideration: B = Bequest/Gift/Donation, S = Superannuation, etc

This extra level of detail could help in gathering useful economic data x jurisdiction (down to municipal level) - based on residence.

27. All payments that entitle the taxpayer to a rebate would need to be recorded on-line via the bank-tax system as the payments are made and received. The data would include: amount, date and code.

As far as possible, the codes should be assigned automatically via the bank-tax system using data from the transaction itself. This may require some change to business and credit card software to make the process seamless.

28. The bank-tax system would also need to assign a unique number to any rebatable transaction and keep a complete record of all such transactions - making it straightforward to trace and claim a rebate of the tax paid on any rebatable item at any time in the future.

5.24.10 Payments and Receipts in Cash (Notes and Coins)

29. As and when cash is withdrawn from an ADA, the bank-tax system will issue a tax receipt to show that tax was paid on the withdrawal. This receipt will be recorded permanently in the system and can be used to later claim any rebate.

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30. Dollar notes would cease to be legal tender for transactions over \$1,000 and all such transactions would be prohibited.

This prohibition may be irrelevant by the time the system is implemented, as all currency may be digital by then. As and when this happens, digital wallets will be able to keep track of tax paid. See section 5.25 for discussion regarding Digital Currency and Tax Evasion.

31. Any business that deals in cash (paper or digital) must have a system to issue a tax receipt for cash received. The system must connect electronically to the Tax Office. With smart devices connected to the internet, this requirement should not be onerous. Likely, many 'apps' would become available to provide the required functionality.
32. All business cash receipts (notes and coins) to be deposited in the business ADA within (say) 48 hours, or longer for remote locations.
33. If income payments (eg wages, fees, drawings, dividends, etc.) are made in cash, UniTax must be deducted and remitted to each jurisdiction based on the residence of the payee. This would have to be done by the payer. The payer would be required to obtain a tax receipt via the bank-tax system, for issue to the payee. This would be evidence that the payee had paid their tax on the cash income.
34. When purchasing assets for cash, the vendor will want proof of sale to obtain a rebate of the tax they paid when they purchased the asset. The purchaser will likewise want it to record the tax they paid when the money was withdrawn from their ADA (so they can get a refund if/when the asset is on-sold). This would include all second-hand goods. The market will create the software that interfaces with the bank-tax system to make this a simple process. Otherwise, the parties will have to obtain paper receipts and make a manual claim.
35. Similar interests will drive lenders and borrowers and payers and payees in transactions that are not for consideration to want the transactions receipted for tax purposes – so they can get the rebates they are entitled to.
36. By the time the system is implemented, there will be little reason (other than attempted evasion) to want to use cash.
37. At some point, it will be simplest and least costly to use digital currency exclusively and cease issue of notes and coins. [IBM is already working on the creation of a digital-currency \(using block chain technology\) to replace each national currency under the control of each Nation's Central Bank.](#)

5.24.11 Payment using Credit

38. Systems used to pay for assets, goods and services on credit will need to be modified to capture the code for the type of payment. Ideally, these codes should be captured from the vendor's software upon sale (as part of the product data); or may be entered manually by the vendor and confirmed by the purchaser when they make the purchase. This is required to ensure tax paid is able to be rebated, if appropriate.

As there are only five principal codes, it should not be onerous (more detail would require the system to present a menu tree).

The likelihood is that in future AI systems will be able to determine the code from the product/service description in the vendor's software without additional coding.

39. A credit provider is a 'lender'. As such, they would have to pay tax (at their rate) on the payments made to vendors. This would be added to the debt due by their customer - ensuring tax is paid as assets, goods and services are acquired.

When the customer pays back all or part of their credit balance (out of their ADA), tax would be paid (at the customer's rate). At the same time, the tax would be rebated to the credit provider (at their rate) - upon receipt of the payment. This rebate would reduce the debt due by the customer, as if they had made the payment direct.

The tax paid by the customer would be allocated in proportion to each of the items on the credit statement. This is to ensure potential tax rebates (ie for assets, such as a fridge) can be readily identified when required. It is expected that software would be provided by the market to meet this requirement.

5.24.12 Credit provided by Vendors

40. Tax would be paid by the purchaser as and when the goods are finally paid for via their ADA.

To avoid vendors offering extended terms as a 'costless discount' (due to deferred tax), we may have to make specific arrangements for 'vendor credit'. This could include:

- a requirement that vendors must obtain the tax number of people using extended credit longer than (say) 90 days.
- upon sale on extended terms, the vendor must notify the Tax Office of the tax number of the customer and the date and amount of purchase and amount outstanding, and of any payments. This could be automated.

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The Tax Office would then issue an electronic demand for interest due on the outstanding tax. The bank-tax system would automatically deduct the interest due from the purchaser's tax ADA. Details of the processes and software would need to be developed to make them as seamless as possible, while limiting avenues for abuse.

5.24.13 Returns and Credits

41. Adjustment would need to be made to the tax paid by the customer, and the business rebate, when the payment was credited for returned goods or refund for poor performance (with appropriate code and transaction references recorded). Again, this should be capable of automation via the bank-tax system and business software.

5.24.14 Payment of Rebates

42. All Australian Residents over 15 to receive the same weekly rebate. See section 10 for a novel way to set the amount; and to fund this rebate
43. The payment of the weekly rebate would not be taken into account in determining entitlement to Government benefits; providing a significant supplement (in relative terms) to welfare recipients and low paid workers - boosting their spending, which would lift the economy.
44. Tax would be rebated on the re-sale of all assets at a rate which is the lesser of:-
 - a) tax originally paid increased by inflation over the period of ownership, and
 - b) the expenditure tax rate times the sales proceeds.
45. All Australian borrowers to receive a rebate of tax (at their rate) - upon receipt of the loan proceeds - equal to the expenditure tax rate times the proceeds.
46. All Australian lenders to receive a rebate of tax (at their rate adjusted for inflation) upon receipt of any capital repayment.
47. All Australian payees in receipt of a payment that did not represent consideration to receive a tax rebate (at their rate).

5.24.15 Foreign Transactions

48. All foreign visitors would buy goods and services in Australia tax-free.
49. Foreigners buying any appreciating asset in Australia (eg property) would have to open an ADA in Australia to make the purchase and pay their tax. They would get this tax rebated (adjusted for inflation) when the property was sold.
50. No purchase or re-sale of registered property by a foreign entity (or anyone else) could be registered until the appropriate tax was paid.

51. Where the payee is a Resident, all Australian sourced income payments made into overseas accounts are to have tax withheld in the name of the payee and remitted by the payer to each relevant jurisdiction.
52. If the payee of Australian sourced income is foreign, tax would also be withheld and information on the payment and payee to be remitted to the Federal Tax Office via the bank-tax system. The tax paid would be adjusted in accord with international tax treaties and the circumstances of the parties and payments (as now).
53. If the payer is foreign, any payments made to Australian Residents must be made into an ADA, or details of the payment must be reported to the Tax Office (by the payer and payee) and appropriate tax paid in accord with international treaties.
54. Importers would pay tax on imports as they withdrew money to pay for them, with the full amount rebated as and when the imported product was sold (as a unit, or as part of another product), ie as a rebate on 'cost of sales'.
55. Exporters would receive export income as now, and be able to claim a rebate of tax on the cost of sales. So it would make no difference from a tax viewpoint whether sales are made in Australia or to an overseas party.

5.25 Digital Currencies

The rise of Digital Currencies is a problem whatever tax system is in place.

The principal purpose of money is not as a medium of exchange. It is to record the value a person has contributed (through their labour, wit or investment) in producing assets, goods and services.

The money is simply the agreed record that entitles them to take out what they have put in (as they spend). Money becomes the 'medium of exchange' only at this point.

The key requirement is that the money-record has a 'fixed unit of account'. If the 'record' was to vary over time there would be a miss-match between what a person contributes (and is paid for) and what they can consume (when they spend).

If we are going to continue to use money for its principal purpose, all digital currencies must have a fixed unit of account and be brought into the banking-tax system.

Bitcoin and its ilk are not an acceptable form of digital money for two reasons:

- the value of bitcoins varies greatly over time, and as importantly
- the creation of the coins provides its creators with an 'unearned' right to society's resources; *simply for spending a bit of money on computing power to 'mine' (create) the 'coins'*. This is just the same as a counterfeiter spending money on paper, ink, plates, printing press and distribution to get an unearned right to resources - when people are fooled into accepting their fake money.

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This breaches two fundamental principles:-

- a) that you should be able to take out only what you put in, and
- b) that you should also pay tax on any gain.

Both the 'counterfeiter' and the 'miner' get to consume without contributing and also pay no tax on their ill-gotten gains.

It is irrelevant that the coins/counterfeit notes are used in valid transactions after they have been created... the fraud is in their creation and use by the counterfeiter/miner, not in their subsequent use by other parties.

The problem is discussed in more detail in the Appendix II (section 10): "Why Bitcoins (and their ilk) are a Really Bad Idea".

The ideal would be to create a national digital currency. We would then have three types of 'money records': metal (coins), paper/plastic (notes) and electronic (digital). Very quickly, we would all end up using the digital currency as it would be equivalent to cash, with the benefits of electronic transfer.

If we move from coins and notes to digital, we can also "Eliminate Moral Hazard from Banking and Stabilise the Financial System." How is discussed in Appendix III (Section 12).

A recent article in Reuters references a [proposal by IBM to use similar technology as Bitcoin](#) (but applied to fiat currency); which is in line with the proposal in Appendix III. Despite concerns in the Reuters article that banks may no longer be needed; banks would still be required to manage the process of allocating new money as loans. As well, UniTax provides a strong value proposition for an on-going role as society's 'tax-collector'.

5.26 LETS, Barter and the Sharing Economy

Where goods and services are exchanged for money, the buyer must pay tax. In most of the following situations, this is not the case.

LETS stands for [Local Exchange Trading System](#). LETS keep a 'record of account' of 'value contributed' and 'value consumed' by members of a (local) community as they trade goods and services using an arbitrary unit of account that is centrally managed by the LETS operator. For the most part these are 'business to business' or 'service provider to service provider' schemes. An example is [Bartercard](#).

Barter involves the direct exchange of goods and services and can include both business and private exchanges. It would include payment in precious metals or other commodities or collectibles.

The Sharing Economy takes two forms:

- In one form, people simply offer their goods and property for use by other people, for a monetary fee. Examples are: [Airbnb](#) and [Uber](#).
- In the other, people put goods into, and take goods out from, a pool, eg: [TuShare](#). This is different from barter, simply because there is no direct exchange.

In the case of Airbnb and similar services (that use *money* to pay for the goods or services provided), they are just like a normal business. In this case, it would be in the interests of the providers (eg home owners or drivers) to register their business, as they would get back the tax they have paid on the costs of running the business.

In all other cases, there is no monetary exchange. The implications are discussed below.

5.26.1 Exchange of Goods and Services for LETS Units

In order for society to function fairly and efficiently, all LETS schemes should be required to be registered with the Tax Office; with a formal exchange rate set against the national currency.

Where the LETS operate nationally, it would be reasonable for tax to be paid in national currency.

Where the schemes are local (eg [Bristol's LETS](#)), tax could be paid in LETS units to the local municipality. It would enable local communities to drive local business and engage the local community using their own currency... which is the whole purpose of LETS.

Regardless, it will require similar regulation to ADTI's to be effective, with similar systems for data exchange. As these schemes grow, similar prudential regulation will also be required to ensure people contributing to the scheme are not defrauded by people 'taking out' and not 'putting in'.

The 'takers' will need to be seen as 'debtors', with their LETS debts just like any other.

5.26.2 Exchange of Goods Directly or via a Pool

As most goods traded (bartered) are non-appreciating assets, the tax paid by the buyer would be the same as the tax rebated to the seller. Hence, such transactions would have no net impact on overall tax receipts.

Under UniTax, registered property must have UniTax paid to be registered.

Given these two conditions, this category of non-monetary trade should not pose a major problem.

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If the rich want to trade gold for jewels, it would have very little effect on the real economy, while exposing them to prosecution if they were operating a business (say selling jewellery) and not declaring the sales. Just like now.

Under UniTax, the incomes of the rich will need to be paid into ADA's (tax-free) like everyone else. And like everyone else, they will pay their fair share of tax (at the same rate as everyone) when they withdraw money to buy gold (or jewels) to trade.

The system will not be perfect. But it does not have to be. It just needs to be simpler and more effective than the current system.

Ultimately what matters is the after-tax income. With everyone paying the same rate, relativities between all people remain the same.

While the flat rebate would also be the *same for everyone*, it would have greater real benefits to the poor, which is as it should be.

5.26.3 Exchange of Goods and/or Services for Services

Under UniTax, services result in the creation of value that ought to be shared via tax when the money received (for the value created) is spent to consume resources.

When services are bartered for goods, it would be in the interests of the 'seller' of the goods to collect the tax rebate they are entitled to upon sale of the goods. They could do this by asking for the tax from the service provider. This would become part of the 'price' imputed to the services to be provided in return. That is, the service provider would have to contribute services equal to the value of the goods and the tax rebate. Otherwise the seller would be missing out on their tax rebate.

The problem is how to tax services that are bartered. In effect, anyone providing bartered services avoids sharing with the rest of society; though they have the same moral imperative as everyone else to share with those 'outside' the production process; and, as they benefit from the services that society provides, so they should share in the cost of providing those services via tax.

While individuals could avoid paying tax by bartering their services; it is difficult to see how such 'barter' could be pursued on a large scale without some form of 'unit of account' being used: if I mow your lawn, and you agree to cut my hair... how many hours of lawn mowing equal how many haircuts?

As soon as 'units of account' are used, the scheme would essentially become a new LETS.

From a tax viewpoint, while such schemes add some administrative complexity, if the UniTax rules are the same across all schemes, and are simple for everyone to

understand, it should be much easier and less costly to bring LETS into UniTax than to incorporate them into the current system.

For the rest, we just have to acknowledge that no scheme is perfect and that there are many occasions where services are rendered either for no exchange (just doing a good turn for a neighbour); or where the exchange is just people helping each other out. The fact that these transactions are not taxed should not be seen as a major impediment to the adoption of UniTax, as they are already outside the tax net.

5.27 Evasion of UniTax

5.27.1 Responsibility for Payment of UniTax

All company auditors and officers and external accountants would be obliged by law to ensure correct tax is paid in all transactions. Given the simple rules and systems available, this would not be an onerous responsibility.

On the other hand, this simplicity would also make it very hard to argue against any charge of evasion where tax was not paid as required.

5.27.2 Heavy penalties to apply for UniTax evasion

As the rules are simple and apply to everyone equally; penalties for evasion should be very high and attach not just to a 'business' but also to the officers and contractors (accounting and legal) who are in a position to ensure tax is paid correctly.

5.27.3 Intensive Data Analytics to Identify Anomalies

With the depth and breadth of data available for all transactions via the bank-tax system, it will be much easier to identify anomalies for close audit.

5.27.4 Focus of Tax Audit on Rebates and Cash

Without the need to audit personal tax returns, or the need to interpret complicated rules, Tax Office resources can be focussed on the payment of rebates (business and personal) as claimed, as well as the cash economy and foreign transactions. This is a much more focussed exercise than under the current system and should act as a much stronger deterrent.

5.27.5 Simple Prosecution

Simple rules would make prosecution straightforward.

5.27.6 Shifting Income and Costs between Jurisdictions

Businesses that operate nationally with stores and branches in a number of jurisdictions could engage in illegal cost and income shifting to the lowest rate jurisdictions.

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However, this should be minimal given that all tax paid by business would be rebated in full (adjusted for inflation) in any case. In these circumstances, cash flow is the only incentive. With strong audit programs and heavy penalties, this should not be a major problem.

5.27.7 Registered Property

Before the transfer of any registered property (such as real estate or cars) was registered, the purchaser would have to provide proof that UniTax had been paid, making evasion difficult in these cases. Cash could always be used illegally to make part of a payment. However, such cash would have to have been earned illegally (without going through the bank-tax system) in order to avoid tax.

5.27.8 Cash Receipts and Payments

Under UniTax no sales over \$1,000 could be made in cash.

The incentive for a business to accept cash (and not declare it); is that they can pay their workers less by paying them in cash. The workers then use the cash to buy goods without ever banking it, and thus avoid paying tax - a 'win' for both the business and the worker.

As well, small business owners could do the same for themselves, never banking the cash, and so never paying tax on their cash incomes.

However, it is already illegal to pay or be paid in cash without declaring it – so we are no worse off.

We would be better off.

First, because all UniTax paid by a business would be rebated in full (adjusted for inflation), there would be much less incentive to try to evade tax.

Secondly, there would be a number of disincentives:

- The penalties would be significant compared to the benefits of dealing in cash and not paying tax.
- With a simplified system we would have better data on each business and all bank transactions, and could devote more resources to identifying the evaders
- As everyone else would be under the same simple rules, there would be much greater incentive to report businesses that fail to comply.
- The simple rules would make a successful prosecution much more likely.

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- The additional complexity and cost required to use cash would tend to push business to not accept cash ([which they can now legally do](#)).

If income payments (eg wages, fees, drawings, dividends, etc.) are made in notes or coins, UniTax must be deducted and remitted to each jurisdiction based on the residence of the payee. This would have to be done by the payer. The payer would be required to obtain a tax receipt via the bank-tax system, for issue to the payee. This would be evidence that the payee had paid their tax on the cash income.

Any business that deals in cash must also have a system to issue a tax receipt for cash received. All business customers will want such receipts, as will consumers (for all goods and assets purchased) - to obtain a rebate where applicable. The system must connect to the Tax Office. With smart phones and other devices connected to the internet, this requirement should not be onerous. Likely, many 'apps' would become available to provide the required functionality.

This will make it possible for the system to be easily audited by doing a test 'buy' using cash – to test if the business fails to issue a receipt, or the receipt fails to be registered with the Tax Office.

Given all these circumstances, it would be much easier for most businesses just to bank any cash received and make all payments gross out of the business's own ADA and into the payee's ADA. This will ensure the payee pays their tax, while the business will get any tax it pays rebated when the cost is charged against sales – simple.

Any signs of growing abuse of the system (eg substantially increased demand for cash) would likely see the large proportion of honest taxpayers pushing for the uptake of digital currencies and a crackdown on the evaders.

5.27.9 Summary

While evasion is still possible, there are a number of factors that should mean a substantial reduction in the level compared with the current system:

1. It's simple to comply; complex to evade and easier to be caught if you do
2. Everyone treated the same – so most people will want to see everyone comply
3. Prosecution would be simple and heavy penalties would apply
4. Business would not expense tax, and all profits would be paid from any business tax free; reducing incentive

5.28 Transition Arrangements

5.28.1 Shift to UniTax like switch from Imperial to Metric

While UniTax entails a great deal of system change, it should be easier than the switch from imperial weights and measures to metrics in the 1960's, as there are no machines to alter. It can all be done via legislation, and software that simplifies all business systems.

No doubt there will be many detailed arrangements to be made in the transition. The following list is indicative of the principal changes required.

5.28.2 Start Date for UniTax in Two Phases

The proposed date for implementation is 1 July, 2030. This allows 5 years to prepare and enact the legislation and ten years to develop the software and business systems; and to ready the transition arrangements before the system comes into effect. It also allows for education across all sectors about UniTax; and provides time for people impacted to make adjustments to their lives (See section 5.28.16 : Vested Interests)

It would be introduced in two phases.

The first phase would be a period of two years to establish correct UniTax rates for all jurisdictions. The second phase would commence on 1 July, 2032 when UniTax replaced all other taxes (other than levies and charges).

5.28.3 Establishing UniTax Rates

To start, it will be difficult to know for certain how much tax would be raised by each jurisdiction. To overcome this difficulty, in the first two years, the UniTax rate could be set to replace the GST only (around 4.8% of income which is around 5% on expenditure).

While all the tax raised would go to the Federal Government (for distribution in accord with then current GST arrangements); the data generated by the system would tell exactly how much came from each jurisdiction.

5.28.4 Jurisdictions to set their Own Tax Rates

At the end of the introductory period, each jurisdiction would have to set their own rates to raise the required income to balance their own budgets, allowing for levies and charges that would continue to apply.

5.28.5 Each Jurisdiction to Repeal other Taxes and enact UniTax legislation

The legislation to give effect to UniTax would have to be Federal, with complementary laws enacted in each jurisdiction (Local and State) to give effect to it nationally.

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Jurisdictions would also need to repeal their own tax laws on the effective date for full implementation.

Repeal of certain taxes should lead to a fall in prices where these are included in the price, eg payroll tax.

5.28.6 Tax Credits for Deposits and Assets Held at the Start of UniTax

At the time of introduction, all assets and cash will be 'tax paid'. To avoid double taxation:

1. every deposit account will need to be increased by the expenditure tax rate, and
2. a tax credit will need to be provided in relation to every asset equal to: its value (at the time) multiplied by the expenditure tax rate.

The extra cash would come from the Central Bank providing 'new money' (electronically) to credit each bank account. To avoid the increase in cash impacting the economy, the total increase recorded across all deposits would be paid back to the Central Bank as a proportion of tax receipts following the start of the new tax regime. This money would be written back into the thin air from which it came. Its sole purpose is to avoid taxing the cash twice.

Similarly in regard to assets, such as cars, property and consumer goods; it would be necessary provide a 'tax asset' that the owner can claim upon re-sale.

This will be a bit more complex and costly. It could be done in a couple of ways.

One way would be to construct 'valuation tables' for most assets that appreciate based on data available in the community (eg property rating data). These tables could be published several years prior to the introduction of the scheme, to allow people to appeal the valuation if it is less than 95% of the value they believe is correct.

Software can be developed to make this a relatively simple exercise... though there would likely be a boom in valuations in the years prior. This would be a 'one-off' expense and would be added to the cost of owning the property, so the tax credit would include this cost.

The second way would be simpler and perhaps less costly over all, though more open to abuse. In this case, each owner would be responsible for declaring the value of such assets – with audit by the Tax Office at the time of the transition.

In either case, owners would be obliged to list their appreciating assets at the time of changeover to the new system, in order to receive a tax credit.

Non-appreciating assets (such as second-hand consumer goods or vehicles) would not have to be listed. They would automatically attract a rebate equal to the sales proceeds times the selling price.

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The tax credit on appreciating assets would not be paid to the asset owner at the start. Instead, it would be recorded against their tax file number and if/when the asset was sold, it would be used to calculate the tax rebate then payable (adjusted for inflation from the start of UniTax). Again, this is to avoid double taxation.

5.28.7 Tax File Number

Every Resident over 15 would have to register to receive a Tax-file number, as would every entity (including foreign entities) doing business in Australia.

5.28.8 Australian Deposit Accounts

Every Resident over 15 and every entity doing business in Australia would also need to open two ADA's in each jurisdiction where they resided and/or did business.

Every ADA must have tax file number associated with it to obtain a tax rebate.

5.28.9 Rebate Codes to be developed

All rebate codes need to be developed, eg: N = Non-appreciating Asset, C = Collectible, P = Property, L = Loan, R = Repayment of Capital, etc. As far as possible, the data should be generated automatically via the bank-tax system using data from the transaction itself. This will require some change to business and credit card software to make the process seamless.

5.28.10 Accrued Tax Losses

These will need to be realised and rebated when the full rates of UniTax are applied in 2032.

5.28.11 ADA, Tax Office and Commercial Software

New Software will need to be developed to ensure the whole process of tax payment and rebate is seamless. This should not be a difficult exercise as the payment and rebate rules are very simple. It could also be developed by the market, once the rules of UniTax are clear.

5.28.12 All payments into ADA's to be made Gross on after Full Implementation

All incomes to be paid gross from the start date of full implementation of UniTax. Until then, the new system and UniTax would have to run in parallel.

5.28.13 Flat Rebate to be introduced gradually from Start Date

The flat rebate should be set to ensure the labour market remains in balance. As it is paid to everyone, at some point it will result in people deciding to cut back their hours of work, or opt out altogether. While there are too many people unemployed, this is

exactly what we want to happen. The aim is to increase the rebate slowly to reach a level of 'dynamic equilibrium' in the labour market. This is discussed in section 10.

5.28.14 Prices to be quoted ex-UniTax

All prices would be quoted ex-UniTax from the initial start date, with UniTax paid from ADA's at the rate sufficient to collect GST to start, before being increased to a rate to replace most other taxes x jurisdiction.

5.28.15 Government Benefits

All Government benefits will need to be assessed (and adjusted if necessary) to ensure no recipient is worse off after the introduction of UniTax. In making this assessment, payment of the flat weekly rebate must be ignored if it is paid as a 'National Dividend'.

5.28.16 Vested Interests

There are really two main groups:

1. Those who benefit from specific tax concessions:
 - Business
 - Personal
2. Those who make a living advising on, and administering, the current system:
 - Public (Federal, State and Local)
 - Private (Accounting and Legal)

The concerns of the first group can only be addressed by making the system clearly fairer and more efficient (less costly) overall. Inevitably, there will be winners and losers to start. However, as detailed in section 7 **Error! Reference source not found.**, the benefits for most people should far outweigh the costs. For example, business would be looking to keep their 'tax concessions', but since these only reduce their tax, they will be much better off overall under UniTax - as no business will expense any tax at all.

The second group is a much more difficult challenge; if the system is to be radically reformed. For they stand to lose not a few concessions, but their whole livelihood.

This problem is a more extreme form of managing a business closure. In 2002 Toyota undertook the then unprecedented step of giving its workforce 4 years notice of closure of its Port Melbourne manufacturing facility. This flew in the face of accepted wisdom which held that the shorter the time, the better... to ensure people remain on the job and to reduce the incidence of sabotage.

As it turned out, by respecting people, providing generous termination packages and giving people time to adjust and to re-train, it was recognised by the union as the best

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managed closure in Australian Industrial history... without a single incidence of sabotage, all KPI's achieved, and laughing and cheering on the last day.

Based on this experience, it is proposed to deal with 'vested interests', by targeting a start date for the proposed system of 1 July 2030.

This gives ample time to adjust. However, time alone does not deal with the issue of loss of livelihoods and businesses.

As the whole community benefits from a change to UniTax, it would be unreasonable to expect a small section to bear the brunt of the cost of making the change - especially when, up until the change, they have been delivering a valuable service.

To ensure support for UniTax from those adversely impacted, we could afford to make generous termination, business cessation and re-training payments for those still working in the system when the change is implemented.

These benefits can come from the first ten years savings that a much simpler and far less costly system will deliver for both the public and private sectors.

While this defers realisation to the monetary benefits for jurisdictions for ten years from the start date of UniTax, the saving will accrue indefinitely into the future from then on, while the administrative and business benefits of removing tax from all decision making will be immediate – and very substantial.

2030 may seem a long time to wait... but only in prospect. Looking back, it is already 15 years since the turn of the century! Had we started back then, we would already have UniTax in place today.

6 **Comparison of UniTax with Ideal Tax System**

CRITERIA for IDEAL TAX SYSTEM	UNITAX
Simple to Understand and Easy to Comply with.	One rule for payment of UniTax with a few simple rules for Rebates.
Have the Lowest Cost of Collection for Revenue Raised	Most tax can be paid and rebated using automated systems that apply across all jurisdictions – using the banking system to collect tax on expenditure.
Difficult to Evade or Avoid	Most tax deducted automatically with simple rules making evasion clear

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CRITERIA for IDEAL TAX SYSTEM	UNITAX
All Earnings assumed to be derived in Good Faith (absence contrary evidence)	UniTax complies
Tax should enhance Competition and Productivity	All business income is able to be distributed to owners tax-free making Australia a very competitive place to invest
Imposition of Tax should not be a disincentive to give, work, invest or trade	All gains (income and capital) are earned tax-free (ie gross) – so the more give, work, invest or trade, the greater the return, without limit.
Tax should have no impact on Decision Making	Only time you need to think about tax is when a Govt. is proposing a rate change
Creation of Value should not be Taxed; only its Consumption	UniTax complies
Only 'Real Gains (after inflation) should be taxed – when spent.	UniTax complies
All Real Gains (Income and Capital) should be Treated the Same	UniTax complies
No Double Taxation: All Real Gains Taxed Once Only	UniTax complies
Tax should be Fair: 'Progressive' without creating 'Second-class Citizens'	UniTax complies. Though everyone pays the same rate of expenditure tax, and everyone receives the same weekly rebate, the combination results in a progressive system.
No Bracket Creep	UniTax complies
Tax should move in-line with GDP without a Rate Change.	UniTax complies as it is levied on all transactions, with rebates that ensure tax is paid on all real gains across the whole economy.
Tax should be non-inflationary	UniTax complies with all prices ex-Tax
Each Jurisdiction should be able to Set its Own Rate	UniTax complies

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CRITERIA for IDEAL TAX SYSTEM	UNITAX
Cross-subsidies between Jurisdictions – as agreed between them	UniTax complies
Levies/Charges still to apply where they directly link to the activity being managed	UniTax complies

7 **Benefits and Downsides for Stakeholders**

7.1.1 Poor

The flat weekly rebate will be of much greater benefit to the poor in relative terms. As it will be paid regardless of other income (unlike other government benefits); there is no disincentive to work to earn more.

7.1.2 Rich

While there will be no escaping the tax, they will pay exactly the same rate as everyone else (and get the same weekly rebate). As well, all business and investment income will be received gross, with all tax paid in business and on investments being fully rebated (adjusted for inflation). In effect, the tax they pay on assets; becomes an asset in itself.

As well, the National Rebate will be spent in their businesses, boosting sales and profits, driving up asset values.

The rich (like everyone) would only expense tax on their actual consumption. As most of their income is re-invested (to create more wealth); tax that is actually expensed (on consumption) would only be a minor part of their real incomes.

7.1.3 Government

All Governments would receive a fixed share of incomes generated within their jurisdictions at the rate they determine (based on election promises), with almost zero cost; apart from audit requirements.

7.1.4 Politicians

Each politician could focus on policy issues, without having to worry about the impacts of tax on specific sectors. If a new project or policy required extra tax, it would impact all sectors equally... so the only job they have to do is argue the benefits of the specific spending proposals. This reduces the sway of 'vested interests' because the whole community has an equal 'vested interest' in the tax *rate*.

UNITAX: Simple, Fair, Efficient and Hard to Avoid

This is a much easier job than needing to raise taxes that impact specific sectors more than others, while arguing for general community benefits for the expenditure it raises.

7.1.5 Banks/ADTI

Banks (and other ADTI's) are under mounting pressure from new forms of payment and lending systems (crowd funding, digital currencies, peer to peer lending, etc). Some argue that traditional banking will soon go the way of traditional media (as both banks and media essentially deal in 'information')... making them vulnerable to disintermediation.

Although this contention ignores the banks' role in creating and allocating 'new money' as loans (See Appendices 10, 11 and 12)

By linking the Banks into the tax system, it ensures an on-going vital role in the economy – for which they should be paid (via a charge against the tax raised).

7.1.6 Investors, Superannuation Funds and Insurers

With all tax paid on their investments being rebated upon sale (adjusted for inflation), investors receive all their income gross, and only pay tax as they spend it... like everyone else. In effect, income that is re-invested simply grows their 'tax asset' along with their other assets, while the community benefits from the payment of tax as and when money is spent.

7.1.7 Business in General (including Sole Traders)

Because all UniTax would be fully rebated (adjusted for inflation), tax would cease to be a factor in decision making. It would make business much simpler and much less costly to operate

7.1.8 Exporters

By removing tax entirely from the price of goods and services, this puts exporters in the most favourable position vis a vis competitor countries.

7.1.9 Importers

Importers are in exactly the same boat as domestic businesses. They pay tax on all their inputs (imports), but are rebated the tax (like every business) on the cost of goods sold.

7.1.10 Charities

Charities would receive a full rebate of tax paid on all donations, effectively making the donations tax-free. In addition, they could have a special tax-exempt account from which all charitable payments are made. This would put them in a similar position as under the current system.

7.1.11 Lenders

Lenders would benefit by having all their income paid tax-free. It would make no difference whether they lend locally or overseas.

7.1.12 Borrowers

Borrowings for investment or business purposes would not be impacted. Tax paid on any interest would be fully rebatable... equivalent to having interest deductible under the present system.

Private borrowers would benefit from having tax paid on appreciating assets being rebated on sale (adjusted for inflation).

7.1.13 Workers

All workers would get their incomes tax-free, giving them every incentive to earn more.

7.1.14 Welfare Recipients

With appropriate adjustment, their benefits should not be adversely impacted.

The payment of the weekly rebate would not be taken into account in determining entitlement to Government benefits. Though paid equally to everyone, this would provide a significant supplement to the incomes of welfare recipients.

7.1.15 Tax Professionals (Government and Private)

By providing a long lead time and generous re-training and payouts to employees and businesses impacted, based on Toyota's experience, we could expect most people impacted to welcome the change.

8 **ABOUT THE AUTHOR**

Michael Haines is CEO and founder of [VANZI](#) (Virtual Australia and New Zealand Initiative), a stakeholder driven Initiative to develop the Legal Framework, Web Services Architecture and Business Processes to underpin the Digital Built Environment:

"An authorised enduring federated fully-integrated certified secure 3D+ computer model of the Natural and Built Environment (inside and out, above and below ground) on all scales required for decision making, together with all Legal Entitlements, for every property over time" - for use throughout all parts of the property cycle, from: planning and design to decommission; to deliver better, quicker outcomes at much less cost, with much less risk.

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Michael has also worked as a Manufacturing Manager for Toyota in Australia, led a major logistics company, sat on the Board of the Australian Logistics Council and chaired its ICT Work Group. His experience includes Consulting and CEO roles in major public companies across Building and Construction, as well as Manufacturing.

He has also spent 30 years researching banking and tax systems and is author of the [world2-0.com](#) blog.

9 **CONTACT**

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10 APPENDIX I: A Novel Way to Fund the Weekly Tax Rebate as a 'National Dividend'

Normally, it would be expected that any rebate was funded from the tax itself. However, because the rebate would apply to all permanent residents over 15, this would not have to be the case.

This section explains 'why' and 'how' the tax rebate could be paid as a 'National Dividend' - funded by simply *creating the money* to pay it - 'out of thin air'... subject to ensuring the payment does not: a) increase inflation, or b) act as a disincentive to take available work.

Of course, if this proposal is regarded as a step too far, the rebate could still be funded out of tax revenue – it would just require a higher expenditure tax rate to fund it, or a lower rebate.

The next sections discuss money's role in the economy; and how it is created, allocated and destroyed; to demonstrate the practicality and impact of paying an 'unfunded' National Dividend.

10.1 Money is the tool that drives Economic Activity and Growth

Nothing in the paid economy gets done without money. It keeps the economy turning by giving expression to demand (for both inputs and outputs). In economic terms: total income = total value of production = total expenditure. Money, in this equation, is simply the 'medium of exchange'.

Growth implies *latent demand* for *more* assets, goods and services than exist, by:

- a) consumers (for more housing and goods and services)
- b) business (for more inputs), and
- c) government (for more inputs into public goods and services)

In this scenario, money is not simply the 'medium of exchange'. It *drives growth* by *giving expression* to *latent demand* (*ideas* for a new process, product or service). Extra money is also required to give expression to demand from a growing population.

Which raises the question: how do consumers, business and government get the money required to express their actual and latent demand?

10.2 Why we need to consider a New Approach to Creating and Allocating Money

Traditionally, consumers have earned the money they need to buy goods and services by working in the production process. This money enables them to signal demand for goods and services *already produced*. In general, the sum of all incomes equals the total of goods produced, enabling those in the production process to consume all they produce... in the absence of 'sharing'.

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Some sharing is done via family transfers and gifts, the rest via tax and borrowing from the savings of those in the production process... though as you need an income to borrow, this usually just means shifting purchasing power between workers and investors.

Under the current system, the only way to signal *latent demand* (for goods and services *yet to be produced*) is to borrow *newly created money* to express it.

As we automate, the pool of well-paying jobs is shrinking; forcing more and more people to increase borrowing and/or sacrifice their lifestyle - as their earnings decline or disappear altogether.

In a seeming paradox, despite our increasing capability to produce more with fewer people, production is constrained - simply because those put out of work lack the money they require to signal their needs. As a result, even though our increasingly automated supply chains could produce all that people require, they do not. This is bad for business; and bad for the people who are out of work.

The National Dividend provides a new mechanism for allocating 'new money' to fill the gap.

It would be paid in recognition of our collective ability to make more with fewer and fewer people in the process - giving people the means to signal their *latent needs*... triggering *new supply*.

This analysis begs the question: in the current system, where does *new money* come from to fund new borrowings to express new demand?

The usual answer is 'from savings'. But savings come from income. Where does the money come from to fund higher incomes? The usual answer is 'productivity'... but productivity just means you can do more with the same amount of money.

As we know, every economy has been growing *in money terms* since money was first invented. So where does the 'new money' come from to fund this growth?

10.3 Money Now Created as Debt

Apart from Quantitative Easing, and contrary to popular belief - *all new money is first created and put into circulation when banks make loans*. And the converse is also true: *money is destroyed as the loans are repaid*.

This is not my contention. The process is simply described in the Bank of England paper: [Money creation in the modern economy](#).

It is as simple as making two simultaneous entries in the books of the bank: Debit Loan to Borrower \$100 (Asset) and *at the same time* Credit Deposit account in the name of the same Borrower \$100 (Liability). These entries are made 'out of thin air' and have no impact on the banks net asset position.

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The money to make the loan is not 'on-lent' from other depositors. It comes from no-one else's account.

When you make a loan, your cash/deposit goes down. When a bank makes a loan, your cash/deposit is untouched.

That is, bank loans are not made 'from deposits'... *bank loans 'create deposits'*.

The Loan simply *records* the Borrowers debt in the bank's books, while the new matching Deposit *records* the Banks obligation to the Borrower - providing the avenue to draw down the Loan... to get cash out.

Also contrary to popular belief, the minting of notes and coins does not create new money; it simply recognises (in a different form) the new money already created by the bank as a 'deposit' when a loan is made. When the borrower gets cash out, their deposit goes down, leaving the net amount of money in the system unchanged. The borrower simply replaces a newly created electronic money record (the deposit) with a paper/plastic money record (the dollar note).

The new money can be injected into the economy via consumers (as they borrow for housing and consumption), and/or via producers (as they borrow to invest in equipment, stock and debtors), and/or via investors (as they borrow to buy securities... the least effective means of creating real wealth).

10.4 Savings from Borrowings and Dis-saving from Repayment of Borrowings

Ignoring non-cash income, savings are first represented by cash or bank deposits. Tracing the money back, our savings come from our income, which comes from others as they pay us; and their income comes from still others, and so on... as the money goes round.

However, at some point, the money has to be created to get into circulation.

It is clear from the [Bank of England Paper](#) (and the above analysis), the usual idea that: "savings represent a source of funds for borrowers", is not correct. It is *borrowings from banks that drive savings growth*.

As the newly borrowed money is spent, it drives economic growth. In the process, the new money becomes someone else's income - *from which savings then accrue*.

The more people borrow, the greater the level of savings.

To repay loans, savings must be drawn down. In practice, the deposit (savings) is offset against the outstanding loan account. This effectively wipes out both entries from the books of the bank - destroying the money that was created when the loans were first made.

As people pay off loans, savings must fall.

10.5 Borrowings (Not Savings) Drive both the Supply of Money and Growth

The only reason the world's money supply has increased is because net borrowings exceed net repayments year on year. These borrowings provide the new money needed to finance economic growth. When the reverse happens, and more money is destroyed than is created, recession and depression follow... simply because there is less money around to signal people's needs (which remain unchanged).

The conclusion is that 'economic growth' is financed entirely from global borrowings: by business itself, or via government or private debt.

The trigger for business borrowing is the *indication* of sustained consumer and/or government spending, as well as ideas for new processes, products and services that the entrepreneur believes will be in demand. From that borrowing, new investments are made.

In practice, growth comes from borrowing across all three sectors.

To sustain and grow activity, if consumers (demand pull) and/or business (supply push) are not borrowing, governments must. Money borrowed by Government is then spent on infrastructure, services and transfers (that are then spent by recipients) – driving up economic activity.

It is all debt driven.

It is why, paradoxically, the more that people and businesses try to 'save' (by not spending, or by paying off their loans) the worse the economic situation gets... forcing governments to borrow to make up the shortfall! It is the 'paradox of thrift'.

10.6 Existing Processes for Creation and Circulation of Money - Summary

The factors driving the creation and circulation of money are:

10.6.1 Income and Expenditure

- Wages, Rent, Interest, Dividends, Royalties, Fees, Trade Debtors, etc. This cycle of payments sustains the economy. While there may be some fluctuation, over time, the cycle is relatively stable: wages weekly, rent monthly, dividends six monthly, supplier terms of trade 30-90 days, etc
- One person's income is another's spending. This cycle cannot generate growth in assets, goods and services, as the same money can only represent the same dollar value of transactions in every cycle. (Productivity may enable us to produce more with less, but it does not add any new money into the system and cannot therefore create 'economic growth' *measured in money terms*).

10.6.2 Savings and Dis-Savings:

- The circulation of money can be reduced by saving. This condition is met when money from one pay cycle is not spent in that cycle. If such saving is wide-spread it will damp demand, sending the economy into recession.

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- As savings are run down, demand will pick up. However, the economy cannot grow beyond the previous high-water mark when all money was in circulation.
- In practice, there is always some saving. It is a problem only if it increases substantially from one period to the next across the whole economy, *and is not matched by higher net borrowing*.

10.6.3 Private and Commercial Lending and Repayments

- Loans between individuals and corporations (other than banks) have no impact on the money supply. The proceeds of the loan go from the lenders account to the borrower and repayments go in reverse.
- The process simply changes the controlling mind that determines what the proceeds are spent on, but does not increase overall activity.

10.6.4 Borrowings from Banks and Repayments

- Borrowing from Banks increases the supply of money and hence the capacity to spend. It is this borrowing that drives growth by providing the money to signal *latent demand*.
- Bank Lending for Housing, Car, Travel, and Consumer Loans all feed money in at the bottom to promote consumption which provides business with the profits that permit higher borrowings to fund growth.
- Bank Commercial Lending feeds in new money to increase production capacity.
- At the individual and business level, the *new money* gives *borrowers* an *unearned right to consume society's resources* that must be *repaid*. Repayments reduce the supply of money and hence spending power.
- Overall, economic growth continues only because borrowings exceed repayments in any period. If we want economic growth, we cannot be surprised at the growth in world debt. Given the way the system works, it cannot be otherwise.

10.6.5 Quantitative Easing

- In this case, new money is created to buy securities from the rich. It has very little direct impact on demand for goods and services as most of the money is simply used to buy other securities, pushing up asset prices. At best this improves 'sentiment', leading to higher borrowing, which drives increased spending, which then drives growth.
- The new money is pulled out of the economy in two ways. Either by selling the securities back to the market, or waiting until they mature and are repaid. In either case, the money received is simply written off – sending it back into the thin air from which it came.

While (apart from QE) new money is today injected via borrowings, it was not always so. Understanding this history; helps to put the proposed National Dividend in context.

10.7 Money Originally Created in Recognition of Services Rendered.

No one knows for sure how money was first created. On one account, money was created by the King *issuing 'tokens'* to his soldiers and household for *'services rendered'*. These tokens did not have to be funded. They were simply *created* (out of sticks, clay, shells, stones, metal, etc.) by *adding the King's mark to the material of the token*. The King determined *how many tokens each person would receive for their services; AND also what each token could buy from the King's store*: one for a chicken, two for a bolt of cloth, three for a sheep, etc. This made it much easier to keep account.

In time, other subjects accepted the tokens from members of the King's household - knowing they could use them to redeem goods from his store. Over time, their use extended throughout the Kingdom, as his subjects exchanged the tokens between themselves for other goods and services (using the King's exchange rate for goods from his store as the benchmark).

At some point the King decided to accept his own tokens in payment of taxes.

This brilliant invention saved all the effort of collecting and distributing goods; and greatly simplified trade.

The king simply paid his household and soldiers in tokens. They, in turn, used them to buy goods and services directly from the King's subjects, who used the money to buy other goods and services... and to pay their taxes. No need any more to collect goods as taxes and to pay in kind.

His subjects relied on the King's capacity to honour the promise attached to the tokens: "that the money issued, could be redeemed for specific value" (namely, goods from his store)¹.

This promise set the exchange rate for all other trade and turned the 'tokens' into 'money'.

Significantly, money started out as simply a 'record of value' already provided. It also entitled the holder to take out the same value they had already put in... in the process becoming the 'medium of exchange'.

10.8 Comparison between Original and Current Money Creation Process

- Quantitative Easing aside, the king (or government) does not create our new money. Instead, government empowers the banks to create it (as explained above).
- Instead of the King, we now rely on the whole of society to make good on the promise to give fair value (in goods and services) in return for the tokens (Coins, Notes and eMoney).

¹ This story is apocryphal. The history of money is not so straightforward. Wikipedia http://en.wikipedia.org/wiki/History_of_money

- Whereas originally, ‘work’ came first, and then money (to recognise the value created through that work); now, no work can be done unless there is money available to pay for it.
- Significantly, instead of money being issued as an *asset* (in recognition of services rendered), it is now issued as a *debt* that requires the borrower to *render future services to pay it off*.

10.9 A New Process to Create and Destroy Money: National Dividend & Money Supply Tax

This paper proposes a further way in which new money may be introduced into the economy: as a ‘National Dividend’ (that does not require ‘borrowing’); and a new way to take it out: a ‘Money Supply Tax’.

The idea of the National Dividend returns money creation to its roots, by creating new money as an asset to recognise value that already exists.

The value arises from the capacity of society to make more with less people in the process. This capability rests on generations of inventive and hardworking people across the broad spectrum of the economy. Every business, every entrepreneur, every person; benefits from this legacy. We can give everyone an equal share in this collective capacity by creating money to represent this capacity, and issuing it equally to all residents over 15.

This new money will allow everyone to express some of their *latent demand* for goods and services, triggering our supply chains to meet their needs. It will be good for them... and good for business.

10.9.1 National Dividend

The National Dividend would be a set amount paid weekly to every resident over age 15. It would represent our collective capacity to make more with fewer people in the process - as the whole supply chain is increasingly automated and virtualised.

Everyone would receive the same ‘base’ money (to meet a part of their needs), with the ability to earn any extra without impacting their ‘dividend’. This eliminates any ‘poverty trap’, and avoids the need to pry into people’s affairs to decide ‘who is entitled’.

A positive for business is that it would only have to pay the marginal wages (over and above the base dividend), required to attract people into the workforce. Unlike now - where the wage must meet an employee’s full income needs.

Power to issue the Dividend could be granted to the Central Bank in keeping with its mandate to keep inflation and unemployment within limited bounds.

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The initial Dividend could start small and be gradually increased so as to not adversely impact employment, or inflation.

As it was increased, people at every level would decide to drop their hours of work or quit employment altogether, depending on their circumstances. The aim would be to lift the amount until the labour market was in 'dynamic balance' around the target unemployment rate.

As the Dividend would be issued to everyone equally; there would be no need to repay it.

In this case, we would all have the same additional claim on society; and each would owe the same amount of money. If I owe everyone money, and they owe everyone (including me) the same amount... it is as if each owes the money to themselves. Figuratively, it could be repaid by simply passing the money from one hand to the other and cancelling the debt!

Nor would the new money need to appear as part of the 'national debt'... since it would not be due to anyone. It would simply represent an increase in the money supply.

The creation of new money to pay the National Dividend would have the same impact as personal borrowing from banks for consumption – without growing the debt, as there would be no need to repay it.

10.9.2 Money Supply Tax (MST)

Inevitably, the Central Bank will overshoot payment of the National Dividend (as it does with interest rates), causing a lift in inflation. At this point it could drop the Dividend. However, it may be better to keep the Dividend relatively stable and instead apply a new tax (MST) at a flat rate on all expenditure

The Central Bank would then continually modify the MST and/or the Dividend (up and down), to create a 'dynamic balance' - just as it does with interest rates, but in a much more direct manner.

The money raised by the MST would not go to the Government or the Central Bank, it would simply be written off... going back into the thin air from which the National Dividend came... to bring the economy back into balance.

The MST would have no impact on resource allocation as it would apply to all expenditure equally (like UniTax).

11 APPENDIX II: WHY BITCOINS (AND THEIR ILK) ARE A REALLY BAD IDEA

As a 'medium for exchange', Bitcoin's 'messaging approach' has a lot going for it. It allows for secure transactions between parties who are unknown to each other.

Though there are negatives. [Exchanges have collapsed](#) and [wallets holding coins have been lost](#). And, once made, the transactions cannot be reversed. The system also consumes a huge amount of computing resources and electricity (currently [around 1.46 terawatt-h per year](#)) – just to make the coins.

Significantly, bitcoin also fails a key test of money: that it should have a fixed 'unit of account'.

The sole purpose of money is to record the value of a transaction. It allows the person receiving the money, to later acquire other resources of equal value (not more or less).

When you are paid in dollars (with a fixed face value), you are clear what you are getting. You can readily account your profit and loss.

Given its [huge swings in valuation](#), with Bitcoin this is impossible.

But that is the least worry. To understand the principal concern, we need to compare the processes of money creation by banks vs bitcoin miners

Creation of Money by Banks

Banks create new money through lending. However, *the new money they create has no impact on their own net worth*. This is not my contention. It is how the system works. See: [Bank of England](#) for details.

It is as simple as making two simultaneous entries in the books of the bank: Debit Loan to Borrower \$100 (Asset) while Credit Deposit account in the name of the same Borrower \$100 (Liability). The Loan records the Borrowers debt, while the Deposit provides the avenue to draw down the Loan... to get cash out. *These entries do not change the net worth of the bank.*

When loans are repaid, the entries are reversed *without impact on the net worth of the bank, or the borrower.*

Nor does the net worth of the Borrower change when the money is borrowed. They get cash (an asset), matched by a debt they must repay (a liability).

When the borrower spends the proceeds of the loan, they hand it over to the seller in recognition of the value given. Again, *the net worth of the buyer and seller is unchanged by the exchange.*

This is the essence of money. *It does not of itself change your wealth* – not when it is created, nor when it is used.

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Creation of Money by Bitcoin Miners

Bitcoin miners who spend money on electricity 'making' bitcoins are like counterfeiters who spend on paper, ink, presses and labour, to make and distribute their dollar notes.

The problem is not in the creation of the tokens per se - whether they are 'paper' (dollar notes), or 'electronic' (bitcoins). The problem is that both counterfeiters and bitcoin miners *create claims on society's resources they have not earned*.

As demonstrated, when a bank creates and issues money, *their net worth does not change*.

When a counterfeiter prints notes, *their net worth goes up immediately by the 'market value' of the notes* - assuming they can get people to accept them. And, just the same...

When a Bitcoin miner creates Bitcoins, *their net worth goes up immediately by the 'market value of the coins'* - assuming they can get people to accept them.

Unlike counterfeiters, the *net worth of Bitcoin miners could go on increasing by many orders of magnitude for many years*. Here's how.

There are currently around 14 million coins 'on issue', with 25 new coins being produced every ten minutes. The rate is designed to halve every 4 years to 2140. At the end of that time a total of 21 million coins will have been produced.

The coin's current value is around \$330, giving a total value of around \$4.6 billion. This is a drop in the ocean of money (\$60 trillion globally). But this is only the start.

Even now, to be of any use in transactions, the coins must be split into units, equivalent to dollars and cents, to buy goods and services. Ultimately, each coin can be split into 100,000,000 units. If bitcoins were to become recognised currency/legal tender, the demand could quickly grow to a point where each unit would be worth a cent (the minimum value for transactions)... turning the whole supply into \$14 trillion and counting, up to \$21 trillion in 2140.

Not such a small amount.

Bitcoiners can accelerate this process by doing three things: 1) restricting circulation, 2) promoting its use, and 3) working to get it legalised as virtual currency/legal tender.... so people will trust it.

As it appears more and more likely that the coins will be legitimized, the value of each coin will quickly grow, with increased demand from speculators. This will also result in a higher and higher value for smaller and smaller units.

As each unit approaches 1 cent, the value will likely stabilise, allowing people to use it as a 'unit of account' for exchange.

At this point, Bitcoiners only have to spend or sell the coins they hold at a rate that doesn't create a massive drop in value due to 'over-supply' - to realise the full effect of their fraud.

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Given the claimed advantages in the *use* of Bitcoins, if they are legitimized, it is conceivable that many people may be happy to buy the coins at a cent per unit, not as an investment or for speculation, but simply for use as a 'medium of exchange'.

For simply running a bit of code, those who mine, hold and judiciously spend the coins into the economy (*entirely for their own benefit*), can push the value of their coins to \$1 million each. That is the fraud. It is better than any counterfeiter could ever hope for.

The Solution

The solution is to create a genuine digital currency/legal tender and outlaw the creation and acceptance of bitcoins (and their ilk), just as we outlaw counterfeiting of notes and metal coins.

Of course, we cannot stop it. And we may push it underground. But it is already used for criminal purposes. What we want is to de-legitimise it - so the rest of society does not get duped into handing over \$trillions of resources for nothing.

There are ways to create a genuine digital currency that not only avoids the problems of Bitcoin, but also stabilises the banking system by eliminating 'moral hazard'. This is the subject of the paper in Appendix III

12 APPENDIX III: HOW DIGITAL CURRENCIES CAN ELIMINATE MORAL HAZARD FROM BANKING AND STABILISE THE FINANCIAL SYSTEM

This paper is in seven parts. The first provides an executive summary. The second gives an overview of why Moral Hazard is so bad; and also details how we can eliminate it from the banking system - without massive regulation or guarantees or insurance; or the need to do away with banks, or gaol bank officers! The third lists the benefits of the new approach for each class of stakeholder. The fourth provides an outline of the transition process. The fifth covers background details about the current system to provide a common base for understanding the changes proposed. The sixth brings it all together in a brief wrap-up. And the seventh reviews other digital currencies.

This proposal applies to all [Deposit Taking Institutions Licenced to operate in Australia](#), hereinafter referred to as 'banks', or 'commercial banks'.

The proposed system would continue to be regulated by [Australian Prudential Regulation Authority](#) (APRA) in accord with new legislation.

Commercial banks would continue to operate as they now do, either under existing legislation, or under the new regime, or both (as they choose).

The Central Bank would continue to perform its current roles, with the addition of some new 'targeted' tools to improve management of inflation and unemployment.

1.0 Executive Summary

1.1 The Problem

Moral Hazard is a *system* problem that encourages *bank officers* to make high-risk loans because they get all the benefits and none of the losses when the loans go bad.

It is the root cause of most of the [100 or so systemic bank failures that have occurred across more than 90 countries over the last 50 years](#). The world is still suffering from the effects of the most recent and widespread failure: the GFC.

To solve any system problem we need to understand how it works.

When banks now make loans, they create an asset. *At the same time*, they must also create a matching liability - a deposit, for the borrower to draw down.

When repayments are made, the entries are reversed.

The fact that the bank's net worth is unchanged in these transactions is one of the keys to understanding both the problem and the solution.

The system problem is four-fold:-

1. Even though bank deposits are treated as money; legally they are not.
2. Because both the loans and deposits are on balance sheet, if there is the slightest hint that all depositors may not get their money back, it can cause a run - imperilling not only the bank, but the whole financial system.
3. To avoid this risk, governments are forced to guarantee and/or insure deposits (at least to a certain level). In practice, they are often forced to do much more: take equity in the bank, buy bad loans for much more than they are worth, and so on.
4. These acts effectively insulate bank officers from the downsides of high-risk lending.

After every major system failure, regulations are written to prevent a recurrence. Unfortunately, people being human, as time goes on, and new employees replace old hands, and as the markets turn, pressure mounts to expand lending to higher risk borrowers for bigger returns. In some cases, regulations put in place to mitigate high-risk practices are removed or watered down: "because they are stifling business". This happened in the lead up to the GFC [when key regulations enacted in the US following the Great Depression, were repealed](#) – and have still not been re-instated.

Inevitably markets crash, deposits are put at risk, and the cycle is repeated.

In a letter dated 21 March 2015, Australian Financial Journalist Alan Kohler warns: "Remember covenant lite? It's where loans are provided with very few restrictions on collateral, income levels and payments terms, and often very little information on those things as well. This was supposed to be one of the things that brought the US financial

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system unstuck in 2007, along with collateralised debt obligations, but... 30 per cent of lending was covenant-lite in 2007 and now it's 70 per cent."

Unfortunately, no amount of regulation can eliminate the problem, because the whole system is built on trust in each and every bank. As soon as trust is lost, panic ensues. As the system stands, only governments can engender sufficient trust... and even they sometimes struggle.

1.2 The Solution

The solution is straight forward:

1. Take both loans and deposits off balance sheet, and put them into Registers managed by the bank - but leave the banks with the liability for default, theft and fraud (as now).
2. In the process, convert the money recorded in the Deposit Register into legal tender. This effectively creates a new form of money: digital currency. It means that as well as having metal (coins) and paper and plastic (notes) as 'records of value', we would also have electronic 'records' (digital currency).
3. Remove government guarantees and insurance from any deposits that remain on balance sheet.

By doing these three simple things, we can create a new digital currency that is 'legal tender'. In the process, eliminating moral hazard from banking and stabilizing the financial system.

No longer would it be necessary to convert the 'at risk' electronic record (deposits) into 'official' paper (notes), or metal (coins) records. All the 'records' (coins, notes and digital) would be legal tender (money), just the same.

The banks go on performing the same roles of lending and managing the payments system, for the same returns, with the same net worth.

The difference is that deposits would no longer be at risk. All the risk would remain with the people earning income from making the loans... just like any business.

1.3 The Transition

The transition from the current to the proposed system would be similar to [Quantitative Easing](#) (QE). In QE, Central Banks electronically created new 'legal tender' to buy existing securities from private holders, with the proceeds turned into 'at risk deposits' in the banking system.

This proposal simply extends the process to convert 'at-risk deposits' back into 'risk-free legal tender'.

The Central Bank would electronically create new 'legal tender' to buy all the loans issued by commercial banks. The banks then use the money to repay all depositors who would be

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required to re-lodge their new 'legal tender' with the Central Bank. The re-lodgement process would be automatic and also done electronically.

The Central Bank then has a Register of Loans (acquired from the commercial bank) and a Register of Deposits made by the bank's former Depositors.

Management of these Registers is then licenced to the commercial bank (from which the loans and deposits were acquired). The commercial bank is also given the power to issue new legal tender. The issue would be done by simply recording new Loans in the Central Bank Register of Loans, with matching new Deposits in the Central Bank Register of Deposits – same process as now, but on the Central Bank's Registers, not the commercial bank's books.

The Central Bank would not be liable for the loans or the deposits. They are simply the authority legislated to manage the supply of money to meet the needs of society – without causing inflation or unemployment (through the issue of too much or too little money).

Each country could enact legislation, independent of any other. Banks could choose to continue trading under the existing framework, move to the new, or a combination.

Ultimately, it would be the market that decided which framework was preferable.

1.4 The Impact

Once the money is converted from 'at risk deposits' to 'risk-free legal tender', the processes of lending and managing the payments system would continue as normal. The change would not impact the operation of traditional banks, or other financial institutions, nor currency trading.

The only difference is that the transactions would be off the books of the commercial banks, and instead on the Registers of the Central Bank - eliminating a step in the transaction process. Today, you have to convert deposits into legal tender to trade (whether locally or internationally). After the change to the new system, the deposit record would already be legal tender in electronic form. It would be true 'digital currency'.

However, because the commercial banks get most of the income from the services they perform under licence, they also continue to bear the risks of default, theft and fraud. This ensures there is no moral hazard in the business of banking.

A bank would fail if losses exceeded its equity - as with any business.

In the case of failure, management of the Register of performing Loans and the full Deposit Register would be taken over by the Central Bank - without a blip (using the commercial bank's staff and facilities). Management of these could be later on-sold for their 'income value' to a viable commercial bank via an auction, with the proceeds going to the Administrator for dispersal according to law.

The only losers would be the non-performing borrowers, the bank officers who lose their jobs when the bank folds, and the shareholders who accepted the high-risk lending for higher returns.

Depositors and all other banks, and hence the whole financial system, would be immune from loss.

This system could be set up under new legislation within 5 years (or sooner), with provision for a transition period (say two years) following enactment of the new legislation.

The next section explains the mechanics in more detail.

2.0 Summary Background and Overview of Proposal

2.1 The Hazard

Moral Hazard is a *system* problem that corrupts behaviour, and is one of the greatest risks to our economic and social wellbeing.

In effect, the *system* works to reward bankers with big salaries and bonuses for taking on unwarranted lending risks (and immoral practices), while exempting them from *personal* losses when the loans go bad.

This hazard has been at the root of just about every one of more than [100 systemic bank failures in 90 countries over the last 50 years](#).

The GFC is simply the biggest most recent failure. The harm done to the social fabric of some of the worst hit countries may take a generation to mend.

After every failure, new regulations have been enacted in an attempt to reduce the risks.

However, no amount of regulation can solve the problem, as the system is inherently unstable. All it needs is for people to lose faith in a bank's ability to meet a call on their deposits, and a 'run' can start (with all depositors rushing to withdraw their money at the same time). Quickly, the bank runs out of cash and is forced to stop trading. This can impact other banks that have made loans to it, spreading failure to the whole system.

While ever bankers know that governments will always step in to save *the system*, Moral Hazard is unavoidable.

That's the problem. Before considering the proposed countermeasure, we need to agree how the current system works - so we are all working off the same base.

2.2 The Current System: 'Money out of Thin Air'

Quite simply, bank lending works to create both deposits and money 'out of thin air'.

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This is not my contention. As the [Bank of England](#) says: “Money creation in practice differs from some popular misconceptions — banks do not act simply as intermediaries, lending out deposits that savers place with them, and nor do they ‘multiply up’ central bank money to create new loans and deposits... *the majority of money in the modern economy is created by commercial banks making loans*”.

The process is as simple as: Debit \$100 Loan to Borrower, and Credit \$100 Deposit to Borrower. The loan represents the Borrower’s debt that must be repaid, while the Deposit provides the means to draw down cash. The ‘deposit’ does not come from anywhere. It is simply recorded in the books of the bank at the same time as the bank records the loan. It is ‘money out of thin air’.

As the loan is repaid, the entries are reversed, sending the money back into the ‘thin air’ from which it came.

The fact that the creation and destruction of money does not increase or decrease a bank’s net worth (because it impacts both assets and liabilities equally), is a key to understanding the proposed countermeasure.

2.3 How Digital Currencies can Eliminate Moral Hazard in Banking and Stabilise the Financial System

With this knowledge, we can pass three simple laws to:

1. Take both loans and deposits off the balance sheets of banks, and put them into Registers managed by the banks – under licence from the Central Bank
2. In the process, convert the Deposits to Legal Tender
3. Remove Government Guarantees and Insurance from Deposits that remain on Balance Sheet.

2.3.1 *Loans and Deposits ‘off balance sheet’ and onto Registers*

As this change removes both Assets (loans) and Liabilities (deposits) from the banks’ books, it would have no impact on their net worth. Nor would it impact their income, as they would go on performing the same services, in the same way, for the same net interest and fees, as now.

As part of this change, the banks would be made liable for any loan defaults, as well as any theft of money from its vaults, or fraud committed by bank officers or third parties in relation to deposits.

This is the same as now, but it would need to be legislated as, with the loans and deposits ‘off balance sheet’, such obligations would normally cease.

It would also be made unlawful for a bank to on-sell any loans they write... so the risk of default remains with them. This is how banking used to work, before it became 'sophisticated'.

The banks' lending would continue to be restricted to a set multiple of its capital (equity and debentures). This is called its [Capital Adequacy Ratio](#) (CAR).

Without the ability to 'on-sell', the only way to increase lending would be to increase capital... just as any business must as it grows. As a sweetener to support the changes, the CAR could be increased by a few percent to allow more lending against the banks' existing capital. This could be done without risk to depositors due to the second law:

2.3.2 Law to recognise Deposits Recorded in a Bank Deposit Register as Legal Tender

The tokens used to denote money are currently metal coins and paper notes. These are just *historical* 'records' in 'standard units of account'. There is no reason why in the 21st Century we cannot have an eRecord to legally represent the amount of money held by an individual. How this can be achieved in practice is discussed in Part 4: The Transition.

2.3.3 Removal of Government Deposit Guarantees and Insurance

Government Deposit Guarantees and Insurance must be removed from all existing banks. This is necessary to put them on the same footing as the proposed Registrars.

Under the new system, there is no need for guarantees or insurance, as the Deposits created by the banks when they make loans would be regarded as 'legal tender', and would not be at risk under any circumstances.

Existing banks could be given a couple of years after the new legislation is passed to transition their corporate structures to the new regime before new entrants set up in competition. However, there would be no need for 'compulsion'. The government can simply enact the new regime and allow any business that can meet the regulatory requirements to set up as a new Registrar.

As the new banks would be able to offer 'risk free' deposit holding, market forces would very quickly nudge all banks to comply.

2.3.4 Overall

This approach leaves the business of banking essentially unaffected. Except that the bankers would be on their own. No longer would there be any ability (or necessity) to call on other parties to cover their losses (due to defaults, thefts and fraud), as the deposits could never be touched.

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If a bank is forced to close because of bad loans, the only losers would be the bank officers who lose their jobs; as well as the shareholders, some creditors and perhaps the debenture holders who do their dough. As in any corporate failure.

The Deposit Register and the Register of 'performing' Loans would be taken over by the Central Bank and managed without a blip – until the management rights could be on-sold to a viable bank, via a tender process.

The non-performing loans would be subject to recovery proceedings by the bank's Administrator. Any recoveries would go first to repayment of principal (that would be written off), with any extra going to pay the administrator, and then outstanding interest and fees (that would go to creditors, debenture holders and then the shareholders - in accord with normal bankruptcy laws).

Never again could there be a 'run' on a bank, as the eMoney is never at risk. It is simply a Record in a bank's Deposit Register... effectively eliminating Moral Hazard.

2.3.5 *Impact on Deposits*

As the [Bank of England](#) paper demonstrates, deposits are not now 'loaned' - they are *created* as the matching loan is made. The same would happen under the new system. The Loan would be recorded in the Loan Register, and the matching Deposit in another Register.

When I pay you, my Deposit account would go down and yours would go up. There would be no need to 'settle' the transactions in 'traditional cash' (paper notes or metal coins), because the Record in the bank's computer would be regarded as eMoney under the law. As with cash, a person could satisfy payment for any goods and services by transferring a valid eRecord (money) from their Deposit account to the seller's Deposit Account.

When a person accepts an eMoney payment it would go straight into their account, increasing the total record... just as if they were paid in cash. Indeed, under the new law, the eMoney would be defined as 'cash'.

Having your money held on the Central Bank Register would be 'risk-free' in the same way as holding notes and coins in a safe is 'risk-free'... only better. If someone steals your cash, you have no comeback. If someone manages to access your deposit without your authority, your money remains intact. It is the commercial bank that allowed the fraud to happen that loses (as now).

Unlike now, you would not have to rely on the commercial bank to 'honour the deposit'.

The eMoney recorded in the Deposit Register is not a liability of the bank. The Register acts more like a 'deposit box'. The contents (your money) are held secure by the bank, but the bank does not own the contents of the Register (as it does not have access to the contents of a Deposit Box).

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It means, no matter what, a person can never lose their Digital Money while it is on deposit.

Another major benefit of eMoney is that it could also be adjusted tax-free by the inflation rate on a daily basis - to ensure the real value of the deposit is retained over time. This would go a long way to offsetting the loss of taxable interest previously paid by the commercial bank. In many cases, the adjustment could be more than the after-tax interest. This money, like the original deposit, would come 'out of thin air' under the proposed legislation. It is not 'extra money'. It simply keeps the purchasing power of your original deposit intact. Interest is not appropriate, as the money would no longer be 'at risk'.

The bank would be paid fees by its customers to operate the Register of Deposits and the Payments system (as now).

2.3.6 *Impact on Lending*

The processes of lending would remain essentially unchanged. Though it is likely there would be much greater focus on risk management.

As now, the loans would be made by banks 'out of thin air', by simply recording the amount of the loan in the Loan Register (rather than in the books of the bank), with a matching entry in the Deposit Register, for the borrower to draw on.

The banks would continue to assess each borrower's ability to repay, and the quality of their collateral.

For this service, as well as for ensuring the loans are repaid and for managing defaults, the bank would charge interest and fees to cover: a) their operating costs, including a predetermined level of defaults, and b) profit.

Since the bank would no longer need to pay interest to Depositors, there would no longer be any 'cost of funds' (except in relation to debentures that would be classed as part of 'capital' for the purposes of their CAR).

There is no reason why in these circumstances the bank's profit could not be the same as any prudent bank now. It would also be more certain, without a fluctuating cost of funds.

Under the legislation, a bank would not be permitted to re-negotiate interest rates on 'good' loans to recover losses on 'bad' loans. (The current practice of increasing interest on existing variable loans to recover losses is like Toyota or GM going back to people who bought cars, and asking for extra money to cover losses on a new model that does not sell as expected!) Borrowers are not in the business of assessing risk on other borrowers. That is the bank's business, for which they get paid. If they get it wrong, then it is only fair that the bank should suffer the loss of poor judgement, or bad practices (not the borrowers who are meeting their obligations!). Again, this is necessary to avoid moral hazard.

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However, just as Depositors are compensated for inflation to retain the real value of their deposit, so each Borrower's outstanding principle should be adjusted up by the same rate, on a daily basis. This ensures they repay the real value of the money they borrow. The adjusted principle would not go to the bank. It would be written back into thin air as it is repaid - *just like the principal is now written back*.

The 'inflation adjustment' on loans would essentially balance the adjustment paid to depositors, eliminating any effect on the money supply. This happens in practice now, as a large part of the interest paid by borrowers goes to pay depositors to cover inflation.

These changes should mean that borrowers' interest and costs could be stabilised over the long term (a boon for all borrowers, especially business), while enabling banks to operate much as they do now, with the same net worth, earning similar profits as now (subject, of course, to emerging competition from new entrants that are more digitally savvy!)

2.3.7 Reduced System Risk

As a result of creating eMoney (by taking loans and deposits off balance sheet), we can eliminate Moral Hazard, reducing system risks for everyone across the whole community – not only within the Banking sector.

The only risks would be inflation and normal business risk.

The bank would no longer bear the inflation risk, as both loans and deposits would be off-balance sheet.

As for normal business risk, the interest on each loan would be priced by the bank based on its assessment of risk of default by the borrower (given their security, income, credit history and the purpose of the loan), as well as competing rates offered in the market – just as now.

However, there would no longer be any 'financial risk' due to fluctuating interest rates. The money for the loan would come direct from the Central Bank without cost. It would not need to be borrowed from the market. This means, the cost of funds for the banks would be zero.

Each bank's costs and profit margin and overall risk premium should be relatively stable, so there should be no need to vary the interest rate over the life of the loan for the bank to make a profit.

Overall, the system would be more stable for banks, borrowers and depositors.

Banks would be the first port of call for loans (as now).

Normal 'at risk' lending by individuals and other institutions would continue, with lenders giving over their cash to borrowers for an agreed term, at an agreed rate to compensate for the risk of loss.

2.3.8 Management of Inflation

As under the proposal, all loans would be 'off balance sheet'; Central Banks would no longer be able to use the 'cash rate' as a tool to affect the amount of bank lending.

Instead, Central Banks could be given a much sharper tool. They could be given the power to levy an extra charge on all new loans borrowed for a specific purpose.

If, for example, house prices were ballooning due to high demand, what we want to do is to shift demand to new houses (to increase stock). To do this, the Central Bank could add an extra charge on ALL *new loans* (bank and non-bank) for *existing* houses. This extra charge would increase the effective cost of buying existing houses, making it relatively cheaper to buy a new home... the exact policy objective we want to achieve.

Similar charges could be levied if, for example, consumer loans, or margin loans against stock, seemed to be pushing prices too high too quickly.

Any extra charges would not go to the lender collecting them, or to the Central Bank they are paid to. They would be written back into thin air as they are paid. The sole purpose of these charges would be to mitigate the rate of borrowing – just as Central Banks now try to use the (very blunt) 'cash rate' to push up *all* interest rates... but much better targeted.

If inflation is widespread, the charge could be applied to all borrowing. It too would be written off as it is paid to the Central Bank – drawing money out of the economy.

Importantly, the charge would only apply to *new* loans, ensuring long term borrowing decisions are not disrupted by short term anomalies in one or more markets.

We don't need to raise rates on existing borrowings to reduce demand for new borrowings. We just have to make new borrowings more expensive, which is what this approach achieves - by asset class, or overall.

3.0 The Benefits

3.1 Depositors

Depositors exchange 'at-risk' commercial bank deposits (earning taxable interest) for 'risk-free' electronic legal tender (digital money) that is equivalent to paper money – only better. It cannot be lost, stolen or destroyed, and it gets increased by the inflation rate, *tax-free*.

The digital money does not belong to the bank. It belongs to you. The bank cannot touch it for any reason.

Having digital money on a Register managed by a bank is like having paper money in a safety deposit box managed by a bank - *except, it can be accessed wherever electronic banking is*

available, rather than only at the branch where the box is held, and it gets increased with inflation.

The digital money can be used in exactly the same way as paper (notes) and metal (coins) money, and is directly exchangeable into either notes or coins, if required.

3.2 Borrowers

3.2.1 *Performing Loans*

Because there is no 'cost of funds', interest rates can be stabilised over the life of the loan. The interest would depend entirely upon the operating costs of the bank, the borrower's own risk profile *at the time of the loan* and *market rates at the time*. The loan will never need to be called in to pay out depositors, nor could their interest rate be increased to pay for losses on other loans.

They would also no longer be at risk of their loan being called in as a result of a 'run' on the bank, or to pay out depositors in the event the bank folds. In that instance, the loan would simply be transferred to a viable bank on exiting terms. It would not be their loan that caused their own bank to fail, it would only be the loans that were not performing – so a new bank should not be prejudiced by taking on the loan. In any case, the loan would be sold to the new bank in a bidding process, with all bidders basing their bids on the cash flow from the loans being transferred.

3.2.2 *Non-performing Loans*

None.

3.3 Bank Officers

With the loans 'off-balance sheet', there would be no need to 'mark to market' if the value of the collateral falls - as long as the borrower is making re-payments. This would stabilise the bank's accounts making it easier to manage risk.

Perhaps counter-intuitively, due to greater focus on risk management, removal of Moral Hazard could reduce stress for most bank employees who may otherwise feel pressure to engage in high-risk or even immoral practices to get higher returns.

With no cost of funds, generation of the bank's net profit would also become less risky. Bank officers would only have to manage operating costs and margins, and the risk premium on their loan portfolio... all much easier to assess than movements in interest rates.

As well, by converting deposits to digital currency, it would assure banks a permanent place in the financial system, enabling the industry to better deal with attack from other new

currencies and payments systems. (The Banks' role would be enhanced by making them society's tax-collector also).

3.4 Bank Shareholders

Shareholders would no longer be at risk of a run. As well, the overall operating risk of the business would be reduced (as discussed under benefits for 'bank officers', above) - without affecting their net assets or income. Again, the conversion of deposits to digital currency would assure the on-going viability of their business against attack from digital currencies.

They could also benefit from increased CAR, allowing them to increase lending without requiring increased capital.

3.5 Bank Creditors

Creditors too would benefit from the same reduced risks that bank officers and shareholders would benefit from.

3.6 Other Financial Organizations

The biggest benefit would be in a much more stable financial system, and hence economy, less prone to asset bubbles and recession, reducing overall risk.

3.7 Central Bank

The biggest benefit would be in a much more stable financial system, and hence economy less prone to asset bubbles and recession.

The Central Bank would also get:

1. licence fees from the commercial banks to cover its costs. Again, these would be stable... ensuring the Central Bank remained fully funded, while ensuring the cost to banks was also stable.
2. new tools to manage inflation and unemployment:
 - targeted interest rate charge added to loans for specific purposes to damp asset bubbles, or all loans to damp borrowing in general, as well as:
 - general levy (like broad-based GST) applied to all transactions to damp inflation
 - general flat payment to all citizens to boost demand and increase employment.

The payments would come out of thin air and not increase total debt. The charges would be written back into thin air. They would be created and levied for use only in managing unemployment and inflation.

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The system can operate without the general levy or flat payment. It simply makes it easier to use them.

3.8 Government

The biggest benefit would be in a much more stable financial system, and hence economy, less prone to asset bubbles and recession.

3.9 Community

The biggest benefit would be in a much more stable financial system, and hence economy, less prone to asset bubbles and recession.

4.0 The Transition

4.1 Legislation would make the change Voluntary. The Market would force the Shift

The expectation is that it may take up to five years to formulate and pass the new legislation, with the transition phased over another two years, in a way that is favourable to existing banks.

Fortunately, we don't need to amend or repeal existing legislation (except to remove government guarantees and insurance on deposits). We only have to introduce new simplified legislation to create the new institutions (Loan and Deposit Registrars)... a much easier task.

Existing banks would naturally transition to the new framework as depositors chose to hold their money as fully secured Digital Currency (adjusted for inflation without tax), rather than traditional bank deposits (which would then be fully at-risk with all interest taxable).

Borrowers too would want to shift for the greater stability offered.

4.2 The Mechanism

4.2.1 *Using new Money to Buy Loans and Repay Deposits*

Essentially, the Central Bank would create new money to buy all the commercial bank loans. This is similar to QE, where Central Banks buy securities off commercial banks (and others) with new money.

Different to QE, as the loans would continue to earn the banks the same income as before the transfer, they would be purchased at their book value (not market value).

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In another difference, the new money would be used by the commercial banks to repay all Deposits.

The money would not actually be paid out. Instead, it would be immediately and automatically deposited with the Central Bank. Each deposit would be recorded in the name of the Depositor in a new Central Bank Deposit Register. All the transactions would be electronic.

This would get both the loans and the deposits off the books of the commercial banks and onto the books of the Central Bank. The Registers would become subsidiary ledgers of the Central Bank under law – managed under licence by the commercial bank that previously held the deposits and loans.

Commercial bank deposits are already regarded as money for all practical purposes. The transactions would simply have the effect of turning the ‘at-risk deposits’ into ‘risk-free legal tender’.

It would mean that our legal tender (money) came in three forms:

- metal records (coins)
- paper and plastic records (notes), and
- electronic records (digital).

All would be issued by the Central Bank, via commercial banks. The paper and metal money would be produced by the mint. The electronic money would be produced under licence by the commercial banks issuing loans and matching deposits via the Central Bank Registers which would be computerised - so any new Deposits would be ‘risk-free legal tender’ from the start.

All forms of legal tender (money) would be exchangeable into one another. Ultimately, metal and paper money will likely disappear altogether.

4.2.2 Technical Increase in Money Supply

Just as QE increased the money supply, this process may also. But it would not result in more money going into circulation, as the commercial banks receiving it would be prevented from using it to buy other assets.

While loans and deposits are raised equally to start, over time, due to trading and investment, any one bank may end up with a more loans than deposits.

When the loans are purchased and the deposits paid out, any difference would represent a net increase in the money supply. If there are any banks with more deposits than loans, the reverse would be true.

Unlike QE, any extra money issued to a commercial bank in this transition process could not be used to buy other securities. It would have to be held on the books of the commercial

bank as a new Deposit with the Central Bank (adjusted for inflation). It could only be used to pay down liabilities of the bank, or in the event of liquidation to pay out shareholders.

The additional money would be held as an asset of the commercial bank, but *it would not affect the bank's net assets, or its net income*. This is best understood by looking at the actual transactions.

An attached spreadsheet shows how the transition would affect the accounts of a real bank (Westpac), based on their 2007 published accounts.

5.0 Background Detail on the Current System

5.1 What's Moral Hazard and Why is it so Bad?

Excluding human disruption of the eco-sphere, Moral Hazard within the Banking sector is perhaps the greatest systemic risk to our economic and social well-being.

It occurs when *a person* making a 'wager', receives a benefit, but does not bear the loss when things go bad.

In the case of banks (and specifically *bank officers*), the 'wager' is that any particular borrower will repay their loan and interest in full. The risk of default is normally covered by charging a 'risk premium' on all loans in the form of higher interest.

Problems arise when high-risk lending is undertaken by any bank. This happens when loans are made to people who have little or no equity, and/or insufficient income to meet rising interest payments – usually in an environment of increasing asset prices.

Bank officers are happy to make these loans because they get the benefit of the interest and up-front fees that go to pay their salaries and big bonuses, while the appreciating collateral covers the principal. Sometimes too, loans with different risk ratings are packaged up and on-sold for a profit to unsuspecting investors who are left to carry the risk. This lending creates a bubble, as borrowers bid up prices for the assets they borrow against... leading to greater apparent equity and even more lending.

Moral hazard occurs because the *bank officers* making the loans either pass the risk to other investors, or because they know that if things turn really bad, they won't lose their job (or even their bonuses!), as the bank will be rescued by taxpayers to stop a 'run'.

A 'run' occurs when depositors believe a bank may fail and all try to get their money out at the same time. As most bank assets are in the form of loans, not cash; withdrawals soon cannot be met. Any bank that cannot meet its cash calls is forced to close, going immediately into administration and possible bankruptcy. This freezes deposits, often for years as the loans are liquidated, often with big losses for depositors... unless the government steps in.

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In such cases, some shareholders may lose... but not the people who actually make the loans – the *bank officers*. These include not only the people writing the loans, but especially those responsible for overseeing bank policy and risk management.

[This last happened in the GFC](#) when, after a period of sustained and widespread high-risk lending, house and share prices were pushed higher and higher, and then collapsed.

Single bank failures are bad enough. The possibility of widespread failures during the GFC put the global financial system at risk.

As a result, taxpayers in many countries have had to rescue their banks – to protect deposits and the payments system. This has included printing \$trillions of dollars, and now euro's, to buy securities from the banks and other major investors at full value to provide liquidity, as well as taking direct equity in some banks, and buying impaired/non-performing loans at high values, together with explicit government guarantees and insurance for deposits.

While shareholders and taxpayers have lost money through the GFC, few *bank officers* have been prosecuted or even had their bonuses confiscated. In effect, those directly responsible have got off scot free... preparing the seed bed for the next generation of 'moral hazard'.

In particular, the rescue has led to the idea of 'Too Big to Fail': that big banks cannot be let fail because it would bring down the payments system and wreck the economy. Without access to their money, people cannot buy goods and services; forcing businesses to lay off staff... causing a downward spiral that could lead to another global Depression... and hence another rescue.

The GFC was only the most recent (and biggest) in a long list of systemic failures. The IMF and World Bank have detailed over 100 such failures in the Banking System across more than 90 countries over the last 40 or so years - all leading to large losses and, in some cases, to severe disruption of the world's financial system. With every failure new regulations are written in an attempt to circumvent the next collapse. In time, these may be unwound by future generations who have no memory of previous failures and hence no understanding of why the regulations are there!

Since the GFC, it has been no different. New regulations have been enacted around the world to try and mitigate the risks, but no one believes that they have solved the problem. They have merely reduced the risk slightly by requiring banks to hold a bit more capital to loans, increasing the buffer before depositors lose their money.

One difficulty is that regulators are always behind the curve. They do not have the resources to monitor the whole system, or to understand the full implications of each new financial instrument or banking practice that appears in the market.

But the real problem is that regulations just don't work.

[A 2010 German study](#) demonstrated from an analysis of actual case studies that: “Most regulatory interventions, such as warnings and penalties, do not reduce moral hazard. Only interventions directly targeting bank management mitigate moral hazard”. If we think about it, it is common sense.

When the next wave of imprudent lending appears, the risk remains that we will have to bail out the same organizations, with the same people taking all the profit and bearing none of the losses... *simply because no amount of regulation can stop a run under the current system.*

5.2 Understanding the Problem

Fortunately, it is now possible to fix the system, using the idea of ‘Digital Currencies’ recorded ‘in Registers that are ‘off balance sheet’... without the need for massive regulatory oversight, nor the need to ‘do away with banks’.

How, was outlined in PART 2.

However, to understand the problem (its root cause) and hence the solution, we have to agree on how the current financial system works. A brief explanation was offered in PART 1. This section provides an-depth look at the role of money; and how it is represented, created and destroyed, within the current system.

This sounds pretty straightforward – but it isn’t!

What follows is my understanding after 30 years of research.

5.3 Role of Money

It needs to be recognised upfront that the role of money is limited. A great deal of ‘value’ (including most of the natural world and all unpaid home, child, aged and disability care, social engagement and much besides) is ‘unpriced’ and hence cannot be accounted in money terms. But that is a separate (major) problem. This paper has a specific purpose, which is to address the problem of Moral Hazard in the Banking System.

In essence, Money is the ‘Record’ of ‘Value’ that we *create* (when we work, trade and invest), or *owe* (when we borrow), and *consume* (when we spend) - in standard or agreed ‘Units of Account’.

Underlying it is an implied social contract between all members of society:

“We should each be able to take out of society, what we put in”.

(This general principle is subject of course to tax, to pay for social goods and services).

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While we have any money, it means that (in economic terms) we have put in more than we have taken out. If we are in debt, it means we have taken out more than we put in - and so must work/invest to create economic value that will enable us to pay off the debt.

When we have spent all our money and paid all our debts, we and society are square.

If we spend money on assets, then those assets represent the amount of value that we have added and not consumed. Society has no claim on them. They are ours by right of having worked and invested (directly and indirectly) to create the (priced) *value* that is in them – ignoring of course inheritance and gifting, or gambling and theft!

Regardless of the facts, the unstated assumption in all transactions is that the bearer has a lawful right to the money they offer... subject only to direct evidence to the contrary. That is, we accept at 'face value', that they (or their *benefactors) have contributed value and are entitled to take the same amount out.

(*benefactor is a person or chain of people who give or bequeath money that they have earned, to the benefit of another person).

As we contribute our labour and capital to the creation of goods and services, we are paid money to 'Record' the value. As we take out goods and services by spending, the money becomes the 'Medium of Exchange'.

The basic principle is that the net wealth of both parties is unchanged by the exchange (not always true in practice of course!)

In all such transactions, it is only the seller that gives real value (in the form of goods and services). The buyer passes over money simply as a 'Record' of the value given, so the seller may in turn take out real value from other members of the communities/nations *who are party to the social contract*.

This contract is expressed as a 'Right' on the one hand and an 'Obligation' on the other. It is the 'Right' of the Bearer of the money to take out of Society what they (or their benefactors) have put in; balanced by the 'Obligation' (on the part of Society) to pay the Bearer (in resources equal to the Bearer's own and/or their benefactor's contribution). These Rights and Obligations are given the force of law by designating certain Tokens as 'Legal Tender' that must be accepted in any exchange.

Importantly too, *without money it is impossible to signal our needs in the paid economy*. Money is thus also a 'Vote' for what *should be produced*, as well as a 'Claim' on what *is produced*.

With a fixed Unit of Account, we can also hold money as a 'Store of Wealth'. This money represents *value* we have added (and been paid for) that *we have not consumed*.

In Summary, the Role of Money is as a:

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- Record of Value (contributed by the Bearer and/or their Benefactors)
- Unit of Account (that fixes the Value)
- Right (of the Bearer to take out Resources from Society)
- Obligation (by Society to hand over Resources to the Bearer)
- Vote for Production (by the Bearer)
- Claim on Production (by the Bearer)
- Medium of Exchange (between the Bearer and a Supplier of Goods and Services)
- Store of Wealth (created by the Bearer and/or their Benefactors)

These are all accounting, legal and political concepts. They express the role of money without reference to the substance of the tokens or forms used to represent it.

5.4 Money's Representation

As Money itself is a concept, and as we cannot see concepts (except in our own head), we need a way to represent it in the physical world.

Traditionally this has been done using all sorts of objects and materials in the form of tokens that we can see and feel.

The token may be a metal coin, or a paper or plastic note, or as in the past: clay tablets, notched sticks, or shells and many other objects.

Currently in Australia, our 'Units of Account' are dollars and cents. The tokens we use are made of metal (coins), and plastic (notes). The number of Units shown on the token is called its 'face value'.

It is the *face value* that is *money*. The *substance of the token is irrelevant to its role as money*.

The one exception to this rule is if the material of the token itself has value (say a precious metal). In this case, problems arise if the *price of the metal* goes above the *face value of the coin* as it leads to hoarding for the value of the metal, rather than spending as money. This has happened many times in the past. It is therefore much better that the token itself has a low 'intrinsic' value relative to its 'face' value, or preferably no intrinsic value.

The idea that money needs to be 'backed' by a precious metal is a misunderstanding of what money is. Money is nothing more than a 'record of value' given in 'standard units of account'.

Money's 'backing' comes from the whole of the human, technological and natural resources of the societies that accept it. It has no other backing.

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If society breaks down, or beyond the borders of the society that accepts it, the money created by and for that society is worthless.

While coins and notes were once our entire pool of money, today they are just a fraction.

Most money is now recorded in electronic form as bits and bytes in banks' computers. The token has in effect become an eToken. We only see it the form of numbers on a bank deposit account statement; sometimes in paper form, often only on a computer screen. While such records are for all practical purposes 'money', *legally they are not*. Only coins and notes are 'legal tender'. This is a significant issue that is central to the problem of, and proposed solution to, Moral Hazard.

The ideal token has a number of attributes. Apart from having no intrinsic value of its own, it should also be immune from counterfeiting, theft and loss, as well as accidental or unlawful destruction.

It should also be easily divisible into any number of standard units and available for use anywhere in the world that it is needed.

Another key requirement is that the number of new *units* of money created should only be sufficient to: a) replace money that is lawfully destroyed, b) to facilitate additional transactions in a growing economy, or c) to boost an economy that is in recession. Not more or less. Less restricts trade; more just pushes up prices. Again, how to keep the money supply in balance is a whole other topic touched on in earlier sections.

The material and form of the token is also irrelevant, except to the extent it meets the criteria.

eTokens can be developed to exhibit all of the ideal attributes of the perfect money token. Being electronic, the units can be created for almost nothing and transported at little cost anywhere they are needed in the modern world. They can also be divided into any number of units. Importantly, they can also be made so counterfeiting, theft, loss, and accidental and unlawful destruction is virtually impossible. This can be done by recording the money in electronic Registers (bank accounts) and in eWallets (that could be a smart device) protected by three factor security and/or block chain technology. Nothing can be taken out of the account without the eWallet. Losing the eWallet does not mean losing the money. You just have to go through the hassle of replacing the eWallet and re-instating its connection to the eRegister. With the eRegister held by the Central Bank, loss of the money would become virtually impossible.

As indicated in the title, eMoney (digital currency) is central to how we may eliminate Moral Hazard.

But to understand the practicality, we need to understand for what purposes and how money is now created and destroyed.

5.5 Creation and Destruction of Money

5.5.1 *Historical Context*

Unfortunately, no one knows for sure how money evolved.

Piecing together many stands, it seems money may have been first created and issued 'out of thin air' by kings in the form of 'tokens' (tablets, coins, etc). These had marks or numbers inscribed on their face (their 'face value') that showed 'standard units of account'. They were issued to recognise the 'work performed' by the king's household and army - with higher ranks being paid more units. The tokens enabled the payees to redeem *goods of specified value* from the quartermaster's store with improved control (eg one unit for a hen, two for a lamb, etc). These exchange rates were set under the king's command, *establishing the value of the tokens*.

In time, the use of these 'units of account' (money tokens) spread to other subjects who accepted them in exchange, knowing that, if no one else accepted the money, they could get value from the king's store.

It was this trust that allowed the use of the money to extend throughout the kingdom.

Then, by agreeing to accept the money in payment of taxes, instead of needing to collect and distribute goods in kind, the king simply paid his courtiers and soldiers with tokens (money) who used them to buy goods off his subjects, who then paid their taxes with them – saving a huge amount of effort... brilliant!

5.5.2 *Current*

Money can be created and issued:

- 1) *as a loan*, with an obligation to give back value through future work and/or investment
- 2) *in exchange* for work performed, goods supplied or securities issued.
- 3) *equally to all* - to boost demand in a recession.

Today, it is the government that issues most money; with our trust now placed in the whole community to honour the tokens for value in goods and services.

However, instead of being issued for 'work performed' (as originally was the case), all new money is now issued *only* as debt - except for Quantitative Easing (QE) which is issued for securities.

No country now issues it 'for work done', nor 'equally to all its citizens, debt free'. But any country could.

Money flows up, much faster than it trickles down.

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In the GFC, printing money to buy securities (QE), just boosted the price of securities, with little flowing down to 'main street'. Instead, in times of recession, the Central Bank could issue a gradually increasing weekly amount to every citizen (rich and poor), until full employment was restored. Most people would spend the new money to meet their daily needs, increasing demand and boosting business activity. This money would never have to be repaid. It would simply represent a permanent increase in the money supply, reflecting the increased activity. The lift in real activity would also boost share prices in a good way... because of increased profits.

Another topic is how new money could be issued for work performed that is highly valuable, but is not now paid because the benefits accrue to society and not to the person paying. This is the subject of a separate paper.

The three principle ways money is now created are:

5.5.2.1 Quantitative Easing

QE is the most recent way. It involves Central Banks buying existing securities from banks and other organizations using money created out of thin air. As this is a recent 'aberration', and is not the usual way money is created, I don't propose considering it in any more detail. Except to note that *the issue of the new money does not change the net wealth of the person to whom it is issued*. They simply exchange securities of a certain value for money of the same value.

QE effectively turned 'legal tender' into 'at risk deposits'. This proposal extends the process and turns the deposits back into legal tender. It would eliminate the need for QE, as there would no longer be any need to 'rescue' banks, or provide liquidity, since deposits would no longer be at risk.

As suggested above, there are also better ways to inflate economies than using QE.

5.5.2.2 Local Exchange Trading Schemes (LETS) and BarterCard style Schemes

In these schemes, groups of people use a 'central registry' to create their own currency and use it to buy goods and services off each other. While there are newer digital versions that warrant consideration, they have little bearing on most trade in developed countries. For that reason I don't intend discussing them in detail.

However, it is important to note that, as with QE, *the net wealth of the parties to the exchange does not change*. LETS and BarterCard issue new 'currency' only in exchange for goods and services, with the person receiving them (the buyer) incurring an obligation to give back equal value - by providing goods or services of their own to the LETS/BarterCard community.

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In essence, the person acquiring the goods or services incurs a debt to give back to the community in equal measure, while the seller, having given value, is entitled to take the same amount out.

The value of the transaction is recorded in a public ledger so everyone can see who is owed goods and services (to what amount), and who is in debt to provide goods and services (again, to the amount specified in the ledger).

LETS and their ilk fall short when dealing in broader markets, while the public nature of the register also raises concerns with some people.

Nevertheless, they are great for boosting activity by monetising small scale transactions between members of a local community.

5.5.2.3 Bank Lending Creates most New Money

Bank Lending goes to the heart of the issue of 'Moral Hazard' in Banking, so we need to look at it in some detail.

Importantly, the ***new money that banks create has no impact on their own net worth.***

A Bank's Liabilities (Deposits) go up at the same time as their Assets (Loans). It is as simple as making two simultaneous entries in the books of the bank: Debit Loan to Borrower \$100 (Asset) while Credit Deposit account in the name of the same Borrower \$100 (Liability). The Loan records the Borrowers debt, while the Deposit provides the avenue to draw down the Loan... to get cash out. See [Bank of England paper for details](#).

As Cash is withdrawn, the Deposit is reduced by the same amount... leaving the Bank's net worth unchanged.

Nor does the net worth of the Borrower change when the money is borrowed. They get the Cash (asset), but also a debt to repay the Loan (liability).

When the borrower spends the proceeds of the loan, they hand it over to the seller in recognition of the value given. Again, ***the net worth of the buyer and seller is unchanged by the exchange.***

This is the essence of money as the 'Medium of Exchange'. ***It does not of itself change your wealth.***

Money only *records* value. This may be the value that you (or your benefactors)

have created through work and/or investment... and not yet consumed. Or it may be money that you have borrowed and must repay.

As the loan is repaid to the bank, the entries are reversed. The money that is repaid goes back into the thin air from which it came. Once again, *the repayment has no effect on the net worth of the bank or the borrower.*

The bank only gets to keep the interest and fees paid. Most of this money is paid out as interest on borrowings (deposits) and operating costs (including salaries). It also goes to pay a 'risk premium' to cover normal defaults. The only part the bank gets is the *after-tax* profit... which goes to shareholders. In many cases, these are big insurers and pension funds representing the interests of the wider community.

The banks earn this profit for providing a service to the community. They allow people to get access to new money, not as a 'gift', but as a loan. The person borrowing the money has done nothing for it, yet it gives them the power to consume resources. By requiring repayment, we force the borrower to contribute their labour and resources to create future value, out of which the debt is repaid. In the end, they are required to put back in what they take out. This service has to be managed, which costs resources. If we did not have banks to lend new money, we'd need another organization with similar prudential controls.

5.5.3 Destruction of Money

Money is lawfully destroyed every day as loans are repaid. The total money supply none-the-less increases, as the total of new loans exceeds repayments. This is necessary to fund growth under the current system (where all new money is created only as debt).

The same would remain true under the proposed system. As loans are repaid, the money (adjusted for inflation) would be written back into the air from which it came.

If general inflation was to become excessive due to too much money being pumped into the economy, besides levying a targeted charge on new borrowings (as previously discussed), the Central Bank could also levy a broad-based GST on all transactions (not just borrowings) to damp total demand. In all cases, the money re-couped would not go to the institution collecting the tax, nor to the Central Bank. It would be written back into the thin air from which it came... to take pressure off prices.

6.0 Conclusion

Banks provide extremely valuable services: they ensure people who borrow new money repay it; and they run the payments system.

We may not like banks because of some corrupt practices, but that is as much as system problem, as it is a personal failing of the officers involved. A problem that this paper seeks to redress.

Banks earn their after-tax profits, not from creating money, but for providing on-going lending and payments services for the community.

The trouble is the way the system is now structured; it creates moral hazard - leading to unsound lending practices that imperil the system, and ultimately the whole society.

By passing a few simple new laws to:

1. Take both loans and deposits off the balance sheets of banks, and put them into Registers managed by the banks
2. Declare the Registered Deposits to be Legal Tender, and
3. Remove Guarantees and Insurance from Deposits that remain on Balance Sheet...

We can turn Deposits into Digital Currency (eMoney) that cannot be counterfeited, lost or unlawfully destroyed, eliminating Moral Hazard – greatly reducing the likelihood of imprudent lending and corrupt practices within the Banking sector.

With a stable banking sector and stable borrowing costs, the whole economy can be stabilised.

Transition to the new system can be phased over several years in a way that is non-threatening to existing banks. We don't even need to amend existing legislation (except to remove deposit guarantees and insurance). We only have to introduce new simplified legislation to create the new institutions (Bank Loan and Deposit Registrars)... a much easier task. The legislation could be extended to Credit Unions and Building Societies.

The only losers would be the few bank employees intent on using corrupt practices for their own benefit. The vast majority of bank employees, and everyone else in society, would be winners by a huge margin.

7.0 Emerging Digital Currencies: The Good and the Bad

7.1 Essence of Money

To understand why some digital currencies are 'good' and others 'bad' it is important to recognise that (as earlier illustrated), *Money does not of itself change your wealth* – not when it is created, nor when it is used. It exists primarily as a measure of your contribution and secondarily as a vote for what gets produced and medium of exchange.

7.2 Bank Created Money

As previously discussed, banks create new money through lending. However, *the new money they create has no impact on their own net worth. Not when the loans are issued, nor when they are repaid.*

Once you repay a bank loan, through doing work or investing (squaring your debt with society), both the deposit and the loan is extinguished... and the money destroyed.

7.3 Digital LETS

Some new digital currencies look promising as a tool for improving 'local activity'. They operate like traditional money. The 'units of account' are created electronically by a third party (the registrar), that acts a bit like a central bank. It involves making two records:

1. the value of work done, or goods supplied, by a member of the community - giving them a *right* to take out of the same community a similar amount of value in specified 'units'.
2. the same amount as an *obligation* by the person for whom the work was done, or to whom goods have been supplied. The obligation is to work or provide goods to other members of the community, to pay off the debt.

The LETS units exist only to recognise value given in an exchange. They disappear (off the register) once the value is returned in kind.

In this regard, they are like new money issued via bank loans and deposits.

7.4 Bitcoin and other Crypto-currencies

Crypto-currencies are completely different. As explain in Appendix I, they are a really bad idea.