Submission to Australia's future tax system review

Challenges facing Australia's tax-transfer system

Challenge 1

Many people simultaneously complain about the amount of tax they pay and the lack of government services. They appear to think that government revenue raising and spending are unrelated.

The tax system is a way of collecting money. Focusing on the efficiency of collecting tax, as the discussion paper does, hides two fundamental questions.

1. How much of GDP are Australians willing to pay to governments to fund transfers and services?
2. What amount and quality of goods and services, and level of transfers do Australians want governments to provide?

Alternatively, the document Architecture of Australia's tax and transfer system, August 2008 (the paper) does not discuss the fundamental concept that Government spending on transfers and consumption equals its income raised though taxes and asset sales plus borrowing minus savings.

If Australians want lots of services, then governments need to have high taxes, sell assets, go into debt or print money. Each has it own problems.

Chart 5.2 makes this point. If a country is below the line, then it is spending more as a percent of GDP than it is collecting and the reverse is true if a country is above the line. This is superficially discussed on page 201
"However, two of the nine countries with lower tax to GDP ratios than Australia also run significant fiscal deficits (the United States and Japan)."
There is no discussion of whether this is deliberate or what the consequences have been. We need to discuss the consequences of these different approaches before we decide on which approach to take.

There have been several calls in the media for lower taxes. However, this usually accompanied by calls for more spending, or criticism of government borrowing.

So, the first major challenge facing the tax system is to have a sensible discussion about government income and expenditure; how much income the government needs and how that is obtained, and how much spending it will do and on what. We do not have limitless resources; comprises need to be made and projects prioritised. People need to understand this before there can be a discussion about tax rates, amount of government borrowing, appropriate returns to work or level of transfers.

Challenge 2

Chapter 3 of the paper discusses equity. However, people do not have a clear idea of what equity is and "how they fit into the equation". The paper provides no evidence of peoples opinions regarding the current version of equity built into the system. It also does not discuss alternative versions of equity and their consequences.

Many people are focused on minimising taxes; either legitimately or otherwise. Many seem intent on investing in assets that only make losses or undertaking high risk investments without reward for the sole purpose of minimising tax.

So, the second major challenge for the tax system is to make clear the principles on which collection of taxes and spending government money is based. A component of this challenge is to educate people that tax is cost of maintaining Australia as a place where they want to live and work. They undertake investments to make money, not loose it. A loss is a loss, not something you do to avoid tax.

Challenges one and two relate to building a consensus about the legitimacy of the tax system.

Challenge 3

The income tax system is a very efficient method of collecting money. It is used to collect income taxes and repayments on student loans (HECS repayments). It could be expanded to efficiently collect other debts. For example fines where defaults are high or new forms of income contingent loans, for example changing the basis of drought relief to income contingent loans.

Risk is a pervasive part of life and different groups have different abilities to manage it. Government is well placed to manage some risks. For example the current health system manages life time risk of needing medical care. The social security system manages the risk of unemployment and providing retirement incomes. Over the last twenty year governments have transferred the management of these types of risk from itself to individuals. However, it has not given individuals the ability to manage these risks.

For example the superannuation system assumes that everyone is able to and interested in managing their superannuation. However, many people are neither able nor interested in managing their superannuation. Whether it initially choosing which fund to enter or monitoring fund performance and changing when appropriate. This is an example of governments transferring risk to people less able to manage it, and, in my opinion, the Australian people will ultimately pay more because of this decision.

The third major challenge of the tax-transfer system is to determine what types of debts it will collect and what types of risks it manage.

Challenge 4

The paper identifies individuals as the group that ultimately pays taxes. However, this is a simplistic analysis. There are two groups of individuals that pay taxes: residents and foreigners. Because residents live in Australia, they get the full benefits of the taxes they pay. Foreigners don’t get the same benefits; however, their taxes help pay for a system which creates a place in which they want to invest. If they did not pay Australian taxes, then Australia may not be such a place.

Residents pay tax at the Australian rate and get credits from foreign tax they pay. Consequently foreign tax rates are irrelevant to Australians as it is their total income from both domestic and foreign sources that determines the amount of tax they pay.

Similarly foreign residents get tax credits at home for tax they pay in Australia, and the same applies to them. Therefore any decrease in Australia’s tax rates (either personal or corporate) merely means that foreign governments collect more tax at the expense of the Australian government.

There have also been calls to combine the effect of both income tax and transfers. The ultimate aim of having a lower tax rate, and saving the transaction costs of collecting tax and paying the transfer. However, the tax and transfer systems serve different purpose and those who receive transfers do not necessarily pay tax.

The fifth major challenge of the tax system is to separate self serving arguments for lowering taxes from reasons related to creating Australia as a place in which its citizen want to live and foreigners want to invest.

Problems with the current tax-transfer system

Problem 1

The paper identifies three tax bases: land, labour and capital. However, I would categorise Australian government income differently. Government income is derived from asset sales, sales of goods and services, collection of debts and money on behalf of other groups, and taxes.

Asset sales includes sale of government business enterprises and land, but it also includes mineral and forestry royalties. The paper does not include income from the first two within the tax base, but it does describe the second two as taxes. Minerals and forests on crown land are natural resources owned by governments. When they are exploited governments are allowing this in return for money — they are selling these assets. These are not unrequited transfers, which is the definition of a tax in Box 2.2 of the paper, and so should not be classified as taxes in the paper.

When governments sell natural resources they should get the best price possible. This money should be used to create other resources of equal value to Australia's general community. It should not be used to pay for infrastructure to support resource exploitation, as these costs should be factored into the cost to exploit the natural resource.

Governments sell goods and services. These include: electricity and transport in some states; postal services by the Commonwealth; until recently, telecommunications, banking and air travel by the Commonwealth; and licences. Payments for licences are not unrequited transfers as they rights to do something that the government has restricted. They should not be classified as taxes as in the paper.

Collection of debts and money on behalf of other groups includes collecting HECS payments and agricultural levies. This money is collected through the tax system because this is the most efficient way of collecting it. Again, these payments are not unrequited transfers as the payers have previously received a benefit which they are now paying for. These should not be classified as taxes as in the paper.

Taxes are levied on income from the three factors of production: land, labour and capital. Taxes are also levied at point where it is easy to detect evasion, such as customs duty on items that cross the boarder.

One problem with the current system is the understanding of what is a tax and where governments are legitimately recovering the cost of providing a service.

Problem 2

Whether government should provide that service or collect money to pay for that service are different questions. However, when governments provide services on a user pays basis, then it is behaving no differently to private business. The money raise should be viewed as being equivalent to all other costs of doing business

The tax and transfer systems assume that people are rational in an economic sense. That is that people determine whether marginal cost is greater than marginal benefit and ignore sunk costs when making a decision. However people do not operate like this. The tax and transfer systems need to take account of how people behave in the real world. A problem with the current system is that it does not do this.

Problem 3

Personal income, regardless of source, should be taxed at the personal tax rate and business income at the business tax rate. People should not be able to shift personal income to a business expense and get a benefit from this. For example company cars. The current system encourages people who can access the scheme to buy bigger and more polluting cars than people who put their hand in their own pocket to buy a car. Company cars tend to be big, where as privately purchased cars are small.

People also structure their affairs to minimise their tax and mine the tax system to accumulate assets.

Many small businesses are focused on how much tax they pay and structure their affairs to minimise tax. However, in doing this they fail to focus on their business and do not make a profit.

A problem of the tax system is that people can manipulate their income and in doing this they do not pay their proper share of taxes, consumption patterns are changed and businesses fail. Any tax system should minimise the incentives and opportunities to manipulate income; whether that is its source or across time.

A problem with the current system is that federal, state, local government fiscal imbalance. Any system should only have broad based taxes. Narrow taxes should be removed. Any system should look at equity and not just collect taxes in a particular way because that way is easy.

Problem 4

Under the current system state based business taxes become income tax deductions and so are in part paid by the Australian government. State stamp duties distort markets and discourage transactions. They influence development policy to citizens' long term detriment.

The fragmented nature of the Australian tax system is a problem.

I would like to see all state taxes and local government rates removed. I would like to see most revenue raised through the income tax system, with personal income tax comprising three parts; a federal, state and local government part. State and local governments could independently set their part, and the rate a person paid would be determined by where they lived.

This type of system would remove the Commonwealth-state fiscal imbalance and enable jurisdictions to collect the revenue they decided was necessary. It would remove market distortions arising from the transactional nature of state taxes. However, it would make the amount of tax paid more explicit and explicitly rely on income as the tax base, rather than asset value or some other tax base.