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Submission
Tax and Welfare Systems

(Please note: Both are covered by this submission as they are integrated. The enclosed proposals represent a total package that needs to be seen in its entirety.)

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Executive Summary

Basic Principals that should apply

- Fairness – taxes aligned to capacity to pay, welfare shouldn't be provided to those in better economic circumstances than those we take tax from
- Neutrality – individuals should get the same result regardless of the assets they own or how they own them
- Simplicity – 90% of people should be able to self assess

Taxing Income and Wealth

- Tax personal exertion income (including fringe benefits) plus a deemed 5% return on net wealth (including the family home)
- Tax rates of 0% up to $20,000, 16% from $20,000 to $60,000 and 32% on the rest
- Corporate tax rate of 32% on business earnings
- Abolish dividend imputation, capital gains tax, fringe benefits tax, deemed dividend tax, FIF, accrued trust income provisions, Medicare Levy and lots more
- Reimburse the States and Local Authorities for Land Tax and other asset related charges, which should also be abolished
- Do away with all special tax rebates and Payroll Tax

Superannuation

- 16% tax rate on deemed earnings of 5% on assets at all times
- Pensions to be drawn after reaching preservation age, tax free as the fund is taxed
- Abolish contributions tax. Include employee contributions in their income and give them a 16% rebate for any contributions made to Superannuation (up to $50,000 pa indexed)
- Remove all death taxes
- Simplify contribution rules – anyone can contribute up to $200,000 pa

The Welfare System

- Include the family home in the assets and incomes tests.
- Reduce entitlements by 50% in the dollar on deemed incomes of 5% on all assets (including Superannuation and the Family home)
- Allow all seniors to draw up to the full age pension, with payments surplus to their calculated entitlement accruing as a debt against the family home.
- Raise the pensions to $20,000 pa (singles) and $35,000 pa (couples), all tax free.

Conclusion

- Broad based, fair tax system
- A generous, equitable welfare system
- Simplicity

Overview

There seems little debate about the need for reform of the taxation and welfare systems. Over the years they have become extremely complicated and inefficient. Furthermore, it is unlikely that minor tinkering at the edges will make a substantial difference.

Every initiative to introduce a new tax, provide relief, or to achieve a desirable social outcome, creates the opportunity for abuse. The accompanying regulation that seeks to anticipate abuse adds further complication. The systems also lead people to make decisions that would not otherwise make economic sense and this perversion of decision making reduces the wealth and efficiency of the nation.

In seeking input into the planned review of the taxation and welfare system the Government will receive ample input from professional associations, industry and special interest groups. Hopefully, there will also be submissions from ordinary citizens (like me) and these views and suggestions will receive at least some attention.

This submission is limited in its scope as it deals primarily with the aspects of the system that impact on individuals. It therefore concentrates on:

- Personal Taxation
- Capital Gains Tax
- Superannuation, and
- Welfare

I have been a personal financial adviser for over twenty years and am well experienced in dealing with issues concerning individuals.

In my view, the tax and welfare system must be judged together against three key criteria.

Fairness

There is no doubt that tax has to be collected but the amount of tax payable should be aligned to each individual's capacity to pay. The current arrangements focus entirely on income and to be truly fair an individual's assets should also be taken into consideration.

There is also no doubt that we need a welfare system. But we shouldn't be providing welfare support to those in better economic circumstances than those we take tax from.

Neutrality

The tax and welfare system should not influence economic decision making other than in ways considered desirable by legislators. Individuals have two basic decisions concerning the use of their income and assets. They can choose to spend or they can choose to save. Both are important to the wellbeing of the nation.

In choosing to save, they will be investing and should ideally be making decisions aimed at maximizing rewards at any given level of risk. These decisions should not be unduly influenced by the tax and welfare systems.

Simplicity

Taxation and welfare compliance impose significant economic costs and provide little economic advantage. This isn't entirely true as the compliance industry is a major employer, but it could be argued that this economic activity adds little in real value to the economy. If the same level of tax could be garnered at a fraction of the cost, the time and money involved in compliance could be directed elsewhere. Given the current and anticipated shortage of skills and infrastructure, there is little doubt that the resources currently employed in compliance could be better directed.

Taxing Income and Assets

Traditionally governments raised taxes by taking a portion of income. Consequently, within the taxation system there is a fixation on income in determining an individual's capacity to pay. There is a realization that income comes from two sources, personal exertion and from investments. Personal exertion income is easily measured and taxed for the vast majority. The taxation of investment income is more complex.

Investment returns are invariably a combination of actual income regularly received and capital gains (and losses) that may be experienced from time to time.

The taxation of investment income varies based on the nature of the income received. Income received by lending money is fully taxable. Income from company dividends is subject to dividend imputation. Income from property and infrastructure investments can be offset by depreciation and building allowances; the remainder is taxable and the allowances reduce the cost base for capital gains tax purposes.

There is no taxation on the implied rent for those who own their home.

Interest and expenses paid to acquire investment income can be deducted from the investment income and, if the interest and expenses are greater than the investment income, these expenses can offset income from other sources including personal exertion income.

Our fixation with income leads us to only tax capital gains at the time of realization. This can occur many years, potentially decades after the asset is acquired. The cost base must be adjusted for any depreciation, maintenance or other factors and this requires considerable record keeping.

From investment capital there is a 'risk free' return equivalent to the interest paid by a bank. In order to get a higher return, the investor must take risk. By taxing investment

returns in the current fashion the government seeks to participate in the risk premium that rightly should accrue to the investor.

The fixation on actual income makes the system far more complex than it needs to be. It would be better to simply assume that those with a high net worth are more able to pay tax than those with less. This assumption would yield the following changes to the taxation system.

1. The abolition of dividend imputation for all taxpayers other than registered charities.
2. The abolition of Capital Gains Tax
3. The imposition of a tax on wealth equivalent to the income that could be achieved by investing that wealth to achieve a risk free return. For the sake of discussion here and elsewhere I have used a risk free return rate of 5%.

Measuring Wealth

At 30th June each year a taxpayer would be required to submit their personal exertion income and a personal balance sheet. The balance sheet would include:

1. All money on deposit and loans to non family members.
2. The value of all listed securities at the market price on the day.
3. The value of all property including investment property, the family home and other lifestyle property based on the Valuer-General's property valuations.
4. An allocation of the net assets of any family trust assets. The value of Family Trust assets can be allocated to beneficiaries for this purpose or the Trust can pay the tax at the top marginal rate.
5. The net tangible asset value of shares in private companies.
6. The value of precious metals and commodities.
7. The insured value of fine art and collectibles (perhaps above a set threshold).
8. The insured value of cars and vessels (also perhaps above a set threshold).

In determining net worth the value of these assets can be offset by debt of all kinds other than debts within the family group. Once the net worth position is determined, 5% of the value would be included in the taxable income for the following financial year.

To avoid double taxation, companies should not pay tax on investment income including interest, rent and dividends as tax will be paid by the owners of the company through the proposed deeming arrangements.

For fairness, it would be appropriate to allow a tax rebate for asset based taxes levied by other levels of government, particularly Local Government Rates and State Government Land Tax and other property related levies.

The inclusion of the family home would be controversial as it has previously been excluded from all forms of taxation other than Local Government Rates and State

Government levies. The argument for including the family home is, however, compelling by any measure of fairness. People who own their own homes or have substantial equity are in a better position to pay tax than those who don't. The dream of home ownership can be more readily achieved by those who don't own homes if they can pay less tax.

In an era where housing affordability is beyond the reach of many, especially the young, it would be fair to recognise that they need assistance with saving and rent payments.

Imposing a tax on wealth as proposed would potentially raise considerably more than current asset taxes in a very reliable manner. The savings from abolishing dividend imputation would be substantial and the entire housing stock of the country would be bought into the taxation system. This should allow a reduction in the level of tax imposed on personal exertion income.

Tax Rates and Thresholds

Progressive taxation rates are sensible. However, to make taxation equitable and simple the following principals should apply.

1. The level of income at which tax starts to be paid should be at least equivalent to the level of the full aged pension. This is currently around $15,000 for a single person and $24,000 for a couple. It is inconceivable that we should be taxing people who earn less from a combination of personal exertion and deemed asset income than these thresholds to pay to others. To allow scope for pension increases as discussed below the tax free threshold should be raised to $20,000.
2. The top marginal tax rate should be equivalent to the company tax rate.
3. Recognise what people already know, that the Medicare Surcharge is just a tax. It should be incorporated into tax rates.
4. Taxable Fringe Benefits should be added to the taxable income of individuals and the Fringe Benefits taxation system for companies should be abolished.

The increase in the tax free threshold may seem extreme but it should be remembered that those with substantial equity in their homes will already be some way towards achieving or exceeding these amounts. If the family home is to be included in the asset base for wealth there would need to be an increase in the tax free rate to make the move tax neutral.

The higher tax free threshold would eliminate the need for the Low Tax Rebate and the Senior Australian's Tax Rebate. Rebates are generally a bad idea as they create distortions in the phase out period.

The synchronizing of the Top Marginal Rate with the Company Tax Rate may require an adjustment to the Company Rate to achieve tax revenue neutrality although the abolition of Dividend Imputation may well be enough to cover the loss of revenue from the current top tax rate payers. From the perspective of simplicity and equity it removes the tax

arbitrage available to some and would all but eliminate the incentive for tax structuring and the complexity of tax administration that seeks to eliminate it.

We would retain a progressive scale of zero, 16% and 32% with no addition for Medicare. The threshold for the implementation of the 32% rate would be set to achieve revenue neutrality.

To achieve equality between the top marginal rate and the company tax rate, the company tax rate should be raised to 32%. The additional 2% could be paid to State Governments in exchange for abandoning payroll taxes.

The Superannuation System

Despite recent changes the superannuation system remains far too complicated. The complication comes from the need for superannuation funds to pay tax on contributions, to differentiate between accumulation and pension balances and to retain detailed information about the composition of superannuation balances to allow the calculation of exit taxes below age 60 and at death.

Arguably, the exit taxes may be justifiable because the arrangements for those in retirement are simply too generous and defy any scrutiny in terms of social equity. To address the complexity of the superannuation system I make the following proposals:

1. That money drawn from the superannuation system should be tax free from preservation age, not age 60. Preservation age is currently being increased progressively to age 60 and the actual tax paid by those drawing in the interim period is negligible anyway.
2. That superannuation funds pay an asset based tax regardless of whether they are in pension mode or not. Based on a rate of 16% applied to a deemed risk free return of 5%, each years they would pay tax of 0.8% on the assets at the start of the year.
3. Contributions tax should be eliminated. Deductible Contributions made by employers should be added to the taxable income of the member and the member should be able to claim a rebate of 16% on <u>net</u> contributions up to the maximum of $50,000.
4. Because the fund has paid tax along the way there should be no tax at death.

By implementing these changes the superannuation system would become incredibly simple. From the fund's perspective, there would be no tax payable on contributions and no need to do anything other than ensure contributions were less than the maximums available. The responsibility for determining the tax applicable to payments would be in the hands of the member. Above preservation age and at death no tax would be payable. Below preservation age all withdrawals should be fully taxable with a 16% tax rebate regardless of the composition of the funds.

For members, high income earners are currently able to put more into superannuation than low income earners as there is a differentiation between deductible and non-deductible contributions. At the end of the current transition arrangements, everyone should be able to put up to $200,000 into superannuation and claim a 16% tax deduction up to the maximum deductible amount regardless of whether they are supported by an employer or not.

Those in lower tax brackets will not be paying tax on money that goes into superannuation, nor will there be any contributions tax. Those in the higher tax bracket will effectively be paying the contributions tax themselves. The elimination of contribution taxes will increase the level of superannuation savings.

The amount on which a deduction could be claimed is the "net" contribution and this is the amount put in, less the amount taken out by any member. This eliminates the current practice of drawing a tax free or rebatable pension at the same time as making fully tax deductible contributions.

The Welfare System

The welfare system is seriously deficient, providing insufficient help to those in the greatest need and paying too much to those with sufficient resources to support themselves. The problems are mainly due to the slow phase out of the pension based on income received and the failure to include the value of the family home in the overall equation. We have the ludicrous situation where a couple with a house that may be worth $1 million or more and other assets of up to $850,000 and/or income of up to $65,000 pa are able to receive some aged pension support.

It is important to recognise that seniors have no ability to build their wealth after retirement but the purpose of welfare should be to provide support to those who need it, not to contribute to the legacies of beneficiaries.

Including the family home in the Assets Test assessment AND deeming income of 5% on the value of the family home and any holiday homes would potentially financially damage many seniors as they can't easily take equity out of their real estate.

I propose that the government allow people to assess their pension entitlements with and without the value of lifestyle real estate. They can then choose to be paid the pension they would receive without the lifestyle real estate being included. The government would then have a charge over the real estate for the extra pension paid and this amount will be indexed for inflation each year. The accrued debt would be repayable at death or at the time of the sale of the property. The accruing debt would also be offset against the value of the real estate in future years in the entitlement tests.

This clawing back of pension payments from real estate sales or eventual estates will allow pensions generally to be increased. I suggest that the single pension could be increased to $20,000 pa and the pension for a couple to $35,000 pa.

The pension should be reduced by 50% for each dollar earned or deemed to be earned elsewhere. To avoid effectively double taxation, pensions should be tax free.

The outcomes from these proposals

1. The elimination of several taxes

Capital Gains Tax

Capital Gains Tax is a bad tax. It requires considerable record keeping and adds substantially to compliance costs. It also interferes with sensible economic decision making and adds an unacceptable amount of friction to the allocation of capital. Our economic system relies on funds being allocated in the most productive fashion. Where a tax interferes, the whole economy eventually suffers.

Fringe Benefit Taxes

Individuals will still pay tax on fringe benefits received but the value of the benefit received would be part of their assessable income and not require a separate tax system.

The Medicare Levy

Simply incorporating the Medicare Levy into tax rates makes enormous sense. They can also become part of the progressive taxation regime that takes a greater amount from those in higher tax brackets.

Superannuation Contribution Tax

This tax is not progressive and discriminates against lower income earners. Superannuation funds have a higher compliance burden as they need to know whether contributions received are concessional or not and account for them separately. Employer contributions should be added to the member's taxable income and a rebate of 16% applied. Allowing individuals a rebate for contributions up to the current concessional thresholds will achieve a number of desirable outcomes.

- Firstly, those in lower tax brackets will receive tax advantages from using the superannuation system.
- Secondly, as any taxes associated with superannuation contributions will be paid by the tax payer and not the fund more money will remain in the superannuation system and add to national savings.
- Thirdly, this measure stops discriminating against those who are working. Currently, those who are working are denied the ability to make concessional contributions against investment income because they are employer sponsored.
- Finally, this provides equal access to all to use the superannuation system. When the current transitional arrangements end only those with sufficient taxable

income to enable a $50,000 concessional contribution will be able to contribute $200,000 in total to superannuation. This level of access should be available to all with a tax rebate allowable on contributions up to the concessional limit.

Superannuation Exit Taxes

The existence of these taxes adds considerably to the complexity of the superannuation system. Those above preservation age but below age 60 have access to tax free withdrawal of around $140,000 and any taxable income flowing from future withdrawals and pensions carry a tax rebate of 15%. An individual can have up to around $45,000 of income and pay only some Medicare levy. The preservation age is lifting to age 60 anyway.

Exit taxes at death will only be paid by those who are unfortunate enough to die unexpectedly. Those with terminal diseases or just getting old with a substantial sum in superannuation will simply withdraw before they die to save their beneficiaries paying the tax. This is the only tax where the estate is taxed differently to the deceased.

2. Tax collection measures to offset the elimination of the taxes above.

The Abolition of Dividend Imputation

Dividend Imputation is a good enough idea to eliminate double taxation but foregoing it is a fair measure to compensate for the abolition of Capital Gains Tax. It will also put an end to the current practice employed by companies where shares are bought back using franking credits for much of the purchase price.

A Broadly Based Asset Tax

Imposing a tax on deemed income of 5% on net assets provides a simple way of recognising that those with assets are able to afford tax more than those with limited assets or no assets at all. Including personal use real estate, expensive cars, boats and art, as well as bullion and collectibles adds considerably to the tax system and should provide relief on personal exertion taxation. Hopefully we might even be able to pay for kids to go the university and get rid of the current dreadful HELP system.

A Deemed Tax on All Superannuation Assets including Pension Funds

If there is $1 Trillion invested in Australian shares by pension funds and the shares yield 4% then pension funds would receive rebated imputation credits totaling $17 Billion. Under the proposed arrangements they would be taxed 0.8% of the capital value or $8 Billion, a turnaround of $35 Billion.

3. Increased Aged and Other Pensions

There has been considerable recent commentary on the inadequacy of Aged and Other Pensions. By including deemed income on personal assets in the Income Test and the value of homes in the assets test pension levels can be increased substantially.

Evaluating the Proposals against the Stated Criteria

Fairness

A couple owns a home valued at $800,000 and has $4.3 million of shares paying them $170,000 of franked dividends and they have no other income. They will pay no tax and no Medicare levy. This seems overly generous. Under the proposed arrangements they may pay $50,000 in tax and given their strong financial position this seems fair.

If they had $2 million in shares they would receive $80,000 in dividends and a further tax rebate of $10,500. Under the proposed arrangements they may pay around $16,000 in tax.

In both cases they wouldn't pay any Capital Gains Tax under the proposed arrangements.

If the $2 million in shares was within a superannuation pension their superannuation fund would currently receive $34,000 in tax rebates. Under the proposed arrangements the superannuation fund would pay $16,000 in tax. The couple would be indifferent about having the money in a superannuation pension or in their own name. They may choose the superannuation system as a handy management arrangement where they don't have to worry about paying the tax personally but they have a choice.

Under the current arrangements a couple, with no home or limited equity in their home, earning $45,000 each would pay $16,000 in tax. Their capacity to pay tax is in no way similar to the people above. Under the proposed arrangements they may pay $8000 in tax. This would assist them greatly in meeting mortgage or rent payments and would immediately assist in housing affordability.

A Pensioner couple has a home valued at $800,000 and investment assets of $575,000. They would currently receive a pension of around $10,500 and possibly $5,500 in franking rebates, a total of $16,000 from the government. This is the money currently paid by the couple earning $45,000 each with no home or other assets.

If the pensioners didn't own a home they would get an additional $2,500 in pension and $500 less in franking rebates. If they wanted to rent a home worth $800,000 it would cost them around, say, $30,000 and the additional compensation is insufficient.

Under the proposed arrangements the non-homeowners would receive a tax free pension of around $21,000. They wouldn't pay any tax but they wouldn't receive any franking credits. Their net income would increase by $3,000 per year or around $60 per week.

The homeowner couple would not be entitled to a pension as the value of their home would rule them out under the Assets Test. They could elect to receive a pension of $21,000 if they were happy for the indexed value of this payment to be offset against the value of their home at their death or the sale of the property. The pension payment would be tax free. They would have deemed asset income of around $70,000 between them and may have to pay tax of around $4,000. They may also be able to have the tax attributable to the property charged against their home value.

Surely this seems fair. The couple earning $45,000 each is currently effectively paying $16,000 each year towards the estate of the home owning couple. This is all well and good if they are the beneficiaries of the estate.

The proposed arrangements appear to be much fairer than the arrangements currently in place.

Neutrality

If the level of taxed paid will be roughly the same regardless what you do with your assets then decision making will not be impacted. People are free to use their money in any way to achieve the best outcome for themselves and in so doing will provide the best outcome for the economy. The proposed arrangements are entirely neutral.

By including the home in the tax base a distortion is removed from residential real estate markets. At the moment, if you own a home there is no tax payable on the implied rent and nor is there any Capital Gains Tax. Investors are disadvantaged in the same market where they are competing with owner occupiers. The proposed arrangements remove this anomaly and should also improve home affordability.

Simplicity

The proposed arrangements offer the opportunity to remove much of the complexity from the current tax system. Those operating businesses through companies will be taxed the same in the company as they would be in their own names and they can simply take the income from the company into their own names with no additional tax to be paid and no rebates to be received. They will pay tax on the deemed income from the net tangible assets of the business but the company will not pay tax on any investment income it receives.

All of the rules relating to loans between companies, trusts and individuals can be jettisoned.

Because tax is calculated on asset values there is no need for detailed accounting of investment income. We would be indifferent about the taxpayer having investments overseas or in Australia.

Tax would be calculated prospectively rather than retrospectively in relation to the broadly based assets tax. The taxpayer merely provides a net worth statement and they will know they have to pay tax on 5% of the value in the coming financial year. This can be collected on a quarterly basis and many taxpayers may choose to pay it through their employers PAYE system. For most people in the country the preparation of a tax return will be a very simple affair that can be completed soon after the end of the financial year.

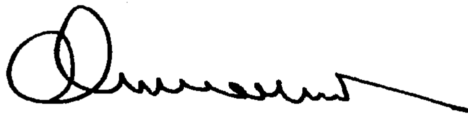
The simpler the tax system is the harder it is to rort.

Concluding Comments

Many of the suggestions included in this paper may be regarded as extreme. It is also true that many of them may be politically unpalatable. It is undoubtedly the case; however, that trying to achieve a fairer, neutral and simpler tax system requires a different way of thinking.

The objective is not to raise less tax or to pay more in welfare. Some will be better off under the proposed arrangements and other will be worse off when the total numbers remain the same. My intention in putting these proposals together was to eliminate the anomalies and improve the arrangements for those who need a better outcome than they currently experience.

I thank you for the opportunity to make this submission.



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