

Australian Tax Reform

Public Policy Foundations and Challenges

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“The political problem of mankind is to combine three things: economic efficiency, social justice and individual liberty.”

J.M. KEYNES, *LIBERALISM AND LABOUR*, 1926

The (unique) Australian balancing act

- Australian public policy built over the 20th century
 - foundation models combining efficiency, justice and liberty
 - elements can be reweighted, but none disregarded
 - Australian policy innovation using tax power (SG, HECS, etc)
- Tax system reflects/delivers this socio-political compact
 - tax reforms often for efficiency/growth – broad base, low rates
 - but preserve/build social re-distribution – “fair-go”
 - and preserve reward – “having-a-go” – especially in relation to property, self-determination and “retirement”

Three Australian policy models

- ❑ Social distribution model
 - ❑ govt. social plus education spending = \$308b (2/3 of tax take)
 - ❑ steep progressivity and targeted assistance (low churn)
 - ❑ dual (public/private) service provision model
- ❑ Private wealth accumulation model
 - ❑ housing and ('compulsory') superannuation
 - ❑ company tax and dividend imputation
- ❑ Federation model
 - ❑ subsidiarity – states as providers of core services
 - ❑ vertical fiscal imbalance, horizontal fiscal equalisation

Tax policy consequences

- ❑ simple optimal tax policy is not (politically) possible
 - ❑ 2014-15 income taxes = flat tax of 22% on net national income
 - ❑ 2014-15 indirect taxes = flat tax of 17% on household consumption
- ❑ Each foundational model has its own constituency
 - ❑ strong support for the “welfare state” and progressivity, with some efficiency overlay such as child care for workforce participation etc
 - ❑ property, superannuation, business constituencies with large tax expenditures
 - ❑ states largely surrendered financial independence but retain strong “democratic voice” role as protector of key services

“A New Tax System” 2000

- ❑ Lower rates, broader bases – within tight constraints
- ❑ Enhanced the social, wealth and federation models
 - ❑ progressivity, (over)full compensation esp. families
 - ❑ company tax rate 30 percent, CGT 50% discount for individuals, refundable imputation credits, super concessions
 - ❑ all GST revenue paid to states
- ❑ Total tax about 30% of GDP (with small surpluses)
- ❑ Indirect taxes peak at 9% of GDP (OECD)
 - ❑ commonwealth share about 7% of GDP

What are the problems now?

1. Fiscal: revenue down by about 2 percent of GDP
 - offset for the states in much higher mineral royalties
 - social spending is up by a similar amount (OECD est)
 - combined budget deficits 3% of GDP (2013-14 ABS)
 - yet political rejection of any “revenue problem”
2. Demographic/structural change in the economy
 - investment boom deferred the problem temporarily
 - challenging growth potential and affordability
3. Ongoing increase in factor mobility
 - raising the (allocative and dynamic) efficiency costs of taxes

Policy response – tensions in foundations

- ❑ Adjusting the social model
 - ❑ reducing entitlement rates – take from the bottom
 - ❑ stricter/extended means testing (client funding) – take from the middle/top
 - ❑ surtaxes/levy on higher incomes – take from the top
 - ❑ uncompensated GST increase – take from all
- ❑ Adjusting the wealth model
 - ❑ targeting/fit-for-purpose superannuation – take from top
 - ❑ company tax and dividend imputation
 - ❑ treatment of interest deductions/losses
- ❑ Adjusting the federation model
 - ❑ land taxes and state tax reform
 - ❑ tensions in the federation model

Before deciding policy packages...

- Is this the right time for tax reform?
 - ***“... Australia and perhaps more importantly the rest of the world is not currently experiencing typical economic times. Policies that suit the long run, which is the focus of the Review, may not necessarily be best implemented in these atypical times...”*** (Future tax system review, Overview, p xxv)
- Are objectives clear for the tax system?
 - getting models clear, and does revenue need to be adjusted?
 - recalibrating to the key features of the ‘new tax system’?
 - asking something of all?

Indirect taxes

- ❑ GST declined as a share of GDP from 4% to 3½%
 - ❑ Higher savings rate, and consumption shifts to untaxed rent, health and education
- ❑ Other Indirect taxes declined by nearly 1% of GDP
 - ❑ Failure to index fuel taxes, and weaker customs duty (free trade), tobacco and gambling
- ❑ Economic efficiency case to restore this tax share
 - ❑ also restores overall distributional position (allow only price indexation)
 - ❑ justifies – 12-14% GST and/or base broadening
 - ❑ GST increase requires an adjustment to the federation model

Superannuation

- ❑ Tax concessions miss the retirement income purpose
 - ❑ excessive gap between top rates and superannuation flat rate – Henry proposed a flat contribution concession of 20 percent for all and per person caps on concession levels
 - ❑ access for early retirement (or even non-retirement)
 - ❑ substantial balances at death, while for those living longer inadequate (or no) longevity insurance
 - ❑ substantially unused for late age care and medical/hospital
- ❑ CGT, refundable imputation, pension stage concessions

Real property

- ❑ Potential efficient state tax base(s)
- ❑ Taxable capacity: Property taxes as a percent of GDP (2013 OECD)
 - ❑ Australia 2.6% US 2.9%
 - ❑ Canada 3.2% UK 4.0%
- ❑ CGT, Negative gearing, pension means test concessions
- ❑ Potential revenue and efficiency gains from a simplified land tax, plus possible deemed yield tax
- ❑ Potential base for “HECS” style funding of longevity risks (that is treating assets as a source of post funding rather than requiring pre-funding schemes)

Company tax

- ❑ International corporate tax competition continuing
 - ❑ Aggressive group under 20 percent (including UK)
 - ❑ OECD average around 25% (unweighted)
 - ❑ Patent boxes and BEPS facilitation
- ❑ Australia has full, refundable dividend imputation
 - ❑ ongoing benefits in efficiency and compliance
 - ❑ potentially rising opportunity cost if rates stay high
 - ❑ is 25 (at least) the new 30?
- ❑ Key issue is future strength of business investment
 - ❑ and the creation of new companies/industries esp mid size

Summary – “recalibrating” tax reform

- Restoring at least some of the lost indirect tax yield
- Substantial superannuation adjustment
- A new approach to land and property taxation?
- Company tax
 - is 25 the new 30? Or too costly/untargeted?
 - or prioritise new investment/start-up/middle tier?
- Negligible scope for (real) personal tax cuts