KPMG

Tax reform

KPMG's submission to Treasury

July 2015

KPMG.com/au/taxreform

Our submission

This document is intended to advance the debate on tax reform and avoid simply restating commonly agreed principles. It is far-reaching, and optimistic.

We have attempted to think deeply - at the roots - about the inefficiency of our current tax system and the various problems we face in our federation.

We offer more than 60 recommendations. These include having one tax collector in Australia, the elimination of bracket creep by linking thresholds to average full time earnings, replacement of the fringe benefits tax system, a new progressive system for the taxation of land with the elimination of a number of highly inefficient taxes, a discount for unfranked dividends with greater consistency of capital taxation, and three new company structures to meet the needs of small business, innovation and collective investment.

The recommendations are intended to be creative yet measured. Underlying all of them are the concurrent themes of greater productivity and equity. While many are hard to achieve, they are not naïve. We believe they are truly realistic with strong political leadership.

Australia faces two traps. The first is an 'insularity trap': that our policy settings focus inwards rather than out towards the rest of the world. This is ultimately a path to declining living standards. For the future, we need innovation companies with a world view and head offices of large multinational corporations located in our major cities. In the past, we have sometimes recognised and overcome our inward focus. A simple example is the decision to float the Australian dollar 21 years ago.

There is also an 'inaction trap'. Decisive actions may seem too hard in a partisan world with minimal public trust. There arises a desire to close down contentious issues. Change is perceived as achievable only if it is furtive or the result of overwhelming consensus. Unanimous agreement becomes part of the vocabulary of inaction. What is debatable is taken out of public discourse. Cynicism abounds.

We hope this document rouses deep reflection about the very foundation of our tax system. As always, we are keen to hear your views so that together we can advance the debate.

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Executive Summary

KPMG welcomes the opportunity to comment on the federal government's *Re:think* tax discussion paper. In this document we have included more than 60 proposals which address the need for fundamental reform across our entire tax system.

For all our proposals, we asked the simple question: how will this fit into and shape the Australia we want in 2030? At the same time, we brought to bear 8 principles of evaluation. Set out in Chapter 1, they are: efficiency, equity, simplicity, sustainability, consistency, transparency, stability and gender.

We were also guided by a large number of consultation meetings that we held throughout the country at the senior executive and director level and a survey we conducted of 222 directors, executive and professionals. The results are described throughout the submission and tabularised at the end of the paper.

A new framework

Our proposed reforms are conceived with an **8 year time frame** in mind. Three years, 2015 to 2018, would be spent bedding down the details of the proposed reforms, including suitable compensation packages. The year 2018 would be the target for legislation, followed by a 5 year transition period to 2023 for implementation.

We recognise that our proposals call for far-reaching change and to this end have recommended the establishment of a **Tax Reform Compensation Commission**. Its role would be to evaluate and model the impacts of tax reform and to recommend permanent and transitional measures, including changes to transfer payments to ensure equity in the system.

We also recommend the creation of **Combined Australian Governments Accounts**. These would be unprecedented in their transparency. They would disclose the federal, state, territory and local government's total revenue and expenditure by source and function, including internal contributions.

Among other accounts (see Chapter 2), we propose that the federal budget produce new **annual intergenerational accounts** primarily at the combined government level, but also at the federal and state levels. The intergenerational accounts for Australian governments would seek to show the burden and benefits of the give and take with government across generations.

In addition, we suggest the creation of **four measures of simplicity**, which would be developed as indices and produced in the federal budget. They would be:

- a large business simplicity index;
- a small business simplicity index;
- a personal taxation-transfer simplicity index; and
- an overall tax-transfer simplicity index.

We also recommend a **single tax collector**. We believe the various offices of state revenue could be absorbed by the ATO, thereby providing considerable efficiency benefits. Getting state buy-in for this measure would involve a voluntary mechanism with a carrot and stick approach. Those states that joined up immediately would share in the resultant productivity benefits and savings. While those that delayed would share in any detriment that resulted therein, suffering a reduction in funding.

Personal Labour Taxation

We propose to link **personal income tax thresholds** to average full time earnings (AFTE), thereby eliminating bracket creep. This would result in four income bands: 15 percent, 25 percent, 35 percent and 45 percent.

There would be no tax free threshold. However, protection for low income earners would be assured through greater use of the Low Income Tax Offset (LITO) and a new Work Incentive Tax offset (WITO), which would encourage greater workforce participation.

We also suggest replacing the **fringe benefits tax** system with a new, simpler system of personal benefits, entertainment benefits and non-personal benefits. Among other things, this system would mean that no fringe benefits tax return would need to be lodged.

Regarding **child care** payments, we propose to conflate the current Family Tax Benefit A and B, Child Care Benefit and Child Care Rebate into 2 simple transfer payments:

- Child care assistance for all forms of child care, provided it is recognised as income by the child care provider. (If an employer were to pay for the top-up costs they would be FBT exempt).
- A primary carer payment made on a per child basis with a cut off at twice average weekly earnings.

Personal Capital Taxation

We would suggest making the **taxation of savings** more consistent and subject to a discount of 25 percent for resident individuals. This discount would apply, among other things, to interest income and unfranked dividend income.

Active Business Income

We propose to lower the **company tax rate** to 28 percent in 2020 and 26 percent in 2023. This would create a differential of less than 10 percent with the current Hong Kong and Singapore headline. There would be a 19 percent differential with the proposed top marginal rate of 45 percent.

We suggest the introduction of three new company structures:

- A **small business company** (SBC) which would seek to duplicate the tax impacts of some but not all of the complex standard business structures currently in place.
- An **innovation company** to assist in reducing the movement of innovative businesses offshore and provide much needed cash to pay salaries during the start-up phase.
- A simplified **collective investment company (CIC)** with the transparency features of our widely held trusts (including managed investment trusts) to assist in simplifying foreign investment into Australia.

Consumption

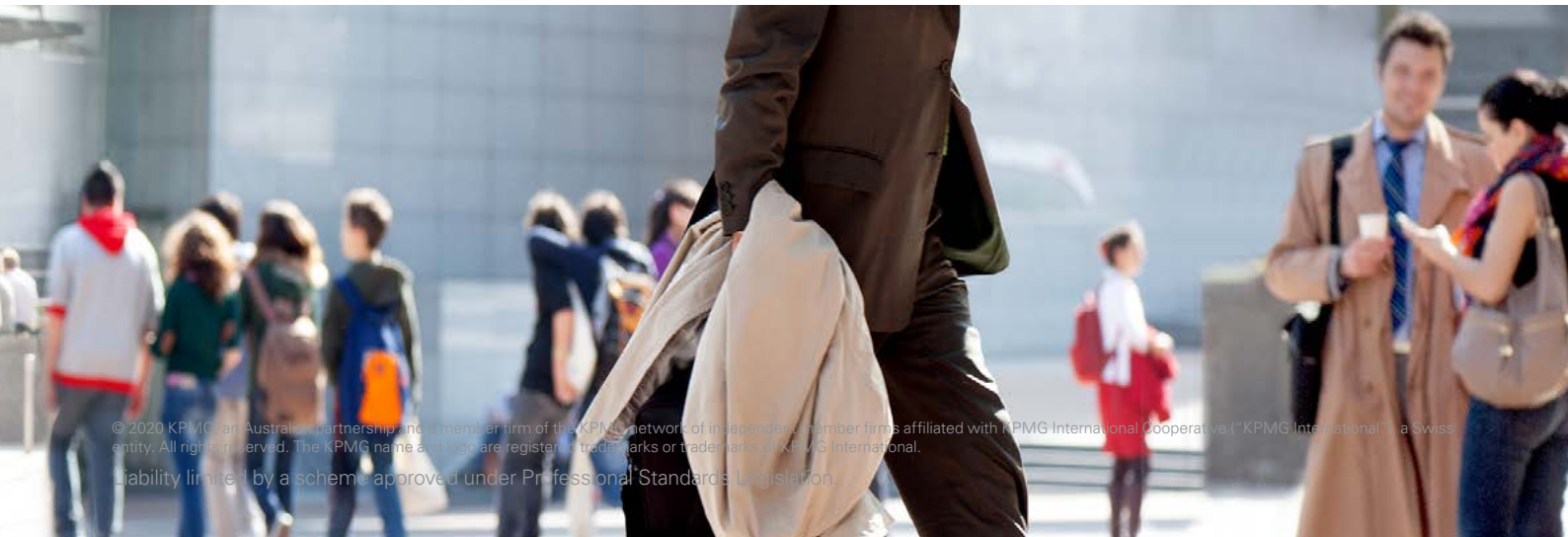
The promise to keep the same **GST** base and rate in the absence of unanimous agreement of the states and territories needs an expiry date. Disregarding the *Intergovernmental Agreement on Federal Financial Relations*, notice should be given to states and territories that GST is subject to change from 2019.

We recommend that the GST rate be increased to 15 percent and the base be comprehensively broadened to include, among other things, all food, health and education.

Taxation of land

We propose to abolish **stamp duty** on the transfer of residential and commercial property, instead conflating rates, land tax, insurance taxes and emergency service levies into a new Property Services Tax.

This document is a call for fundamental change. Some of the proposed reforms are far-reaching. They go a long way to helping shape the Australia we want in 2030.



Chapter 1 – Setting the scene

Our nation and the future

Underlying this document is a sense of what we need to be as a future nation.

We need to be the *clever country*, to use a term coined by former prime minister Bob Hawke.

We need to be in the *Asian Century*, and not peripheral to it.

We need to be *a global economic player* with both strong Australian-based large enterprises and innovative new businesses.

We need to be *efficient* and think deeply about what government and the private sector each does.

We need to be highly *productive*, both in labour and through capital intensity and infrastructure.

We need to be truly *meritocratic*, allowing opportunity for all not social immobility.

We need to be *evaluative*, so that the choices we make reflect the true costs and benefits.

We need to be *cohesive*, so that there is a robust social compact between individuals and the community with a strong sense of fairness.

Evaluation principles

We propose eight principles of evaluation, the first three of which are commonly made: efficiency, equity and simplicity. Most of these evaluation principles are supported by a measurement proposal, detailed in Chapters 2 to 8.

> We need to be *cohesive*, so that there is a robust social compact between individuals and the community with a strong sense of fairness.

Ultimately, we need to be forward-looking as a nation. While the past provides useful perspective, the present can weigh too heavily upon us, denying us optimism and creativity.

For any reform measure we need to ask the question: how will this fit into and shape the Australia we want in 2030?

> It is important to emphasise that productivity and the generation of value is at the very foundation of what we are trying to achieve. The efficiency of a tax is thus highly critical.

The eight evaluation principles are listed in the table below.

Evaluation principles	
1	**Efficiency.** All taxes are bad in the sense that they distort behaviour and, in doing so, reduce economic welfare. Some are worse than others. Economists since Adam Smith and his *Wealth of Nations,* 1776, have described, analysed and sought to measure this phenomenon. They have done so using the language of 'excess burden', either the average excess burden or the marginal excess burden of a tax. The former measures the average economic 'cost' of a tax and the latter the 'cost' of the last dollar of the specific tax collected. It is important to emphasise that productivity and the generation of value is at the very foundation of what we are trying to achieve. The efficiency of a tax is thus highly critical. Also, we should recognise that the legal incidence of a tax differs from its economic incidence. This is particularly important in relation to company tax and payroll tax and involves both efficiency and equity.
2	**Equity.** We need to consider equity at six levels: • the impact of each tax – whether it is regressive or progressive; • the fairness of the tax and transfer system as a whole in similar terms; • the impact of taxation on wealth inequality; • the impact on different communities – urban, suburban, regional and rural; • inter-generational equity; and • gender equity. Generational equity has come to the fore in the past decade in relation to pricing carbon, but has largely been ignored. Equity is a consideration in all our recommendations, but gains prominence in our recommendation that the budget produce intergenerational accounts (see Chapter 2, Recommendation 2.7). Gender equity is both complex and hugely important. It is a substantial source of productivity gains in the future. It is thus discussed separately as it sits alongside the evaluation principles below. There is an underlying principle supporting the tax reform recommendations made in this report. It is that Australia can embrace a far more efficient tax system. The efficiency benefit grows the pie. But in growing that pie one must always be aware of the equity impacts. When evaluating the equity impacts, it is important to consider the system as a whole and its parts. We must also consider the equity in terms of what has happened in the past and projections for the future.

Evaluation principles

3 **Simplicity.** This has many manifestations. The complexity of our federal system reduces the ease of doing business in Australia and thus the ability of Australia to attract foreign capital. Complexity adds to compliance costs and diminishes the level of trust.

We propose four simplicity indices to be used in the budget, a reallocation from state to federal government of collection mechanisms (including payroll tax) and a simplification of concepts used in tax legislation. We also propose greater convergence of taxation and accounting concepts and bright line tests on the capital-income distinction (See Chapter 2, Recommendation 2.9 and 2.13; Chapter 3, Recommendation 3.7 and Chapter 5, Recommendation 5.8).

4 **Sustainability.** The budget must be sustainable in the long term. This is a highly complex issue and one that is prone to political exaggeration and manipulation. For long-term financial projections, extrapolation of small differences can manifest in staggering numbers. There is the uncertainty surrounding the future global economic environment – particularly the terms of trade, demographics, and thus the level of domestic growth.

That said, we need to confront the complexity and deal with it as honestly as we can. Deficit budgets on current expenditure clearly place a burden on the next generation. That is not to say that that generation cannot themselves place a burden on future generations. There is a limit to that thinking, however.

That limit might be measured in net debt as a percentage of Gross Domestic Product (GDP). There is a rough line of indebtedness that is problematic to cross. This bar is generally lower in small to medium size economies, such as Australia, than larger ones. Some countries, such as the United States, carry such strong economic influence that the bar is a very high one.

The intergenerational accounts proposed below deal both with equity and sustainability (See Chapter 2, Recommendation 2.7).

5 **Consistency.** Changes to a tax system from year to year, and differences between jurisdictions and even countries, is an important evaluation consideration. Tax reform and tax law changes generally should be given at least a five year life with a minor review after two years for unintended consequences. This is maintenance.

Harmonisation between states on tax rules and consistency with concepts in international tax rules is important, provided sovereignty is not compromised. We recommend a process of change that embeds new rules for a period of time and seeks to minimise constant tweaking.

In one proposal involving a Collective Investment Company designed to attract foreign investment, we recommend that the law includes a rule which promises a five year notice period for any detrimental change (See Chapter 5, Recommendation 5.7). Constant change diminishes the general level of trust in the system.

6 **Transparency.** Transparency of corporate income tax has received prominence in recent times, both through disclosure of information on the Commissioner's website and through the consideration by the Board of Taxation of a code for voluntary disclosure. There is appropriate concern that such information may be misused.

However, there are two completely different realms of transparency that need evaluation.

The first lies in what the budget papers say and how transparent they are in conveying important information. This is a neglected area but an important one in setting the agenda for clarity of thinking about taxation.

The second lies in the covertness of some forms of taxation. This is particularly important in relation to bracket creep on personal income taxation and taxation of personal fringe benefits at the top marginal rate, but also certain state insurance taxes (See Chapters 3 and 7). Some of these are highly regressive.

7 **Stability.** There are two main elements to consider here. Firstly, the extent to which the system – revenue and expenditure – contains automatic stabilisers. For example, a fall in company tax receipts and capital gains tax due to an economic downturn contain stabilising elements.

Secondly, the extent to which revenue and expenditure settings are fixed with a view to the economic cycle. Our recommendations on the way in which the federal budget should be presented together with budget targets assist in providing this needed stability (See Chapter 2, Recommendations 2.4 to 2.11).

Evaluation principles

8 **Gender equity.** One of the greatest single sources of productivity gain in our society is higher female participation in the workforce. The interaction of the tax system with the transfer system is an integral part of the quest for this future benefit. Unravelling where we have been, where we are now, and where we should go is complex and not without inherent tensions. It touches on our notions of the importance of individual capability, family and relationships.

The domains in which this discussion is relevant are:

- the impact of the use of joint income or family income in the tax and transfer systems;
- the impact of the taxation treatment of child care on productivity; and
- an equity prism through which the whole system should be viewed.

The first two issues are explicitly dealt with in Chapter 3, Recommendation 3.9.

So far as the third issue is concerned, we hope it informs all our recommendations. Overall, women have less superannuation savings than men and although there is little supporting data available, it seems they are more likely to derive interest income than dividends or capital gains. Women also tend to have a greater portion of their wealth in home ownership than in other assets while consumption taxation is likely to affect them disproportionately. With such factors in mind, it is readily apparent that any changes to the whole taxation system must be considered through a gender equity prism.

Bottom up approach

Underlying any broad discussion of the revenue base is a fundamental question: "What should governments do?" This question needs to be asked looking forward. There are two counter-veiling forces at work here.

Do more

The community wants governments to do more in some areas. Disability care, education and early childhood learning are examples. Many of these items 'pay for themselves' in greater productivity over the long term.

Do less

The community wants governments to do less in other areas. These are areas where the private sector could do the job. Australia has benefitted considerably from the privatisations of government business enterprises such as the Commonwealth Bank, Qantas and Telstra in the 1990s and 2000s. We are currently experiencing, albeit with some hiccups, the benefits of privatisation of ports and electricity generators at the state level and will continue to see further modest privatisations at the federal level.

Government as director

The future is likely to see governments contracting more to the private sector as they become increasingly sophisticated in dealing with activities that involve structural losses, such as the operation of public transport.

Government is likely to become a greater high-level 'director' of what is done, rather than doing the activities itself.

Tax bases and inflation

One of the structural problems with federal and state budgets is that expenditure is growing at a faster rate than the revenue base. In particular, the growth in costs in health and infrastructure exceed the change in the consumer price index (CPI) and economic growth. Increases in pensions have been set to a community standard (average earnings), rather than CPI, reflecting the reversal of a decision made in the May 2014 budget.

While current government policy involves limiting increases in federal funding of states and territories in health and education to CPI over the long term, this is a problem parked and not solved.

A partial solution is to link a portion of the revenue base to Health Inflation and Infrastructure Inflation. Accordingly, we have made recommendations to link alcohol and a portion of gambling licence fees to Health Inflation, with a reduction mechanism to Wage Inflation if certain targets are met (See Chapter 6, Recommendations 6.7).

So far as fuel excise and proposed congestion charging are concerned, we have suggested linking these items — one half to Health Inflation and the other half to Infrastructure Inflation (See Chapter 8, Recommendation 8.1).

Partially offsetting this is our proposed model to deal with bracket creep. The model is based on Average Full Time Earnings (AFTE) and will move with Wage Inflation (See Chapter 3, Recommendation 3.1). We recognise that this takes away the ability for government to rely on increases in personal labour taxation to solve the structural problem.

While it will not always be the case, it is likely that CPI will be lower than Wage Inflation which itself will be lower than Health Inflation. Health Inflation is likely to continue to grow faster than Wage Inflation due to the increased use of costly technology in dealing with health issues.

Infrastructure Inflation, which would deal with the cost of new large construction projects, may or may not exceed Health Inflation or indeed Wage Inflation. This will depend not only on wages and the cost of materials, but also on the safety and environmental features of new infrastructure that the community feels to be appropriate.

"One of the structural problems with federal and state budgets is that expenditure is growing at a faster rate than the revenue base.

In particular, the growth in costs in health and infrastructure exceed the change in the consumer price index (CPI) and economic growth."

Federalism

Vertical fiscal imbalance unlikely to be solved

It is clear that the allocation of responsibilities for expenditure between the states and federal governments is intrinsically wedded to tax reform.

In the absence of a significant change in the functions of each tier of government, the problem of vertical fiscal imbalance is unlikely to be solved, although it could be reduced. Options that would see its elimination – such as allocating personal income tax rights to the states, either through revenue-sharing or the use of a state surcharge – raise issues of equity and complexity.

State personal income tax

The primary *equity* problem this presents is that states or territories with lower wages and participation rates would need to levy heavier taxes to raise the same per capita revenue. This problem would escalate as the higher-taxed, poorer states drove people to move to lower-taxed, richer states.

The issue of *complexity* has many dimensions.

Residency. Living in one state or territory becomes much more attractive than living in another with differential income taxes. It would encourage the artificial establishment of residency as occurs, for example, in the United States to avoid the heavier taxation of New York City. We would need to deal with people moving from state to state throughout the year.

Concessions. There becomes an impetus to adjust the base through concessions. Payroll tax is one such example. It was handed to the states in 1971. Within three years, the rate had doubled in all the states, but in the next 20 years the base was halved through concessions. If the states collected personal income tax, NSW could choose, for instance, to offer state income tax concessions to overseas residents in the finance industry as an incentive to move countries, thereby promoting Sydney as a financial centre.

Ease of doing business. The complexity would decrease the ease of doing business in Australia compared, in particular, to Singapore and Hong Kong which are not federations.

Transfer system. It would make dealing with the interaction between the tax system and the transfer system even more difficult than is currently the case. Would social security transfers to individuals from the federal government take into account different levels of state income taxation?

Ultimately, this route does not present a path for the future. It harks back to an earlier period where we wanted the government to do less.

"In the absence of a significant change in the functions of each tier of government, the problem of vertical fiscal imbalance is unlikely to be solved, although it could be reduced."

States carry burden of inefficient taxes

A further observation is that the states and territories currently carry the burden of a higher portion of inefficient taxes, such as insurance taxes. That is not inevitably the case, land tax is a very efficient tax and conducive to raising revenue at a local level, albeit with some equalisation measures as argued below. Some of the benefit of the elimination of highly inefficient state taxes would not simply accrue solely to the states themselves, but to the economy as a whole. This should be acknowledged.

Federation has inherent tension

On one level it is a vision of a shared future, common welfare and security. On another, it reflects the desire to protect regional diversity and autonomy. There is a clear drift towards the centre or national government as more prominence is given to common welfare. This trend is likely to continue. Past attempts to avert it, such as former prime minister Malcolm Fraser's New Federalism in the late 1970s, and attempts in the early 1970s and mid-1960s, have not been successful.

Blurring

It is difficult to deal with the inherent tension of federalism through clear lines of functional allocation. There will inevitably be blurring. That is not to say that considerable improvement could not be achieved by functional reallocation.

Transparency

But part of the solution is greater transparency of what the states and federal governments are each doing. This is embodied in the recommendations below. The current opaqueness allows inefficiency to continue unquestioned. Another avenue for improvement is the use of funding formulas designed to promote efficiency. This requires innovative thinking.

Consultation and survey

This submission was informed by a large number of consultation meetings throughout the country at the level of Non-Executive Directors (NEDS), Chief Executive Officers (CEOs), Chief Financial Officers (CFOs) and Heads of Tax. We also conducted a survey of 222 directors, executives and professionals. The survey contained a 'nuance box' which sought to bring to the fore different dimensions on the issues surveyed.

Some of the results were stark. The extent to which participants wanted the imputation system left unchanged was significant, although there were some differences between the east coast and the west coast reflecting the different nature of their prominent businesses. Also, the desire to reduce the deficit was a low priority compared to getting the tax settings right.

The results of the survey are described throughout the submission and tabularised at the end.

Two results are important in setting the scene. The first is that most saw the general issue of reform as involving both the expenditure and revenue side, with a slight tilt in favour of dealing with expenditure.

The second is that most felt that increasing the deficit to invest in the future was desirable. This was a prominent concern for NEDS, CEOs, CFOs and Heads of Tax.

Chapter 2 – A new framework

Time horizon

This submission is about the future. It adopts an eight year time frame divided into two periods – up until 2018 and then to 2023. It leaves aside some of the difficulties of getting where we need to be and seeks to climb above the tree line. That said, it does intend to embrace concrete proposals.

The first period until 2018 would involve bedding down details of the reforms, including compensation packages. The year 2018 would be the target for legislation, followed by a five year transition period to 2023 for implementation.

If governments achieve full parliamentary terms in office, there will be three elections before 2023 – in 2016, 2019 and 2022. Both major political parties may well be in power for some of these electoral periods. While bipartisan support for the reform process is desirable, it is not critical. We believe 2018 is a useful target year to set changes into a legislative framework as it is likely to be the second year of a new government, whatever its colour.

Clearing impediments

Some impediments need to be brushed aside. The promise former prime minister John Howard made in May 1999 to keep the same GST base and rate in the absence of unanimous agreement of the states and territories needs an expiry date. This should be 20 years.

The current *Intergovernmental Agreement on Federal Financial Relations*, which embodies the political promise Howard made, should not be treated as an extra-constitutional impediment to tax law change. Thus, notice should be given to the states and territories that the GST could be subject to change from 2019.

That is not to say that the impacts of tax reform on each sector should not be considered closely. They are critical and need to be given strong weight. Transition and compensation issues are particularly important. The solution we propose in this submission is based on a process that should not undermine the ultimate vision and should convey the required trust to each sector.

Compensation

Our recommendations for tax reform largely comprise tax redesign. They envisage a beneficial future model. Gains to the system as a whole arise from greater tax efficiency. Inevitably there are winners and losers from the process. Some, but not all, of these windfall losses require compensation to deal with transitional and permanent inequities.

This is a difficult process. It requires empirical evidence, community trust, balance and finesse. There is a significant deficit of trust in government generally at the present time. This is not based on the actions of one political party and is an international phenomenon.

"Our recommendations for tax reform largely comprise tax redesign. They envisage a beneficial future model."

Recommendations

1.1 **Eight year time frame.** That the Tax Reform agenda be set with an eight year time frame divided into two periods of three and five years. The first period to 2018 would involve bedding down details of the reforms including compensation packages. The year 2018 would be the target year for legislation with a five year transition period for implementation.

1.2 **Clear the impediments.** That the Tax Reform White Paper, while accepting the need for unanimous agreement amongst the states for major change to the base and rate for GST, put on notice that such agreement should not extend beyond a 20 year period and thus end in 2019.

Tax Reform Compensation Commission

In our view a Tax Reform Compensation Commission (TRCC) should be established to consider the impact of tax reform. It should recommend a path for change in relation to each element of the reform process and the reform process as a whole. It should be based on certain principles as outlined below.

Not a delegation of tax design

The purpose of the TRCC is not to delegate responsibility of taxation to an independent body in the same manner that monetary policy has been delegated to the Reserve Bank. Rather, the body would be commissioned to evaluate and model the impacts of tax reform and to recommend permanent and transitional measures, including changes to transfer payments to ensure equity in the system.

Three members appointed by both houses of Parliament

The TRCC would comprise three members appointed by a sitting of both houses of Federal Parliament after consultation with the states. Federal Treasury would act as a secretariat, although the TRCC could have analytical work undertaken by the universities and those outside government. It would report to parliament with transparent analysis. It would operate for a limited life of, say, 10 years.

Ability to withstand the politics of change

An independent TRCC would better withstand the difficult politics and publicity arising from those that stand to lose from tax reform and would give greater objectivity to the process.

The principles adopted by the TRCC

The principles to be adopted by the TRCC in recommending compensation levels are as follows:

- **Deficit budgets.** These essentially involve borrowing from the future, while the benefits of tax reform are mostly enjoyed by future generations. It is thus not unreasonable to move into deficit for a compensation package.
- **Permanent and transitional compensation.** A distinction should be made between transitional compensation and permanent compensation. The cost of permanent compensation may reduce the benefits of long-term tax reform. Indeed, it is feasible that such costs are so great they outweigh the benefits.

  The line between permanent and transitional compensation is not a clear one. Permanent compensation can take the form of a change to the tax system or additional expenditure such as transfer payments.
- **Additional expenditure.** Permanent compensation can also take the form of beneficial additional expenditure in a particular area. Thus, if the GST was to be placed on education and the revenue raised allowed for additional expenditure in a particular area of education or for a particular group, this should be treated as a form of compensation and taken into account.
- **Transitional compensation.** The need for transitional compensation is mitigated by more distant introduction dates. This arises because:

  (a) it provides time for people to adapt their behaviour in response to the changes;

  (b) it diminishes the impact of the changes itself (thus the slow withdrawal of concessions will reduce the potential for material decline in the value of a tax-preferred asset);

  (c) it reduces the potential for secondary shocks, where the market over-reacts to a change; and

  (d) it reduces the cost in present value terms, simply because the loss of benefit occurs in the future.

> "The need for transitional compensation is mitigated by more distant introduction dates."

- **Losses to be compensated.**
  The extent to which losses should be compensated are governed by the following principles:

  (a) **Capacity to absorb a loss should be given significant weight.** This generally will be a function of wealth and discretionary spending power.

  (b) **Reversal of a windfall gain.** Benefits taken away that were not in accordance with the original policy intent and therefore constitute a 'windfall gain' should receive minimal compensation.

  (c) **The age of an impacted individual is important.** Consideration should be given to whether the person is in a retirement phase and has limited ability to adapt behaviour or not. This of itself is nuanced. Loss of wealth that would be passed to the next generation should be treated differently from wealth that would be consumed during a person's lifetime.

  (d) **Uneven benefits of tax reform.** While it is true that the benefits of tax reform do accrue to all Australians, the benefits of greater economic growth will accrue differently for various sectors and income quintiles in our community. This needs to be taken into account.

- **Phase-out rules rather than grandfathering means less complexity.**
  We still bear the economic cost of the lock-in impact of pre-CGT assets. In some cases, a grandfathering rule can be combined with a phase-out rule which may be long dated.

Importance of budget presentation and other data

The manner in which the federal budget figures are calculated and presented significantly shapes the discourse on taxation and expenditure. We recommend the presentation of three new sets of accounts (as discussed below). In addition, we recommend statistics be provided in the federal budget on the efficiency of different taxes; four simplicity indexes be created; and that new policies be costed based on both primary impacts and secondary impacts.

This is relatively easily achieved and will help drive the reform agenda.

Combined Australian Governments accounts

We recommend the creation of Combined Australian Governments Accounts (CAGAs). They would present many advantages. They would disclose the federal, state, territory and local government's total revenue and expenditure by source and function, including internal contributions.

State and territory governments would present their budgets in March which, together with estimates from the Commonwealth Grants Commission, would be fed into the May federal budget and the Combined Australian Governments Accounts.

These accounts would be for the period of the forward estimates (four years) plus an additional six years. They would be presented annually.

They would make transparent both the level of structural vertical fiscal imbalance and compensation measures dealing with horizontal fiscal equity. They would highlight different expenditure outcomes for residents in different states on a gross and per *capita* basis.

Much of this information is already collected, but is not put together in a coherent form on an annual basis.

The transparency of Combined Australian Governments Accounts would lift the community debate on spending and revenue within our federation. It would drive greater efficiency and accountability.

Current revenue and infrastructure accounts

A new set of accounts would split current revenue and expenditure from spending on specific hard infrastructure, a portion of which would be placed in the infrastructure accounts as determined by a new body, the Independent Infrastructure Council. The council might replace a number of existing bodies.

This recommendation seeks to deal more sensibly with the issue of government net debt in a manner that will better inform the Australian community. While this is not strictly a tax reform measure, it has a strong bearing on how we measure revenue needs and targets.

The underlying principles are as follows:

- Government borrowing to finance *current* net expenditure is generally problematic over the business cycle, although it may be appropriate in periods of economic downturn.
- Government borrowing to finance *infrastructure* expenditure which will 'pay-back' the community through greater productivity and investment is generally beneficial.
- It is true that expenditure on education, health and other welfare can be viewed as an investment with a measurable payback, but this would be considered to be too uncertain to be incorporated into the new budget model which is designed to deal with hard infrastructure.
- An Independent Infrastructure Council would be established which would prioritise Australia's major infrastructure projects. For high priority infrastructure projects, the Independent Infrastructure Council would approve their allocation to the infrastructure account.
- Other infrastructure projects supported by the government of the day, without priority designation by the Independent Infrastructure Council, would be financed on current account. In this manner, parliament is not denied sovereignty on infrastructure expenditure. This process could occur at both a federal and state level.
- For designated infrastructure projects, say 70 percent of the project cost would be allocated to the infrastructure account.
- A portion of the borrowing on infrastructure should be allocated to current account. We recommend 30 percent. This reflects a rough estimate of the uncertainty of the success of infrastructure projects.
- The Independent Infrastructure Council would 'designate' investments depending on the level of total government net debt as a percentage of GDP. The Reserve Bank should guide the Independent Infrastructure Council on an appropriate top and bottom range for total government net debt as a percentage of GDP.
- Interest costs on the borrowings incurred for the infrastructure project would be capitalised into project and productivity benefits and would be amortised against such costs (including principal amortisation) until the project had effectively paid for itself. These estimates would be undertaken by the Independent Infrastructure Council in consultation with federal and state treasuries.

"A new set of accounts would split current revenue and expenditure from spending on specific hard infrastructure, a portion of which would be placed in the infrastructure accounts as determined by a new body, the Independent Infrastructure Council."

Continued cash flow accounts and representation of current information

Cash flow based accounts would be prepared as they are presently. These accounts would act as a check to potential political manipulation through the current and infrastructure accounts. They also would be an important source of historical comparison. They would, however, be presented as secondary accounts.

An exercise should be undertaken to consider how existing federal budget information could be better presented. Part of the problem is that the community lacks perspective on numbers. Another problem concerns the disaggregation of proposed new expenditure or revenue measures into government departments impacted.

Better presentation of current budget information would give rise to better community discussion on new measures. The community does not have an adequate perspective on the size and context of new measures. This lack of understanding presents its own impediments to reform.

Intergenerational accounts

The federal budget would produce new annual intergenerational accounts primarily at the combined government level, but also at the federal and state levels.

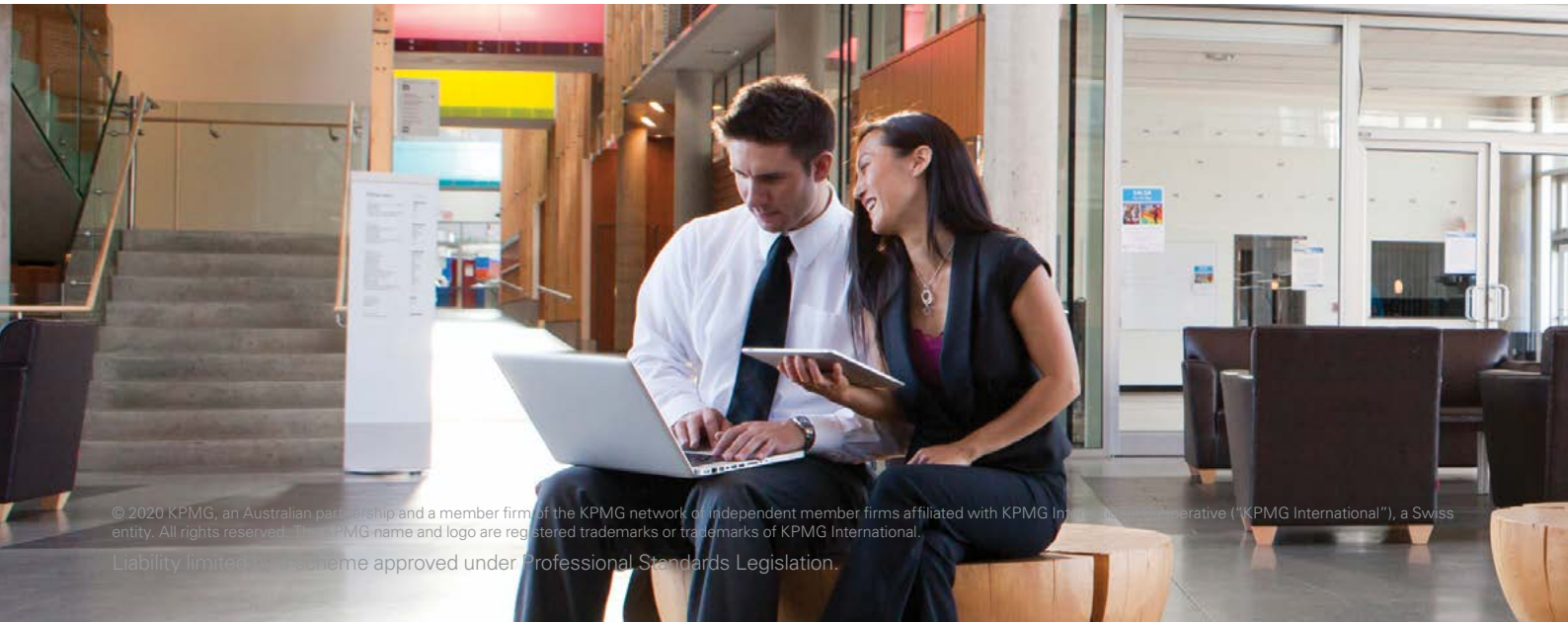
These accounts would be for 10, 20 and 40 years and based on current government policy settings. The intergenerational accounts for Australian governments would seek to show the burden and benefits of the give and take with government across generations. Some of these items could be broken down into income quintile, gender and indigeneity.

It is appreciated that presentation of the data itself has its own political dimensions. Elsewhere the concept has been criticised by both sides of the political spectrum as either exaggerating the burden of current deficits on future generations or exaggerating the impact of current settings on future income, gender or indigenous inequality.

This data will clearly not be perfect. Nor is the current data contained in the five yearly intergenerational reports instigated by the Howard government. Yet intergenerational equity involves a debate that we need to have continually. It helps drive our focus on the future.

It is proposed that there be three main intergenerational accounts:

- **Future net contribution rates by age bracket – income, taxes and transfers.** These would show by age brackets of 10 years, *projected future income*, taxes and transfers for periods of 10 years, 20 years and 40 years. These could also be based on current income quintiles, gender and indigeneity. They would be based on all Australian government current policy settings.
- **Lifetime benefit rates by age bracket – income, taxes and transfers.** These would show *historical* and future benefit rates by age brackets of 10 years and could be cut by gender and indigeneity. It would be difficult to cut this by income quintile as people move throughout various quintiles over their lifetime. This would be a meaningful statistic to evaluate the rate of increase of gender equality over the long term.
- **Intergenerational transfers from current to 10, 20 and 40 years.** Debt burden would be seen as a negative, while infrastructure and additional education expenditure would be seen as a positive. This is about the community burden on – or legacy for – future generations.



Measure efficiency of top 20 Australian taxes

In addition to the above presentation of accounts, additional measureable information would be provided based on the current state of taxation law and the economy. These seek to deal with three of the eight evaluation principles: efficiency, simplicity, and equity. The first is efficiency.

For the top 20 taxes, there would be a measure of the 'economic burden' which would be calculated by reference to the average excess burden and, possibly in part, the marginal excess burden.

There would also be a description of the 'short-term economic incidence' and 'long-term economic incidence' which would be a description of the economic incidence of the tax as against the legal incidence of the tax. Thus the short-term economic incidence of company tax might be company shareholders, the long-term economic incidence of company tax might be 60 percent on real wages, 20 percent consumers and 20 percent company shareholders.

There would also be a description of the change in the tax collections over the past 10 years and the projected future change over the next 10 years as a percentage of GDP.

Creation of four simplicity indices

Four measures of simplicity would be developed as indices and produced in the federal budget. They would be:

- a large business simplicity index;
- a small business simplicity index;
- a personal taxation-transfer simplicity index; and
- an overall tax-transfer simplicity index.

For businesses, the first two indices would measure the ease of doing business in Australia.

The personal taxation-transfer simplicity index would measure, in the main, how simple it is for individuals to deal with government.

The overall tax-transfer simplicity index would be a measure of the whole Australian Tax-Transfer system.

Each of these indices would contain sub-indices which could show improvement and decline at each level of government – federal, state and territory, or local.

The creation of simplicity indices would not be a straightforward task and would not be without limitations. But it would provide a useful tool for measuring changes from year to year. More importantly, it would provide a point of focus for governments and administration.

Presentation of new policies

A key improvement would be to model and disclose both direct impacts – as currently takes place – in addition to direct and indirect impacts. Thus the cost-benefit of a change to the fringe benefits tax treatment of child care, for example, might be seen against future long-term gains from workforce participation.

Presentation of tax expenditures

In addition, tax expenditures should also be modelled taking into account reasonable estimates of behavioural change with secondary impacts. This would be an inexact science, to be sure, but it would better inform the debate about the cost of potential changes.

Impact reviews

Every five years there should be a major debrief on legislation that has undergone significant policy changes involving stakeholders, Treasury, the Australian Taxation Office (ATO) and Office of Parliamentary Council. These should be conducted by Treasury in a spirit of continuous improvement. Reviews for unintended consequences should be conducted after two years.

The political dimensions to such reviews should be kept to a minimum. The main focus should be on how well the policy intent was achieved through the process.

Administration and data

Looking to the long term, it seems evident that electronic data collection is going to be an even greater source of efficiency than it is now. Clearly the ATO is embracing this world with its drive for pre-filled returns and its Smarter Data initiative.

The management of electronic data is critical to both the integrity of the system – reducing the so-called tax gap – and increasing the user-friendliness of the system.

The potential for change is not incremental but revolutionary. It is recognised by many that tax returns could be pre-filled by the administrator for a large number of taxes and taxpayers.

Equally, it is recognised that the beneficiary of a tax levied need not be its collector as is evident through the GST and the National Tax Equivalent Regime for de facto corporate income tax. Considerable cost savings could arise if taxes were collected federally and simply allocated to the states based on an agreed formula.

Indeed, there is no reason why all taxes should not be collected by the ATO with revenue allocated to the states or sub-regional bodies. This could be a significant source of productivity improvement.

Single tax collector for all Australian taxes

We believe the various offices of state revenue could be absorbed by the ATO, thereby providing considerable efficiency benefits as follows:

- There would be cost savings from a reduction in duplication of effort from eight states and territories – this extends beyond administrative staff to expensive computer capacity.
- There would be clear compliance benefits from data-matching.
- There would be greater simplicity in dealing with the tax system as a taxpayer.

In addition, the tax administration would be able to look at a taxpayer more holistically in evaluating the level of risk and appropriate level of 'touch' that should be applied. In the future, good tax administration would involve getting the risk-touch balance right, such that those who should be left to deal with other things in life are left do so. Those for which a stronger touch is needed – be it firmer or with more compassion – should be appropriately dealt with. This ability would be greatly enhanced by an administration seeing the whole picture.

This does not aim to take away sovereignty from the states. It is simply about finding the most efficient collection mechanism.

It is thus proposed that the ATO become the administrator for all taxes in Australia from 2023. This would include state and local taxes.

Gaining state buy-in for a single tax collector

Why would the states and territories agree to this? The best way to enable the ATO to become the single tax collector involves a voluntary mechanism with a carrot and stick approach for the states. There are two elements to this approach.

- **Federal government bears administration costs.** The federal government would bear the full cost of transition and the permanent cost of administration for all taxation. The states would thus derive a financial windfall from the ATO taking over the cost of collecting and administering the state and territory tax system.
- **All-in benefit vs some-in detriment.** We propose that the Productivity Commission undertake two analyses of the costs and benefits for a period of five years from 2023 to 2028.

The first analysis would focus on all productivity benefits and savings, including all secondary benefits from greater foreign investment for all state and territory participation, but net of any costs of a single administrator. This would be the 'all-in benefit'.

The second analysis would focus on the productivity and cost detriment for only some state participation as against the 'all-in benefit' position. This would be the 'some-in detriment' and a cost.

Joining states would receive their share of the estimated 'all-in' benefit through additional funding, once they agreed to join. Declining states would receive their share of the 'some-in detriment' through a reduction in funding.

This means joining states would not be disadvantaged by signing up early. Those states that chose to hold out, on the other hand, would be significantly disadvantaged as they would bear the cost of the full 'all-in benefit' not being achieved.

This reverses the general principle that it is better to hold out for a better deal. It creates a new framework of simplicity of doing business in Australia. It is also fair. If a state chooses to take a position that denies a benefit to the whole of the Australian economy, it should bear the cost as against a co-operative state.

Potential new world for business and other entities

For both large and small businesses, all government-related taxation matters would be concentrated on the one website. It would cover all taxes and workers compensation insurance.

For each and every business, superannuation fund, trust and not-for-profit, the website could provide:

- a business tax cash-flow statement covering all taxes including company taxes, GST, employee withholdings, payroll tax and property service taxes described below;
- simplified on-line registration for federal, state and local government taxes;
- comparative data for small and medium sized businesses involving industry averages that would be based on a sufficient breadth of data to address confidentiality and competiveness concerns;
- more extensive tools, which would allow for scenario planning from the data contained on the website; and
- data storage facilities for supporting documentation.

Most importantly, the tax administrator would be in a position to see each business as a whole. This means they would be in a position not only to pre-fill considerable information but, more importantly, to have better dealings with taxpayers. The tax administrator would understand the broader picture, creating a positive cycle of confidence, trust and a light touch or heavier touch where appropriate.

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Potential new world for individuals

For individuals the single website would provide:

- details of personal income tax, transfer benefits, property service taxes and personal superannuation balances;
- stored data supporting tax returns at the option of individuals;
- tax and transfer cash–flow statements;
- community averaging data; and
- scenario planning tools.

Importantly, as for business, each individual could expect to have more responsive dealings with the revenue administration.

Some state considerations

There are several state considerations that need to be addressed.

- **Employment moving interstate based on centralisation of functions within the ATO.** This concern has a practical solution. The ATO could reasonably distribute offices throughout Australia, but without rigid restrictions on the most efficient location for its activities.
- **That a single administrator will drive a single base and rate on various taxes.** This would be likely, but not necessary. The drive for harmonisation would be ultimately a good thing.
- **That one state may be a much more efficient collector of current state taxes.** This is true, but current best practice might assist in a model for all states and territories. In most cases, however, the expanded ATO would be dealing with a new taxation regime as proposed in the tax reform agenda.

Australia could become a best practice country for ease of doing business. This would present significant rewards in terms of greater efficiency and attracting foreign investment. Looking forward to 2030 and beyond, it is the inevitable that our federation will seek to achieve greater harmonisation and synergies of tax administration.

Consultation and survey

In our survey we asked about the goals of tax reform. Greatest weight was given to the efficiency of taxes and international competitiveness. Least weight was given to balancing the budget and vertical fiscal imbalance in our federalism. Equity and simplicity, however, were considered important.

The recommendations below seek to highlight to a broader audience the differences between the efficiency of different taxes. They also seek to give greater transparency to federal-state revenues and expenditures and to assist increasing responsibility in our federation.

Importantly, it is recommended that tax collection be the sole province of the ATO. This is consistent with many discussions about the inefficiency of dealing with multiple levels of government.

Recommendations

2.1 **Tax Reform Compensation Commission.** That an independent Tax Reform Compensation Commission (TRCC) be established for a limited period to consider transitional and permanent compensation for the tax reform measures based on established principles.

The three members of the TRCC would be agreed by both houses of federal parliament after consultation with the premiers of the states and territories in order to establish community trust in the compensation proposals. They would report to parliament. A secretariat to the TRCC would be housed in Treasury.

2.2 **Principles of compensation.** Compensation for tax changes would be determined with regard to the following principles.

- Compensation should be classified as permanent or transitional. Permanent compensation may diminish the benefits of reform, although in some cases it may improve economic outcomes (e.g. increased expenditure on education as a form of compensation).
- A long dated introduction diminishes the need for compensation because, among other reasons, it better allows for changed behaviour and diminishes the potential decline in value of tax-preferred assets.
- The capacity to absorb a loss, including wealth and discretionary spend, needs to be given weight.
- The reversal of a windfall gain generally requires little compensation.
- The age of the individual that is impacted is important, although consideration needs to be given to whether there is a loss of discretionary spend or whether wealth is passed on to the next generation.
- The benefits of tax reform need to be taken into consideration. While the benefits of tax reform spread across the whole economy, they do not do so evenly. This needs to be factored in.
- The level of additional expenditure in a particular area. For example, if the GST was to be placed on education, but the government decided that as a result additional grant expenditure would be given to schools, this would need to be taken into account.

2.3 **Phase-out preferable to grandfathering.** For transitional compensation, a phase-out approach is generally preferable to permanent grandfathering which adds complexity to the system. A combination of phase-out and grandfathering may be appropriate in some circumstances.

2.4 **Combined Australian Governments Accounts.** That the federal budget contain the Combined Australian Governments Accounts, including state, territory and local government. State and territory governments would present their budgets in March which, together with estimates from the Commonwealth Grants Commission, would be fed into the May federal budget and the Combined Australian Governments Accounts. These accounts would be for the period of the forward estimates, four years plus six years, giving a rolling, 10-year picture. They would be presented annually.

Recommendations

2.5 **Current accounts and infrastructure accounts.** A new set of current accounts and infrastructure accounts would be developed and become the main focus of the deficit or surplus. This would apply to both federal and state governments and the Australian Consolidated Governments Accounts. The concept would involve the following:

- An Independent Infrastructure Council would be established which would prioritise Australia's major infrastructure projects. For high priority infrastructure projects, the Independent Infrastructure Council would approve their allocation to the infrastructure account. Other infrastructure projects supported by the government of the day, without priority designation by the Independent Infrastructure Council, would be financed on current account.
- For designated infrastructure projects, say, 70 percent project cost would be allocated to the infrastructure account. Meanwhile, 30 percent of the borrowing and associated costs would be allocated to current account.
- The Independent Infrastructure Council would 'designate' investments depending on the level of total government net debt as a percentage of GDP. The Reserve Bank should guide the Independent Infrastructure Council on an appropriate top and bottom range for total government net debt as a percentage of GDP.
- Interest costs on the borrowings incurred for an infrastructure project would be capitalised into project and productivity benefits and would be amortised against such costs (including principal amortisation) until the project had paid for itself. These estimates would be undertaken by the Independent Infrastructure Council in consultation with federal and state treasuries.
- These accounts would be for the period of the forward estimates, four years plus six years, giving a rolling, 10-year picture.

2.6 **Cash flow accounts** should be prepared as they would now act as a check on the new current and infrastructure accounts and for historical comparisons. However, their presentation should be revamped to make them accessible to the general community.

2.7 **Intergenerational accounts.** At the time of the federal budget, the government would produce intergenerational accounts on a combined government, federal and state government basis outlining three statistics:

- **Future net contribution rates by age bracket – income, taxes and transfers.** These would show by age brackets of 10 years, *projected future income*, taxes and transfers for periods of 10 years, 20 years and 40 years. These could also be based on current income quintiles, gender and indigeneity. They would be based on all Australian government current policy settings.
- **Lifetime benefit rates by age bracket – income, taxes and transfers.** These would show *historical* and future benefit rates by age bracket of 10 years and could be cut by gender and indigeneity.
- **Intergenerational transfers from current to 10, 20 and 40 years.** Debt burden would be seen as a negative, while infrastructure and additional education expenditure would be seen as a positive. This is about the community burden on – or legacy for – future generations.

2.8 **Economic burden, incidence and changes in collections of taxes.** That the federal budget work papers release the following details in relation to the top 20 taxes in Australia:

- **Economic burden:** This would be the drag on the economy as a result of the tax and, in the language of economists, would be the average excess burden or possibly a combination of the Average Excess Burden and the Marginal Excess Burden of the tax.
- **Short-term economic incidence:** This would be the short-term economic incidence of the tax. Thus, for company tax, it might be the shareholders.
- **Long-term economic burden:** This would be the long-term economic incidence of the tax. Thus, for company tax, it might be a combination of real wages, consumption and shareholders.
- **Change in tax collections** over the past 10 years as a percentage of GDP and change in projected tax collections for the next 10 years as a percent of GDP.

Recommendations

2.9 **Simplicity indices.** At the time of the federal budget the government should produce four indices dealing with complexity or simplicity of the Australian – federal, state and local – tax system. They would be:

- a large business simplicity index;
- a small business simplicity index;
- a personal taxation-transfer simplicity index; and
- an overall taxation-transfer simplicity index.

The indices would contain sub-indices which would enable people to look at the sources of complexity at each level of government. The benefit of the index lies largely in changes over time and not its initial absolute value. The basis for the indices would be transparent.

2.10 **New policies should contain cost-benefit of secondary impacts as additional disclosure.** New policies should be costed both in respect of their primary impacts and separately their primary and secondary impacts which should be disclosed in the budget. Therefore, a change in fringe benefits tax on child care would take into account anticipated long-term participation rate implications in the broader impacts disclosure.

2.11 **Tax expenditures** should contain reasonable estimates of behavioural change with secondary impacts as a separate disclosure.

2.12 **Debrief major policy changes.** There should be a debrief of major policy changes after five years involving stakeholders, Treasury, Australian Taxation Office and Office of Parliamentary Council. A review for unintended consequences should be conducted after two years. This should be conducted by Treasury as a matter of course.

2.13 **Conflate the offices of state revenues into the ATO by 2023.** That state revenues move into the ATO as the sole tax administrator for all taxes. The federal government would bear both the transitional cost and the permanent costs of administration. This would present significant benefits:

- Cost savings from a reduction in duplication of effort from eight states and territories. This would extend beyond administrative staff to expensive computer capacity.
- There would also be obvious compliance benefits from data-matching.
- There would be greater simplicity in dealing with the tax system as a taxpayer.
- The tax administrator would be able to look at a taxpayer more holistically in evaluating the level of risk and appropriate level of 'touch' that should be applied.

2.14 **Gaining state and territory buy-in on a single administrator.** This would be a voluntary mechanism with the following carrots and sticks.

- Federal government would bear full permanent and transitional tax administration costs presenting a windfall to the states.
- The Productivity Commission would undertake two analyses for five years from 2023 to 2028. The first would be the 'all-in benefit' of all states participating in the new system. The second would be the 'some-in detriment' which would be the cost to the system as a whole of some states holding out.

The joining states would receive their share of the all-in benefit on joining up, and going forward through additional payments. The states that held out would receive reduced payments from the federal government to reflect the detriment of the all-in benefit not being achieved.

This reverses the general principle that it is beneficial to hold out for a better deal. If a state chooses to take a position that denies a benefit to the whole economy, it should bear the cost as against a co-operative state.

Chapter 3 – Personal labour taxation

Bracket creep

The main tension within the personal labour income tax system concerns bracket creep or fiscal drag. It is the increase in average rates of tax as a result of inflation under a progressive personal tax system. The effect occurs for anyone above the tax-free threshold and is not limited to those moving into a higher marginal tax rate.

Raises revenue

In one sense, bracket creep is a good thing as it results in raising revenue. It is the major contributor to fiscal repair. To put this into context, of the total budget repair in the four years of the forward estimates following the 2014 budget, the majority arose from bracket creep. By contrast the Temporary Budget Repair Levy, which provided an additional 2 percent levy on taxable income for taxpayers earning above $180,000 for three years, repaired the budget by about 3 percent.

Inequitable

But the arguments against bracket creep are powerful. In short, it is inequitable:

- It increases the *absolute* burden of taxation in real terms.
- It changes the *relative* burden of taxation amongst taxpayers. It modifies 'vertical equity' policy settings until reset by ad hoc tax cuts.
- It is *regressive*. It bears most heavily on those with a lower level of discretionary spend.
- It is *hidden* in the sense that it is stealthy – most do not know it is there.
- It is also *hidden* in the sense that it *unpublicised*. The budget does not baldly state the level of bracket creep – it must be extracted by economists.
- It is further hidden because it is rarely directly dealt with by government. To the extent that it is ever indirectly addressed this occurs through 'tax cuts' which are virtually always framed as dealing with other policy initiatives.

Consider the past 30 years. Significant tax cuts were delivered in the late 1980s and 1990s as part of a series of price and income accords using lower taxes as a trade-off for wage restraint. In 2000, they were considered as compensation for GST and throughout the 2000s were delivered to increase labour force participation or improve international competitiveness. Most recently in 2012-13, tax cuts were introduced to offset the carbon pricing mechanism.

Indexation of thresholds

The standard solution to bracket creep is to index the thresholds to either prices or wages. There are a number of countries that do this including the United States, Canada and Switzerland.

The automatic indexation of thresholds linked to prices was a solution proposed in Australia by the Matthews Committee in May 1975. The committee was established by former prime minister Gough Whitlam in August 1974 to report on the impact of inflation on the taxation system. It considered both personal and company taxation and some of its recommendations were adopted by the Fraser government from 1976. However, automatic indexation was initially discounted, then halved, and then abandoned during the period of the Fraser government, largely to raise more revenue.

The Harmer Report on pensions, released in 2009 and adopted by the Rudd-Gillard governments, recommended indexation of pensions based on a 'community standard' reflecting the wages of a fulltime employee, with a safety net if price increases exceeded wage increases. This was abandoned by the current government in the May 2014 budget, which introduced a Consumer Price Index (CPI)-only increase in pensions, but was reinstated in the May 2015 budget.

"The main tension within the personal labour income tax system concerns bracket creep or fiscal drag."

Thresholds based on Average Full Time Earnings

People generally judge what is fair and equitable based on 'what most people are getting'. It is a relative and community standard rather than an absolute one. Thus our proposed solution is based on using Average Full Time Earnings (AFTE) as a basis for the determination of four tax brackets. Currently, AFTE is about $80,000.

Low Income Tax Offset and Work Incentive Tax Offset

In addition, we propose that the tax free threshold is dropped. Protection for low income earners arises from the greater use of the Low Income Tax Offset (LITO) and a new Work Incentive Tax Offset (WITO). The settings and taper rates for LITO and WITO would have regard to the other changes. WITO, which would sit on top of LITO, would provide an offset based on labour participation.

One of the changes described below is to make all transfer payments exempt from tax. LITO would need to be set with this in mind. It would seek to ensure that small, additional interest income of pensioners, for instance, would not be taxed.

WITO would be designed to encourage greater participation in the workforce. In Australia, the interaction between the transfer system and the tax system gives rise to high effective marginal rates. This emanates from a number of factors, including our highly targeted transfer system and the use of family income to determine entitlements in certain circumstances. The proposed WITO would be focused on increasing labour participation among the low incomes, generally second incomes, in a family. This should assist in increasing female participation.

New personal rate system

Under our AFTE-based proposal there would be four rates of tax – 15 percent, 25 percent, 35 percent and 45 percent.

- The first band would be from nil to one third of AFTE, currently about $27,000, and be set at 15 percent.
- The second band would be between one third and AFTE and would be set at a rate of 25 percent. This would be between about $27,000 and $80,000.
- The third band would apply from AFTE to twice AFTE, currently $80,000 to $160,000, and would be set at, say, 35 percent.
- The top band would apply from twice AFTE, currently $160,000, and would be set at, say, 45 percent.

Setting the top marginal rate is not without difficulty. Most would agree it should be less than 50 percent. Forty percent would appear to be at the lower end of what most would find acceptable.

"People generally judge what is fair and equitable based on 'what most people are getting'. It is a relative and community standard rather than an absolute one. Thus our proposed solution is based on using Average Full Time Earnings (AFTE) as a basis for the determination of four tax brackets."

The personal tax rate banding would look like the following table:

	Rate	AFTE ratio		Current equivalent based on $80,000 AFTE	
First band	15%	0	0.33	$0	$27,000
Second band	25%	0.33	1.0	$27,001	$80,000
Third band	35%	1.0	2.0	$80,001	$160,000
Fourth band	45%	2.0		$160,001	

The marginal and average rates, based on the current position, would be as follows:

Income as a percentage of AFTE	Amount based on current AFTE of $80,000	Prima facie average rate	Marginal rate	LITO and WITO effect
30%	$24,000	14%	15%	0%
40%	$32,000	17%	25%	0%
50%	$40,000	18%	25%	
100%	$80,000	22%	35%	
150%	$120,000	26%	35%	
200%	$160,000	28%	45%	
695%	$556,000	40%	45%	

There is a simplicity in this system which is attractive.

Conflate levies into rates and thresholds

We propose incorporating the Medicare Levy, Zone Rebate and similar items into the personal tax rates and thresholds, in effect abolishing these complex 'add-ons'.

Cash-out work related expenses

We propose cash-out work related expenses with an optional proof of expenditure above a certain level, but limited by a cap. New Zealand undertook this reform in the late 1980s with a reduction in tax rates as compensation. This reduced the number of taxpayers required to lodge returns significantly. Australia could follow New Zealand. This reform could be undertaken with the change in tax rates outlined above.

Exempt all transfer payments from income tax

We would suggest exempting all transfer payments from income tax. Ultimately, the current system has the effect of doing this for the most part, but in a complex manner.

Problems with fringe benefits tax

Fringe benefits tax was introduced in 1986. It has four features which leave it ripe for modification:

- **Tax on employers at top marginal rate not employees' marginal rates.** The legal incidence of the tax is on employers and is incurred at the top marginal rate of tax. This is inequitable to the extent that the marginal rate of an employee is below the top rate. It is possible to move the incidence of the tax to the employee and tax the fringe benefit at the employee's marginal rate.

  Given that employers are required to report personal fringe benefits of an employee (where they exceed $2,000) on the employee's PAYG summary for the purposes of determining whether means test thresholds are met in the transfer system or for child maintenance support, a movement of the incidence of the tax to employees from employers should not be problematic.

- **Concessionary valuation.** The fringe benefits tax system carries with it valuation methodologies that are highly concessionary. Realistic valuation methodologies should be put in place.

- **Complex exemptions.** Over the years the system has generated a complex array of exemptions, some with low (and un-indexed dollar sums) and most with disproportionate compliance costs.

- **Additional compliance burden** on employers with a separate fringe benefits tax return.

Replace fringe benefits tax with a new system

A potential solution to the above problem is as follows. It involves abolishing the fringe benefits tax system and replacing it with a new system.

- Fringe benefits would be divided into three categories:

  (a) personal benefits,

  (b) entertainment, and

  (c) non-personal benefits.

- **Personal benefits** would arise where they are directly related to an individual (e.g. cars, loans, personal expense reimbursements). They would be personal benefits if a certain threshold was reached. We would propose a threshold of $4,000 or 5 percent of AFTE, but a lower amount, say, $2,000 or 2.5 percent of AFTE, might be appropriate. Tax would be withheld at the employee's marginal rate (based on salary). The value of the fringe benefit would be included in the employee's assessable income.

- **Entertainment benefits**, unless it was a reimbursed 'salary-sacrificed' personal benefit, would be taxed to the employer. It would appear on the company tax return and be non-deductible. It is proposed the tax rate would be 40 percent. No distinction would be drawn between client and employee entertainment. The reason for the separate classification of entertainment benefits is that it is difficult to allocate it to a personal benefit. The new entertainment tax could be allocated to the states.

- **Non-personal fringe benefits**, that is all fringe benefits which are neither personal benefits (either because they are not personal in nature or below the personal benefit threshold) or entertainment benefits, would either be exempt (certainly if minor) or would be non-deductible to the employer. This would depend on the nature of the fringe benefit.
- **Childcare top-up benefits.** An exception to the above would be childcare top-up benefits. They would be exempt benefits when paid to a registered provider of child care for the difference between the cost of the child care and the amount paid by the government as a transfer payment.
- **Compliance costs.** This would significantly reduce compliance costs for employers. Not-for-profit organisations would not experience the 'detriment' of non-deductibility for non-personal benefits, given their exempt tax status, but employees that work for not-for-profits would be on a relatively equal footing with the broader group of employees.
- **Valuation methodologies** would be reviewed to ensure they are realistic.

Simplify concepts

We would propose simplifying concepts within the personal tax legislation to 14 basic framework terms. These are outlined in the recommendations section below.

Payroll tax – the current problems

Payroll tax is a state tax levied on employers at varying rates (4.75 percent to 6.85 percent) with varying thresholds ($550,000 to $1,800,000) and a variety of exemptions, although a program of harmonisation has been in place since 2007. The multiplicity of systems is itself highly inefficient, although as a tax, economists generally see payroll tax as relatively efficient.

KPMG modelling suggests that the marginal excess burden (a measure of a tax's detriment to the economy) of payroll tax is 14 percent, making it less efficient than GST at 7 percent, but more efficient than personal income tax at 30 percent and company tax at 39 percent. (Source KPMG).

Payroll tax was introduced into Australia at the federal level during the Second World War to fund child endowment. It was handed to the states in 1971 in an attempt to reduce vertical fiscal imbalance. Within three years the states doubled the rates. Over the next 20 years, they halved the base through the granting of concessions.

Although the legal incidence of payroll tax is on employers, it is generally thought that the economic incidence flows through to employees, either in the form of lower wages (and thus is akin to personal income tax) or through to higher prices (and thus is akin to a consumption tax). Economists argue that since income equals consumption plus savings in the long run, the ultimate incidence of the tax is similar. On the other hand, many employer groups argue that payroll tax reduces employment.

"We would propose simplifying concepts within the personal tax legislation to 14 basic framework terms."

Payroll tax – the solution

One solution is for payroll tax to be collected at the federal level with PAYG collections. We propose that this should be at a rate of 5 percent on salaries and personal (fringe) benefits with no threshold and no exemptions.

Payroll tax collected by the federal government would be allocated to the states and territories based on the number of employees located in each state. This could be achieved in the absence of a broader reform to transfer all tax administration to the ATO as discussed in Chapter 2 above.

This reform would bring into the payroll tax net a large number of small businesses. This is not without political difficulty, but the administrative cost would be negligible.

Family assistance and child care

There have been four main discourses in the tax-transfer discussion of family assistance and child care.

- The first concerns whether payments should exist as a universal right, and thus not be subject to means testing, or whether payments should be considered to be a measure for those on lower incomes. This debate has arisen many times. Child Endowment, which was introduced in 1941 by the Menzies government and applied universally, Family Tax Benefit B that was introduced in 2000 but modified in 2008, and the abandoned Paid Parental Leave policy have all focused on the right itself. The Whitlam–Fraser–Hawke–Keating years focused on targeted assistance for lower income earners and most of the assistance during this period was relatively strongly means tested.

- The second centres on who should receive the payments. While the original Child Endowment was paid to mothers as it was not indexed, it diminished in value in the post-war period. For a series of deductions and later rebates that arose through the tax system, the cash beneficiary was usually the male in the household, received through a tax refund or lower instalments. This was changed in the late Whitlam–Fraser years by the introduction of Family Allowance, and later the Family Income Supplement, which was a Fraser initiative implemented by Hawke under a bi-partisan approach. Low income women were the main beneficiaries. From 1993, the beneficiary of all child transfer payments became the 'principal carer', which was gender neutral in form, but in practice benefitted women. A reversion to the use of the tax system in the 2000s changed the beneficiary in some cases.
- The third concerns the role of the family. There have been different gender-based pathways to family contribution. Three prominent ones are the traditional breadwinner–homemaker, the primary–secondary earner and the dual-income. From the late 1990s, government policy sought to promote the breadwinner–homemaker on the basis that it provided 'choice' and redressed what some perceived to be the inherent disadvantages suffered by sole income families.

The introduction of Family Tax Benefit Part A and Part B in 2000 and Child Care Benefit and the Child Care Tax Rebate in 2004 as it was, were based on family or joint income. The word "tax" in Family Tax Benefits Part A and B is a misnomer. They are paid through the transfer system and not the tax system, although certain FTB supplements are paid only after a tax return is lodged and income is reconciled. Originally, the FTB could be paid either through the transfer system or the tax system. However, it was presumably named a tax benefit so that it could fit within the personal tax component of relief for introduction of the GST. FTB Part A, based on family income, was designed to help families with the cost of raising children. FTB Part B, on the other hand, was designed to help families with one main income earner or single income parents and originally had no income test for the primary earner (although this was changed in 2008). The Child Care Benefit is paid to reduce the costs of child care and is based on family income, while the Child Care Rebate is a rebate of out-of-pocket expenses for child care and is capped, but not income tested.

There is a deeper challenge to the political discussion concerning family. It centres on the view that ultimately the 'unit' of well-being is the individual. It is the individual's capability to achieve what she or he values that is important. That is not to deny the family may be an intrinsic part of an individual's own sense of well-being and capability. But it does suggest that the important concept of family should not prevent us from looking to how individuals are impacted within the family. It might be that the promotion of 'choice' for the breadwinner–homemaker path – desirable for some – actually denies choice for many in so far as it helps 'lock out' someone who is not a primary earner from the paid workforce.

- The fourth discourse is the relationship of childcare costs to employment. From the 1970s, we have had a debate about whether childcare costs should be tax deductible and, from the 1980s, about the nature and scope of the fringe benefits tax treatment of child care. There are inconsistencies and inequities between employees in this space.

We propose that all child care and family assistance be conflated into two transfer payments.

Firstly, we propose that assistance be provided to all forms of child care, provided it is recognised as income by the childcare provider. This would be based on a percentage of the cost of child care per child with 100 percent payment for low costs rising to, say, 75 percent payment for high costs with a cap, based on the highest average major city cost of child care. If an employer were to pay for the top-up costs they would be fringe benefits tax exempt.

Secondly, we propose that a primary carer payment be made on a per child basis with a cut off at twice average weekly earnings. This means that the assistance for child care should be linked to the child and not partner income.

Apart from the complexity of the current four payments - Family Tax Benefit Part A, Family Tax Benefit Part B, the Child Care Benefit and the Child Care Tax Rebate - the means testing based on family income effectively creates a very high marginal rate for the second earner through the loss of benefits. This is a trap and one that creates a strong disincentive for women to enter the workforce where they would provide a second income in the family. This has long-term, detrimental productivity impacts which are greater and more far-reaching the longer they stay out of the workforce.

Our proposal would not be inexpensive as a short-term cost, but it would produce substantial long-term benefits by minimising the disincentive within the tax-transfer system to remain outside the workforce, thereby making a significant contribution to increased productivity in the future.

Our proposal would not be inexpensive as a short-term cost, but it would produce substantial long-term benefits by minimising the disincentive within the tax-transfer system to remain outside the workforce, thereby making a significant contribution to increased productivity in the future.

Consultation and survey

Our survey results revealed the following:

- The personal tax system is second only to GST as the area most ripe for reform.
- Within personal taxation reforms, eliminating bracket creep is considered the most important area by a substantial amount.
- Simplification through conflating Medicare into the thresholds is considered the next highest priority, followed by an incentive to increase labour productivity.

Recommendations

3.1 We propose four rates of personal income tax – 15 percent, 25 percent, 35 percent and 45 percent.

- The first band would be from nil to one third of AFTE, currently about $27,000, and be set at 15 percent.
- The second band would be between one third and AFTE and would be set at a rate of 25 percent. This would be between about $27,001 and $80,000.
- The third band would apply from AFTE to twice AFTE, currently $80,001 to $160,000 and would be set at, say, 35 percent.
- The top band would apply from twice AFTE, currently $160,001, and would be set at, say, 45 percent.

3.2 That we modify the low income tax offset and introducing a work incentive tax offset. This would be designed to deal with the abolition of the tax free threshold and to provide a measure to increase labour participation and deal with the high marginal tax rates for some people entering the workforce given the loss of transfer benefits.

3.3 That we conflate the Medicare Levy, Zone Rebates and similar items into the above rates. This would, in effect, abolish these add-ons.

3.4 That we cash out work-related expenses with optional proof above a certain level but limited by a cap.

3.5 That we exempt all transfer payments.

3.6 That we replace the fringe benefits tax system with a new system of personal benefits, entertainment benefits and non-personal benefits.

- Personal benefits would be taxed at the employees' marginal rate and appear on the group certificate. They would be benefits referable to a specific individual such as motor vehicle and loan fringe benefits. They would need to exceed a threshold such as $2,000 or $4,000 in total. This threshold should be linked to AFTE.
- Entertainment benefits would be subject to a tax that would appear on the company tax return. It would set at a rate of 45 percent and be non-deductible. It would not be a company tax or generate franking credits. The tax would be allocated to the states. There would be no separate instalment system for this tax.
- Non-personal benefits, which are those benefits that are not personal benefits or entertainment benefits, would be split between exempt items and non-deductible items. Child care top-up benefits, reflecting the difference between the cost of child care and the amount of transfer payment from the government would be an exempt benefit.
- Not-for-profits would not experience the detriment of non-deductibility although they would experience the Entertainment Tax if they chose to provide entertainment benefits.
- Valuation methodologies would be revisited to ensure they are realistic and should be set at the 'average value'.
- No fringe benefits tax return would need to be lodged.

Recommendations

3.7 In seeking to simplify concepts, there would be 14 basic framework terms within the personal tax system which would be geared to an everyday understanding. They are:

1	Ordinary income	**8**	Discount personal capital deductions
2	Statutory income (including personal benefits)	**9**	Non-deductible expenses
3	Discount personal capital income	**10**	Taxable income
4	Exempt income	**11**	Refundable offsets
5	Top rate special income (including minor income)	**12**	Non-refundable offsets
6	Ordinary deductions	**13**	Tax
7	Statutory deductions	**14**	Benefits income (for transfer system)

3.8 That we broaden and simplify the payroll tax system. We propose this would involve:

- A 5 percent rate on all payroll and personal benefits (without exemption or thresholds), but excluding payroll tax on consultants.
- The tax would be collected federally through the group tax mechanism. This would be very simple and effectively involve one additional box.
- The tax would be allocated to the states based on the residence of the employee.

3.9 That we conflate the current Family Tax Benefit A and B, Child Care Benefit and Child Care Rebate into two transfer payments:

- Child care assistance for all forms of child care, provided it is recognised as income by the child care provider. That it be based on a percentage of the cost of child care per child with 100 percent payment for low costs rising to, say, 75 percent payment for high costs with a cap based on the highest average major city cost of child care. If an employer were to pay for the top-up costs they would be fringe benefits tax exempt; and
- A primary carer payment made on a per child basis with a cut off at twice average weekly earnings.

Chapter 4 – Personal capital taxation

Exclusion of own home from revenue base

There is a principle that underlies our personal taxation system that we should tax gains. We make an exception for people's principal place of residence. This exception has its foundation in deep notions of the 'private realm' within the community.

Such notions do not extend to taxes designed to service property – such as a Property Services Tax proposed below, or even acquisition transfer taxes such as stamp duty – but do extend to taxes on gains from a person's own home. Thus, even measures that would apply only to very substantial gains and impact only the wealthy do not gain traction with the majority of Australians who see such measures as an encroachment of the private realm.

It is therefore a political reality that the principal residence needs to be left out of the income tax base.

It should be recognised that the concessional treatment of home ownership raises equity issues with those that do not own their own home. This is a complex question concerning, among other things, housing affordability. While beyond the scope of this submission, it impresses us that we can be more innovative in relation to home ownership.

We should be considering structures that may allow people to part-own and part-rent a house. This is not without complexity, but the potential benefits of pioneering thinking are substantial.

Comparison of taxation of labour income and personal capital income

The taxation of personal capital income is essentially the taxation of savings. There are two main issues with the taxation of savings: first, the difference with the taxation of labour income and, second, the difference in taxation of different forms of savings.

The question of how savings should be taxed as against labour income goes to the question of whether a dollar of labour income should be taxed the same as a dollar of income from savings. There is a view prevalent in the community, to misquote Gertrude Stein, that "income is income is income". This is not quite true for two reasons.

The first concerns inflation. Let us assume I earn $100 in salary and am taxed at 35 percent. My effective tax rate both in nominal terms and in real terms is 35 percent. Let us assume I earn $100 as interest, at 5 percent, from a $2,000 bank deposit with 2.5 percent inflation. At the end of 12 months, I now have $2,100, which is worth about $2,050 in real terms. My effective tax rate is close to 72 percent in real terms. At a return of 6 percent, my real effective tax rate falls to 61 percent, at a 7.5 percent return it falls to about 54 percent, and a 10 percent return sees it fall to 48 percent.

The second concerns the impact of the taxation of income, which compounds, over a period. Let us assume inflation is nil and that rather than investing my $2,000 for one year, I invest for five years with a tax rate of 35 percent. The impact of taxing interest income as it accrues and is reinvested has the impact of increasing my tax rate. Thus the effective tax rate after five years is about 48 percent and after 10 years is about 51 percent.

The impact of both the inflation effect and the compounding effect is that the taxation of savings at normal marginal rates presents a disadvantage to the taxation of labour income. This disadvantage is not the end of the story, but represents the beginning of a balancing exercise. So while it is clear that people who save some of their labour income are at a disadvantage to people who spend it all, other equity and productivity concerns come into play. These are as follows:

"The impact of both the inflation effect and the compounding effect is that the taxation of savings at normal marginal rates presents a disadvantage to the taxation of labour income.

This disadvantage is not the end of the story, but represents the beginning of a balancing exercise."

- The higher taxation on savings increases the incentive to work. This is a positive for those willing and able to do so. It will have no impact on those who are unable to do so – particularly the aged.
- On the other hand, the higher taxation on savings increases the propensity to spend, rather than save. This has a detrimental effect as it diminishes the pool of savings.
- The propensity to save itself involves a multiplicity of complex factors. It will depend on the level of discretionary spend plus generational, cultural and educational factors. It will also have aspirational elements for those seeking to buy their first home. It is probably true to say, however, that those on higher incomes are more likely to save.
- In addition, it should be recognised that not all savings are derived from a person's own labour income. Some savings may be derived from inherited income. That may have arisen from another's labour or may not.
- Finally, it should be recognised that those that choose to spend now rather than later will have different secondary impacts on both the transfer system and the direct and indirect tax systems. This is hugely complex on its own.

Comparison between different forms of personal capital taxation

The above discussion has concerned a comparison between personal labour taxation and normal taxation of savings at marginal rates. A second issue concerns the difference in the taxation of savings. As is commonly understood, there is a significant difference between the effective rate of taxation on different types of savings vehicles – normal interest income from bank accounts, rental property income, listed and unlisted shares. These differences arise both from the impact of the capital gains tax discount, imputation and the differences that arise from debt and equity funding.

It is beneficial to reduce the taxation differences between different forms of savings and the differences between equity and debt funded investments. Superannuation is considered separately below.

Discount of 25 percent on personal capital income

Considering the myriad of factors outlined above, we propose that a discount of 25 percent apply to personal capital income and expense for resident individuals for:

- interest income,
- interest expense to acquire income-producing personal capital assets,
- net rental property income or expense,
- capital gains and losses without regard to an ownership period, and
- unfranked dividend income.

This would:

- reduce the detriment of the taxation of savings through interest;
- reduce the impact of negative gearing;
- not create a substantial incentive to move from investment in property to investment in shares;
- diminish the bias towards investment in Australia as against foreign investment without diminishing the benefits of imputation; and
- assist our Australian-based multinationals expanding overseas by diminishing the investment pressure to pay franked dividends.

Negative gearing

This means that the capital gains tax discount would be reduced from 50 percent to 25 percent. The benefits of negative gearing would be reduced but not eliminated. There would not be a significant incentive to move away from the negative gearing of property towards negative gearing of shares. The non-deductible interest component would not increase the cost base of assets.

Unfranked dividends

Unfranked dividends would receive the benefit of the 25 percent discount for resident individuals. It would also apply to superannuation funds (see below). This would reduce the current disincentive for Australian multinationals to invest overseas to derive profits that do not carry franking credits.

Prima facie, this measure would improve the rate of return on investments in New Zealand and may act as a preferred option for the mutual recognition of franking credits.

Transition

The above proposals should be implemented over a period of time, say, five years. This would reduce the impact of any current tax preference capitalised into property prices – be they bonds, real estate or shares.

Superannuation – need for comprehensive review

The superannuation system should be subject to a comprehensive review which would establish objectives. Those objectives are not clear at present. While most would agree that at least one purpose of superannuation is to provide people with an adequate level of retirement income, the community needs to establish the weight that should be given to other factors. These include:

- Whether the system should be designed to relieve the age pension, and if so, for what period, such that longevity risk is borne by government?
- Whether a purpose of the system should be to increase national savings or whether this is just a beneficial secondary impact (albeit with substantial historic benefits)?
- Whether the system should be a mechanism for passing on inter-generational wealth?
- Whether, for compulsory superannuation, the impact on real wages should be a consideration throughout the lifetime of an individual?

Superannuation – interim measures

Interim measures to decrease the level of superannuation benefits for those on high incomes should be considered, but they should not derail the need for a comprehensive review for implementation from 2018 to 2023. Such interim measures could include a lifetime cap on superannuation non-concessional contributions and superannuation balances.

Further, consistent with the taxation of individuals above, but having regard to the objectives once established, consideration should be given to providing superannuation funds with the benefit of the 25 percent discount on unfranked dividends. The capital gains discount for superannuation funds would decrease from 33 percent to 25 percent.

Superannuation – future – consistency between phases

In addition, once the objectives of superannuation are established, regard should be had to the consistent taxation of earnings between the accumulation phase and the pension phase. This might be set at 7.5 percent, as envisaged by the *Henry Review*, or another percentage and would need to be subject to transitional measures.

Death as a realisation event

There is clearly not an appetite to introduce death duties in Australia. We specifically reject the introduction of a death duty, inheritance tax or accession tax. We do, however, believe consideration should be given to the treatment of death as a realisation event under the capital gains provisions (CGT) in certain circumstances. However, we would propose five significant exceptions outlined below. Therefore, if such a proposal were to be adopted, death would be considered a realisation event for CGT assets held by an individual, excluding:

- a principal place of residence;
- a family farm;
- a family business which meets an active asset test and is below a value threshold;
- assets jointly owned by a spouse, to which an inter-spousal rollover should be available; and
- where the remaining assets fall below a high de minimus threshold.

This measure, if adopted, would only tax latent capital gains, and would diminish the ability to pass wealth from generation to generation untaxed, except where there were sound reasons for doing so. The rule invites planning that would place non-exempted assets in discretionary trusts. This could be dealt with by the gradual withdrawal of the CGT discount on assets flowing through a discretionary trust, albeit with the ability to partially duplicate that effect through the concept of a small business company as outlined below.

It is important to recognise that this proposal is not the instigation of a death duty. It is merely a partial withdrawal of a rollover currently embedded in our system with the denial of the CGT discount to discretionary trusts. It is recognised that this rule has the potential to be reframed by some members of the community who choose to misrepresent it.

Consultation and survey

There was moderate support for limiting the benefits of negative gearing, which was strongest among non-executive directors (NEDs). NEDs also felt strongly about limiting the benefits of discretionary trusts.

There was support for reducing tax differences for different forms of savings. There was a strong aversion to introducing death duties.

On superannuation, there was a clear desire to see a comprehensive review of superannuation, including its objectives, and to limit concessions for large superannuation balances. There was very low support for eliminating the refundability of imputation credits for superannuation funds.

Recommendations

4.1 That the taxation of savings should be more consistent and subject to a discount of 25 percent for resident individuals. The 25 percent discount would apply to:

- interest income,
- interest expense to acquire income-producing personal capital assets,
- net rental property income or expense,
- capital gains and losses without regard to an ownership period, and
- unfranked dividend income.

4.2 Capital losses would not be quarantined from revenue gains. Sole trader and partnership active business income would also obtain the benefit of a 25 percent discount, so that there would be minimal differences between an individual trading in shares and simply investing in shares (see below).

4.3 The superannuation system should be subject to a comprehensive review which would establish objectives.

4.4 Interim measures to decrease the level of superannuation benefits for those on high incomes should be considered. Such interim measures could include a lifetime cap on superannuation non-concessional contributions and superannuation balances.

4.5 Consideration should be given to providing superannuation funds with the benefit of the 25 percent discount on unfranked dividends. The capital gains discount for superannuation funds would decrease from 33 percent to 25 percent.

4.6 Regard should be had to taxation of earnings consistently between the accumulation phase and the pension phase. This might be set at 7.5 percent, as envisaged by the Henry Review, or another percentage.

4.7 A death duty, accession tax or inheritance tax should be rejected. However, consideration should be given to treating death as a realisation event for CGT assets held by an individual excluding:

- a principal place of residence;
- a family farm;
- a family business which meets an active asset test and is below a value threshold;
- assets jointly owned by a spouse, to which an inter-spousal rollover should be available; and
- where the remaining assets fall below a high de minimus threshold.

4.8 The capital gains discount for discretionary trusts would be phased-out. This would assist in dealing with planning involving death as a realisation event and support the promotion of the small business company structure outlined below.

Chapter 5 – Active business income

Tensions

Company tax as a revenue base contains some strong and difficult tensions. As a medium sized nation dependent on foreign investment, we have a very high company tax rate which makes us less competitive in attracting capital. Lowering the rate, however, is not easy given that we are so dependent on the base for revenue. Meanwhile, there is a small number of companies that pay a significant portion of our company tax which is not healthy. Ultimately, company tax is highly volatile and our heavy reliance on it makes our revenue base less stable.

Sensitivity of foreign investment to the company tax rate

There are differing views in the business and taxation community on how sensitive foreign investment is to our company tax rate. Our survey suggests that most, but certainly not all, senior business people feel it is sensitive. Greater empirical research needs to be undertaken here.

Some have argued that the current international environment, particularly with low interest rates, has not seen 'a queue' of investment waiting to enter the Australian market. Others have argued that much foreign investment into Australia duplicates global businesses and is thus less tax rate sensitive than other economies.

Our view is that the global environment will change, even if you were to give weight to the argument that there is reduced appetite for investment into Australia at the present time. We need to focus on the future. Moreover, there is a strong need for us to become more than a subsidiary economy. Indeed, it is particularly important that we maintain our 'head-office businesses' – that is, our large Australian-based multinational entities. The secondary benefits that arise from having head-office businesses in Australia are substantial.

Measuring the impact of a reduction in the company tax rate on GDP will depend substantially on the assumptions that are put in the modelling. But in broad terms, and at the more positive end of the spectrum - based on the recent UK budget - a 2 percent reduction in the company tax rate would lead to a nearly 1 percent increase in GDP over the long term.

High economic burden and economic incidence on labour

Company tax is considered by economists to have a high economic burden. Moreover, the long-term economic incidence of company tax is thought to fall on real wages. The extent to which this occurs is subject to debate, although the balance of opinion and international empirical evidence is that labour bears the majority of the burden of company tax.

Therefore, a fall in the company tax rate should promote higher foreign capital investment which would change the level of capital intensity or deepening in the Australian economy. This in turn would lead to higher productivity and, hence, greater real wages.

26 percent tax rate in 2023

Our recommendation is that our company tax rate should fall to 26 percent. This would apply to all companies. At 26 percent, the differential with the current Hong Kong and Singapore rates would be less than 10 percent. However, the differential with the top marginal rate would be 19 percent which is far from desirable.

Preservation of imputation

One option to reduce the benefits of imputation for a reduction in the current company tax rate, simply does not have support with a substantial portion of the business community. There is concern that reducing the benefits of imputation would reduce investment in Australia and promote investment overseas which would not be offset by a corresponding increase in foreign investment into Australia.

We need to ensure that the preservation of our imputation system does not make us more insular as an economy. It could do this if investor analysts pressure boards to focus more on deriving Australian profits that give rise to franking credits, rather than considering offshore opportunities. This should be considered in greater depth in 2020. In the meantime, the 25 percent discount on unfranked dividends should reduce the drive to insularity.

Simplified small business company

Many small business structures are complicated by the perceived need for flexibility in allocating income to family members and obtaining the benefit of capital gains tax concessions. We propose a special small business company with features that seek to emulate some, but not all, of the features of a more common company/discretionary trust structure.

A new Small Business Company (SBC) would be established which would seek to duplicate the tax impacts of some, but not all, of the complex standard business structures currently in place. Key features would be as follows.

- To qualify for an SBC, more than 80 percent of income and assets would need to be active business assets in a year of income and the gross assets and turnover would need to be below a specified threshold.
- Taxable profit would be based on cash flow – business income less business outgoings – plus capital gains on assets held for less than two years. Other capital gains on active business assets would be subject to a pass through. There would be no depreciation or amortisation. There would be a simplified carry-forward loss regime.
- The tax rate would be 28 percent from 2020 and 26 percent from 2023.
- There would be two classes of shares – ordinary shares and discretionary shares – which must be owned by individuals. Up to 20 percent of shares could be discretionary shares. Dividends need not be paid on the discretionary shares, but if they are they would need to be paid *pari-passu* across both classes of shares. They could be franked or unfranked. There would be no 45 day or 'at risk' rules.
- Dividends on the discretionary shares could be paid to any individual resident nominated in that specific year. Loan-backs would not be permitted. An SBC could not lend money to an associate or shareholder, but could pay a dividend or return capital subject to a solvency test only. Loans could be made to the SBC, however.
- Capital gains on the sale of active business assets of the SBC held for more than two years could be passed through to ordinary and discretionary shareholders and be taxed in the hands of individuals with a CGT discount (proposed to be 25 percent) or could be retained in the company and be taxed at a concessional rate (to gain equivalence with the pass through).
- Small business assets could be rolled over to an SBC within a limited time frame.
- Small business capital gains concessions would apply only to SBCs after a transitional period.
- Discount capital gains from assets held by a discretionary trust would be phased out. This would provide a clear advantage for the SBC over current structures.
- Once the SBC grows beyond the SBC threshold, it would convert into a normal company. Ownership of the discretionary shares would then become fixed based on a company election.

The key advantage of the simplified SBC is to reduce complexity and to have a vehicle that provides for concessions.

"A new Small Business Company (SBC) would be established which would seek to duplicate the tax impacts of some, but not all, of the complex standard business structures currently in place."

Innovation company

A new innovation company would be established which would seek to assist in reducing the movement of innovative businesses offshore and provide much needed cash to pay salaries during the start-up phase. Innovation companies in a start-up phase are generally short of cash and find funding difficult in the $2 million to $40 million range. One asset that most innovation companies have is tax losses. This would be a mechanism to monetise the tax losses.

We believe the initiative would be attractive to many high net worth individuals with company structures who would prefer to pay an amount to a company in which they have, or are to obtain, an investment interest, rather than additional tax. Thus the initiative fits well with the motivations and drivers of many wealthy individuals.

Key features are as follows.

- The definition of an innovation company would need to be established and would probably be between the current research and development (R&D) framework and an eligible start–up (used for employee shares).
- It would be able to transfer losses to another company. The transferable loss would be limited to 70 percent of the amount of salary expenditure.
- Full consideration would be paid for the loss at the 28 percent or 26 percent tax rate.
- In order to be able to receive the benefit of a transferred loss, an equity investment of the multiple of the loss (say, five times) would need to be made for at least two years. If the two-year investment period was not met, the loss transfer would be effectively reversed in the year that the two year rule was broken.
- A cap on the maximum amount of a transferable loss would be set, say, at $5 million.

The two main advantages with the above approach is that the concession follows the commercial decision to invest (and government is not picking winners) and that it promotes salary expenditure (which will be assessable at marginal rates).

R&D expenditure

Innovation provides substantial benefit to the Australian economy and to society. It is also a key component of a globally competitive knowledge economy. Australia has many innovation success stories to build on. Its innovation policy should focus on both tax incentives and broader measures such as greater partnership between government and the private sector.

R&D is a strategic investment which requires funding to be diverted from operational expenditure, which thereby places an immediate drain on cash flow and consequently dilutes short-term profit at the expense of long-term growth. This presents challenges for both start-ups and mature companies.

Providing cash flow to companies when not yet profitable is key, and particularly relevant to young companies, but also mid-sized established companies. The refundable component of Australia's tax Incentive serves this function for smaller companies, but not those with an aggregated turnover of $20 million or more. This is contrasted with the UK where even large companies can cash out R&D tax benefits. Increased access to refundable tax offsets, including expansion to mid-sized companies, would alleviate the cash flow constraints faced by both start-ups and more mature companies and support R&D.

An immediate or accelerated write-off of expenditures on R&D equipment and facilities would reduce the cost of investing in assets used for R&D activities.

Better promotion of public-private partnerships (PPPs) such as those between CSIRO and industry would be appropriate to encourage investment in innovation and entrepreneurship. Research shows that creating PPPs and centres of excellence provide significant spill-over effects and promote better innovation in both the public and private sectors.

"Innovation companies in a start-up phase are generally short of cash and find funding difficult in the $2 million to $40 million range. One asset that most innovation companies have is tax losses. This would be a mechanism to monetise the tax losses."

Collective Investment Company

Australia has adopted trust structures for collective investment vehicles because of the decision at the end of the First World War to treat trusts, at least in part, as transparent entities. The widely held trust presents a disadvantage to a transparent company for foreign investors unfamiliar with trust law and structures. This is particularly true of China.

Thus a simplified Collective Investment Company (CIC) with transparency features of our widely held trusts, including Managed Investment Trusts, should be established to assist in simplifying foreign investment into Australia. Such a company would have simplified carry-forward loss, passive income and source rules. Rollover rules for transfer of assets to a CIC would need to be available. It is a widely held view in the industry that a CIC is required.

The CIC rules, under our proposal, would also have the unusual feature of providing certainty either through a binding ruling or regulation which would be legislated in multiple languages including Mandarin, Japanese, Korean and Spanish with a promise of five years notice for a detrimental change of law.

While placing our tax law into non-English codes might appear 'gimmicky', it is likely to have a significant impact on retail investors in the Asian market and particularly China. The Asian Century is producing a large number of wealthy families who are investing on various Asian stock exchanges. Familiarity and comfort based on 'own language' analysis would be very important in this environment. Australia needs to take a lead in initiatives like this, to ensure that it does not fall further behind as a financial centre for Asian investment.

Our funds management industry will be an important source of export income in the future and moves to remove tax uncertainty from the appointment of an Australian funds manager for offshore portfolio management through the Investment Manager Regime are welcome. But again, we could go further by presenting such tax rules in multiple languages, particularly Mandarin, and providing a rolling, five-year notice period for any potential changes.

Bright line tests for capital-revenue distinction

A two-year holding period rule should be established for distinguishing capital gain from revenue gain, except for financial institutions. Generally for financial institutions, all gains and losses should be on revenue account, although many assets would be taxed on a 'profit' basis rather than a gross flow basis. Further, some financial institutions might have investment portfolios which are direct competitors of superannuation funds. These should be placed on a level playing field.

Simplified carry-forward and other loss provisions

Australia has one of the most cumbersome set of carry-forward and unrealised loss provisions in the world. They act as an impediment to changing business activity and are damaging to the economy. They should be substantially simplified and focus on eliminating egregious trading-of-loss companies.

Frankable dividend for company law and tax law

The current misalignment between the concept of a company law dividend and a frankable tax law dividend creates considerable complexity. However, there is a revenue cost in releasing trapped franking credits. This should be dealt with through a slow release mechanism, allowing for significant simplification in the future through alignment.

General simplification

There is considerable scope for simplification in the area of business taxation. For example, Australia has very complex rules regarding financial arrangement, foreign exchange gain and loss and controlled foreign corporation. They are grossly over-engineered.

There is potential to reduce these rules to one tenth of their current size, if not more. These rules should be reviewed and simplified under the tax reform process.

Review of tax law changes

A debrief and review process should automatically be in place for any significant tax law change and be undertaken in the spirit of continuous improvement as outlined in Chapter 2 above. This should have three elements.

- After the legislation is enacted there should be a debrief of the process of formulation and consultation by stakeholders, Treasury, the ATO and the Office of Parliamentary Council.
- After two years, there should be a short review with a view to ensuring there were no unintended consequences. If there are, these should be amended in a general tax law amendment bill.
- After five years, there should be a review of the legislation to ensure that the policy intent of the legislation is changing behaviour as envisaged.

Consultation and survey

The following observations can be made from the survey. They are consistent with comments from the roundtable discussions.

- As a goal of tax reform, by far the greatest weight at all levels was given to reducing taxes with a high economic cost. Clearly company tax is one of those.
- One of the most striking features of the survey was the strong desire to leave the current imputation system in place.
- Company tax, however, was considered to be the fourth most important area for reform after GST, personal income taxes and state taxes.
- In terms of company tax, reducing the tax rate was considered to be most important area for reform. The level of investment was considered to be very sensitive to the company tax rate, CEOs and CFOs giving this the greatest weight. NEDs viewed investment as less sensitive compared with the average response in the survey. About a third each thought there was high, medium or low sensitivity.
- Aligning capital allowance with effective life and providing tax relief for goodwill were considered to be very low priorities.
- Within small business taxation, tax loss transfers for innovation companies were considered to be the highest priority.

Recommendations

5.1 **Company tax rate.** That the company tax rate be lowered to 28 percent in 2020 and 26 percent in 2023. This would create a differential of less than 10 percent with the current Hong Kong and Singapore headline. There would be a 19 percent differential with the proposed top marginal rate of 45 percent.

5.2 **Maintenance of the current imputation system with a review undertaken in 2020.** As Australia becomes more closely linked to the international economy, the benefits of imputation decline. There is currently significant support for maintaining the current imputation system. This may decline as a greater portion of investment in Australia is determined by a foreign cost of capital.

Our proposal would be to provide a 25 percent discount to individuals on unfranked dividends as discussed in the personal capital taxation section (See Chapter 4 Recommendation 4.1).

5.3 **Small business company.** That a new Small business company (SBC) be established which would seek to duplicate the tax impacts of some but not all of the complex standard business structures currently in place. Key features would be as follows:

- To qualify for an SBC more than 80 percent of income and assets would need to be active business assets in a year of income and the gross assets and turnover would need to be below a specified threshold.
- Taxable profit would be based on cash flow – business income less business outgoings – plus capital gains on assets held for less than two years. Other capital gains on active business assets would be subject to a pass through. There would be no depreciation or amortisation. There would be a simplified carry-forward loss regime.
- The tax rate would be 28 percent from 2020 and 26 percent from 2023.
- There would be two classes of shares – ordinary shares and discretionary shares – which must be owned by individuals. Up to 20 percent of shares could be discretionary shares. Dividends would not need to be paid on the discretionary shares but if they were, they would need to be paid pari-passu across both classes of shares. They could be franked or unfranked. There would be no 45 day or 'at risk' rules.
- Dividends on the discretionary shares could be paid to any individual resident nominated in that specific year. Loan-backs would not be permitted. An SBC could not lend money to an associate or shareholder, but could pay a dividend or return capital subject to a solvency test only. Loans could be made to the SBC, however.
- Capital gains on the sale of active business assets of the SBC held for more than two years could be passed through to ordinary and discretionary shareholders and be taxed in the hands of individuals with a CGT discount, proposed to be 25 percent, or could be retained in the company and be taxed at a concessional rate to gain equivalence with the pass through.
- Small business assets could be rolled over to a SBC within a limited time frame. Small business capital gains concessions would apply only to SBCs after a transitional period.
- Discount capital gains from assets held by a discretionary trust would be phased out. This would provide a clear advantage for the SBC over current structures.
- Once the SBC grew beyond the SBC threshold it would convert into a normal company. Ownership of the discretionary shares then would become fixed based on a company election.

5.4 **Sole trader and partnership active business discount.** Profit of a small business sole trader or partnership should be taxed with a discount equivalent to the personal capital taxation discount.

Recommendations

5.5 **Innovation company.** A new innovation company would be established which would seek to assist in reducing the movement of innovative businesses offshore and provide much needed cash to pay salaries during the start-up phase. Innovation companies in a start-up phase are generally short of cash and find funding difficult in the $2million to $40million range. One asset that most innovation companies have is tax losses. Our proposal provides a mechanism to monetise the tax losses. Key features are as follows:

- The definition of an innovation company would need to be established and would probably be between the current R&D framework and an eligible start-up (used for employee shares).
- It would be able to transfer losses to another company. The transferable loss would be limited to 70 percent of the amount of salary expenditure.
- Full consideration would be paid for the loss at the 28 percent or 26 percent tax rate.
- In order to be able to receive the benefit of a transferred loss, an equity investment of the multiple of the loss (say, five times) would need to be made for at least two years. If the two-year investment period was not met, the loss transfer would be effectively reversed in the year that the two-year rule was broken.
- A cap on the maximum amount of a transferable loss would be set, say, at $5 million.

The two main advantages with the above approach is that the concession follows the commercial decision to invest – and government is not picking winners – and that it promotes salary expenditure – which will be assessable at marginal rates.

5.6 **R&D.** We recommend that access to refundable tax offsets be expanded to medium-sized companies and that accelerated depreciation be allowed for R&D assets.

5.7 **Collective Investment Company.** A simplified CIC with the transparency features of our widely held trusts (including managed investment trusts) should be established to assist in simplifying foreign investment into Australia. Such a company would have simplified carry-forward loss, passive income and source rules. Rollover rules for transfer of assets to a CIC would need to be available.

The CIC rules would also have the unusual feature of providing certainty either through a binding ruling or regulation which would be legislated in multiple languages including Mandarin, Japanese, Korean and Spanish with the promise of five years notice for a detrimental change of law. This innovation could also be applied to the proposed Investment Manager Regime (See Chapter 5).

5.8 **Bright line tests for capital-revenue distinction.** A two-year holding period rule should be established for distinguishing capital gain from revenue gain, except for financial institutions. Generally for financial institutions, all gains and losses should be on revenue account, although many assets would be taxed on a 'profit' basis rather than a gross flow basis. Some assets held by financial institutions are contained in portfolios that compete with superannuation funds. These should be treated in such a way as to maintain a competitive balance.

5.9 **Simplified carry-forward and other loss provisions.** Australia has one of the most cumbersome set of carry-forward and unrealised loss provisions in the world. They act as an impediment to changing business activity. They should be substantially simplified and focus on eliminating egregious trading-of-loss companies.

5.10 **Alignment of the concept of a frankable dividend for company law and tax law purposes.** The current misalignment creates considerable complexity. On the other hand, there is a revenue cost in releasing trapped franking credits. This should be dealt with through a slow release mechanism, allowing for significant simplification in the future.

Recommendations

5.11 **General simplification.** There is considerable scope for simplification in the area of business taxation. For example, Australia has very complex foreign exchange gain and loss rules which are grossly over-engineered. It is possible they could be reduced to one tenth of their current size, if not more. These rules should be reviewed and simplified under the tax reform process.

5.12 **Tax law change debrief and review.** A debrief and review process should automatically be in place for any significant tax law change and be undertaken in the spirit of continuous improvement. This should have three elements:

- A debrief of the process of formulation and consultation of new legislation by stakeholders, Treasury, the ATO and the Office of Parliamentary Council.
- After two years there should be a short review with a view to ensuring that there were no unintended consequences.
- After five years there should be a review of the legislation to ensure that the policy intent of the legislation is changing behaviour as envisaged.

Chapter 6 – Consumption

Promise of unanimous agreement on GST

The promise of former prime minister John Howard made in May 1999 to keep the same GST base and rate in the absence of unanimous agreement of the states and territories needs an expiry date. This should be 20 years. The current *Intergovernmental Agreement on Federal Financial Relations* which embodies the political promise should not be treated as an extra-constitutional impediment to tax law change. Thus, notice should be given to states and territories that GST should be subject to change from 2019.

Comprehensive GST is an efficient tax

It is widely acknowledged that GST is a highly efficient tax. KPMG modelling in recent times put GST at a very low level of excess burden. Inefficiency arises because of boundary issues on exemptions. GST is levied on only 47 percent of its potential base.

Regressive GST is overstated

In 2014, the OECD did a survey of 20 countries on the extent to which their VAT systems were regressive. They concluded:

> "Overall results for the 20 countries covered in the report show VAT systems are regressive when measured as a percentage of income, but are generally either proportional or slightly progressive when measured as a percentage of expenditure.
>
> In interpreting these results, the report argues that an income-base approach may be of particular interest in analysing the immediate distributional effects of consumption taxes, especially if household consumption patterns are not strongly affected by borrowings and savings behaviour. However, the report also argues that an expenditure-base approach will provide a more reliable measure of the lifetime distributional effects of a consumption tax. **The results therefore challenge the general public perception that VAT systems are regressive, at least in a lifetime context.**"

In relation to certain targeted exemptions, the report indicates that it can have the desired progressive effect. However, it goes on to say:

> "…despite this progressive effect, these reduced VAT rates are still shown to be a very poor tool for targeting support to poor households: at best, rich households receive as much aggregate benefit from a reduced VAT rate as do poor households; at worst, rich households benefit vastly more in aggregate terms than poor households.
>
> Overall, these distributional results suggest the need for a careful, case by case reassessment of the relative merits of various reduced VAT rates in many countries."
>
> OECD, *The Distributional Effects of Consumption Taxes in OECD Countries*, 2014

Further, Saul Eslake in Australia's Tax Reform Challenge, 2011 writes:

> "The highest-income quintile (fifth) of Australian households spends almost six times as much on GST-free food as the lowest-income quintile. As a result, **more than one third of the $6 billion in revenue foregone as a result of the exemption of food from GST benefits households in the top 20 percent of the income distribution.**"

Comprehensive base and rate at 15 percent

We recommend that the GST rate be increased to 15 percent and the base be comprehensively broadened to include, among other things, all food, health and education.

The current *Intergovernmental Agreement on Federal Financial Relations* which embodies the political promise should not be treated as an extra-constitutional impediment to tax law change.

Thus, notice should be given to states and territories that GST should be subject to change from 2019.

GST on financial services is recognised to be difficult throughout the world. A solution may be to zero-rate GST on financial service products and to put in place a value-added calculation which can be simply determined with a financial institutions accounting system. This would be a GST-proxy. This would require consultation with the major financial institutions.

High GST or VAT rates are embraced by progressive countries throughout the world given the efficiency of the tax. Other areas of the tax-transfer system are used to deal with the regressive nature of the tax. New Zealand is a model for us to follow. It has 96 percent of the potential tax base covered and a relatively high rate.

Luxury car tax

This is a 33 percent tax on cars with a value in excess of approximately $75,000 for fuel efficient vehicles and $63,000 for less fuel efficient vehicles. It is inefficient and grounded in perceptions of wealth which may not be well founded. There is a high level of consensus that it is a poor tax and thus should be abolished.

Alcohol taxes

Additional alcohol taxes are justified on the basis of the social and health damages that arise from alcohol. Such harm is considerable and needs to be recognised. On the other hand, alcohol is enjoyed by many without detriment. This is an inherent tension that has a bearing on the taxation of alcohol. But it would be true to say that many, if not most, involved in the industry would like to see their business flourish with minimal damage to the community.

For historical reasons, alcohol taxes have developed a structural complexity which needs to be addressed. As stated in, for example, the greater taxation of ginger beer with lower levels of alcohol has no rational justification.

To reduce this complexity, we propose that the Wine Equalisation Tax be conflated into alcohol excise and applied to four categories: (1) wine and sake, (2) beer and ciders, (3) spirits, fortified wines and (4) alcopops.

In determining how much is to be allocated to each category, we propose that the current total tax from alcohol be allocated based on a 'health detriment' assessment to be determined by the Productivity Commission in conjunction with health experts. This would take the form of new excise rates for the four categories.

A Health Inflation index would apply to each category. However, uniquely for a taxation rule, this level of increase in excise could be reduced to Wage Inflation for future years, based on industry efforts within each category of excise to reduce problem drinking. These efforts would need to be broadly commensurate with the excise savings to the industry and determined and evaluated by measurable criteria.

As the industry is in the best position to promote responsible drinking and discourage irresponsible, harmful drinking, they would benefit both through reputation and financially by such a mechanism.

There are a number of difficulties with this proposal. There will be differences of opinions regarding the health detriment allocation to each of the four categories. There will be difficulties with setting targets and in evaluating them. There will be a focus on health that may make some in the industry uncomfortable. But, to quote Voltaire, "The enemy should not be an enemy of the good".

Another issue for consideration is the industry reaction to this proposal. It is possible that many in the industry would acknowledge its benefits, providing better focus for its advertising and might avert greater restrictions in the future as it gains reputational kudos for its efforts.

One incidental benefit of the above taxation model would be to reduce taxation on higher value wine, thereby improving our export potential. This is not, however, a main driver of the change.

"Additional alcohol taxes are justified on the basis of the social and health damages that arise from alcohol. Such harm is considerable and needs to be recognised."

Gambling taxes

Like alcohol, gambling is enjoyed by many, but becomes problematic for a few. Gambling taxes also have structural complexity which needs to be addressed. Currently, they comprise a series of turnover, player loss taxes and licence fees.

We propose that gambling taxes should be consolidated into a single rate based on player losses. Licence fees should be reviewed and form two components. One would be linked to the level of 'economic rent' arising from the fact that the market is not an open one and limited to those receiving the benefit of the licence.

The second element should relate to the costs of problem gambling. Those costs should be estimated by the Productivity Commission and be based on the form of gambling. After all, lotteries, racing and poker machines have very different incidences of broader social costs.

The component of licence fees relating to problem gambling should be linked to Health Inflation with a mechanism to reduce the rates to Wage Inflation based on efforts to reduce the level of problem gambling.

The arguments raised above, in relation to alcohol excise, equally apply here. That is, there would be difficulty formulating measurable targets and the evaluation process. The industry is diverse with substantially different levels of problem gambling in particular sectors.

However, the industry is in the best place to introduce measures which reduce problem gambling and this may assist in the process.

Tobacco taxes

The justification for tobacco excise is generally grounded in the cost of the adverse health implications of smoking. Excise increases are currently geared to Wage Inflation. We propose that this be changed to Health Inflation. It is acknowledged that there is a debate about the level of illegal tobacco products. This a policing issue and should be dealt with in other ways.

Consultation and survey

There was clear consensus that GST was the area most ripe for reform. This was consistent with the desire for tax reform to focus on reducing taxes with a high economic cost. GST is widely understood to have a low economic cost.

Approximately 16 percent of survey responses gave weight to leaving the system unchanged.

The majority gave weight to lifting the rate to 15 percent and expanding the base to all areas including health and financial services.

Recommendations

6.1 That the states, territories and general community be put on notice that unanimous agreement will not be required for changes to GST operative from 2019.

6.2 That the GST rate be increased to 15 percent and the base be comprehensively broadened to include all food, health, education and other services.

6.3 The extension of GST to financial services requires consultation on the best manner for achieving this, having regard to the systems capability of major financial institutions. It may be appropriate to zero rate financial services and to place a substitute charge on the value-added.

6.4 That the Luxury Car Tax be abolished.

6.5 That the Wine Equalisation Tax be conflated into alcohol excise and applied to four categories : (1) wine and sake, (2) beer and ciders, (3) spirits, fortified wines and (4) alcopops.

That the current total tax from alcohol be established. That the level of excise for each category be allocated based on its health detriment estimated by the Productivity Commission. That the excise be indexed to Health Inflation with a reduction mechanism to reduce the excise to Wage Inflation based on industry efforts to reduce alcoholism. These efforts would be evaluated by the Productivity Commission and would determine the excise for the following year.

6.6 That tobacco excise be indexed to Health Inflation. It is currently indexed to Wage Inflation.

6.7 That gambling taxes be mostly consolidated into a single ad valorem rate based on player losses. Licence fees should be reviewed and form two components. One would be linked to the level of 'economic rent' arising from the fact that the market is not an open one and limited to those receiving the benefit of the licence.

The second element should relate to the costs of problem gambling. Those costs should be estimated by the Productivity Commission and be based on the form of gambling. Lotteries, racing and poker machines have very different incidences of broader social costs. The component of licence fees relating to problem gambling should be linked to Health Inflation with a mechanism to reduce the rates to Wage Inflation based on efforts to reduce the level of problem gambling.

Chapter 7 – Taxation of land

Efficiency

Stamp duty, insurance taxes and emergency service levies are highly inefficient taxes. Stamp duty gives rise to multiple costs in a development, acts as a disincentive for people to move to where there are employment opportunities, and leads to a greater size of housing stock as people are encouraged to upsize through renovation, but downsize through moving.

Insurance taxes and emergency service levies give rise to underinsurance and non-insurance. They are also regressive. Also, at least in the case of major disasters, they give rise to greater burdens on government which often 'steps in' where there is no insurance cover.

Land tax, by contrast, is a very efficient tax base due to the immobility of land.

It is clearly desirable to replace stamp duty, insurance taxes and emergency service levies with greater land tax. There are two main difficulties here. The first relates to cash flow. The second relates to transition.

Cash flow

Stamp duty is usually financed by a higher mortgage and paid over time as mortgage repayments are made. For those paying stamp duty with additional borrowings, replacing stamp duty with land tax would present some cash flow differences. But the effect in both cases is to spread the cost.

On the other hand, the imposition of land tax on those with a fully paid mortgage – most often older people – can present some hardship. To deal with this, we propose that those over the age of 60 should be able to defer the payment of land tax (referred to as a Property Services Tax) until they dispose of the property or death. This deferral would come with an interest cost and would be optional. The scheme, outlined below, would be run by one of the major financial institutions under tender.

Transition

There is the simple difficulty that those who have recently paid stamp duty suffer a detriment if the base moves to ownership of land. Two observations are made here. Firstly, the greater the time lapse between purchase and the change of tax base, the lower the transitional inequity and, indeed, the lower the effective tax rate of the stamp duty. Secondly, the cost of stamp duty may be differently capitalised into the value of property when compared to land tax which is spread over time.

These factors would need to be taken into account by the Tax Reform Compensation Commission when formulating transitional measures through the change of base.

Regressive elements

A land tax can be structured such that it is progressive and thus better deal with the inherently regressive nature of insurance taxes and fire service levies and the disadvantage arising from under insurance.

Proposal

Our proposal involves the following regime:

- Abolish stamp duty on the transfer of residential and commercial property.
- Conflate rates, land tax, insurance taxes and emergency service levies into a new Property Services Tax which would be levied on progressive rates based on unit values and a minimum threshold and be administered by the ATO, and not state-based Offices of State Revenue.
- Two thirds of the Property Services Tax would be spent locally, based on the desired form of local government attributable to the relevant state or territory.

"It is clearly desirable to replace stamp duty, insurance taxes and emergency service levies with greater land tax. There are two main difficulties here. The first relates to cash flow. The second relates to transition."

- One third of the Property Services Tax would go into a Property Services Equalisation Fund which would be organised by an independent state body equivalent to the Commonwealth Grants Commission.
- This body would distribute funds to local governments to help equalise the capacity of local government to provide local infrastructure and services. The remainder of the funds would be used for projects involving multiple local entities.
- The Property Services Equalisation Fund would produce highly transparent reports. It would show comparative income and expenditure of local government including top-up grants. This, of itself, would drive greater efficiency.
- Current federal government funding of local government which includes per capita and local road funding of about $2.3 billion would be redirected to the Property Services Equalisation Fund.
- The Property Services Tax would involve a deferral scheme 'owned' by the Property Services Equalisation Fund but managed by a financial institution or consortia of financial institutions determined by tender. The deferral scheme would provide:

  (a) That any individual owner over the age of 60 could defer 80 percent of the Property Services Tax until sale of the property or death with a government bond rate interest charge. There would be pro rata rules for joint ownership.

  (b) A selected group of others (disability pensioners etc.) would be able to enter the deferral scheme.

  (c) Properties not owned individually (that is, those held in discretionary trusts) would not be entitled to the scheme.

Consultation and survey

Those surveyed gave a very high weight to replacing stamp duty with land tax. A relatively low weight was given to replacing insurance taxes with an increase in land tax, although about half considered this a medium priority.

Recommendations

7.1 Abolish stamp duty on the transfer of residential and commercial property. Conflate rates, land tax, insurance taxes and emergency service levies into a new Property Services Tax which would be levied on progressive rates based on unit values and a minimum threshold. It would be administered by the ATO.

7.2 Two thirds of the Property Services Tax would be spent locally, based on the desired form of local government attributable to the relevant state or territory.

7.3 One third of the Property Services Tax would go into a Property Services Equalisation Fund which would be organised by an independent state body equivalent to the Commonwealth Grants Commission. This body would distribute funds to local governments to help equalise the capacity of local government to provide local infrastructure and services. The remainder of the funds would be used for projects involving multiple local entities.

7.4 Current federal government funding of local government, which includes per capita and local road funding of about $2.3 billion, would be redirected to the Property Services Equalisation Fund.

7.5 The Property Services Tax would involve a deferral scheme 'owned' by the Property Services Equalisation Fund but managed by a financial institution or consortia of financial institutions determined by tender. The deferral scheme would provide:

- That any individual owner over the age of 60 could defer 80 percent of the Property Services Tax until sale of the property or death with a government bond rate interest charge. There would be pro rata rules for joint ownership.
- A selected group of others (disability pensioners etc.) would be able to enter the deferral scheme.
- Properties not owned individually would not be entitled to the scheme.

Chapter 8 – Transport and environment

Costs of road transport

There are four main costs of road transport: (i) additional health costs due to motor vehicle accidents and pollution; (ii) environmental costs from carbon emissions and particulate matter; (iii) infrastructure costs of building roads or finding alternatives to take vehicles off roads, such as rail transport or cycle ways; and (iv) economic costs from congestion.

Health impacts

It is clear that road transport gives rise to significant health costs. These extend well beyond injury and death and include respiratory illness, mental wellbeing from noise pollution and congestion, and diminished physical fitness of a driving community.

Congestion

It would seem clear that the economic costs of congestion in the major cities will continue to grow. Congestion pricing would appear to be part of the solution. In the longer term, technology should be part of the solution for comprehensive time-distance-mass-location pricing. In the short term, this might be achieved through greater use of tolls. There are clearly privacy issues associated with comprehensive pricing. They are not, however, insurmountable.

Rural considerations

There is the perception of a 'regional and rural versus city' divide in relation to fuel for vehicles. Although there is evidence that those in urban areas drive more kilometres in passenger vehicles per annum, this may be because those in rural areas are more likely to be driving utes and trucks.

It is also more likely that they will drive larger vehicles and possibly less fuel efficient ones.

Further, average incomes in the major cities tend to be greater than in the rural and regional areas, thus suggesting fuel costs are likely to be a greater burden as a percentage of income for those in rural and regional areas.

Fuel excise and motor vehicle registration

Fuel excise is a relatively efficient tax to collect. Until recent times, however, it has been a diminishing tax base as it has not been indexed to inflation.

Motor vehicle registration is a relatively inefficient tax and tends to be regressive.

Proposal for transport

Our proposal involves indexation of fuel excise and the associated road-user charge, reducing the fuel excise rebate by one half referable to Health Inflation and one half referable to Infrastructure Inflation. Fuel excise would be hypothecated to rural and regional roads.

We also propose the introduction of congestion pricing in major cities. This should replace motor vehicle registration charges, except for the administration fees, and be indexed one half to Health Inflation and one half to Infrastructure Inflation. It would be hypothecated to major city infrastructure that is designed to reduce congestion, including road and designated cycle ways.

Carbon pricing

In all likelihood, that Australia will face more stringent international obligations to reduce carbon emissions. Under current policy settings this will give rise to a greater drain on the budget position as payments are made from consolidated revenue for businesses to reduce emissions unless greater use of penalties are put into place.

We recommend that the Direct Action Plan evolve into different form of payment-penalties whereby carbon pollution would be priced in such a manner as to encourage the reduction of carbon emissions.

Consultation and survey

The environment did not receive prominence in the survey results, although about half gave weight to increased congestion charging.

About 42 percent gave weight to the stresses between human activities and ecosystems as a future challenge of the taxation system.

Recommendations

8.1 Indexation of fuel excise and the associated road-user charge, reducing the fuel excise rebate by one half referable to Health Inflation and one half referable to Infrastructure Inflation. Fuel excise would be hypothecated to rural and regional roads.

8.2 Introduction of congestion pricing in major cities. This should replace motor vehicle registration charges (except for the administration fees) and be indexed one third to Health Inflation and two thirds to Infrastructure Inflation. It would be hypothecated to major city infrastructure that is designed to reduce congestion, including road and designated cycle ways.

8.3 In relation to putting a price on carbon, the current Direct Action Plan should evolve from a scheme which involves payment from consolidated revenue to reduce emissions with supporting penalties, to one which transfers the burden of meeting our international carbon reduction obligations on those with higher emissions.

Chapter 9 - Summary of revenue measures

A summary of recommendations with direct revenue impacts is depicted below.

		Productivity	Revenue	Equality	Gender equity	Difficulty
Chapter 2 – A new framework						
1.1	Agenda 8 years – 3 years setting to 2018 + 5 years implementation to 2023	▲	–	–	–	Med
1.2	Announce end to need for accepting unanimous agreement on change to the GST after 20 years	–	–	–	–	Med
2.1	Establish Tax Reform Compensation Commission – members agreement 2/3 Parliament	–	–	▲	–	Med
2.2	Establish compensation principles	–	▼	▲	▲	Low
2.3	Establish a phase-out approach for transitional compensation	▲	–	–	–	Med
2.4	Introduce new Combined Australian Governments Accounts in federal budget	▲	–	–	–	Med
2.5	Introduce new Current Accounts & Infrastructure Accounts in federal budget	▲	–	–	–	Med
2.6	Introduce modified current cash flow accounts in federal budget	–	–	–	–	Low
2.7	Introduce new Intergenerational Accounts in federal budget	▲	–	▲	▲	Med
2.8	Disclose Economic Burden, Economic Incidence & change in collection of top 20 taxes in federal budget	▲	–	▲	–	Low
2.9	Introduce tax simplicity indices for taxation of Large & Small Business, Individuals and Overall	▲	–	▲	–	Med
2.10	Disclose both additional projections for new policies based on primary and secondary impacts	▲	–	▲	▲	Low
2.11	Disclose Tax Expenditures with reasonable estimates of behavioural change with secondary impacts	▲	–	▲	▲	Low
2.12	Debrief major policy changes after 5 years with a review of unintended consequences after 2 years	▲	–	–	–	Low
2.13	Conflate Offices of State Revenue into ATO by 2023	▲	▲	–	–	Hard
2.14	For 2.13, 'buy in' from joining states through 'all-in benefit' with hold-out states 'some-in detriment'	▲	▲	–	–	Hard
Chapter 3 – Personal labour taxation						
3.1	Link tax thresholds to Average Full Time Earnings & abolish tax free threshold	▲	▼	▲	▲	Hard
3.2	Modify Low Income Tax Offset and introduce a Work Incentive Tax Offset	▲	▼	▲	▲	Hard
3.3	Conflate Medicare Levy, Zone Rebates and similar items into personal rates	▲	▼	▲	▲	Hard
3.4	Cash out work related expenses with optional proof above threshold but with cap	▲	▲	▲	▲	Hard
3.5	Exempt all transfer payments	–	–	–	–	Low
3.6	Replace FBT with new Personal Benefits, Entertainment Tax & exemption for childcare top-up	▲	▼	▲	▲	Hard
3.7	Simplify personal tax into 14 concepts	▲	–	–	–	Low
3.8	Expand and simplify payroll tax with federal collection & allocation to states	▲	▲	▲	–	Hard
3.9	Conflate family & childcare assistance into two payments - no longer based on family income	▲	▼	▲	▲	Hard
Chapter 4 – Personal capital taxation						
4.1	25% discount for interest, net rental property, interest expense, capital gains & unfranked dividends	▲	▼▲	▲	▲	Hard
4.2	Capital losses would not be quarantined from revenue gains	▲	▼	▲	–	Med
4.3	Establish superannuation objectives	▲	–	▲	▲	Med
4.4	Superannuation – interim measure – lifetime cap	▲	▲	▲	▲	Med
4.5	25% discount for unfranked dividends for superfunds	▲	▲	▲	–	Med
4.6	Superannuation – long term – consistent taxation earnings & pension phase	▲	▼	–	–	Low
4.7	Death should be a realisation event except for own home, family farm & business, and other assets	–	▲	▲	–	Med
4.8	Phase-out capital gains discount for discretionary trusts	–	▲	▲	–	Med

A summary of recommendations with direct revenue impacts is depicted below.

		Productivity	Revenue	Equality	Gender equity	Difficulty
Chapter 5 – Active business income						
5.1	Reduction in company tax rate to 26%	▲	▼	–	–	Med
5.2	Maintain current imputation system with review in 2020	–	–	–	–	Low
5.3	Introduce new simplified small business company – discretionary shares & capital gains flow through	▲	▼	▲	–	Med
5.4	Introduce sole trader & partnership 25% active business discount	▲	▼	▲	–	Med
5.5	Introduce Innovation Company with ability to transfer losses to investors for additional investment	▲	▼	–	–	Med
5.6	Expand R&D refundable tax offsets to medium companies and accelerated depreciation on R&D assets	▲	▼	–	–	Med
5.7	New Collective Investment Company – binding multiple language rules & 5 year no-change	▲	–	–	–	Low
5.8	Introduce a 2 year bright line test for revenue-capital distinction	▲	▼	▲	–	Low
5.9	Simplified carry-forward and other loss rules	▲	▼	▲	–	Low
5.10	Alignment of concept of frankable dividend for company law and tax law	▲	▼	–	–	Low
5.11	Simplification of current drafting – eg. foreign exchange rules	▲	–	–	–	Low
5.12	Tax law change and debrief reviews	▲	–	–	–	Low
Chapter 6 – Consumption						
6.1	States & territories put on notice unanimous agreement not required after 2019	▲	–	–	–	Med
6.2	GST rate increased to 15% & base comprehensively broadened	▲	▲	▼	▼	Hard
6.3	Extension of GST to financial services - zero-rating GST and value-add methodology cater for systems	▲	▲	–	–	Med
6.4	Abolition of Luxury Car Tax	▲	▼	▼	–	Med
6.5	Alcohol taxation consolidated & indexed to Health Inflation with incentive reduction to Wage Inflation	▲	▲	▼	–	Hard
6.6	Tobacco excise be indexed to Health Inflation	▲	▲	▼	–	Hard
6.7	Gambling licences – economic rent & problem gambling with Health Inflation with incentive reduction	▲	▲	▼	–	Hard
Chapter 7 – Taxation of land						
7.1	Abolish stamp duty & conflate rates, land & insurance taxes, service levies into a Property Services Tax	▲	▼▲	▲	–	Hard
7.2	Two-thirds allocation of Property Services Tax to be spent locally	–	–	–	–	Hard
7.3	One-third allocation of Property Services Tax to go into an equalisation fund	▲	–	▲	–	Hard
7.4	Federal funding of local government to go into equalisation fund	▲	–	▲	–	Low
7.5	Establishment of a deferral scheme for Property Services Tax for those over 60	▼	▼	▲	–	Med
Chapter 8 – Transport and environment						
8.1	Index fuel excise 50% each to Health Inflation & Infrastructure Inflation (rural)	▼	▲	▼	–	Hard
8.2	Congestion charging for major cities indexed to Health & Infrastructure Inflation	▲	▲	▼	–	Hard
8.3	Evolve Direct Action Plan to a scheme that places obligations on higher emitters	▲	▲	▼	–	Hard

Chapter 10 – KPMG Tax Reform survey, summary of results

The survey was conducted during the period from 26 May to 31 May 2015 and contained 222 respondents. There were 14 questions, 11 of which required the allocation of 20 points to six priorities. A maximum of 15 points was able to be allocated to one priority. An allocation of zero or one point was considered to be a negligible priority; two to 10 points, a balanced priority; and 11 to 15 points a weighty priority. The average scores were also measured.

A breakdown of the respondents is as follows:

Respondents	
Non-Executive Directors	**9%**
CEOs and CFOs	**11%**
Heads of Tax	**10%**
Partners and Directors of advisory firms	**17%**
Other advisory firm personnel	**30%**
Other professionals	**23%**
	100%

	Subject	Main points
1	Structural imbalance requires adjustment mostly to expenditure or revenue	• Balance in favour of adjusting expenditure, but not overwhelming • CEOs and CFOs more focused on expenditure • NEDs more neutral
2	Desirable to 'invest' in a transitional phase as a cost of resetting tax policy	• More than half thought this was desirable with about one quarter thinking it not desirable
3	Goals of tax reform	• Greatest weight given to efficiency of taxes and international competitiveness • Least weight given to balancing the budget and vertical fiscal imbalance • Equity and simplicity important
4	Areas most ripe for tax reform	• GST and income tax received the greatest weight, followed by company tax • Very little appetite for reforming imputation
5	Future challenges	• Ageing population by far the greatest concern, followed by global supply chains and digitalisation
6	Potential reforms to company tax	• Greatest focus on lowering the rate followed by increasing the R&D concessions • Relief for acquired goodwill and alignment of capital allowances with accounting receiving very low rankings
7	Foreign investment sensitivity to company tax rate and concessions	• About 45 percent thought the rate and concessions were sensitive with 14 percent suggesting not sensitive • Greatest sensitivity was experienced by CEOs and CFOs
8	Reforms to small business taxation	• Strong support for loss transfers to investors for innovation companies with greatest support from NEDs • Support for small business concessions but not differential tax rate
9	Reforms to imputation system	• Overwhelming support for leaving imputation alone at all levels • Support for alignment of accounting and tax concepts of a frankable dividend
10	Reforms to personal labour taxation	• Very strong support for eliminating bracket creep • Moderate support for earned tax credit
11	Reforms to personal capital taxation	• Moderate support for limitation of negative gearing • Very low support for introduction of death duties
12	Reforms to superannuation	• Strong support for comprehensive review including objectives • Minimal support for elimination of refundability of franking credits
13	Reforms to consumption taxation	• Greatest weight given to increasing the rate to 15 percent and expanding the base comprehensively
14	Reforms to state tax system	• Greatest weight given to eliminating stamp duty through increase in land tax • Harmonisation of payroll tax and collection at a federal level important

Appendix – Survey results

1. Structural imbalance

Do you think the structural imbalance between the expenditure of government and revenue raised requires adjustment mostly to expenditure or mostly to revenue?

Results

	Mostly expenditure (1 and 2)	Neutral (3)	Mostly revenue (4 and 5)	Average
All (222)	33%	39%	27%	2.8
NEDs (19)	21%	58%	21%	2.9
CEOs and CFOs (25)	44%	40%	16%	2.4
Heads of Tax (23)	40%	30%	30%	2.6

Respondents' comments

"The tinkering with the welfare system, whilst necessary on an ongoing basis, is in my view too simplistic a response to where Australia finds itself. We did a terrible job managing the bonus of a resources boom. We have an ageing population. Yet we have major opportunities to now develop a modern economy – – with an emphasis on education and research. This will require a reworking of taxation and will mean some will have to give up what they have, including in the superannuation space and with such things as negative gearing. Just how brave, honest and forward thinking we are as a nation is a very open question."

"Expenditure is growing far more quickly than by inflation. Politicians are continuing grand policy changes without funding (i.e. Gonski). However, revenue policy needs attention as well particularly in GST with the amount of exemptions meaning a continued focus on personal and company income taxes to collect the majority of the revenue. But with the top marginal rate of tax set very high at 49 percent it is acting as a disincentive to work and an incentive to use mechanisms such as trusts, private companies and superannuation to reduce this amount."

"Governments create fixed expenditures but receive variable revenues which inevitably is unsustainable."

"Cutting costs has a limit. It is more effective to broaden the revenue base."

"At a general level, the Australian economy is faced with expenditure that increases overtime due to increases in healthcare and support based payments that are tied to the ageing population. This combined with a shrinking revenue base that is weighted heavily towards individual and corporate direct taxation results in an unsustainable fiscal balance."

"Part pension payments and concessions to those with substantial assets will need to be reduced, while there are opportunities to raise revenue in ways that increase efficiency – road charging, carbon pricing, higher tax on wine, etc."

2. Cost of resetting our tax policy

Do you think it is desirable to 'invest or spend' a portion of our GDP (say 1–2 percent) in a transitional phase (up to 10 years) as a 'cost' of resetting our tax policy?

Results

	Not desirable (1 and 2)	Neutral (3)	Desirable (4 and 5)	Average
All (222)	23%	24%	54%	3.3
NEDs (19)	26%	16%	58%	3.4
CEOs and CFOs (25)	20%	16%	64%	3.4
Heads of Tax (23)	13%	9%	78%	3.8

Respondents' comments

"The overblown focus on deficits is unnecessary. We can afford to borrow to fund worth-while activities/investments."

"Ten years is too long. The money is there to fix the issue. The areas of spending need to be reviewed and rebalanced."

"I don't think it is avoidable from a political point of view, but the answer is preferably not. Having said that, the reality I think is that in order to make the structural changes needed, we will need to provide for those who can least afford it both in the transition and post re structure."

"In theory a good idea but if there was a global shock or even regional economic shock in say, eight years, there is a risk we are left with unsustainable debt levels."

"A 'cut through' is necessary to engage with significant interest groups, the general population and all jurisdictions. I can't see that buy-in happening without a significant campaign and commitments that in the longer term most of the population will be better off. Deficits have been demonised by those seeking smaller government. In so doing they have limited progress on infrastructure spending which leads to increased productivity. Care needs to be taken NOT to be funding recurrent outlays with borrowings."

"Tax reform is an important source of economic growth. Without transition it is unlikely to happen."

"In order to achieve a balanced tax policy which encourages growth and investment, a long-term approach needs to be taken when reforming taxes which may require increased spending now."

"A consensus across interest groups and political parties is needed. An investment across a transitional phase may just 'buy' broad agreement or at least limited heated public disagreement."

3. Goals of Tax Reform

Rank the goals of Tax Reform

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Equity – income inequality and similar income treated the same
(ii) Efficiency – reduction of taxes with a high economic cost
(iii) Simplicity – reduction of returns and ease of understanding
(iv) International competitiveness – attractive to foreign investment
(v) Reducing fiscal imbalance between federal and state governments
(vi) Balanced budget

Results

	Equity	Efficiency	Simplicity	Competitive -ness	Imbalance state and federal	Balanced budget
All – Negligible (0–1)	26%	11%	26%	20%	50%	55%
All – Balanced (2–10)	72%	86%	74%	79%	50%	44%
All – Weighty (11–15)	2%	3%	0%	1%	0%	1%
All – Average	3.8	5.1	3.3	3.9	2.0	1.9
NEDs – Average	5.0	3.6	2.4	4.3	2.4	2.4
CEOs and CFOs – Ave	2.8	4.6	4.4	4.1	1.8	2.2
Heads of Tax – Ave	2.3	6.9	3.0	4.7	1.7	1.4

Respondents' comments

"A balanced budget is required over the business cycle but is not necessary for each year. Removal of taxes that raise relatively insignificant amounts will improve simplicity and efficiency and can be offset by minor increases in other taxes. Simplicity will also increase international competitiveness by reducing the compliance burden and easing understanding."

"By increasing simplicity, that will improve international competitiveness and efficiency."

"Elimination of taxes with a high economic cost that will provide productivity gains, also making Australia more competitive to attract foreign investment is critical to growth."

"Simplicity is always touted as a tax reform principle, then ignored by everyone. We live in a complex world – so let's stop pretending tax can be simple. The most we can hope for is that people with simple tax affairs face simple tax laws. This would be a major step forward and is a long way from current reality. International competitiveness is not just being 'attractive to foreign investment'. More important is that our Australian companies are not saddled with Australian laws which make it hard for them to compete internationally. I am less concerned about foreigners coming in: we have stable government, the rule of law, and a fairly good economy. That is rare these days and in my view we do not have to compete on tax rates at present. That will change as the rest of the world recovers. But why reduce our rates now when that is not a factor for international competitiveness?"

"Tax laws must apply fairly to companies in the same industry."

"On the equity/efficiency spectrum, my feeling is that there is a lot to be gained by rebalancing the tax system to reduce the attractiveness of debt capital compared to equity capital. The current tax preference for debt capital seems to have contributed to the enormous private debt load carried by Australians. From a macro-economic perspective, this seems dangerous."

4. Ripe for tax reform

Rank the areas most ripe for tax reform

Results

	Income tax	Company tax	GST	State taxes	Imputation	Super
All – Negligible (0–1)	23%	30%	17%	27%	82%	42%
All – Balanced (2–10)	75%	69%	77%	72%	18%	57%
All – Weighty (11–15)	2%	1%	6%	1%	0%	1%
All – Average	3.9	3.1	5.7	3.7	0.7	2.9
NEDs – Average	3.7	2.7	5.6	3.2	0.6	4.1
CEOs and CFOs – Ave	4.4	3.8	5.8	3.4	0.6	1.9
Heads of Tax – Ave	3.5	2.7	7.5	4.6	0.3	1.4

Respondents' comments

"Reform has to start with GST and super to reform other areas. Super changes need to include reinstatement of restrictions on borrowings and imposition of tax on drawdown of funds above a certain level. Major change to income tax should only be to address bracket creep, achieve productivity improvements (e.g. family unit taxation), remove capital distortions (negative gearing on property) and equality (i.e. neutralise tax sharing mechanism around trusts)."

"State taxes should be broader property based, with less payroll and stamp duty."

"GST should be broader and rate aligned with OECD average."

"The states' reliance on stamp duty receipts in respect of land transfers is anachronistic and flawed in multiple ways:

- It gives the state government a strong vested interest in escalating land prices, which is anathema both to the global competitiveness of our industry (land costs being an input cost to almost all industries, as cost of maintaining premises) and citizen welfare (through reduced housing affordability. Ultimately, of course, this also flows through to industry competitiveness through wage demands)
- It is a cyclical revenue source, likely to expand when the state economy is strong and contract in recessionary times
- Stamp duty is, of course, also universally recognised as a hugely inefficient tax.

A transition to a universally applied (i.e. including private residences) land tax set at a rate to replace stamp duty revenues seems to be in order. What the ACT is doing in this regard is a step in the right direction."

"A great benefit of the land tax is that it would tend to help make future infrastructure investment self-funding, as uplifts in the value of land located near infrastructure would be captured through increased land tax receipts."

"I'm of the view that the states might have a role in 'fixing' the excessive generosity of the superannuation system by re-introducing inheritance taxes. This would, amongst other things, re-capture as government revenue situations where superannuation concessions (i.e. transfers from taxpayers) have been used not to fund retirement income streams but to accumulate funds for inter-generational transfer."

5. Future challenges

Future challenges that have an impact on the tax system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item)

(i) An ageing population
(ii) Deriving economic benefits from rapidly growing Asian middle class
(iii) Increasing globalisation of supply chains and digitalisation
(iv) Improving participation rates particularly for women with young children
(v) Declining terms of trade
(vi) Stresses between human activities and ecosystems

Results

	Ageing population	Asian Century benefits	Global supply chains	Improving participation	Decline terms of trade	Stress on eco-systems
All – Negligible (0–1)	7%	35%	18%	37%	35%	58%
All – Balanced (2–10)	87%	65%	81%	62%	65%	42%
All – Weighty (11–15)	6%	0%	1%	1%	0%	0%
All – Average	6.4	2.7	3.9	2.6	2.4	1.9
NEDs	5.6	2.7	3.9	2.7	2.4	2.6
CEOs and CFOs	7.9	3.0	3.4	2.0	2.3	1.4
Heads of Tax	7.0	3.2	4.1	2.1	2.5	1.0

Respondents' comments

"Climate change will disproportionately impact Australia – we need to put a price on carbon."

"Australia desperately needs to move up the value chain from being the world's iron ore quarry to at least being a supplier of steel and (hopefully in time) a supplier of advanced manufactured goods."

"In relation to the growing Asian middle class and ageing population, I'm hopeful that the country can engage in civilised and rational debate about whether it is wise to try to grow, as we do now, seemingly for the sake of growing, importing additional population to grow gross GDP (while GDP per capita remains the same) and temporarily dilute the ageing population statistic (seemingly forgetting that the newly-imported workforce will also age in a few decades, compounding the problem) and putting additional strain on our existing infrastructure."

"Somehow the raising of children has become a community cost, regardless of the income of the parents. We can't afford this. Families have to work out the best solution for their family and their children, with the government only stepping in where the welfare of children is seriously compromised by unemployment etc. Somehow parenthood has been socialised in a single generation, and we need to wean ourselves back to the basic responsibility of being the parents."

"Superannuation is extraordinary – the rate for employees is too low and government has ensured that there is no certainty. While there is a huge debate about equal opportunities for women, it is probably more important in the longer term to incentivise employers to keep older employees (say over 65) in the workforce irrespective of their gender. This could be achieved by some sort of rebate per older employee."

6. Importance of potential reforms

Importance of potential reforms to our company tax system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item)

(i) A reduction in company tax rate
(ii) Introduction of a system designed to tax "economic rent" (above normal profits)
(iii) Simplification of carry-forward loss rules
(iv) Providing tax relief for acquired goodwill
(v) Increasing R&D concessions
(vi) Capital allowance alignment to effective life although may reduce competitiveness

Results

	Reduce company tax rate	Tax economic rent	Simplify carry-forward losses	Relief for acquired goodwill	Increase R&D concessions	Capital allowances to effective life
All – Negligible (0–1)	20%	48%	37%	54%	30%	62%
All – Balanced (2–10)	63%	48%	62%	46%	68%	38%
All – Weighty (11–15)	17%	4%	1%	0%	2%	0%
All – Average	6.4	3.1	2.8	1.7	3.7	1.6
NEDs	5.4	3.3	2.1	1.1	4.5	1.6
CEOs and CFOs	7.4	2.6	2.7	2.4	2.9	1.8
Heads of Tax	9.3	1.6	2.7	2.3	2.9	1.3

7. Foreign investors

How sensitive do you believe potential foreign investors to Australia are to lower company tax rates and concessions?

Results

	Very sensitive (1 and 2)	Neutral (3)	Not sensitive (4 and 5)	Average
All (222)	45%	41%	14%	2.6
NEDs (19)	37%	33%	32%	2.9
CEOs and CFOs (25)	56%	32%	12%	2.6
Heads of Tax (23)	43%	52%	4%	2.4

Respondents' comments

"I would include imputation as part of the company tax system, and query whether it should remain and what should replace it (intention to have an investment tax regime more neutral to different types of investment)."

"Tax economic rent is an absurd proposal. Why punish an organisation for doing well? Instead provide an incentive for companies to come to Australia to improve the standard of living for all."

"Tax relief for goodwill achieves nothing without reform of imputation system. The 30 percent company tax rate is way too high. It needs to be nearer 20 percent and I expect the overall tax take would not actually reduce that much. Carry forward loss rules are broadly consistent with international norms. R&D incentives are necessary to encourage investment."

"Reduced company tax is important for the health of the economy, employment and investment. R&D also encourages investment in innovation and encourages innovation on-shore."

8. Small business

Importance of potential reforms to small business taxation

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) A greater concessional active small business company tax rate
(ii) Tax loss transfers to investors for innovation start-ups
(iii) Special simplified small business companies with partial 'flow-through' features
(iv) Cash flow taxation for active small business entities
(v) No general concessions for small business as against large business
(vi) Concessions but no differential tax rate for small business

Results

	Greater concessional rate	Loss transfers investors innovation	Simplified small business company	Cash-flow taxation	No general concessions	Concessions but no differential tax rate
All – Negligible (0–1)	47%	25%	36%	43%	73%	43%
All – Balanced (2–10)	48%	72%	64%	55%	22%	53%
All – Weighty (11–15)	5%	3%	0%	2%	5%	4%
All – Average	3.4	4.2	3.1	2.9	1.9	3.7
NEDs	2.7	5.1	1.9	2.5	1.7	5.0
CEOs & CFOs	4.2	3.6	3.2	2.3	2.4	4.0
Heads of Tax	4.7	3.3	2.4	3.3	2.4	2.1

Respondents' comments

"I completely fail to understand why small business thinks of itself as different to all business. If the problems of red and green tape, and an unwieldy industrial relations system, are too much, then that problem needs to be tackled directly, not by giving a tax discount to help pay for a problem borne by all businesses rather than just small business."

"I know 'tradies' who are operating small businesses, paying no tax, and taking home many times more than me. However, there are many types of small business. A draw back with a start-up tax concession would probably result in many businesses starting up and becoming phoenixes."

"I have a philosophical problem with a different rate for small businesses but would support a level of concessions, provided this is efficient."

"Small businesses require incentives through concessions to build, invest and employ. These concessions should be on a sliding scale as they reach what is a big business. The question is 'what is a small business?' This needs to be re-considered and not necessarily follow what is cast in stone now."

"Small business is difficult to get off the ground and start-up concessions, especially around loss provisions and absorption against other income of the taxpayer, in the early phases are important."

"Rates should be slashed, and as a consequence less deductions and exemptions would be needed."

9. Imputation system

Importance of potential reforms to the imputation system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Reduce level of refundability of franking credits for superfunds and not for profits
(ii) Reduce level of franking credits for all to finance a lower company tax rate
(iii) Reduce the level of franking credits for all to finance lower personal income tax
(iv) Allow partial imputation refundability to flow through to non-resident investors
(v) Leave the current system unchanged
(vi) Alignment of accounting and taxation concepts of frankable dividend

Results

	Reduce refundability	Reduce franking benefit to lower company tax	Reduce franking benefit to lower personal tax	Partial imputation refund to flow to non-residents	Leave imputation un-changed	Align accounting and tax concepts of frankable dividend
All – Negligible (0–1)	61%	61%	60%	73%	38%	45%
All – Balanced (2–10)	35%	38%	38%	26%	28%	53%
All – Weighty (11–15)	4%	1%	2%	1%	34%	3%
All – Average	2.6	2.2	2.4	1.4	6.8	3.6
NEDs	1.5	1.4	1.5	1.5	11.4	2.7
CEOs and CFOs	0.7	1.5	2.5	0.7	9.9	4.4
Heads of Tax	2.5	3.6	0.7	1.5	8.0	2.8

Respondents' comments

"The imputation system is a simple and effective way of ensuring profits are only taxed once. There is no need to ensure profits are not taxed at all and therefore refundability should be eliminated for superfunds and not-for-profits. Otherwise the system is well designed, and I believe encourages or rewards corporate responsibility."

"Trans-Tasman recognition of imputation credits between Australia and NZ is crucial."

"I think reform to imputation for super funds is necessary, but could equally be done by reform to tax rules for super funds. I believe there is a sensible trade off to a substantially lower company tax rate (i.e. sub-20 percent) and no imputation. Imputation was originally designed as a simple, flexible system and over the years has become horrendously complicated. Even if imputation is retained I think it would be sensible to have a re-write of the rules."

"Any changes to imputation will have severe and long-term negative implication for retirement incomes as super funds (being the major investor sector) would bear the brunt of paying more in taxes, and thus permanently reducing member balances for use in retirement."

"The imputation system is brilliant. Leave it alone. Possibly look at reduced refundability for super and pension funds and NFPs."

"Reducing the level of refundability for super funds could be achieved by scrapping the pension-phase tax exemption (to get the level of taxation to 15 percent). This will be more and more important to the budget bottom line as, with the passage of time, a greater weight of funds moves from the accumulation phase into pension phase."

10. Personal labour taxation system

Importance of potential reforms to personal labour taxation system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Eliminating bracket creep through an indexation of thresholds
(ii) Removal of deductions for work related expenses below a threshold
(iii) Conflating Medicare levy etc. into a simplified sets of thresholds and rates
(iv) Introduction of an 'earned tax credit'* to encourage greater participation
(v) Increase child care subsidies (beyond budget 2015 announcements)
(vi) Alignment of FBT treatment between for-profits and not-for-profits

Results

	Eliminate bracket creep	Removal of work-related expenses below a threshold	Conflate Medicare levy etc. into a simplified rate	Introduce an earned tax credit	Increase child care subsidies	Alignment FBT between for-profits and NFPs
All – Negligible (0–1)	22%	62%	34%	43%	53%	53%
All – Balanced (2–10)	64%	38%	65%	54%	46%	45%
All – Weighty (11–15)	13%	0%	1%	3%	1%	2%
All – Average	6.2	1.8	3.6	3.1	2.4	2.3
NEDs	6.5	2.0	3.3	3.6	1.4	2.9
CEOs and CFOs	7.0	2.0	4.2	3.0	0.9	2.6
Heads of Tax	7.6	2.0	3.8	2.3	1.9	2.3

Respondents' comments

"Bracket creep with the resultant benefit to the budget is a lazy way to manage income."

"Bracket creep is resulting in increasing inequity and reduced participation. Increased childcare relief also would lead to greater participation."

"Deductions below a certain threshold should be, say, $500 or even $1,000 without question, without receipts. Earned tax credit sounds like a good initiative. Childcare subsidies are not necessary for high income earners. Remove them."

"Indexing thresholds is a really bad idea. Bracket creep is the only way the government can raise taxes without political pain at the moment."

"Negative income tax is a fantastic concept and may work to reduce those who choose not to work. Alignment of FBT is important. There is no good enough reason to provide additional FBT to those who work in not-for-profits. Childcare rebates should be scrapped."

"Eliminating bracket creep is a key step to keeping the government 'honest' and avoiding entrenching a culture of over-spending in the hope of revenue eventually, covertly, catching up to spend."

"An earned tax credit system seems favourable to the current approach to encourage greater participation."

"The lack of provision of child care is the biggest inhibitor to increasing levels of employment."

11. Personal capital or savings tax system

Importance of potential reforms to personal capital or savings tax system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Reduce tax differential between different forms of savings (interest, capital gains)
(ii) Reduce rate of tax on capital taxation (e.g. Henry 40 percent discount)
(iii) Limit negative gearing on rental property income
(iv) Alignment of taxation of investments with salary income
(v) Reduce the ability to allocate income through discretionary trusts
(vi) Introduce estate duties

Results

	Reduce tax difference for different savings	Reduce rate of tax on capital taxation	Limit negative gearing	Align taxation investment with salary	Restrict discretionary trusts	Introduce death duties
All – Negligible (0–1)	38%	49%	36%	53%	43%	78%
All – Balanced (2–10)	56%	46%	53%	45%	52%	21%
All – Weighty (11–15)	7%	5%	11%	2%	5%	0%
All – Average	4.3	3.2	4.9	2.6	3.6	1.1
NEDs	4.1	2.4	5.8	1.5	5.0	1.2
CEOs and CFOs	3.3	3.6	4.1	4.5	3.5	0.8
Heads of Tax	6.9	4.3	2.4	1.3	4.3	0.7

Respondents' comments

"Trusts seem to be the most abused form of vehicle for aggressive tax planning and their use needs to be strictly controlled to eliminate abuse – possibly the only way to do this is to eliminate them or remove their tax concessions."

"People forget that the CGT discount was designed solely to replace the old inflation adjustment with a simple calculation. I would prefer to reintroduce indexation, so that it is fairly applied to all taxpayers and thus only taxes real gains."

"Income such as interest and unearned capital gains, including house price gains (on realisation and excepting your personal residence), should be taxed the same. Introduce estate duties on super balances above a certain amount."

"Only real capital gains should be taxed. Indexation of acquisition cost should be reintroduced."

"There should never be death taxes or estate duties. That is an inherently unfair and unequitable concept. Tax should only ever be levied on earnings and not wealth."

"Start with quarantining negative gearing to new builds only and reducing the capital gains discount on investment property."

"I would favour a system that would differentiate between economically productive investment (i.e. funds spent to bring something new into existence) and economically unproductive investment or risk-taking (i.e. merely buying and holding an asset that is already in existence, having already been created by another)."

"Accumulated wealth should not be left to the next generation without some form of taxation."

12. Superannuation system

Importance of potential reforms to our superannuation system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Comprehensive review of retirement income policy including objectives
(ii) Reduce level of concessional treatment for those with large super balances
(iii) Equalise rates at 7.5 percent between accumulation and pension phase and capital gains
(iv) Leave superannuation rules untouched for five years
(v) Eliminate refundability of imputation credits for superannuation funds
(vi) Improve superannuation for low income earners

Results

	Comprehensive review including objectives	Reduce concessions for large super balances	Equalise rates at 7.5% for accumulation, pension and capital gains	Leave super untouched for 5 years	Eliminate refundability of imputation for superfunds	Improve super-annuation for low income earners
All – Negligible (0–1)	34%	40%	70%	60%	77%	38%
All – Balanced (2–10)	57%	52%	30%	28%	23%	60%
All – Weighty (11–15)	10%	8%	0%	12%	0%	2%
All – Average	5.0	4.4	1.5	3.6	1.2	3.6
NEDs	5.8	4.9	1.1	4.4	0.4	3.4
CEOs and CFOs	6.8	2.8	0.8	6.6	0.5	2.0
Heads of Tax	5.2	4.9	1.1	4.3	1.9	2.7

Respondents' comments

"Current superannuation tax concessions lack a coherent policy rationale. If the idea is to reduce the cost of future government spending on pensions, why are we giving most of the superannuation tax concessions to those that would never qualify for a pension in any event?"

"We need a strong superannuation system. We should do two things, (1) introduce a tiered tax on funds with balances over, say, $2 million to be indexed and (2) legislate that all super funds should be required to invest a proportion of their assets in an in-country, independently controlled, infrastructure fund."

"Let's have legislated objectives then manage the system to those objectives, with independent experts singing off on any changes."

"Equalisation of rates in various phases should be looked at."

"Reducing concessions to wealthier investors and increasing them to low income investors is the priority. Refundability of imputation credits should be looked at but not eliminated in total."

"A retiree's assets outside of the superfund should be considered. For example, a retiree who does not own their own home should not receive as big a reduction in super concessions as a retiree who does own their own home. This includes effectively owning a home via a family trust."

"Super should only be used to pay a pension/annuity and this should be taxable to the recipient at, say, 30 percent over a 'comfortable living' threshold, say, $100,000 p.a."

13. Consumption tax system

Importance of potential reforms to our consumption tax system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Expansion of the GST base to education and fresh food, but not health
(ii) Expansion of the GST base to all areas including health and financial arrangements
(iii) Increase the rate to 12.5 percent
(iv) Increase the rate to 15 percent
(v) Leave the current system unchanged
(vi) Forego requirement that all states need to agree to change the base and rate of GST

Results

	Expand GST base to education and fresh food but not health	Expand GST base to all areas including health and financial services	Increase rate to 12.5%	Increase rate to 15%	Leave current system unchanged	Forego agreement of all states to change base and rate
All – Negligible (0–1)	62%	50%	63%	43%	83%	49%
All – Balanced (2–10)	36%	41%	35%	46%	8%	49%
All – Weighty (11–15)	3%	9%	2%	12%	9%	2%
All – Average	2.5	4.3	2.4	5.1	2.0	3.2
NEDs	2.1	3.9	1.8	5.1	2.5	3.2
CEOs and CFOs	1.2	5.7	2.6	5.7	1.3	3.4
Heads of Tax	3.0	4.8	1.9	6.2	1.2	3.0

Respondents' comments

"Reduce personal tax rates and increase GST. Do not keep the current GST exemptions."

"GST being a regressive tax should only be increased or broadened at the same time as the income tax system is reformed."

"GST needs to be broadened and the rate increased. And it would be far better to have it able to be changed by a vote of, say, a 75 percent majority of the states plus the federal government."

"Simplify the GST – apply it to everything you possibly can."

"Increase the GST rate to collect tax on expenditure. Have the rates set at higher rates on luxury goods whilst keeping essentials to minimum or low rate. Work on bringing more business to Australia and create more jobs to encourage the spending."

"GST should apply to all transactions as it widens the GST base and hence lowers the need to increase the rate on all other currently taxable supplies. The system has been in place for 15 years now. Preference is to expand the base first then raise the rate slowly if required to meet funding requirements. Agreement from all states still good checks and balance requirement and should remain."

14. State tax system

Importance of potential reforms to our state tax system

Respondents were asked to rank the options below by allocating 20 points in total (with a maximum of 15 to one item).

(i) Eliminate stamp duty through an increase in land tax over time
(ii) Harmonise payroll tax – minimal concessions, collect federally, allocate to states
(iii) Eliminate insurance taxes through increase in land taxes
(iv) Allocate a portion of personal income tax to states
(v) Increase road congestion taxation through greater use of user pays
(vi) Allocate GST on a per capita basis to states

Results

	Eliminate stamp duty through increase in land tax	Harmonise payroll tax, minimal concessions, federal collection	Eliminate insurance taxes through increase in land tax	Allocate a portion of personal income tax to states	Increase road congestion taxation	Allocate GST on a per capita basis
All – Negligible (0–1)	29%	30%	53%	60%	52%	57%
All – Balanced (2–10)	62%	65%	47%	38%	45%	40%
All – Weighty (11–15)	8%	5%	0%	2%	3%	3%
All – Average	5.1	4.4	2.2	2.1	2.8	2.8
NEDs	4.1	3.4	2.8	3.4	3.3	2.7
CEOs and CFOs	3.7	4.5	1.9	1.7	4.0	3.1
Heads of Tax	8.2	5.8	2.0	1.0	1.2	1.7

Respondents' comments

"We cannot allocate GST on a per capita basis. That would be ridiculous! Western Australia is already getting hammered it has a relatively low population. However, we have to build infrastructure over one third of the country! There should be a floor on the percentage call it 50 percent of revenues raised and then the floating redistribution should be only on the other 50 percent."

"Current situation wherein Western Australia is only going to receive 30 percent of the states' GST contribution is totally unethical for a federation."

"Given the costs that the states bear, they need to be allocated a greater proportion of total tax revenue. An increase in the GST with all going to the states would be a start and some percentage of the personal income tax would also help. There would then need to be an allocation by the federal government to assist the poorer states."

"Stamp duty is easy to change to land tax. For new purchasers of property after the change, land tax applies. For those who own a house before the change, they are given a non-cash credit on stamp duty as if they just purchased the property, land tax charges are debited against this credit until the credit is exhausted. Any unexpired credit on selling the property is lost (just as it would be the result if purchasing another property you'd pay stamp duty on that new property under the stamp duty system). I like the idea of a tax on kilometres a metro-registered vehicle does, with the rate varied by, say, size / weight of the vehicle, with a work-to-home-to-work travel concession or exemption by distance or rate."

"Stamp duty should be reduced through widening of the GST base and increase in the GST rate, not by increase in land tax. Otherwise you continue to unfairly tax one particular segment of the market (housing) compared to others."

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