GENERAL DIRECTIONS FOR TAX REFORM

[This Note summarises a number of problems and options for action which have been identified by tax experts, leading community sector organisations and other analysts as needing attention in the Henry report. TaxWatch itself does not express policy views.]

SOME KEY PROBLEMS

Although Australia's taxation system has some very good features, it also has substantial weaknesses. Amongst other things, there are strong grounds for concluding that key aspects of the system

- promote excessive speculation in asset prices (especially in real estate and financial markets), rather than long-term investment in enterprises which generate ongoing profits or other income streams;
- encourage excessive borrowing, especially from overseas;
- inflate house prices and rents, as well as encouraging inefficient housing use;
- unduly discourage and penalise some lower-income people who are trying to re-enter the workforce or increase their working hours;
- aggravate environmental damage and lead to patterns of urban development which harm productivity and work/life balance;
- exacerbate unfairness and divisive pressures within the community, rather than promoting social inclusion and equity;
- discourage important forms of saving for people of modest means;
- provide excessive opportunities for tax avoidance and evasion, often involving complex and wasteful processes.

These problems reflect substantial biases in the system towards

- assets rather than income;
- financing through debt rather than savings or equity;
- retirement saving rather than saving for other purposes;
- home purchase rather than other forms of investment;
- wealthy people rather than people of more modest means;
- overseas rather than Australian investors;
- income from gifts, bequests and investment rather than wages and salaries;
- cars rather than other forms of transport.

SOME KEY DIRECTIONS FOR ACTION

These problems require improvements to be made in the efficiency, equity and simplicity of the system. Key directions for action could include

- strengthening the system's capacity to provide sufficient revenue for public investment and other expenditure and to adjust that level for future needs (eg, arising from an aging population);
- removing or reducing unjustifiable distortions in the treatment of different kinds of income, assets and usage (eg, between different types of investment income or different kinds of resource use);
- removing or reducing distortions, concessions or loopholes which unjustifiably aggravate disparities in income and wealth (eg, by putting an upper limit on tax

- exemptions and providing progressive payments or tax credits rather than regressive concessions);
- simplifying the system, especially its impact on taxpayers' actions (eg, by removing unnecessary variations in tax treatment and closing off avenues for complex tax minimisation);
- ensuring that encouragement or discouragement of particular economic or social activity (eg, home purchase, saving, vehicle use) is provided on a cost-effective, equitable and sustainable basis;
- responding to international tax trends on the basis of objective analysis and long-term perspectives (eg, taking account of all relevant aspects of the tax systems, and stages of development, of the countries being compared.

Key reforms are more likely to be achievable if they form part of an integrated and balanced package, possibly including spending initiatives as well as tax measures. This could include

- reducing gaps in the range of income, assets, goods or services to which a particular tax applies (ie, "base broadening") while also reducing the rate at which the tax is levied;
- increasing the base or rate of a tax, or introducing a new tax, while also improving important public services;
- strengthening some taxation of people's assets while also reducing some taxation of their incomes;
- reducing tax benefits for some stages of people's lives while also strengthening benefits for other stages.

SOME KEY DIFFERENCES

Key differences between Australia and other comparable OECD countries include:

- the overall level of tax revenue per capita is much lower than the OECD average and than almost all comparable countries (including the US);
- most other countries require employers and employees to pay social security contributions (often larger than their corporate income taxes and much more than our compulsory superannuation contributions);
- unlike almost all other countries, personal income tax is reduced by the full amount of corporate tax paid on income distributed as dividends ("dividend imputation");
- most other countries have gift and estate duties, and a number have annual taxes on total asset-holdings;
- most other countries have higher GST rates.

[For further details of these comparisons, see the research report *Aspects of the Australian System* in the Tax Facts section of the Tax Watch website.]