The Australian Financial Review
www.afr.com • Monday 3 May 2010

Henry review walks a tightrope

There are some unstated but clear objectives in the Henry taxation review, writes **Neil Warren**.

The 138 recommendations in the Henry tax review challenge the government on many fronts in areas of public policy which are complex and politically charged.

The review will undoubtedly stand tall with the passage of time. In the detail underlying its recommendations are some serious challenges to established practices. Where this review is really different is that it is not a reaction to publicly perceived failings in the current tax system. Nor is its reform proposals framed against the traditional axioms of equity efficiency and simplicity.

Rather, it is framed against the background of an ageing population, the need to invest and renew social infrastructure, and to ensure housing affordability and sustainable social programs. The question then is whether the tax system can meet these future demands in this new environment while Australia also remains competitive both for capital and skilled labour?

And it is here that the Henry review recommendations walk a tightrope between the objectives of social justice and budget sustainability as against the imperatives of economic efficiency and international competitiveness. This has engendered in the review an air of impatience on a number of crucial issues and this impatience is not yet shared by the government as evident from its modest response to the review's 138 recommendations.

Sure, the recommendation relating to a super profits tax has been accepted by the government which has in turn applied this revenue to company tax rate reductions, various small business concessions, and incentives for low-income earners to contribute more to superannuation.

However, these same businesses will over the coming decade have to increase their employee superannuation guarantee payments from 9 to 12 per cent, which presumably they will pay from their company tax rate cut. This is the extent of the government's immediate response to the review's 138 recommendations, although it has promised there will be further instalments as the election nears.

However, implicit in the review are some fundamental questions which will need to be addressed in the upcoming debate over tax, and some of these pose quite fundamental challenges to established institutions.

The most glaring issue arising from the review is its unstated but clear view that everything that the states currently do with their taxes needs to be either repealed or radically reformed.

The review has no time for any stamp duty (including conveyancing duty and insurance taxes), the payroll tax, the land tax as currently structured or how gambling taxes are set.

With its resource super profits tax, states have also effectively had their resource royalty taxes repealed. This obviously brings into question the relevance of states – or at least the whole current approach to funding state governments and deciding what service provision responsibilities they should hold.

The other unstated but clear priority is the review's support for an increase in the GST rate. The reference in recommendation 55 to a broad-based cash flow tax applied on a destination basis replacing the payroll tax and various other state taxes reads very much like a GST rate rise recommendation.

The review also took straight aim at the uneven treatment of personal income from capital.

Nothing was sacrosanct – the family home, capital gains, rental incomes, interest on bank accounts, or superannuation earnings. Most of these the government will not take to an election but they will no doubt get currency post-election. Even so, there are limits for any government in following the machinations of economists on the issue of housing. After all, economists are bound by principles and not the ballot box, unlike politicians.

A clear tension in the review – and one starkly evident in the government's response – is how to ensure Australia remains a competitive destination for international capital.

The real challenge though is how to design business taxation in a two-speed economy. Dropping the company tax rate 2 percentage points funded through a super profits tax on mining companies is a bet on what one loses on the swings one gets on the roundabout.

We had all better hope that their guess of where to set the company and super profits tax rates is right. Now we need to sit back and wait for the next series of instalments – but at least now we can all enter into our own debate about what the government should do in response.

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