NATIONAL TAX REFORM SYMPOSIUM

Taxation of Personal Income, Assets & Saving

→ Old Parliament House & National Press Club, Canberra
→ 25 – 26 February 2009

A Summary of the Symposium

INTRODUCTION

The first National Tax Reform Symposium was convened by the Community Tax Forum in February 2009.

The Forum is an alliance of the Australian Council of Trade Unions, Australian Council of Social Service, Australian Conservation Foundation and Consumers' Federation of Australia. It was formed in 2008 to stimulate consideration of possible tax reforms, especially in the context of the Commonwealth Government's current Taxation Review.

The Symposium focussed principally on possible problems in the current taxation of personal income, assets and savings and on responses which could be adopted to address them. It also included broader overviews of international developments. A second Symposium will be held in May 2009 to focus on other tax reform issues, including those relating to housing, transport, the environment, corporations and families.

The Symposium was attended by about 60 individually invited participants from across Australia. Most of them represented national organisations from the community sector, especially union, welfare, consumer and environmental organisations. Other participants were independent experts in tax policy, including international experts from the Tax Policy Center in Washington, York University in Toronto and the OECD in Paris.

The Treasurer, Hon Wayne Swan MP, kindly agreed to address the Symposium Dinner and representatives of the Taxation Review Panel which he has appointed were present at each of the Symposium sessions.

A major aim of the National Tax Reform Symposiums is to promote exchange of reliable data and other information. Another is to encourage constructive discussion, and convergence of views where possible, about priorities for reform. They are not intended to produce an agreed statement of views or recommendations for action.

The Symposium was chaired by Prof Julian Disney and his concluding remarks provided an overview of key issues and options raised in the course of presentations and discussion. They are being made available in this booklet and also on the Community Tax Forum section of the website, www.taxwatch.org.au. That section includes the Issues Papers and other papers prepared for the Summit by the community information service, TaxWatch, as well as a number of the presentations by speakers

The Forum welcomes suggestions about other ways of helping to promote informed public discussion on tax reform issues which are of great importance to the members of our organisations and the community in general.

Jeff Lawrence
(Secretary, ACTU)

Clare Martin
(CEO, ACOSS)

Catriona Lowe
(Chair, CFA)

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AN OVERVIEW OF DISCUSSIONS AT THE SYMPOSIUM

Closing Remarks by the Chair

Prof Julian Disney

INTRODUCTION

The opening day of the Symposium provided an opportunity for wide-ranging overviews of the general strengths and weaknesses of the current Australian tax system, especially in an international context.

There appeared to be broad agreement that:

- the tax system must raise adequate revenue on a sustainable basis to meet the cost of public investment which strengthens both the economy and the community;
- Australia is already a very low-tax country and the global economic crisis and, over the longer term, the aging population will reduce revenue while increasing needs for public expenditure;
- these considerations make it especially important to remove loopholes and waste from the current tax system (often called "broadening the base");
- this approach can enable tax rates to be kept internationally competitive and boost investment in productive businesses rather than debt-funded asset speculation;
- it can also improve the fairness and simplicity of the tax system for both individuals and businesses.

Presentations from international speakers confirmed recent analyses by TaxWatch and other researchers that:

- higher-tax countries tend to achieve better social development and to perform at least as well economically as low-tax countries;
- the overall levels of taxation in Australia on personal incomes and on businesses are not especially high by OECD standards;
- some real estate transactions are taxed more than in most other countries but general ownership of real estate and other assets is taxed much more generously;
- globalisation makes it very important to obtain reasonable contributions from taxes on immobile assets (especially land), as well as from taxes on income and consumption;
- tax exemptions and other forms of "tax expenditure" often escape adequate public scrutiny, resulting in substantial waste, unfairness and inefficiency.

The second day of the Symposium focused on the impact of the current tax system in three key areas and on the possibilities for reform. In doing so, it also considered key aspects of the social security system which fall within the ambit of the Taxation Review Panel. The three key areas were:

- Work and Work Income;
- Assets and Asset Income;
- Savings and Retirement Income.

The following remarks outline some of the main problems that were raised in presentations and discussion and some of the options that were canvassed as possible responses to those problems.

WORK AND WORK INCOME

Social security

It appeared to be common ground that the current level of the Newstart payment for unemployed people is much too low. Frequent reference was made to the substantial shortfall which developed during the last decade by comparison with payments for pensioners (even those who are in much better financial circumstances). The problem can be especially acute for unemployed people who have no children and thus no Family Tax Benefit, and for those who are in private rental accommodation.

The large and widening gap between pension and Newstart rates is a severe barrier for sole parents and people with disabilities who are eligible for pensions but decide to try a job which then does not work out. Their efforts may lead to them being considered ineligible for the pension rate or they may experience considerable delays in being restored to it.

There was also considerable concern about the impact of Newstart means-testing on people whose only feasible work opportunity is part-time, casual or intermittent work. The global economic crisis is already substantially increasing the number of these people. The income test ignores modern labour market realities by starting to clawback Newstart from a very low level of wage income and not adequately allowing "averaging" of income across fortnights in which work opportunities may fluctuate greatly.

These problems are aggravated by interaction with means-testing of other benefits, such as public housing and child care, which can leave many people worse off financially than if they had not been in work. Severe work disincentives also arise from the withdrawal of concession cards and rent rebates as soon as a person finds full-time work, even if it at a low wage.

It was emphasised, however, that these problems of "effective marginal tax rates" may be less significant if they apply over only part of the increase in income which an unemployed or under-employed person achieves through moving into full-time work on reasonable wages.

Suggested responses to these problems included:

- substantially increasing the basic Newstart rates and indexing them in the same way as for pensions;
- substantially increasing the threshold wage income from which Newstart payments start to be clawed back;
- substantially increasing the basic rates of Commonwealth Rent Assistance and indexing them for inflation;
- applying incomes to be averaged over at least 8 weeks under the Newstart income test (or increasing the size of the current Working Credit);
- allowing concession cards and some other entitlements to continue for, say, six months after long-term unemployed people find full-time work.

Income tax scales and family assistance payments

Income tax liabilities for most high income people have fallen substantially over the last decade or so. People on very low incomes have benefited from increases in the Low-Income Tax Offset (LITO) as have people with children through increases in Family Tax Benefits. But tax cuts have been much less for many full-time workers on low or modest wages who do not have dependent children.

This inequity can also be counter-productive as it reduces the net gains of entry into full-time work. Many people on below-average wage rates face effective marginal tax rates which are higher than for people earning three or four times as much, even without taking account of any loss of means-tested benefits. The imbalance could be reduced considerably by giving them access to an expanded LITO and abolishing the general tax-free threshold.

Concerns were also expressed about complexity, inequity and waste in the current array of family assistance payments. This includes Family Tax Benefits A and B, Dependent Spouse Rebate, Child Care Tax Rebate, Child Care Benefit and the baby bonus. It was also emphasised that expenditure on assistance to individual families should not be at the expense of direct funding for providers of family services, especially government and non-profit provision for lower-income families. These issues will be discussed in greater detail at the second Symposium.

Proposals to address some of these problems included:

- substantially increasing the Low-Income Tax Offset and abolishing the general tax-free threshold;
- adopting a principle that no-one should face effective marginal tax rates above the top marginal rate (or, preferably, the second highest rate);
- replacing Family Tax Benefit B, the Dependent Spouse Rebate and the baby bonus with a strengthened version of Family Tax Benefit A and a government-funded parental leave scheme;
- indexing the LITO, and perhaps the 30% tax rate threshold, to allow for price inflation or adjust for average wage increases.

Remuneration packages and work expenses

A number of concerns were raised about the Fringe Benefits Tax (FBT), in addition to the basic question of whether it should continue to be imposed on employers rather than employees. They included the inequity and waste of the concessions for fringe benefits in the form of private motor vehicles, especially as the concessions are more readily available and valuable to high income-earners and encourage excessive use of vehicles in order to qualify for lower tax rates. They discriminate against public transport users and against people whose employers are unable or unwilling to structure the necessary remuneration packages.

Concerns were also expressed about the availability of FBT concessions for child care. They, too, are more readily available and valuable to higher-earners and, in addition, are available only for child care which is provided by employers at the workplace.

The FBT concessions available to charities and other non-profit organisations were criticised as creating great complexity, distorting behaviour (especially vehicle usage) and unfairly disadvantaging some other organisations. It was recognised, however, that any reduction in these concessions would need to be balanced by other government initiatives to help charities attract and keep staff.

The system of claiming tax deductions for work-related expenses was seen as both unfair and inefficient because it favours some kinds of expenses rather than others without good reason. For example, education expenses are claimable by people if they are in work but not if unemployed. The system is also a major reason why such a large proportion of taxpayers seek professional assistance with their tax returns. Abolition of deductibility, however, would be unfair to workers who cannot get their employees to meet the expenses and it would increase the attraction of pretending to be an independent contractor so that all expenses could be claimed (see below).

Many people, usually relatively high-earners, now engage in extensive tax avoidance through the device of salary sacrifice which is often not available to people of more modest means or working in smaller businesses. Adverse consequences include unfairness, economic distortions, complex administration and loss of public revenue. These problems would be lessened, but not eradicated, by reducing the hugely generous tax concessions for fringe benefits and superannuation.

Suggested responses to some of these problems included:

- abolishing or reducing the FBT concessions, especially for motor vehicles and child care;
- restricting the concessions for superannuation (see further below);
- providing a flat-rate tax credit for work-related expenses (including for jobseekers) with additional claims allowable only on very limited grounds;
- reducing the excessively generous tax treatment of "golden handshake" payments.

Independent contractors

Many employees are being pressured or even required by their employers to operate as if they are independent contractors, thereby enabling the employers to avoid having to pay payroll tax, compulsory superannuation and other worker entitlements. The attractions for some employees of this arrangement include being able to set themselves up as a trust or company so that they can income-split or pay tax at the lower corporate rate. They may also have more scope to claim tax deductions for work-related expenses.

This situation was criticised as unfairly depriving employees of rights and governments of revenue. It also creates considerable complexity and expense for the employers and employees in establishing the requisite arrangements and for the taxation office in monitoring and enforcing compliance.

Suggested options for addressing these problems included:

- strengthening enforcement of current restrictions on the creation of independent contractor status, income-splitting arrangements such as trusts, and claims for work-related expenses;
- tightening those restrictions;
- taxing the undistributed profits of private companies at the top marginal rate for personal income.

ASSETS AND ASSET INCOME

Introduction

Presenters and discussants called for greater emphasis on taxing assets and on reducing inconsistent tax treatments of different forms of asset income which (a) favour short-term speculation to the detriment of productive usage and investment, and (b) encourage excessive borrowing to the detriment of saving. It was also pointed out that assets tend to be a better indicator than income in relation to longer-term capacity to pay taxes and likely overall benefit from tax-funded activities. Taxation of immobile assets, especially land, tends to be less vulnerable than other forms of tax to the pressures of international competition.

Asset ownership

It was pointed out that the principal Australian taxes on asset ownership are land taxes and council rates. Many other countries have an annual wealth tax which is intended principally to encourage assets to be used productively or sold, rather than held as a way of avoiding income tax and thereby aggravating inequity. This kind of tax can have efficient and equitable impacts on the ownership and use of assets. It may not raise much revenue directly but can do so indirectly by encouraging use or disposal of assets in ways which generate taxable income.

Criticism of Australian land taxes focused mainly on the uncapped exemption of principal residences which, together with the similarly uncapped exemptions from the capital gains tax and pension assets tests, is seen as contributing substantially to house price inflation, distorted patterns of national investment and aggravated inequity. But exemptions up to a generous level might remain necessary to encourage affordable home ownership. These and other issues relating to land tax on rental properties will be discussed in greater detail at the second Symposium.

Options raised for consideration in response to these problems included:

- capping the exemption of principal residences from land taxes so that it does not apply to very high-value houses;
- taking principal residences above a specified value into account for the purposes of the pension assets test;
- introducing an annual tax at a very low rate on very high levels of total asset ownership.

Asset transfer

Unlike almost all OECD countries, Australia no longer has taxes on the transfer of assets by gift or upon death. Widespread concern was expressed that this lack, especially in conjunction with the other tax exemptions for principal residences, greatly aggravates inherited inequity and promotes "hoarding" of assets to avoid tax rather than using and transferring them in an efficient manner. It can also reduce the motivation to make philanthropic donations.

Taxes on these transfers, like taxes on asset ownership, may raise more revenue indirectly by encouraging activities which generate taxable income. It was pointed out that, as in other countries, they might need to be confined to very high-value transfers in order to avoid undue concern about inequity and discouragement of adequate family provision.

On the other hand, sales of real estate are taxed relatively highly in Australia by imposition of stamp duties. Although exemptions for first homebuyers are now widespread, the duties still raise concerns about impacts on housing mobility which has become increasingly necessary as jobs and relationships have tended to become less permanent.

While these problems will be considered in greater detail at the second Symposium, suggested options for addressing them included:

- introducing a national gift and inheritance tax on assets exceeding a high total value;
- reducing or removing stamp duties on home purchasers up to, say, median values as well as capping the exemption of principal residences from land tax (as mentioned earlier);
- introducing a "deemed realisation" rule that accrued capital gains above a high level are to be taxed when assets are transferred by gift or death.

Asset Income

Considerable criticism was directed towards the 50% tax discount which is enjoyed by asset income that is received in the form of capital gains rather than, for example, as bank interest or share dividends. When combined with the tax being levied only on final sale rather than annually on accrued gains, the effect is to distort investment towards property speculation rather than activities which generate recurrent income.

It was pointed out that these distortions are aggravated by the complete exemption from capital gains tax which is provided for principal residences and by Australia's uniquely generous deductibility of interest payments on borrowings to buy assets (often referred to as "negative gearing"). These factors are likely to have contributed to the excessive borrowing and asset price inflation which is now causing substantial damage to the general economy.

Reference was made to "dual income" tax systems in a number of European countries which seek to tax all forms of asset income in the same way and at substantially lower (often, flat) rate than applies to work income. This approach could "tidy up" the position in Australia, where different forms of asset income are treated very differently. But it could also aggravate current distortions and inequity between taxation of work and assets.

Considerable doubt was cast on whether even the current favourable treatment of asset income, let alone provision of further concessions, is necessary to maintain international competitiveness and attract overseas investment. This is partly because most capital gains by overseas investors in Australia are already exempt from our capital gains tax and therefore do not benefit from the 50% discount and other concessions.

It was noted that the main sources of asset income for low-income Australians are bank and superannuation accounts, for neither of which they receive significant tax concessions. This contrasts starkly with the treatment of capital gains for high-income people.

A number of reforms were proposed to address these problems. They included:

- removing or reducing the 50% tax discount on capital gains;
- removing the exemption from capital gains tax which is enjoyed by property acquired prior to 1985;
- adopting a deemed realisation approach to assets transferred upon death (as mentioned earlier);
- taxing deemed rates of annual return on assets, analogous to the approach taken in the pension assets test;
- reducing the special concessions and exemptions from capital gains tax which have been provided to small businesses in recent years;
- capping the exemption of principal residences from capital gains tax so that it does not apply to very large real gains;
- providing a low flat-rate exemption to simplify compliance, or an indexed lifetime exemption in place of all current exemptions;
- restricting deductibility of interest payments and expenses so that it applies only against income from the same source (eg, from investment properties).

SAVINGS AND RETIREMENT INCOME

Age Pensions

There was widespread agreement that the current Age Pension rates are much too low, particularly for people who are single, and that pensioners who are in private rental accommodation are especially likely to be in financial hardship. A contrast was drawn with the very considerable expenditure on better-off retirees which has been incurred in recent years by extending pensioner concession cards to non-pensioners and providing very large tax cuts through the Senior Australians Tax Offset (SATO).

Criticism was also directed at the complex, inefficient and unfair interaction between the Age Pension and superannuation systems. This was seen as due partly to a lack of coherent and appropriate policy on the ages at which (a) superannuation benefits can be accessed, (b) those benefits can be accessed tax-free, and (c) Age Pensions can be claimed. It also reflected interactions between the means tests for pensions, concession cards and SATO and the rules relating to withdrawals of superannuation benefits.

Some participants suggested abolishing the Age Pension income test to reduce these problems of interaction, as part of a package which commensurately reduces the superannuation concessions for wealthier retirees. This approach could also diminish motivations for pensioners to limit their income from work or investments, whether artificially or otherwise, in order to retain pension eligibility.

Other views, however, favoured stricter means-tests (especially the assets test) in order to target pension expenditure more tightly on those in greater need. Criticism focused especially on the complete exemption of principal residences from the assets test, which was seen as unfair, wasteful and unduly encouraging older people to stay in homes which had become too large for them.

Suggested options for addressing these problems included:

- substantially increasing the basic Age Pension rate, especially for single people;
- substantially increasing Commonwealth Rent Assistance (as mentioned earlier);
- tightening the pension means tests (at least the assets test in relation to principal residences, as mentioned earlier);
- abolishing the pension income test and commensurately reducing superannuation concessions for high-earners;
- substantially reducing the Senior Australians Tax Offset.

Superannuation

There was widespread agreement that the current superannuation tax concessions are wasteful, inequitable and ill-designed to promote greater national saving. Strong criticism was focused on their impact on low-income people, for whom the concessions are of very little or no value despite the fact that their compulsory contributions may have been made at the expense of much-needed take-home pay.

It was pointed out that the current system is not appropriate for people with interrupted working lives, most of whom are likely to be women, because they will be less able to take full advantage of the concessions and develop adequate levels of benefit for their later years. It also, of course, does not provide adequate benefits for many people who were already middle-aged when the scheme commenced.

Participants noted that the current economic crisis has highlighted the severe hardship which can be experienced by people who reach retirement age when their funds are losing money. It was emphasised that for these and other reasons the Age Pension must remain as the foundation of the retirement income system rather than a residual or supplementary element.

Numerous examples were cited of the extraordinary complexities of the current superannuation system, including those arising from its interaction with the pension system and SATO to which reference has been made earlier.

Concerns were also expressed about the age and circumstances under which benefits could be withdrawn. The current access to lump sum withdrawals was regarded as being much too generous. The recent provision of tax-free access to benefits for people from age 60 (even if they are still working) was the subject of especially strong and widespread criticism.

On the other hand, it was argued that early access to some benefits should be permitted on broader and more transparent grounds than under the current "hardship" provisions. There appeared to be little support for increasing the minimum eligibility age for the Age Pension or encouraging deferred applications for it, mainly because of the resultant aggravation of hardship and inequity.

A number of important reforms were proposed to reduce these problems. They included:

- substantially reducing the generosity of the current tax concessions for high-income people and strengthening the support provided for lower-income people by, for example,
  - taxing contributions at the contributor's marginal rate and then providing a government co-contribution which phases out at a modest level; or
  - taxing contributions at, say, 15% less than the contributor's marginal rate;
- requiring government or employer contributions during some periods out of the paid workforce, such as parental leave;
- tightening the restrictions on lump sum withdrawals (especially for people seeking to withdraw tax-free benefits after reaching the age of 60) and removing current disincentives to taking benefits in the form of annuities.

General savings

Concern was expressed about the tax system's inadequate support for saving to meet mid-life needs by contrast with its treatment of saving through superannuation for needs in later life. This applies especially to saving by low- or middle-income people, who tend to be less able to take advantage of other tax-preferred ways of accumulating resources which can be drawn on without great delay or disadvantage.

It was pointed out that saving for mid-life needs may facilitate investment to reduce later vulnerability (eg, home purchase or further education) or provide access to supplementary finance during periods of unemployment, ill-health or withdrawal from paid work in order to raise children. Saving for home purchase has been singled out for tax concessions through the new system of First Home Saver Accounts but saving for other purposes may be at least as beneficial to a person's long-term security and self-sufficiency.

Attention was drawn to the growing practice of borrowing for mid-life needs with the intention of making repayments from subsequent superannuation benefits. This approach may be understandable in the absence of concessions focused on mid-life needs but it tends to negate the purpose of providing the concessions for superannuation.

Participants referred to an increasing tend towards mid-life schemes in other countries, some of which were considered to be unduly limited to particular purposes such as education, housing or health rather than recognising the great diversity of needs for which withdrawal of savings might be in the interests of both the particular saver and the broader community. The haphazard and inequitable nature of current arrangements for early access to superannuation was reiterated in this context.

Suggested responses to these problems included:

- providing early access to specified amounts of accrued superannuation benefits without any, or at least many, restrictions on purposes for withdrawal;
- broadening the First Home Saver Account system to allow savings and withdrawals for other purposes;
- incorporating the superannuation and home saver systems into a broader system of tax-preferred Lifelong Savings Accounts, including government contributions for lower-income people.

CONCLUSION

There appeared to be a considerable degree of consensus amongst participants about broad principles for reform and directions or action. This included support for

- *strengthening the revenue base* in order to meet future challenges and opportunities requiring public investment, rather than eroding it through further unnecessary or ineffective rate cuts;
- *improving economic efficiency and international competitiveness* by removing distortions in the tax system, rather than letting them continue to impede efficient development and application of Australian resources;
- *providing a tax system which is fairer* between people and between businesses, rather than retaining tax concessions in forms which disproportionately benefit the wealthiest and most powerful;
- *creating a simpler tax system* by removing loopholes and anomalies, rather than preserving incentives to engage in complex tax avoidance techniques.

A number of ways of pursuing these goals have been outlined above and are described in further detail in material which was presented to the Symposium and is available through the TaxWatch website. Some of them will also be amongst the wide range of tax reform options to be discussed at the second National Tax Reform Symposium in May 2009. That symposium will focus especially on tax reform issues relating to corporations, housing, transport, the environment and families.

NATIONAL TAX REFORM SYMPOSIUM

A TAXATION SCORECARD

- Total tax revenue in Australia is in the bottom-third of all OECD countries. It is at least $40 billion less than if we matched the OECD average.
- The level of taxation based on incomes, whether paid by individuals or by corporations, is in the bottom half of all OECD countries.
- The top marginal tax rate and threshold for personal income tax are generous by OECD standards.
- Total tax per dollar earned has fallen by at least 20% for high-earners over the last two decades but there has been little or no decline for lower-earners.
- The proportion of corporate profit which is paid as income tax is lower than it was a decade and two decades ago.
- The tax rates on corporate income and on capital gains are not especially high by OECD standards and there is no evidence that general business taxation is high.
- Taxation of goods and services is relatively low by OECD standards, partly because most European countries have a GST rate of 15% or more.
- Australia is one of only four OECD countries without some form of gift or death duty.
- Public support for "social spending" rather than "tax cuts" rose from 25% to 47% over the last decade while the preference for tax cuts fell from 47% to 34%.

TaxWatch

Based on the TaxWatch online report: Aspects of the Australian Tax System: A Preliminary Outline (www.taxwatch.org.au)

Hosts of the National Tax Reform Symposium:

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