PRIORITIES FOR TAX REFORM

SECOND NATIONAL TAX REFORM SYMPOSIUM

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A Summary of the Symposium

Symposium Hosts:

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PREFACE

The second National Tax Reform Symposium was convened by the Community Tax Forum in Sydney in May 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 first Symposium, held in Canberra in February 2009, 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.

The second Symposium focused on other tax reform issues, including those relating to housing, transport, the environment, corporations, trusts, non-profit organisations and families.

The Symposium was attended by about 50 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 and representatives of the Taxation Review Panel.

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 second Symposium was chaired by Prof Julian Disney and he also coordinated preparation of this Summary of key issues and options raised in the course of presentations and discussion.

The Summary is being made available in this booklet and on the Community Tax Forum section of the website, www.taxwatch.org.au. That section also includes the Issues Papers and other papers prepared for the Summit by the new community information service, TaxWatch, as well as a number of the presentations by speakers.

The Community Tax 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.

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PRIORITIES FOR TAX REFORM: SOME PROBLEMS AND OPTIONS

INTRODUCTION

The Symposium opened with a session on general directions for action in tax reform. The importance of public debate on the underlying values of taxation was emphasised, as was the need to conduct rigorous analysis and develop detailed proposals for reform.

An ambitious and strategic approach was urged, as was the importance of developing balanced packages which, so far as possible, include some measures that benefit people who might be disadvantaged by other measures. But a warning was sounded that balanced packages may become badly skewed as they move through processes of legislation and implementation.

Emphasis was placed on key goals such as

- adequacy of revenue, especially for a growing and aging population;
- simplicity, but not at the expense of rigour and effectiveness;
- transparency, especially in the provision of tax concessions and other benefits;
- equity, not only between people but also between types of activity or organisation;
- efficiency, especially over the longer-term and taking into account economic, social and environmental impacts.

It was noted that concern to maximise economic growth and investment should focus on genuine and sustainable development rather than narrow and simplistic measures. There was widespread agreement that a focus for reform should be facilitating workforce participation, although this could be difficult to achieve without reducing the targeting of assistance towards lower-income people.

It was noted that a lack of options is leading States to rely increasingly on inequitable and inefficient taxes. The need to consider the interaction between individual States' tax systems and the amount of funding allocated to them by the Commonwealth Grants Commission was emphasised.

The Symposium then focused for the remaining sessions on the impact of the current tax system in five key areas and on the possibilities for reform. In doing so, it also considered key aspects of the social security system in those areas. This reflected the breadth of the Review of tax and "transfer" systems being conducted for the Commonwealth Government by the Panel chaired by Dr Ken Henry.

The five key areas were

- Land and Housing;
- The Environment and Transport;
- Companies and Trusts;
- Non-Profit Organisations;
- Families.

The following remarks outline some of the main problems that were raised in background papers and presentations to the Symposium and in the course of discussions at it. They also summarise some of the options that were canvassed as possible responses to those problems.

LAND AND HOUSING

Home purchase

Widespread concern was expressed about the inflationary impacts on house prices arising from the full exemption of principal residences from capital gains tax and land tax. It was pointed out that house prices relative to household income are higher in Australia than in almost every other OECD country. It was also pointed out that our taxation of housing is more generous than in almost every other country.

The exemptions were criticised as being highly inequitable because they are of very much greater value for higher-earners than lower-earners, both overall and per dollar spent on home purchase. They greatly disadvantage young home purchasers, often also bearing the costs of parenting, while hugely benefiting established home owners. These problems are exacerbated by Australia's almost uniquely generous approach towards taxation of assets in general, due to the lack of a general wealth tax or gift and inheritance tax.

Concerns were also expressed about distortions in the use of housing, and in patterns of urban development, which arise from the exemptions. They tend to aggravate urban sprawl and lengthy travel times within cities. Together with the exemption of homes from the pension assets test, and the relatively high stamp duties on people wishing to sell and buy elsewhere, they encourage people to build or remain in housing which is larger than they need or is inappropriately located.

Detailed estimates were given of the huge cost to revenue caused by the exemptions. In addition, governments incur extra cost through inflation of the prices which they have to pay for public housing and of the size of grants to first home buyers. Yet even when some houses increase greatly in value due to planning changes or major public expenditure on a road or other key urban infrastructure, their owners' windfall gains remain entirely tax-free. By contrast, the cost of buying in some new suburbs may be increased by councils requiring developers to help meet basic infrastructure costs.

Suggested responses to these problems included:

- putting an upper limit on the value of capital gains from a principal residence which will be exempt from the capital gains tax;
- putting an upper limit on the value of a principal residence which will be exempt from annual land tax, but allowing payment to be partially deferred until the property is transferred by sale or death;
- if limiting the exemption from land tax, also removing or reducing stamp duty on purchases of principal residences below a specified mid-level value, irrespective of whether they are first home purchases;
- putting an upper limit on the value of a principal residence which is exempt from the assets test, or the "deemed" income test, for the age pension;
- introducing a "betterment tax" on increases in value arising from major planning or infrastructure initiatives by government, while also discontinuing or reducing developer levies;
- applying the capital gains tax when property is transferred by bequest, rather than only by gift or sale.

Rental housing

Serious harm was said to have resulted from excessive encouragement for investors in residential property to engage in "negative gearing". This includes the generous rules concerning tax deductibility of investors' expenses, such as mortgage payments, and the general 50% discount on capital gains tax for property which has been held for more than 12 months. The attractions of negative gearing are increased by the fact that capital gains are taxed only when the property is sold, rather than as they accrue during the period of ownership, yet the investor's expenses can be deducted on an annual basis.

The huge increase in negative gearing during the last decade or so was criticised as having greatly inflated house prices to the detriment of homebuyers and also of many investors who did not want to negatively gear. When inflation eventually peaked and investors could no longer be sure of major capital gains, the shortage of rental accommodation soon became acute and rent levels surged. Other adverse consequences were seen as including inflation of debt levels and also diversion of investment resources into property speculation rather than genuinely productive activities.

It was pointed out that the wide array of exemptions from land tax means that rates for non-exempt investors are higher than would otherwise be necessary to raise the same amount of revenue. Some landlords may be deterred from having substantial portfolios of low-rent dwellings by the fact that land tax rates per dollar usually increase as the value of the landlord's total rental property holdings increases, rather than being assessed separately for each property ("disaggregated').

Proposals to address some of these problems included:

- making interest payments and other investment expenses deductible only against investment income rather than, for example, against salaries;
- reducing or removing the 50% discount on capital gains for individuals, at least for assets held for less than five years (perhaps with a capped exemption for all gains, including housing, below an overall lifetime total);
- providing disaggregation of land tax rates for low-rent dwellings (eg, those under the new National Rental Affordability Scheme).

THE ENVIRONMENT AND TRANSPORT

Sustainable development

A range of criticisms were made about the impact of the taxation system on the use of natural resources. They focused especially on the special concessions for capital investment in industries such as mining, oil exploration and aviation which consume non-renewable resources and have a high impact on the environment. The current rates of fuel taxes and depreciation allowances were regarded as unduly discouraging early replacement of vehicles, equipment and technology with more energy-efficient alternatives.

It was agreed that this symposium was not an appropriate occasion at which to focus in detail on the Carbon Pollution Reduction Scheme or alternative approaches involving some form of carbon tax. However, it was pointed out that some of the problems described above could operate to undermine the effectiveness of the Scheme. Instead, the tax system should be reinforcing the Scheme by actively encouraging low consumption of non-renewable resources and low generation of atmospheric pollution.

The current tax treatment of housing, as outlined in the previous session, was described as highly damaging to the environment. This related especially to the adverse impacts of urban sprawl on pollution and climate change, and to the undue encouragement of large houses with very high energy consumption. The tax system was criticised as biasing investment towards industries which are highly capital-intensive rather than also providing strong job opportunities.

Suggested options for addressing some of these problems included:

- introducing a carbon tax instead of, or in addition to, the Carbon Pollution Reduction Scheme;
- phasing out subsidies for fossil fuel products while also implementing measures to protect vulnerable low-income households;
- altering depreciation allowances to remove the special benefits which favour the mining and airline industries and to expand those which encourage environmental protection activities and replacement of energy-inefficient equipment or technology;
- adopting proposed reforms in relation to taxation of housing (see above) and transport (see below);
- expanding the range and effectiveness of taxes on resource use and waste, accompanied by revenue-neutral reduction in corporate income taxation.

Transport

Taxation of fuel is very low by international standards, partly because the fuel excise has not been indexed for almost a decade. Its undue generosity distorts choices in favour of private vehicle use and disadvantages other modes of transport (such as rail, bus, bicycle and walking) which tend to cause less pollution, greenhouse gases, urban congestion and depletion of non-renewable resources. Similar impacts arise from the especially low excise rate on aviation fuel.

The Fringe Benefits Tax (FBT) arrangements for motor vehicle use were the subject of widespread criticism. They were seen as excessively generous in general and the varying rate scale was seen as increasing incentives to drive long distances, thereby aggravating excessive fuel consumption, pollution and traffic congestion.

The FBT arrangements were criticised as unfairly disadvantaging other modes of transport which do not have such damaging environmental impacts. They were also described as inequitable because they greatly favour higher-earners and people with employers who are willing and able to provide the vehicles. These impacts are accentuated by the FBT concessions for free or discounted parking.

It was suggested that the current level of stamp duty on motor vehicle purchases may deter replacement of older cars with newer more energy-efficient models. An alternative approach is to reduce upfront tax of this kind and increase tax on vehicle usage, especially for high-consumption vehicles.

The current array of exemptions and concessions in transport-related taxation was criticised for causing a substantial loss of revenue which is badly-needed to improve transport infrastructure. It was also seen as a highly ineffective and outmoded way of trying to encourage Australian-based manufacture of vehicles.

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

- increasing the general level of fuel excise or at least restoring indexation;
- phasing out the concessional excise rate for aviation fuel;
- phasing out or reducing most elements of the fuel tax credits scheme for heavy on-road transport and off-road mining use;
- introducing congestion charges and other user charges for motor vehicles, while reducing taxes on purchase of energy-efficient vehicles;
- restructuring the concessional FBT rates to discourage excessive vehicle usage and to encourage use of energy-efficient vehicles;
- replacing the FBT concessions with a log book system for determining work usage;
- removing the special FBT concessions for parking.

COMPANIES AND TRUSTS

Corporate and shareholder income

Concerns were expressed that the current corporate income tax rate is too low, thereby depriving the government of necessary revenue and putting upward pressure on the personal income tax and GST rates. The large gap between this rate and the top personal income tax rate was seen as contributing to financial manipulation by wealthier taxpayers in order to receive income as a corporate entity (eg, by diverting income into private companies or pretending to be an incorporated contractor rather than an employee).

Another view was that the corporate income tax rate needed to be lower in order to attract more foreign investment, especially as foreign investors do not get the benefit of dividend imputation. Removal of dividend imputation could save enough revenue to enable a very large cut in the corporate rate without overall loss of revenue. On the other hand, it was argued that our current rate is not very high by international standards (especially as most OECD countries also require employers to pay large social security contributions for their employees) and that most overseas investors can already avoid paying tax on their dividends from Australia.

Attention was drawn to the tax exemptions in relation to overseas subsidiaries which can encourage Australian businesses to transfer their operations to other countries and which also disadvantage Australian residents wishing to invest at home. It was also pointed out that overseas lenders are taxed very little on their interest receipts while their Australian borrowers enjoy full deductibility for the interest paid. As at the first Symposium, concerns were expressed that providing full and immediate deductibility for interest expenses, but only taxing capital gains upon eventual sale and at a discount, unduly encourages heavy borrowing for speculation.

Suggested options for addressing these problems included:

- increasing the corporate income tax rate to raise more revenue, especially for infrastructure investment, and to reduce the difference from the top personal income tax rate;
- abolishing or reducing dividend imputation and reducing the corporate income tax rate;
- taxing undistributed profits from private companies at the top personal income tax rate;
- restricting the exemption of dividends and capital gains from overseas subsidiaries;
- restoring withholding taxes on all dividends paid from Australia to non-residents and broadening the scope of withholding taxes on interest paid to non-residents;
- removing recently-provided exemptions from tax on capital gains by non-residents;
- removing or reducing the 50% discount on capital gains tax for individual investors but restoring indexation of the value of gains.

Corporate payrolls

Other countries raise much more revenue than Australia from taxes which are based on payrolls, thereby enabling corporate income tax and other taxes to be lower than might otherwise be the case. On the other hand, this approach increases the cost of employing people and also much of the cost of paying the tax is probably recovered by companies cutting wages and/or increasing their prices to consumers. It may be less fair than taxing companies principally on their income as a measure of corporate profit and capacity to pay.

In Australia, payroll taxes are levied at the State level. Opinions differed as to whether there was a strong need for greater uniformity between States and for reducing the extensive exemptions which may cause unfairness between businesses and distortions in the use of resources. It was pointed out that some employers seek to reduce their payroll tax liabilities by creating the appearance that some of their employees are actually independent contractors.

Reforms proposed to address these problems included:

- reducing the tax-free thresholds for payroll taxes and reducing payroll tax rates;
- removing or reducing payroll tax exemptions for particular types of employer (eg, local councils);
- replacing any reductions in payroll tax revenue by increasing corporate income tax;
- harmonising payroll tax systems between States.

Trusts

Discretionary trusts have proliferated in recent years and were identified as vehicles for substantial tax avoidance by high-earners. This is partly because they facilitate splitting of income, especially with spouses and children, in order to reduce effective tax rates. They also provide access to tax concessions such as the 50% capital gains tax discount which are not available through corporate structures. The establishment and operation of these trusts can divert substantial time and money from genuinely productive activities.

Suggested responses to these problems included:

- taxing discretionary trusts in the same way as companies and providing beneficiaries with the equivalent of dividend imputation;
- reducing the frequency with which proportionate allocations between trust beneficiaries can be changed;
- taxing distributed profits from trusts as if they are income in the hands of the controller of the trust;
- strengthening the enforcement of rules relating to independent contractor status.

NON-PROFIT ORGANISATIONS

Provision of tax benefits

Views differed to some extent about the desirability of providing special tax benefits to particular types of non-profit organisations such as "charities'" or "public benevolent institutions". Some wondered whether it might be preferable, at least in principle, to provide assistance through direct grants which are likely to be somewhat more transparent and appropriately targeted.

There was a particular focus on the desirability of the current concessions in relation to GST and Fringe Benefits Tax. They concessions can distort the choices made by organisations and their staff about use of resources and methods of remuneration, especially in relation to the purchase and use of motor vehicles. On the other hand, provision of general grants in lieu of these concessions might be more vulnerable to subsequent erosion in value by governments under budgetary pressure. It could also make organisations more vulnerable to excessive control and political pressure by governments.

Discussion canvassed two key directions for reform:

- replacing at least some of the current benefits with increases in support from direct grants;
- improving the definitions of eligibility for tax benefits in the ways outlined below.

Eligibility for tax benefits

There was widespread agreement that the current system of eligibility for tax benefits for non-profit organisations is highly unsatisfactory. It is highly complex, with a number of different types of benefit and many categories of non-profit organisations which may be eligible for one or more them. The key categories are very vaguely defined and classification of individual organisations is made by the Tax Office, even though it can have major impacts outside the field of taxation. Major delays and costs can be incurred by seeking to establish eligibility.

Eligibility for the most substantial benefits is generally based on definitions of "charities" and "public benevolent institutions" which can exclude organisations on unfair or counter-productive grounds. This can occur, for example, if organisations provide assistance for people while they are moving out of poverty rather than only while they remain in it. It can occur if, rather than directly alleviate poverty, organisations undertake research and draw attention to problems of poverty and call for action to prevent or mitigate it. These issues were substantially addressed by the recommendations of the Charitable Definitions Inquiry which were reported to the Commonwealth Government in 2001 but have not been implemented.

Difficult issues of policy and definition arise in relation to "non-profit" organisations which seek to make a profit out of some part of their activities in order to subsidise others. A strict approach can unduly limit the cost-effectiveness of charitable work while a loose approach can allow unfair advantages to commercial enterprises. Some of these problems have been exacerbated by benefits being made available to non-organisations if they are "religious" or provide "education" or "community service".

Proposals to address some of these problems included:

- adopting the three categories of non-profit organisations which were proposed by the Charitable Definitions Inquiry, or the statutory definitions in the United Kingdom;
- specifying eligibility for tax benefits by reference to this classification;
- establishing a Charities Commission to determine individual organisations' classifications, with an appeal to a specialist tribunal;
- in lieu of these measures, clarifying eligibility by specific legislation about particular types of organisation (eg, non-profit housing) or activity (eg, advocacy or profit-making activities).

FAMILIES

General family income

The Australian system general payments and tax benefits for families was described as providing more and better-targeted assistance than in most other OECD countries, although also being excessively complicated. It was criticised for providing insufficient support for low- and middle-income families with teenage children, for whom parenting costs tend to be higher than for younger children, but being excessively generous to some middle- and higher-income families.

Concern was expressed at the recent decision to index the payments to movements in prices rather than in wages. There was also criticism of the impact on many low-income and sole parent families of the growing divide between the rates and conditions applying to pensions and the harsher levels of assistance provided by Newstart and other social security payments.

Proposals for addressing these problems included:

- adopting a standard benchmark for adequacy of family payments, based on an independent and up-to-date measure of a decent standard of living;
- restoring indexation of family payments to movements in wage levels;
- increasing the rates of Family Tax Benefit A at the same time as mildly tightening the means test;
- limiting Family Tax Benefit B to families with young children;
- tightening the income test on the Baby Bonus;
- integrating Family Tax Benefit A, Family Tax Benefit B and the Baby Bonus;
- removing or reducing the gap between the entitlements and means tests of pensioners and those applying to other social security recipients.

Work and child care

Means-testing was acknowledged as an inevitable consequence of targeting family assistance payments mainly towards lower-income families but care needed to be taken to avoid excessive barriers and disincentives for workforce participation. The design of Family Tax Benefit A was seen as helping to avoid high effective marginal tax rates for low-earners commencing work but as less good for low-wage workers seeking to improve their earnings and in some respects too harsh on second earners in middle-income families.

The new parental leave was welcomed as an important initiative in this context but the crucial importance of access to child care was also emphasised. The basic payment for child care costs (Child Care Benefit) was criticised as inadequate for low-income families. On the other hand, the additional assistance provided by the Child Care Rebate and the FBT concessions for child care services were was seen as being too generous to higher-earners, of no little or no benefit to low-earners, and driving up child care fees. The concession was also seen as unfair because, in practice, it is available only to certain types of employees (usually in large organisations).

This array of different forms of assistance with child care expenses was generally agreed to be unnecessarily complex. It was also argued that the rate of assistance should not vary according to whether the care is provided by a parent, child care centre or other paid or unpaid source. The overall level of support for child care was described as low by international standards and there was said to be a particular shortage of government assistance for non-profit services to establish and operate in low-income areas. Emphasis was also placed on the desirability of integrating support for child care and early childhood education programs.

A number of responses to these problems were canvassed. They included:

- relaxing the income test for Family Tax Benefit A, especially in relation to its impact on second earners in low- and middle-income families;
- relaxing the income test for Family Tax Benefit B in relation to second earners;
- basing income tests for all family payments on the income of primary earners, except perhaps in relation to very high-income families;
- abolishing or tightening the Child Care Rebate;
- abolishing the FBT concessions for child care services;
- increasing the Child Care Benefit, especially for low-income families;
- merging Child Care Benefit, Child Care Rebate and Family Tax Benefit B into a general contribution to the costs of child care, whether paid, unpaid or by parents;
- increasing funding for non-profit and government child care providers in areas of unmet need.

CONCLUSION

The Symposium did not aim to develop an agreed statement of reforms. The Chair concluded the Symposium, however, by listing some areas which might be considered when selecting priorities from those which had been discussed. They included:

- limiting the value of principal residences which is exempt from land tax and the pensions assets test, while also cutting stamp duty on lower-priced home purchases;
- allowing investors' expenses to be deducted only against income from the same type of economic activity;
- restructuring FBT concessions for motor vehicles to remove encouragement for excessive vehicle usage and be less biased towards higher-earners;
- reducing special tax concessions for fuel, mining and other resource use which consumes non-renewable resources and damages the environment;
- taxing trusts in the same way as companies and taxing undistributed profits in private companies at the top marginal rate;
- implementing the recommendations of the Charitable Definitions Inquiry and establishing a Charities Commission to administer them;
- paying Family Tax Benefit B only to families with young children;
- abolishing the Child Care Rebate and FBT concessions for child care, while also increasing the Child Care Benefit and grants to non-profit and government providers of child care services.

Further details of many of the views and proposals mentioned in this Summary will be found in the papers and presentations which were prepared for the Symposium and have been placed on the Community Tax Forum section of the TaxWatch website (www.taxwatch.org.au).

SECOND NATIONAL TAX REFORM SYMPOSIUM

A TAXATION SCORECARD

- Total tax revenue in Australia is in the bottom-third of all thirty OECD countries. It is at least $50 billion less than if we matched the OECD average (as a proportion of GDP).
- 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 ago (and two decades ago).
- The tax rates on corporate income and on capital gains are not especially high by OECD standards; nor is the overall taxation of business.
- 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%.

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

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