

Australian Tax Reforms: Past and Future

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Interacting approaches to reform...

- ▶ Ideals based on tax ‘axioms’ leading to –
 - fiscal discipline
 - tax neutrality
 - ‘Haig Simon’ economic income
- ▶ Policy repair
- ▶ Changing responses to the new
 - Technology
 - Social needs or problems
 - Economic competition – ‘globalisation’
- ▶ Policy adaptation

Idealised Reform

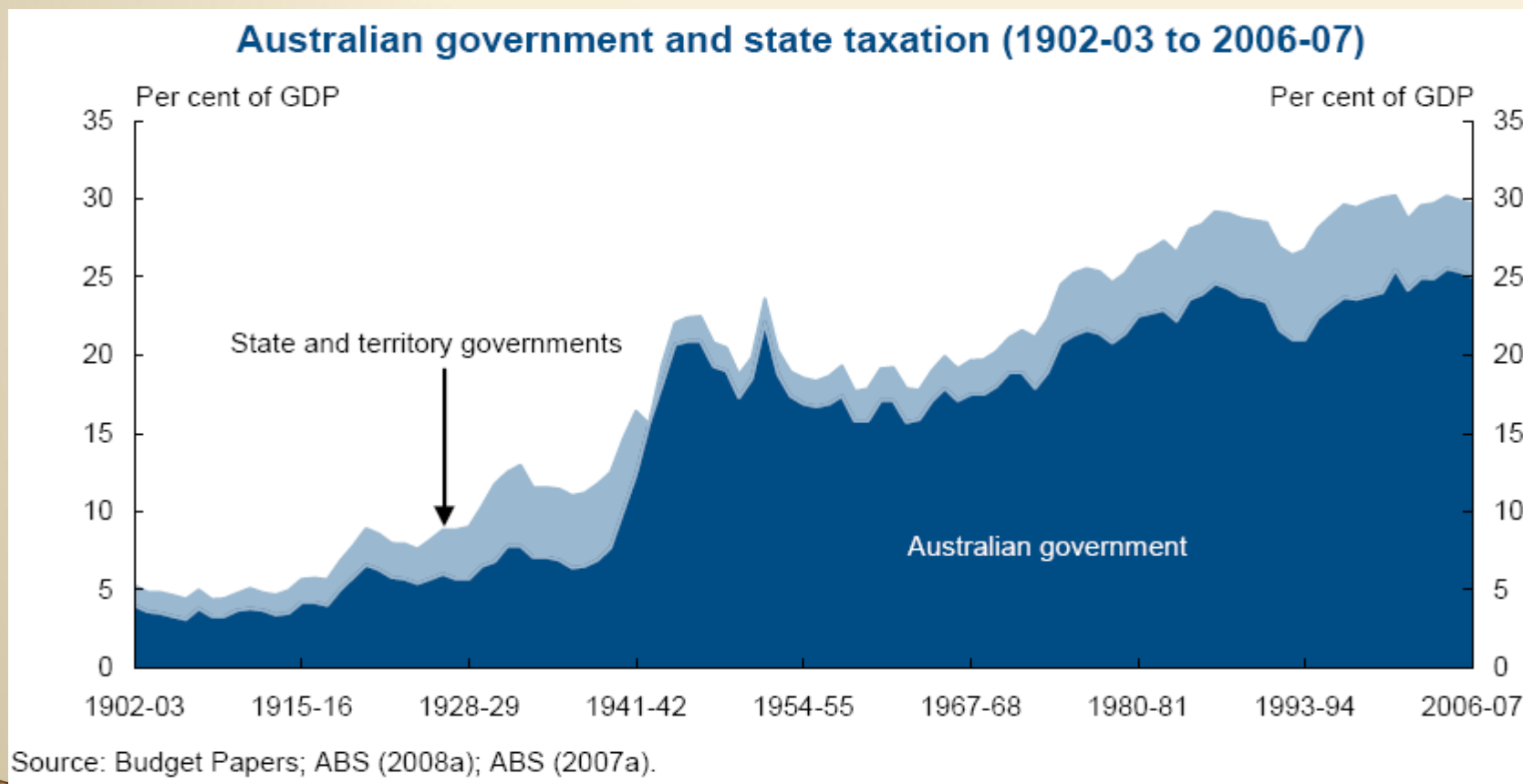
Responsive reform

Australia in 1983...repair needed

- ▶ Emerging from global economic recession, local drought
- ▶ Entrenched 'stagflation'
- ▶ A mood for change – Australia falling behind
- ▶ Ideal blueprints: Asprey and Campbell reports

System stressed by growth...

- War and the welfare state: from 5% to 30% of GDP



State of the tax system

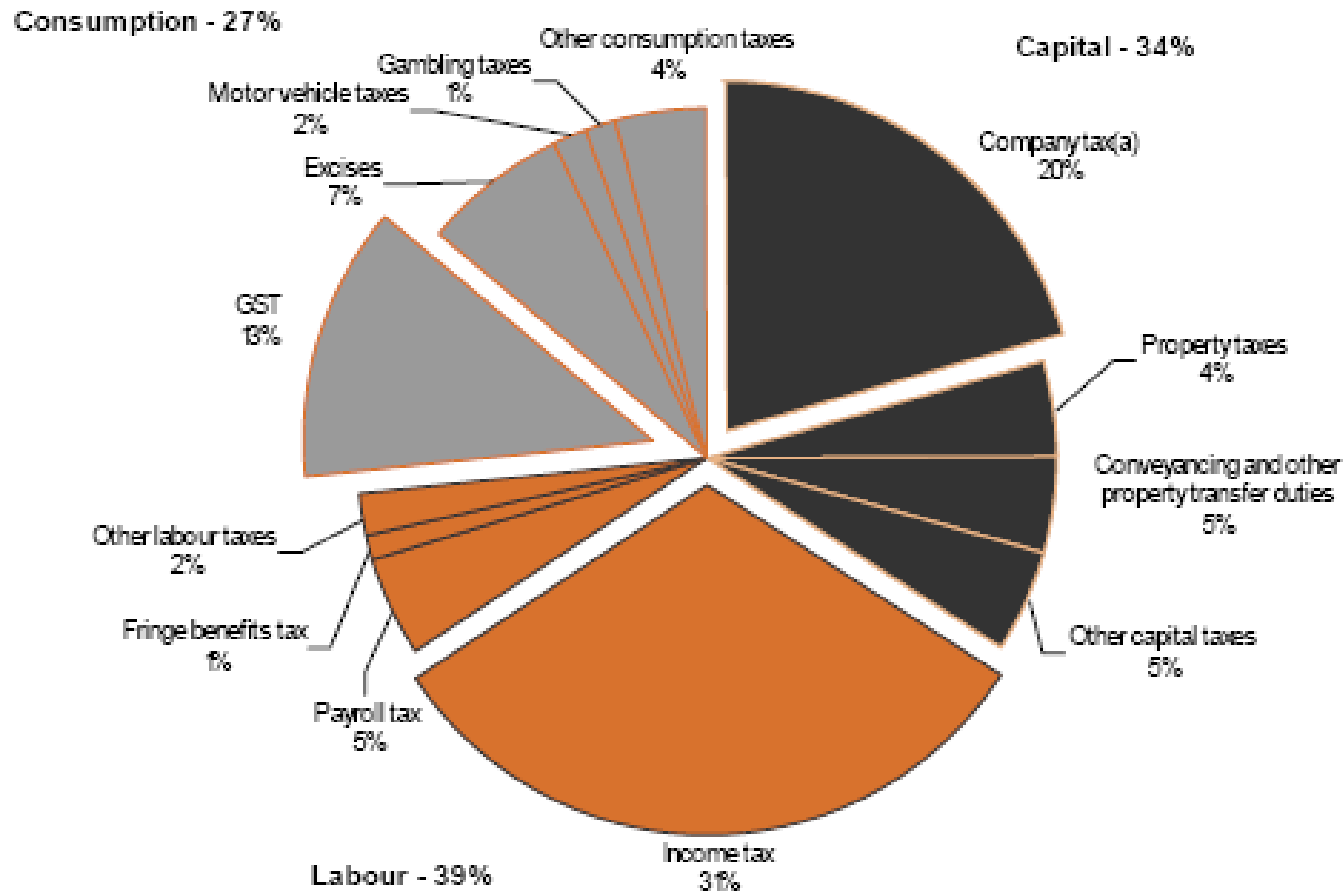
- ▶ Income tax under stress
 - Narrow base
 - High rates: 60% top personal, 46% company
 - Widespread tax avoidance
- ▶ Substantial budget deficit
 - 3.3 percent of GDP (underlying) in 1983–84
- ▶ No general consumption tax
 - Inefficient/inequitable excises and wholesale tax
- ▶ No social security tax

Political Economy of Reform

- ▶ The authority of experts
 - Asprey, Campbell, the Tax Summit, the Ralph Committee
 - The Board of Taxation (standing policy review body)
- ▶ The authority of 'crisis response' political leadership
 - 1985 Reform of the Australian Tax System
 - Imputation, FBT, CGT
 - 1988 Economic Statement
 - Business tax reform
 - 1998 New Tax System
 - GST

Tax mix – primacy of income bases

Chart 3.1: Contributions to Australia's tax mix
All Australian governments (2007-08)

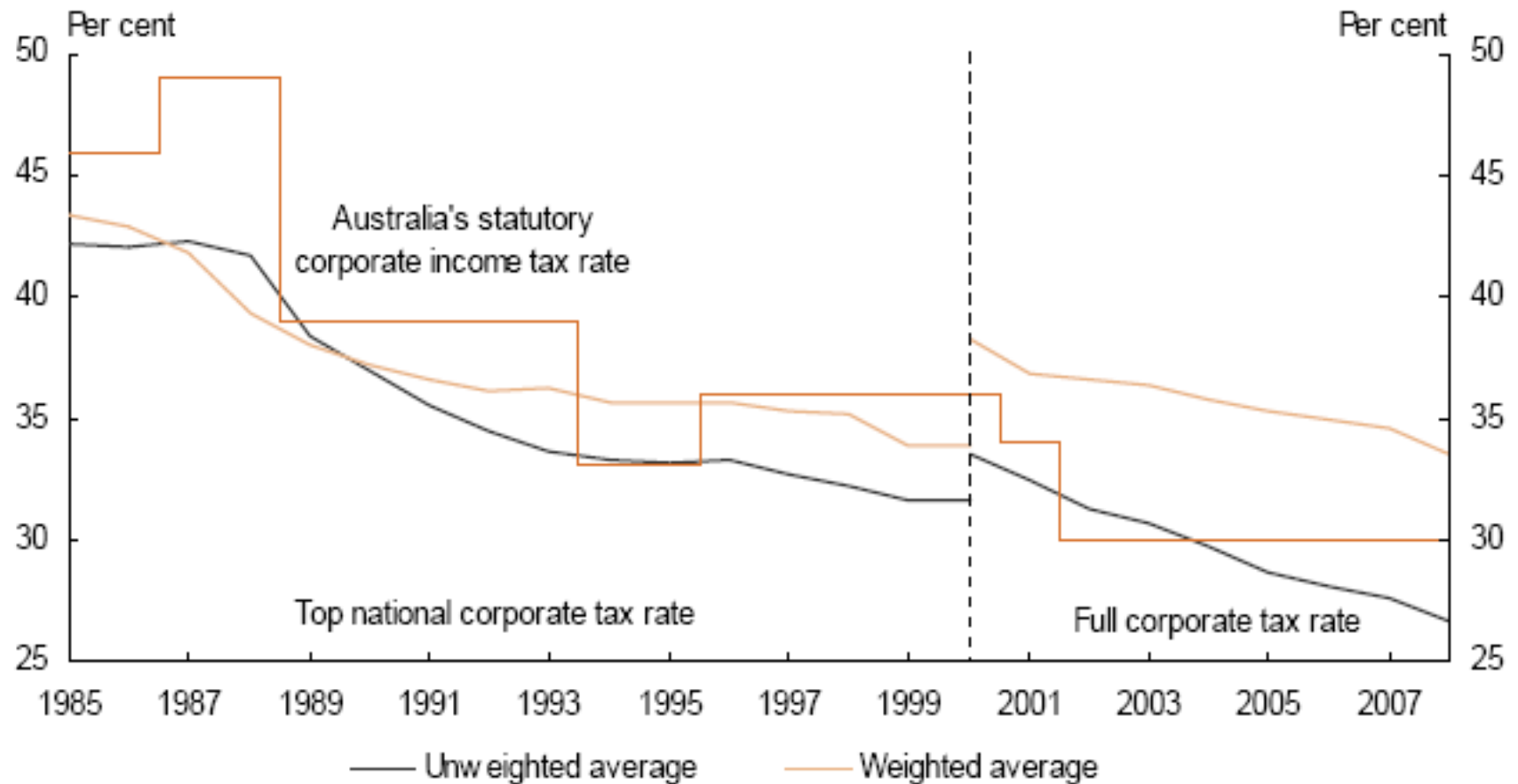


Business tax reform

- ▶ Economic Income:
 - lower rates
 - broader base
- ▶ Broadly matching OECD patterns
- ▶ No substantive change in effective tax rate
 - Corporate income growth flowed to tax coffers
 - Company base strength until now
- ▶ Very high rate of national investment despite high reliance on capital taxation

Business taxes – statutory rates

Chart 1.1: Statutory company income tax rates of OECD countries (1985 to 2008)

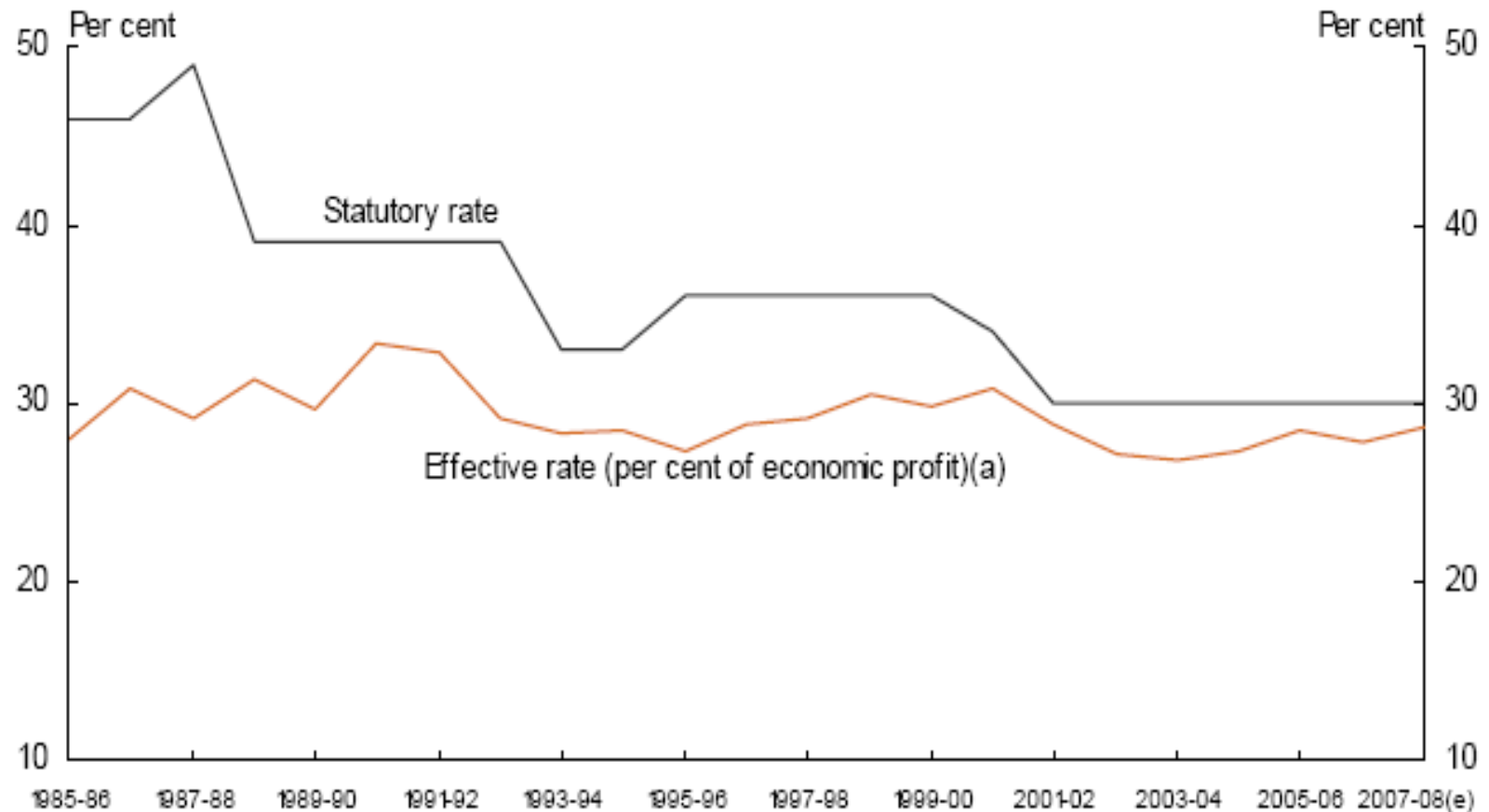


Business base measures

- ▶ Removal of exemptions (e.g. goldmining)
- ▶ Foreign source income (now weakened)
- ▶ Capital gains tax (indexation replaced by discount)
- ▶ Effective life depreciation
- ▶ Anti-avoidance provisions
- ▶ Dividend imputation integrity
- ▶ Established broad-base features (losses etc)
- ▶ Exceptions old and new:
 - Small business, agriculture and mining, film-making, rental housing, offshore banking, venture capital and business R&D

Statutory and effective rate

Chart 3.5: Measures of the company tax rate in Australia (1985-86 to 2007-08)



Entities and integration

- ▶ Full dividend imputation
- ▶ Short-lived alignment of tax rates
- ▶ Wide access to credits (especially superannuation funds)
- ▶ Failed attempt tax trusts as companies
- ▶ Dividend streaming anomalies
- ▶ Imputation ironically supported by tax payers and tax authorities

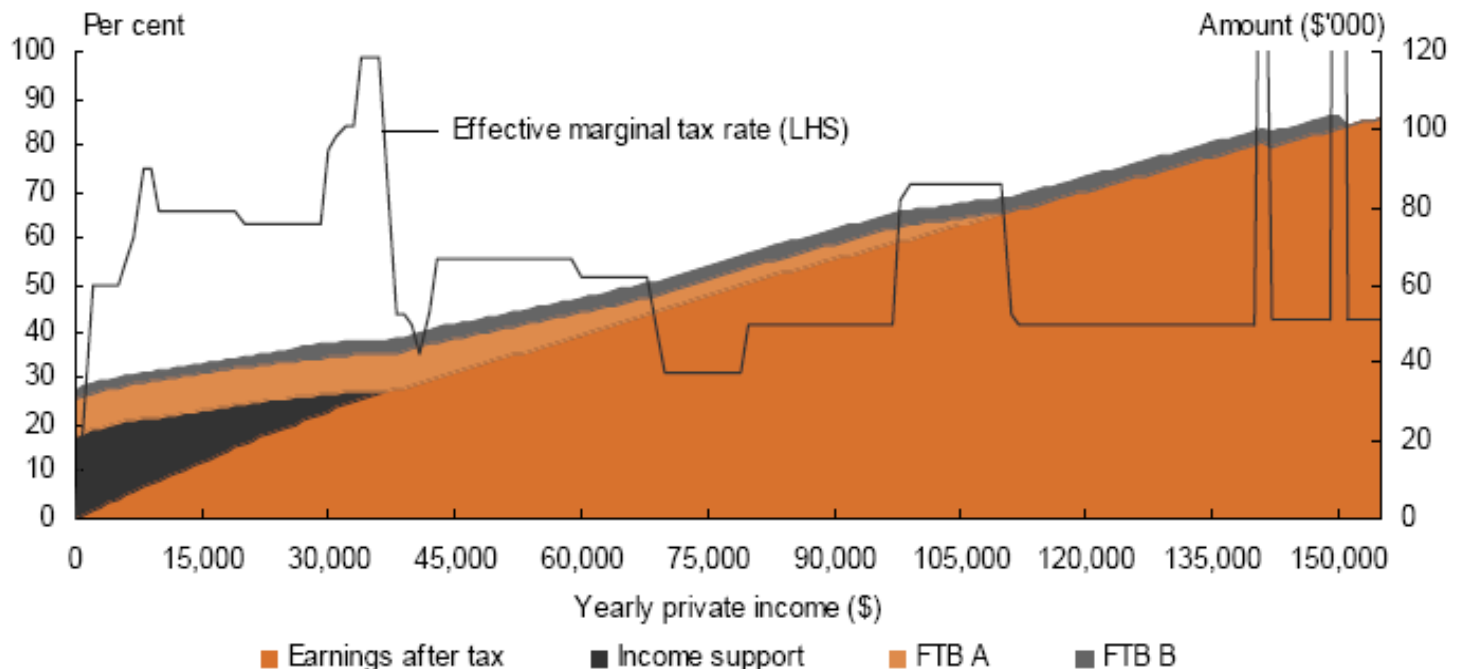
Personal taxes & transfers

- ▶ Top rate reduced from 60% to 45%
 - threshold effectively doubled relative to earnings (\$180,000)
- ▶ At average earnings – effectively now 35½%
 - higher for many families
- ▶ Base broadening:
 - fringe benefits, business entertainment, capital gains
- ▶ Large transfers for families
 - allowances, child care, \$5,000 ‘baby bonus’
 - means tested

Horizontal and vertical confusions

► Tax and means tests combined (family)

Chart 4.5: Effective marginal tax rates and disposable incomes^(a)
By yearly private income, single earner couple with two children



(a) Effective marginal tax rates (EMTRs) are calculated using a \$1000 income increment. Spikes in EMTRs at \$140,000 and \$150,000 reflect the imposition of the Medicare levy surcharge and the loss of FTB Part B respectively.

Source: DEEWR estimates.

Retirement income policy

- ▶ 3 policy concerns
 - Adequacy and sustainability of age pension
 - 1980s wage overhang
 - National saving shortfall
- ▶ 3 'pillars'
 1. Age pension 'safety net'
 2. Compulsory saving
 3. Voluntary saving
- ▶ 3 'taxing points'
 - Contributions
 - Fund earnings
 - Benefits (means tests)

Slow Boat to the GST

- ▶ 1975 Asprey proposal: VAT
- ▶ 1985 Keating option: retail sales tax (12½ %)
- ▶ 1993 Hewson option: VAT (15%)
- ▶ 1998 Howard proposal: VAT (10%)
 - Reasonably comprehensive base
 - Single rate
- ▶ Increases in GST rate and base ruled out in the 2008–09 Review terms of reference

Other indirect tax goals

- ▶ The GST replaced the Wholesale sales tax (goods based, multiple rates) and some State transaction taxes
- ▶ Other significant indirect taxes retained
 - Gambling, alcohol and tobacco
 - Transfer duties (increased through non-indexation)
 - Road Fuels (and motor taxes)
 - Very limited link to road funding, although an effort has been made to achieve better pricing for road use by heavy trucks (4.5+ tonnes)

Background to Tax System Review

- ▶ Australia 2020 Summit (April 2008)
 - ...to reach the top 5 in world per capita income
 - A tax review one of the requirements
- ▶ Australia's Future Tax System Review
 - taxes and transfers
 - pension adequacy
- ▶ Interim reports (retirement) for 2009 Budget
- ▶ Final report December 2009

Legacies of past reform

- ▶ Unchanged total tax burden –30% of GDP
- ▶ Economic income tax and means test bases
- ▶ High share of capital taxes
- ▶ Complexity and operating costs
- ▶ Little reform of state taxes or federal imbalance

Competing responses to legacy

- ▶ Investment attraction following terms of trade decline
- ▶ economic infrastructure
- ▶ skilled labour
- ▶ Social infrastructure
- ▶ Housing affordability
- ▶ Household debt
- ▶ Social program demand and costs
- ▶ Ageing, pensions and the loss of savings

Growth concerns

Distributional concerns

Growth, taxes and political economy

- ▶ Can tax reform induce higher growth?
- ▶ Switch from capital to labour/ consumption
- ▶ Political economy requires demonstrable, quick reward for this to be sustainable?
- ▶ Population ageing alone – 4% of GDP
- ▶ 10 percentage points on either the GST or personal tax base
- ▶ On top of a tax mix switch?

A lower tax future

A higher tax future

The business tax

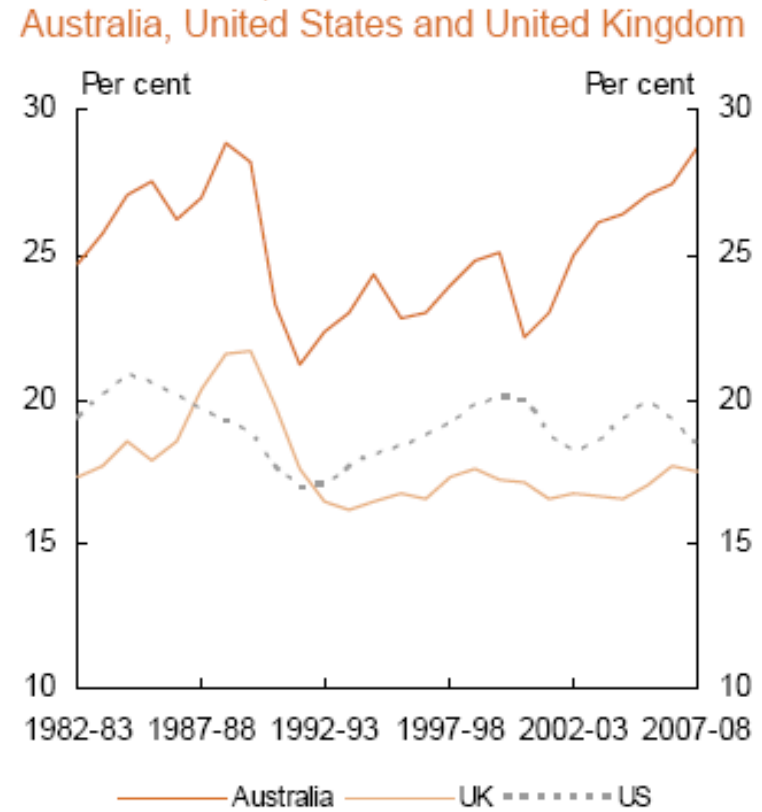
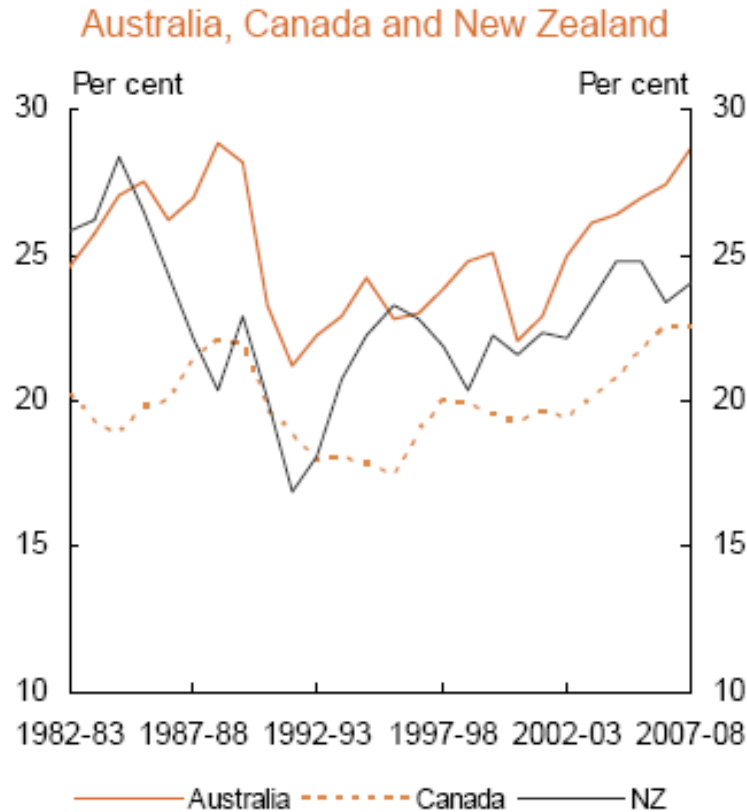
- ▶ Strong push to reduce capital taxes overall
- ▶ Business tax base
 - Recent initiatives: temporary investment incentives
 - Fundamental questions: cash flow taxes and ACE options
 - Underlying long list of specific base concerns
- ▶ Tax rate
 - one way pressure, drives base concerns
 - Change in global strategic environment? Temporary?
 - Base and rate trade-off
- ▶ Distributions
 - Imputation still supported
 - But increasing anomalies in global setting
 - Not consistent with radical base reforms

Economic Rents

- ▶ Petroleum Resource Rent tax – offshore oilfields
 - State royalties on other minerals
- ▶ Business economic income taxes imposed both on normal returns and economic rents
 - Efficiency/growth benefits of reducing former generating interest in systems that differentiate these returns
- ▶ Location rents (resources, financial system) have long been very significant in Australia
- ▶ Greater emphasis on the problems of profit shifting than investment attraction

Can national investment be higher?

Chart 6.2: Gross national investment
Per cent of GDP (1982-83 to 2007-08)



Source: ABS (2008a), IMF (2008), Statistics New Zealand (2008).

Radical simplification

- ▶ Tax-transfer system highly complex
- ▶ 72% of taxpayers seek professional help
- ▶ Two strategies:
 - New technology – the IT fix
 - New policy: simplified schedular bases
- ▶ Simpler business taxation – may rely more on a large reduction in role of capital taxes
 - Or further simplification only for small business

Some sectoral issues

- ▶ Federal tax reform
 - Limited prospects for new state tax bases
 - Harmonisation and removal of the least efficient taxes
- ▶ Reform of housing markets
 - Property, transactions, income, capital gains, means tests, GST all highly non-neutral taxes by tenure
- ▶ Reform of the land transport market
 - Possible shift of land transport (roads) from a public service model to a commercial market model

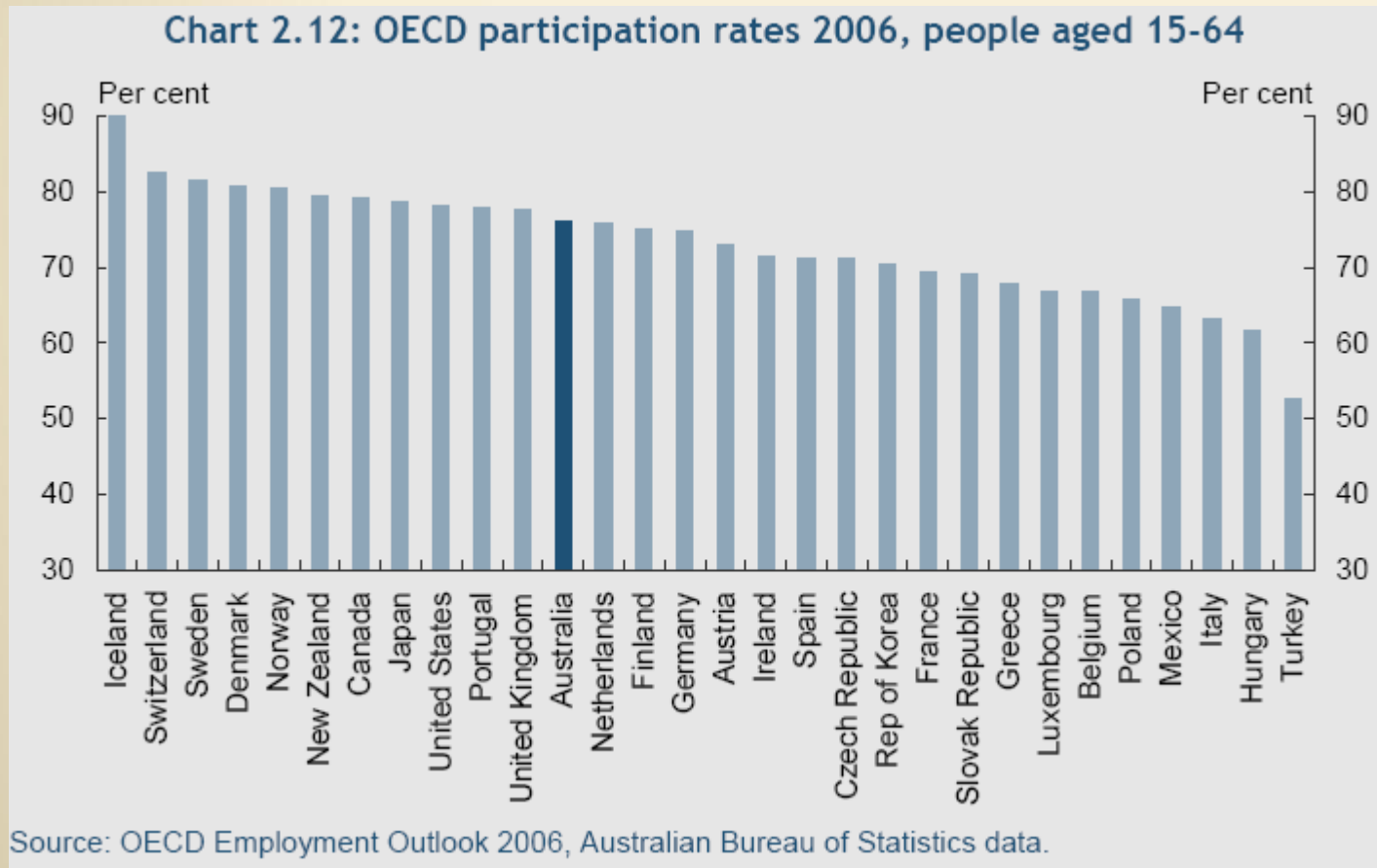
Retirement income

- ▶ Pillar 1 (age pension and services)
 - Conflicting pressure on adequacy and sustainability
- ▶ Role and scale of compulsory employee superannuation (pillar 2)
 - Little relief on pillar 1
 - anomalous (and complex) asset and income means tests
- ▶ Defining retirement: different age rules
- ▶ Consumption deferral only to retirement date
 - concern about longevity risk

Tax-transfers and Participation

- ▶ High effective marginal (and lifetime) tax rates
- ▶ Desire to shift Australia towards the higher end of participation rates (at least catch NZ)
 - Some concern also about lifetime savings incentives
- ▶ Tension in means test and offset design
 - Steep tapers claimed to affect fewer people

Australia's labour force participation lags the US, Japan, UK (and New Zealand)



Concluding Comments

- ▶ How can a 'review' promote change?
 - Better understanding
 - Renewed systemic vision
 - Lengthened policy time horizon
- ▶ The current economic crisis initially conspires against each of these
 - Yet past change motivated by crisis
- ▶ All taxes are 'bad' – reform requires
 - analysis of context in each country
 - whole system review so that meeting ideals in one area doesn't come at the cost of other areas