Re-think

Better tax, better Australia

Tax Discussion Paper

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General Comment:

In this paper I will address some of the summary questions, as they pertain to my interests, as well as adding additional points, which in my view should be considered in the context of taxation reform, but have not been included in the government's tax discussion paper.

I write these comments as a Third Ager, commercially qualified including in accounting and taxation, retired from the paid workforce, but with a strong interest in taxation, social security and superannuation reform.

Summary Questions

Q1: Is more fundamental change required?

Any taxation reform should take a holistic approach and not just consider the revenue-raising side of taxation but also where the taxes are dispensed. Thus, social security and superannuation must be considered in the context of this paper.

Furthermore, the system(s) must be fair and equitable, transparent, and as simple as possible. Thus, there should be as few taxes as possible to maximize an ongoing revenue stream.

Any taxation (and social security) system should aim to maximize personal responsibility inclusive of risk sharing (social insurance) and minimize entitlements (social welfare).
A good taxation system should be geared to reward diligence and hard work, innovation and entrepreneurialism.

Q6: What should the individual tax system look like?
Q12: Tax Planning Problems

Following on from Q1 it follows that I favour a tax system that relies more on indirect than direct taxes but not a total abolition of direct taxes in the foreseeable future, although long-term that could be considered on a gradual phase-in/phase-out basis.
The Income Tax scale should be a relatively flat rate of tax:
no tax-free threshold; instead a low tax rate for low incomes; a slightly higher rate for middle incomes; and again a somewhat higher rate for high incomes.
Revenue loss from such a tax scale could at least partially be recovered by a consolidation of what are now eligible deductions, and - as media reports recently stated – are used in the tax planning industry for high income earners to the point where some taxpayers with gross incomes in excess of $1 million do not pay any tax at all.
Whilst such tax planning is perfectly legal, it is immoral and unethical. Those loopholes must be closed.

Q20: Dividend Imputation

Dividend imputation has served Australian investors well and must be retained.
In the 1970s and also 1980s, prior to the introduction of franking credits, and with interest rates being high, I gave the share market a miss. Double taxation of dividends versus tax-free savings from a ten-year bond coupled with high interest yields made my personal investment decisions easy. Plunging interest rates and franking credits reversed the investment philosophy not just for me but many in my age group.
Retirees rely on franking credits for their retirement income.

Q21: CGT and Negative Gearing

Whilst negative gearing applies to all investments, it is usually seen in the context of property investment.
Many analysts would agree with me that the residential property market in Australia, especially in the capital cities, is overheated. A number of factors contribute to this phenomenon:

- Population growth, mainly through immigration, which the government could and must curtail for environmental reasons alone, if we want future generations to enjoy prosperity, personal and environmental health.
- Overseas investments, which the government could easily control through stricter regulation, penalty charges and the collection of economic rent. Better even, overseas investors should not be permitted to purchase freehold land. Australia is one of a few countries where investors can undertake such purchases.
- Discounted capital gains
- Negative gearing.

Discounted capital gains are an attraction to the short- and middle term investor.
The long-term investor, a group that many mum-and-dad investors belong to, often hold their portfolios for decades. They would benefit from the indexed capital gains system which preceded the current model (indexation of the cost base).
I regard the indexed capital gains system as more equitable and therefore the preferred one.

Negative Gearing suits the high income earner and cannot be regarded as very equitable. A better approach would be to neutralize gearing, where costs can be deducted up to the level of income. Losses can then be carried forward and deducted against any future profits from that particular investment. In other words, negative gearing would be de-coupled from other sources of income, especially income from exertion.

Q22: Superannuation

Superannuation needs more than just a fiddling around at the edges with the tax system.
The current superannuation system is a tax-effective investment scheme for the better off and will do little to phase out the aged (welfare) pension.
My full proposal was submitted to the Cooper Review and will not be repeated here.
However, a summary of this submission is included as follows:

- Compulsory superannuation for each and every permanent resident in Australia from a certain age onwards (say 20)
- Contributions and growth to be tax-free during the accumulation phase
- Under no circumstances can superannuation be accessed prior to retirement
- Fund change from accumulation to Pension Mode on retirement
- Superannuation to be paid as a fully taxed annuity or pension for life, indexed by the below UPI, with payments based on the amount available in the fund and the life expectancy of the beneficiary.
- No reversionary pensions. There is no need for such, as everyone has superannuation.
- No lump sum payments. No residual left to an estate. Any residual on death will benefit those who live past their life expectancy.

Needless to say that such a proposal will not be enthusiastically embraced by superannuants and self-funded retirees, although as it would have to be phased-in over several decades an education process could prepare future generations for the inevitable need for such reform.
Neither will governments like it: current governments have to forego superannuation tax revenue: a short-term pain for a two-fold long-term gain: taxing the retirement stream and virtually being able to abolish the aged (welfare) pension.
Yet, the change is also necessary as in an age where by necessity the population has to shrink, the younger generation cannot be expected to support the older generation. There has to be an intra-generational support system in place.

Q23: Improve Domestic Savings

One way to encourage domestic savings would be to apply a lower tax rate to earnings from interest and dividends.
Intuitively I ask the question whether it is fair to tax income from non-exertion at a lower rate than income from exertion.
This dilemma may be overcome through social security reform (see below) and an overall decrease of the personal income tax rate.

Q54: GST
A short question to answer: I am a proponent of indirect taxes.
Australia's GST rate is low by international standards and there are many exceptions.
I favour a broadening and deepening of the GST rate: include all goods and services and increase the rate as well.
I reject the call from welfare groups that a GST would disadvantage the low income earners.
This would only apply where low and high income earners have the same or very similar expenditure patterns.
Furthermore, genuine low income earners can be compensated. Not all low income earners are genuine low income earners. Where an income earner merely supplements a generous family income or has substantial income from other non-reportable and non-assessable sources, the low-income rule is not applicable.

ADDITIONAL COMMENTS:

A1. Tobin Tax

This tax, put forward in 1972 by Nobel-prize winner James Tobin, has raised much debate and has its proponents and critics. At the moment, it is favoured by some eleven EU countries for introduction.

Originally designed as a currency transaction tax, I – as a proponent of the tax – would like to see it introduced for share transactions as well. The percentage could be miniscule small so as not to punish mum-and-dad investors too heavily. An extra $5 to $10 on a $20,000 investment package would not carry too much of a burden, but given the massive volumes of shares traded on a daily basis, such tax would certainly add handsomely to the revenue stream.

It should at least be included on the agenda for discussion and possible implementation.

A2. Land Tax and Natural Resources Taxes

A land tax was foreshadowed in the Ken Henry Review and should be re-visited. Whilst currently small amounts of land tax are levied on investment properties (at least in Victoria), the fact remains that many freehold property owners derive huge windfalls (economic rent) from the sale of their property when publicly funded infrastructure and government policy drive up land prices.
It may not be a popular tax, but it is a tax that cannot be avoided and evaded.
As a consequence, income taxes should be reduced.

Natural Resources Taxes have so far had a rough ride in Australia. But we need them. Our environment is deteriorating in leaps and bounces. Australia is lagging behind many OECD countries in taking counter-action.
We should place taxes on the use (and abuse) of fossil fuels.
At the moment people who are frequent drivers and especially frequent flyers are rewarded with discounts.
My proposal is for a personal and individual allocation of driving kilometers and flying kilometers per annum at which level standard prices apply. Any driving/flying above that allocation would attract a penalty charge. Personal allocations would vary from person to person depending on need; they would not be transferable, but could be cumulative.

Some may see this as a nightmarish undertaking. However, in my childhood I grew up with food rationing and all sorts of other rationing. It worked well. In those days there were no helpful computers and plastic cards around.

A3. Social Security Systems
Australia's social security system is a welfare system, sourced from taxpayer contributions and paid from Consolidated Revenue. Unlike many other countries, Australia's social security system does not rely on social insurance contributions, superannuation excepted. The Medicare levy is a token contribution to the Health Sector and cannot be regarded as social insurance.

Any tax reform must therefore also address social welfare reform.

If the Australian government would introduce compulsory and universal social insurance with no lower and upper thresholds for contributions, for the key areas of health, aged care, disability and unemployment, income taxes could be substantially decreased whilst direct funding to these key areas should impose a more equitable contribution rate than the current taxation system does.
Ergo, it could produce fairer and also less complex taxation as well as social insurance systems.

A4. Pension Indexation and Asset Test
Asset Test:
Many aged (welfare) pensioners are income-poor and asset-rich. The increase in property values (see also A2) over several decades has turned ordinary Australians into multi-millionaires. It should really be a no-brainer to include at least part of the value of the principal residence in the asset test, above a certain (average) amount.
Such move would not require the pensioner to sell the home, take out a reverse mortgage or lower the pension. Instead the pensioner could have the excess pension debited against the excess value of the home, with or without interest charge. When eventually the property is sold (most likely by the estate), the accumulated debt would be recovered .
I would favour a scenario where no HECS-style interest charges apply. However, an annual administration charge need to be levied to recover administrative costs.

Pension Indexation:
This topic has been a favourite in the media recently.
Over many years, in many submissions, to various political parties and politicians, have I argued that neither the CPI nor a Wages Index are the appropriate indexation methods for an aged (welfare) pension or for that matter for any retirement income.
Third Agers, no longer in the paid workforce and relying on either self-funding, the government pension or a mix of both, have different lifestyles, different expenditure patterns and different needs to the younger generations.
The ABS currently maintains the PBLCI, which may be used as a start in the right direction. I personally favour the introduction of a UPI (Universal Pensioner Index) used for all retirement incomes (whether welfare pensioners, parliamentarians, public servants et al) and all retirement benefits which are subject to indexation.
A uniform approach to all retirement indexation should be welcomed by all interested parties.

A5: Tax Exempt Status of Religious Organisations

We live in a secular society where religious organizations should not enjoy a special tax exempt status.

Much additional revenue could be raised if the commercial operations of religious organizations would have their tax exempt status withdrawn.