

Australia's future tax system

Report to the Treasurer

December 2009

Part One Overview

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**Australia's
future tax system**

23 December 2009

The Hon Wayne Swan MP
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

We are pleased to present the Report on Australia's Future Tax System.

The Report presents a vision of a future tax and transfer system that would position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and would enhance community wellbeing.

We note that the terms of reference call for a review of Australia's tax system, taking into account the relationships with the transfer payment system and other social support payments, rules and concessions. We considered these relationships to be of such importance that we have applied a systemic approach encompassing both transfers and taxes.

The Review has attracted wide public interest, evidenced by over 1,500 written submissions, many stakeholder meetings and around 30 speeches and presentations to a diverse audience, as well as the extensive coverage of the Review in the media since its announcement in the 2008-09 Budget. We thank everyone who has participated in this process.

It is evident from this level of interaction that the Review has raised the community's awareness of the tax and transfer system and its implications for the wellbeing of Australians. We hope this Report further contributes to that awareness and supports an informed debate about future tax and transfer policy.

We wish to record our appreciation for the help and support provided by the Review secretariat, other areas of the Treasury, the Department of Families, Housing, Community Services and Indigenous Affairs, the Australian Taxation Office, Centrelink and other agencies, including the State and Territory treasuries.

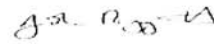
Yours sincerely



Ken Henry
Chair



Jeff Harmer
Member



John Piggott
Member



Heather Ridout
Member



Greg Smith
Member

Notes

- (a) Figures in tables and generally in the text have been rounded.
- (b) The following notations are used:
- | | |
|----------|------------------|
| \$m | \$ million |
| \$b | \$ billion |
| cat. no. | catalogue number |
- (c) References to 'the States' or 'each State' include the Australian Capital Territory and the Northern Territory. The following abbreviations are used for the names of the States, where appropriate:
- | | |
|-----|------------------------------|
| NSW | New South Wales |
| VIC | Victoria |
| QLD | Queensland |
| WA | Western Australia |
| SA | South Australia |
| TAS | Tasmania |
| ACT | Australian Capital Territory |
| NT | Northern Territory |
- (d) The term 'Australian Government' is used when referring to the current government and the decisions and activities made by the current Government on behalf of the Commonwealth of Australia.
- (e) The term 'Australian government' is used when referring to a past government or governments and the decisions and activities made by past governments on behalf of the Commonwealth of Australia.
- (f) The term 'Commonwealth' refers to the Commonwealth of Australia. The term is used when referring to the legal entity of the Commonwealth of Australia.

Preface

In the 2008-09 Budget the Australian Government announced a comprehensive ‘root and branch’ review of Australia’s tax system. The aim is to create a tax structure that will position Australia to deal with its social, economic and environmental challenges and enhance economic, social and environmental wellbeing.

The terms of reference call for a review of Australia’s tax system that takes into account its relationships with the transfer payment system and other social support payments, rules and concessions. These relationships are of such importance that a systemic approach, encompassing the legal, economic and administrative structure of both transfers and taxes at all levels of government, has been adopted in this Review.

The perspective in this Report is necessarily long term. Economic, social and environmental change over the next 40 years is expected to have a profound impact on the tax and transfer system, but will evolve gradually. The significant reforms required to respond to these changes will take time to implement and will require further adaptation over time. This Report sets out the main reforms policy-makers should implement as they position the system for the future.

The recommendations in this report reflect a wide body of evidence. The two background papers, *Architecture of Australia’s tax and transfer system* and *Pension review background paper*, and an extensive process of community engagement, including in response to the Review’s *Consultation paper* and *Retirement income consultation paper*, have yielded a wealth of information about the strengths and weaknesses of the existing tax and transfer system and community perspectives on potential reform paths. A series of commissioned papers and a tax and transfer policy conference (June 2009) distilled important insights from recent economic theory, empirical research and experiences in other countries.

The findings and recommendations in this Report complement the initial findings and recommendations on the retirement income system in *The retirement income system: report on strategic issues*, released earlier this year.

The recommendations include specific policy changes, directions for policy change and areas for further investigation. In some areas guiding principles are articulated, against which specific tax settings could be reviewed. The general nature of many of the recommendations reflects both the longer-term nature of the Review and its limited capacity to comprehensively examine policy settings across the entire tax and transfer system.

For the same reason, not every aspect of the tax and transfer system has been reviewed. For example, industry policy, carbon pollution policy and most aspects of tax administration and legislative drafting have not been reviewed here. The scope of the income support system is very broad and the Review Panel has not undertaken a detailed review of adequacy or reviewed all individual payments. The Review has focused on the broad architecture of the transfer system – such as the relationships between payment categories – and its interactions with the personal tax system, rather than a detailed review of individual payments or adequacy. In considering payment adequacy, the Review has taken the policy

settings established by the Australian Government following the 2009 Pension Review as the benchmark for pensions.

This report is structured in two parts. Part One outlines the emerging challenges faced by the tax and transfer system, and sets out a broad overview of the findings and recommendations. Part Two provides detailed analysis for each area of the tax and transfer system.

Terms of reference

Australia's future tax system

Objectives and scope

1. The tax system serves an important role in funding the quality public services that benefit individual members of the community as well as the economy more broadly. Through its design it can have an important impact on the growth rate and allocation of resources in the economy.
2. Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community.
3. The comprehensive review of Australia's tax system will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes. The review will consider:
 - 3.1. the appropriate balance between taxation of the returns from work, investment and savings, consumption (excluding the GST) and the role to be played by environmental taxes;
 - 3.2. improvements to the tax and transfer payment system for individuals and working families, including those for retirees;
 - 3.3. enhancing the taxation of savings, assets and investments, including the role and structure of company taxation;
 - 3.4. enhancing the taxation arrangements on consumption (including excise taxes), property (including housing), and other forms of taxation collected primarily by the States;
 - 3.5. simplifying the tax system, including consideration of appropriate administrative arrangements across the Australian Federation; and
 - 3.6. the interrelationships between these systems as well as the proposed emissions trading system.
4. The review should make coherent recommendations to enhance overall economic, social and environmental wellbeing, with a particular focus on ensuring there are appropriate incentives for:
 - 4.1. workforce participation and skill formation;

- 4.2. individuals to save and provide for their future, including access to affordable housing;
 - 4.3. investment and the promotion of efficient resource allocation to enhance productivity and international competitiveness; and
 - 4.4. reducing tax system complexity and compliance costs.
5. The review will reflect the Government's policy not to increase the rate or broaden the base of the GST; preserve tax-free superannuation payments for the over 60s; and the announced aspirational personal income tax goals.
 6. The review's recommendations should not presume a smaller general government sector and should be consistent with the Government's tax to GDP commitments.
 7. The review should take into account the relationships of the tax system with the transfer payments system and other social support payments, rules and concessions, with a view to improving incentives to work, reducing complexity and maintaining cohesion.
 8. The review should take into account recent international trends to lower headline rates of tax and apply them across a broader base, as well as domestic and global economic and social developments and their impact on the Australian economy.
 9. The review will also incorporate consideration of all relevant tax expenditures.

Composition and consultation

10. The Review Panel will be chaired by the Secretary to the Treasury, Dr Ken Henry AC and will also comprise Mr Greg Smith (Australian Catholic University); Dr Jeff Harmer (Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs), Mrs Heather Ridout (Australian Industry Group CEO); and Professor John Piggott (University of New South Wales).
11. The Review Panel will be supported by a working group from within the Treasury, with representation from the Department of Families, Housing, Community Services and Indigenous Affairs, and drawing on other Australian government and state agencies as appropriate.
12. The Chair may task members of the Review Panel to oversee programs of work related to their field of expertise.
13. The Review Panel will consult the public to allow for community and business input.
14. The review will also, where necessary, draw on external expertise and shall have the cooperation of state governments and their Treasuries as well as relevant COAG working groups.
15. The Minister for Families, Housing, Community Services and Indigenous Affairs will provide input on issues related to transfer payments, family assistance and retirement incomes.

Structure and timing

16. The review process will be conducted in several stages. These will follow the release of an initial discussion paper by Treasury on the architecture of the tax system and an examination of the existing tax rates and bases (excluding the GST). The paper will be released by the end of July 2008.
17. The Review Panel will provide a final report to the Treasurer by the end of 2009. The Government will respond in a timely way to the tax review's recommendations as they are released.

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Executive summary

The task

This Review considers how Australia can best structure its tax and transfer system to meet the challenges of the 21st century and to enhance its economic and social outcomes.

Australians face far-reaching change. As we navigate that change, our challenge is to maintain our strengths, sustain our values and fulfil our promise.

The Review looks forward over the next 40 years to mid-century. Through these decades we expect:

- a new world economic order based on ever-deepening international integration, with new centres of competition and opportunity increasingly located in close proximity to us;
- the transformation of business, commerce and personal lives by technological advances, especially in digital electronics and communications;
- ageing of the population, reducing some tax bases and raising the costs of health, aged care and dependency;
- strong growth and cultural diversification of our population, with high demands for economic infrastructure, education and social infrastructure spending;
- deepening stresses between human activities and wider ecosystems, globally and locally; and
- further stresses on housing affordability and pressure on urban amenity.

Unfortunately, we must also assume that the world will continue to present high risks of conflict imposing high security costs.

Our task is to define a tax and transfer system that anticipates and responds to those expectations. We find that much of the key architecture of the existing tax and transfer system, built last century, reflects sound policy frameworks and Australian social values and will still serve us well.

But not all of it will – a range of key reforms would even better equip us for the changing era ahead.

The setting

Through this period, we expect that the Australian economy can continue its well-established high rate of economic expansion, provided policy reforms continue to support growth and structural change. This is vital for us. It will ensure that Australians can continue to deliver all of the things they most value — including improving living standards, support for the needy, fairness, social advancement, security and protection of the environment.

Policy reforms over the past quarter century, particularly those that have made the economy more flexible and responsive to price changes, have contributed to a remarkably resilient economy. Australia's strong growth continued through the Asian financial crisis of 1997–98 and the recession in the industrialised world in 2001, and Australia has been the strongest performing developed economy through the 2008–09 global financial crisis. Since the early 1990s, our per capita incomes have moved up the OECD rankings and we have maintained an equitable pattern of overall income distribution.

We expect that Australians will find their futures best secured by much the same overall balance of complementary public and private activity that has prevailed for many years, though its style and structure should continue to respond to changing needs and opportunities. We do not expect total tax burdens will rise in the next few years, but some increases in later times may be unavoidable. The combination of ageing and high population growth will contribute to a considerable increase in public investment needs, and in spending on services, and it will be important that this be funded in ways that improve public saving over time so that our national saving effort is increased and our fiscal strength maintained. We need a tax system that is robust and efficient, and that can adapt to changing future circumstances.

Most of all we need a tax and transfer system that is oriented to supporting strong and sustainable economic growth. We need policies that not only redistribute income but also promote the growth of incomes at all levels, including through high-quality investment in the nation's infrastructure. This means more capital per worker, more workforce participation and higher creativity and skills.

Our anticipated high population growth and continuing economic growth will also put pressure on our increasingly fragile ecosystems. To ameliorate this pressure a suite of policy interventions will need to be considered, including environmental taxes where appropriate, along with targeted stewardship and statutory duty of care programs.

We also want a tax system that fully exploits the opportunities of the new digital age and integrates neatly with the new ways we live our lives and conduct business. As far as possible, we want to enmesh the tax and transfer systems into our economy and society in ways that, while transparent, are simple and unobtrusive. This means simplifying, coordinating, making transparent and automating the operating elements of the tax and transfer systems.

The vision

A 21st century tax and transfer system should meet its purposes efficiently, equitably, transparently and effectively. Critically, it would support per capita income growth rates at the upper end of developed country experience by encouraging high workforce participation, a more efficient pattern of saving, and stronger investment in education and physical capital. It would be robust, capable of supporting large structural change, dealing with unforeseeable external shocks and encouraging patterns of economic activity that prove fiscally and environmentally sustainable. It would support economic dynamism and diversity. Through both its direct and indirect effects, it would support the commitment to Australian values of fairness, and support for those who are disadvantaged. It would exploit opportunities to reduce compliance costs and make interactions with the tax and transfer system easier, more certain, and more understandable. It would enhance the accountability of governments to their citizens.

The future architecture

The Review has identified a wide range of reform opportunities that can deliver this vision. The main directions and proposals are presented here in nine broad themes. A full listing of recommendations appears at the end of this Part, and their supporting analysis is provided in Part Two.

1. Concentrating revenue raising on four efficient tax bases

Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax and transfer systems. The capacity of the legislative and operating platforms of these systems, and their human users, to deal with the resulting complexity has been overreached. The tax and transfer architecture is overburdened and beginning to fail in dealing efficiently and effectively with multiplying policy goals and demands. Rationalisation of the tax and transfer architecture should now be a strategic priority.

Key directions

- Revenue raising should be concentrated on four robust and efficient tax bases:
 - personal income, assessed on a more comprehensive base;
 - business income, with more growth-oriented rates and base;
 - private consumption, through broad, simple taxes; and
 - economic rents from natural resources and land, on comprehensive bases, noting that revenue from rent taxes will likely be more volatile than from the existing resource royalties it will replace.

- Other taxes should be maintained only if they efficiently address social or economic costs — such as taxes on tobacco, alcohol, gambling and environmental costs, and efficient road user taxes or charges.
- In time the following taxes should be abolished and their revenues replaced by taxes applying to the four robust and efficient tax bases:
 - insurance taxes;
 - payroll tax;
 - property transfer taxes;
 - stamp duties on the purchase of motor vehicles;
 - resource royalties, replaced by the rent tax;
 - luxury car tax;
 - the tax on superannuation contributions in the fund;
 - income taxes on all government pensions, allowances and benefits; and
 - fuel and vehicle registration taxes, if replaced by more efficient road user charges.

2. Configuring taxes and transfers to support productivity, participation and growth

The continued strength of long-term economic growth is vital for Australia, and will determine future incomes and living standards at all levels. The reforms in this Report could potentially increase national output by around 2 to 3 per cent, or around \$25 billion to \$40 billion in 2010–11 values over the long term. Long-term growth is supported by increasing workforce participation and by increasing productivity, including through stronger investment. Both tax theory and research evidence strongly suggest that the architecture of taxes has a major impact on each of these. Workforce participation is strongly influenced by incentives in the tax and transfer system, and by the affordability of quality child care. Productivity is increased by more efficient tax bases, support for skill acquisition and ensuring the efficient and timely supply of infrastructure. Investment is particularly supported by lower company income tax rates. Higher economic growth promotes higher wage growth, and provides revenue growth to fund income transfers and community services. A number of other countries with strong social support policies have at the same time increasingly adopted strongly pro-growth tax structures. Accordingly, Australia should configure its tax and transfer architecture to promote stronger economic growth through participation and productivity.

Key directions

- Maintain the company income tax rate towards the lower end of the small to medium OECD economy average, with a reduction to 25 per cent over the medium term. This aims particularly to increase the level of business investment in Australia across all sectors, including foreign direct investment; promote more entrepreneurial activity; and reduce incentives for profit-shifting offshore.
 - A business-level expenditure tax could suit Australia in the future and is worthy of further consideration and debate, along with a reconsideration of dividend imputation's place in an internationally integrated economy.
- Promote higher workforce participation through:
 - improving support for quality child care;
 - building clear work incentives into the levels of income support payments; and
 - targeting means tests to facilitate higher workforce participation by groups with differing participation opportunities and expectations. Steeper means test withdrawal rates should anticipate full-time participation by those fully able to work, now or in the near future, but they should anticipate, through gentler withdrawal rates, part-time work for others, including pensioners and students.
- Within practical limits, lift productivity through more efficient and neutral taxes:
 - for business risk, an improved treatment of business losses, with a one-year carry-back of company losses;
 - for investment in productive assets, streamlined and enhanced capital allowance arrangements, including allowing low-value assets to be written off, with a high threshold for small business, and streamlined small business capital gains tax rules; and
 - for investment of personal savings in the presence of inflation, a common 40 per cent discount for interest, net residential rents and capital gains.
- Increase the efficiency of use and investment in roads by a program of road reforms that includes greater use of road user charges, including congestion charges.

3. An equitable, transparent and simplified personal income tax

The personal income tax system will remain Australia's largest source of tax revenues. The personal tax structure should be the sole means of delivering progressivity in the tax system, supporting the even more direct distributional role of the transfer system. Personal tax compliance has become inordinately complex, and complexity hides its policy intent from citizens. An opportunity exists to greatly simplify personal tax, to make its policy more transparent, and to use 21st century technologies to make it fairer, easier to comply with, and more robust. At the same time, personal tax can be better coordinated with the transfer system.

Key directions

- A much higher personal tax-free threshold, around \$25,000, should replace the current complex array of thresholds and offsets.
- All pensions, allowances and other transfer payments should be tax-free.
- A simple transparent two-step tax scale should apply.
- Deductions and offsets should be rationalised — with most work-related deductions replaced by a standard rate of deduction linked to the level of income from work.
- Progressivity of the tax system should be enhanced by including all forms of work remuneration in personal tax returns — including employer superannuation contributions (see below for new concession framework) and the main fringe benefits.

4. A fair, adequate, and work supportive transfer system

The overall architecture of Australia's transfer system is well founded — it is focused on poverty alleviation, clear targeting and sustainability. The Pension Review developed adequacy benchmarks for age, disability and carer pensions paid to those where there is limited or no expectation of work. Adequacy benchmarks are also required for other government payments, but these must also address incentives to work. In the 21st century, given both changing social expectations and increasing age dependency, there will be a greater expectation that those who are able to support themselves through work will do so. This Review provides strategic directions for these arrangements, relating to income support, student assistance and assistance for children and parents. Once established, the adequacy of payments should be maintained by common indexation arrangements. While full integration of the tax and transfer systems is not practicable given their different objectives, better coordination between them is possible.

Key directions

- Three levels of primary support payment should be established — pensions for the aged, disabled and carers; lower-rate participation allowances for those of working age; and assistance payments for young people and students — each with means test withdrawal rates reflecting different work expectations.
- Once adequacy benchmarks are reached, they should be preserved by common indexation arrangements applied to each of the main payment types.
- Following the Pension Review changes, the relativity between single and couple payments should be improved across other payment types.
- The assets test should be abolished, and a comprehensive means test base established for the main pension and allowance payments (including for Rent Assistance to prevent additive withdrawal rates). Income from savings would take the form of deemed returns from assets.
- Family assistance should be paid through a single program principally based on the assessed additional costs of children, in general increasing with age, and means tested in accordance with family taxable income on the same base as for income tax.

5. Integrating consumption tax compliance with business systems

Consumption spending, if broadly defined, is potentially an efficient and robust tax base. The introduction of the GST made Australia's consumption tax base more efficient because it replaced a range of narrowly based Commonwealth and State taxes. However, the GST is itself an operationally complex tax, designed on tax invoice concepts more suited to the documentary standards of the 1960s than the digital potential of the 21st century. Moreover, Australia retains some other inefficient State taxes on consumption (such as insurance taxes) and a narrow payroll tax. It would be possible to replace the current narrow State taxes base (including payroll tax) with a low-rate, broad cash flow tax that exempts business export sales, more effectively utilising the consumption base. By using existing tax reporting mechanisms, the new tax could more readily be based on the automated systems increasingly used by businesses.

Key directions

- Inefficient State taxes (including the current payroll tax) could be replaced by a low-rate destination cash flow tax, with revenues allocated to fund State services.
- Replace the current inefficient input taxation of financial services under the GST with a more efficient financial services tax, developed in consultation with the industry.

6. Efficient land and resource taxation

The returns to immobile factors of production constitute an efficient tax base. A rent-based tax would ensure the right levels of exploration and extraction and provide sufficient encouragement for private sector participation. A tax on high-value resource rents would on average over time likely raise higher revenues than existing output-based royalties. There are several alternative mechanisms for applying a rent-based tax, and transitional arrangements are critical.

A land tax is efficient if it is broadly based. Existing land taxes are quite inefficient because they are not broadly based, and rates vary according to land use and landholding aggregation rules. An efficient land tax would apply equally to all land uses and aggregate holdings, but could have a threshold and different rates based on the value per square metre of land. In practice this could mean that most land in lower-value use (including most agricultural land) would not face a land tax liability and the tax would apply moderate rates to most other land. Transitional rules will be critical in changing the basis of land taxes, to smooth valuation effects and to allow ample time for those affected to make adjustments to their investments in land.

Key directions

- Except for low-value commodities, existing resource royalties should be replaced by a project-based uniform resource rent tax set at 40 per cent.
 - Resource taxation should include a symmetric treatment of losses and be based on the capital allowance rather than cash flow method of assessment.

- With appropriate transition rules, the new tax should apply to both new and existing projects.
- The Australian and State governments should negotiate an appropriate allocation of the revenues and risks of the tax.
- Existing land tax arrangements should be replaced, subject to a long transition to slow valuation effects and facilitate landholding adjustments, by a land tax applying to all land regardless of use. The rate scale would be based on the value per square metre of land.
 - A unit value threshold would effectively exempt most land in agricultural use.
 - Most residential land could be subject to tax of about 1 per cent. A higher rate may apply to the highest value land (per square metre).
 - Land tax revenue would also replace stamp duties on land transfers.

7. Completing retirement income reform and securing aged care

The Review's interim report on retirement incomes was released in May 2009. It supported the basic framework of the current system, and made a range of recommendations for improvements. However, the Review did not address all issues because it wanted to consider many of these in the context of other proposals. There is scope to improve the equity and simplicity of the superannuation arrangements, and in doing so it is also possible to increase the effective rate of savings delivered by the superannuation system. The Review proposes that these changes be made and sees them as taking Australia's superannuation system towards its logical design conclusion — as a subsidised expenditure tax. This is important, because there has been concern that superannuation has undergone constant change.

Aged care is a major challenge for Australia with rapidly increasing demand. The Review proposes some reforms in this area. It notes that this may be an area requiring compulsory levies, on all taxpayers.

Key directions

- The tax on superannuation contributions in the fund should be abolished, increasing saving from currently taxed contributions by 17.5 per cent.
- Instead, employer superannuation contributions should be included in employee taxable income. Subject to annual limits, all contributions would attract a tax offset payable to contributors.
- All income and gains of superannuation funds should be taxed at a rate of 7.5 per cent, further increasing savings.
- The \$50,000 transitional cap for contributors aged 50 or older should be continued indefinitely.

- Superannuation balances should be included in Age Pension means tests on the same basis as other savings.
- The development of longevity insurance products should be encouraged and the government should consider offering such products itself.
- Care services for the aged should in general be separated from accommodation choices and provided on a means tested basis – preferably, any future compulsory funding levies should apply to all personal taxpayers and not be linked only to the superannuation guarantee.

8. Toward more affordable housing

Over the past decade, large parts of Australia have experienced worsening housing affordability problems. Rising housing prices have been underpinned mainly by rising residential land values (with high construction costs contributing in some cases, particularly in remote areas). While the overall demand for housing is increased by favourable tax and transfer provisions particularly for owner-occupied housing, these provisions are of very long standing and have deep community support. The sharp deterioration in affordability in recent times is more likely to reflect demand and supply factors such as high rates of immigration and household formation and government land use policies. The Review anticipates continued strong population growth and continued overall favourable tax-transfer treatment of owner-occupied housing. On that basis it has considered whether other features of the tax and transfer systems are appropriately configured to maintain fairness and efficiency in housing markets. It proposes a series of changes that would improve equity and market efficiency – but policy changes outside the tax and transfer systems will be necessary to better match aggregate housing supply and demand if overall housing price pressures are to be alleviated.

Key directions

- Maximum rates of Rent Assistance for income support recipients should be substantially increased and linked to movements in market rents.
- Subject to transition arrangements, public housing rent concessions should be replaced by Rent Assistance and a new form of assistance for high-needs tenants, to improve equity and work incentives.
- Over a long transition period, a land tax should be introduced on all land on a more efficient and uniform basis linked to unit land values, removing disincentives for institutional investment in rental property and integrated over time with property rate assessments.
- Over a similar period, transfer taxes on property should be reduced, and ultimately removed, with revenues replaced by efficient taxes, preferably annual land tax.
- Subject to transitional provisions, and following action to improve the current shortfall in housing supply, a more neutral personal income tax treatment of private residential rental investment should be introduced, with less volatile market effects, through a 40 per cent discount on all net residential rental income and losses, and capital gains.

9. A more open, understandable and responsive tax system

Both tax policy-making and administration should be as responsive as possible to problems experienced by taxpayers. This requires a more transparent and understandable system, with citizens having clear rights to information on the tax system and their experience with it. It also requires more effective mechanisms to respond to both policy and administrative issues as they arise. Further, it is critical that the integrity of the tax system be maintained and that threats be promptly dealt with as they emerge.

Key directions

- In time, citizens should be able to access, through a suitable choice of channels, comprehensive and timely information on their tax and transfer affairs, and be able to see and interpret how their tax and transfer outcomes have arisen and may be affected by choices they may make.
- The Board of Taxation should be empowered to initiate its own reviews of how current tax policies and laws are operating.
- A board should be established to advise the Commissioner of Taxation on the general organisation and management of the ATO.
- The government should ensure that sufficient resources are devoted to the Inspector-General of Taxation, the Australian National Audit Office and the Commonwealth Ombudsman, and clarify that the role of the Inspector-General of Taxation is to examine systemic tax administration issues that affect businesses.
- Governments should make available data and publish analyses of taxes and transfers to inform and encourage community debate about the performance of the tax and transfer system. High standards of transparency and accountability should apply to all taxes, transfers and government spending.

Pathway to reform

This Review has aimed to set the strategic directions for the future architecture of the Australian tax and transfer system. It has not produced a one-off tax policy package, and it has not advanced the detailed design or timing of measures. Indeed, it is neither possible nor desirable to make all of these changes too quickly.

There are several reasons for this approach:

- First, taxes and transfers are instruments of government policy — they rarely provide a full expression of the underlying policy itself in isolation from other policies. There are critical links between tax and transfer policies and the other policies of government — mainly regulatory and expenditure policies. The future implementation of many tax and transfer policies depends on developments in this broader fabric of policy. For example:

- retirement income policies must take account of expected future policies for funding the rapid escalation of costs of health and care for the aged;
 - transfer system support for child care depends on the development of the capacity and regulation of the quality of child care services;
 - the effectiveness of tax arrangements for housing, and of housing assistance transfers, depends critically on future land and housing regulatory policy;
 - road tax and charging reform depends critically on reform to the institutional and reporting framework of road providers; and
 - the best assignment of taxes by level of government depends on models for future funding of major programs in areas like health, education, welfare and transport.
- Second, as the Review has addressed a vast field of policy, it is inevitable that some changes will be timed differently than others. This creates the need for future policy-makers to ensure that desired balances are maintained on an ongoing basis, but it is not practical for the Review to anticipate or prescribe in advance all of those sequencing challenges.
 - Third, policy reforms are usually aimed at changing market or other behaviours and outcomes, but such responses are rarely instantaneous. Markets, businesses and households need adjustment time. Many reforms will need further consideration closer to the time of implementation.
 - Fourth, the Review has been asked to look at taxes and transfers at all levels of government. Clearly, implementation will require agreement at the intergovernmental level, and will require detailed assessment of financial implications – likely in more than one step.
 - Fifth, tax reform should not be pursued independently of fiscal and macro-economic circumstances. Australia, and perhaps more importantly the rest of the world, is not currently experiencing typical economic times. Policies that suit the long run, which is the focus of the Review, may not necessarily be best implemented in these atypical times. Governments need the flexibility to pursue changes in accord with fiscal and other macroeconomic conditions, and the Review has not attempted to predict or anticipate that future pathway.
 - Sixth, policy changes that affect the distribution of income and benefits always confront the fact that many people have arranged their affairs on the basis of prior or existing policies. Adjustment itself has costs and requires time, and sometimes help is essential. Where adjustment is costly for the welfare of those affected, other provision may need to be made. The Review has not attempted to define every one of these possibilities and recognises that future policy decision-making will need to take these issues into account.

In drawing attention to all of these issues, however, the Review is by no means advocating a slow boat to reform. A number of the recommendations in this Report, if they were to be implemented immediately and without compensating changes elsewhere, could be represented as leading to losses of real disposable incomes (or real wealth) for some people in the community. Recognising the implementation challenges posed by such recommendations, the Panel has nevertheless decided to state clearly its views on what a future tax and transfer system should look like. The Panel sees no value in ignoring those features of the present system it strongly believes have no place in a 21st century architecture, for no better reason than some Australians currently gain more than others from those features.

The Panel appreciates that reform packages constructed on its recommendations will take some account of static distributional impacts, but considers that such accounting should not result in a failure to implement recommendations that would produce a tax and transfer system of enhanced durability, integrity and equity.

Australia's future success depends vitally on a robust approach to an ongoing reform agenda, and this will rely on support from all sections of the community. To maintain strong forward momentum, the Review recommends that all governments, and institutions such as the Council of Australian Governments (COAG) and the Productivity Commission, should be charged with the task of pressing ahead with reform implementation on an open, transparent basis.

Part One: Overview

1. The need for reform

Over the past 30 years, Australia's tax system and transfer system have undergone an almost continual process of reform in response to a changing policy context and as problems have been identified with existing policy settings. These reforms have underpinned Australia's fiscal position and the fairness of the tax and transfer system and contributed to Australia's strong economic performance over the past two decades.

In particular, this reform process has contributed to the remarkable resilience of the Australian economy, which has experienced uninterrupted growth through the Asian financial crisis of 1997-98 and the recession in the industrialised world in 2001. Australia has been the strongest-performing developed economy through the 2008-09 global financial crisis. Since the early 1990s, Australia's per capita income has moved up the OECD rankings, while an equitable pattern of overall income distribution has been maintained.

But Australia is now facing a different set of economic, social and environmental circumstances to those that have shaped tax and transfer policy since federation. Emerging demographic, health and other pressures on budgets at all levels of government, and expected challenges to our economic circumstances, call into question the durability of the tax and transfer system. The re-emergence of the Asian region as a centre of world economic activity together with increasing globalisation, characterised by increasing mobility of capital and to a lesser extent labour, will have a further profound effect on how investment is taxed and will increase the need for tax and transfer policy settings that support productivity growth.

In addition, changes to tax policy are required as part of the concerted response to help mitigate emerging environmental pressures. Developments in technology are also transforming the way businesses operate and people live, as well as opening new opportunities in the administration of taxes and transfers. Further, there is a need to create a more sustainable tax structure.

The breadth of this Review, spanning taxes and transfers at all levels of government, has provided a unique opportunity to consider how Australia can best structure its tax and transfer system to anticipate and respond to these challenges and opportunities. Policy settings that support economic growth and structural change will ensure that the living standards of Australians continue to rise and that they can continue to live in a society that supports the needy, is fair, enables social advancement and values the environment. Maintaining strong growth will require increased workforce participation, higher levels of capital per worker and support for entrepreneurial creativity and skill formation.

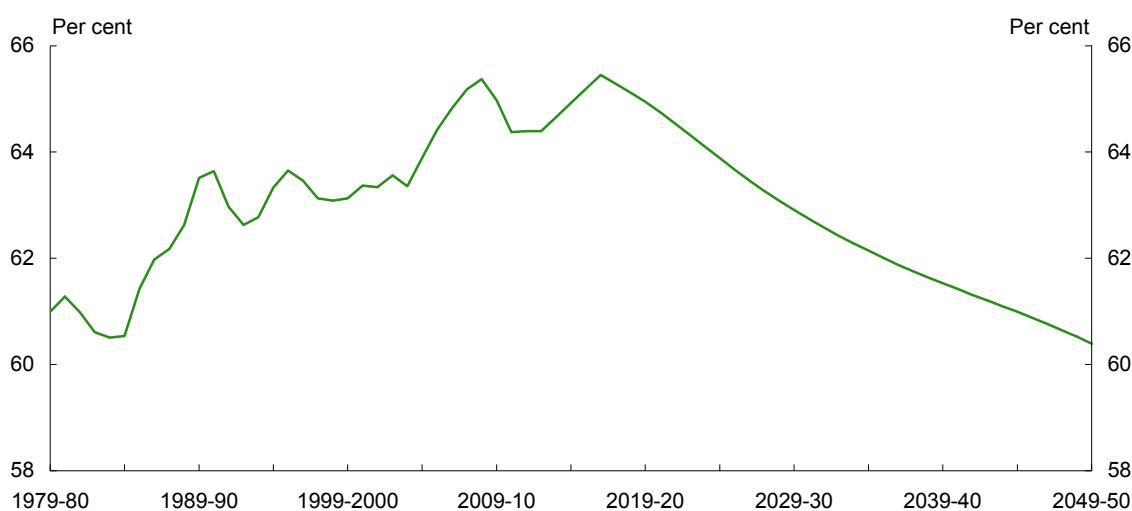
1.1 Demographic change in Australia

By the middle of this century, Australia's population is projected to rise to around 35 million (Treasury projections), an increase of around 60 per cent from today. The proportion of

Australians aged 65 years¹ or older is projected to increase to 22 per cent, from 13 per cent today. Even more remarkably, the proportion of Australians aged 85 years or older is projected to treble to 5 per cent.

The proportion of Australians in work or looking for work is projected to stabilise and then decline significantly over this period. This is in stark contrast to the rising participation trend over the past few decades (see Chart 1.1). It means that demographic change will shift from being a positive influence on income growth per person to a negative one. Coupled with this, the old age dependency ratio (people aged 65 years or older as a proportion of people of working age) is projected to double by the middle of the century. In 40 years time there could be just 2.7 people of working age for each person aged 65 years or older, compared with 5.0 people today and 7.5 people 40 years ago.

Chart 1.1: Participation rate^(a)



(a) The participation rate is the proportion of the population aged 15 years or older in work or looking for work. Source: Treasury projections.

The projected increase in the population and the higher proportion of older Australians bring rising costs of new economic and social infrastructure, health and aged care and dependency. The *Intergenerational Report 2007* (Australian Government 2007) projected that over the subsequent 40 years, Australian government expenditure requirements would increase by more than 4 per cent of gross domestic product (GDP). The Productivity Commission (2005) has projected that, in addition, State spending requirements could increase by around 0.8 per cent of GDP. Demographic change, and in particular the ageing of the population, is expected to account for a sizeable part of the projected increase in government spending. Health expenditure is also projected to increase significantly over the next 40 years, due in part to the ageing of the population, but also because of increased demand for health services in the broader community.

The demand for affordable aged care services is expected to increase significantly as the proportion of older Australians increases and so too does their average life expectancy. Ensuring equitable access to care will be an important challenge, as the availability of

1 In response to the Review's recommendation in its report to the Treasurer on retirement incomes, the Australian Government announced in the 2009-10 Budget the phased introduction of an increase in the Age Pension age, from 65 to 67 years.

affordable, quality aged care has the potential to affect the lives of Australians of all ages through its effects on government spending and the availability of people to work.

Our ageing population will also test the adequacy of the retirement income system. With the fastest rate of population growth projected to be among Australians aged 85 years or older and increasing life expectancies, there will be more interest in mechanisms to enable people to finance a higher level of income and services throughout their retirement.

If these projections prove correct, government budgets will need to change. One option would be to reduce other areas of government spending. Another would be to increase revenue. The latter would present particular problems for the States, whose existing taxes are relatively inefficient and have limited revenue-raising capacity. It would therefore be prudent to design a tax system now that would be capable of delivering higher tax revenues efficiently in future decades, should that prove necessary. Increasing the revenue-raising capacity of the tax system would require a greater emphasis on broad-based taxes.

To highlight the scale of the fiscal challenge, financing the projected increases in Australian and State government spending would be equivalent to the entire revenue raised by the GST.

Timely policy responses, including through the tax and transfer system, to boost workforce participation and lift productivity could ameliorate some of the projected impacts of demographic change. For example, in response to the Review's recommendation in its report to the Treasurer on retirement incomes, the Australian Government announced in the 2009-10 Budget the phased introduction of a higher Age Pension age, of 67 years. More generally, opportunities exist to reduce the cost that the tax and transfer system imposes on growth through disincentives for people to work and distortions to the allocation of investment and productive resources. This would increase productivity, raise incomes and make the task of financing future government expenditure less burdensome.

1.2 A changing social context and expectations

Changes in the structure of the Australian economy and attitudes toward workforce participation by women have resulted in greater diversity in work patterns. Australians are also expecting better community living standards over time. In addition to the rising demand for health, aged care services and disability support and services, there is pressure to increase spending on child care, housing and education.

A changing labour market

Over the past 30 years the predominance of full-time male workers in the labour force has given way to increased part-time work by men, increasing workforce participation and employment periods of women, and increasing numbers of older workers. These trends may continue for some time. The composition of the workforce is likely to continue to change, given that the participation rates in Australia of prime-age men, women of child-bearing age and older people are still below those in many other OECD countries. Australia ranks 6th lowest of 30 OECD countries in terms of the participation of prime-age males; 8th lowest for women of child-bearing age; and 13th for older men and women in the OECD (Abhayaratna & Lattimore 2006).

Changes have resulted in a more flexible labour market, but have increased the complexity in people's lives as they balance work with education, caring responsibilities and preparation for retirement. There are fewer single-income family households, and more dual-income family households as well as those without any private income. The increasing prevalence of part-time work has increased the role of income support as an income supplement for people in work. As a consequence, high effective rates of tax, due to the cumulative effect of personal income tax and the withdrawal of income support and family assistance, affect a large number of people.

Increasing female workforce participation has also focused attention on the balance between nurturing children and paid work. The introduction of a paid parental leave scheme will enable almost all primary caring parents to stay with their infants for the first six months.

However, extended labour market absences become more critical to the longer-term employment prospects of carers, which may be detrimental to their and their children's longer-term wellbeing. The interaction of tax and transfer rules can create disincentives for women of child bearing age to re-enter the workforce. Another issue is access to affordable high-quality child care, which has a major impact on family wellbeing, particularly in the case of the primary caring parent returning to work while children are young.

Rising expectations about community living standards

Over the past decade, housing affordability and vacancy rates for rental accommodation have declined over large parts of Australia. The sharp deterioration in affordability reflects an emerging housing shortage due to rising demand and constraints in supply. The housing market is expected to remain tight over the next few years. Concern is also being expressed about the existing arrangements for accessing public housing. Rationing of public housing can lead to inequitable outcomes, result in a poor alignment between housing and need, and discourage tenants from working or moving.

Individuals and the business community are demanding higher standards of education at all levels and greater access to higher education. Retraining can be an important step in re-entering the labour market during periods of economic adjustment.

While many policies affecting these issues are beyond the Review's terms of reference, the design of the tax and transfer system is relevant to them all. At a minimum the tax system will need to fund community access to these services. The design of the tax and transfer system may also influence how people pay for these services and the level of assistance they receive to acquire them, or assist people to save so they can afford them.

1.3 The rise of Asia and the shifting centre of world economic activity

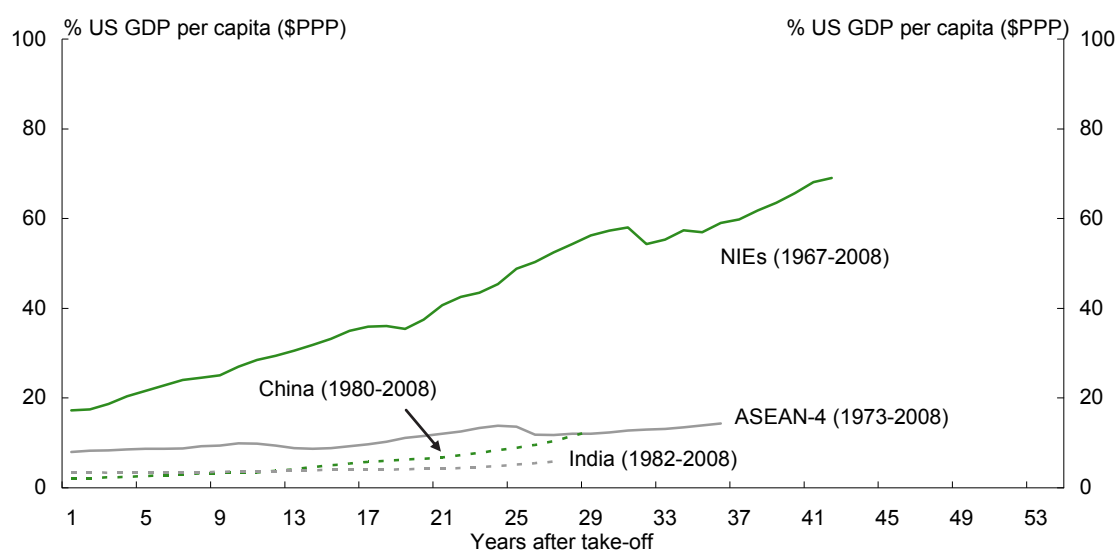
The Australian economy is being transformed by the emergence of new centres of competition and opportunity in the region. The shift of the centre of gravity in the world economy towards Asia is reducing the distance between Australia and its export markets, adding considerable value to our natural resource wealth and opening new investment, trade and employment opportunities. However, growth in Asia will also attract globally mobile capital. Australia will need to respond if it is to remain an attractive place to invest

and do business. Part of this response should be to ensure that the tax system supports investment, allocates resources to their most valued uses and does not inadvertently add to the cost of production through taxes on business inputs or excessive complexity and compliance costs.

With much of China and India at an early stage of catching up with the living standards of the developed world, strong growth in these countries could continue for a long time (see Chart 1.2). It is therefore likely that demand for non-renewable resources will remain strong and underpin, for some time and possibly for decades, a structurally higher terms of trade² than existed for much of the past 50 years. This view appears to be shared by investors, as evidenced by strong international interest in investing in the Australian resources sector.

It would be a mistake to conclude that the prospect of a continuing high terms of trade would translate into increased wealth for all or underpin a broad employment base. The expansion in the resources sector and a stronger exchange rate will continue to draw productive resources from other parts of the economy. Policy responses that expand the supply of productive resources in the economy may ameliorate this adjustment and support a more broadly based economy. Tax and transfer policy settings can influence the effective supply of labour and capital through their effects on the incentives to save, invest and work, and by improving the productivity of labour and capital.

Chart 1.2: Per capita GDP convergence for selected Asian countries



Note: The lines show the paths of GDP per capita relative to the United States in selected Asian countries, commencing at the time of 'take-off' in their economic growth. The first year of take-off for economies, excluding China and India, is the year when the three year moving average of constant price export growth first exceeded 10 per cent. The first year of take-off is 1980 for China and 1982 for India. The ASEAN-4 consists of Indonesia, Thailand, Malaysia and the Philippines. The newly industrialised economies (NIEs) consist of Hong Kong, Korea, Singapore and Taiwan.

Source: The Conference Board Total Economy Database (2009), IMF (2009a) and Treasury estimates.

2 The terms of trade represent the relationship between export and import prices. Australia's terms of trade are calculated by dividing the implicit price deflator for exports by the implicit price deflator for imports (ABS 2000).

1.4 Increasing globalisation

With continuing globalisation, tax settings will be of increasing importance for decisions about where capital will be invested, especially for small open economies like Australia.

Many countries are reducing tax rates on business and capital income relative to labour income and consumption. There has been a clear downward trend in statutory company income tax rates, particularly among small open economies (Table 1.1). Empirical evidence indicates that company tax rates matter for investment decisions, particularly investments for which location is not critical, and decisions by firms about where to declare profits and pay tax.

Table 1.1: Statutory company tax rates by size of economy

	Average statutory corporate income tax rate ^(a)		
	2000	2004	2008
Large-sized OECD countries United States, Japan, Germany, United Kingdom, France, Italy	39.5	36.0	33.1
Medium-sized OECD countries Canada, Spain, Korea, Mexico, Netherlands, Australia (30%)	35.7	33.1	29.1
Small-sized OECD countries Belgium, Switzerland, Turkey, Sweden, Austria, Poland, Norway, Greece, Denmark, Ireland, Finland, Portugal, Czech Republic, Hungary, New Zealand, Slovak Republic, Luxembourg, Iceland	30.9	26.6	23.6
OECD total	33.6	29.8	26.6

(a) Unweighted averages.

Source: Heady (2009).

Australia reduced its company tax rate over the period from the late 1980s to 2000. This adjustment was an important element of policy reforms that have led to strong growth. A continuation of this responsive adjustment would underpin further growth.

Increasing capital and labour mobility will result in strong competition for capital, especially direct investment. Foreign direct investment in Australia as a share of GDP is low in comparison to many developed countries. The significant growth in the stock of foreign investment in Australia over the past 20 years has been largely in the form of portfolio equity and debt. This is likely to reflect our tax settings, at least to some extent. While it is likely that the strength of our financial sector will continue to ensure access to debt financing, and that the resources sector will have little difficulty in attracting foreign direct investment, the relatively high costs imposed on foreign direct investment by Australia's 30 per cent company income tax rate may make it harder for other sectors of the economy to secure capital.

With increasing globalisation, people's choices about where to work may also become more sensitive to tax. Several submissions to the Review have highlighted the increasing international mobility of people, particularly of the more highly skilled. The flow of skilled workers into Australia has generally exceeded the outflow. However, in the future, population ageing in Australia and many other countries could lead to increased competition for skilled labour and more opportunities for Australians to work abroad.

National savings

Australia has benefited enormously from running current account deficits to finance levels of investment that are high by OECD standards. However, the global financial crisis highlights the potential risks associated with high levels of economic integration between countries, particularly where there are prolonged and large global macroeconomic imbalances. Due to a combination of sound regulation, a flexible economy, responsive policy and a generous endowment of natural resources, Australia has fared relatively well, despite its history of relatively large current account deficits. Coming out of the global recession, Australia's current account deficit is likely to continue to widen and possibly stay at historically high levels for some time – but due to continued high investment rather than low national savings.

Nevertheless, the potential risks and vulnerabilities arising from a high current account deficit can be mitigated by ensuring a strong national savings effort. There appear to be three important points of intersection between a strong national savings effort and the tax and transfer system.

- The first and the most critical is for Australia to maintain its strong public sector balance sheet, which more recently has enabled governments to fund both public investment and recurrent spending. It has also provided flexibility for the government to respond to the global financial crisis without exposing Australia to undue credit risk. Maintaining a strong balance sheet reinforces the need for broad and robust tax bases.
- Second, some additional forms of insurance might be appropriate to enhance national savings and help pre-fund community needs arising from ageing and disability, but the mode and delivery would need to be carefully considered. Ideally, it should be universal, applying to all taxpayers.
- Third, other private savings such as superannuation, and a more balanced tax treatment of household borrowing and saving, should continue to assist the national savings task.

It will also be important that investment financed by current account deficits is allocated to its most productive uses and that the choice of equity or debt financing reflects sound commercial considerations. A more neutral tax treatment of investment and financing choices would encourage this outcome.

1.5 Growing environmental pressures

Awareness of the fragility of Australia's natural environment is increasing – especially environmental pressures emerging in areas such as land degradation, species decline, water use and climate change. The projected increase in Australia's population over the next 40 years, together with continued economic growth, will put pressure on our increasingly fragile ecosystems. It will also place pressure on our cities and their supporting infrastructure.

Quite apart from the intrinsic importance that many people ascribe to a healthy environment, our economic growth prospects are strongly linked to environmental sustainability. The environment provides natural resources essential to Australia's productive capacity, and ecosystems that absorb and assimilate the waste generated by

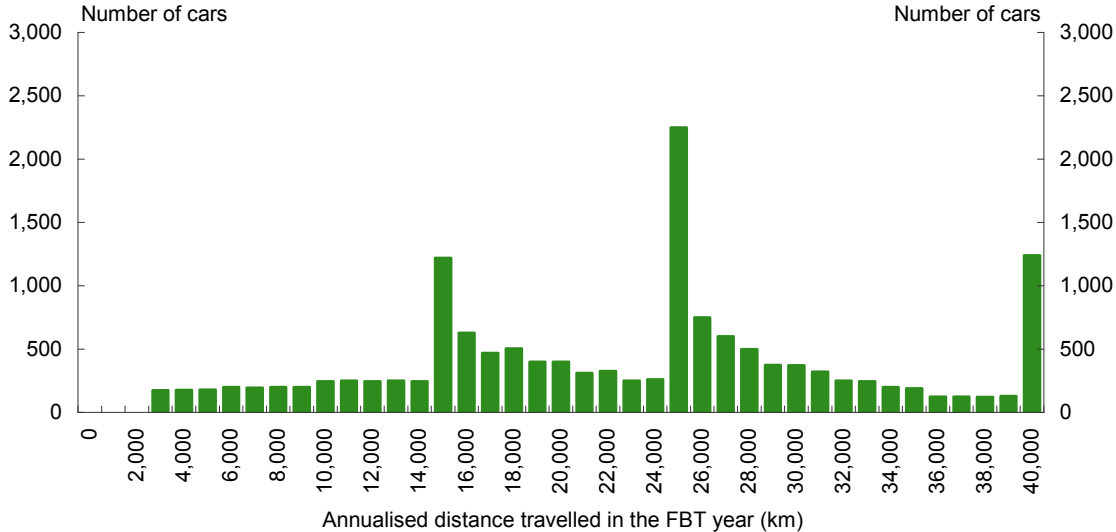
people and industry. Sound land and water management practices are essential to maintaining agricultural production; biodiversity enables technological progress, particularly in medical and pharmaceutical applications; and low atmospheric pollution is essential to climate stability. Moreover, as people's incomes and wealth increase, so too will their demand that government policy is consistent with maintaining environmental amenity.

People and businesses make decisions on a daily basis that affect environmental quality. In many cases they are not fully aware of their impact or do not value those impacts as highly as others do, particularly future generations. Accordingly there is a role for government to influence decision-making with a view to achieving better environmental outcomes. The Carbon Pollution Reduction Scheme aims to make businesses and households face a price in relation to generating carbon associated with their production and consumption choices.

Potentially, the tax system can play a greater role in promoting sustainable policy outcomes, by influencing the incentives that lead to environmental degradation. An equally important consideration is to ensure that settings within the tax and transfer system do not unintentionally produce adverse environmental incentives or conflict with the broader environmental goals of regulatory and other policy measures. In some cases, existing tax and transfers settings are inconsistent with broader environmental objectives (see Part Two, Section E2 Taxes to improve the environment).

For example, the statutory formula for valuing car fringe benefits applies so that the taxable value of a car's fringe benefit falls as total kilometres driven per annum increases. At the margin, this may create an incentive for individuals to travel additional kilometres to reduce the taxable value of their car (particularly at the points at which the statutory fraction falls — 15,000, 25,000 and 40,000 kilometres per annum, as shown in Chart 1.3). In turn, this increases pollution and road congestion.

Chart 1.3: Number of vehicles by kilometres travelled
 2007–08 fringe benefits tax (FBT) year



Source: Based on SG fleet submission to the 2009 Review of Australia's Automotive Industry, as cited in the AFTS submission of the Federal Chamber of Automotive Industries.

1.6 Technology

Business, commerce and people's lives are being transformed by technological advances, especially in digital electronics and communications.

In a competitive global environment, technological change can create both opportunities and challenges. Maintaining high levels of investment will support the adoption of new and emergent technologies and foster value-creating activity in Australia.

New technologies will enable greater use of user charging to address social spillover³ costs (the cost to society as a whole of a transaction) and improve environmental outcomes. For example, electronic tagging of vehicles and GPS technology could allow congestion charging in cities and road-use charges for heavy vehicles. This would lead to a much more efficient use of road networks and investment in transport infrastructure.

The new digital age could dramatically alter how government and citizens interact in the tax and transfer system. It provides the opportunity to enmesh the tax and transfer system into the economy and society in ways that are transparent, simple and unobtrusive. For example, better use of technology could enable tax administration to increasingly utilise 'natural' business systems rather than requiring people to operate separate systems for tax purposes. People's engagement with the system may also be transformed through the use of internet-based technology and greater automation of the tax and transfer compliance process.

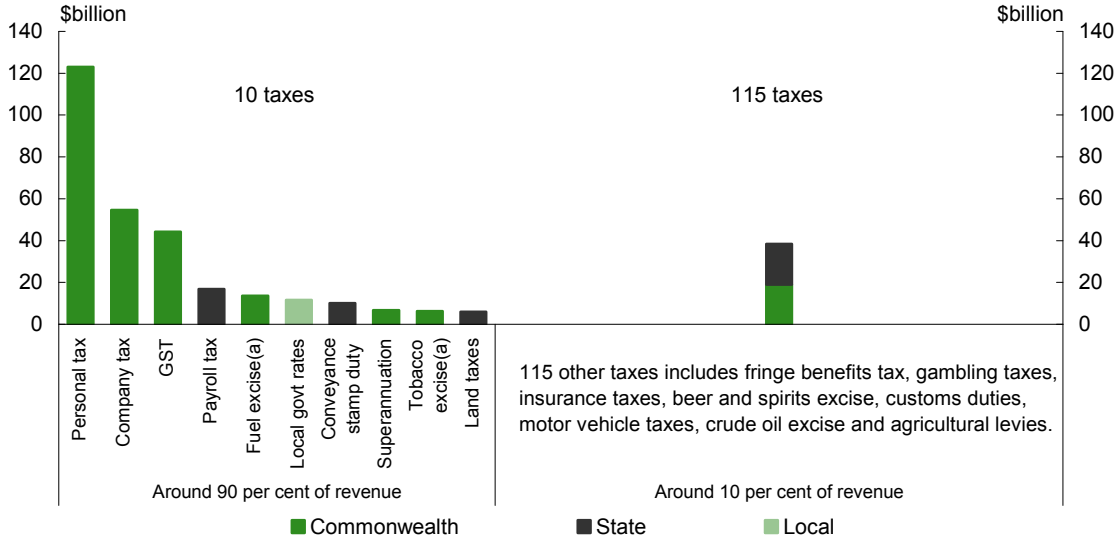
1.7 An unsustainable tax structure

Australia has too many taxes and too many complicated ways of delivering multiple policy objectives through the tax system. The capacity of the legislative and operating platforms of these systems, and their human users, to deal with the resulting complexity has been overreached. To a large extent this is a reflection of a compartmentalised and incremental approach to tax policy that has been weighted toward achieving finely calibrated equity and efficiency outcomes at the expense of simplicity.

Around 90 per cent of Australian tax revenue is raised through only 10 out of some 125 different taxes that are currently levied on businesses and individuals (see Chart 1.4).

3 A spillover occurs when a person's actions impose involuntary costs (or benefits) on others. That is, in addition to the private costs and benefits that accrue to the decision-maker, some costs and benefits can 'spill over' on to others.

Chart 1.4: Ranking of Australian taxes by revenue in 2009–10



(a) Fuel excise and tobacco excise includes excise equivalent customs duties for these products.
 Source: Treasury estimates.

Many taxes detract from the overall efficiency of the system (see Box 1.1), with many of the least efficient taxes being levied by the States. Years of incremental policy change have eroded the bases of even potentially efficient taxes. It has also led to a relatively low degree of policy consistency among the States, and across levels of government, in terms of the way taxes are levied and administered. Consequently there have been repeated calls, particularly by business groups, to improve the structure of the tax and transfer system. These calls were echoed in submissions to the Review.

Improving the structure of the tax system, by replacing inefficient taxes with a rationalised suite of taxes and streamlining administration, has the potential to increase government accountability, reduce system complexity and business compliance costs, and make the Australian economy more productive.

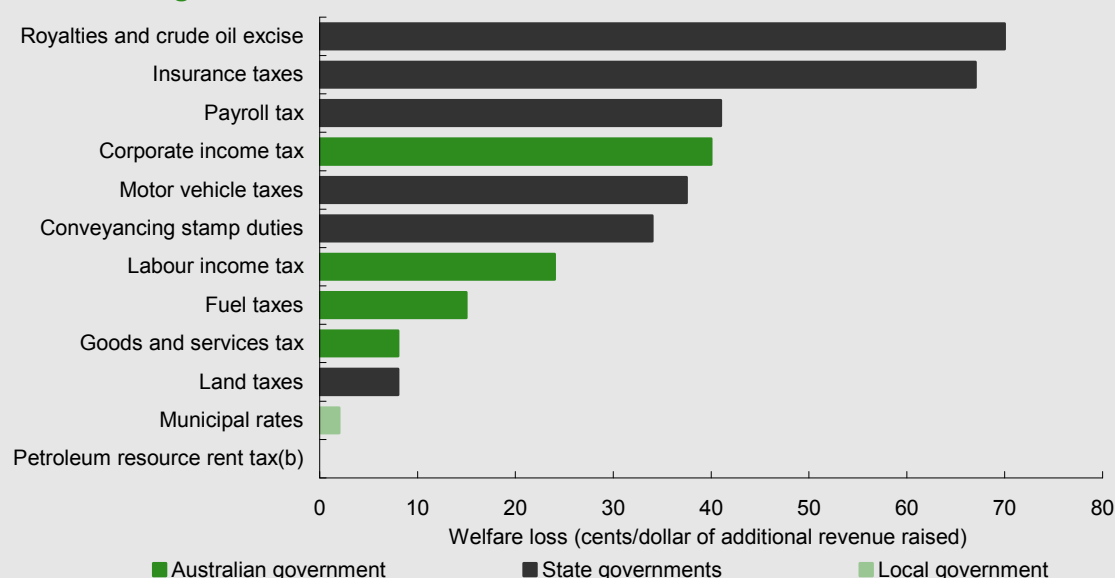
Box 1.1: The economic efficiency of Australian taxes

Most taxes result in some loss of economic efficiency. For example, a tax may reduce incentives for people to work or invest or induce them to alter their consumption patterns. This leads to losses in consumer welfare, which can be expressed relative to the amount of revenue raised. An efficient tax system involves taxes that result in relatively low losses in consumer welfare per dollar of revenue raised.

Chart 1.5 compares the marginal welfare loss arising from a small (5 per cent) increase in each of a range of major Australian taxes (marginal excess burden), estimated using the KPMG Econtech MM900 model. This model contains a high level of tax detail, enabling estimation of the efficiency impacts of a broad range of existing taxes. However, as with all such models, the results are only indicative due to limitations in the way taxes and the economy are represented. For example, the full range of efficiency costs associated with conveyance stamp duties, the complexity of the personal and company income tax bases, and some potential spillover effects of taxes cannot be measured with this type of model. Also, the relative welfare loss associated with a small change in one tax may not be representative of that associated with the removal of that tax or where multiple taxes are changed together.

The estimated welfare losses of municipal rates and land tax are lower than, or similar to, those of the GST, and a lot lower than for personal tax on labour income and company income tax. This ranking is consistent with empirical work by the OECD (Johansson et al. 2008). The existing payroll tax is estimated to have a relatively high welfare cost, reflecting the effect of the tax-free threshold on business size. A payroll tax with no tax-free threshold is estimated to have a welfare loss similar to the GST. For a more detailed discussion see KPMG Econtech (2009).

Chart 1.5: Marginal welfare loss from a small increase in selected Australian taxes^(a)



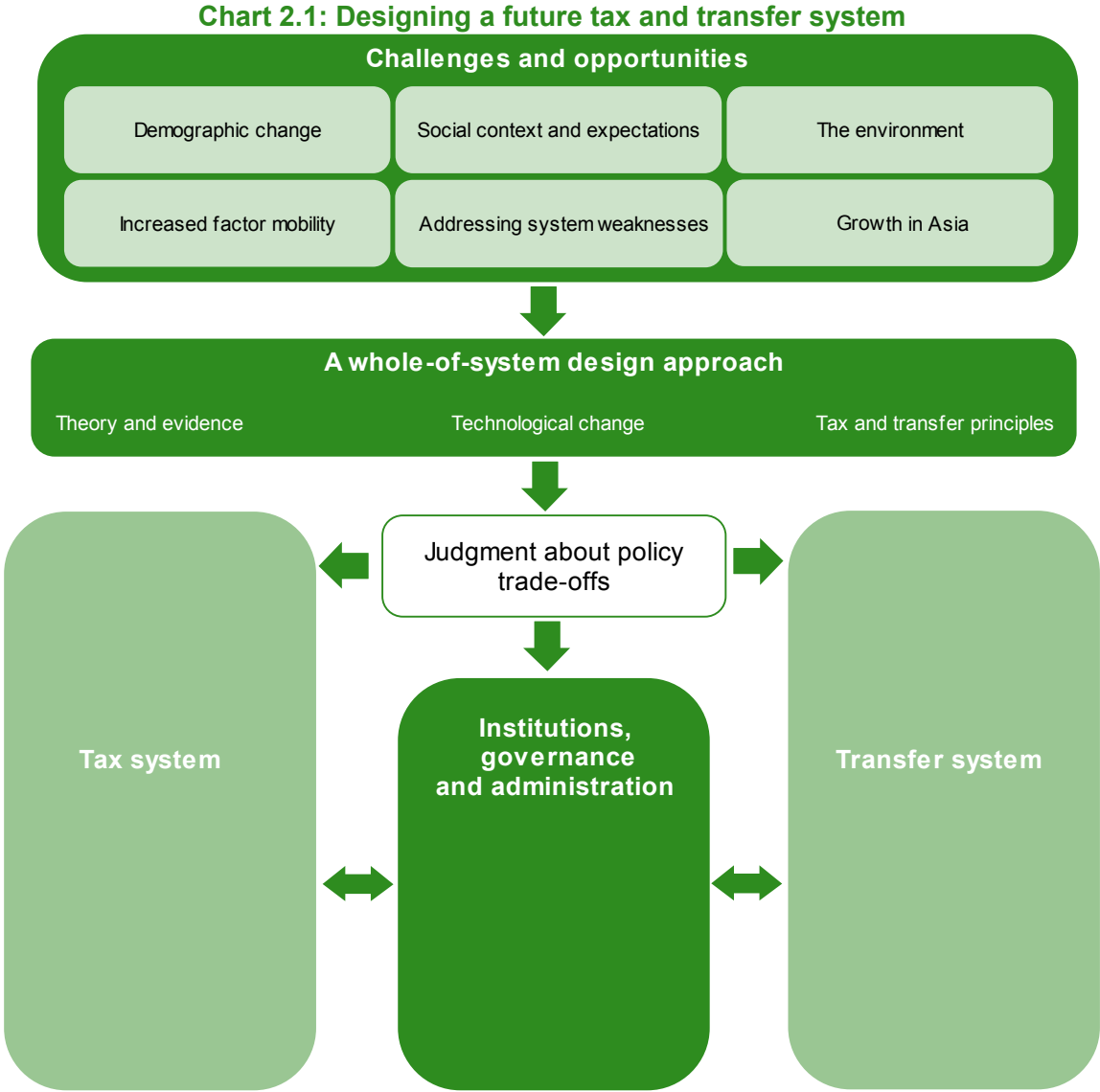
(a) The welfare effect of varying each tax has been assessed using the KPMG Econtech MM900 general equilibrium model of the Australian economy. The welfare loss is the loss in consumer welfare per dollar of revenue raised for a small (5 per cent) increase in each tax, simulated individually. It is measured as the amount of lump sum compensation required to restore the representative consumer's level of satisfaction to its original level, after returning the revenue raised by the tax to the consumer as a lump sum transfer. The extent of such compensation reflects the distorting effect of the tax on the economy.

(b) The petroleum resource rent tax is modelled as a pure rent tax giving rise to a zero welfare loss. In practice, a small increase in this tax could be expected to induce some welfare loss. However, it would be expected to rank as one of the more efficient taxes in the chart.

Source: KPMG Econtech (2009).

2. Designing a future tax and transfer system

Consistent with its broad terms of reference, the Review has taken a systemic approach in redesigning the tax and transfer system (see Chart 2.1). That is, the Review has evaluated specific taxes and transfers from the perspective that each is a part of a single national tax and transfer system. Recommendations on the implementation of reforms as they affect the system’s administration, the client interface and the assignment of revenue within the federation also reflect this perspective.



In forming its recommendations the Review has drawn on the latest developments in economic theory and rigorous evidence-based analysis of the impact of taxes and transfers (see Section 2.1 below). Translating this information into policy design has, of necessity, required the Review to make judgements about its relevance in the Australian context and about the trade-offs that arise between the goals of fairness, efficiency, simplicity,

sustainability and policy consistency (see Box 2.1). In evaluating these trade-offs, the Panel has been guided by the following broad objectives:

- The tax system must be capable of raising sufficient revenue to fund the expenditure required of future governments.
- Revenue should be raised from taxes that are least detrimental to economic growth and that support a diverse economic structure.
- The transfer system, together with progressive personal taxation, should be the predominant means through which the government influences the distribution of income in the economy.
- People in similar circumstances should be treated in a similar way under the tax and transfer system.
- The transfer system should provide assistance to those in need in accordance with intended distributional outcomes, while retaining a strong incentive for people to work and improve their lifetime opportunities if they are able.
- Policy settings should be coherent and reflect a greater emphasis on simplicity and transparency than is presently evident.
- Policy design should be integrated with technology to raise revenue efficiently, enhance social outcomes through tax design and improve the experience of people and business in interacting with the system.
- The design of the system and the assignment of revenue within the federation should support effective government and clear accountability of governments to citizens.
- The design and governance of the system should ensure that the benefits of reform are enduring.

2.1 New insights about the design of taxes and transfers

In redesigning the tax and transfer system, the Review has taken advantage of better and stronger understandings developed recently about the way taxes and transfers affect people's behaviour and the economy. The international consensus on these matters has moved some way since the last major reviews of the tax and transfer systems, the Asprey review of the tax system in 1975 (Asprey 1975) and the *Social Security Review* initiated in 1986 (Cass 1986).

Box 2.1: Design principles for the tax and transfer system**Equity**

The tax and transfer system should treat individuals with similar economic capacity in the same way, while those with greater capacity should bear a greater net burden, or benefit less in the case of net transfers. This burden should change more than in proportion to the change in capacity. That is, the overall system should be progressive. Considerations about the equity of the system also need to take into account exposure to complexity and the distribution of compliance costs and risk.

Efficiency

The tax and transfer system should raise and redistribute revenue at the least possible cost to economic efficiency and with minimal administration and compliance costs. All taxes and transfers affect the choices people and businesses make by altering their incentives to work, save, invest or consume things of value to them. The size of these efficiency costs varies from tax to tax (see Chart 1.5 in Box 1.1) and from transfer to transfer, reflecting, in part, the extent to which they affect behaviour. Instability in policy settings can reduce economic efficiency by increasing uncertainty about the expected payoffs to long-term decisions such as investing in education, choosing retirement products, investing in long-lived productive assets and the choice of business structure. These costs represent a net loss to society as a whole, whereas revenue raised through a tax is redistributed among members of society through government expenditure, including transfer payments.

Simplicity

The tax and transfer system should be easy to understand and simple to comply with. A simple and transparent system makes it easier for people to understand their obligations and entitlements. People and businesses will be more likely to make the most beneficial choices for themselves and respond to intended policy signals. A simple and transparent system may also involve lower compliance costs for taxpayers and transfer recipients.

Sustainability

A principal objective of the tax system is to raise revenue to fund government programs, including transfer payments. The tax system should have the capacity to meet the changing revenue needs of government on an ongoing basis without recourse to inefficient taxes. To be sustainable the tax system, together with the transfer system, must contribute to a fair and equitable society. The cost of the transfer system needs to be predictable and affordable in the light of demographic change. Sustainability also means that the structural features of the system should be durable in a changing policy context, yet flexible enough to allow governments to respond as required. Legal and administrative institutions and frameworks should also be robust to maintain the effectiveness of the system and underpin the legitimacy of the system. Policy settings should also contribute to environmental outcomes that are sustainable.

Policy consistency

Tax and transfer policy should be internally consistent. Rules in one part of the system should not contradict those in another part of the system. To the extent possible, tax and transfer policy should also be consistent with the broader policy objectives of government. However, the primary objectives of the tax and transfer system, to raise revenue and provide assistance to those in need, should not be compromised by other policy objectives.

The impact of taxes and transfers on economic growth

Encouraging strong economic growth is one of the most effective ways of dealing with the fiscal pressures that are likely to be associated with the ageing of Australia's population. Recent empirical studies suggest that economic growth is affected by the structure of the tax system. Company income tax has been found to have the largest adverse effects on economic growth, followed in rank order by taxes on personal income, consumption and land (assuming all these taxes are on suitably broad bases) (see Table 2.1). This ranking reflects the higher efficiency costs of a tax levied on a base that can be moved or changed. For this reason, there should be a lighter tax burden on more mobile bases, particularly investment.

Table 2.1: Long-run percentage change in GDP per capita from a revenue-neutral shift of 1 per cent in tax revenues — selected OECD countries^(a)

Shift in tax mix	Estimated change in GDP (per cent)
From income tax to consumption taxes	+ 0.74
From income tax to recurrent taxes on immovable property	+ 2.47
From consumption and property taxes to personal income taxes	- 1.13
From consumption and property taxes to corporate income taxes	- 2.01

(a) Johansson et al. (2008) note that while the size of the estimated effects are large compared to what would be reasonably expected, the tax base rankings are robust to a large number of robustness checks and alternative specifications. Further, other studies have found similarly high point estimates.

Source: Johansson et al. (2008).

Tax and transfer policy should support productivity through the efficient allocation of investment and productive resources to their most highly valued uses. When products are taxed at the same rate, relative prices will be unaffected and there will be less impact on the decisions of individuals and businesses. A broad base also enables a lower rate of tax for a given revenue objective, which results in smaller distortions to people's and businesses' choices. Broadly-based taxes are, therefore, more consistent with an allocation of resources in the economy that supports a high rate of economic growth and individual satisfaction. Narrowly-based taxes can, however, improve resource allocation where they address cases of market failure or support improved social outcomes.

People's choices about participating in the workforce are affected by both taxes and transfer payments. International and Australian research has highlighted the different ways in which tax and transfer rules impact on the workforce participation of men, single and partnered women and women with children. In particular, partnered mothers and single parents are quite sensitive to the impact of taxes, transfer withdrawal rates and the level of transfer payments in deciding whether to undertake paid work.

Associated with increased female workforce participation and the growth of two-income households, there is now also a greater awareness of the importance of policies that enable primary carers of children to make workforce participation choices that are in the best interests of their children and themselves. Studies generally confirm that in the period immediately following childbirth, both the mother and the baby benefit from the mother being at home. However, extended absences from the labour market tend to affect a person's longer-term labour market prospects, with detrimental effects on longer term outcomes for both children and their parents, especially women. However, the potential for improved family wellbeing as a consequence of the primary caring parent returning to work while children are young depends on the availability of high quality affordable child care.

The tax and transfer system also affects people's choices to save and invest. Recent theoretical and empirical research has brought a new perspective to the long-standing debate about the relative merits of comprehensive income taxation, under which savings income is taxed at a taxpayer's marginal rate, and expenditure taxes, under which savings income is exempt. This work strengthens the argument that while there are potential benefits from taxing savings income, it should be taxed at a lower rate than labour income.

Designing transfers to improve lifetime wellbeing

In framing policies to alleviate disadvantage, a simple focus on the adequacy of income, judged against criteria such as the Henderson Poverty Line,⁴ has been replaced by broader goals that focus on lifetime income and the capacity of people to engage in work and other social activities. In particular, there is greater awareness that assistance should not encourage short-term choices which compromise the development of capabilities that offer potential medium to long-term improvements in a person's wellbeing. For example, government assistance, and its interaction with taxation, should not lock people into welfare dependency by discouraging them from working, working longer hours, studying or retraining. This has seen increased emphasis on requiring people to work, actively seek employment or participate in training. Similarly, housing assistance should not lock people into geographical disadvantage.

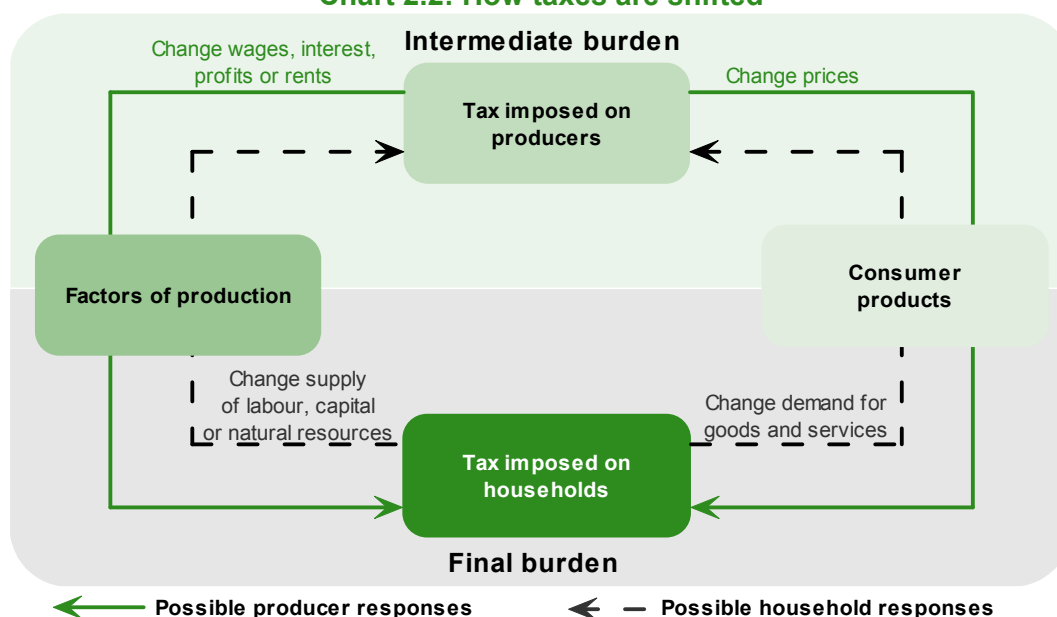
The distributional implications of taxes

All taxes ultimately bear on or benefit people, not businesses or other entities. It is the distribution of the economic burden of taxes that is important for equity, not who remits a tax. Different community perspectives about the merits of a specific tax setting often reflect a difference of view about who ultimately bears the burden of a tax.

It has long been understood that the person or entity legally obliged to remit a tax may not be the person, or the only person, whose income or consumption opportunities are altered. For example, taxes are shifted from businesses to households through higher prices for products or through lower returns to the use of domestic factors of production such as reduced wages, reduced rent or reduced prices for the use of natural resources (see Chart 2.2). The distribution of the burden of a tax can also vary over time as markets adjust. It is generally accepted that the burden of a tax will fall to a greater extent on:

- a person consuming a product or owning a factor of production for which the demand or supply is unresponsive to a change in its price;
- a person consuming a product with no ready substitutes; or
- a person owning a factor of production that is relatively immobile.

4 The Henderson poverty line defines the amount of income below which a particular household would be considered to be in poverty. The benchmark level relating to 1973 was established by the Henderson Commission of Inquiry. This level is adjusted by per capita household income and is therefore a relative, rather than absolute, measure of poverty (Henderson 1975).

Chart 2.2: How taxes are shifted

There has been less agreement about the extent to which tax shifting occurs in practice and where the burden of most taxes ultimately rests. It follows, however, that in a small open economy like Australia's, where capital and products can move relatively freely between Australian and overseas markets, the burden of most taxes ultimately is likely to fall largely on Australian residents. It also follows that the extent to which this occurs is likely to be higher in the longer term, as there is greater capacity for resources to be reallocated across the economy in response to changes in prices or the return to investment. Recent empirical work using economic models is shedding greater light on this issue.

At least some of the burden of company income tax is shifted onto labour. This is because investors can avoid the tax by moving their capital abroad. Less capital in the economy means lower productivity of labour and land and this means lower wages and lower rents for the owners of land. These effects are less pronounced where a tax is levied on profits that arise because of the specific location of an investment, as is often the case with non-renewable resources.

Taxes (such as payroll tax, insurance tax and GST) on the factors of production and other business inputs tend to be shifted to households through lower returns to those factors or higher product prices. Taxes that appear to be borne by the business owner end up being borne by them either as a supplier of labour or as an owner of specific capital. In contrast, the burden of a broad-based uniform tax on land will fall primarily on existing landowners. The fixed supply of land limits the ability of landowners to pass the tax onto others. Instead, the price of land would adjust to restore the market rate of return to holding land as an asset.

Policy measures that compensate people for the indirect impacts of taxes, such as changes to the rates of transfer payments by indexation or other compensation measures and increases to first home owner grants, effectively shelter the recipients from the burden of those taxes. A consequence of such indexation is that it adds a degree of progressivity, even to broadly based indirect taxes that are fully passed on through consumer prices. The principle underlying compensation measures in this context is that where taxpayers have arranged their affairs on the basis of the existing arrangements or are poorly placed to rearrange their financial affairs (either because they are not able to do so, or because it would be

unreasonable to expect them to absorb the cost of doing so), it is necessary to effectively shelter them from the burden of those taxes. Compensation measures have also reflected judgements about the distributional impact of taxation changes.

However, compensation measures can be complex. Grandfathering arrangements can result in service delivery agencies administering two sets of rules. Measures to insulate income support and family assistance recipients from the price changes of major shifts in the tax base can also result in complex arrangements. A payment indexed only to the CPI will automatically adjust to changes in prices (though in some circumstances special measures will be needed to bring forward the payment of the CPI increase). However, if it is important that payments benchmarked to community living standards do not reduce in real value, other changes in addition to normal indexation are necessary.

The Report does not outline specific compensation measures for the recommended changes to taxation. The design of any such measures will depend on government decisions about policy reform packages. However, in this context it should be noted that if payment or taxation rates are effectively adjusted to compensate low and middle income households for changes that are often regarded as regressive (such as flat rate taxes and consumption taxes), such taxes can have an overall progressive effect. Consistent with the principles articulated in Part Two, the personal income tax and transfer system is the most appropriate mechanism for compensating low- and middle-income households for major tax changes.

The costs of complexity

The complexity of the tax system and the costs of complying with it are perennial concerns, particularly of the business community. Recent research suggests a range of costs associated with this complexity. It reduces transparency, impeding optimal decision making by businesses and individuals and their ability to respond to intended policy signals. It can cause people inadvertently to pay the wrong amount of tax or claim more or less than they are entitled in transfer payments. It is regressive in its impact, affecting mostly those people with the least capacity to deal with complexity and the least access to professional help.

Significant among the causes of complexity are the pursuit of finely calibrated equity and efficiency outcomes, instability in policy settings and people's incentives to maximise their after-tax and transfer incomes or after-tax business profits. The provision of choice in determining a tax liability can increase complexity and result in higher compliance costs where taxpayers seek to discover the best tax outcome. Complexity may also be compounded where policy settings within the system do not draw on 'natural' taxpayer systems or are inconsistent with broader policy objectives of government.

Related to the issue of complexity are the costs of administering and complying with the tax and transfer system. These costs represent a net loss to the economy, because the resources engaged in these activities could otherwise be put to more highly valued uses. Recent research suggests there is an optimal level of system complexity and operating costs, one that balances administration and compliance costs with improved efficiency and distributional outcomes.

3. A tax and transfer system for the 21st century

The broad architecture of Australia's tax and transfer system provides a good starting point for meeting the challenges and opportunities that Australia faces in the 21st century. There is, however, a need for reform to better align the design of the system with Australia's future economic, social and environmental conditions.

3.1 Existing strengths

The existing tax system comprises several relatively efficient taxes capable of providing a sustainable flow of revenue over the long-term, as well as a number of specific taxes that, properly applied, could enhance social outcomes or market efficiency.

The overall framework of the tax and transfer system rests on the broad principle that levels of taxation should reflect ability to pay, and that support should be provided when needed. Australia's personal income tax system is relatively progressive and the transfer system is highly targeted and broadly supports workforce participation. The retirement income system, based on a unique mix of public and private provision, shares the burden and risks in providing retirement incomes.

These features provide a foundation for achieving socially acceptable distributional outcomes in a fiscally sustainable manner. Indeed, largely because of these structural features, Australia is better placed than many OECD countries to deal with the challenge of an ageing population.

Australia also has a high standard of administration of both taxes and transfers, with an increasing emphasis on exploiting opportunities offered by emerging technologies to improve tax processes.

3.2 Opportunities for improvement

Although Australia is better placed than many other countries to deal with an ageing population, the sustainability of our current system is not assured.

The States raise a significant proportion of their tax revenue from some of the least efficient taxes in our system. The more efficient of the taxes available to the States are poorly designed and, as a result, are currently limited in their capacity to generate revenue.

The least efficient taxes undermine Australians' living standards, reducing productivity and incomes by discouraging investment and workforce participation or by directing investment and resources to less valued activities.

The level of some transfer payments, and the basis on which relativities between payments are set, is not sustainable in the medium to long term. The projected growth in the

proportion of people aged 65 years or older will test the capacity of the retirement income system.

Living standards are also undermined by tax settings that discourage people from making choices that would yield greater lifetime wellbeing. The transfer system, and its interactions with personal taxation, can also discourage workforce participation and lock people into welfare dependency through short-term choices that compromise their lifetime wellbeing.

Australia's tax and transfer system is too complex. Complexity in the tax system is a primary reason why Australians rely on tax agents to complete their personal tax returns to a far greater extent than in other OECD countries. There are too many taxes, many of which apply to the same activity, and too many administering authorities for a country with Australia's population. It is difficult and costly to comply with the requirements of the tax system, which is a major source of dissatisfaction in the business community. Policy inconsistency across the tax and transfer system has eroded the underlying principles in some areas.

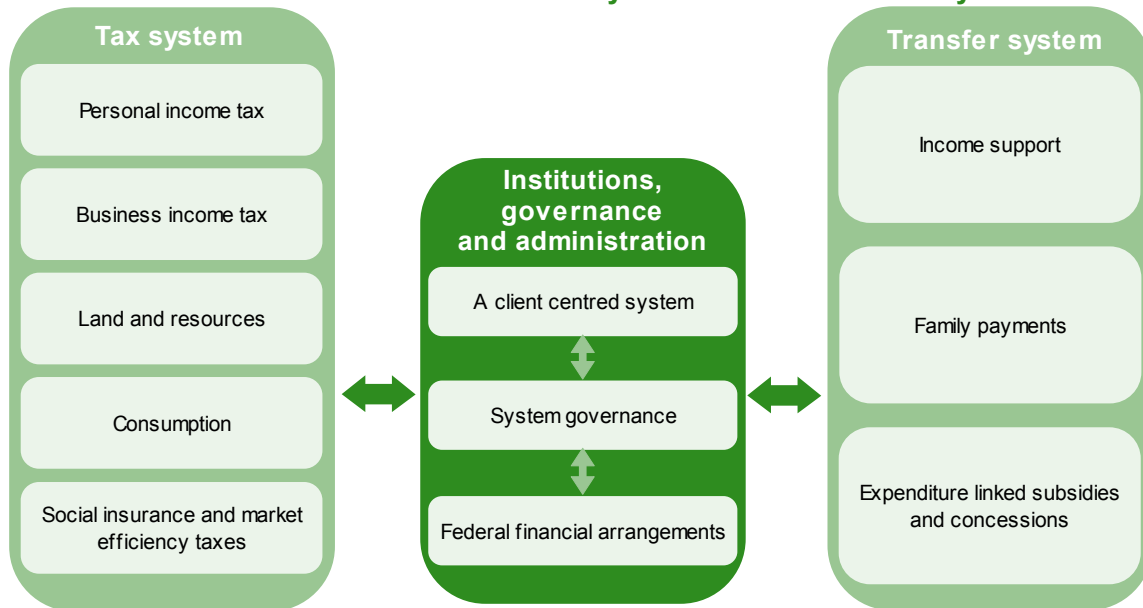
The potential opportunities for simplification offered by new digital technology suggests a considerably larger payoff now than in the past from reassessing the weight given to equity and efficiency relative to simplicity when designing policy.

3.3 The future architecture

The architecture of Australia's future tax and transfer system is represented schematically in Chart 3.1.

The architecture is designed from a national rather than jurisdictional perspective. That is, taxes and transfers have been designed primarily to meet national revenue and income redistribution objectives.

The existing structural separation of the tax system from the transfer system should be retained. The extent to which the two systems might be integrated has been considered in some depth and the Review has concluded that integration is neither achievable nor desirable because of their different purposes. The tax system should raise revenue based on individual capacity to pay, while support through the transfer system should be based on household need. Nevertheless, the design of policy settings in each system has taken into account their interactions with the other system and the overall implications of taxes and transfers for the choices people make.

Chart 3.1: A tax and transfer system for the 21st century

A key recommendation for reform is that revenue raising should be concentrated on four robust and efficient, broad-based taxes:

- personal income, assessed on a more comprehensive base;
- business income, designed to support economic growth;
- economic rents from natural resources and land; and
- private consumption.

Narrow-based taxes, such as those on specific goods and services, should only be levied where they improve social outcomes or market efficiency through better price signals. Such taxes would only be used where they are a better means of achieving the desired outcome than other policy instruments. With these taxes, the rate would be set in accordance with the marginal spillover cost of the activity. User charging should play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services.

In the case of both specific taxes and user charges, revenue would be a by-product of the tax or charge, not the reason for it. Other existing taxes should have no place in the future tax system and over time should be abolished.

Recommendation 1: Revenue raising should be concentrated on four robust and efficient broad-based taxes:

- personal income, assessed on a more comprehensive base;
- business income, designed to support economic growth;
- economic rents from natural resources and land; and
- private consumption.

Additional specific taxes should exist only where they improve social outcomes or market efficiency through better price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the marginal spillover cost of the activity.

User charging should play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services.

With both specific taxes and user charges, revenue would be a by-product of the tax or charge, not the reason for it.

Other existing taxes should have no place in the future tax system and over time should be abolished.

Transfer payments would remain highly targeted through eligibility criteria and means testing based on a person's circumstances. Transfer payments would continue to be targeted through a range of mechanisms — eligibility criteria, payment rates and withdrawal rates. The rates and conditions of payment would reflect community expectations about people's standard of living and their obligations to become self-reliant.

There would be clear incentives for people to improve their lifetime opportunities through workforce participation, investing in education or saving. Payment categories in the income support system would clearly define social expectations about the responsibilities of people to look for work. Once established, rates of payment would be maintained through consistent indexation arrangements.

The assessment of a person's means for transfer purposes would take into account their income, including that derived from assets, generally at a deemed rate, with capped exemptions for the home and personal effects. Reflecting community expectations about the role of partners in couples in caring for one another, it would also take into account the income and assets of a person's partner.

The tax and transfer system would be designed with a focus on improving the experiences of individuals and business in interacting with the system and improving the effectiveness and accountability of government. Reducing the number of taxes and transfers, and improving the effectiveness of those that remain, is necessary but not sufficient to achieve this goal.

The administration system would allow people to engage with the tax and transfer system through a single, individualised portal that draws on natural business systems to automate

business interactions with government. Governance arrangements would support a more responsive system and ensure the benefits of reform are preserved and enhanced over time.

The reforms required to achieve this vision are outlined in Sections 4 to 10 and in greater detail in Part Two of this report. Section 11 discusses the implications of the reforms for economic growth and other macroeconomic outcomes and fiscal sustainability. A consolidated list of the recommendations is provided in Section 12.

4. Personal taxation

Fair and efficient personal income taxation is essential to position Australia to respond to the challenges and opportunities of the 21st century, particularly population ageing. However, this objective should not be pursued in isolation. Personal tax and transfer policy settings need to complement each other to be coherent and transparent. They should also support the application of modern information technologies to provide a better client experience of the system.

As the largest source of tax revenue, personal income taxation can be an important influence on the choices that Australians make. Reducing the disincentives for people to work and improving their incentives to save is critical to a high growth response to the projected fiscal pressures of population ageing and assisting people to meet their own costs. Narrowing the focus of personal income taxation to raising revenue through simpler and more transparent policy settings would provide clearer signals to people. It would also support greater automation of personal income tax return preparation.

To be sustainable, personal income taxation must also be perceived by the community to be fair. The fairness of personal income tax is fundamental as an expression of societal values and is a prerequisite for people to be committed to the system and prepared to meet their obligations. A fair tax system would feature a progressive tax rate structure, and a tax base that treats most forms of remuneration from working in a consistent manner and that recognises the punitive effect of income tax on the return to savings, particularly in the presence of inflation. Given its vital role as the population ages, retirement income savings should be subject to lower tax rates than other savings.

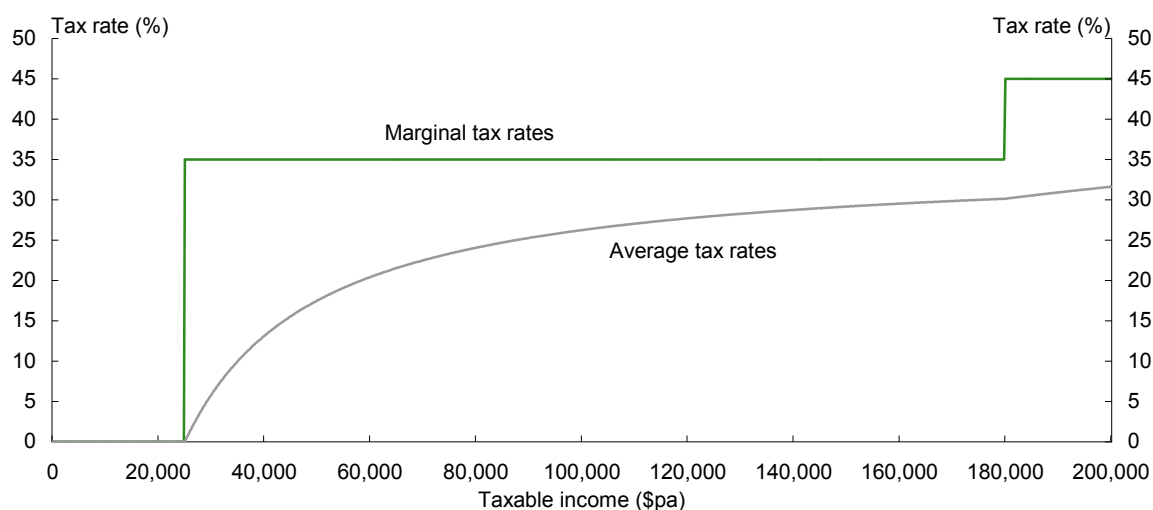
4.1 Fairer, more efficient and simpler personal taxation

The personal tax structure should be the sole means of delivering progressivity in the tax system, supporting the more direct re-distributional role of the transfer system.

The centrepiece of personal taxation would be a simple and transparent personal income tax rates scale. Progressivity would be delivered through a high tax-free threshold and a simple progressive tax rate structure, largely incorporating the Medicare levy and structural offsets – the low income tax offset, the pensioner and beneficiary tax offsets, and the senior Australians tax offset.

Chart 4.1 shows an indicative personal income tax rates scale, with progressivity delivered through a \$25,000 tax-free threshold and a constant marginal tax rate of 35 per cent for 97 per cent of taxpayers.

Chart 4.1: Indicative personal income tax rates scale
A simple scale with a high tax-free threshold



Source: Treasury estimates.

There would be minimal reliance on special provisions, such as non-structural tax offsets, to achieve distributional objectives. Any special provisions would be universal, rather than subject to separate means tests. Other offsets could be limited to where they meet an ongoing need that could not be met in a more targeted way.

A consistent tax exemption of all transfer payments would improve the interaction between the personal income tax system and the transfer payments system for the large number of individuals who are subject to both.

The definition of taxable income should be broad. Alternative forms of remuneration for work, including wages, salaries, fringe benefits and employer superannuation contributions, would be taxed in a more consistent manner and with few exemptions. Income from savings would be taxed on a more consistent basis with other income (see Section 4.2).

Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other fringe benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate (and non-reportable for employees). These arrangements would improve the progressivity of the current system, while minimising compliance costs for employers.

To further ease compliance costs for employers, the scope of fringe benefits that are subject to tax could be simplified. The broad definition of fringe benefits in the FBT law could be reviewed to exclude essential workplace items such as chairs, stationery and toilets. All FBT exemptions should be reviewed to determine their continuing appropriateness, and consideration should be given to excluding fringe benefits from tax where the costs of compliance outweigh equity and tax integrity considerations.

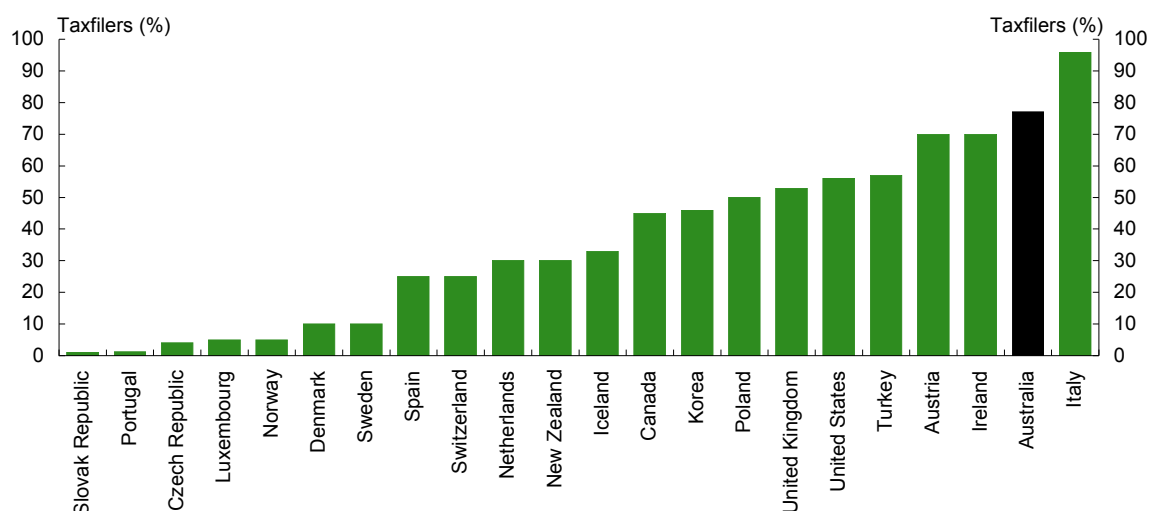
Simpler personal income taxation

Personal income tax compliance has become inordinately complex. This complexity hides its policy intent from citizens. For many people, the personal tax system is complex not only because of the rates scale and the lack of a coherent definition of taxable income, but also

because they must deal with a large suite of complex deduction rules, numerous tax offsets and a variety of exempt forms of income.

Seventy-two per cent of taxfilers now seek advice from a tax agent, even though 86 per cent either claim no deductions at all or only claim work-related expenses, gifts and the costs of managing tax affairs. Australia's use of tax agents is high by international standards; second only to Italy's (see Chart 4.2). By contrast, the Nordic countries, which have pre-filing arrangements for tax returns, have low levels of tax agent use.

Chart 4.2: Percentage of taxfilers using a tax agent, 2005



Source: OECD (2005).

An automatic standard deduction should be introduced to simplify people's interactions with the tax system and facilitate much greater levels of pre-filing of tax returns.

Work-related expenses are deductible from taxable income, on the grounds that it is fair to assess a person's disposable income taking account of costs they incur in earning that income. While they are the most commonly claimed deductions for employees, and claims have been growing substantially over recent years, they are also one of the key sources of complexity and compliance costs for individuals.

A standard deduction for the great majority of taxpayers would remove their need to collect receipts. A tighter nexus between the deductibility of the expense and its role in producing income would also constrain the scale of work-related deduction claims. To ensure that individuals with more complex affairs or high expenses are not disadvantaged, taxpayers would still have the option of substantiating a claim for all eligible expenses.

These two reforms, together with policy refinement to align income definitions and rationalise the number of personal tax deductions and offsets, would support the pre-filing of tax returns. Significantly, such changes would free most personal taxpayers from having to prepare their tax return, and instead allow them to lodge a default return prepared by the ATO. For most taxpayers, such default returns would only require them to provide minimal additional information or simply confirm the details in order to lodge their return. These reforms would allow personal taxpayers to avoid much of the complexity surrounding their tax return, as well as the expense of a tax agent.

In the longer term, opportunities exist to use 21st century technologies to make the system fairer, easier to comply with and more robust. Policy design should support greater

automated reconciliation of tax affairs to reduce or remove the requirement for the taxpayer to collect their own information over the course of the tax year.

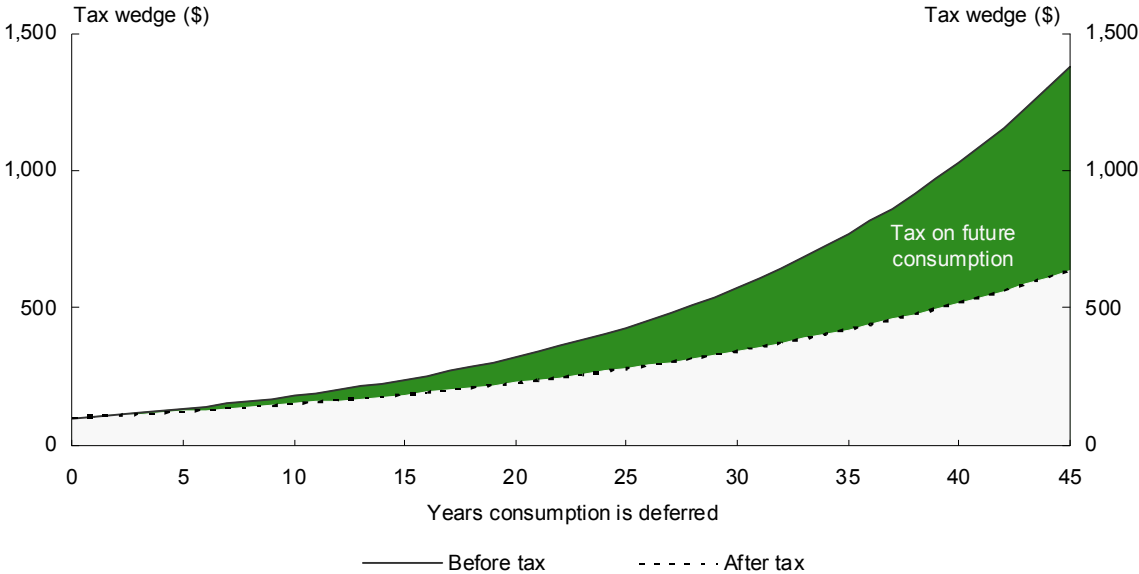
4.2 Taxing income from savings

Australia's personal income tax system should continue to represent a hybrid personal income tax, with the main forms of lifetime savings for most Australians — superannuation and owner-occupied housing — taxed at a lower rate or exempt from income tax, but with other savings taxed more consistently to achieve a more productive and better allocation of savings.

Savings invested in owner-occupied housing or superannuation would either be tax-exempt or close to exempt in practice, both being important determinants of people's living standards in retirement. This treatment would be consistent with a progressive expenditure tax benchmark, which exempts the returns to saving. Comprehensive income taxation, under which all savings income is taxed the same as labour income, is not an appropriate policy goal or benchmark.

The essential reason for treating lifetime, long term savings more favourably is that income taxation creates a bias against savings, particularly long-term savings. Taxes on savings income, including the taxation of inflationary gains, can discriminate against taxpayers who choose to defer consumption and save. The longer the person saves and reinvests, the greater the implicit tax on future consumption (see Chart 4.3). These individuals pay a higher lifetime tax bill than people with similar earnings who choose to save less.

Chart 4.3: Tax wedge on future consumption



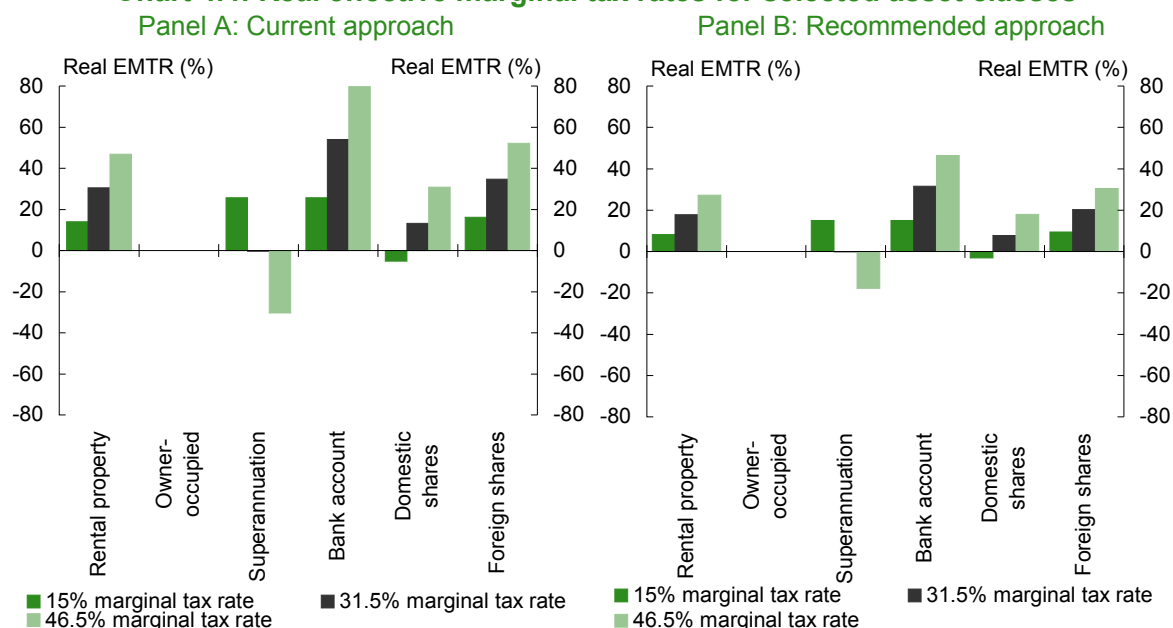
Assumptions: Pre-tax interest rate of 6 per cent per annum and a tax rate of 30 per cent.
 Source: Treasury estimates.

Current arrangements lead to tax outcomes that vary widely depending on the form of saving undertaken (see Chart 4.4). Interest has the least favourable tax treatment. The entire return, including inflationary gains, is included annually in taxable income, generating an effective marginal tax rate on the real return greater than the statutory marginal personal tax

rate. In contrast, shares benefit from the capital gains tax discount, while domestic shares also benefit from dividend imputation.

Rental properties benefit from the differential treatment of gains and losses, driven by the capital gains discount and exacerbated by high levels of gearing. Returns from owner-occupied housing are untaxed, giving rise to a zero effective tax rate. For superannuation, the ability to make contributions out of pre-tax income (rather than post-tax income as for other savings, including your own home), can result in a negative effective marginal tax rate on saving through superannuation.

Chart 4.4: Real effective marginal tax rates for selected asset classes



Notes: The real effective marginal tax rate on saving is defined as the difference between the pre-tax and post-tax return from a marginal investment as a proportion of the pre-tax return (net of inflation). A zero effective tax rate reflects a prepaid expenditure tax benchmark, where saving is undertaken out of post-tax labour income and the return to saving is exempt from income tax. Negative rates for superannuation reflect the reduction in tax from either making contributions out of pre-tax income (current approach) or by accessing the recommended refundable tax offset for contributions.

Assumptions: 6 per cent nominal return; 2.5 per cent inflation; for rental property, 50 per cent of the return is attributable to capital gain, 50 per cent to rental income and the rental property is held for 7 years then sold; shares are held for 7 years then sold; superannuation is held for 25 years and the individual is eligible for a tax-free payout at the end of the period. Does not account for interactions with the transfer system.

Source: Treasury estimates.

There is considerable evidence that such tax differences can have large effects on the assets in which a household's savings are invested (OECD 2007a). The large variations in tax treatment can therefore alter the allocation, ownership and the management of the nation's savings. This can have adverse impacts on overall economic efficiency, capital market stability and the distribution of risk between individuals. The tax advantages from borrowing to invest in a rental property, also relevant for shares, leads to investors taking on too much debt and distorts the rental property market.

A move to a broad 40 per cent discount for income from bank deposits, bonds, rental properties, and capital gains and for certain interest expenses would address these problems by providing more consistent tax outcomes. Savings would be allocated more productively, distortions to rental property and other markets would be reduced, and household investment and financing choices would better suit their circumstances and risk-preferences.

The discount would also provide a means of adjusting for the effect of inflation, which increases the effective rate of tax on savings income.

Phasing in the discount over time would allow investors to adjust to the new tax settings and reduce the potential for market disruption. In particular, a smooth transition for highly geared investors in rental properties would limit any short-term disruptions in the supply of rental properties. However, this should only be adopted following reforms to the supply of housing and to housing assistance.

Extending the uniform discount to dividends and business income could also be considered as part of long-term alternatives to dividend imputation (see Section 5). Doing so could provide an alternative means of avoiding the double taxation of company profits in the hands of shareholders and would further improve the consistency of income tax arrangements for savings income.

In the short to medium term, some areas of the current taxation of savings could be simplified. In particular, the capital gains tax rules should be simplified by excluding some low-revenue generating assets, removing grandfathering rules, and considering a principles-based rewrite of the rules.

In addition, the small business entity capital gains tax concessions should be rationalised and streamlined. The active asset 50 per cent reduction and 15-year exemption concessions should be abolished. The lifetime limit for the retirement exemption should be increased and taxpayers who sell a share in a company or an interest in a trust should be able to access the concessions via the turnover test.

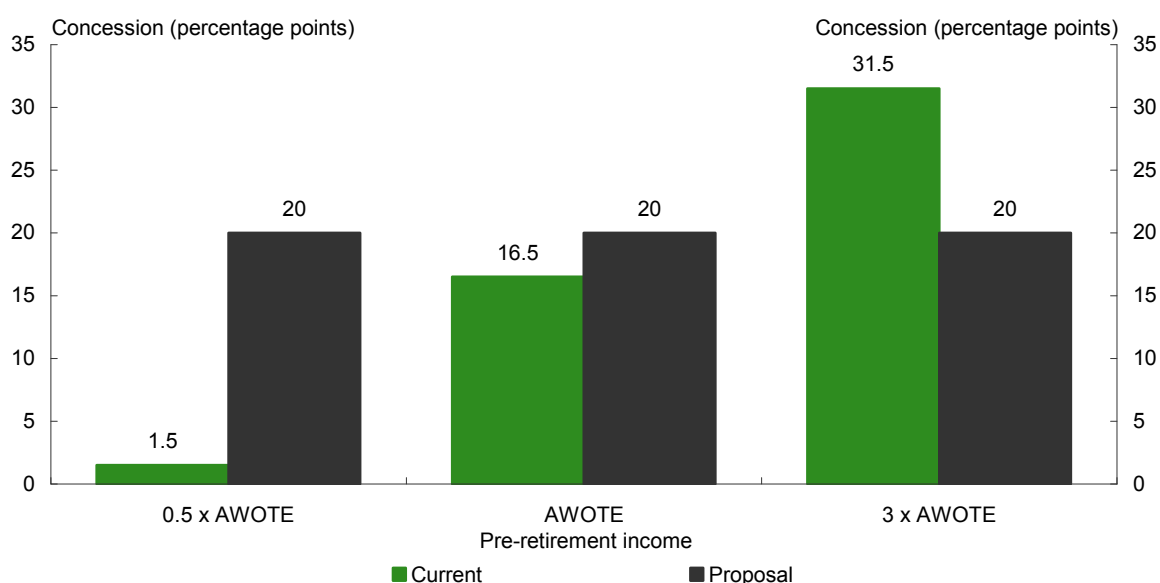
4.3 Improving retirement incomes

The ageing of the population, longer life expectancies and more people interacting with the system pose challenges for the retirement income system. A key finding of the Review Panel's strategic report on the retirement income system, released in May 2009, was that the current three-pillar retirement income system is well placed to deal with these challenges.

Privately funded superannuation will remain a key component of the retirement income system and should continue to receive a concessional tax treatment compared to other savings. However, the current taxation of superannuation favours high-income earners compared to low- and middle-income earners. For example, around 2.5 million individuals receive little or no personal income tax benefit from their superannuation contributions. In contrast, around 200,000 taxpayers (those earning more than \$180,000) receive a concession on their superannuation contributions of 31.5 per cent.

Concessions should be distributed more equitably between low- and high-income earners by including employer superannuation contributions in an individual's income and taxing them at marginal rates. A universal uniform concession in the form of a refundable offset could be provided up to a cap. Voluntary contributions should also be eligible for the offset subject to the cap. The tax on superannuation contributions within the fund should be abolished. This arrangement would provide a consistent concession to all contributions irrespective of a person's income (see Chart 4.5).

Chart 4.5: A more equitable concession for contributions
Based on a 20 per cent offset^(a)



(a) The chart assumes a single person who does not receive income support. The figures for the current situation are based on the 2009–10 marginal tax rate schedule with Medicare levy. In this case, a person on 0.5 x average weekly ordinary time earnings (AWOTE) has a marginal tax rate of 16.5 per cent, a person on AWOTE has a marginal tax rate of 31.5 per cent and a person on a 3 x AWOTE has a marginal tax rate of 46.5 per cent. AWOTE is currently around \$1,200 per week (\$62,400 per year). Around half of workers earn less than three-quarters of AWOTE.

Note: The recommended concessions are based on the indicative personal income tax rates scale in Section 4.1.

Source: Treasury estimates.

In isolation from other changes to personal tax, the effect of the recommendation would be to reduce a person’s disposable income. However, retirement incomes would increase as the fund would no longer pay contributions tax. In these respects, the effect would be similar to requiring employees to make an additional compulsory contribution into superannuation. Implementation would require consideration of arrangements to address the immediate impact on disposable incomes.

These arrangements should also make the system simpler and more transparent by replacing the different concessions for different types of contributions with one treatment (see Chart 4.6).

Chart 4.6: A more consistent treatment of superannuation contributions

Current contributions tax in fund						Proposed
Employer		Employee	Self-employed		Spouse	
Super guarantee	Salary sacrifice	Post-tax	Pre-tax	Post-tax		
15%	15%	N/A	15%	Nil	Nil	NO TAX

Current other personal income tax						Proposed
Employer		Employee	Self-employed		Spouse	
Super guarantee	Salary sacrifice	Post-tax	Pre-tax	Post-tax		
Nil	Nil	Marginal tax rate (0 -46.5%)	Nil	Marginal tax rate (0 -46.5%)	Marginal tax rate (0 -46.5%)	MARGINAL TAX RATE (0-45%)^(a)

Current concession						Proposed
Employer		Employee	Self-employed		Spouse	
Super guarantee	Salary sacrifice	Post-tax	Pre-tax	Post-tax		
Marginal tax rate less 15%	Marginal tax rate less 15%	Co-contribution (if eligible). No concession if not eligible for co-contribution.	Marginal tax rate less 15%	Co-contribution (if eligible). No concession if not eligible for co-contribution.	Spouse superannuation tax offset	FLAT-RATE TAX OFFSET

(a) Based on the indicative personal income tax rates scale (see Section 4.1).

Removing the tax on superannuation contributions in the fund would increase the value of superannuation guarantee contributions and could also increase the value of voluntary contributions in the fund. This would lead to higher retirement incomes. Halving the tax on superannuation earnings to 7.5 per cent would further increase retirement savings. These two reforms are projected to result in replacement rates⁵ of 88 per cent for a median income earner (approximately 0.75 times average weekly ordinary time earnings (AWOTE))⁶ and 76 per cent for an average income earner. Applying the earnings tax to the pension phase would considerably simplify the compliance requirements of superannuation funds.

A structural weakness in the current retirement income system is a failure to provide products that would allow a person to manage longevity risk. The government should support the development of these products and better facilitate their provision by the private sector. This could be achieved through issuing long-dated bonds and removing rules that restrict the development of income stream products. The Review is not convinced, however, that the purchase of such products should be made compulsory.

The government also has a role in improving people’s awareness of the retirement income system. This could be achieved by requiring superannuation guarantee contributions to be paid at the same time as wages, linking superannuation records and developing a single portal through which people could interact with government agencies.

5 A replacement rate compares a person’s spending power before and after retirement (that is, income and fringe benefits after tax is paid). For example, a replacement rate of 75 per cent would mean that a person would be able to spend in a given time period \$75 in retirement for \$100 spent before retirement.

6 AWOTE is currently around \$1,200 per week (\$62,400 per year).

4.4 Wealth transfer taxes

A bequest tax would be an economically efficient way of raising revenue and would allow reductions in other, less efficient taxes. It would not affect saving decisions to fund an adequate standard of living in retirement. Saving decisions motivated by the desire to leave a bequest would be affected, but only to a limited extent.

Given the controversial history of bequest taxation in Australia, the Review has not recommended the introduction of a bequest tax, but believes that there should be full community discussion and consultation on the options. Most OECD countries impose bequest taxes – either through taxes on the whole estate or individual inheritances.

5. Investment and entity taxation

Globalisation carries profound implications for Australia’s tax system and for the taxation of investment in particular. In a world of increased capital mobility, company income tax and other taxes on investment have a major impact on decisions by businesses on where to invest, how much and what they invest in and where to declare their profits.

Australia has been successful over recent decades in attracting foreign capital to finance relatively high levels of domestic investment. While the continuing growth of China and India, and the consequent strength in Australia’s terms of trade, should ensure continued strong investment in Australia’s resource sector, attracting investment in other sectors may become more challenging.

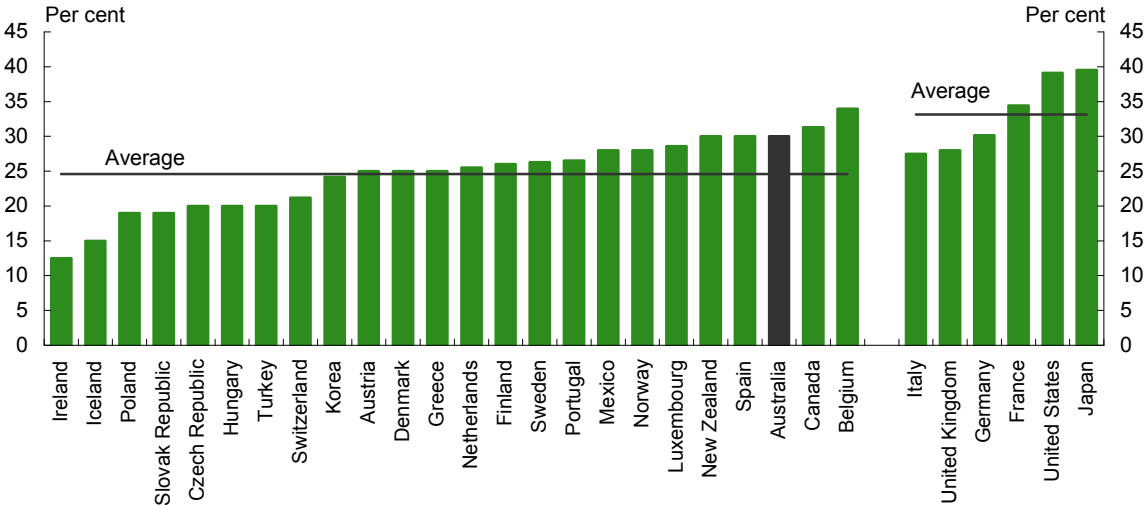
In the future it will be important to ensure that Australia remains an attractive place to invest in, and that investment is directed towards its most productive uses. In the long term, a larger and more productive capital stock will not only result in higher growth but is also likely to result in higher wages.

5.1 Reducing tax on business investment

A lower company income tax rate

Relative to other similar size OECD countries, Australia’s company income tax rate is high. In 2009, Australia’s company tax rate of 30 per cent was around 5 percentage points higher than the average for small to medium size OECD economies and was third highest behind Belgium, which has a significantly narrower company tax base, and Canada, which is moving to a lower rate (see Chart 5.1).

Chart 5.1: Statutory corporate tax rates, OECD countries 2009



Source: OECD (2009d).

Australia should respond to these developments by reducing the company income tax rate to 25 per cent over the short to medium term, as fiscal and economic circumstances permit. This would ensure that Australia remains an attractive place to invest — not only in the resources sector but also in the non-resource sectors of the economy.

Given company income tax also acts as a tax on profits derived from Australia's non-renewable resources, improved arrangements for charging for the use of these resources should be introduced at the same time. A broad-based resource rent tax would be a more effective way to ensure an appropriate return to Australians for the exploitation of their natural resources (see Section 6.1).

Reducing taxes on investment, particularly company income tax, would also encourage innovation and entrepreneurial activity. Such reforms would increase income for Australians by building a larger and more productive capital stock, and by generating technology and knowledge spillovers that boost the productivity of Australian businesses. A lower company income tax rate would also reduce incentives for foreign multinationals to shift profits out of Australia.

Improving resource allocation

Continuing to reduce biases in favour of particular assets or activities by aiming for a broader, more uniform company income tax base would ensure that investment is targeted to its most productive uses. Reducing biases against risk-taking would also encourage entrepreneurial activity, which is important for economic growth.

Aside from inherent difficulties in measuring economic income, features of the current system may bias investment and other business choices towards less productive outcomes. In turn, this may reduce productivity and economic growth.

Table 5.1: Effective tax rates by industry, selected countries (domestic)

	Australia	Canada	Japan	United Kingdom	United States
All industries	24	24	39	26	26
Construction	23		36	21	25
Financials	27	13	36	26	15
Information	14	19	35	21	19
Manufacturing	25	24	38	25	28
Mining	17	17			22
Other	24	23	41	26	30
Professional	19		36	24	21
Real estate	23		40	26	24
Retail trade	27		44	27	34
Transportation	22		39	25	24

Source: Markle & Shackelford (2009), Table 4.

Some of the biases from existing arrangements arise from current capital allowance arrangements, which favour some assets over others. Existing concessional arrangements should be reconsidered, including those relating to statutory effective life caps, capital works (including buildings), exploration expenses and the taxation of agriculture and forestry more generally.

Capital allowance arrangements could be improved by enhancing and streamlining the capital allowance arrangements. The existing low-value pool should be abolished, and instead all assets with a value of less than \$1,000 should be immediately deductible for all

taxpayers – apart from those eligible for the small business concessions, who can already write off assets with a value of less than \$1,000 and for whom an increase in this threshold is recommended (see ‘Simplifying arrangements for small business’ below). This would reduce record keeping requirements, removing the need to maintain a low-value pool.

Another bias in current company tax arrangements relates to the asymmetric treatment of gains and losses. To improve current loss arrangements, companies should be allowed to carry-back and offset a revenue loss against a prior year’s taxable income, with the amount of any refund limited to the company’s franking account balance. Allowing the carry-back of losses would also improve the automatic fiscal stabilisers.

To reduce biases in how foreign debt is accessed, interest withholding tax on interest paid by financial institutions operating in Australia should generally be removed. In addition, consideration could be given to removing interest withholding tax in future tax treaty negotiations, providing there are appropriate safeguards to limit tax avoidance.

Taxation arrangements applying to Australian managed funds and related services should also be improved to provide greater certainty that foreign savings managed by Australian businesses and invested offshore will not be subject to Australian tax.

Simplifying arrangements for small business

Small businesses bear a disproportionately higher share of the tax compliance burden. To reduce this burden and to provide small business with greater tax certainty, the existing small business tax concessions should be streamlined and broadened. Access to the small business tax concessions under the small business framework should be extended by increasing the ‘small business entity test’ (turnover test) from \$2 million to \$5 million.

In addition, the threshold for determining a low-value asset for small businesses should be increased to \$10,000. This would allow small businesses to immediately write off most of their asset purchases, simplifying and providing more certain arrangements while also providing cash flow benefits.

Arrangements for small business should be simplified further by allowing any remaining depreciating assets (other than buildings) that are not immediately written-off to be grouped in a single pool (rather than the two existing pools), with the entire pool written off at a single declining balance rate.

Combined with streamlining and rationalising the small business capital gains tax concessions (see Section 4.2), and the Standard Business Reporting program (see Section 10.3), these measures will result in significant simplification for small businesses.

5.2 The treatment of business entities and their owners

A key issue for the review has been whether Australia should continue with dividend imputation as the means of integrating the taxation of companies and shareholders. Globally there has been a trend away from dividend imputation, leaving Australia and New Zealand as the only two OECD economies with imputation systems.

Dividend imputation continues to provide benefits such as neutrality around financing and entity choices. It also enhances the integrity of the tax system by reducing the benefits of minimising company income tax. These benefits mean that dividend imputation should be maintained in the short to medium term.

However, as the Australian economy has become more open, the benefits of dividend imputation have declined. Accordingly, if the trend of increased international openness and integration with international capital markets continues, alternatives to dividend imputation should be considered.

Such alternatives could include switching double tax relief from the shareholder to the company. One option would be a shift to a partial integration system, with the company income tax rate reduced at the same time as more limited relief is provided to dividends. Moving to a company or business level expenditure tax (see Section 5.3) would be another, more far-reaching option.

While imputation is maintained, imputation credits should continue to be provided only for Australian company income tax paid, and existing prohibitions on dividend streaming and franking credit trading practices should be maintained. Moving away from these positions would compromise the integration function and integrity benefits of dividend imputation for little gain.

As Australia's dividend imputation system affects the allocation of investment between Australia and other countries, mutual recognition of imputation credits between Australia and New Zealand has been raised in the context of developing closer economic relations. To further economic integration, consideration could be given to the appropriate degree of harmonisation of business income tax arrangements between the two countries, with bilateral mutual recognition only one element of this broad consideration.

In contrast to companies, partnerships and trusts are typically taxed on a flow-through basis. This treatment remains broadly appropriate. However, the rules that set out how trusts are taxed are complex and give rise to uncertainty and should be updated and re-written.

5.3 A company income tax system for the future

The increasing globalisation of the Australian economy raises questions about the long-term appropriateness of the existing company income tax system and the dividend imputation system.

Australia, in the future, should consider moving the company income tax system towards a business level expenditure tax, such as an allowance for corporate equity, subject to further international development of tax models.⁷ A business level expenditure tax would reduce source-based taxes on the normal return to investment in Australia, provide greater neutrality between debt and equity and reduce tax biases across different investments, improving the stability and productivity of domestic business and investment. It may also provide opportunities for wide-ranging simplification of the company income tax system.

7 The case for these systems was outlined for the Review in the Australia's Future Tax System Conference Papers (Sørensen and Johnson 2010 & Auerbach 2010).

Such a system would provide a more effective mechanism for company and personal tax integration in a world of increased capital mobility.

However, in contemplating the replacement of company income tax with an expenditure tax, a significant concern for the Review is that there has been limited or no practical use of such taxes for this purpose. Replacing the current company income tax system with one of these alternatives would therefore involve considerable risks. For example, the practical implications from a tax administration and compliance perspective are unknown. There may also be opportunities for tax arbitrage if Australia is one of only a few countries using such a system.

In light of the potential benefits of business level expenditure taxes, there is likely to be increased interest internationally in them as replacements for company income taxes. Such a system may suit Australia and is worthy of further consideration and public debate. It is possible that other economies will move towards such systems over coming years and it could be in Australia's interest to join this trend at an early stage. An example of a blueprint for the reform of Australia's company income tax system, based on the allowance for corporate equity, is presented in Sørensen and Johnson (2009).

Moving to a business level expenditure tax could be complemented with improved taxation of savings income. This could include moving to a broader-based dual income tax that includes dividends and greater use of accrual recognition or deeming to measure savings income. Such a move could provide a more equitable and efficient basis for the taxation of savings, and be designed to reduce income conversion problems.

5.4 Not-for-profit organisations

Reflecting their highly valued contribution to community welfare, not-for-profit (NFP) organisations receive government and community support for their philanthropic activities.

Tax concessions and regulatory arrangements

Tax concessions are an important and longstanding source of funding for the NFP sector (see Table 5.2). However, the system of concessions is complex and does not appropriately reflect current community values about the merit and social worth of activities. The complexity of these concessions is exacerbated by the opaque and inconsistent regulatory arrangements for the NFP sector.

Consistent with the recommendations of previous inquiries, these issues could be addressed through the establishment of a national charities commission to monitor, regulate and provide advice to all NFP organisations. The commission could be tasked with streamlining the NFP tax concessions, and modernising and codifying the definition of a charity.

Table 5.2: Main tax concessions for major types of NFP organisations^(a)

	Value (\$m) (2008–09)	Charities	Public benevolent institutions(b) and health promotion charities	Deductible gift recipients	NFP and public hospitals, and public ambulance services
Income tax exemption(c)(d)	*	Yes	Yes	-	Yes
GST concessions	*	Yes	Yes	Yes	Charities only
FBT exemption (\$17,000)	260	-	-	-	Yes
FBT exemption (\$30,000)	715	-	Yes	-	-
FBT rebate(e)	20	Charitable institutions only	-	-	-
Deductible gifts	1,080	-	Yes	Yes	Yes

(a) Entities may have more than one status (for example, a charity could also be a deductible gift recipient).

(b) There are over 11,000 public benevolent institutions in Australia, including organisations such as: Anglicare Australia Inc; Australian Federation of Disability Organisations Ltd; Australian Red Cross Society; Parents, Families and Friends of Lesbians and Gays Inc; Refugee Council of Australia Inc; and Society of St Vincent de Paul Pty Ltd.

(c) Many NFP organisations are taxable, but are entitled to special rules for calculating taxable income and lodging income tax returns and are able to access special rates of tax.

(d) Income tax exempt entities that do not meet the broad definition of a NFP organisation, such as municipal corporations, local governing bodies, constitutionally protected funds, and public authorities constituted under Australian law, are not discussed in this section.

(e) Certain non-government NFP organisations are eligible for this concession.

* The value of the concession cannot be quantified.

Source: ATO (2007) and Treasury (2009).

Commercial activities

The High Court of Australia's 2008 decision in the *Word Investment* case has significantly increased the scope of NFP organisations to undertake commercial activities. In light of this decision, the Review has considered the impact of the three main tax concessions (income tax, GST and FBT) on competitive neutrality.

While the income tax and GST concessions do not appear to violate this principle, the FBT concessions provide recipient organisations with a competitive advantage in labour markets, as they enable them to pay the market wage at a lower cost. This distortion is particularly problematic in relation to hospitals, where nursing shortages are an ongoing concern.

The FBT concessions should be removed and replaced with direct government funding. All NFP organisations eligible for tax concessions should be eligible to apply for funding for specific projects, or to assist with the costs of recruiting specialist staff. Reflecting the importance the concessions in helping existing recipients to deliver their services, the concessions should be reconfigured over 10 years to provide them with sufficient time to adjust the prices they charge for their services, and to renegotiate employment contracts and funding models.

Mutuality

Where NFP clubs operate large trading activities in the fields of gaming, catering, entertainment and hospitality, the rationale for exempting receipts from these activities from income tax on the basis of a direct connection with members is weakened. Simple, efficient and concessional tax arrangements should be established for clubs with large trading

activities in these fields. One option is to apply a concessional rate of tax to total net income from these activities above a high threshold.

6. Land and resource taxes

Well-structured taxes on land and natural resources are a highly efficient means of raising revenue. Existing taxes on land and resources fall short of this ideal, and should be reformed so they are a more effective means of raising revenue.

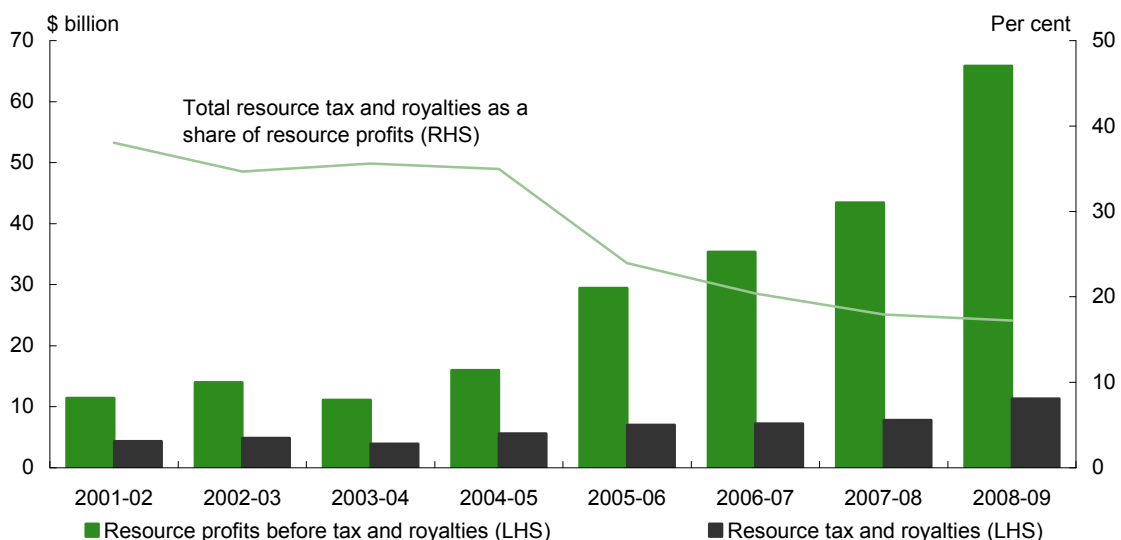
6.1 Charging for non-renewable resources

The current resource charging arrangements should be replaced with a uniform resource rent tax administered by the Australian government. Such a tax would provide a more consistent treatment of resource projects and promote more efficient investment and production outcomes. It would also ensure that the Australian community receives an appropriate return on its non-renewable resources.

Australia has abundant non-renewable resources, which are expected to continue to command high prices driven by demand, particularly from China and India. Non-renewable resources such as petroleum and minerals are a significant asset of the Australian community. Australia has the world's largest economically demonstrated resource reserves of brown coal, lead, mineral sands (rutile and zircon), nickel, silver, uranium and zinc and the second largest reserves of bauxite, copper, gold and iron ore (contained iron).

The current charging arrangements distort investment and production decisions, thereby lowering the community's return from its resources. Further, they fail to collect a sufficient return for the community because they are unresponsive to changes in profits, particularly output-based royalties. For example, existing resource taxes and royalties have collected a declining share of the return to resources over the recent period of increasing profitability in the resource sector (see Chart 6.1).

Chart 6.1: Existing taxes are inefficient and unresponsive^(a)



(a) Resource profits before tax and royalties are measured using income less an allowance for corporate capital. Source: Treasury estimates.

A uniform resource rent tax should be set at a rate of 40 per cent. It would use an allowance for corporate capital system, with taxable profit associated with a resource project equal to net income less an allowance for undeducted expenses or unused losses. The allowance rate would be set by the long-term government bond rate, as the government would share in the risks of projects by providing a loss refund if the tax value of expenditure is otherwise unable to be used.

Subject to transitional arrangements, the new rent-based tax should apply to existing projects, replacing existing charging arrangements. The allocation of revenue and risks from the new tax should be negotiated between the Australian and State governments. A cash bidding system could also be adopted to supplement the resource rent tax and promote the efficient allocation of exploration rights.

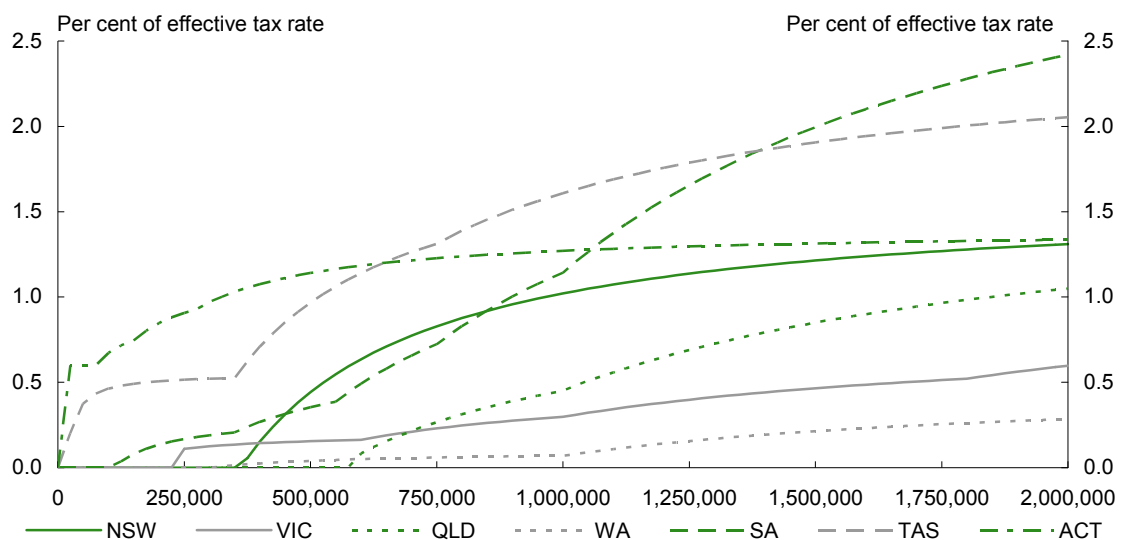
6.2 Land tax and conveyance stamp duty

Stamp duties are a highly inefficient tax on land, while land tax could provide an alternative and more stable source of revenue for the States.

When applied uniformly across a broad base, land tax is one of the most efficient means of raising revenue. This efficiency arises from the immobility of the tax base and, unlike most other taxes, levying different rates of land tax in different States has very low efficiency costs.

Existing land taxes are narrow, which make them less efficient and fair than they could be. Levying higher taxes on larger holdings discourages land-based investment by institutional investors, such as in rental housing. As owner-occupied housing is exempt, land tax on residential investment properties is probably passed through to renters as higher rent.

Chart 6.2: Thresholds and average rates of land tax



Note: Land tax in the ACT is determined on a value per property, not on aggregate holding.
Source: NSW Treasury (2009).

The structure of land taxes could be improved by broadening the land tax base to eventually include all land. Land tax rates should be based on the value of a given property, so that the tax does not discriminate between different owners or uses of land. A tax-free threshold based on the per-square-metre value of the land could be set such that there would be no tax

liability on most agricultural and other low-value land. Higher-value land could be taxed at differentiated rates based on the per-square-metre value of the land.

Stamp duties on conveyances are inconsistent with the needs of a modern tax system. While a significant source of State tax revenue, they are volatile and highly inefficient and should be replaced with a more efficient means of raising revenue.

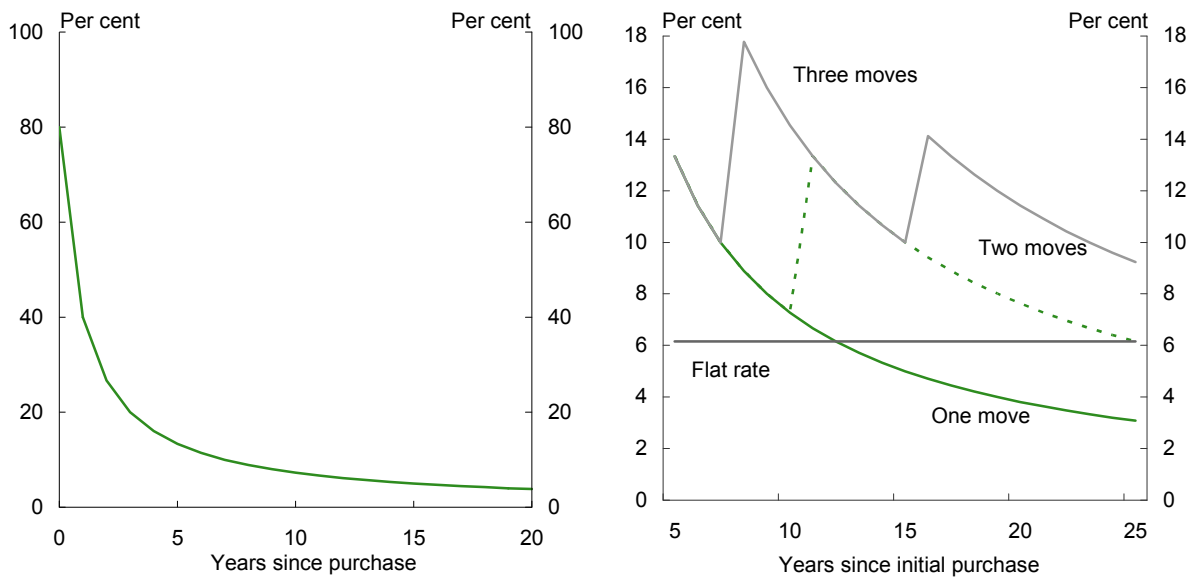
Conveyance stamp duty is highly inefficient and inequitable. It discourages transactions of commercial and residential property and, through this, its allocation to its most valuable use. Conveyance stamp duty can also discourage people from changing their place of residence as their personal circumstances change or discourage people from making lifestyle changes that involve a change in residence. It is also inequitable, as people who need to move more frequently bear more tax, irrespective of their income or wealth.

Reforming land tax and conveyance stamp duty arrangements, along with the proposed changes to the taxation of rental housing and Rent Assistance, will go some way toward improving housing affordability. However, to a significant extent housing affordability is a supply issue (see Box 6.1).

Chart 6.3: Stamp duty effective tax rate^(a)

Panel A: Effective tax rate falls with occupancy duration

Panel B: Increased tax rate on people who move



(a) The effective tax rates are calculated as the ratio of stamp duty (assumed to be \$20,000) to the value of imputed rent over the period the property is owned (assumed to be \$25,000 per annum). In Panel B, the 'flat rate' reflects a constant tax on imputed rent, with the rate equal to the effective rate faced by a person making two moves in 25 years (which is not average but intended to be indicative).

Source: Treasury estimates.

Box 6.1: Housing affordability

Access to affordable housing is a key policy issue for the Australian community that is likely to grow in importance. Government policies have traditionally treated owner-occupied housing as a preferred housing tenure. This approach reflects the desire of most Australians to own their home and recognises the benefits ownership can deliver to both the community and owners, such as through greater security in retirement. The approach in this Report is consistent with this policy goal. On that basis the Review has considered whether other features of the tax and transfer system are appropriately configured to meet pressures in the housing market.

Measures of housing affordability emphasise different aspects of the problem, but all reflect the price of housing and people's means to pay for it. The transfer system has a key role in ensuring that low-income earners can access an adequate standard of housing, and reforms to housing assistance will promote affordability in this regard. For purchasers, affordability is constrained by prices that are high relative to average income levels. While high prices can result from increases in housing demand, they can only be sustained when supply is not responsive. Evidence suggests that the current supply of housing is at insufficient levels, placing ongoing pressure on house prices.

The recommended reforms to stamp duties and land tax in particular should reduce current impediments to housing supply generated by the tax system. However, as taxation is not the major source of supply constraints in the Australian housing market, housing affordability would be best promoted through wider reforms that facilitate housing supply. Following these reforms and improvements to housing assistance, the taxation of investment housing should be reformed to ensure a more neutral treatment of rental property investment. While these reforms will address the significant distortions the tax system has on the housing market, a range of non-tax policies have a more significant impact on housing supply and affordability.

Housing supply can be restricted through a range of policies, such as planning and zoning regulations, as well as the approvals processes that govern them. However, such policies are designed to achieve a range of policy objectives, against which their impact on the price of housing should be assessed. The use of infrastructure charges has the potential to improve the allocation of infrastructure. However, where they are not set appropriately, infrastructure charges can reduce the supply of housing, and increase overall house prices.

While they may promote housing affordability, proposals that increase housing supply may reduce existing home values and change the shape of Australian cities in ways that many existing residents do not desire. This suggests a serious community dialogue is needed on the distribution and quality of housing across Australia. As a first step, the Council of Australian Governments should review zoning, planning and development approval policies and infrastructure charges to ensure they do not unnecessarily reduce housing supply.

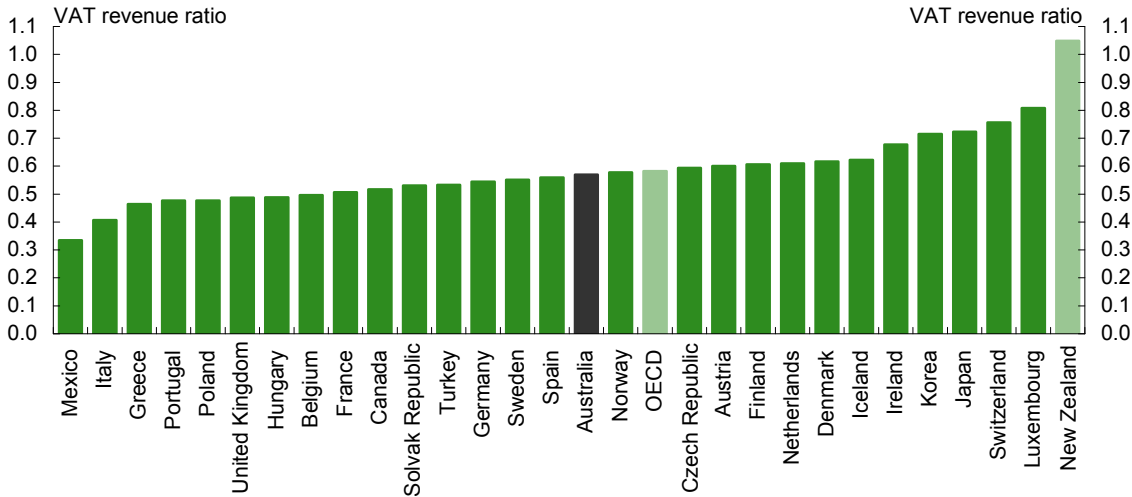
7. Taxing consumption

Consumption is potentially one of the most efficient and sustainable tax bases available to governments. Empirical evidence indicates that a broad-based tax on consumption is one of the least damaging taxes to economic growth. Many countries rely heavily on consumption taxes, levying them at rates well above Australia’s 10 per cent GST rate.

The introduction of the GST made Australia’s consumption tax base more efficient because it replaced a range of narrowly based Commonwealth and State taxes. While the GST is an efficient tax relative to most other taxes levied in Australia, it is less efficient than it could be because of its failure to tax consumption on a truly comprehensive basis (see Chart 7.1).

Moreover, complying with the GST is costly for business – particularly small businesses. It is an operationally complex tax, designed on tax invoice concepts more suited to the documentary standards of the 1960s than the digital potential of the 21st century.

Chart 7.1: VAT revenue ratio, 2005^(a)



(a) Unweighted average used for OECD. The VAT revenue ratio = (VAT or GST revenue)/[(consumption (including government consumption) — VAT or GST revenue] x standard VAT or GST rate). An 'ideal' value added tax, which would apply at a single rate on all domestic consumption, would have a VAT revenue ratio of 1. A VAT revenue ratio above 1 can reflect investment in residential housing that is taxed on a prepaid basis (and rents are input taxed) but is not included in national accounts as consumption, or cascading effects of input taxation in the value chain.
Source: OECD (2008a).

Australia retains a range of additional inefficient taxes on consumption (such as insurance taxes and the luxury car tax) and narrow payroll taxes. It would be possible to replace these taxes with a low-rate broad-based cash flow tax that more effectively utilised the consumption base. Exports would be exempt and imports subject to the tax, to ensure that it taxes consumption in Australia. The tax could be designed so that returns from labour would be taxed, making an additional payroll tax unnecessary. It would be highly efficient, because it would cover most of the consumption tax base. It would also be a relatively simple tax if it could be added to the existing tax reporting obligations of businesses.

Taxing the consumption of financial services, where value is generated through interest rate spreads rather than prices for products, is problematic for both the GST and a simple cash

flow tax. The use of input taxation as a proxy for GST potentially biases production and consumption decisions, despite additional complex rules designed to mitigate the inefficiency. This is because it over-taxes business by around \$500 million while under-taxing consumption by around \$2.5 billion (see Table 7.1).

Table 7.1: GST with input taxation of financial services

	Non-financial goods and services Explicit price = wages + economic rent	Financial services Implicit price in interest margin
Households	10% tax on price	10% tax on some inputs into financial services
Business	GST refunded, except for embedded tax	10% tax on some inputs into financial services
Exports	GST free - some embedded tax	GST free - some embedded tax

Financial services should be taxed equivalently to other forms of consumption. That is, the consumption of financial services by Australian households should be fully taxed. There are a range of options for how this could be done, although the actual design of the tax would need to be informed by extensive consultation with the financial services industry.

8. Enhancing social and market outcomes

In Australia's future tax system, the only additional taxes to those on the four broad bases described earlier would be specific taxes imposed for one of three purposes: to improve market or social outcomes by addressing spillover costs and benefits; to help counteract self-control problems (in the special case of tobacco); and to improve market efficiency through appropriate price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the social cost of the activity. Revenue should be a by-product of such taxes, not the reason for them.

User charging would play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services and rationing individuals' access to community resources, including renewable resources. User charging can be an efficient means of financing some government-supplied goods and services, provided the user is charged the cost (or loss) that consuming the good or service imposes on others. Where users do not directly impose costs on others, as is the case with public goods, funding should be by way of general taxation.

Other existing taxes would have no place in a future tax system and should be phased out over time. The elimination of a large number of taxes that distort production decisions or add to production costs would improve the competitiveness of Australian business. Fewer taxes would also enable further automation of tax administration, reducing business compliance costs.

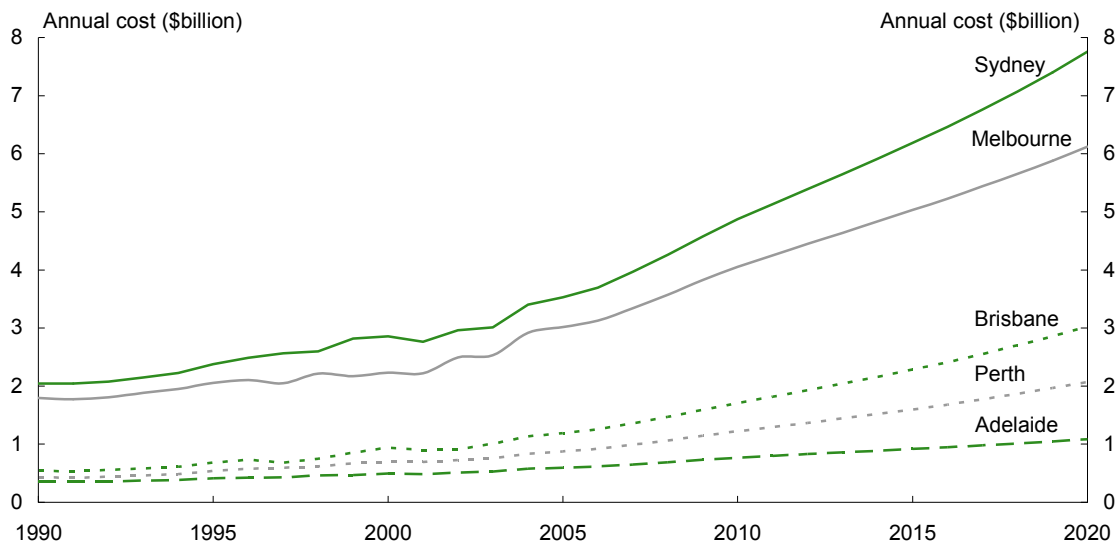
8.1 Road transport taxes

Current road tax arrangements will not meet Australia's future transport challenges. Poorly functioning road networks harm the amenity, sustainability, liveability and productivity of our society. Moving from indiscriminate taxes to efficient prices would allow Australia to leverage the value of its existing transport infrastructure. Less congested roads, shorter travel times and investment in road infrastructure that addresses user demand would provide a foundation for further productivity growth, improved living standards and more sustainable cities.

There are large challenges facing transport in Australia. In particular, under 'business as usual' assumptions, the avoidable costs of urban congestion may grow to around \$20 billion in 2020. This cannot be reduced simply by building more city infrastructure, as most new road space induces new traffic. Helping to manage road use, through efficient prices, provides the best long-term approach to reducing congestion.

If fuel tax is used as a variable road charge, it should apply to all transport fuels. Equally, fuel taxes should not exceed the levels justified by broadly defined social costs of use (whether of roads or environmental costs).

Chart 8.1: Social costs of congestion for Australian metropolitan areas
Base case projected estimates (1990–2020)



Note: Projected costs for Canberra, Hobart and Darwin are less than \$1 billion in 2020. Time costs are based on deadweight losses for current congestion. That is, social costs refer here to the estimated aggregate costs of delay, trip variability, vehicle operating expenses and motor vehicle emissions — associated with traffic congestion — being above the economic optimum level for the relevant network.
Source: BITRE (2007).

In major cities, location-specific congestion charges should vary according to the time of day. City roads would be less congested during peak periods, with travel at higher speeds and shorter travel times, saving time for road users, reducing vehicle costs and greenhouse emissions. The revenue from congestion charges on existing roads should flow back to the community, initially to finance public transport in affected areas.

Heavy vehicle charging would ensure that individual trucking operators pay their own specific costs, no longer cross-subsidising or being subsidised by other operators. Truck operators would have incentives to avoid route choices and vehicle configurations that cause the highest costs, but would have access to roads and bridges they are willing to pay for. Revenue from road-wear would directly fund road owners' maintenance.

In addition to helping manage demand for transport, reforms could be considered to ensure that spending on roads matches anticipated need. This should be determined according to strategic planning and comprehensive and transparent benefit-cost analysis. This would help ensure new roads are built where needed, and roads are maintained to minimise total life cycle costs, including costs to road users. Road users with specific needs could enter commercial agreements with road suppliers.

Existing institutions have not led to the most efficient use and supply of roads. Prices are essential to making the best use of roads, but they must be coupled with improved governance that better serves the needs of road users, now and in the future. New investment based on economic criteria and accountability for investment decisions would help ensure that roads are constructed and maintained in accordance with future needs.

8.2 Taxes to improve the environment

Our environment underpins our standard of living. People and businesses often do not take into account the environmental costs imposed on others, through pollution or other degradation, in the consumption and production choices they make.

Taxes can help to address environmental problems by providing people with a price signal that reflects the damage they cause to the environment and gives them an incentive to alter their behaviour. Where such corrective taxes are effective, they can be highly efficient – delivering greater environmental benefits for a given cost to the community than other forms of intervention. However, effective environmental taxes can be difficult to design and implement. Therefore, they are likely to be only one part of the response to addressing unacceptable environmental damage, along with regulation or other market-based mechanisms.

Once introduced, the Carbon Pollution Reduction Scheme (CPRS) will be the largest environmental intervention in Australia. It will be a cost-effective way to reduce Australia's carbon emissions. The effect of the CPRS should continue to be monitored, and opportunities taken to make it more efficient, to reduce other taxes (as revenues permit), and to remove supplementary measures including regulatory imposts.

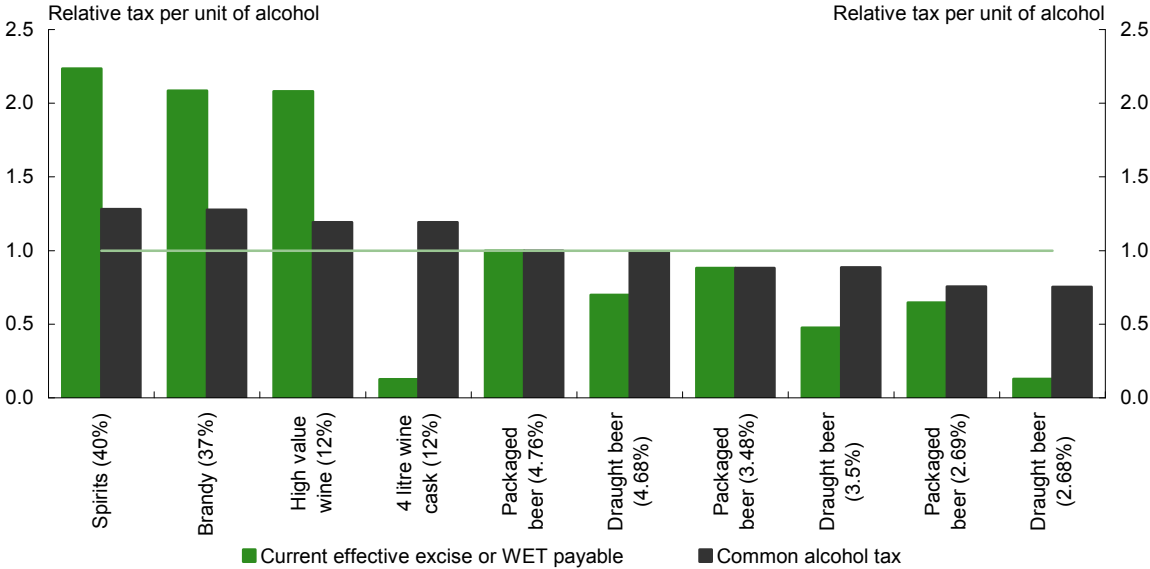
8.3 Alcohol taxation

Taxes on alcohol should be set to address the spillover costs of alcohol abuse, when this delivers a net gain to the community's wellbeing and is more effective than alternative policies. The tax rate should be determined by reference to evidence of spillover cost and based on a common volumetric standard applied to all forms of alcohol consumed in Australia.

The social costs of alcohol abuse by individuals are not effectively targeted by current tax and subsidy arrangements for alcohol. In particular, the wine equalisation tax, as a value-based revenue-raising tax, is not well suited to reduce social harm. For example, a two litre wine cask costing \$10.99 includes roughly \$1.59 of wine equalisation tax. An equivalent volume of alcohol in full strength beer would attract \$7.48 in excise, and in spirits, \$16.45.

A common volumetric tax on alcohol would better address social harm through closer targeting of social costs. The rate should be based on evidence of net social costs. Moreover, by removing the distinction between different manufacturing processes, the compliance and administration cost of the existing excise system would be reduced.

Chart 8.2: Relative taxation of alcohol under a common alcohol tax^(a)
By beverage type (alcohol by volume)



(a) The tax per unit of alcohol is measured relative to full-strength packaged beer.
 Note: The 1.15 per cent low alcohol threshold reduces the effective tax payable on beer below the statutory rate. For example, the effective excise payable on full-strength packaged beer is $1 - (1.15/4.9) = 76\%$ of the statutory excise rate. This treatment would be extended to all beverages under a common alcohol tax. The effective WET liability is calculated based on a 750 ml bottle of high-value wine retailing at \$40 and a 4 litre wine cask retailing at \$12.99.
 Source: Treasury estimates and ABS (2009c).

A common alcohol tax should be phased in over a long time, to ensure that sudden price rises or price falls do not adversely affect production or consumption decisions. However, shifting wine taxation from an *ad valorem* to a volumetric basis should be pursued as a priority.

8.4 Tobacco taxation

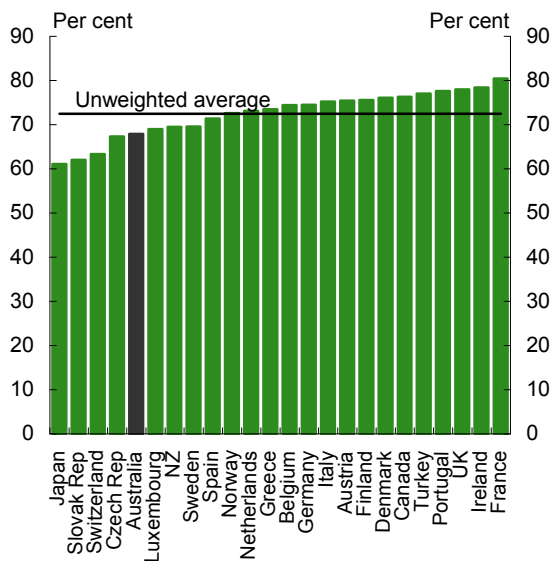
The strongly addictive qualities of tobacco, its serious health impacts and its uptake by minors, justify government intervention in the tobacco market. The costs that smoking imposes on non-smokers also support the case for government intervention. Tobacco taxes raise prices and reduce both smoking rates and smoking intensity.

There is a strong case for a substantial one-off increase in tobacco excise. Australian retail prices for cigarettes are moderate by international standards and taxes constitute a relatively small share of the retail price.

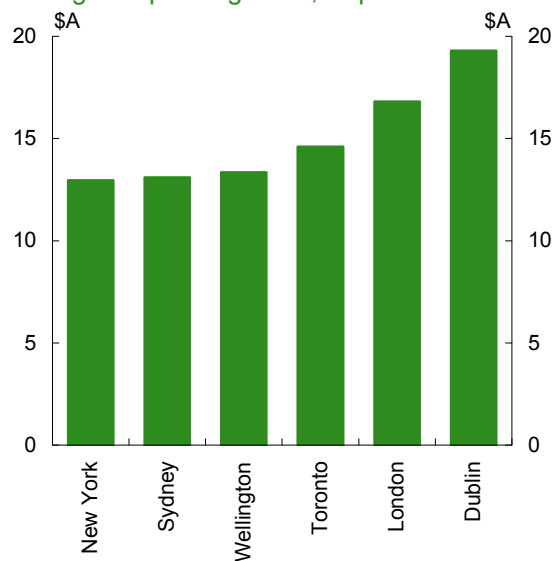
To maintain its policy effectiveness tobacco excise should be indexed to wages rather than consumer prices. Indexation of excise to consumer prices means that excise will fall as a proportion of average wages over time.

Chart 8.3: Tobacco taxes and prices in OECD countries

Panel A: Tobacco taxes as a percentage of price, 23 OECD countries



Panel B: Price of 30 cigarettes in six English-speaking cities, September 2008



Note: Tobacco taxes in Panel A include VAT, and Australia's GST, as well as tobacco-specific taxes. Many European countries have much higher VAT rates than Australia's 10 per cent GST rate, so that the differences between total tax rates on tobacco products and other products are smaller in those countries than in Australia. In Panel B, prices are for popular brands from medium-priced stores.

Source: Panel A: Scollo & Winstanley (2008); Panel B: National Preventative Health Task Force (2009).

8.5 Gambling taxation

Government restrictions on the supply of gambling services, implemented through licensing arrangements, mean that some gambling businesses can earn excess profits (economic rent). Economic rent is an efficient tax base and should be appropriated by the government, either through licence fees or taxation.

The rationale for continuing to impose specific taxes on gambling is to capture any economic rents that have not been captured by licence fees. Unlike tobacco excise, taxation may not be an appropriate mechanism to address problem gambling. It is not clear how problem gamblers react to higher taxes. In some forms of gambling, the price of gambling is not easily observable. Even if problem gamblers do observe changes in price, it is not clear that they respond by reducing the amount they lose.

Nevertheless, gambling taxes constitute an important revenue source for State governments and, as they do not currently have access to many high quality sources of revenue, they may be reluctant to reduce the amount of revenue they collect from them.

If so, they may have to make difficult choices in balancing revenue raising with regulating gambling in a way that limits problem gambling. For this reason, the Australian and State governments should explore options for the regulation and taxation of gambling that would minimise conflicts in policy-making between revenue raising and addressing problem gambling.

Even if the current tax burden on the gambling industry as a whole is considered appropriate, the way it is raised across the industry may not be. Current rates of tax on

different forms of gambling differ markedly without clear reason. If State governments retain gambling taxes, they should be designed with a clearer focus on capturing economic rent.

8.6 Rationalising other taxes

Taxes with narrow bases tend to be inefficient unless they effectively correct for a failure in a particular market or unless, in their effect, they function as user charges for particular goods and services.

Australia has several other taxes that should be phased out over time, including insurance duties and the luxury car tax. Imposing specific taxes on insurance deters people from insuring their property and encourages them to bear unnecessary risks, rather than pooling risk with others. Rates of non-insurance (for building and content insurance) generally are higher at lower incomes, yet low-income people are less able to bear the risk. The luxury car tax discriminates against a particular group of people because of their tastes. It is a complex and ineffective way of redistributing income from rich to poor.

There are also more than 90 minor taxes, levied by the Australian and State governments that should be subject to a systematic review against the principles set out in this Report. This Review should be coordinated with the introduction of the proposed system-wide Tax and Transfer Analysis Statement (see Part Two, Section G5 Monitoring and reporting on the system).

9. The transfer system

A 21st century tax and transfer system should reflect the commitment to Australian values of fairness and support for those who are disadvantaged, but do so in a way that is efficient, sustainable, simple and transparent, and internally consistent.

With changing social expectations and increasing age dependency, there is likely to be a greater expectation in the future that transfer recipients who are able to support themselves through work will do so. More generally, if Australia is to pursue a high-growth response to the fiscal challenge of an ageing population it is critical that transfer payments are designed to provide a strong incentive to work. This could be achieved by building clear work incentives into the levels of income support payments, by tailoring means test arrangements according to the participation opportunities and expectations of recipient groups, and through improved support for quality child care.

The broad architecture of Australia's transfer system is well suited to these goals. Australia has the most progressive transfer payment system in the OECD, reflecting effective targeting of support to low income households. However, the system is overly complex, can treat people of similar means differently and can result in people making choices that potentially undermine lifetime wellbeing. It would benefit from a more principles-based approach to setting payment levels and the design of payments to improve workforce participation incentives. Streamlining payment types and applying a comprehensive means test base would ensure a more consistent treatment of payment recipients. Establishing adequacy benchmarks for transfer payments not considered in the Pension Review would make the system more robust, particularly if the benchmarks were preserved through a common but sustainable indexation arrangement.

While full integration of the tax and transfer systems is considered impracticable, given their different objectives, better coordination between them is desirable. A coordinated approach should extend to the consideration of housing assistance, access to aged care and transfers that are tied to expenditure on other goods and services. A coordinated approach would support greater equity between transfer recipients, reduce the inherent disincentives to work created by taxes and transfers and underpin a better client experience of the tax and transfer system.

9.1 Three types of income support payment

Income support is a crucial social institution. Its primary focus should continue to be the provision of a minimum adequate level of income to people who are unable to support themselves through work or their savings. It should be based on three broad payment types (see Chart 9.1).

- Pensions should be available to people who are not expected to work and be sufficient to provide an adequate standard of living, based on an accepted community standard.

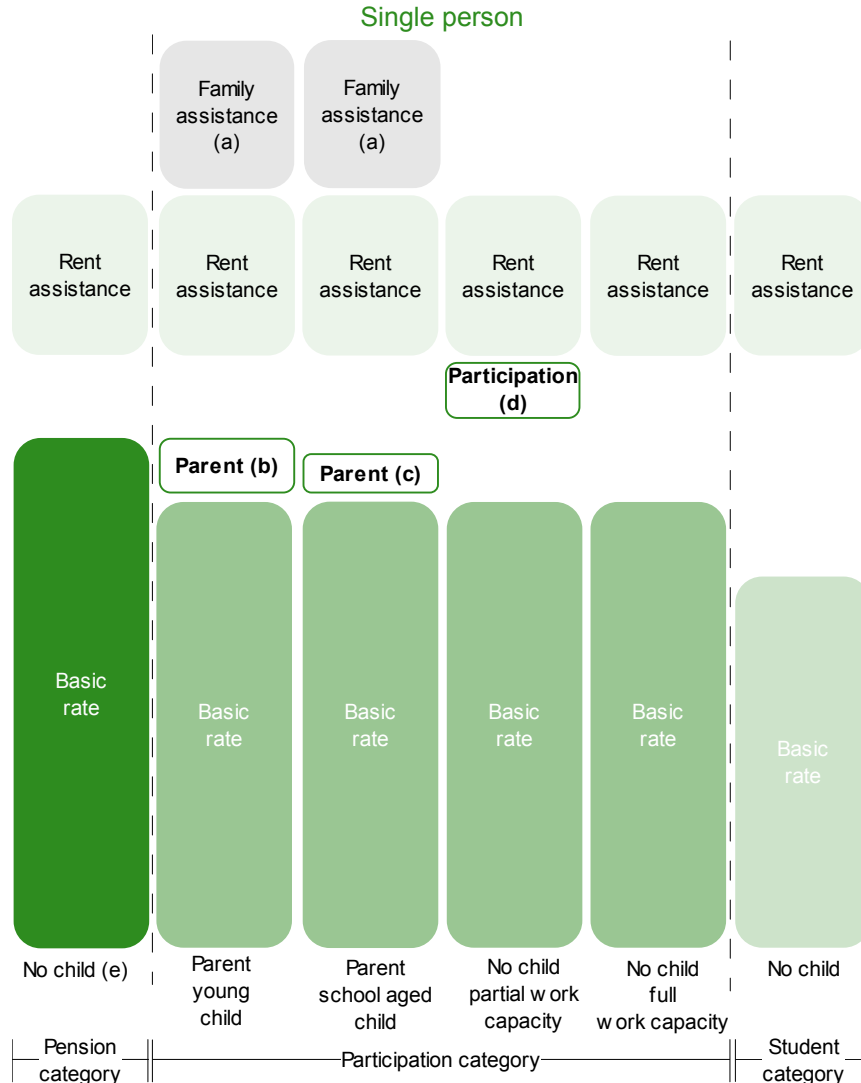
- Participation payments should be available for people who are able and expected to work, now or in the near future. Rates of payment should provide a basic level of adequacy and means test settings should provide incentive to seek employment.
- Student assistance should be paid at a rate less than the participation allowance rate. Some students have the capacity to work part-time. However, students should not be expected to work to an extent that undermines the benefits of their study. Students should, therefore, be able to access a loan facility to provide additional income up to the participation rate.

In addition to these three types of income support payments, supplements could raise the level of income support for parents (Parent Supplement) and assist with the direct costs of renting (Rent Assistance) and children (Family Assistance).

Parents would be eligible, subject to means, for additional assistance that would raise the level of their income support above the rate for those without children. The level of the parent supplement would vary with the age of the youngest child. For couples and single parents with a youngest child under six years, the supplement would be paid through the family payment system. Its level should be set such that the total support for single parents wholly reliant on income support would be equivalent to the maximum rate of pension. For couples whose youngest child is aged six years or older, the family supplement should be paid at a lower rate through the income support system. For single parents with a youngest child aged six years or older, this lesser amount should be paid through the family payment system, subjecting it to a gentler withdrawal rate. As a condition of receiving these payments, primary carer parents would have a requirement to look for part-time work once their youngest child reaches four years of age.

People with disability and with a partial capacity to work who receive a participation payment would be eligible for a participation supplement, which would provide an incentive to work part-time.

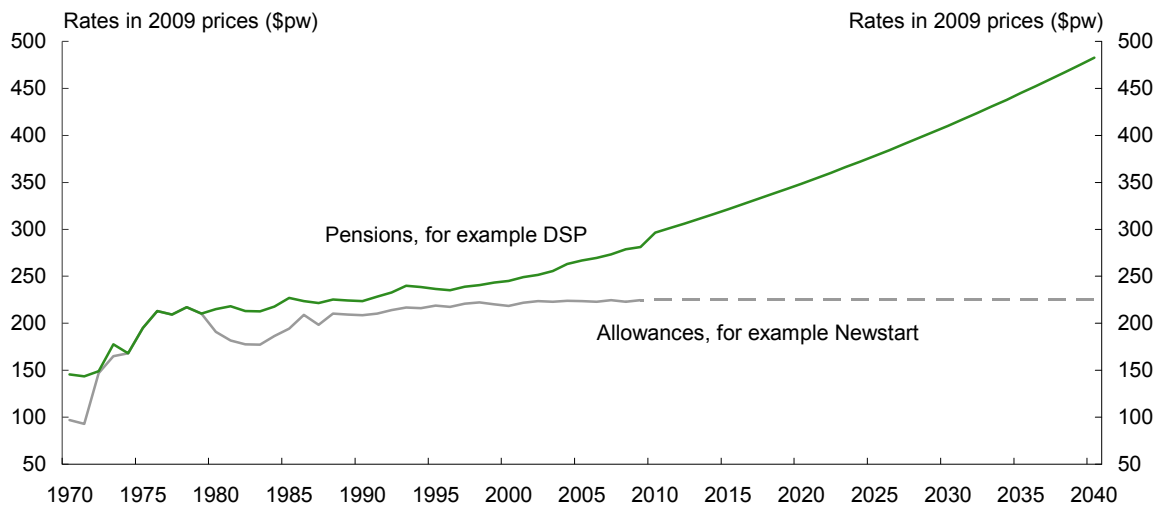
Chart 9.1: Indicative structure of adult working-age income support



- (a) Family assistance for the direct costs of children.
- (b) Parent supplement for families with a youngest child aged under six would be paid through family assistance and be available to working families.
- (c) Parent supplement for single parents with a youngest child six and older would be paid through family assistance. For partnered parents it would be paid as part of income support.
- (d) Participation supplement could be delivered through the means test.
- (e) Age, Disability and Carer pensioners would be eligible for the parent supplements.

There are currently large differences in rates and conditions of payment, especially for people of working age, which produce very different outcomes for people with a similar ability to work. These differences can create disincentives to work or incentives to move to higher payments. The differences in rates of payment are increasing as a result of differences in their indexation (see Chart 9.2).

Chart 9.2: Pension and allowances over time^(a)
2009 prices



(a) Projected values assume no policy change.
Source: Treasury estimates.

To improve fairness, the current differences in rates of payment should be reduced by gradually increasing the single person rates of payment in the participation and student categories. The rates of payment for single people in these categories would be lower than the amount paid for single pensioners. However, there should be a consistent treatment of the amount paid to single people compared to the amount paid to couples in the income support system. Once established, the relativities in the levels of adequacy in the three payment categories should be maintained through a consistent approach to indexation. Indexing to the current community standard for pensions would involve a significant cost, so governments will need to regularly review the benchmark.

9.2 A more comprehensive definition of means

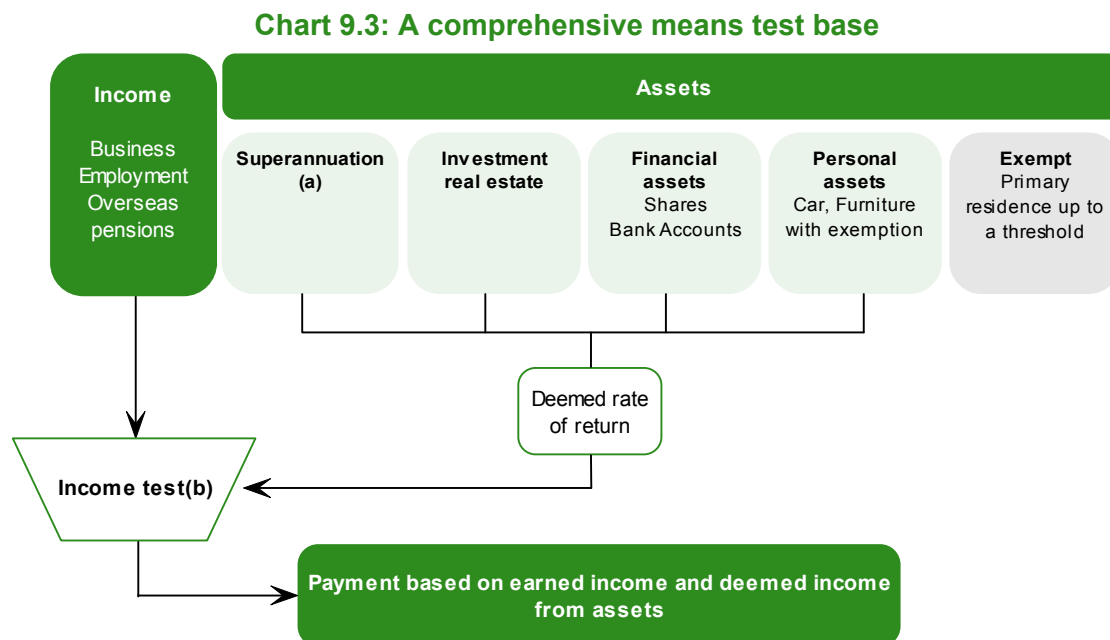
Means testing is an important tool for targeting government payments to those with most need and for managing the sustainability of the transfer system. It is a defining characteristic of Australia's highly targeted transfer system, which should be maintained. However, it could be improved so that income and assets are more fairly assessed and incentives to work and save are strengthened.

The concept of means for income support payments should include not only income but also the ability of a person to generate income from their assets. Striking an appropriate balance between targeting need and maintaining incentives to work and save is a significant challenge in designing a means test. Further, means testing can increase the complexity a person faces in interacting with the tax and transfer system.

A comprehensive means test base that determined access to all income support payments, including Newstart Allowance and the Age Pension, should replace the current two part means test – the income test and the assets test. This would involve deeming an income on most assets (see Chart 9.3). The deeming rates would be based on the returns expected from a portfolio of assets held by a prudent investor.

The comprehensive means test base would be fairer and less complex. Under the current two-part means test, people can receive different levels of government payments even though they have the same level of wealth. This is because some assets are assessed under both tests, while other assets are assessed only under the assets test.

The comprehensive means test base would provide a platform for tailoring the means test parameters, such as free areas, withdrawal rates and earnings disregards, to the circumstances of particular groups. These would determine the amount of income support payment.



(a) Deeming on account-based superannuation assets would apply from Age Pension age. Special arrangements would apply to income streams where deeming is difficult. Superannuation assets would not be deemed for people under Age Pension age unless they are being drawn down.

(b) Free areas and withdrawal rates would apply to determine the amount of income support payment.

The new means test would not apply to family payments. These would continue to be assessed on taxable income.

9.3 Better targeted family-related payments

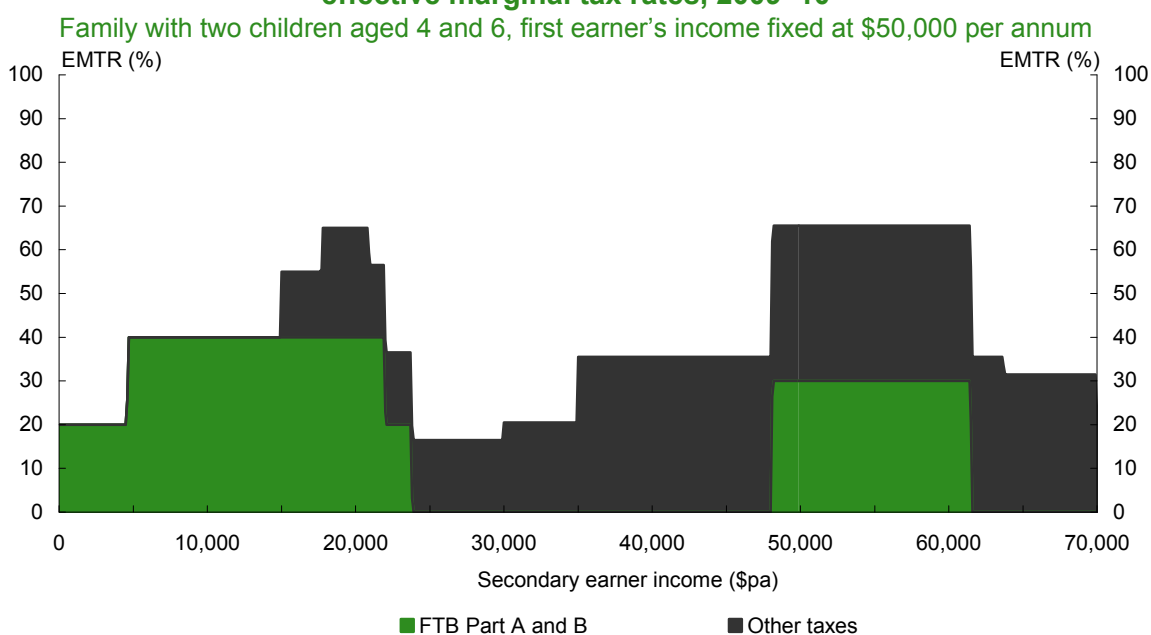
Family payments are integral to the total package of support available to families, particularly families with insufficient private income to support themselves and their children. They also provide a degree of horizontal equity between taxpayers with dependent children and taxpayers not supporting children. This horizontal equity role must be traded off against the higher cost of providing more universal family assistance.

Family payments should cover the direct cost of children in low-income families. Multiple existing payments should be replaced with one simple age-based family payment designed to reflect the additional cost of children as they age. It should be means tested in accordance with family taxable income (on the same base as for tax) in a way that minimises workforce disincentives.

Current rates of assistance do not always reflect the direct costs of children, particularly older children. For example Family Tax Benefit Part A rates are broadly adequate for 5–15 year olds, more than adequate for 0–4 year olds, but below the cost of children for 16–17 year olds (as is Youth Allowance).

Multiple family payments result in stacking of withdrawal rates, reducing the return to paid employment and unnecessarily discouraging participation. The simultaneous withdrawal of Family Tax Benefit Part A and Family Tax Benefit Part B adds to effective marginal tax rates of second earners (see Chart 9.4).

Chart 9.4: Effect of withdrawal of family payments on secondary earner's effective marginal tax rates, 2009–10



Notes: Family Tax Benefit Part A begins to withdraw at a rate of 20 per cent when family income is \$44,165, while Family Tax Benefit Part B begins to withdraw at a rate of 20 per cent when the second earner's income is \$4,672. The combination of these withdrawal rates, together with income tax rates, can lead to high effective marginal tax rates (EMTRs). Other taxes include the marginal tax rate, the low income tax offset and its withdrawal, and the Medicare levy shade-in.
Source: Treasury estimates.

Family payments have a role in ensuring that the choice to spend a reasonable length of time out of the workforce to care for young children is not constrained by financial need. Paid parental leave provides a strong signal that an absence from employment is appropriate and provides an alternative source of income for primary carers after the birth of a child.

Beyond the immediate post-birth period covered by paid parental leave, many parents continue to stay out of the workforce or reduce their hours of participation to provide care for young children. While the youngest child is under six years of age, low- to middle-income families should be supported to balance work and family responsibilities with an additional supplement through the family payment system tested on family income.

For parents with a youngest child aged six years or older, a supplementary per family support should be provided for couples receiving income support and single parents on low and middle incomes through the family payment system.

Family payments should be the main form of assistance for children aged up to 18 years, or until the completion of secondary school in the year a person turns 18 years. Beyond these

points, youth payments focused on encouraging study, training or workforce engagement should be available.

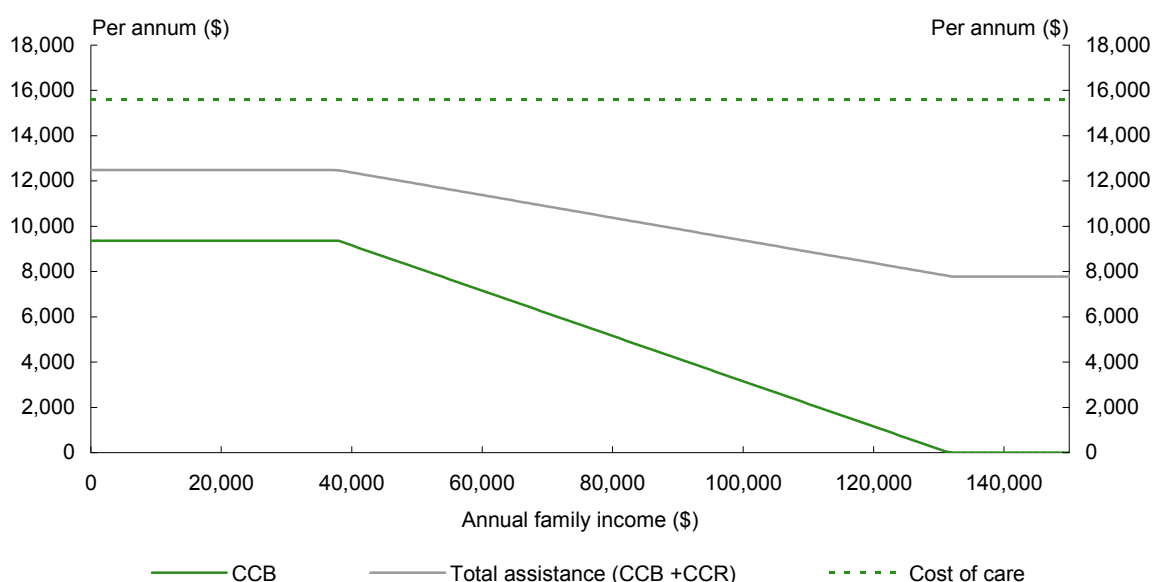
There should be a seamless transition from family assistance to income support for young people. This should be based on the person's circumstances and only one payment should be available in each circumstance, rather than families having to choose between youth and family payments. Assistance would still need to be flexible, to accommodate diverse transition paths by recognising earlier independence in a number of circumstances.

9.4 Child care

Access to high-quality and affordable child care can be an important factor in a parent's decision to remain in or return to the workforce. Child care assistance provides secondary earners and sole parents with material support to participate in the workforce. Assistance with child care costs recognises that child care is a cost of employment and thereby reduces the disincentives to participate that are created by the tax and transfer system. Access to quality child care also plays a role in early childhood development, particularly of children from families experiencing, or at risk of, social exclusion.

Currently, there are two main child care payments: Child Care Benefit (CCB) (a means-tested per hour rate of assistance payment) and Child Care Rebate (CCR) (which covers 50 per cent of out-of-pocket costs). These two payments combine to provide a total level of assistance which is higher for low income families and still significant for middle and higher income families (see Chart 9.5).

Chart 9.5: Child care assistance, 2009–10
One child in full-time care (50 hours per week) assuming a weekly fee of \$300 per week



Note: Assumes that the child is in approved care and not of school age and that the child care fee is constant across all income levels.

Source: Treasury estimates.

Child Care Benefit and Child Care Rebate should be combined into a single payment to make child care assistance simpler and more transparent. The new payment should be set as

a percentage of out-of-pocket expenses to ensure that the rate of assistance is maintained over time and that it accommodates the wide distribution of child care prices in Australia.

Low-income families should receive a high rate of assistance to facilitate workforce participation and support the use of child care for early learning and development. The payment should be means tested, but all families where parents participate in work, training or study should have access to a base rate of assistance, set with reference to the marginal tax rate faced by most taxpayers.

9.5 Housing assistance

Access to adequate housing is integral to a decent life enabling full participation in society.

Including Rent Assistance as part of the income support system allows assistance to be targeted to need and delivered in a way that does not discourage workforce participation. However, the current maximum levels of assistance are too low for many people to secure an adequate standard of housing. Further, indexation of assistance to the Consumer Price Index means that assistance is not well targeted over time, leaving recipients to bear the risk of rent fluctuations.

Rent Assistance should be increased so that assistance is sufficient to support access to an adequate level of housing, and indexed to market rents. Rent Assistance should also be extended to public housing tenants, with tenants charged rents that reflect market rates, subject to grandfathering or other transitional arrangements.

Public tenants currently receive a higher average level of assistance than private tenants, with assistance poorly targeted to need. As most public tenants have similar means to recipients of Rent Assistance, the large difference in assistance levels is inequitable. The gap in assistance leads to rationing of access to public housing through queuing and can lead to poor outcomes for tenants in the long-term.

The use of queues to ration public housing and income-based rent setting discourages workforce participation. Further, public housing funding neither effectively targets assistance, nor encourages the use of the housing stock in ways that reflect the needs of clients.

Social housing providers should receive a new source of funding for tenants with high housing needs, such as those with high costs due to disability or people likely to face discrimination in the private market. The payment would be based on the needs of recipients and directed by them to providers of their choice. In combination with Rent Assistance, this assistance would encourage the formation of a more dynamic social housing market that would reduce reliance on the current system of block grants.

The Australian government and the States should retain the option of providing capital for social housing provision.

9.6 Transfers tied to goods and services

Governments also provide other transfers in the form of concessions or payments that are linked to the purchase, or supply, of a particular good or service.

The current approach to concessions should be reviewed, both in terms of how they are funded and provided, and how they interact with other parts of the tax and transfer system. The provision of this type of transfer across the three levels of government is not always consistent with other aspects of the tax and transfer system. The use of concession cards as a gateway to a number of concessions provided by the Australian, State and local governments creates a strong incentive for people to gain eligibility for concession cards. Further, some concessions are regressive, as they effectively provide higher value to people with higher means.

The Productivity Commission should review concessions across all levels of government and provide recommendations for consideration by the Council of Australian Governments (COAG).

The capacity of the tax and transfer system to deliver improvements to people's wellbeing is also highly dependent on how governments fund and provide other public services, such as health and education. Governments use a range of mechanisms to support access to these services and current arrangements can sometimes lead to unintended outcomes. Given that governments will face cost pressures in funding public services in the future, there is merit in reviewing the principles of public service delivery and the scope for services to be delivered in different ways.

Therefore, the manner in which public services are delivered should also be subject to further review, beginning with a Productivity Commission study to enable COAG to consider broad principles and directions.

9.7 Aged care

Access to adequate aged care services is a key determinant of the wellbeing of older Australians. The ageing of the population is expected to lead to strong demand for aged care from recipients with a wider range of needs and preferences. This will test the limited choice available within the current system and its fiscal sustainability.

Australia's aged care sector is complex in both its regulatory system and its funding arrangements. The priorities for governments are to determine what an adequate level of aged care should be, the necessary pricing and regulatory arrangements to deliver it, and the most sustainable funding arrangement to ensure access by those who cannot afford it.

There is considerable scope to reform aged care funding so that it is consistent with a recipient's needs and provided in a way that supports their choices. Unbundling government assistance for aged care into accommodation, care and daily living expenses would allow the most appropriate subsidy to be targeted to each (including consistent means-testing). It would also allow the biases to particular types of care to be removed and improve service quality, by directing resources to a recipient's preferred provider; for

example, allowing people to receive care in their preferred setting, whether in a home or care facility.

Implementation of these reforms to funding arrangements would be significantly limited by regulations that govern the supply and price of aged care. Reforming these regulations would involve complex sequencing and transition issues. The Productivity Commission should consider the potential to revise funding arrangements for aged care as part of its broader upcoming inquiry into aged care.

The long-term sustainability of aged care could be supported by insurance mechanisms, which could involve compulsory funding through levies applying to all personal taxpayers. The potential for this type of funding arrangement should also be considered by the Productivity Commission, as it would be similar to some of the social insurance attributes of broader disability insurance, into which the Commission is inquiring.

10. Institutions, governance and administration

A 21st century tax and transfer system should deliver services in a way that meets the needs and preferences of clients. This requires a new approach, one that gives far greater weight to users' experience of the system. Reducing the number of taxes and transfers and improving the effectiveness of those that remain is necessary but not sufficient to achieve this goal.

Policy design needs to place a premium on outcomes that enhance the user experience, including through the use of client-centred information technology, potentially at the cost of achieving other policy objectives.

The system has to respond to the needs and expectations of the community. It should help people make informed decisions that are in their best interests. People will be more willing to engage with a system that they understand. Technological advances are likely to make it easier for people to navigate complexity, while also improving the transparency of the system. Increased monitoring and reporting on the system will also enhance transparency and lead to greater trust in its operation.

Ultimately, Australians care about how taxes affect their lives, not about which level of government is responsible for them. While the nature of our federation means that taxes will continue to be raised at different levels of government, tax policy and administration needs to be coordinated.

10.1 A responsive and accountable tax system

Australia needs modern and sophisticated tax policy and administration processes that can deliver a tax system to meet the demands of the 21st century. The tax system will face a range of challenges over the next few decades that will affect how tax policies are developed and administered. It is imperative that the tax system can meet these challenges and respond to the needs of the community.

The operation of Australia's tax system is fundamentally sound and there is general confidence in the system. The level of voluntary compliance is high, reflecting positive perceptions about the fairness and integrity of the system and how it is administered. Many of the current institutional arrangements will continue to perform well. However, a number of reforms would make the system more robust in the face of future changes in Australia's policy context.

The nature of any tax system means there will always be some tension between taxpayers and tax authorities. The tax law is complex and there are inevitable uncertainties in its application to complex commercial arrangements or in novel situations. This can create tension about the authorities' interpretation of the law and efforts to improve certainty through amendments to the law. A more transparent and accountable system has the potential to ease some of these concerns.

Governments should further develop open and inclusive processes by which the community can raise issues and have them considered by government. Building on its existing strengths,

the Board of Taxation could act as a 'circuit breaker' in the system — to quickly identify problems, particularly those that arise at the boundary between policy and administration.

Enhanced governance mechanisms would improve the accountability of the system and bring other perspectives to tax administration issues. An advisory board could contribute further external views into the management of the Australian Taxation Office (ATO). These external views would help the ATO meet the considerable demands of the coming decades. Other changes would improve the effectiveness of external scrutiny of the system.

10.2 State tax reform

The tax system spans the three levels of government in Australia — Australian, State and local. Individual governments separately administer their own taxes, but there is much interaction between the policy objectives and the administration of taxes levied by different governments.

Improving the structure of the tax system should begin with recognising that the wellbeing of the Australian people is affected by the taxes of the entire federation. A tax affects people in the same way irrespective of which government is responsible for it. People also make choices in response to the totality of taxes and transfers they face.

For as long as the States have significant expenditure responsibilities, they should have access to significant and sustainable tax revenue. Furthermore, the States should also have some autonomy over the amount of tax revenue they raise, so they are accountable for their expenditure decisions.

Although the States currently have access to significant taxes, there are problems with the quality of these taxes or the way they are levied. Increasing the rates of existing State taxes would not be an efficient or sustainable way of funding services in the future. Assuming no change in expenditure responsibilities between levels of government, the States will need better access to sustainable tax revenues to deal with these cost pressures.

The capacity to phase-out existing narrow-based taxes depends on the States having access to an alternative, more efficient revenue source. This could be a reformed land tax, revenue from a cash flow tax and/or a tax base sharing arrangement for personal income tax.

Achieving many of the reforms listed in this report will require cooperation between the Australian government and the States. Changes are required to taxes, transfers and other types of expenditures across levels of government. Reforms would also need to be sequenced in a way that allows people to understand the reason for change and how they will be affected. One way to coordinate and implement reforms over time would be through an intergovernmental agreement between the Australian government and the States. A well-managed process would not only allow for poorly performing taxes to be replaced by more sustainable ones, it could also be a mechanism to deliver better policy outcomes across the federation on an enduring basis.

Local governments are generally established under State legislation and have access to one tax — local government rates levied on properties within their municipality. Unlike State governments, local governments fund the majority of their expenditures through own-source

revenue (83 per cent in 2005–06), with local government rates making up around 45 per cent of this.

The immobility of land makes rates based on land value an appropriate tax base for local governments. States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality.

Over time, state land tax and local government rates should be more integrated. Taxpayers could receive one tax assessment that identifies local government rates and State government land tax in a transparent manner.

10.3 The client experience of the tax and transfer system

Currently, people's interactions with the tax and transfer system tend to be complex and fragmented. Among other things, this is due to the complex objectives of the tax and transfer system, the world in which it operates, and the desire to tailor the system to the diversity of people's lives. A person's experience in interacting with the tax and transfer system can increase or reduce their costs and risks.

While initiatives to improve people's experiences of the system by delivery agencies have been pursued, to date most have been primarily organisational or portfolio specific. At the same time, policy and program complexity has continued to increase.

A significant improvement in people's experience of the system requires a new approach to policy design. A 21st century tax and transfer system should allow individuals to engage with it in ways that meet their needs and preferences – a citizen-centric design. It should help people make informed decisions that are in their best interests. It should be transparent and trusted in its operation, and aligned with the 'natural systems' of individuals and businesses (the things they do anyway).

Such a new approach, that brings together policy design and implementation across agencies and portfolios, is needed to achieve the transformation in the client experience summarised in the table following (Table 10.1).

Greater use of technology, improved coordination and management of information, plus better design and integration of processes will enable such a transformation of the client experience. This will not just enhance the experience of individuals, but also equally enhance and improve the business experience of the system. Providing people with their own online tax and transfer client account, and sending people default pre-filled tax returns, are key initiatives that will enhance people's experience of the system.

Current government strategies, such as the Standard Business Reporting Program, will improve businesses' experience of the system, including through a reduction in the compliance costs of interacting with government. Extending these strategies to other business interactions has the potential to further improve outcomes.

Table 10.1: Transforming the client experience

Old system	New system
Limited range of transactions can be performed online	All transactions (except those that need to be conducted in person due to a policy requirement) can be performed online.
Information has to be reported multiple times, sometimes in different ways.	Information such as a change in address or new employment details will be provided once and used across the system.
Account balance information for tax and transfers is not easy to access.	Totality of financial relationship with government will be accessible online with clients able to see historical data as well as real time information.
Difficult to calculate how a change in income or circumstances such as having a child or retiring will affect a client's tax liability and transfer entitlements.	Clients will be able to see how their tax and transfer situation will change if their income or circumstances change.
Different processes for benefits and transfers administered by different policy departments.	Common processes so clients have a similar experience when transitioning between payments.
Many rebates, offsets and deductions providing welfare-type assistance in the tax system.	Greater use of standard deductions and outlays.
Information from third parties such as financial institutions and employers is pre-filled in electronic tax returns where available; other information is manually entered.	Tax and transfers reporting is designed so that most information can be pre-filled automatically.
Many clients get assistance to manage their tax and transfer affairs.	Most clients will feel confident to manage their own affairs because the process is simpler and more automated.
Clients use face-to-face and call centre services to make queries or provide information when they would be willing and able to use self-service applications if they were available.	Extensive self-service options are complemented by personalised assistance for those needing more intensive assistance.

10.4 Monitoring and reporting on the system

Monitoring the tax and transfer system is essential to its long-term performance. Without government action, too little information will be collected about the operation of the system. This information is necessary to identify areas where particular transfers or taxes are not meeting their policy objectives. It can also support research that improves community understanding of the effects of the system and guide policy responses to emerging problems.

High standards of transparency and accountability should apply to all taxes, transfers and spending programs. However, despite their similarities, tax expenditures and spending programs are not created, maintained, reviewed or reported in the same way. This means that there is often less transparency and accountability in the use of tax expenditures. While this situation continues, programs should not be delivered as tax expenditures unless there is a clear countervailing benefit in terms of efficiency, equity, complexity, sustainability and policy consistency.

11. Macroeconomic and fiscal impacts

Australia's tax and transfer system needs to raise and redistribute revenue efficiently, equitably and in a fiscally sustainable manner. In doing so, it should be fair, support increases to national income through higher productivity and workforce participation and be consistent with environmental sustainability.

To evaluate the economic and fiscal impact of the reforms, the Review has assessed the macroeconomic implications of the recommendations and their overall fiscal impact using indicative policy parameter values. The findings from this high-level analysis are that the recommendations would significantly increase overall national output, increase real wages, contribute positively to macroeconomic stability and add to national savings. They would also be fiscally sustainable.

Many of the recommendations of the Review have focused on enhancing distributional outcomes. However, the way the recommendations might be implemented, the specific values of their key policy parameters, their timing and the prevailing economic environment in which they are implemented would influence how they affect individuals and businesses. For this reason, the Review has not undertaken detailed quantitative distributional analysis of the impact of the recommendations.

11.1 Implications for economic growth

The reforms outlined in this Report have the potential to significantly increase the productive capacity of the economy by reducing the extent to which the tax and transfer system interferes with the decisions of individuals and businesses, including investment and workforce participation decisions.

The economy-wide impacts of the Review's primary recommendations have been analysed using the MM900 economic model of the Australian economy, developed for the Review (see Box 11.1). Unlike other general equilibrium models of the Australian economy, the MM900 model incorporates considerable detail about the Australian tax system. Its predecessor, MM600, is a widely used and well-respected Australian economy model.

The economy-wide analysis has included the following reform directions:

- reducing company income tax;
- improving the taxation of Australia's non-renewable resources and land;
- replacing a range of narrow product taxes with a broad-based cash flow tax; and
- improving the structure of other taxes aimed at improving social outcomes.

Other recommendations have not been modelled, either because there is insufficient policy detail to perform the simulation or the policy detail could not readily be modelled within MM900.

The potential overall gain to output has been estimated to be in the order of 2 to 3 percentage points, the major contributors to which are state tax reform and improved business taxation, including a reduced company tax rate and increased reliance on more efficient resource taxation. The increase to GDP is broadly equivalent to around \$25 to \$40 billion in 2010–11 values. The real wage rate (the wage rate adjusted for the change in consumer prices) has been estimated to increase in the range of 3 to 5 per cent.

Significantly, the estimated increases to national output and to real wages do not include potential gains to economic efficiency from: improved transport pricing; improved workforce participation incentives arising from personal taxation and transfer payment reform; a higher level, and more efficient allocation, of savings and investment; and increased entrepreneurial activity. They also exclude the efficiency gains from lower system administration and compliance costs.

The estimated increases would be expected to arise over an extended period, in part because reforms are likely to be implemented progressively over many years, but also because it takes time for people and businesses to respond to changes in prices, particularly where this involves changing employment, changing business operations or replacing existing assets. Consequently, the gain to national income would be expected to accrue through a higher rate of annual economic growth over the transition period.

11.2 Macroeconomic stability and national savings

Elements of the tax system can affect macroeconomic stability. For example, tax distortions such as the asymmetric treatment of debt and equity can encourage excessive leveraging and other financial market problems, which have been evident in the recent global financial crisis (IMF 2009b).

While reductions in the company income tax rate would reduce this bias, the business level expenditure tax (identified by the Review as meriting further consideration) would substantially reduce it or eliminate it altogether.

The existing tax system is also likely to encourage excessive leveraging in pursuit of tax-preferred income. Where capital inflow is used to finance less productive assets, this can also affect long-term macroeconomic stability. In this regard, recommendations to provide a more neutral tax treatment of savings, to reduce the benefits from negative gearing and eventually abolish stamp duties on housing would also help improve macroeconomic stability.

Overall, a more efficient and flexible economy is likely to be able to respond more easily to macroeconomic shocks. A more transparent and accountable tax and transfer system would improve this flexibility and perceptions of Australia's economic prospects.

The likely widening of Australia's current account deficit coming out of the global recession might refocus public debate on the level of Australia's national saving.

The Review's recommendations for the taxation of superannuation would have a positive effect on national savings. The proposed changes to the taxation of superannuation would provide a significant increase in private savings mainly driven by the proposed elimination of the superannuation contributions tax and the halving of the earnings tax, both of which would significantly increase superannuation assets.⁸

In addition, the Review Panel has noted that for areas of policy where community needs are likely to increase due to the ageing of the population (such as aged care and disability), some form of compulsory insurance to meet the costs of seniors might be appropriate. While these reforms would be important in their own right, they would also enhance national savings and help pre-fund fiscal risks.

Box 11.1: Computable general equilibrium models

An understanding of the impact of taxes and transfers on the allocation of resources in the economy is crucial to tax policy design. A general equilibrium economic model of the Australian economy is the only viable means of assessing the economic effects of reform of the scale outlined in this report. Such models represent the economy, the way it operates and the way people and businesses respond to changing price signals, using a consistent economic framework. They enable the economy-wide effects of a policy change to be observed, including so-called second-round effects in markets not directly affected by the policy under consideration.

While they provide a sophisticated means of assessing the impacts of policy change, these models have limitations. They are an approximation, or simplified version, of the real world. They are usually highly aggregated, reflecting both data limitations and the need to make the models tractable. Consequently, these models will not provide insight into all the possible effects of a policy change. For example, the actual impact of a policy change may vary between individual firms in a particular industry, due to differences in their business structure, but such effects will not be captured in an aggregated model.

Importantly, the results obtained from such a model are influenced by the structure of the model itself and its underlying assumptions about producer and consumer behaviour. There are also limitations to the precision with which individual taxes and transfers can be represented in such models.

The model used to analyse the economic effects of the recommendations in this Report is the KPMG Econtech MM900 computable general equilibrium model of the Australian economy. This model has a high level of tax detail, which has enabled a broad range of the existing Australian taxes and recommended policy changes to be modelled. It estimates the long-run impacts of a policy change, usually taken to be about 10 years. An overview of the MM900 model is provided in KPMG Econtech (2009) (available at www.taxreview.treasury.gov.au).

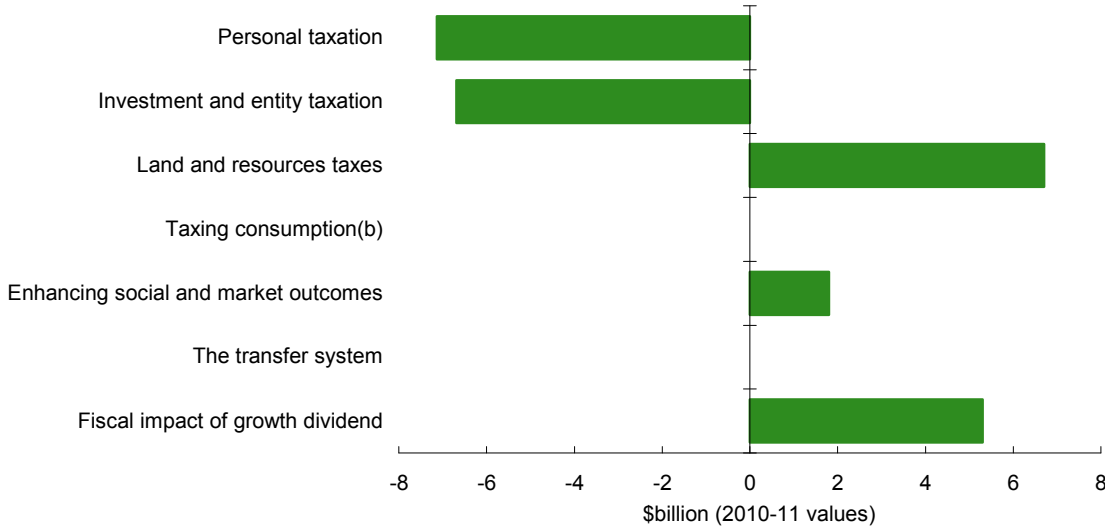
⁸ The overall effect on national savings, however, also depends on the effect on the government's fiscal position (that is, public savings). Superannuation affects public savings by reducing future Age Pension outlays, but the cost of concessions (such as halving the earnings tax) reduces government revenue, thereby decreasing public savings. However, based on the assumptions set out in Part Two, the superannuation tax proposals are estimated to result in a net increase in national savings.

11.3 Fiscal sustainability

Indicative estimates of the national fiscal implications of the reform vision are summarised in Chart 11.1. The estimates reflect the potential fiscal impact of the recommendations when mature, that is, when any transitional arrangements or transitional revenue effects are complete. In each case, the mature measure has been costed using 2010–11 as a reference year. Further detail about how the estimates have been derived and their limitations is presented in Box 11.2.

The recommendations in this Report are designed to improve the structure of the tax and transfer system, not to raise additional revenue. Overall, the reform vision is estimated to be broadly fiscally neutral, after taking into account the net fiscal gain from the estimated increase in national output. This 'efficiency dividend', is estimated to be equivalent to around \$5 billion in 2010–11 values.

Chart 11.1: Indicative impact of the recommendations on the shape of the system^(a)



(a) Indicative costings are provided on a mature measure basis (expressed in 2010–11 values) for recommendations indicating clear policy outcomes. Recommendations calling for further review, or that outline tax and transfer design principles or very broad directions, are not included.
 (b) The changes to taxes on consumption have been assumed to be revenue neutral.
 Source: Treasury and FaHCSIA estimates.

The recommendations would, however, change the shape of the system by shifting the tax mix from taxes on capital income, both at the business and personal levels, toward land and resources.

- The recommendations relating to the taxation of investment and business entities are estimated to reduce revenues by around \$7 billion in 2010–11 values, when fully mature. Most of this reflects the recommended reduction in the company income tax rate to 25 per cent.
- The recommendations relating to the taxation of resources and land are estimated to lead to a gain to revenue of around \$7 billion in 2010–11 values, when fully mature. This estimate reflects the impact of the proposal on the tax treatment of resource rents. Consistent with the recommendations, changes to taxes on land are assumed to be fiscally neutral.

- The recommendations relating to the taxation of personal income are estimated to reduce revenues by around \$7 billion, most of which is accounted for by the changes to retirement savings (around \$5 billion).
- The recommendations relating to government assistance payments are estimated to be approximately fiscally neutral.
- The changes to taxes on consumption have been assumed to be revenue neutral.

Box 11.2: The basis of the fiscal estimates

The estimates in Chart 11.1 reflect the potential fiscal impact of the recommendations when mature. They are measured against the expected fiscal position in 2010–11 and announced policy settings for that year. The estimates are not comparable to conventional Budget estimates, as they include recommendations that might not be implemented for many years and exclude the fiscal implications of phasing in some recommendations.

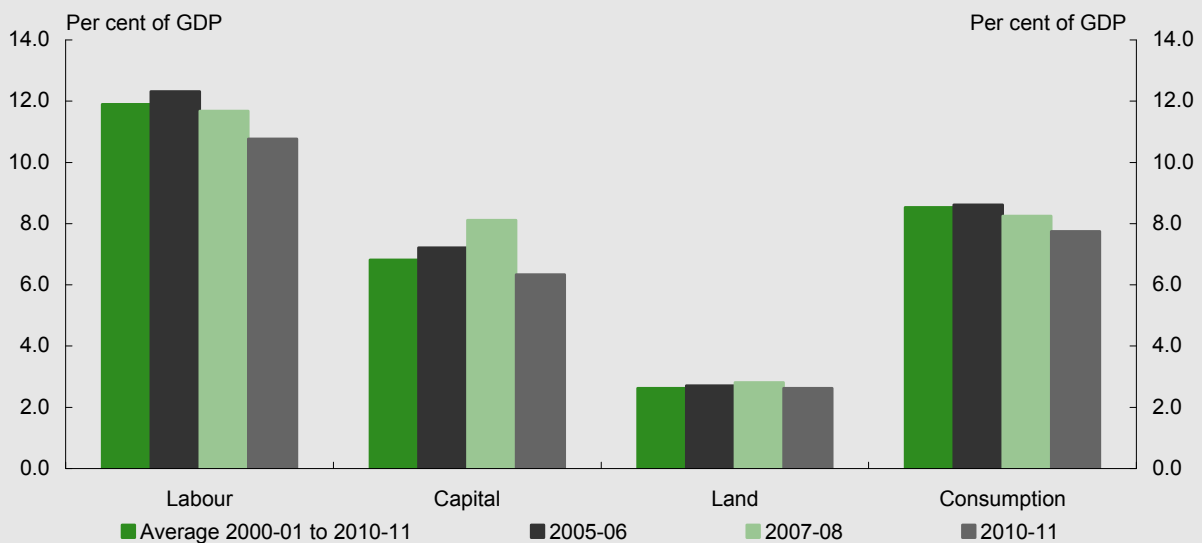
The fiscal impact is the net impact of the policy change on total Australian, state and local government revenue or expenditure, and generally include interactions with other recommendations, expected behavioural responses by people and businesses, and direct flow-on effects to other items of revenue or expenditure. The estimates do not take into account second-round revenue effects arising from the economy-wide effect of a change in a tax or transfer. These effects are reflected in the growth dividend.

Not all recommendations have been costed. Those that are very broad, that set out tax and transfer design principles or that call for a further review have been excluded. Administrative expenses or savings have been excluded on the basis they are unlikely to be material in the context of the policy change being recommended.

An important consideration in the choice of reference year is whether it is representative of the future fiscal context. The tax mix in 2010–11 is broadly representative of the average tax mix since 2000–01, when the GST was introduced (see Chart 11.2). A more notable difference is in the share of revenue attributable to taxes on capital, mainly company income tax, between 2007–08 and 2010–11. Even so, a higher level of company income, similar to that in 2007–08, would have only a minor impact on the overall fiscal feasibility of the vision.

Similarly, transfer payments are estimated to be above average in 2010–11, implying a slightly higher fiscal cost of the recommendations concerning the level of income support payments than might be expected assuming a stronger economy. Nevertheless, the overall fiscal impact of recommendations concerning the transfer system is estimated to be broadly neutral.

Chart 11.2: Sources of tax revenue



Source: Treasury estimates.

12. List of recommendations

Consolidated list of recommendations

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Part One — A tax and transfer system for the 21st century

Recommendation 1: Revenue raising should be concentrated on four robust and efficient broad-based taxes:

- personal income, assessed on a more comprehensive basis;
- business income, designed to support economic growth;
- rents on natural resources and land; and
- private consumption.

Additional specific taxes should exist only where they improve social outcomes or market efficiency through better price signals. Such taxes would only be used where they are a better means to achieve the desired outcome than other policy instruments. The rate of tax would be set in accordance with the marginal spillover cost of the activity.

User charging should play a complementary role, as a mechanism for signalling the underlying resource cost of publicly provided goods and services.

With both specific taxes and user charges, revenue would be a by-product of the tax or charge, not the reason for it.

Other existing taxes should have no place in the future tax system and over time should be abolished.

A — Personal taxation

A1 — Personal Income tax

Recommendation 2: Progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity.

Recommendation 3: The primary unit in the personal tax system should continue to be the individual, and subsidies for dependants through the tax system should be restricted (see Recommendation 6a). However, there could be a case for optional couple assessment for people of late retirement age.

Recommendation 4: Income support and supplementary payments should be tax-exempt.

- (a) Family assistance should remain exempt from tax because it addresses direct costs associated with children.
- (b) Government payments that are similar in nature to income support, such as scholarships, should be exempt from tax to align their treatment with that of income support.

Recommendation 5: The Medicare levy and structural tax offsets – the low income, senior Australians, pensioner and beneficiary tax offsets – should be removed as separate components of the system and incorporated into the personal income tax rates scale. If a health levy is to be retained, it could be applied as a proportion of the net tax payable by an individual.

Recommendation 6: To remove complexity and ensure government assistance is properly targeted, concessional offsets should be removed, rationalised, or replaced by outlays.

- (a) The existing dependency offsets should be replaced with a single dependant tax offset where one of the following circumstances apply:
 - the dependant is unable to work due to disability or carer responsibilities; or
 - either the taxpayer or dependant has reached Age Pension age.
- (b) The zone tax offset should be reviewed. If it is to be retained, it should be based on contemporary measures of remoteness.
- (c) The mature age worker, employment termination payment, overseas civilian, entrepreneurs', and notional tax offsets should be removed (see Part Two Annex A1). The education tax refund should be replaced as part of the single family payment, but as a back-to-school (lump-sum) amount.
- (d) The overseas forces tax offset should be replaced by adjusting remuneration to maintain net incomes.
- (e) Averaging tax offsets for primary producers, the offset for 'special professionals' and the lump sum payment in arrears tax offset should be retained to minimise the extent to which the timing of such income influences tax liability (see Part Two Annex A1).

Recommendation 7: Consistent with recommendations by the National Health and Hospitals Reform Commission:

- (a) The medical expenses tax offset should be removed following a review of the scope and structure of health safety net arrangements.
- (b) The Medicare levy surcharge and assistance for private health insurance should be reviewed as part of the package of tax and non-tax policies relating to private health insurance. The Medicare levy surcharge lump sum payment in arrears tax offset should be retained if the Medicare levy surcharge is retained (see Annex A1). Assistance, if retained, for private health insurance should be provided exclusively as a direct premium reduction.

Recommendation 8: All forms of wages and salary for Australian resident taxpayers should be taxable on an equivalent basis and without exemptions.

- (a) Private education payments provided in respect of employment or as an incentive to undertake employment and employment-related payments should be assessed as income and taxed at marginal tax rates.
- (b) The broad exemptions for foreign employment income should be removed and such income should be taxed at marginal tax rates.
- (c) Defence and disciplined forces payments should be taxable and direct remuneration increased for affected personnel.

Recommendation 9: Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other fringe benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate (and non-reportable for employees). The scope of fringe benefits that are subject to tax should be simplified.

- (a) Market value should generally be used to value fringe benefits (with an appropriate adjustment for employee contributions).
- (b) The current formula for valuing car fringe benefits should be replaced with a single statutory rate of 20 per cent, regardless of the kilometres travelled.
- (c) All fringe benefit tax (FBT) exemptions should be reviewed to determine their continuing appropriateness. To improve simplicity, consideration should also be given to excluding fringe benefits from tax where the costs of compliance outweigh equity and tax integrity considerations. The broad definition of fringe benefits in the FBT law could be reviewed to exclude essential workplace items such as chairs, stationery and toilets.
- (d) For fringe benefits that are taxed in the hands of employers, a small *de minimis* threshold, below which fringe benefits are exempt from tax, should apply. The threshold could vary depending on the number of employees within an organisation.
- (e) Not-for-profit entities' FBT concessions should be reconfigured (see Part Two Section B3). The FBT exemptions for members of the Defence force should be replaced with direct remuneration increases for affected personnel (see related Recommendation 8c).

Recommendation 10: Consideration should be given to a revised regime to prevent the alienation of personal services income that would extend to all entities earning a significant proportion of their business income from the personal services of their owner-managers, whether in employee-like or non-employee-like cases. This regime may also apply an arm's length rule to deductions arising from payments to associates to ensure deductions reflect the value of services provided.

Recommendation 11: A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.

Recommendation 12: There should be a tighter nexus between the deductibility of the expense and its role in producing income.

Recommendation 13: Gift deductibility should be retained, with the deductibility threshold raised from \$2 to \$25.

Recommendation 14: Provide a 40 per cent savings income discount to individuals for non-business related:

- (a) net interest income;
- (b) net residential rental income (including related interest expenses);
- (c) capital gains (and losses); and
- (d) interest expenses related to listed shares held by individuals as non-business investments.

In conjunction with introducing the discount further consideration should be given to how the boundaries between discounted and non-discounted amounts are best drawn to achieve certainty, reduce compliance costs, and prevent labour and other income being converted into discounted income. Further consideration should also be given to addressing existing tax law boundaries related to the treatment of individuals owning shares in order to address uncertainties about when the shares are held on capital account (and subject to capital gains tax) and on revenue account (and taxed as ordinary income).

Recommendation 15: When the 40 per cent savings income discount is introduced a smooth transition should be provided to minimise any disruption that may arise. The transition to a savings income discount for net residential rental income should only be adopted following reforms to the supply of housing (Part Two Section E4 Housing affordability) and reforms to housing assistance (Section F5 Housing assistance).

Recommendation 16: As part of the consideration of alternative company tax income arrangements and dividend imputation (see Recommendations 26 and 37), consideration should be given to extending the discount to other savings income.

Recommendation 17: The capital gains tax regime should be simplified by:

- (a) increasing the exemption threshold for collectables and exempting all personal use assets;
- (b) rationalising and streamlining the current small business capital gains tax concessions by:
 - removing the active asset 50 per cent reduction and 15-year exemption concessions;
 - increasing the lifetime limit of the retirement exemption by permanently aligning it with the capital gains tax cap for contributions to a superannuation fund; and
 - allowing taxpayers who sell a share in a company or an interest in a trust to access the concessions via the turnover test.
- (c) removing current grandfathering provisions relating to assets acquired before the commencement of capital gains tax, with a market value cost base provided for those assets when the exemption is removed, or before the end of previous indexation arrangements. A relatively long lead-time should be provided before these removals take effect; and
- (d) rewriting the capital gains tax legislation using a principles-based approach that better integrates it with the rest of the income tax system.

A2 — Retirement incomes

Recommendation 18: The tax on superannuation contributions in the fund should be abolished. Employer superannuation contributions should be treated as income in the hands of the individual, taxed at marginal personal income tax rates and receive a flat-rate refundable tax offset.

- (a) An offset should be provided for all superannuation contributions up to an annual cap of \$25,000 (indexed). The offset should be set so the majority of taxpayers do not pay more than 15 per cent tax on their contributions. The cap should be doubled for people aged 50 or older.
- (b) An annual cap on total contributions should continue to apply.
- (c) The offset should replace the superannuation co-contribution and superannuation spouse contribution tax offset.
- (d) Compulsory superannuation contributions made by employers should not reduce eligibility for income support or family assistance payments. They should also not form part of the calculation for child support.

Recommendation 19: The rate of tax on superannuation fund earnings should be halved to 7.5 per cent. Superannuation funds should retain their access to imputation credits. The 7.5 per cent tax should also apply to capital gains (without a discount) and the earnings from assets supporting superannuation income streams.

Recommendation 20: The restriction on people aged 75 and over from making contributions should be removed. However, a work test should still apply for people aged 65 and over. There should be no restrictions on people wanting to purchase longevity insurance products from a prudentially regulated entity.

Recommendation 21: The government should support the development of a longevity insurance market within the private sector.

- (a) The government should issue long-term securities, but only where this is consistent with its fiscal obligations, to help product providers manage the investment risk associated with longevity insurance.
- (b) The government should make available the data needed to create and maintain a longevity index that would assist product providers to hedge longevity risk.
- (c) The government should remove the prescriptive rules in the *Superannuation Industry (Supervision) Regulations 1994* relating to income streams that restrict product innovation. This should be done in conjunction with the recommendation to have a uniform tax on earnings on all superannuation assets.

Recommendation 22: The government should consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income. This should be subject to a business case that ensures the accurate pricing of the risks being taken on by the government. To limit the government's exposure to longevity risk, it should consider placing limits on how much income a person can purchase from the government.

Recommendation 23: The government should help make people more aware of the retirement income system, and therefore better able to manage their superannuation, by increasing the regularity of superannuation guarantee contributions, making it easier for people to manage their superannuation and providing people with a single point of contact for government agencies.

- (a) Superannuation guarantee contributions should be paid at the same time as wages. This should be introduced over time so businesses can adjust their cash flows. As a first step, larger businesses (that is, businesses required to lodge their business activity statements on a monthly basis) should be required to pay superannuation guarantee contributions at least monthly.
- (b) Employers should report superannuation contributions to their employees when a contribution is made.
- (c) There should be a method of linking superannuation records, such as client identifiers like the tax file number, to make it easier for people to manage their superannuation.
- (d) A superannuation portal where people can interact with government agencies and get information on retirement incomes should be developed. Over time this portal should evolve, subject to suitable safeguards, so that people can manage all their superannuation through one channel.

Recommendation 24: The preservation age for Service Pensioners should remain at 60 as it is already legislated to align with the eligibility age for that pension. An increase in the preservation age should apply to people who currently have a legislatively prescribed retirement age.

A3 — Wealth transfer taxes

Recommendation 25: While no recommendation is made on the possible introduction of a tax on bequests, the Government should promote further study and community discussion of the options.

B — Investment and entity taxation

B1 — Company and other investment taxes

Recommendation 26: The structure of the company income tax system should be retained in its present form, at least in the short to medium term.

A business level expenditure tax could suit Australia in the future and is worthy of further consideration and public debate. It is possible that other economies will move towards such systems over coming years and it could be in Australia's interest to join this trend at an early stage.

Recommendation 27: The company income tax rate should be reduced to 25 per cent over the short to medium term with the timing subject to economic and fiscal circumstances. Improved arrangements for charging for the use of non-renewable resources should be introduced at the same time.

Recommendation 28: The capital allowance arrangements should be enhanced and streamlined to ensure effective rates more closely match rates of economic depreciation, and to reduce administration and compliance costs overall. This should include:

- (a) allowing low-value assets (assets costing less than \$1,000) to be immediately written-off; and
- (b) reviewing the impact of special provisions applying to different investments in agriculture and statutory effective life caps and other concessional write-off provisions.

Recommendation 29: The capital allowance arrangements for small business should be streamlined and simplified, by:

- (a) allowing depreciating assets costing less than \$10,000 to be immediately written-off; and
- (b) allowing all other depreciating assets (except buildings) to be pooled together, with the value of the pool depreciated at a single declining balance rate.

Recommendation 30: The small business entity turnover threshold should be increased from \$2 million to \$5 million, and adjustments to the \$6 million net asset value test should be considered.

Recommendation 31: Companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income, with the amount of any refund limited to a company's franking account balance.

Recommendation 32: If earlier access to tax benefits from exploration expenses (relative to other expenses) is to be provided, it should take the form of a refundable tax offset at the company level for exploration expenses incurred by Australian small listed exploration companies, with the offset set at the company income tax rate.

Recommendation 33: Financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents.

Recommendation 34: Consideration should be given to negotiating, in future tax treaties or amendments to treaties, a reduction in interest withholding tax to zero so long as there are appropriate safeguards to limit tax avoidance.

Recommendation 35: Taxation arrangements applying to Australian managed funds and related services should be improved to provide greater certainty that conduit income will not be subject to Australian tax.

B2 — The treatment of business entities and their owners

Recommendation 36: The current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application.

Recommendation 37: Dividend imputation should be retained in the short to medium term, but for the longer term, consideration should be given to alternatives as part of a further consideration of company income tax arrangements.

Recommendation 38: A flow-through entity regime for closely held companies and fixed trusts should not be adopted for now, but would merit further consideration if there is a move away from dividend imputation in the long run.

Recommendation 39: While dividend imputation is retained, imputation credits should continue to be provided only for Australian company income tax. Dividend streaming and franking credit trading practices should, in general, continue to be prohibited.

Recommendation 40: If increased integration of the Australian and New Zealand economies is desired, a broad examination of the appropriate degree of harmonisation of business income tax arrangements between Australia and New Zealand should be undertaken.

B3 — Tax concessions for not-for-profit organisations

Recommendation 41: Consistent with the recommendations of previous inquiries, a national charities commission should be established to monitor, regulate and provide advice to all not-for-profit (NFP) organisations (including private ancillary funds). The charities commission should be tasked with streamlining the NFP tax concessions (including the application process for gift deductibility), and modernising and codifying the definition of a charity.

Recommendation 42: Categories of NFP organisations that currently receive income tax or GST concessions should retain these concessions. NFP organisations should be permitted to apply their income tax concessions to their commercial activities.

Recommendation 43: NFP FBT concessions should be reconfigured.

- (a) The capped concessions should be phased out over ten years. In the transition period, the value of the caps would gradually be reduced. Reportable fringe benefits for affected employees (that is, those benefits that are easily valued and attributed) would be exempt from tax up to the relevant cap, and taxed at the employee's marginal tax rate above the cap. The market value of these benefits would be taken into account for transfer payment purposes. Non-reportable fringe benefits would be taxable for NFP employers.
- (b) The FBT concessions should be replaced with direct government funding, to be administered by relevant Australian government portfolio agencies or the charities commission. All NFP organisations eligible for tax concessions should be able to apply to the relevant body for funding for specific projects or for assistance with the costs of recruiting specialist staff.

Recommendation 44: Simple and efficient tax arrangements should be established for clubs with large trading activities in the fields of gaming, catering, entertainment and hospitality. One option is to apply a concessional rate of tax to total net income from these activities above a high threshold. For clubs below the threshold, no tax would be applied to income from these activities.

C — Land and resource taxes

C1 — Charging for non-renewable resources

Recommendation 45: The current resource charging arrangements imposed on non-renewable resources by the Australian and State governments should be replaced by a uniform resource rent tax imposed and administered by the Australian government that:

- (a) is levied at a rate of 40 per cent, with that rate adjusted to offset any future change in the company income tax rate from 25 per cent, to achieve a combined statutory tax rate of 55 per cent;
- (b) applies to non-renewable resource (oil, gas and minerals) projects, except for lower value minerals for which it can be expected to generate no net benefits. Excepted minerals could continue to be subject to existing arrangements if appropriate;
- (c) measures rents as net income less an allowance for corporate capital, with the allowance rate set at the long-term Australian government bond rate;
- (d) requires a rent calculation for projects;
- (e) allows losses to be carried forward with interest or transferred to other commonly owned projects, with the tax value of residual losses refunded when a project is closed; and
- (f) is allowed as a deductible expense in the calculation of income tax, with loss refunds treated as assessable income.

Recommendation 46: The resource rent tax should not provide concessions to encourage exploration or production activity at a faster rate than the commercial rate or in particular geographical areas, and should not allow deductions above acquisition costs to stimulate investment.

Recommendation 47: Existing projects should be transferred into the proposed system with an adjustment, as appropriate, to the starting base for the allowance for corporate capital. The Australian government should set out a time-frame to implement the resource rent tax and provide guidance at the time of announcement on how existing investments and investment in the interim will be treated under the resource rent tax.

Recommendation 48: The Australian and State governments should negotiate an appropriate allocation of the revenues and risks from the resource rent tax.

Recommendation 49: The Australian and State governments should consider using a cash bidding system to allocate exploration permits. For small exploration areas, where there are unlikely to be net benefits from a cash bidding system, a first-come first-served system could be used.

Recommendation 50: The Australian and State governments should abolish fees and stamp duties on the transfer of interests in a resource project except those related to administrative costs.

C2 — Land tax and conveyance stamp duty

Recommendation 51: Ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the States, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases. Increasing land tax at the same time as reducing stamp duty has the additional benefit of some offsetting impacts on asset prices.

Recommendation 52: Given the efficiency benefits of a broad land tax, it should be levied on as broad a base as possible. In order to tax more valuable land at higher rates, consideration should be given to levying land tax using an increasing marginal rate schedule, with the lowest rate being zero, with thresholds determined by the per-square-metre value.

Recommendation 53: In the long run, the land tax base should be broadened to eventually include all land. If this occurs, low-value land, such as most agricultural land, would not face a land tax liability where its value per square metre is below the lowest rate threshold.

Recommendation 54: There are a number of incremental reforms that could potentially improve the operation of land tax, including:

- (a) ensuring that land tax applies per land holding, not on an entity's total holding, in order to promote investment in land development;
- (b) eliminating stamp duties on commercial and industrial properties in return for a broad land tax on those properties; and
- (c) investigating various transitional arrangements necessary to achieve a broader land tax.

D — Taxing consumption

Recommendation 55: Over time, a broad-based cash flow tax — applied on a destination basis — could be used to finance the abolition of other taxes, including payroll tax and inefficient State consumption taxes, such as insurance taxes. Such a tax would also provide a sustainable revenue base to finance future spending needs.

D1 — A cash flow tax

No recommendations in this section.

D2 — The goods and services tax

Recommendation 56: The Government should consider making greater use of GST-free business-to-business transactions or reverse charging, provided the potential compliance cost savings outweigh the additional complexity costs and risks to revenue.

D3 — Payroll tax

Recommendation 57: State payroll taxes should eventually be replaced with revenue from more efficient broad-based taxes that capture the value-add of labour.

D4 — Taxing financial services

No recommendations in this section.

E — Enhancing social and market outcomes

E1 — User charging

No recommendations in this section.

E2 — Taxes to improve the environment

Recommendation 58: Once the Carbon Pollution Reduction Scheme (CPRS) is operational, additional measures which seek to reduce emissions (in sectors covered by the CPRS), and which are not justified on other grounds, should be phased out.

Recommendation 59: The industry assistance arrangements introduced in consequence of the CPRS should be regarded as transitional. The Government's policy is to commission an independent review of the CPRS, including in relation to emissions-intensive trade-exposed (EITEs) assistance, every five years starting in 2014. To complement this, the Productivity Commission should be asked to undertake and publish an annual review of CPRS-related assistance arrangements for the life of the CPRS to provide a basis for future decisions on assistance policy. To assist the Productivity Commission, an Associate Commissioner with appropriate knowledge and industry expertise should be appointed to the review.

Recommendation 60: The government should continue to monitor tax concessions aimed at supporting environmental outcomes, and consider replacing them with targeted spending programs where this would be a more effective and efficient method of achieving the appropriate environmental outcome.

E3 — Road transport taxes

Recommendation 61: Governments should analyse the potential network-wide benefits and costs of introducing variable congestion pricing on existing tolled roads (or lanes), and consider extending existing technology across heavily congested parts of the road network. Beyond that, new technologies may further enable wider application of road pricing if proven cost-effective. In general, congestion charges should apply to all registered vehicles using congested roads. The use of revenues should be transparent to the community and subject to further institutional reform.

Recommendation 62: The Council of Australian Governments (COAG) should accelerate the development of mass-distance-location pricing for heavy vehicles, to ensure that heavy vehicles pay for their specific marginal road-wear costs. Revenue from road-wear charges should be allocated to the owner of the affected road, which should be maintained in accordance with an asset management plan. Differentiated compliance regimes to enforce this pricing policy may need to be considered to balance efficiency benefits from pricing against the costs of administration and compliance for some road users.

Recommendation 63: States should improve compulsory third party insurance to better reflect individual risks.

Recommendation 64: On routes where road freight is in direct competition with rail that is required to recover its capital costs, heavy vehicles should face an additional charge on a comparable basis, where this improves the efficient allocation of freight between transport modes.

Recommendation 65: Revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes. If a decision were made to recover costs of roads from road users through fuel tax, it should be linked to the cost of efficiently financing the road network, less costs that can be charged directly to road users or collected through a network access charge. Fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the CPI. Heavy vehicles should be exempt from fuel tax and the network access component of registration fees if full replacement charges are introduced.

Recommendation 66: The revenue-raising component of State taxes on motor vehicle ownership and use should be made explicit, and over time only be used to recover those costs related to road provision. The administrative costs of providing government services should be recovered through user charges where applicable. Quantity limits on taxi licences should be phased out.

Recommendation 67: Governments should continue to reform road infrastructure provision, applying economic assessment to investments comparable to that for other forms of infrastructure.

Recommendation 68: COAG should develop a National Road Transport Agreement to establish objectives, outcomes, outputs and incentives to guide governments in the use and supply of road infrastructure. COAG should nominate a single institution to lead road tax reform, and ensure implementation of this agreement.

E4 — Housing affordability

Recommendation 69: COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability.

Recommendation 70: COAG should review infrastructure charges (sometimes called developer charges) to ensure they appropriately price infrastructure provided in housing developments. In particular, the review should establish practical means to ensure that these charges are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations.

E5 — Alcohol taxation

Recommendation 71: All alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a low-alcohol threshold introduced for all products. The rate of alcohol tax should be based on evidence of the net marginal spillover cost of alcohol.

Recommendation 72: The introduction of a common alcohol tax should be accompanied by a review of the administration of alcohol tax, to ensure that alcohol taxpayers do not face redundant compliance obligations.

E6 — Tobacco taxation

Recommendation 73: The existing regime for tobacco taxation in Australia should be retained, with the rates of tax substantially increased, depending on further evidence on the costs of harm from tobacco smoking.

Recommendation 74: Tobacco excise should be indexed to a broad measure of wages rather than CPI.

Recommendation 75: There should be no duty free allowance on tobacco for international travellers entering Australia.

E7 — Gambling taxation

Recommendation 76: Gambling taxes should be reviewed to ensure that they are focused on recouping economic rent generated by government restrictions on the supply of gambling services or are being used efficiently to impose such restrictions.

Recommendation 77: Governments should eliminate gambling tax concessions for particular types of gambling business, such as clubs. If governments wish to subsidise particular types of businesses, they should do so through direct expenditures.

Recommendation 78: Governments should consider the allocation of responsibilities for the regulation and taxation of gambling, with a view to minimising conflicts in policy-making between revenue-raising and addressing problem gambling.

E8 — Rationalising other taxes

Recommendation 79: All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.

Recommendation 80: The luxury car tax should be abolished.

Recommendation 81: Governments should undertake a systematic review of existing and potential user charges and minor taxes against the principles set out in this report. This should be coordinated with the introduction of the system wide Tax and Transfer Analysis Statement proposed in Recommendation 132.

F — The transfer system

F1 — Income support payments

Recommendation 82: There should be three categories of income support payments:

- (a) A **pension category** for people who are not expected to support themselves through paid work, whether because of their age, disability or because they are providing full-time care for a person with disability (or frail aged). This pension would be paid at a rate that provides a basic acceptable standard of living, having regard to prevailing community standards.
- (b) A **participation category** for people of working age who are expected to support themselves through paid work now or in the near future. This would cover the unemployed including youth (both under and over 18), those who are temporarily incapacitated, people with a partial capacity to work and primary carers of dependent children. The rate of payment, for those who are expected to work, should provide a basic level of adequacy while maintaining incentives to work. This would be less than the pension rate. Parents on income support would receive a higher total level of payment. Unemployed youth aged less than 21 would be paid no more than full-time students to avoid creating incentives to leave full-time study for unemployment.⁹
- (c) A **student assistance category** for people engaged in full-time study. Students aged 21 and over would continue to be paid at a lower rate than the unemployed and at the same rate as younger students in similar circumstances. Some students have the capacity to work part-time to supplement their income support. Other students could be given the ability to borrow against future income to supplement their student assistance.¹⁰

Recommendation 83: There should be a more consistent approach to payment relativities within each of the three categories of payment based on the single to couple pension relativity. A more consistent approach would mean an increase to base rates for single income support recipients in the participation and student assistance categories. However, a lower relativity for singles in these categories without children may be warranted given their greater capacity to share accommodation.

⁹ Rates of payment for participation category customers aged less than 21 are discussed in Section F3 Family and youth assistance.

¹⁰ Rates of payment for student assistance category customers aged less than 22 are discussed in F3 Family and youth assistance.

Recommendation 84: Payments and income test parameters should be indexed in a consistent way to maintain relativities across the three payment categories and to reflect changes in community standards. Governments should regularly review indexation as community standards are likely to be affected by significant changes in the composition of the workforce and household incomes in coming decades. The current community standard for pensions is set by reference to Male Total Average Weekly Earnings. Indexing all payments to this standard has been projected to involve a significant increase in budgetary outlays over the coming decades so it will be necessary for governments to regularly review the appropriateness of this measure and the level of the benchmark.

Recommendation 85: Income support arrangements for parents should support and encourage participation in work while maintaining adequate levels of assistance to families. As a condition of payment parents should be required to look for part-time work once their youngest child turns four. Parents would receive supplements as follows:

- (a) For couples and single parents with a youngest child under six years, the amount of the supplement should be set such that the total support for single parents on income support will be equivalent to the maximum rate of pension. The supplement would be paid through the family payment system.
- (b) For single parents with a youngest child aged six or older, the supplement should be paid at a substantially lower rate through the family payment system.
- (c) For couples with a youngest child aged six years or older, the lower rate supplement should be paid through the income support system.

Recommendation 86: People with disability who have a partial capacity to work, excluding people receiving Disability Support Pension (DSP), should have a part-time work requirement. They should be subject to a means test or payment arrangements that provide an incentive to work part-time and that recognises that they face higher average costs of work. This could also be achieved by an in-work supplement and/or an earnings disregard in the means test.

Recommendation 87: Students should have access to an income test that facilitates significant part-time work at a level that does not compromise educational outcomes. Adults requiring additional income should be able to borrow to top up their student rate of income support to the level of the participation payment rate. The feasibility of using the existing income-contingent loans scheme and the potential impact of it on access to higher education of students from a low socioeconomic background should be examined.

F2 — Means testing

Recommendation 88: The current income and asset tests for income support payments should be replaced with a comprehensive means test based on a combined measure of employment income, business income and deemed income on assets. The comprehensive means test would:

- (a) extend deemed income on assets in addition to financial assets, including superannuation income streams, rental housing and other asset classes (whether income-producing or not). Superannuation income streams where deeming income would be difficult to apply would be tested on gross income but with an actuarially fair deduction for capital;
- (b) have low and high deeming rates based on the returns expected from a portfolio of assets held by a prudent investor. These rates should be set by reference to an appropriate benchmark;
- (c) continue the means test exemption for owner-occupied housing up to a high indexed threshold;
- (d) set a high capped exemption for personal-use assets;
- (e) retain the current concessional treatment of employment income for certain allowances and pensions;
- (f) have different free areas for pensions and allowances; and
- (g) remove the liquid assets waiting period and the sudden-death cut-out that applies to people on certain payments.

Recommendation 89: Means testing for family assistance payments should be based on the same measure of taxable income as for income tax, including fringe benefits. However, payments should not be reduced as a result of the inclusion of compulsory superannuation contributions in taxable income. Consideration should be given to aligning the definitions of income and periods of assessment for family assistance payments more closely to those that apply to income support payments. However, this should not include deeming income on assets.

F3 — Family and youth assistance

Recommendation 90: Current family payments, including Family Tax Benefit Parts A and B, should be replaced by a single family payment. The new family payment should:

- (a) cover the direct costs of children in a low-income family (that is, the costs associated with food, clothing, housing, education expenses); and
- (b) assist parents nurturing young children to balance work and family responsibilities.

Recommendation 91: The direct cost of children component of family assistance should be a per child payment.

- (a) Rates of payment should increase with the age of the children to recognise the higher costs of older children. Three rates of payment should apply: for 0–11 year olds; 12–15 year olds and 16–18 year olds while in secondary school. These age bands would appropriately accommodate the increasing costs of children (this would require higher payments rates for 12, 16 and 17 year olds). The Baby Bonus should be abolished and a small supplementary payment, reflecting the direct costs of a new-born baby, should be paid over the first three months.
- (b) A shared-care rate to recognise the higher costs of separated families should be considered, taking into account interactions with child support as well as other income support payments.
- (c) Additional payments for larger families, including the Large Family Supplement, the Multiple Birth Allowance for children over one year, and higher thresholds for larger families should be reconsidered as the case for these payments is not strong.

Recommendation 92: A supplement for parents nurturing young children (aged under six years) should be provided as a per-family payment, means tested on family income in addition to the recently announced Paid Parental Leave arrangements.

- (a) The maximum rate of the supplement should be set such that the total support for single parents wholly reliant on income support is equivalent to the maximum rate of pension.

Recommendation 93: For single parents with children aged six or older, a parental supplement (which should be considerably smaller than under Recommendation 92), should be paid through the family payment system.

Recommendation 94: For couples with children aged six or older, a parental supplement at the same rate as for single parents should be paid through the income support system (See Part Two Section A1 Personal income tax).

Recommendation 95: Assistance for families should also recognise that there are specific circumstances, such as parents caring for disabled children and foster care children with higher needs, for which additional support beyond the early years is appropriate.

Recommendation 96: The total amount of family assistance should be withdrawn with a single means test to avoid cumulative withdrawal rates which create unnecessarily high disincentives for working. A single low withdrawal rate of 15–20 per cent would be appropriate to minimise workforce disincentives.

Recommendation 97: While family payments should be the main form of assistance for families with children up to the end of secondary school, or the school year in which they turn 18 (the earlier of the two), youth payments should be available to older children in some circumstances.

- (a) Dependent older children for whom a suitable pathway may be leaving school and looking for work or combining part-time work and part-time study should have access to a youth payment, governed by strict participation requirements.
- (b) Children without access to financial support from their families should continue to have access to a youth payment, governed by strict criteria.

Recommendation 98: Youth payments should be the main form of income support from the age of 18 until the age of independence.

- (a) Family payments should not be provided for those aged 18 and over unless they are completing secondary school in the year they turn 18.
- (b) Youth payment rates should reflect the fact that most young people have lower needs than adults but need adequate assistance to participate in education and training.
- (c) Dependent youth payment recipients should be subject to a parental income test consistent with that applying to family payments. Family means tests should be designed so that families with dependent children in both the family payments and youth payments system are not disadvantaged.
- (d) The age of independence should be aligned for full-time students and non full-time students.

F4 — Child care assistance

Recommendation 99: Child Care Benefit and Child Care Rebate should be combined into a single payment to parents (or to child care centres) in respect of each child based on a percentage of child care costs. The payment should have the following features:

- (a) a high rate of subsidy for low-income families that covers most of the costs of child care (up to 90 per cent). This would involve a small co-payment for low-income families;
- (b) a base rate of assistance for all families that use child care to facilitate parental engagement in the workforce. The base rate of assistance should be set as a proportion of child care costs, with reference to the marginal tax rate faced by the majority of taxpayers. (Based on the indicative personal income tax rates scale in Part Two Section A1, this would indicate a rate of assistance of 35 per cent);
- (c) access to the base rate of assistance subject to a requirement that parents participate in work, education or training. Where parents are not participating, the maximum rate of assistance should be available for a limited number of hours. The number of hours subsidised without a participation requirement should be the same as the number of hours of universal access to pre-school (15 hours by 2013); and
- (d) coverage of the full costs of child care for at-risk children and children facing multiple disadvantages, without participation requirements on parents.

Recommendation 100: The child care payment should be means tested down to the base rate of assistance based on family income and should have regard to the interaction with other means tested payments (income support and family payments) and marginal tax rates, to ensure that effective marginal rates of tax are not excessive.

Recommendation 101: The fringe benefits tax exemption for child care facilities provided on an employer's business premises for the benefit of employees should be removed.

F5 — Housing assistance

Recommendation 102: The maximum rate of Rent Assistance should be increased to assist renters to afford an adequate standard of dwelling. To ensure that Rent Assistance can be maintained at an adequate level over time, the rent maximum should be indexed by movements in national rents, which could be measured by an index of rents paid by income support recipients.

Recommendation 103: To better target an increase in the maximum rate, Rent Assistance should be part of the income support system, with eligibility based on rent paid and the income support means test, rather than on eligibility for another payment (for example, Family Assistance).

Recommendation 104: Mechanisms should be developed to extend Rent Assistance equitably to public housing tenants along with removing income-linked rent setting in public housing.

Recommendation 105: A high-need housing payment should be paid to social housing providers for their tenants who have high or special housing needs or who may face discrimination in the private market. This payment should be funded by the Australian government. The Commonwealth and the States should retain the option of providing capital for social housing construction.

Recommendation 106: Income-linked rents should be phased out in social housing, with providers charging their tenants rents linked to the market rate, with existing rent-setting for current tenants phased out using grandfathering or other transitional arrangements. However, continued use of income-limited rents is appropriate in some circumstances, such as in remote Indigenous communities.

F6 — Transfers tied to goods and services

Recommendation 107: The Productivity Commission, constituted to include an appropriately qualified and experienced member, should review concessions across all levels of government and provide recommendations for consideration by COAG.

Recommendation 108: The Productivity Commission should examine the principles of public service delivery and the mechanisms that are available to governments to deliver public services and their implications for financial arrangements in the federation. The findings of this study should be considered by COAG.

F7 — Funding aged care

Recommendation 109: There is considerable scope to align aged care assistance with the principles of user-directed funding to provide assistance in line with recipients' needs, enable their choice of care and support the fiscal sustainability of the aged care sector. However, effective user-directed funding is significantly limited by regulations that govern supply and price, reforms to which would have complex sequencing and transition issues. As such, the Productivity Commission should consider this potential reform direction in its upcoming inquiry into aged care.

Recommendation 110: It is important for governments to determine what an adequate level of aged care should be, the necessary pricing and regulatory arrangements to deliver it, and the most sustainable funding arrangement to ensure access by those who cannot afford it. Given this, and noting that the Productivity Commission will be inquiring into the disability insurance scheme, its consideration of aged care should include the potential for insurance to play a role in helping to fund aged care as Australia's population ages.

G — Institutions, governance and administration

G1 — A responsive and accountable tax system

Recommendation 111: The government should establish a more transparent means of dealing with community ideas about the tax system by extending the Tax Issues Entry System website and further developing its use.

Recommendation 112: The government should commit to a principles-based approach to tax law design as a way of addressing the growing volume and complexity of tax legislation, and as a way of helping those laws to be interpreted consistently with their policy objectives.

Recommendation 113: The Board of Taxation should be empowered to initiate its own reviews of how current tax policies and laws are operating, in consultation with the government. This would be in addition to reviewing matters referred to it by the government, though it should not engage in substantive policy development unless requested by the government.

In giving effect to these changes to the nature and functions of the Board, the government should ensure that the Board has adequate resources (including its own permanent secretariat). The government should also consider:

- (a) how to manage the increased workload for the Board, including whether the Board would require further members and/or members who can devote more time to the Board;
- (b) whether the Secretary to the Treasury, the Commissioner of Taxation, and the First Parliamentary Counsel should be appointed as advisers to the Board, rather than as members; and
- (c) whether the Inspector-General of Taxation, the Auditor-General, the Commonwealth Ombudsman and the Chair of the Tax Practitioners Board should be appointed as advisers to the Board of Taxation.

Recommendation 114: Information or advice provided by Treasury to assist the ATO in determining the purpose or object of the law, or materials used by the ATO to determine policy intent (other than correspondence with or from government) should be made public.

Recommendation 115: A board should be established to advise the Commissioner of Taxation on the general organisation and management of the ATO. The board would not be a decision-making body and would have no role in interpreting the tax laws or examining individual taxpayer issues. The government would appoint members to the board.

Recommendation 116: The government should clarify that the role of the Inspector-General of Taxation is to examine systemic tax administration issues that affect businesses.

Recommendation 117: The government should ensure that sufficient resources are devoted to the functions of the Inspector-General of Taxation, the Australian National Audit Office and the Commonwealth Ombudsman, recognising their importance in maintaining a fair and efficient tax system.

Recommendation 118: The Joint Committee of Public Accounts and Audit should examine reports of the Inspector-General of Taxation and the Commonwealth Ombudsman, and monitor the ATO's implementation of the recommendations in those reports.

G2 — State tax reform

Recommendation 119: Reforms to State taxes should be coordinated through intergovernmental agreements between the Australian government and the States to provide the States with revenue stability and to facilitate good policy outcomes.

G3 — Local government

Recommendation 120: States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality.

Recommendation 121: Over time, State land tax and local government rates should be more integrated. This could involve:

- (a) moving to a joint billing arrangement so that taxpayers receive a single assessment, but are able to identify the separate State and local component; and
- (b) using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State).

G4 — Client experience of the tax and transfer system

Recommendation 122: A tax and transfer client account should be developed, based on customer research and with customer input into its design. The account should include at least the following features:

- (a) Up-to-date presentation of income earned from all sources, taxes withheld, tax liabilities incurred, transfers received and information flows from third parties;
- (b) complete information from past periods;
- (c) an optional single point for updating personal information, undertaking transactions, and reporting information or making applications, with extensive pre-filling of forms based on information previously provided; and
- (d) the ability to test the impact of hypothetical changes in circumstances.

Recommendation 123: Pre-filled personal income tax returns should be provided to most personal taxpayers as a default method of settling their tax affairs each year.

Recommendation 124: Existing tax and transfer provisions should be reformed to support improvements in client experience, including greater alignment of income definitions and reporting, rationalising of personal tax deductions and offsets, and streamlining of mandatory administrative requirements. Future new policy proposals should be subject to comprehensive, published expected impact assessments on client experience systems and outcomes.

Recommendation 125: Where possible, information required for determining tax liabilities and transfer entitlements should be collected from third parties, including employers, government agencies, financial institutions, and share and property registries.

- (a) Over time, electronic provision of this information by third parties should be made mandatory.
- (b) To reduce current and minimise new compliance costs, reporting obligations should as far as possible be aligned with existing information concepts and systems of third parties, and facilitated through electronic interaction with information held in the 'natural systems' of those entities.

Recommendation 126: Further approaches (extension to and approaches which build on Standard Business Reporting) should be pursued to reduce the compliance costs associated with business interactions with government.

Recommendation 127: The government should assist small businesses to be 'business ready' when they begin business. This could be achieved through education and financial assistance, which may include assistance to small business to get ready for Standard Business Reporting (SBR).

Recommendation 128: Common information standards, leveraging from the standards and governance put in place by the SBR Program, be developed and adopted to support system interoperability between tax and transfer agencies, and between those agencies and third parties, such as employers.

Recommendation 129: A modern privacy and secrecy framework be developed and adopted that maintains and streamlines protection of personal information held by government agencies, and facilitates exchange of information (other than an individual's health information) between agencies to support improved client experience of the tax and transfer system.

Recommendation 130: A method of linking records, for example by linking existing client identifiers, be developed to facilitate development of a single client account for tax and transfer financial information. This would allow better service delivery by supporting interoperability and data exchange between the appropriate government agencies, and flows of tax and transfer information from third parties to those agencies. Information should not include individual health information.

Recommendation 131: A high level taskforce be established, under central agency leadership, to progress a whole of government approach to improving the client experience of the tax and transfer system, with:

- (a) membership from relevant agencies, the private sector and client representatives;
- (b) terms of reference requiring the taskforce to:
 - develop, consult, oversee and regularly report to government and Parliament on a whole-of-system reform of the administrative arrangements and technologies that deliver the client experience of the tax and transfer system;
 - position these reforms within the overall government initiative to improve the relationship between it and citizens; and
 - lead consultations with relevant stakeholders, including citizens, privacy advocacy groups, professional associations, financial institutions and employers.
- (c) a mechanism for capturing feedback from citizens on government service delivery, including both current administration and new proposals.

G5 — Monitoring and reporting on the system

Recommendation 132: The government should, every five years, publish a Tax and Transfer Analysis Statement that analyses and reports on the overall performance and impact of the system, including estimates of efficiency costs and distributional impacts.

Recommendation 133: The Australian and the State governments should systematically collect data on aspects of existing taxes and transfers – including compliance cost data – according to consistent and transparent classifications and concepts, and make this information – including confidentialised tax unit records – freely available for further analysis and research.

Recommendation 134: The government should support one or more institutions to undertake independent policy research relevant to the Australian tax and transfer system.

Recommendation 135: The Australian government should ensure that the rules governing the development of the Budget encourage trade-offs between tax expenditures and spending programs. Budget decision-making processes should measure and treat tax expenditures and spending programs symmetrically, to ensure that there is no artificial incentive to deliver programs through one mechanism rather than another.

Recommendation 136: The government should introduce legislation to amend the *Charter of Budget Honesty Act 1998* to recognise the publication of detailed information about tax expenditures in a Tax Expenditures Statement separate from the Mid-Year Economic and Fiscal Outlook (MYEFO). However, the Tax Expenditures Statement should continue to be released by the end of January in each year, or within six months of the last Budget, whichever is later.

Recommendation 137: The government should ensure that reporting standards are independently developed for the identification and measurement of tax expenditures in the Tax Expenditures Statement. In addition, the standards should establish a basis for reporting the broader economic and distributional effects of tax expenditures in the periodic Tax and Transfer Analysis Statement (see Recommendation 132).

Recommendation 138: The Council of Australian Governments should examine the ways in which the States could uniformly report tax expenditures annually according to the independent standards developed under Recommendation 137.

Appendices

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Appendix A: Acronyms

AAT	Administrative Appeals Tribunal
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACAT	Aged Care Assessment Teams
ACC	allowance for corporate capital
ACCC	Australian Competition and Consumer Commission
ACFI	Aged Care Funding Instrument
ACMA	Australian Communications and Media Authority
ADF	Australian Defence Force
AFP	Australian Federal Police
AFTS	Australia's Future Tax System
AGIMO	Australian Government Information Management Office
AIHW	Australian Institute of Health and Welfare
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
APSC	Australian Public Service Commission
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AWOTE	average weekly ordinary time earnings
BAS	business activity statement
BITRE	Bureau of Infrastructure, Transport and Regional Economics
BTO	beneficiary tax offset
BTRE	Bureau of Transport and Regional Economics
CACP	Community Aged Care Program
CASA	Civil Aviation Safety Authority
CCB	Child Care Benefit
CCR	Child Care Rebate
CFT	cash flow tax
CGC	Commonwealth Grants Commission
CGT	capital gains tax
COAG	Council of Australian Governments
CPRS	Carbon Pollution Reduction Scheme
CTP	Compulsory Third Party insurance
DEEWR	Department of Education, Employment and Workplace Relations
DEWHA	Department of Environment, Water, Heritage and the Arts
DGR	deductible gift recipient
DHA	Department of Health and Ageing
DHS	Department of Human Services
DSP	Disability Support Pension
DVA	Department of Veterans' Affairs
EACH	Extended Aged Care at Home
EC	European Commission
EITE	emissions-intensive trade-exposed
EMTRs	effective marginal tax rates
ETO	entrepreneurs' tax offset
ETR	education tax refund
EU	European Union

FAMT	Family Actual Means Test
FaHCSIA	Department of Families, Housing, Community Services and Indigenous Affairs
FB	fringe benefits tax
FMW	federal minimum wage
FST	financial services tax
FTB	Family Tax Benefit
GDP	gross domestic product
GOS	gross operating surplus
GST	goods and services tax
HACC	Home and Community Care
HECS	Higher Education Contributions Scheme
HELP	Higher Education Loan Program
HFE	horizontal fiscal equalisation
IGOT	Inspector-General of Taxation
IMF	International Monetary Fund
IPART	NSW Independent Pricing and Regulatory Tribunal
IVU	in-vehicle units
IWT	interest withholding tax
JCPAA	Joint Committee of Public Accounts and Audit
LCT	luxury car tax
LITO	low income tax offset
LPG	liquefied petroleum gas
MAWTO	mature age worker tax offset
MTAWE	male total average weekly earnings
MYEFO	mid-year economic and fiscal outlook
NFP	not-for-profit
NHHRC	National Health and Hospitals Reform Commission
NRR	net replacement rate
NRS	National Relay Service
NSA	Newstart Allowance
NTLG	National Tax Liaison Group
PAYG	pay as you go
PPL	paid parental leave
PPP	Parenting Payment Partnered
PPS	Parenting Payment Single
PRRT	petroleum resource rent tax
PTR	participation tax rate
RBA	Reserve Bank of Australia
RET	renewable energy target
RWT	royalty withholding tax
SATO	senior Australians tax offset
SBR	standard business reporting
SPP	special purpose payment
SSAT	Social Security Appeals Tribunal
UK	United Kingdom
US	United States
USO	universal service obligation
VAT	value added tax
WET	wine equalisation tax
WRE	work related expenses
YA	Youth Allowance
ZTO	zone tax offset

Appendix B: The Australia's Future Tax System Review Panel

Dr Ken Henry AC (Chair), Secretary to the Treasury

Dr Henry was appointed Secretary to the Treasury in 2001, after holding a number of other senior positions within the Treasury, including Minister (Economic and Financial Affairs) in the Australian Delegation to the OECD in Paris, head of the microeconomic modelling unit, head of the taxation policy division and Executive Director (Deputy Secretary) of Treasury's Macroeconomic Group.

Dr Jeff Harmer, Secretary, Department of Families, Housing, Community Services and Indigenous Affairs

Dr Harmer was appointed Secretary of the Department of Family and Community Services in late 2004, and led the department through the changes associated with the addition of the Office of Indigenous Policy Coordination in 2006 and post 2007 election resulting in the department being renamed as Families, Housing, Community Services and Indigenous Affairs. Prior to that Dr Harmer was the Secretary of the Department of Education, Science and Training (2003–2004) and before that Managing Director of the Health Insurance Commission (1998–2003).

Professor John Piggott, Professor of Economics and Associate Dean, Research, Australian School of Business, University of New South Wales

John Piggott is Professor of Economics and Associate Dean Research in the Australian School of Business, University of New South Wales, where he also heads up the Australian Institute for Population Ageing Research. He has published extensively in the fields of Public Finance and Pension Economics, and has consulted on pension policy and related issues to various governments, especially in the Asian region.

Mrs Heather Ridout, Chief Executive, Australian Industry Group

Mrs Ridout is Chief Executive of the Australian Industry Group, a leading industry association representing a broad spectrum of Australian industry. She has a deep interest in public policy and is a member of a number of the Australian Government's key policy setting and consultative groups including the National Workplace Relations Consultative Committee; Infrastructure Australia; and Skills Australia. Her other appointments include Director of Electrolux Home Products, Trustee of AustralianSuper and Director of the Australian Research Alliance for Children and Youth.

Mr Greg Smith, Adjunct Professor, Economic and Social Policy, Australian Catholic University

Mr Smith consults and teaches in economic and social policy, public policy, advising and leadership. He worked as a tax adviser to the then Treasurer in the mid-1980s and has held senior positions in the Treasury, including Executive Director Budget Group and Revenue Group. He was also Secretary to the Financial System Inquiry, which reported to government in 1997.

Appendix C: Documents of the Review

The following documents of the Review are published on the Australia's Future Tax System website (www.taxreview.treasury.gov.au).

Papers published

Three sets of papers have been released relating to the Review:

Paper released on 6 August 2008

Architecture of Australia's tax and transfer system

Papers released on 10 December 2008

Australia's Future Tax System – Consultation Paper – Summary

Australia's Future Tax System – Consultation Paper

Australia's Future Tax System – Retirement Income Consultation Paper

Paper released on 12 May 2009

Australia's Future Tax System – The Retirement Income System: Report on Strategic Issues

Media releases

Australia's Future Tax System
(13 May 2008)

Treasurer and Treasury Secretary release Australia's future tax system discussion paper
(6 August 2008)

Tax review calls for submissions and sets out consultation process
(19 August 2008)

Tax review to provide early advice on retirement income system
(5 December 2008)

Tax review releases consultation papers and calls for continued community input
(10 December 2008)

Tax review invites Australians to have their say
(25 February 2009)

One week left to make a submission to the tax review
(23 April 2009)

Tax review report on the retirement income system
(12 May 2009)

Appendix D: Consultation

Public meetings and focus groups

Information on the public meetings and focus groups is on the Australia's Future Tax System website (www.taxreview.treasury.gov.au), including the report from Colmar Brunton Social Research.

Public consultation meeting dates and attendees

Five hundred people attended a public consultation meeting.

No.	City	Dates	Review Panel Member attending	Attendees
1	Brisbane	Monday 16 March 2009	Ken Henry	43
2	Darwin	Monday 16 March 2009	Greg Smith	15
3	Perth	Tuesday 17 March 2009	Greg Smith	39
4	Sydney	Wednesday 18 March 2009	John Piggott	78
5	Wagga Wagga	Wednesday 18 March 2009	John Lonsdale — Treasury	12
6	Canberra	Thursday 19 March 2009	Greg Smith	49
7	Melbourne	Monday 23 March 2009	Greg Smith	144
8	Geelong	Tuesday 24 March 2009	John Piggott	50
9	Hobart	Wednesday 25 March 2009	John Piggott	24
10	Adelaide	Thursday 26 March 2009	Jeff Harmer	46
			Total	500

Focus group meeting dates and attendees

Thirteen focus groups were conducted, with 100 people attending. Details of the focus groups are shown in the table below.

No.	Group	Location	Attendees
1	Small business operators (mix of industry, employing vs non-employing)	Sydney Wednesday 8 April 2009	8
2	Small business operators (including at least 4 farmers)	Shepparton Tuesday 7 April 2009	8
3	Individuals — single people (taxpayers), full-time wage and salary earners, under 30 years, no children, including 2–3 part-time students	Melbourne Monday 6 April 2009	7
4	Individuals — mix of people who receive income support (3), retired people (pension recipients, minimum 2) and people who work part-time	Melbourne Monday 6 April 2009	6
5	Individuals — general taxpayers, 45–55 years	Sydney Wednesday 8 April 2009	8
6	Individuals — people who work part-time, 30+ years	Brisbane Tuesday 14 April 2009	8
7	Individuals — from families with children (4 with pre-school age children and 4 with older dependent children)	Townsville Wednesday 15 April 2009	8
8	Individuals — general taxpayers, 30–45 years	Lismore Tuesday 14 April 2009	10
9	Individuals — general taxpayers, 30–45 years	Perth Monday 20 April 2009	9
10	Individuals — people who receive income support (Disability Support Pension, Carers' Payment, Newstart Allowance or Austudy)	Adelaide Wednesday 15 April 2009	8
11	Individuals — from families with older dependent children (female)	Adelaide Wednesday 15 April 2009	7
12	Small business operators (mix by industry and employing vs non-employing)	Brisbane Thursday 14 April 2009	6
13	Small business operators (mix by industry and employing vs non-employing)	Perth Monday 20 April	7
Total		13	100

Stakeholder meetings

The Review Panel and the Secretariat met with more than 130 stakeholders and attended stakeholder events throughout the Review. This included the following programmed stakeholder meetings and consultations.

Meetings	Stakeholder organisations
Stakeholder meetings — round 1 22 October 2008 to 24 October 2008 Sydney, Melbourne & Canberra	Association of Superannuation Funds of Australia (ASFA) Australian Chamber of Commerce and Industry (ACCI) Australian Conservation Foundation (ACF) Australian Council of Social Service (ACOSS) Australian Council of Trade Unions (ACTU) Australian Local Government Association (ALGA) Business Coalition for Tax Reform (BCTR) Business Council of Australia (BCA) Corporate Tax Association (CTA) CPA Australia (CPAA) Institute of Chartered Accountants in Australia (ICAA) Investment and Financial Services Association (IFSA) Taxation Institute of Australia (TIA)
Stakeholder meetings on retirement incomes 6 March 2009 and 9 March 2009 Sydney & Melbourne	Association of Superannuation Funds of Australia (ASFA) Australian Council of Social Service (ACOSS) Australian Council of Trade Unions (ACTU) Australian Institute of Superannuation Trustees (AIST) CPA Australia (CPAA) Financial Planning Association (FPA) Institute of Actuaries of Australia (IAA) Institute of Chartered Accountants in Australia (ICAA) Investment and Financial Services Australia (IFSA) Self-Managed Super Funds Professionals' Association of Australia (SPAA) Taxation Institute of Australia (TIA)
1 June 2009 Canberra	Global Foundation
Stakeholder meetings — round 2 3 June 2009 to 5 June 2009 Sydney, Melbourne & Canberra	Australian Bankers' Association (ABA) Australian Conservation Foundation (ACF) Australian Local Government Association (ALGA) Business Coalition for Tax Reform (BCTR) Business Council of Australia (BCA) CPA Australia (CPA Australia) Federal Chamber of Automotive Industries (FCAI) Institute of Chartered Accountants in Australia (ICAA) Insurance Council of Australia (ICA) National Council of Women of Australia (NCWA) National Foundation for Australian Women (NFAW) Property Council of Australia (PCA) Women's Electoral Lobby (WEL)
21 August 2009 Sydney	Infrastructure Australia

Meetings	Stakeholder organisations
Business consultation 15 October 2009 Sydney	Australian Chamber of Commerce and Industry (ACCI) Australian Industry Group (AIG) Business Coalition for Tax Reform (BCTR) Business Council of Australia (BCA) Corporate Tax Association (CTA) CPA Australia (CPAA) Deloitte Ernst & Young Group of 100 Institute of Chartered Accountants in Australia (ICAA) Ken Spence of Greenwoods & Freehills KPMG PriceWaterhouseCoopers Taxation Institute of Australia
Community Tax Forum 20 October 2009 Canberra	Australian Conservation Foundation (ACF) Australian Council of Social Service (ACOSS) Australian Council of Trade Unions (ACTU) Consumers' Federation of Australia (CFA) Community Tax Forum independent Chair <u>Independent experts:</u> Allens Arthur Robinson Australia Institute Monash University University of Canberra
5 November 2009 Canberra	Minerals' Council of Australia

Speeches

Around 30 speeches and presentations were provided to a diverse audience. The following speeches are available on the Australia's Future Tax System website (www.taxreview.treasury.gov.au).

15 October 2009	<i>Lessons from tax reform past</i> Address to the Committee for Economic Development of Australia (CEDA) Dr Ken Henry, Chair, Australia's Future Tax System
1 October 2009	<i>Towards a better taxation of savings</i> Address to the Australian Conference of Economists Business Symposium Dr Ken Henry, Chair, Australia's Future Tax System
17 September 2009	<i>Tax reform – future direction</i> Minerals Council of Australia's Biennial Tax Conference 2009 David Parker, Executive Director, Revenue Group, Treasury
21 August 2009	<i>Perspectives on company tax</i> Australia New Zealand Leadership Forum Dr Ken Henry, Chair, Australia's Future Tax System
19 August 2009	<i>Taxation reform and fiscal federation – implications of Australia's Future Tax System review</i> Australian Economic Forum Dr Ken Henry, Chair, Australia's Future Tax System
3 April 2009	<i>How much inequity should we allow?</i> Australian Council of Social Service National Conference Dr Ken Henry, Chair, Australia's Future Tax System
27 March 2009	<i>The future of State revenue</i> 2009 Commissioners' Conference Dr Ken Henry, Chair, Australia's Future Tax System
13 March 2009	<i>Confidence in the operation of the tax system</i> Taxation Institute of Australia conference Dr Ken Henry, Chair, Australia's Future Tax System
23 February 2009	<i>A tax system for Australia in the global economy</i> Australian Business Tax Reform in Retrospect and Prospect colloquium Dr Ken Henry, Chair, Australia's Future Tax System
12 November 2008	<i>Towards a tax and transfer system of human scale</i> National Press Club Dr Ken Henry, Chair, Australia's Future Tax System

Submissions

The Review invited two rounds of submissions. The first round of submissions closed on 17 October 2008 and informed the Review Panel's consultation paper. The second round of submissions included submissions on retirement incomes, which closed on 27 February 2009, and general submissions, which closed on 1 May 2009. Input received after these dates was considered by the Review Panel up until 1 November 2009.

The Review received over 1,500 submissions and over 4,600 items of correspondence. Submissions lodged up until 30 September 2009 are available on the Australia's Future Tax System website (www.taxreview.treasury.gov.au), except where authors requested confidentiality, or whose submissions contained personal information. The following is a list of people and organisations that made non-confidential submissions.

A.S. Turner & Associates	Anstey, H	Association of Superannuation Funds of Australia
Abacus Australian Mutuels	ANZ	
ACT Department of Treasury	Armitage, S	Atheist Foundation of Australia
ACT Government	Armstrong, R	AusBiotech
ACT Peak Oil Inc	Arnold Milton Pty Ltd	Austen, M
Adam, K	Arthur, D	Australand Holdings Limited
Adams, J	Ashcroft, F	Australasian Fleet Managers Association
Ahmed, K	Asia Pacific Travel Retail Association	Australasian Institute of Mining and Metallurgy and the Women in Mining Networking Committee
Alcohol Education Rehabilitation Foundation	Association for Good Government	Australasian Railway Association
Alexander, B	Association of Consulting Engineers	Australia Council for the Arts
Alexander, T	Association of Former Employees of Asian Development Bank	Australia ICOMOS
Allan, M	Association of Former Members of the South Australian Parliament	Australia New Zealand Leadership Forum
Allatt, C	Association of Independent Retirees	Australia New Zealand Secular Association
Allen, DCK	Association of Mining & Exploration Companies	Australian Association of Former International Civil Servants
Allen, P	Association of Neighbourhood Houses & Learning Centres	Australian Automobile Association
ALP Adamstown Branch	Association of NZ Retirees in Australia	
AMP Limited		
Anderson, A		
Anderson, G		
Andersson, M		
Anglican Church Diocese of Sydney		
Anglicare Australia		

Australian Bankers' Association	Australian Financial Markets Association	Australian Pensioners and Superannuants League WA
Australian Bicycle Council	Australian Food and Grocery Council	Australian Petroleum Production & Exploration Association
Australian Chamber of Commerce and Industry	Australian Forest Growers	Australian Private Equity and Venture Capital Association
Australian Charity for the Children of Vietnam	Australian Foundation Investment Company	Australian Publishers Association
Australian Communications and Media Authority	Australian General Practice Network	Australian Rail Track Corporation
Australian Conservation Foundation	Australian Health Ministers' Conference	Australian Religious Response to Climate Change
Australian Council for International Development	Australian Historic Motoring Association	Australian Shareholders' Association
Australian Council of National Trusts	Australian Hotels Association (NSW)	Australian Shipowners Association
Australian Council of Public Sector Retiree Organisations	Australian Human Rights Commission	Australian Social Inclusion Board
Australian Council of Social Service	Australian Information Industry Association	Australian Society of Authors
Australian Council of Trade Unions	Australian Institute of Aboriginal and Torres Strait Islander Studies	Australian Taxation Reform Group Inc
Australian Council of Wool Exporters & Processors	Australian Institute of Petroleum	Australian Taxation Solutions
Australian Council on Smoking and Health	Australian Institute of Policy and Science	Australian Trucking Association
Australian Duty Free Association	Australian Institute of Superannuation Trustees	Australian Wine and Brandy Corporation
Australian Employee Ownership Association	Australian Investors' Association	Aveling, B
Australian Evangelical Alliance and Missions Interlink	Australian Libertarian Society	AXA Asia Pacific Holdings Limited
Australian Federation of Disability Organisations	Australian Liquefied Petroleum Gas Association	Axiom Wealth Pty Ltd
Australian Finance Conference	Australian Listed Investment Companies Association	Ayres, A
Australian Financial Centre Forum	Australian Local Government Association	Bailey, C
	Australian Network of Environmental Defender's Offices	Baker, G
		Baker, R
		Ball, C
		Bardell, B
		Batallion Legal

Batten, P	British American Tobacco Australia	Camera land Camera House and Duty Free
Baulch, K	Brons, C	Cameron, S
Beal, G	Brons, R	Campbell, J
Belani, D	Brooker, R	Campbell, W
Bergman, T	Brookes, J	Cancer Council and National Heart Foundation
Bernstone, R	Brooks, G	Cane, M
Bhati, U N	Brotherhood of St Laurence	Care Australia
Bicycle Network	Broughton, J	Career Industry Council of Australia
Bicycle Victoria	Brown, C	Carers Australia
BicycleNSW	Brown, L	Carlisle, J
BIKESydney	Brown, M	Carrad, H
Biofuels Association of Australia	Brown, S G	Carson, A
Biotech Daily	Brown, T	Carter, J
Birdseye, C	Browne, A	Cassidy, R
Bishop, P	Browne, M	Catherine Brown & Associates P/L and Alice Macdougall of Freehills Lawyers
Blackburn, J	Bruinsma, R	Catholic Health Australia
Blake Dawson	Bryce, L	Catholic Social Justice Commission
Blanchard, R	Buch, I	Catholic Social Services Australia
Blandthorn, I	Buchler, D	Centre for Policy Development
Blows, M & J	Bunting, R	Cesta, D
Blunt, E	Burfitt, H	Challenger Financial Services Group
Board of Airline Representatives Australia	Burke, G	Chamber of Commerce & Industry Queensland
Boden, A	Bus Industry Confederation	Chamber of Commerce and Industry of Western Australia
Bolan, M	Business & Professional Women Australia	Changemakers Australia
Bond, G	Business Coalition for Tax Reform	Chapman, G
Boroondara City Council	Business Council of Australia	Chapman, I
Bowhill, S	Business Tax and Regulation Reference Group	Chiveralls, K
BP Australia	But, M	
Braby, R	Butters, J	
Breen, I	Butterworth, P	
Brewers Association of Australia & New Zealand	Callinan, C J	
Brisbane Airport Corporation		
Brisbane-Webb, P		

CHOICE	Consumer Action Law Centre	Davey, K
Cielinski, J	Consumer Credit Legal Centre (NSW) Inc	Davies, G
City of Mandurah	Conyers, A	Davies, T
City of Sydney	Cord, S	Davis, A
Clark, J	Corporate Super Association	Daw, S
Clarke, B	Corporate Tax Association and Ernst & Young	Dawes, M
Clayton Utz & North Australian Aboriginal Justice Agency Ltd	Corporate Taxpayers Group – New Zealand	Dawson, S
Clean Energy Council	Cossar, G	De Hoedt, S
Cleary, L	COTA Over 50s Ltd	De la Rue, I
Cloud No.9	Council for the Australian Federation	Defence Force Welfare Association
Clubs Australia	Council of Single Mothers and their Children	Diageo Australia
Coard, P	Cox, C	Diment, A
Coca Cola Amatil	Cox, J	Dinse, G
Cochlear Ltd	Cox, K	Distilled Spirits Industry Council of Australia
Cole, A	CPA Australia	Ditchburn, P
Collins, A	Cracknell, K	Dixon Advisory & Superannuation Services Pty Ltd
Combined Pensioners and Superannuants Association of NSW	Craig, J	Doherty, M
Commerce Queensland	Craig, T	DomGas Alliance
Commissioners for Children and Young People	Crisafi, S	Dooleys, S
Communications Electrical Plumbing Union Retired Members Association	Crisp, P	Doring, A
Communities@Work	Croke, G	Downing, R
Community and Public Sector Union	Cross, R W	Drew, Dr L
Community Housing Federation of Australia	CSR Limited	Duffy, GL & YM
Compleat Interiors P/L	Cullen, P	Duffy, G
Condon, Thomas	Curnow, R	Duffy, M
Connelly, Paul	Curtin, M	Duigu, G
Construction, Forestry, Mining and Energy Union	Curtin, T	Dunnill, M
	Curtis, C	Dunsford, G
	Cycling Promotion Fund	Durney, J
	Daly, D	Durnin, J
	Danila Dilba Health Biluru Butji Binnilutlum Medical Service	Duty Free World Council
		Dwyer, T
		ECA Consulting
		Edgerton, Dr B
		Ellett, G

Ellis, J	Frazer, M	Group of 100
Ellison, R	Freudenberg, B	Gulf Savannah Development
Emerald Chamber of Commerce Inc	Frost, K	Gull Group
Emerson, MP C	Fullarton, L	Gunn, R
Employee Ownership Group	Fundraising Institute Australia	Haar, A
Erwin, R	Gale, I	Hagstrom, E
Etax Accountants	Gallagher, A	Hailes, R
Evans, B	Gasteen, P	Hajszan, W
Evans, Dr M	Gaunt, R	Halacas, C
Evans, N	Gayler, D	Hall, C
Fairhall, L	Gebhardt, A	Hall, G
Falzon, B	Geelong Chamber of Commerce	Hall, M & J
Farquharson, R	Georgist Education Association Inc	Hall, T
Farthing, A	Gibson, D	Hamilton, R
Federal Chamber of Automotive Industries	Gifford, E J	Hamilton, S
Feitsma, H	GM Holden	Hammer, M
Fels, R	Gnieslaw, I	Hancock, G
Fennessy, K	Goegan, P	Haniszewski, S
Fernandez, P	Goodall, D	Harris, G
Financial Planning Association of Australia Limited	Goodwin, K	Harrison, I
Financial Services Tasmania	Goodyear, M	Harrison, S
Fisher, G	Gordon, T	Hart, R
Fisk, S	Grage, P	Hassed, M
Fitzgerald, J	Graham, J	Hawkins, G
Flanagan, A	Graham, L	Hayes, T
Fletcher, B	Grant Thornton Australia Ltd	Health Insurance Restricted Membership Association of Australia
Flinders University	Grant, I	Hearn, W
Floyd, S	Grant, P	Heart Foundation
Ford, M & N	Gray, M	Heathers, J
Foresters ANA Mutual Society Ltd and Parent to Parent Association Queensland	Gray, S	Hemlof, L E K
Fraser, B	Greening Australia	Henderson, B
	Greenpeace Australia Pacific Ltd	Henderson, D
	Greenspeed Pty Ltd	Henkel, G
	Griffin, P	Heritage Council of Victoria
		Heron, S

Hestelow, J	Institute of Actuaries of Australia	Killeen, H
Highfield, R	Institute of Chartered Accountants in Australia	King, G
Hignett, C	Insurance Australia Group	Kirk, T
Hill, R & E	Insurance Council of Australia	Koci, S
Hinson, K	International Institute for Self-governance	KPMG
HLB Mann Judd	InterPrac Financial Planning	Kunath, M
Hobbs, A	Investment & Financial Services Association Ltd	La Trobe University and RMIT University
Hodgkinson, N	Ireland, D	Lagarenne, B
Hodgson, P	Irving, A	Laird, P
Hoff, B	Isakov, M	Lance, J
Hogbin, J	Isolated Children's Parents' Association of NSW	Land & Environment Planning
Holland, F	IUCN World Commission on Protected Areas Oceania	Land Values Research Group
Holland, P	Jablonka, I	Lang, L
Hollingsworth, D	Jackson, R	Laris, P
Holmes, P	Jacobi, M	Larsen, E
Homan, S	Jamieson, L	Larson, R
Homesafe Solutions	January, M	Law Institute of Victoria
Hotel Motel & Accommodation Association	Jensen, D	Law, C & A
Housing Industry Association	Jensen, G	Lawrence, J
Howell, R	Jervis-Read, R	Lawrence, P
Hughes, S	Johannessen, E	Lawson, W
Hunt Partners Solicitors on behalf of Bindaree Beef	Johanson, A	Leabrook Estate Wines
Hurley, S	Johnston, A	Leaver, G
Hurley, T	Johnston, M	Leeson, R
Hutchings, S	Kavanagh, B	Lefevre, K
Independent Distillers Australia	Keats, R	Legge, D
Indigenous Higher Education Advisory Council	Kenna, J	Lend Lease Corporation
Industry Funds Forum	Kenrick, R	Lesbian & Gay Solidarity
Industry Super Network	Kern, L	Leslie, R
Infrastructure Partnerships Australia	Keys, N	Lester, D
ING Australia		Lester, R
		Lester, T
		Lewis, B
		Liepins, D
		Lifschitz, S

Lim, L L	McDowall, K I	Moreton Bay Regional Council
Lincolne Scott	McEwen, S	Morgan, G
Little, R	McGreevy, S	Morgan, J
Liverpool Plains Land Management Inc	McIlroy, K	Morgan, T
Local Government Association of South Australia	McIntosh, S	Morre, J
Lodge, J	McIntyre, C	Moss, H
Loring, P	McIntyre, P	Motor Trades Association of Australia
Lorkin Delper Harris	McKinna, I	Motorcycle Riders Association of Queensland
Lowcock, M	McMillan Shakespeare	Moult, J
Lowry, D	McPherson, M	Municipal Association of Victoria
LPG Australia	Media, Entertainment & Arts Alliance	Murphy, T
Lucas, S	Medicines Australia	Music Council of Australia
MacDonald, C	Melrose, S	National Association of Forest Industries
MacDonald, R	Mercer WealthSolutions	National Council of Women of Australia
Macfarlan Lane Pty Ltd	Meriton Apartments	National Council of Women of Western Australia
Mackenzie, G	Metropolitan Transport Forum	National Disability Services
Maclean, N	Meyer, J	National Drug Research Institute
Madell, B	Meyer, N	National Employment Services Association
Madigan, R	Midas Insurance Brokers	National Ethnic Disability Alliance
Maher, V	Middleton, D	National Farmers Federation
Maitland RSL Sub Branch	Mihaljevic, M	National Foundation for Australian Women
Maloney, S	Mills, A	National Independent Retailers Association
Manildra Group	Minerals Council of Australia	National Information Centre on Retirement Investments
Mannison, M	Mitchell, D	National Institute of Accountants
Mareeba District Fruit and Vegetable Growers Association	MLC and NAB Wealth	
Maritime Union of Australia	MND Australia	
Martin, B	Moffet, R	
Martin, P	Montfort International PLC	
Mason, C	Moody, T	
Master Builders Australia Inc.	Moon, B	
Matthews, G & C	Moore, C	
Mawdsley, A	Moore, J	
	Moore R	
	More, T	
	Moreland City Council	

National Insurance Brokers Association	NSW Federation of Housing Associations	People for Ecologically Sustainable Transport
National Preventative Health Taskforce	NSW Government	Permaculture North
National Road Freighters Association	Nygren, G	Petersen, B
National Roundtable of Nonprofit Organisations	Nyst, E	Peters-Fawcett, M
National Seniors Australia	O'Brien, P	Peterson, T
National Tax and Accountants Association	O'Connell, A	Peterson, V
National Tertiary Education Union	O'Donnell, C	Pettigrew, J S
National Tourism Alliance	O'Donnell, J	Pfizer Australia
National Transport Commission	O'Malley, I	Philanthropy Australia Inc
National Union of Students	One Nation Queensland Division	Philip Morris Ltd
National Welfare Rights Network	O'Neill, P	Phillips, M
Nature Conservation Trust of NSW	Onkaparinga Exporters Club	Phillips, S
Nelson, K	Orams, W	Philps, N
New Internationalist Publications Pty Ltd	Ord, M	Piggott, R
Newman, N	Owners Corporations Victoria	Pinniger, G
Nguyen, D	Oxfam Australia	Pirie, R
Nichols, P	Pace, J	Pitcher Partners Advisors
Noack, J	Pacheco, V	PKF Chartered Accountants & Business Advisers
Nock, T	Pacific Brands Ltd	Police Federation of Australia
Non-Smokers Movement of Australia Inc	Parish, D	Policy Centre Australia
Northern Rivers Social Development Council	Parke, MP M	Pollard, P
Northern Territory Government	Parkes, L	Pope, J
Notholt, P	Partington, R	Porter, E
Nott, A	Pascher, F	Portnoy, A
NSW Business Chamber	Paskin, J	Pottsville Beach Neighbourhood Centre Inc
	Passant, J	Practical Ecology P/L
	Paterson, R	PricewaterhouseCoopers — Australia
	Paul Laris and Associates	PricewaterhouseCoopers — New Zealand
	Payne, E	Prince, A
	Pears, Adj Prof A	Pritchard, C
	Peck, C	Property Council of Australia
	Pedal Power	
	Pennington, J	
	Penrith City Council	
	Pension Reforms	

Property Investment Essentials	Reynolds, D	Schorel-Hlavka, G
Prosper Australia	Reynolds, M	Schwab, S
Prout, R	Rheem Australia Pty Ltd	Scolyer, D
Prudames, G & A	Rice Warner Actuaries	Secular Party of Australia
Public Interest Advocacy Centre	Richard Lester Consulting	Securities & Derivatives Industry Association
Public Interest Law Clearing House	Richardson, J	Seda Opals Pty Ltd
Public Transport Users Association Victoria	RL Lewis Pty Ltd	Self Managed Super Fund Professionals' Association
Purdue, B	RMIT University	Sellar, E
Pursehouse, G	Roberts, A	Senior Australians Equity Release Association of Lenders
Putland, G	Roberts, D	Seret, D
QANTAS Airways Ltd	Roberts, G W	Seth-Purdie, R
Queensland Government	Robinson, M	Seve, J
Queensland Resources Council	Roman, E	Seventh-day Adventist Church
Rac, M	Ronan, N	Severn, Z
RACQ	Rose, A	Sexton, R
Raicu, S	Rose, K	Sheeran, J
Rainbow, J G	Ross Edwards & Associates Pty Ltd	Shell Company of Australia
Rantzen, J	Rowan, P	Shrapnel, J & J
Rationalist Society of Australia	Rowland, J	Singer, D
Read, G	Rowland, P	Skinner, B
Real Estate Institute of Australia	Royal Australasian College of Physicians	Skipworth, G
Reddyhough, J	Royal Flying Doctor Service	Smart Salary
Redmond, T	RSPCA	Smartsuper
Regional Aviation Association of Australia	Rumney, C	Smith, D
Rehbein, R	Runnalls, J	Smith, J
Reis, C	Russell-Stone, C	Smith, M
Renewable Fuels Australia	S.A. Sports Federation Inc	Smith, N
Renton, N	SA Superannuants	Smith, R
Restaurant and Catering Australia	Sach, R	Smith, R L
Revenue Review Foundation	Salvation Army	Smith, R
	Saunders, G	Smithers, G
	Saxton, I	Smokeless Tobacco Action Group
	Scarf, G	Snowball, C
	Schaper, PC	
	Schlottmann, E	

South Australian Farmers' Federation	Tasmanian Department of Environment, Parks, Heritage and the Arts	Total Environment Centre
South Australian Government	Tasmanian Government	Tourism and Transport Forum
South Australian Government Superannuated Employee Association	Tasmanian Heritage Council	Tourism Western Australia
Spain, D	Taxation Institute of Australia	Towers Perrin
Spakia Pty Ltd	Taxpayers Australia	Townsend, T
Sporting Wheelies and Disabled Association	Taylor, B	Toyota Finance Australia Ltd
Spry, S	Taylor, N	Triumph Sports Owners Association of WA
St.Vincent de Paul Society	Teece, P	Trotter, G
Stafford, J	Telstra	Trustee Corporations Associations of Australia
Standley, S	Thackeray, I	Tucker, B
Stanford, C	Thackrah, D	Tuckerman, P
State Library of Western Australia	The Australia Institute Ltd	Turner, P
Steel, D	The Australian Lung Foundation	Udell, A
Steiner, C	The Church of Jesus Christ of Latter-Day Saints	UniSuper
Stephens, I	The Geelong Chamber of Commerce	Uniting Church in Australia
Stewart, M	The Nature Conservancy Australia	UnitingCare Australia
Stoner, A	The Nuance Group	UnitingJustice Australia
Stuart, B	The Smith Family	University of Auckland Retirement Policy and Research Centre
Such, MP B	The Tax Base Pty Ltd	University of Melbourne Law School
Sullivan, L	The Treasury - Inland Revenue, New Zealand	Urban Development Institute of Australia
Sully, P	Thian, D	Urban Taskforce Australia
Summer, B	Thomas, G	Varley, C
Summers, B	Thompson, D	Verick, A S
Superannuated Commonwealth Officers' Association	Thompson, G	VicSport
Superannuation Information Centre	Thomson, M	Victorian Farmers Federation
Swainston, J	Thorp, D	Victorian Government
Tanner, R	Thorpe, G	Victorian Land Tax Coalition
Tanswell, K	Tieman, D	Virgin Blue Airlines Pty Ltd
Tasmanian Association of Microbrewers	Tipping Point Institute Pty Ltd	Wagner, R
	Tomlinson, J	Waldie, J

Walker, C	West-Newman, S	Wittwer, S
Walker, G	Wheatley, H	Women's Action Alliance
Walker-Roberts, B	White, E	Women in Social & Economic Research
Walker-Rolls, A	Whitlam, C	Women's Electoral Lobby Australia
Wallace, MP C	Whitton, E	Women's Health Victoria
Walshaw, T	Wickham, D	Woods, F
Ward, A	Wilden, J	Woodside Energy Ltd
Ward, D	Wilkes, V	Woodward, L
Ward, M	Wilkin-Smith, T	Woolworths Limited
Warneford, R	Wilkinson, G	World Vision Australia
Waters, H	Will, N	Wren, M
Watt, W	Williams, J	Wright, M C
Way, M	Williams, N	WWF-Australia
WB Financial	Williams, N	Wynn, R
Webb, J	Williams, R	Xiao, C
Webster, S	Williams, S	Young, D
Weir, O	Willoughby City Council	Young, J
Wells, J	Wilson, RH	YWCA Australia
Western Australian Department of Indigenous Affairs	Wilson, R	Zeitoun, A
Western Australian Government	Winemakers' Federation of Australia	
	Winthrop, R	
	Withers, A	

Appendix E: Research and consultancies

Papers presented at the Tax and Transfer Policy Conference

The Tax and Transfer Policy Conference was held on 18 and 19 June 2009. It was jointly hosted by the Melbourne Institute of Applied Economic and Social Research and the Review Panel. Around 150 people attended, including Australian and international experts on tax and transfer policy. The papers presented at the conference are available on the Australia's Future Tax System website (www.taxreview.treasury.gov.au).

Papers

Speakers at the conference provided papers to support their presentations.

Professor Alan Auerbach, University of California, United States
Directions in tax and transfer theory

Professor Richard Bird (and Michael Smart), University of Toronto, Canada
Assigning state taxes in a federal country: The case of Australia

Professor Sijbren Cnossen, University of Maastrich, The Netherlands
Excise taxation in Australia

Professor Richard Disney, University of Nottingham, United Kingdom
Australia: Issues in the tax treatment of pensions and housing

Professor John Freebairn, University of Melbourne
Environmental taxation and its possible application in Australia

Professor Christopher Heady, University of Kent, United Kingdom
Directions in overseas tax policy

Professor Michael Keane, University of Technology Sydney
The tax-transfer system and labour supply

Professor Joel Slemrod, University of Michigan, United States
Complexity in the Australian tax and transfer system

Professor Peter Birch Sørensen (and Shane Johnson), University of Copenhagen, Denmark
Taxing capital income – options for reform in Australia

Professor Peter Whiteford, University of New South Wales
Transfer issues and directions for reform: Australian transfer policy in comparative perspective

Discussants

Discussants reviewed the papers and provided presentations (some of these were documented in PowerPoint and are available on the Australia's Future Tax System website).

Professor Patricia Apps, University of Sydney

Professor Alan Auerbach, University of California, United States

Mr Matt Benge, Inland Revenue Department, New Zealand

Mr Don Challen, Department of Treasury and Finance, Tasmania

Professor Harry Clarke, La Trobe University

Professor Julian Disney AO, University of New South Wales

Professor Chris Evans, University of New South Wales

Professor John Freebairn, University of Melbourne

Professor Quentin Grafton, Australian National University

Mr Matthew Ryan, taxation policy consultant

Mr David Smith, Queensland Treasury

Professor Peter Birch Sørensen, University of Copenhagen, Denmark

Professor Richard J Vann, University of Sydney

Professor Neil Warren, University of New South Wales

Professor Gavin Wood, RMIT University

Professor Mark Wooden, University of Melbourne

Research papers

The Review commissioned research papers on specific areas of tax policy. These papers are available on the Australia's Future Tax System website (www.taxreview.treasury.gov.au).

Professor Harry Clarke and Dr David Prentice, La Trobe University

A conceptual framework for the reform of taxes related to roads and transport

Colmar Brunton Social Research

Perceptions and attitudes towards the current tax and transfer system: Public meetings and

Perceptions and attitudes towards the current tax and transfer system: Focus groups

Lindsay Hogan and Rebecca McCallum, Australian Bureau of Agricultural and Resource Economics

Non-renewable resource taxation in Australia

Professor Andrew Leigh, Australian National University

The impact of the tax-transfer system on education and skills in Australia

KPMG Econtech

CGE analysis of the current Australian tax system

PriceWaterhouseCoopers

Small Medium Enterprises Total Tax Contribution Report

Andrew Reeson and Simon Dunstall, CSIRO

Behavioural economics and complex decision making: Implications for the Australian tax and transfer system

Professor Michael Sherris and Associate Professor John Evans, University of New South Wales

Longevity management issues for Australia's Future Tax System

Dr George Kudrna and Professor Alan Woodland, University of New South Wales

Simulating policy change using a dynamic overlapping generations model of the Australian economy'

Professor Gavin Wood, Australian Housing and Urban Research Institute (AHURI),

Associate Professor Miranda Stewart, University of Melbourne and Dr Rachel Ong, Curtin University of Technology

Housing taxation and transfers: Research study for the Australian Treasury

Seminar speakers

The AFTS Secretariat hosted a series of seminars for Treasury staff on issues relevant to the Review. The external presenters were:

Professor Patricia Apps,
University of Sydney

Professor Valerie Braithwaite,
Australian National University

Mr Robert Carling,
Centre for Independent Studies

Professor Deborah Cobb-Clark,
Australian National University

Adjunct Professor David Collins,
Macquarie University

Professor Sinclair Davidson,
RMIT University

Professor Bob Deutsch, Atax,
University of New South Wales

Dr Brett Freudenberg,
Griffith University

Dr Matthew Gray,
Australian Institute of Family Studies

Dr Steve Hatfield-Dodds,
Department of Climate Change

Professor Chris Heady,
University of Kent

Mr Richard Highfield,
Centre for Tax Policy and
Administration, OECD

Adjunct Professor Steve Holloway,
University of Canberra

Dr David Ingles,
Australia Institute

Dr Simon Kelly, NATSEM,
University of Canberra

Professor Rick Krever,
Monash University

Professor Helen Lapsley,
University of New South Wales

Professor Andrew Leigh,
Australian National University

Mr Gordon Mackenzie, Atax,
University of New South Wales

Mr Vince Mangioni,
University of Technology, Sydney

Professor Myles McGregor-Lowndes,
Australian Centre for Philanthropy and
Nonprofit Studies

Mr David Mitchell,
Bureau of Infrastructure, Transport and
Regional Economics

Mr Peter Mullins,
Australian Taxation Office

Mr Ken Oliver,
Department of Education, Employment
and Workplace Relations

Ms Jocelyn Pech PSM,
Australian Fair Pay Commission
Secretariat

Ms Julia Perry,
Social policy analyst

Associate Professor Jeff Pope,
Curtin University

Professor John Quiggin,
University of Queensland

Mr Matthew Ryan,
Taxation policy consultant

Dr Julie P Smith,
Australian National University

Associate Professor Michael Walpole,
Atax, University of New South Wales

Professor Peter Whiteford,
University of New South Wales

Honorary Associate Professor Judy Yates,
University of Sydney

Consultants

The Review commissioned a range of consultancies to provide advice, including the review of the content of this report and communications advice.

Colmar Brunton Social Research — for the facilitation and conduct of public meetings and focus groups

Mark Dando, Jeff Fitzgibbon, Wendy Hamilton — for communication advice and editing services

Professor John Freebairn (University of Melbourne) — for review and advice on draft content of the final report

David Glynne Jones — for advice on service delivery trends and input to the Client Experience Reference Group

Melbourne Institute of Applied Economic and Social Research — for hosting the Tax and Transfer Policy Conference

Andrew Robertson — for advice on longevity risks

Ken Spence of Greenwoods and Freehills — for review and advice on draft content of the final report

Other contributors and commentators

The following contributors reviewed draft content or provided information or advice during the Review.

John Austen, Infrastructure Australia

Donna Ah Chee, Central Australian Aboriginal Congress

Professor John Braithwaite, Australian National University

Dave Elsmore, Queensland Philatelic Federation

Dr Mark Harvey, Bureau of Infrastructure, Transport and Regional Economics

Professor Christopher Heady, OECD

Professor Flavio Menezes, University of Queensland

Sean O'Shannassy, NSW Road Traffic Authority

Professor John Quiggin, University of Queensland

Tony Richards, Reserve Bank of Australia

Paul Roe, Infrastructure Australia

Ben Smith, Australian National University

Appendix F: Secretariat and support

A secretariat was established in the Treasury to assist the Review Panel. It consisted of approximately 35 staff, drawn from within the Treasury, the Department of Education, Employment and Workplace Relations, the Department of Families, Housing, Community Services and Indigenous Affairs, the Australian Taxation Office and Centrelink.

The Secretariat was assisted by other areas in the Treasury, a Taskforce set up in the Department of Families, Housing, Community Services and Indigenous Affairs, the Australian Taxation Office and a range of other Commonwealth departments and agencies. It also received assistance from State treasuries.

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Glossary

Term	Definition
Adjusted taxable income	For the purposes of certain means-tested assistance programs, taxable income is adjusted to include other income items, such as fringe benefits, certain tax-exempt foreign income amounts and net investment losses.
Ad valorem tax	A tax that is levied as a percentage of the value of a particular good or service; for example, a 3 per cent royalty on the value of gold production or an 8 per cent tax on the value of an insurance premium.
Allowance for corporate equity (ACE)	A form of business expenditure tax that provides a deduction (allowance) for corporate equity at the corporate level, equivalent to that provided for interest on debt.
Allowance for shareholder equity (ASE)	A form of expenditure tax similar to the allowance for corporate equity that provides a deduction (allowance) for shareholder equity at the shareholder's level.
Allowee	A person who receives an income support allowance (for example, Newstart Allowance or Youth Allowance), rather than a pension, such as the Age Pension or the Disability Support Pension.
Average weekly earnings	Average weekly earnings statistics represent average gross (before tax) earnings of employees. Estimates of average weekly earnings are derived by dividing estimates of weekly total earnings by estimates of number of employees.
Average weekly ordinary time earnings (AWOTE)	Weekly ordinary time earnings refers to one week's earnings of employees for the reference period attributable to award, standard or agreed hours of work. It is calculated before taxation and any other deductions (for example, superannuation, board and lodging), have been made.
Capital income	Earnings from investments and savings, including interest, net rental and business income, capital gains and dividends.
Cash flow tax	A system that taxes the difference between cash receipts and cash outgoings.
Categorical income support	Income support that is paid on the basis of eligibility conditions that divide people into groups. For example, age, disability, caring responsibilities, and those undertaking education or training.
Compliance cost	Expenses incurred in meeting the requirements of legislation or regulations. Compliance costs include a wide range of monetary and non-monetary costs.

Term	Definition
Concessional superannuation contribution	A contribution that has not been taxable as income in the hands of an individual, or for which the person has received a deduction. These contributions are currently taxable within a superannuation fund.
Corrective tax	A tax designed to make markets more efficient by exposing producers and consumers to prices that reflect the costs that they impose on others (such as pollution).
Cut-out point	The level of income or assets that results in a person no longer being eligible for a transfer payment.
Deduction	Losses or outgoings incurred in producing income or running a business that can be used to reduce assessable income.
Deeming	Assuming a rate of return on an asset regardless of its actual rate of return. Used in determining eligibility for some transfer payments.
Depreciation (economic)	The decline in the market value of an asset over its life.
Depreciation (tax)	The decline in value of an asset for taxation purposes, which may differ from economic depreciation.
Distortion	Any action or thing that reduces economic efficiency. Distortions generally arise when private action (such as price-fixing by a cartel), or public action (such as a tax imposed by government), changes an individual's or firm's behaviour.
Dividend imputation	A system that integrates the taxation of companies and shareholders by allowing companies to pass imputation credits (representing tax paid at the company level) to shareholders upon payment of a dividend. This allows the shareholder to take into account any company tax paid in respect of a dividend they receive when calculating their tax liability. For example, if a shareholder has a marginal tax rate of 30 per cent and receives a fully franked dividend (one paid out of earnings that have already been subject to the 30 per cent company income tax), they would not be required to pay any additional personal income tax.
Dividend streaming	A strategy that aims to direct ('stream') dividends with imputation credits attached to those shareholders for whom imputation credits are of most value. For example, as resident shareholders are able to use imputation credits to lower their tax liability while non-resident shareholders cannot, dividend streaming would see profits that have imputation credits attached to them paid to resident shareholders, while profits without imputation credits attached to them would be paid to non-resident shareholders.
Dual income tax	A dual income tax system imposes differential rates of tax on capital and labour income.

Term	Definition
Economic incidence	The individual or entity which bears the final burden of a tax (or receives the benefit of a transfer), after response effects, such as price and wage changes, are taken into account. This is distinct from the legal incidence of the tax or transfer. For example, the legal incidence of a consumption tax is often the supplier of goods and services who is legally required to pay the tax. However, the supplier may be able to factor in the tax they pay into the price of their products or services that they charge to consumers. This results in the consumer paying a higher price for the good or service. In such cases, the consumer bears the economic incidence of the tax through paying higher prices even though it is the supplier that is legally liable to pay all of the tax.
Economic rents	An economic rent is the excess of the return to a factor of production above the amount that is required to sustain the current use of the factor (or to entice the use of the factor). For example, if a worker is paid \$100,000 but would still be willing to work at the same job if they were paid \$75,000, their economic rent would be \$25,000.
Effective life	The period over which a depreciating asset can be used for income-producing purposes.
Effective tax rates (labour taxes)	<p>Effective Marginal Tax Rates (EMTRs) for labour measure the proportion of gross pay lost in taxes and reduced transfer payments due to a small change in gross income (for example, a change of \$1.00).</p> <p>Effective Average Tax Rates (EATRs) for labour are a measure of the proportion of gross pay that is lost to tax or reduced transfer payments due to that gross income.</p>
Effective tax rates (savings and investment)	<p>Effective Marginal Tax Rates (EMTRs) on savings and investment measure the effect of taxation on the return to an investment in a marginal project, which is one that earns no super normal profits.</p> <p>Effective Average Tax Rates (EATRs) for investment measure the effective tax burden on an additional unit of investment. EATRs can be used to examine the tax burden on investments with super normal profits.</p>
Efficiency	<p>Efficiency means making the best use of resources.</p> <p>‘Technical’ or ‘productive’ efficiency means producing as many goods or services as possible from a given set of inputs.</p> <p>‘Allocative’ or ‘economic’ efficiency means putting productive resources (like labour, land or capital), to their highest value use and distributing goods and services to consumers in a way that best satisfies consumer needs and wants.</p>

Term	Definition
Elasticity	A measure of the responsiveness of one variable to changes in another. For example, the 'price elasticity of demand' refers to the percentage change in the amount of a good purchased ('demand') following a percentage change in its price. If the percentage change in demand is more than the percentage change in price, demand is said to be price 'elastic'; if it is less, demand is said to be price 'inelastic'.
Entity	A unit for taxation purposes. Entities include a company, trust, partnership, any unincorporated body or association, and an individual.
Excise	A commodity-based tax levied on the manufacture or production of selected goods in Australia (including liquid fuel, tobacco and some alcoholic beverages). Imported equivalents are subject to an excise-equivalent customs duty.
Excise-equivalent customs duty	An import tariff applied as the equivalent to an internal tax to ensure that goods that would otherwise be subject to excise if manufactured or produced in Australia are subject to the same rate of duty when imported.
Expenditure tax benchmark	A theoretical tax structure that involves levying tax on a person's consumption (or expenditure). Expenditure can be measured in a variety of ways, including as income less net new savings. This benchmark differs from <i>income tax benchmark</i> , by proposing that income from savings not be taxed.
Factor (of production)	An input into the production process. The four broad factors are labour, capital (including plant and equipment, buildings, skills or 'human capital' and know-how, or 'intellectual property'), land (including natural resources), and enterprise (which brings the other factors together in a productive endeavour).
Family payments	Australian Government transfer payments made to parents with dependent children. For example, Family Tax Benefit.
Flow through	A form of integration between an entity (such as a company), and its underlying owners (the shareholders). It can apply to the entire operations of the entity, such that individual shareholders are taken to have earned their relevant share of assessable income of the entity and incurred the relevant share of losses and outgoings.
Foreign direct investment	Foreign investment that conveys a significant degree of influence in the management or control of the entity in which the investment is made. In Australia, an equity interest of 10 per cent or more by a non-resident investor is defined as foreign direct investment.
Free area	The level of income or assets a person can have before a person starts to lose part of their transfer payments.

Term	Definition
Fringe benefits	Benefits received by employees from their employer in respect of employment that are in a different form to salary and wages, such as the use of a car for private purposes.
Gift deductibility	Personal donations to some organisations may be tax deductible where they are: made to a deductible gift recipient; money or a certain type of property; made voluntarily and without material benefit to the donor; and comply with other relevant gift conditions.
Grandfathered	The preservation of the benefits of previous arrangements for those who qualify, while phasing in new arrangements for the future.
Horizontal equity	Horizontal equity refers to people in similar circumstances being treated in a similar way. For instance, by paying a similar amount of tax in the context of the tax system, or receiving a similar level of benefit in the transfer system.
Horizontal fiscal equalisation	The process by which the capacities of sub-national governments to provide services to their citizens are made more equal. In Australia, State governments receive funding from the Commonwealth through the horizontal fiscal equalisation process such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standards.
Imputed rent	The estimated rent that an owner-occupied dwelling would attract if it was rented at market rates.
Income effect	If the price of a commodity (of any type) rises, there are two effects. Firstly, the real income of people who use it falls. This generally, but not always, causes them to use less of it and/or other goods. This is called the income effect. Secondly, the price of that commodity rises relative to other commodities, causing people to use less of it and more of the other commodities. This is called the substitution effect.
Income support	Transfer payments from government to low-income individuals and families to assist with the cost of living. There are two types of income support payment in the existing Australian transfer system: pensions (for example, the Age Pension or the Disability Support Pension), and allowances, like Newstart Allowance and Youth Allowance. In most cases, pensioners are not expected to work while allowees are expected to work, either immediately or (at least) soon. Pensions are paid at a higher rate than allowances.

Term	Definition
Income tax benchmark	A theoretical tax structure that involves levying tax on all additions to an individual's ability to purchase goods and services in a given period. It taxes both the return from labour and the return from savings. A nominal income tax taxes the entire return from saving. A real income tax taxes only the return from saving in excess of inflation; that is, it taxes additions to the real quantity of goods and services the individual can purchase in a given period.
Intangible assets	Assets that cannot be seen or touched, such as goodwill, patents, software, trademarks and copyright.
Interest withholding tax	A tax levied on interest paid to a non-resident lender. The tax is withheld by the Australian payer on payment of the interest.
Legal incidence	The individual or entity legally liable to pay a tax or receive a transfer bears the legal incidence of the tax or transfer. The legal incidence often differs from the economic incidence (<i>see</i> economic incidence).
Longevity insurance	A product that a person can purchase that will pay them an income until they die.
Market failure	<p>Markets fail when they do not allocate resources efficiently. There are four main causes of market failure:</p> <p>Market power, which arises when a single buyer or seller can exert significant influence over prices or output;</p> <p>Spillovers (sometimes referred to as 'externalities'), which arise when the market does not take into account the effect of economic activity on people not directly involved. For example, a firm may ignore the costs it imposes on others by polluting the environment;</p> <p>Public goods, such as national security, where enjoyment of the good by one person does not reduce the consumption possibilities available to others; and</p> <p>Incomplete or asymmetric information; for example, where an applicant for insurance knows more about the risk that they will make a claim than the insurance company.</p>
Mutual receipts	The receipts that not-for-profit, member-based organisations (such as licensed clubs), collect from trading with their members. These receipts are generally treated as non-assessable, non-exempt income.
Negative gearing	An asset is negatively geared when its interest payments on borrowings used to finance the asset exceed the income it generates, net of other expenses. Negative gearing commonly refers to the ability to deduct such a loss against another source of income, such as wages.

Term	Definition
Not-for-profit organisation (NFP)	An organisation that is not operated for the profit or gain of its individual members, both while the organisation is being carried on, and on its winding up.
Offshore banking unit (OBU)	An offshore banking unit provides financial intermediation services between non-residents. OBUs are concessionally taxed on such income, (currently subject to an effective tax rate of 10 per cent), and are entitled to withholding tax concessions.
Offset	Tax offsets directly reduce the amount of tax paid. They are different from deductions, which reduce total assessable income. Tax offsets were previously known as rebates. They can be non-refundable (that is, they can reduce a taxpayer's liability to zero, but cannot result in a refund), or refundable.
Operating costs	The administration and compliance costs associated with a tax.
Ordinary income	<p>In the tax system, ordinary income is an income measure that describes earnings such as income from labour or the return on investment, such as interest, dividends or rent.</p> <p>In the transfer system, ordinary income is an income measure used to determine eligibility for pensions and allowances. This is broader than the tax definition as, generally, it does not allow for deductions, salary sacrificed amounts and fringe benefits.</p>
Participation	Labour force participation is people in work or looking for work. The labour force participation rate is the labour force as a percentage of the civilian population aged 15 years and over.
Participation tax rate (PTR)	The proportion of gross pay lost in taxes and reduced transfer payments when a person takes up paid employment.
Personal use asset	An asset other than a collectable that is used or kept mainly for personal use or enjoyment.
Petroleum Resource Rent Tax (PRRT)	The petroleum resource rent tax applies to all petroleum projects in offshore areas, other than certain production licences subject to the excise and royalty regime. It is applied to super normal profits derived from the recovery of petroleum in a project.
Portfolio investment	Investment (including loans), that does not convey a significant degree of influence in the management or control of the entity in which the investment is made. In Australia, a foreign portfolio equity investment is defined as one where the non-resident investor has an equity interest of less than 10 per cent.
Post-tax contribution	A superannuation contribution made by a person from income on which they have already paid tax.
Productivity	The amount of goods or services that can be produced from a given set of inputs. Productivity rises when more outputs can be produced from a given number of inputs.

Term	Definition
Profit-based royalty	A royalty levied on the net cash flow or some other measure of the profit of a project.
Profit shifting	Shifting the location of profit between entities, which are typically in different countries, without corresponding changes in real activity.
Progressive taxation	Where the average rate of tax increases as income increases.
Property rights	Rights that an individual or a legal entity like a company enjoy in relation to any 'thing'; for example, the right to use (but not to sell) a particular piece of land or the right to use (and to sell) a chair.
Public good	A good where the enjoyment of that good by one person does not reduce the consumption possibilities available to others. For example, one person receiving a benefit from national defence does not reduce the ability of others to enjoy such benefits. Public goods have the characteristics of being 'non-rivalrous' – consumption of the good by one individual does not reduce availability of the good for consumption by others – and 'non-excludable' – no-one can be effectively excluded from using the good.
Rebateable employer	A non-government, non-profit organisation that is currently eligible for a rebate of 48 per cent of the amount of fringe benefits tax that would otherwise be payable.
Regressive taxation	Where the average rate of tax decreases as income increases.
Resource rent tax	A tax that applies to the super normal profits, or economic rent of a resource project.
Rulings	The Commissioner of Taxation's statements about how the tax law applies in particular cases. They include public rulings which apply to taxpayers generally, or to a class of taxpayers, and private rulings which apply to a particular taxpayer. Tax law rulings are usually legally binding on the Commissioner.
Social costs	The total costs of an activity. This includes the private cost as well as the spillover or external cost imposed on people who are not directly involved in the activity.
Specific royalty	An output-based royalty that is levied as a set charge per physical unit of production; for example, \$1.00 per tonne of marble.
Spillover	A spillover (sometimes referred to as an 'externality'), occurs when the actions of an individual or firm impose involuntary costs (or benefits) on others. That is, in addition to the private costs and benefits that accrue to the decision-maker, some costs and benefits can 'spill over' on to others.
Substitution effect	See Income effect.
Tangible assets	Assets that can be seen or touched, such as an oven or a building.

Term	Definition
Tax base	The tax base is the assessed value upon which a tax is levied; for example, taxable income.
Tax expenditure	A tax concession that provides a benefit to a specified activity or class of taxpayer.
Tax wedge	An economic distortion caused by a particular tax measure. For example, a tax on labour results in a wedge between the gross amount that the employer pays and the take-home pay the employee actually receives.
Thin capitalisation	An entity is thinly capitalised where it uses a high level of debt, relative to equity, to finance assets.
Transfer	A transfer is a direct government payment, grant, or in-kind benefit made to an individual or a family based on certain eligibility criteria, rather than being made in return for goods or services. State governments also provide transfers, including through concessions.
Transfer payment	A transfer payment provides direct financial assistance to individuals or families who are unable, or are not expected, to fully support themselves.
Transfer pricing	The practice of pricing related party transactions in a way that artificially shifts profits between the parties.
Trust	A trust exists when a person (the trustee) holds property on behalf of others (the beneficiaries) who are intended to benefit from the property or income of that property.
Untaxed fund	A superannuation fund that does not pay tax on some, or all, of its contributions and earnings.
Vertical equity	Vertical equity is the principle that people with low means should receive greater assistance than those with higher means, and that those with greater economic capacity should have a higher tax burden.
Vertical fiscal imbalance	The situation in a federation where the capacity of different levels of government to raise revenues does not match their expenditure responsibilities.
Volumetric taxation	A tax based on the volume of a product (for example, litres of alcohol), rather than its price.
Wealth tax	Wealth taxes can be either recurrent or levied on transfers between one party and another (for example, bequest and gift taxes). A recurrent wealth tax is levied on the entire wealth of a household or business. A tax on a specific asset class, like a land tax, is a property tax but not a wealth tax.
Withdrawal rate	The rate (also known as a 'taper rate'), at which government assistance is reduced as private income or assets increase.

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