AUSTRALIA’S FUTURE TAX SYSTEM

FOREWORD
This submission makes suggestions which would radically modify both the Tax System and the Transfer System. It is taken from the perspective of lower income individuals or self-funded retirees on low income. The suggestions are made to:

- eliminate anomalies and provide equity to all Australians, irregardless of age or financial circumstances;
- eliminate sections of the tax transfer system; and
- make a modified tax system as fair and tax neutral as possible.

This proposal intends to:

- separate income tax and capital gains tax currently used to calculate total tax and entitlements;
- establish a base limit below which no income tax is payable equal to that at which tax offsets are given to senior Australians, and abolish tax offsets;
- subject all income and capital gains to taxation either at source or in the hands of the beneficiary, without exemption (including the family home);
- base all indices on MTAWE (male ordinary time average weekly earnings) rather than CPI;
- eliminate the assets test and idealized deeming rules from the transfer system in favour of material incomes;
- treat capital gains income as one-off events;
- ensure that all taxable entities file a tax return for recording and statistical purposes in order to guide present and future tax policy, and provide Centrelink with an annual summary from individual tax returns; and
- focus the tax transfer system as administered by Centrlink on enhancing the incomes of low income earners below the base limit.

Examples of how this could be put into practice are given below:

TAXPAYER A.

This individual is between 40 and 45 years of age, unmarried, is renting, has a very ordinary modest income from personal assets, including capital gains, and unable to access any rebates or offsets. The situation in tax year 2007-08 was as follows:

Ordinary income	Capital gains, adjusted using 50% rule	Taxable income	Total tax payable, including Medicare levy
28000	7000	35000	5625

The following table is by way of comparison to a system change proposed for Taxpayer B, who is over 65 and independently retired (see below). This submission advocates that all classes of citizens should be treated equally for taxation purposes. The nil tax base adopted is $21680, which was the phase out figure for the maximum amount of the Senior Australian Tax Offset in 2007-08. This proposal suggests an adoption of a 30% tax on ordinary income above this level, a 15% tax on capital gains and the abolishment of all tax offsets.

Ordinary income	Tax on 21680	Tax on 6320 @30%
28000	Nil	1896
Capital gains adjusted for 5% MTAWE over one year		Tax on capital gains @15%
13300		1995
Medical levy		620
Total tax		4511

For many taxpayers on low incomes, capital gain events of this magnitude would be a relatively rare event, and by aggregating them as total income, erode assets, and push taxpayers into a higher tax bracket in the following year. Anomalous situations such as this should be avoided, rather than promoted.

Note that the treasury would suffer a loss of revenue from $5625 to $4511 under the proposal for this class of taxpayer. This revenue would in all likelihood be more than recouped if all entities and asset classes were included for consideration of income tax and capital gains tax by:

- removing exemptions from complying taxed superannuation funds providing pensions to retirees; and
- removing the capital gains exemption from the family home.

These particular exemptions are grossly inequitable to all other Australians.

TAXPAYER B

This person is over 65 years of age, retired, married and obtains a modest income from personal assets, including capital gains, and unable to access rebates or offsets in 2007-08, because taxable income was too high. The situation in tax year 2007-08 was as follows:

Ordinary income	Capital gains, adjusted using 50% rule	Taxable income	Total tax payable, including Medicare levy
28000	7000	35000	5625
SATO on ordinary income $812 *note: not available*			*4813*

Assuming that capital gains tax were separated from ordinary income, and taxed independently, there would have been a Senior Australian Tax Offset (SATO) for the ordinary income earned between $21680 and $28000 valued at $812. This offset was unavailable if total taxable income exceeded $34496 in 2007-08.

THE PROPOSAL FOR CHANGE

The following table summarises how this retiree would be treated under a radically altered taxation system and makes the following assumptions:

- ordinary income below a base of $21680 would be untaxed, as currently occurs for all eligible retirees earning incomes below this amount (using the SATO and the Low Income Offset for 2007-08).
- ordinary income above $21680 was taxed at 30%
- total net capital gains adjusted for MTAWE of 5%, was taxed separately at 15%

Ordinary income	Tax on 21680	Tax on 6320 @30%
28000	Nil	1896
Capital gains adjusted for MTAWE of 5% over one year		Tax on capital gains @15%
13300		1995
Medical levy		620
Total tax		4511

Exempting the first $21680 of ordinary income from taxation obviously produces a radical result in total tax payable, in this instance from $5625 to $4511; or from $4813 to $4511 *if* the SATO had been applied to ordinary income as noted in the previous table. Self-funded retirees would feel that this reduction is justified, in that it produces an equitable result compared to other retirees who currently obtain tax-free accumulations and income from complying taxed superannuation income streams. This methodology abolishes the Senior Australian offset and the low income offset. It also recognizes that capital gains events can be one-off or very occasional and beyond the control of the individual. The goal in retirement should be the maintenance of income, and non-reliance on government pensions. All pensions should be limited to individuals or couples with material (not idealized) incomes less than a base-line figure pre-set by government.

What hasn't been discussed so far is GST, and its effects on the spending power and asset retention outcomes for low income earners and retired persons. GST is a regressive tax consuming a higher percentage of income after all other State and local taxes have been paid. The earlier progressive income tax and sales tax regime probably served this income-earning class in a more fair and transparent fashion. Spending cannot easily be modified to offset the effect of a tax on goods and services which is almost universal in its application.

THE TRANSFER SYSTEM

The interaction between Centrelink and the Tax Office has to be improved if radical changes to the tax and transfer system were to be made along the lines recommended in this submission. The transfer system administered by Centrelink is barely intelligible to the average citizen.

In the case of retirement incomes and in order to receive pensions, the imposition of the asset test is a travesty of logic, as is the imposition of the deeming rates applied in order to calculate incomes from assets. The only test which should apply to retirees is an income test. Material (as apposed to deemed) incomes can easily be acquired from the Tax Office if every entity is required to submit a tax return, and meshed into Centrelink offices on a yearly basis. Capital gains increases should be averaged out over a period of time for the purposes of assessing incomes for pensions for eligible retirees. Not all capital gains are planned events, but are forced upon individuals as circumstances change, especially in older life. All changes to the indices used by Centrelink and the Tax Office should be linked to changes in MTAWE on a yearly basis. The aim of this change is to totally eliminate the inequities that exist between primarily self-funded retirees and retirees who draw incomes from complying taxed superannuation funds, which do not pay any tax on drawdown. The transfer system in this regard not only discriminates in favour of these funds and their clients, but all other Australians.

In both the tax system and the transfer system, the aim of policy should be to maintain a minimum income sufficient to sustain an acceptable existence, not erode the asset base and incomes of those most vulnerable. The Tax and Transfer systems are desperately in need of overhaul to meet a dynamic world. The present systems do not meet this challenge.

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