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Re: Australia's Future Tax System

I respond to only a small part of the Tax System review. I will use your headings for my contribution.

Q1.1 In considering the community's aspirations for the type of society that Australia should become over the next two decades and beyond, which key features should inform or drive the future design of the Australian tax-transfer system?

Simply, the pursuit of distributional equity across personal income groups; not only towards and across target groups, but also towards a reduction of income difference between the ranges of income groups (eg. between [say] the 2nd income earning decile and 9th decile).

Business wealth accumulation is motivated by different philosophical and ideological ideologies than personal wealth accumulation.

As a (now retired) academic, I have often been reminded by academic presentations that Australians tend to treat income differently to wealth. And, that largely, income is a means to the end of lifestyle, and that wealth generation is a means to a future scenario (whatever envisaged).

Perhaps more importantly, Australians still hold dear the principle of egalitarianism in income distribution, and distributional equity is an important component of egalitarianism.

Since the 1950's, the reduction in the number of tax levels and rates payable has been marked. For example, in 1951 (if my memory serves me correctly) more than 50% of Australians did not pay income tax. Then, income tax was focussed on the wealthy. Now, the tax load has been spread across (nearly) all income streams.

The tax rate changes over the past half century has resulted in some significant changes to the division of wealth accumulation (favouring higher income earners). Portrayals of wealth accumulated per sector does not in itself display the underlying theme of wealth relative to income. For example, just because one person on (say) $100,000 income may pay a top marginal tax rate of 42% does not mean that that person will engage in wealth creation opportunities. Instead, all that can safely be said is that the education level of a person earning $100,000 is such that they are more likely to pursue wealth creating opportunities as well as maximising their income.

I understand from presentations made to me by Canberra-based academics is that in the 1950's, the ratio of difference in the accumulated wealth of the 2nd highest income earning decile and the 9th highest was some 7.5 times. Apparently the difference between these income earning sectors is now greater than 30 times. This suggests equity in personal wealth accumulation has eroded over time. But, in saying this, a question arises as to whether the difference in wealth accumulation across deciles is a result of income, tax rates, or knowledge to use the income / tax nexus more efficiently. I suspect the latter. So, if correct, then tax deductions relative to personal income appear unnecessary.

It is possible that the tax system could be divided into three 'ideas'.

First, other than deductions directly attributable to producing a personal income (eg. membership to a union, specialty work clothes, etc), there is no deductibility in the tax paid. Instead, government provides benefits to sectors based on income, assets and (expected) expenditure.

Second, wealth generating activities are treated as a separate entity to personal income tax, and the person engaged in wealth generation submits a separate tax return applicable to that activity.

Third, wealth itself, however defined, be the subject of a tax regime. For this scenario, wealth tied up in a family business would not be considered 'wealth' as the capital is used to produce income. Except for the family home (up to a designated value and indexed) wealth tied up in assets such as property, equities, or bonds - as well as capital gains - would be taxed.

Q3.1 What problems, if any, are generated by the overall mix of taxes in Australia on business and labour income, consumption, transactions and assets, and what changes, if any, should be made?

The pursuit of 'deductions' has enabled some groups to offset tax; at the expense of other groups unable to find/use such avenues. For example, a company manager can offset a greater range of personal expenses as company expenses than a blue collar worker in the same firm. Similarly, the Collins St (or Pitt St) 'farmer' is able to utilise deductions merely by holding a productive land holding, where an investor in a pastoral company cannot; assuming they both invested the same financial amount.

The monetary and mental effort expended to enhance 'deductions' has now reached a level where the fundamental principle warrants reconsideration (and the scale wound back).

To my way of thinking, only costs specifically associated with the actual production ought be eligible as a deduction. For example, the costs associated with the use of a Toyota Camry car by a salesperson actually undertaken sales related activity can be classed as related to actual production. It is very hard to say that there are equivalent production costs associated with an expensive 'lifestyle' BMW. Similarly, the Jaguar used by the CEO appears unrelated to actual production costs.

On a similar vein, the 'costs' associated with a Range Rover by a Collins St farmer, generally parked in Collins St, or the BMW X5 used by the farmer to ride to town, ought not be treated the same as a Toyota Land Cruiser utility used by a cattle producer to service property fencing (etc.).

I suggest 'deductions' need simplification to relate only to productivity, not lifestyle.

Q3.3 Does Australia's tax-transfer system appropriately deal with property and wealth, or should new approaches be introduced? What, if any, implications would any changes have for the taxation (or means testing) of capital income flowing from property and wealth?

I also refer to my comments above in relation to Q 1.1. Here I wish also to address the top marginal rate of tax.

In the second half of the 20th Century, the top marginal rate of tax was 66.6%.

There needs to be a major rethink on what is a reasonable income for effort, and what is acquired merely because a person is a monopolist and able to gouge a massive salary. For example, it matters little whether a CEO of a major firm is worth an exorbitant sum or not. That person is a monopolist in that they can dissuade a board from seeking a replacement, argue that a (cheaper) replacement may not provide the expected returns, such that there is no competitor for the position. And, in that environment the monopolist is able to gouge a massive income.

Simply, the level of 66.6% needs to be reintroduced into Australia for personal income above a level equivalent to the total income of the Prime Minister; maybe plus (say) 10%.

Q4.1 How might the personal tax system be changed to better achieve the goals of greater simplicity, transparency, equity and efficiency?

As argued above, reduce the scope and range of/for 'deductions' unrelated to producing the income. Similarly, fringe benefits need to be treated no less than straight income.

For equity, refer the comments above.

Q4.2 What is the appropriate distribution of income tax across income levels and how should it differ from the current distribution? Should governments seek to maintain a similar distribution over time, or should they fix the value of current tax thresholds through indexation?

The simplicity of the current stepped threshold levels of personal tax is generally effective and is a transparent indicator to the income earner.

However, and as noted above, if the matter of allowable 'deductions' was not only simplified, but also focussed upon the aspects of income production (rather than wealth generation *per se*, or lifestyle), then the efficacy of these levels would be enhanced.

The income levels upon which each step is attributed ought be adjusted to CPI to address equity. Also, the tax free threshold is too low. To my way of thinking, the tax free threshold not only needs to be indexed with inflation, but also the appropriate level today is an amount that has been adjusted by inflation from (a time no later than) 1970.

Without doubt, the relationship between tax levels and income (the thresholds) should be indexed. The political manoeuvring now evident to 'reward' certain voting support groups suggests that even if this inquiry addressed equity across income groups and/or employment/income sectors, without indexation any focus on equity (or other provision) would be lost over time.

Q4.6 .... Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?

Overwhelmingly yes - simplify by using the OCD practice! And, at a rate equal to straight income.

Q4.9 What are the key factors that should affect rates of transfer payments? What should be the relative importance of duration on income support, ...

Without doubt, need should ever be the **<u>only</u>** criterion. Australia is sufficiently wealthy to show the world that human need is a more important criterion than lower taxes for those that have work.

Q4.12 In a targeted system there is a trade-off between the level of income support and workforce incentives. Given this, what priority should be given to reducing the disincentives to work?

The media cite various purported disincentives used by income support recipients against work; *level of income support received, choice of work, travel times, mental attitude.*

In many respects, the media are articulating a selfishness advocated by some Australians that if it were not for income support, they would retain more of their gross income (via reduced taxes).

There is no doubt that long term unemployment can (for example) affect self esteem, reduce a sense of motivation to enter the workforce [especially, where the income is in the vicinity of the income support], and/or undertake physically or mentally challenging tasks.

I believe it would be advantageous if there were to be an increase in the amount of income allowed to be earned before a reduction of income support occurs. This, I suggest, would allow the person on income support to supplement their income in a meaningful way.

The only proviso I would make to the above proposal is that for the unemployed, the additional scope of income allowed ought be time related. So, for someone becoming unemployed, or an unemployed person undertaking reskilling, full access to the amount may be assumed. However, where an unemployed person has failed to appropriately pursue reskilling, or undertake other options to enhance employment opportunities, the full amount of income 'allowed' could be reduced (even negated) after some pre-determined time period.

The amount of income allowed to be earned before a reduction of income support occurs has not kept pace with inflation over time. To my way of thinking, if the tax free threshold was adjusted as suggested above, the amount of income allowed to be earned before a reduction of income support occurs could also be adjusted upwards (by indexing to 1970), and thereafter indexed to CPI.

Simply, the current VERY limited scope to enhance income support constricts the purchasing power of those in receipt of same. I suggest that 'income allowance' could be effectively used as a means to motivate the unemployed to gain work (at the risk of losing the opportunity), to use the limited work opportunities to leverage longer hours or full time work, and maintain self esteem. Similarly, those on income support for non-employment related reasons (eg single mums, re-education, etc.) would also have a capacity to use the greater income generating opportunities (ie part time work) to make a step towards more hours of work.

Q4.14 Does the tax-transfer system create disincentives for individuals seeking to acquire new skills or upgrade existing skills? If so, what sort of tax or transfer changes would provide better incentives?

Given the response immediately above, it is possible that the amount of income allowed to be earned before a reduction of income support occurs could be enhanced - even significantly (for certain types of reskilling / upgrading) where need is evident (eg. while the person undertakes the reskilling / upgrading). For example, an unemployed person undertaking a viable reskilling course may have the income threshold doubled for the duration of the course. Similarly, this attribute could also be used in other ways. For example, a nursing or teaching course might have the threshold for allowable income (say) trebled for the duration of the course merely because there is a pressing need for nurses or teachers. Normal tax rates would still apply.

Q6.7 Should the tax system be restructured to deliver a more neutral tax treatment for the different forms of return on household savings and investments, and if so, how?

Given the current economic circumstances, it is clear that there is a focus in Australia towards wealth generation and away from 'savings'. Some might say that the end result is the same. However, risk averse income earners appear not to be rewarded for merely saving income.

For some Australians, saving for a major investment - be it a house, or car, or education - ought not be risked via a wealth generation strategy. For them, saving is better than debt servicing.

There seems merit in providing an income tax offset for lower level income earners to benefit (non superannuation) savings. For example, for incomes up to (say) $50,000 might have a tax offset for interest earned on qualifying savings accounts of (say) up to $2,000.

Q8.1 Which taxes or transfers are the most complex and impose the greatest costs? How should these costs be reduced (by abolishing the taxes or transfers or by making the rules applying to them simpler)?

On this topic, I note the key message "*In relation to individual taxpayers, submissions are concerned about Australia's very high reliance on tax agents. Record keeping and retention are also seen to have a high cost. Examples are given where people miss out on benefits due to difficulty in finding the right information or onerous record keeping requirements.*"

As can be inferred from above, these 'costs' are not taxes, rather a desire to minimise tax.

That there are tax minimisation opportunities, every person is well advised to pursue these options. Removing the range of deductions as a tax minimising option removes the scale of the 'problem'.

As noted above, if general personal income were treated differently to wealth generation, a completely different approach to tax acknowledgement would prevail.

Q7.1 What is the appropriate tax treatment for NFP organisations, including compliance obligations?

As a secretary to several small non-business type NFP community associations, I generally concur with the views expressed in the section "***Key messages in submissions***".

The statement "*Several submissions recommend the extension of the mutuality principle to provide a complete tax exemption for member-based organisations to provide clarity and certainty*" has merit. However, this suggestion also serves to embed tax exemption into society such that there will become an increasing division between quasi business (ie NFP associations acting like a business under a tax exemption umbrella) versus ordinary business. I no longer support tax exemption for donations.

I believe that all NFP's be subject to ordinary 'business' tax arrangements, save for 4 forms of income; **membership dues, donations, sale of gifts,** and **grants**. In the case of a larger organisation, employee activity directly associated with any of these 4 forms of income would be non-taxable. There may need to be limits on what constitutes 'sale of gifts' For example, in a smaller organisation, the use of member funds or donations to buy sausages and bread for a sausage sizzle 'fund raiser' could fall into the 'sale of gifts' category if the revenue from such activity fell below some threshold. However, a 'club' operating a restaurant would be limited by virtue of the annual activity being above the threshold. Similarly, the sale of a property being a bequest in a will to an association may be allowable at any amount if it can be shown the association could not foresee that bequest.

On the topic of tax concessions for givers, the main hurdles for associations are not on providing relevant activity, but complying with the lengthy and detailed obligations produced by the ATO.

An association to which I am secretary has access to tax deductibility for donations. But, more funds are received outside the tax deductible structure than within. This leads me to believe that tax deductibility for the giver is not a central issue. Rather, if available some givers will use the receipt to minimise their tax. Thus, tax deductibility does not overly affect altruism: the recent Victorian bush-fire donations also showed that more people just donated, even though if they wanted they could get a tax deductible receipt, showing that altruism for a 'cause' over-rides tax deductibility.

In discussions with larger firms about donations, I am constantly reminded that the size of the 'donation' relates to the publicity opportunities for the firm. I draw the conclusion that for some businesses, tax deductible giving is more about an alternate advertising medium than altruism.

It appears clear to my experience that tax deductibility has become:

1/. a means by which associations with 'deductibility' gain funds over associations that cannot offer same, and/or

2/. A means by which a giver can appear beneficial, but the gift is supported by the tax system.

I doubt that Australians would reduce their financial contributions to NFP associations were the tax deductibility options withdrawn. I believe that tax deductibility for donations should be removed.

Given the current credit 'crisis', I also doubt that withdrawing the tax deductibility option will radically alter the current dearth of funds flowing from business to small NFP associations. As an alternate advertising medium, I suggest that the current situation would probably not alter the habits of large business to major NFP organisations: tax deductibility or otherwise.

Q10.1 What should be the objective of the tax-transfer system in respect of housing? Should there be assistance for housing over other assets or services? Should assistance be based on housing tenures? Should assistance be focused on people on low incomes? Should assistance differ between public and private tenants?

The family home asset currently 'enjoys' no capital gains tax. This provision has resulted in significant wealth being 'stored' in the family home. There is evidence that the tax advantages of using the family home as an asset has denied capital to be used for other (more productive) purposes.

There exists an opportunity to create a monetary ceiling for capital gains tax exemption on the family home. The question ever is "*what amount? A Sydney or Hobart sum for an average family home*?".

Maybe the answer is to determine an amount that would purchase (say) an average family home in suburbs dominated by family occupancy in all capital cities, and determine an average. That sum would be declared and indexed. But this could 'hurt' those long term residents who, upon eventual sale, incurred an unexpected capital gain. Hence, there might also be an attribute enhancing the tax free component for a family home in line with occupancy.

Say an amount of $500,000 was determined as the capital gains tax free level (and this is indexed according to CPI inflation), the 'tax free' level could <u>also</u> be enhanced by (say) 1% for every year of occupancy.

Q11.1 Is it appropriate to use taxes on specific goods or services to influence individual consumption choices, and if so, what principles can be applied in designing the structure and rates of such taxes?
Q11.2 Can the competing potential objectives of alcohol taxation, including revenue raising, health policy and industry assistance, be resolved? What does this mean for the decision to tax alcohol more than other commodities?

Where additional taxation on consumption goods is advocated (or exists), the tax needs to be related to (1) taxing luxury, and/or (2) taxing significantly unhealthy products.

Tax rates on luxury are ideological.

Tax rates on health related products needs to be related to the assumed health cost. For example, tax on alcohol or tobacco should be related to the actual extra health care costs experienced in Australia. For example, if studies show that tobacco related institutional health care (eg hospitals) costs (say) $2 billion, then the tax applicable to alcohol or tobacco should be focussed to 'repay' as much of that as possible.

Industry assistance to firms making products that are either unhealthy or are made to appeal as luxury goods should not be entertained. Frankly, the Australian 'cringe' is such that purchases of luxury goods for status translates into overseas made goods (generally Nth America or Europe).

Q11.3 What is the appropriate specific goal of taxing tobacco? Is it necessary to change the structure or rate of tobacco taxes?

First, reduce consumption, Second, to recover as much of the health care costs each year as tobacco consumption generates.

Q11.4 If health and other social costs represent the principal rationale for specific taxes on alcohol and tobacco, is any purpose served in retaining duty free concessions for passenger importation of these items?

No. In fact, the price paid by most Australians at duty free shops for duty free goods is approximately the same as they could have paid at a competitive outlet WITH tax. For example, I can buy branded whisky cheaper when on 'sale' at BWS than at any 'duty free' store.

Other than lining some retailers pockets, duty free concessions do not advantage Australians.

Q11.6 Should the tax system have a role in influencing the relative prices of different types of cars, including luxury cars and higher polluting cars, and if so, on what basis? What does this mean for taxes on the purchase price of motor vehicles?

The short answer is yes. The longer answer is that the rationale is political and so the rates should be left to politicians.

I would also like to add that if product deductibility (ie cars) were focussed on actual production (rather than lifestyle within production) then the contestability of the issue would subside.

I have always believed that issue of what constitutes 'deductibility' is not an external trade issue. Given this, I believe that the manner in which a vehicle cost is deducted should also relate to the place of manufacture. Thus, where a car is made or assembled in Australia, then the percentage of 'Australian made' should constrict the capacity to deduct. For example, if an Australian made car was 'attributed' as 60% Australian (made), then a business deduction should be limited to only 60% of the deductible amount. Similarly, where a vehicle is to be used in production, but no such vehicle is made in Australia, then the full amount of 'deductibility' be allowed. As an example, a Toyota Land Cruiser '70 series' would 'earn' full deductibility. However, if (say) Ford made an Explorer 4WD sedan in Australia, then a Toyota Sahara would not be 'deductible' because it is fully imported and there was a locally made option available. Contentious, yes. But, would enhance Australia's car industry.

Q12.1 How can motor vehicle related taxes and road funding arrangements be designed to improve the efficiency of transport of people and goods in Australia?

Use of a road oriented vehicle in Australia is subsidised in that motorists / transport operators do not pay the full cost of road provision and maintenance. The actual cost of road provision and maintenance as a direct cost of operating a vehicle should be factored into vehicle use as a tax.

I believe that the full cost of road provision and maintenance should be hypothecated into fuel taxes. Given the impact of this, the introduction should be undertaken over time. Only after the full impact of road provision costs are related to vehicle use would rational transport choices emerge.

Some years ago, Australian government acknowledged the cost of transport fuel for some rural communities, and provided subsidy/tax support. If fuel tax embraced the cost of road provisioning and maintenance, rural transport support strategies may again be entertained.

Q12.3 Do the existing tax arrangements lead people to make economically inefficient transport choices, and if so, how might they be improved?

Mass or public transport is under supported in Australia because the actual cost of private transport on 'public' roads is not apparent to the motorist.

If fuel tax reflected the full cost of road provision and maintenance, I believe Australians would make quite different choices. For example, I believe Australians would pursue downsizing the family car and begin renting a large vehicle for some trips. And/or choosing public transport more frequently.

Q13.1 Bearing in mind that tax is one of several possible instruments that can address environmental externalities, what opportunities exist to use specific environmental taxes to address Australia's environmental challenges?
Q13.2 Noting that many submissions raise concerns over unintended environmental consequences of taxes and transfers, such as the fringe benefits tax concession for cars, are there features of the tax-transfer system which encourage poor environmental outcomes and how might such outcomes be addressed?
Q13.3 Given the environmental challenges confronting Australian society, are there opportunities to shape tax-transfer policies which do not currently affect the environment in ways which could deliver better environmental outcomes?

I hold a Bachelor of Environmental Science at Honours level.

The economic principle that externalities exist rests on the failure of the current market system to include all production and transaction costs in price setting.

The environmental movement has been adept in illustrating the impact of some externalities on the environment. The question is not whether these externalities exist - they are but a range of externalities [positive and negative] - rather, what approach do Australians want to take about inculcating the costs associated with negative externalities as they affect the environment.

I am personally of the belief that the environmental footprint of human activity in Australia is depleting (and degrading) the environmental, ecological, and farming integrity of the land called Australia. I also believe that the actual cost of this depletion / degradation will be borne by future generations in reduced opportunity, lifestyle options and/or potential.

Considering tax as a means to address environmental depletion / degradation cannot be a case by case matter. It is either all in, or none in: *on the basis that many other nations appear hell bent on permanently degrading their environment for short term economic gain*.

Currently a carbon tax is being considered to address the (perceived) negative externality of carbon emissions. Meanwhile, salinity in the Murray-Darling basin, with the consequential reduction in soil fertility, lowering of agricultural yield, and structural asset degradation, though recognised does not receive adequate tax or regulatory attention. That native vegetation clearance is a central factor in salinity, I doubt too many residents of the Murray-Darling basin would support programs (including taxes) designed to promote vegetation renewal to address the issue.

Simply, environmental taxes need to be targeted to address the totality of the impact, not a specific sector that takes our attention and/or is portrayed to generate some proportion of impact.

Q14.1 When considering the appropriate return to the Australian community for the use of its non-renewable resources, what relative weight should be given to the determinants of that return?
Q14.2 What is the most appropriate method of charging for Australia's non-renewable resources, given they are immobile but that Australia needs to compete globally for mining investment?
Q14.3 What is the role of the tax system in ensuring that renewable resources are used both sustainably and efficiently?

Economists show that in theory, in the global marketplace finite resources have a predictable pricing pattern: expensive until a surplus is provided, then cheap (or at least extraction costs and a reasonable return), then increasing price as supply dwindles.

There is no uniform answer to tax (or rent) for resource extraction. Each commodity commands a different approach. Coal is different to oil is different to gas, is different to clean potable water, is different to pristine wilderness, is different to national parks near urban centres, *et cetera*.

The only thing that needs to be recognised is that tax (or rent) opportunities exist to address the impact of non-renewable resources, and that the level of tax (or rent) applicable needs to be measured on a periodic basis in relation to demand and supply.

Should you wish to discuss further any part of my submission, please feel free to call or write.

Regards

Dr Bruce Moon