
SUBMISSION

Context

As a result of globalisation (i.e. falling barriers to the flow of capital and labour across national borders), capital is almost perfectly mobile and labour is increasingly mobile especially in highly-skilled jobs. Global competition for skilled labour is high.

The efficacy of the “law of one price” increases with mobility of capital and labour. Multinational corporations, capital allocators and wealthy individuals can and do choose which tax jurisdiction they want to pay their taxes in. The same applies for highly-skilled labour.

The law of one price is skewed by the presence of differential tax regimes across nations. If capital and labour were perfectly mobile, there will only be one tax regime globally as capital and labour will arbitrage between high- and low-taxing jurisdictions. We are not there yet but globalisation will ultimately push us closer to this outcome.

Nations compete for investment and talent as these are the key resources for sustainable economic growth. A simplified, well-designed, stable, transparent and low-burden tax regime is one of the key areas where nations (and even states within a nation) compete for fresh capital and talent.

I will not propose specific changes here as I believe our complex tax system cannot be simplified from its present form, especially with the expected lobbying by interest groups and pork-barrelling by polities. The Australian tax code needs a fresh rewrite by fresh minds unfettered by self-interest. Instead, I will outline several principles which I believe will assist in designing a system that will provide better outcomes for the broader Australian community and economy as a whole. These principles may go beyond the panel’s existing terms of reference which should be expanded to allow for a more comprehensive rethinking and retooling of Australia’s tax system.

Simplify, simplify, simplify.

Australia’s tax system has evolved to become one of the most complex tax systems in the world. The only way to simply the tax code is to re-write it from scratch without any reference to the present code. The re-write should be spearheaded by independent persons without a vested interest in seeing the present tax code perpetuated.

There are too many tax deductions at present. It is estimated that these reduce the tax recovered by approximately \$13 billion. Elimination of these would allow the tax rates to be reduced.

Avoid using the tax system to assist particular disadvantaged people, groups or entities – this forces the tax system to become unnecessarily complex and unwieldy. The tax system should be used solely for raising public revenue and not for addressing equity issues in society. Financial assistance to disadvantaged groups should be targeted via direct expenditure from the budget i.e. via transfer payments or grants.

Advantages of a simplified tax system:

- Reduced compliance & monitoring costs (not to mention more time for recreational activity);

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- Increased economic productivity;
 - Increased business confidence; and
 - A more stable tax system, less subject to meddling by polities who love to pork barrel for their pet projects

Here's a real test of whether any tax reform has managed to sufficiently simplify our unwieldy "tax-and-transfer" system: Can tax residents who draw their main source of income from salaried work be exempted from filing a tax return as their PAYG withheld income taxes should be sufficient.

Tax neutrality across entities, structures and persons.

Tax treatment should be the same for an individual, a corporation, a trust or any other structure. This will prevent the need for tax minimisation game/arbitrage that favours the higher end of town which can pay for an army of tax lawyers to structure their taxes away. It also means that the highest marginal tax rate on personal income cannot be any higher than the corporate tax rate. By implication, it also means having less tax brackets. Having an abnormally high percentage of the workforce involved in tax minimisation, compliance and monitoring is deadweight in terms of productive economic activity foregone.

Tax neutrality across countries.

This means that high-taxing countries including Australia need to get their act together as the pressure is on them to make their tax systems more competitive. There is little use huffing and puffing about cracking down on so-called "tax havens" as the one of the main reasons why these exist is the presence of high-taxing regimes. So long as high taxing jurisdictions exist, capital and labour will, at the margin, move to tax-friendly jurisdictions. Naturally, the OECD and its constituent members (Australia included) have to be seen taking the stick to these "tax havens" for domestic consumption. But are they really addressing the issue in an effective manner?

Domestically, the highly publicised tax information fishing expeditions (e.g. Operation Wickenby) are designed to make the relevant authorities look as though they are doing something in the public eye. However it is yet to be proven that they are recovering more tax dollars than they are spending (see Australian Financial Review 23/4/09 pp. 1 & 61). I wonder if their time and effort can be channelled more productively elsewhere.

If we are really serious about recouping all our "lost" tax dollars that have hopped over to low tax jurisdictions, why don't we become a low tax jurisdiction ourselves? That would neutralise any tax advantage of moving one's tax residency abroad and we will even see the return of that "lost" capital thereby even offsetting any short-term fall in revenue. It will also encourage better tax compliance domestically. Let's think big.

For those still taken in by claims that Australia's tax rates are not extremely high, it is only true when framed in an OECD context. However, the OECD average tax rates are skewed upwards by high-taxing European and Scandinavian countries. Australia is not competing for talent and capital with these countries. Australia is really competing with its Asian neighbours and framed in this context, Australia's tax rates are among the highest in this region. For a bird's eye view of our tax competitiveness please refer to the following link:

<http://www.forbes.com/global/2009/0413/034-taxing-spending-raising-roof.html>

According to this survey, Australia has recently added to the tax burden of its residents whereas many of our neighbours (including New Zealand, Taiwan, South Korea and Singapore) have recently reduced their respective tax burdens.

Tax system must not punish risk-taking which is the fundamental driver of growth in our economy.

Risk-taking here refers to productive risk-taking including but not limited to business investment, public investment, personal investment etc. Capital gains tax (CGT) is the main punitive tax against risk-taking. Australia has among the highest tax revenue contribution by CGT in the world. In my opinion, CGT together with negative tax loss carry forwards should be completely abolished. It is a tax on economic growth. Any recipe that reduces the size of the pie before it is divided only ensures a smaller share for the entire community.

Moreover, if the government is truly serious about making Australia a centre for funds management activity, then it should follow the best practise in financial capitals which have either no or low CGT.

Tax design must not skew rational economic and financial decision-making.

An example of such skewing is the rule that applicable CGT rates are halved when an investment is held for over one year. Does 365 days determine the difference between speculation and investment i.e. on what basis does any investment held for 363 days be deemed speculative against one held for 367 days? This is highly subjective and I find no rational basis for such a distinction. Why should an investor's after-tax outcome be determined by whether he held an investment for 367 vs. 363 days? Such arbitrary rules skew the economics of investment decision-making and lead to sub-optimal outcomes for both the individual and society.

Increase tax competition within Australia.

The states already compete on payroll taxes, stamp duty and land taxes. However, the key sources of tax revenue i.e. income, corporate taxes is not subject to competition and should be devolved to the states or even local government levels.

Advantages: Avoid the annual "hat in hand" by State Treasurers to the Federal Treasurer for GST revenue allocation which is a highly subjective political decision. Let the states and local governments compete by setting their own tax rates for income and corporate taxes. This will also force them to compete to provide the best public services (be it schools, hospitals, public transport, roads, police and emergency services) to their local populations for the lowest tax dollar spent. In effect the current corporate and income tax will be split into three portions – a Federal level, a State level and the local government level. While the Federal level tax is fixed for all tax residents, the State and Community level taxes are allowed to vary. This will force the States and Local Communities not only to compete in terms of keeping taxes at competitive levels, but also to provide their tax residents with the best bang for their tax dollars in terms of public services delivered. The ultimate collection agency will be the local government which then passes on the state and federal portions to their respective agencies.

It also means devolving authority from the Federal to state and community governments for the delivery of most public services except for common Federal services such as national defence, foreign policy, AFP etc. This is a far-reaching proposal for Australia and goes against the more recent tendency for the Commonwealth to centralise power at the Federal level. However, it is a necessary reform if Australia wants to become a more competitive tax jurisdiction. Why is competition only good for the private sector and not for the public sector? What is good for the goose must surely be good for the gander too. It is also worth noting that differing taxes and levies was not uncommon prior to Federation and in the early years of the Federation.

Stop aping the US tax system and the Internal Revenue Service (IRS).

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The U.S. has amongst the most complex tax systems I've come across and it is certainly not rated highly in terms of best industry practise. All the U.S. tax system has managed to achieve with spectacular success is to drive U.S. tax residents (and non-tax residents) to distraction. Even U.S. citizens and green card holders who are residing abroad have to file a US tax return! This also makes life difficult for other countries that may have U.S. citizens or green card holders as they have to accommodate this over-reach by the US tax system. Also, the IRS' combative attitude is not conducive to compliance. Compliance by fear can never be as good as voluntary compliance. The ATO's combative stance against Australian tax payers largely mirrors what the IRS is doing in the US. The ATO would not need such posturing if Australia's tax system was internationally competitive.

Think outside the box.

Why can't Australian tax authorities (Plural not singular as under my proposal there are multiple State and Local Community tax authorities) be allowed to do individual deals with an extremely wealthy persons or multi-national corporations to attract them to take up tax residence in Australia?

For example, there is no economic reason why a tax authority cannot offer a high net worth person/entity a preferential tax rate of x% capped at \$y where x% is far less than the standard tax rates an ordinary individual or entity would pay provided that \$y would far exceed (by several multiples) any amount that the average individual or corporate would ever pay. We know that these high net worth persons and entities would not be a burden on the public health or social services system as they can afford these services from private providers. So their tax dollars are net revenue to the public purse.

Wouldn't we rather have these high net worth entities and persons paying taxes here in Australia than in another country? Why do high-achieving and wealthy Australians have to move offshore to reduce their tax burden? Or is our sense of "fairness" so skewed that we blind ourselves potential new sources of tax revenue which can then be spent on public services for the less fortunate and the broader community.

Of course, some will argue that this will encourage these multi-national corporations and high net worth individuals to shop around for lower taxes and play off one jurisdiction against another. The short answer is that they are already doing this so why force Australia to compete with both arms tied behind its back? Instead of whingeing about "tax evasion" by the high end of town and employing a losing strategy, why not utilise a winning strategy by offering them incentives to remain within a more competitive Australian tax system.

Another spill over benefit of more funds being retained within a more competitive Australian tax system is increased funds under management for our funds management industry – a target growth priority of current government policy.

Finally, I harbour no illusions as to the massive task the review panel is undertaking. Nor do I underestimate self-interest of various interest groups that will lobby to defend or increase their stake under the present system which is universally regarded as too complex and unwieldy.

I wish the panel all the very best in its efforts as Australia's international competitiveness and future prosperity depends, in great part, on its recommendations.

Yours truly,

Anonymous