

AUSTRALIA'S FUTURE TAX SYSTEM

SUBMISSION

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THE BROWN TAX ON ECONOMIC RENTS

While it would have been ideal to respond to each and every question in the Consultation Paper, I thought it best to make a few essential points. I have concentrated on the issue of business taxation, and a few related issues.

1. Australia's business taxation system is highly distortionary, and has the overall effect of reducing economic growth, reducing Australia's international competitiveness, and thus increasing unemployment.
2. The current business tax system discriminates against and reduces capital expenditure, reducing the level of capital expenditure below the optimum rate. This has a very adverse effect on Australia's economy.
3. Australia could raise the same revenue or more from a better designed and theoretically more efficient business tax system, while at the same time reducing distortions, increasing investment and international competitiveness, and thus increasing growth and increasing employment.
4. Is there such a thing as an 'economic free lunch' accepted as theoretically correct by all tax economists, and yet is low cost to implement – little more than changing regulations on the present system? Too good to be true? Why has not this tax been implemented?
5. Yes there is such a tax. The proposal has been around for years. This tax is the only true 'cash flow' tax. (There are a number of taxes masquerading with the name 'cash flow' tax, such as the Kaldor expenditure tax or the Meade R,F,S tax-base proposals. Aside from these tax proposals being outdated, mathematical analysis show that these primitive proposals are technically inefficient and 'double taxation' – nonsense tax proposals. Basically their flaw is that they depend on the re-valuation of assets and taxation of capital appreciation – the Haig-Simons proposal, which in turn can be shown to be 'double taxation'. What appears to be 'fair' is not necessarily 'efficient').

6. Incidentally the Capital Gains Tax on income producing assets is technically double taxation.
7. The only true 'cash flow' tax is also a tax on economic rents. It goes by the strange name of the 'Brown Tax on Economic Rents', named after its inventor E. Cary Brown. The Brown Tax is an income tax just like a corporation tax. However there are two differences: -
 - a. **the depreciation rate is 100%**. Or in other words, all capital expenditure is 'expensed' in the year it is spent.
 - b. **interest payments are NOT deductible.**
8. Economic rents are monopoly and quasi-monopoly rents which exist in the economy. In other words above average profits brought about by structural advantages in the market place.
9. The Brown Tax is the only true 'cash flow' tax as it taxes cash flows only. It is not reliant on valuations and re-valuations of assets to calculate the tax base. Asset values are irrelevant; effectively they are a 'sunk cost'.
10. To the average business person, both these changes are shocking, especially the non-deductibility of interest payments. They have become dependent on interest deductions as a form of tax avoidance, and as such there is over-borrowing in the economy, and there is a false distinction made between debt and equity.
11. By encouraging too much debt in company structures, the current tax system encourages a too risky debt-equity ratio, and a higher level of business failure.
12. "It can be shown"¹ that the outcome of a tax which uses 100% depreciation and zero deduction of interest payments is to tax economic rents only.
13. Why tax economic rents only? The main reason is that taxing economic rents is non-distortionary. In other words, as long as the tax is imposed entirely on the economic rent tax base, the financial decision making of the economic actor

¹ Sumner, M.T., 1975, "Neutrality of Corporate Taxation or on not Accounting for Inflation", Manchester School of Economics and Social Studies, Vol. 43, pp. 353-361.

(business decision maker) is not affected. There is neither under-investment (as happens now under the current corporation tax) or over-investment (as happens in China), or under-borrowing or over-borrowing. The efficiency of the economic system is vastly improved. This has a major effect on the performance and growth rate of the economy.

14. Currently Australia does have a Brown Tax of sorts – the Garnaut and Clunies-Ross Resource Rent Tax. By all accounts it works very effectively, although it is only applied in Commonwealth jurisdictions, which effectively means off-shore oil and gas extraction. The States, under pressure from the mining companies, refuse to have this tax applied in their jurisdictions and depend on the royalty system, with the result that they miss out on major revenues. A large part of their tax-base is 'missing'. Or to put it another way, they could raise more taxes using a Resource Rent Tax without reducing mining company activities.
15. Another reason for taxing economic rents is that there are major economic rents in the Australian economy that are currently un-taxed. A calculation using ATO statistics shows that replacing the corporation tax by the Brown Tax would increase business tax revenues by at least a third!
16. The belief that a 100% depreciation rate will reduce government revenue is wrong, for the simple reason that currently interest deductions exceed depreciation deductions.
17. This is not a crushing tax. This calculation is based on tax rates remaining the same. The tax will not adversely affect business performance. In fact it will improve them. It will just change the way business makes its decisions.
18. Administratively the tax can be changed overnight without warning (which is probably necessary to prevent advance actions by business) by simple regulation changes, changing depreciation rates to 100% and interest deductions to zero.
19. In regard to Banks and other lenders, it can be shown that interest may continue to be deducted for amounts borrowed to be re-lent. You are still taxing economic rents. That is the only complication. Otherwise it is a very simple tax.

20. For the self-employed, an activity which is effectively a business, (even that of a consultant, lawyer or doctor), business income is taxed at the Brown Tax base, and the self employed deduct a personal income from the business tax base that is taxed on the personal tax base. Not much different from the present system.
21. In regard to personal taxation, it is also a good idea, though not at all necessary, to tax the economic rents only on personal income. These may continue to be taxed at a progressive rate. One way to estimate economic rents for personal income is to have an un-taxed income threshold, which is estimated to be 'not economic rent from personal income' and only tax the income above that threshold. This threshold could be estimated administratively and be on the level of something like the minimum wage.
22. Australia is, as frequently said, a small open economy. To survive and prosper, it must have an 'edge'. We cannot continue to survive by digging things up and selling them, as especially with climate change there will be falling demand for these products. Climate change will also make it more difficult for Australia to grow and export its agricultural products. There must be a change of attitude. We must realise that we are an island trading nation, and our future lies in a more efficient industry. (And this includes more efficient internationally tradable services). To have an efficient, internationally competitive and enterprising industry structure we must have an efficient tax structure that encourages investment in efficient and internationally competitive activities. One of the most important and effective ways to do this is to have a Brown Tax on business economic rents.
23. It can be argued that Australia's future survival critically depends on having a Brown Business Tax, and introducing it now.

Signed
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