SUBMISSION

Australia’s Future Tax System

Responses to Consultancy Questions

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Overview

This submission will reveal how the major shortcomings of the present tax-transfer system - inequity, inefficiency and complexity - can be corrected in a three-step process:

- The decoupling of welfare components from the federal budget
- The expansion of the tax base to include all income taxed by disposition rather than source
- The separate funding of basic welfare through a national welfare trust to which every taxpayer will contribute

Strategy

The removal of welfare from the federal budget provides scope for substantial reductions in tax rates.

The reduction in tax rates will relax opposition to a broadening of the tax base to include unrealised gains on shares, real estate and other property

Welfare will become a self-funded affair in which every dollar of contribution will be returned to taxpayers with interest – assisted by tax windfalls from the above changes

Outcomes

- Tax rates will be substantially lower than comparable countries
- Tax avoidance will be eliminated
- Income will be taxed by disposition rather than by source
- The inflation element will be removed from wage claims
- The goals of equity, efficiency and simplicity will be met
- The cash economy, fringe benefits and international profit shifting will cease to be major issues
- Foreign investment will be attracted by above reforms
- The disbandment of the ‘tax industry’ will allow skilled professionals to be redeployed to more productive work

1 Challenges and Opportunities for Reform

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?

The tax system most desired by Australians is one that runs quietly in the background doing what it should without demanding constant course correction or regular maintenance. Such a system would have to be fair and be seen to be so. It would have to be unavoidable so that everyone due to pay tax does in fact pay. If such a system were also simple and did not require a bureaucracy to administer or an industry to operate in the savings and benefits would translate into lower taxes for all.

We don't have to go very far to find a tax system that works this well, has wide support and delivers revenue streams that are predictable, constant and not beset by avoidance behaviour. Australia's local government rating system is such a system. If we look the Victorian *Local Government Act, 1936* and specifically at the provisions relating to rates and their collection we will find that the number of pages devoted to that function in the 1936 act are not substantially different from the act current in 2009. On the other hand the original *Income Tax Assessment Act 1936* comprised some 266 sections over 365 pages – vastly different from the current model. Why has one kept its slimline figure while the other has become morbidly obese?

If we lift up the logic and principles of the Victorian rating system, and lay them over our present income tax system we will see many differences. Having done this our first observation is that in the rating system the tax is directly related to ownership of a unique physical object – property. This means that the tax cannot be avoided guaranteeing a predictable revenue stream with no bad debts.

Another major difference is that the rating levy is usually very low – down around the ankles compared to waist level for income tax. High tax rates stimulate avoidance and tax planning behaviour, particularly when encapsulated in a progressive tax regime. No evidence is required for the proposition that the lower the tax-rate the greater community acceptance as it is self-evident. It should be observed that the local government rates are not progressive so higher valuations means only a proportionately higher rating levy, which is acceptable to all ratepayers.

The local government rating system also does not require any annual input from ratepayers; the council knows everything it needs to know to enable it to strike the annual rate and distribute the rate assessments.

This submission will be recommending and demonstrating how the basic principles that underlie the local government system can be applied to the Australian Income Tax system. These are a low tax rate, a flat tax rate, the elimination of avoidance and evasion, the relating of income tax to physical asset ownership, no regular tax returns, low manpower and the greater use of technology. The proposal is not radical but merely applies accounting principles in taxing the same income more efficiently.

Q1.2

Assuming that the absolute size of government will not fall, should (and can) Australia nonetheless aim to reduce the burden of taxation over time by promoting faster economic growth than public spending growth? Can it be demonstrated that alternative tax policies could help deliver that outcome?

When we examine federal budget outlays we find that a very significant portion relates to welfare – pensions, unemployment, medical etc. These are outlays that benefit each individual taxpayer to a greater or lesser degree. But all individual taxpayers do benefit even if that benefit is only potential or remote. But because this return back to the taxpayer is not direct enough the tax that relates to welfare is still considered to be a tax, and properly so. But what if that potential benefit was made to be real and specific to each individual taxpayer? What if each individual taxpayer was required to contribute to his own welfare in that he had to make provision for old age, health and unemployment. What then? What if his contributions were logged and invested in his name with the proviso that <u>every single dollar of contribution would be returned to him with interest either as a benefit or unused balance at death?</u> In such circumstances the welfare component of tax paid by an individual would not be a tax and would be outside the purview of the federal budget and would be severable from outlays for non-welfare purposes.

By unbolting welfare from the federal budget and sending it off to be funded elsewhere, the amount of tax required to fund non-welfare aspects will consequently be much less allowing scope for tax rates to fall very substantially. If this reduction in tax rates for the non-welfare componentary were accompanied by a broadening of the tax base to include all income this would allow scope for even further reductions in tax rates. The accumulated scope for reductions in tax rates together with further suggestions later in this submission may allow tax rates to end up in the mid to high teens and may even get close to the GST rate.

Two significant observations can now be made which are critical to later aspects of this submission:

1) that the above modifications will result in a significant transitional tax windfall for most taxpayers
2) that the low tax rate will energise the Australian economy and encourage foreign investment into Australia or to remain here.

The above suggestion shows that there are other ways of reducing tax without relying on economic growth.

3. The Revenue Mix

This section invites commentary and proposals on the revenue mix at various levels but specifically on revenue contributions from labour, capital and consumption tax bases. The writer believes that such distinctions as to income sources are unnecessary and confusing and suggests instead the single base of economic income taxed according to disposition.

Income is still the appropriate base for taxation. The income concept properly defined and administered will deliver all the benefits that are being sought by this tax review. To work out what is the correct way to define income for tax purposes we must first look at what is wrong with the present tax system and its approach to income.

Our Present Tax System and its Income Concept

The principal issues with our tax system stem from its inability to define the tax base properly. Income streaming in from some sources (salary, wages, dividends, profits etc) is taxable while income from other sources (unrealised gains, lottery winnings, inheritances etc) is not. By discriminating income by source in this way our tax system is defeating the very purpose of the tax base and indeed contorting the concept of income itself. It is also passing up the opportunity for a simple, efficient and equitable tax system.

Many consequences flow from our tax system permitting a taxable income stream and a non-taxable one to develop. Most obvious is that it promotes tax avoidance by encouraging diversions from the taxable stream to the non-taxable one. Less obvious is the restriction it places on the Commissioner of Taxation in measuring his performance. Our Commissioner cannot employ that primary key performance indicator available to other administrators – he cannot relate his collection efforts to the tax base as a whole. That is, he cannot say this is the total number of income dollars earned in Australia during this last year of which (say) 90% have been scored by taxation and 10% have not. Because he cannot do this Australian public has been kept in the dark and the real inefficiency of our tax system has been hidden.

Income in its simplest form is the growth in capital between two points in time. In this understanding income is not a thing itself but merely the measure of something else. Income is only an aspect of capital. This can be demonstrated more clearly by what an accountant does when he measures the profit or income of a client. After the end of a financial period the accountant will use the profit and loss account mechanism to calculate the profit or income from changes that have already taken place in certain balance sheet assets. Thus he teases out the income result from capital balances that have been adjusted by commercial activity over the period. Having identified the profit of the client but before he can use this profit to adjust proprietorship in the balance sheet he must consider other factors. He is required to look at the valuation of other balance sheet items and consider whether external forces have impacted materially on existing valuations. If this is the case he must determine what further adjustments are necessary to ensure that the economic standing of the client will be truly and fairly presented in the new balance sheet. Through this process the accountant is measuring the economic income of his client. This economic income includes profits from actual transactions (ordinary income) as well as adjustments that reflect the changing value of the various assets of the enterprise (unrealised gains).

If our present income base was to be expanded to embrace the economic income of individual taxpayers this would normally be done by legislative amendment inserting in our Income Tax Assessment Act a definition of income that would somehow include unrealised gains and other non cash windfalls. This approach to expanding the tax base would simply add more complexity, as tax returns would get larger to accommodate more line items. But that same economic income can be measured more simply by disposition than by source.

<u>It is in the nature of income that it must be disposed of either by consumption spending or by saving it by the end of the financial year in which it arose</u>, there can be no other option. This will apply to every dollar of income whether it was derived from labour, capital or other sources. This observation opens up the route to a simplified, equitable and efficient tax system. For instead of identifying income directly and taxing income accumulations as done at present, <u>that same income</u> can be taxed indirectly as consumption expenditure through a separate GST and by a new tax on additions to savings/ investments that occurred during the financial year.

This submission is advocating the repeal of the present income tax legislation and its replacement with a revamped GST that will tax all consumption spending and introduce a flat tax on additions to savings/investment.

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?

Individuals are presently taxed on derivation under PAYG with the after-tax income being taxed again under the GST where that after tax income is disposed of by consumption. However, where after-tax income is saved or invested a secondary or double tax is not forthcoming. This outcome is clearly unfair to middle and lower income earners who must consume more of their after-tax income as living expenses while those with greater incomes do not. The compensation package that came with the introduction of the GST, merely rubbed salt into the wounds for while the GST was solidly indexed for inflation the compensation package was not. This left those with a propensity to save better off than those with a propensity to spend. If anyone was looking for a cause for ballooning welfare the locus might well be here. In the writers view the GST does not fit well with the present income tax system. The income tax act in its entirety should be repealed and replaced with a tax on ‘new savings and investment’, typically, the growth in net assets over an income period. The GST plus this new tax would effectively tax the same income as the present income tax system but do so more efficiently.

The corporate sector pays tax on its taxable income but pays dividends from profits determined under accounting rules (i.e., including unrealised gains!). When the company pays a dividend to resident Australian shareholders and passes on imputation credits the accounts profit of the company is effectively being taxed at the marginal tax rates of its Australian shareholders.

Surely it would make good sense to exempt companies from tax entirely and for good measure to exempt Australian shareholders as well but to replace both with a withholding tax. So a company would be able to declare dividends equal to 100% of profits but would be required to pass on to the Commissioner a say 15% withholding tax with the remaining 85% being received by Australian shareholders as a tax free dividend.

The above suggestion would remove an enormous burden from corporate taxpayers who currently go to extreme ends to minimise the company taxation that is simply handed over to shareholders along with the dividend.

Q3.2
Does Australia's tax system penalise (or favour) the returns to savings relative to other activities and should this lead to changes in the structure of taxes and means tests?

This question is possible only because Australia's tax system recognises as 'assessable' income the economic resources that flow in from some income events within the income year while ignoring the contribution to a taxpayer's economic resources from other events. Take as an example a taxpayer who has received a $100,000 bonus from his employer in addition to his salary. This receipt is income because it is 'ordinary income' and his economic resources, ignoring any spending, have increased by this amount within the year of income. But what if his share portfolio had also increased by $100,000? So we have two abnormal amounts each of $100,000 and both escalate his economic worth to exactly the same degree but only one is taken away and taxed. The increase in the value of the share portfolio is both real and available to the taxpayer and is technically income however it is a type of income that our present tax system does not recognise. Since the share portfolio proper is a store of economic value accumulated over prior income periods and hence 'savings,' the escalation in value by $100,000 in the year of income due to market conditions is effectively a 'return to savings', which is not taxed. Dividends, another return to savings, are however taxed. Clearly, Australia's tax system does favour the returns to savings over other activities.

The unfairness demonstrated above could not exist were income determined in its undifferentiated form, that is, without reference to where it came from or of what type or character it may be. But to change the axis of our tax system from differentiated to undifferentiated would require the income concept to be defined so that it embraced all income.

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?

Frankly, the Australian tax–transfer system deals appallingly with property and wealth. Property and wealth have been used – deliberately- to shield wealthy taxpayers from taxation. The 'trail' has been cleverly disguised by complexity and legal jargon leaving obvious distractions that confuse all but the cognoscente. Progressive tax rates are designed to place a progressively greater tax burden on higher income earners than on those at lower altitudes. But one can only wonder why or how this most articulate and capable group of individuals are silent about the obvious inequity of a progressive tax rate system. The earth it seems is bathed in more energy from the faintest star in the remotest galaxy than vocalisations of injustice from this group of individuals. The reason is clear the wealthy do not pay tax on all their income as was demonstrated in the writer's original submission.

Our tax system must change but in ways that will be broadly acceptable to all Australians.

Q3.4
Assuming no increase in the rate or base of the GST, what principles should guide the future development of other consumption taxes in Australia, and is there a need to change the role and structure of such taxes?

No Comment

Q 3.5
Could greater application of user charges, rather than general taxes, in the funding of government services or infrastructure bring social, environmental or economic benefits?

Most definitely. It is the central part of the writer's submission that welfare be completely removed from the federal budget. Federal funding will be replaced by contributions from taxpayers to a federal fund in which all welfare needs at a basic level will be met. In order to remove welfare components from the budget welfare benefits will have to be linked to contributions by individual taxpayers. A welfare system will be proposed where <u>every dollar of contribution by an individual taxpayer for his own welfare will eventually be returned to him with interest whether by way of benefit or unused balance at death</u>. The benefits will be paid out to everyone without means testing.

The above proposal will allow significant structural changes to be made to tax rates. Ownership and control of welfare by taxpayers will encourage taxpayers to be parsimonious in its use.

4 Personal Tax and Transfers

Overview of a Replacement Tax Transfer System

This proposal has two key elements: first the complete removal of welfare from the federal budget and secondly the broadening of the income tax base to include all income. With welfare gone the federal budget will effectively be slashed in half allowing income tax rates to be lowered sympathetically. But by broadening the income tax base at the same time to include all income the tax rates will be able to fall even further. Still further reductions in the personal tax rates are possible if the Economic Method is used to measure income. Basically, the Economic Method would measure income by comparing the opening and closing balances of the net assets of a taxpayer and taxing in some way the identified difference and at the same time eliminate major areas of tax avoidance. Consumption spending would be taxed separately under a revamped GST.

The Economic Method would require the annual submission by taxpayers of a statement of assets and liabilities in place of the traditional income tax return. However, because the Economic Method will be looking at assets and liabilities instead of referred instances of income it might be possible to further reduce tax rates by eliminating the need for regular tax returns. This further reduction in tax rates would arise if instead of identifying the individual return on assets for a financial year a standard return was deemed or imputed on the net assets balance at the end of the year. While this tweaking of the Economic Method would have obvious inequities such inequities would be overwhelmed by its obvious efficiencies. Applying the saving in administration costs to further reduce the tax rate would lessen any inequity caused by this short-cut. The Commissioner of Taxation would theoretically be able to assemble a statement of net assets of any taxpayer with only minimum input from those taxpayers. This would save administration costs because the elements of wealth are already available on computer databases. Thus the new tax system might run on the basis of occasional inputs from taxpayers.

The deeming of a standard rate of return would also have two further benefits. It would eliminate the losses issue as lost capital would already be taken into account in the lower net assets balance. A standard rate of return would provide a constant flow of revenue in depressed times.

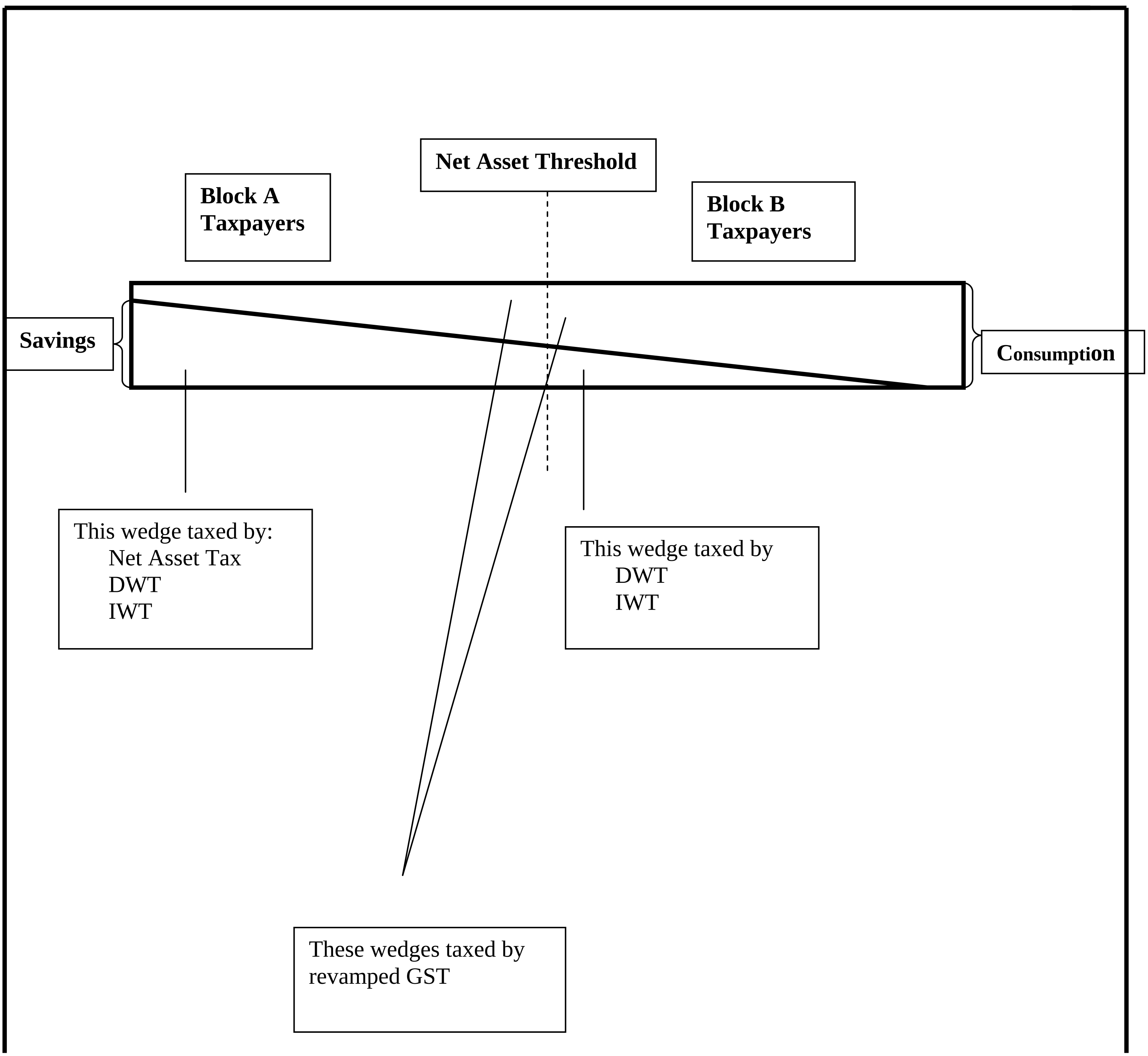
If the above ideas were feasible a tax rate that equalled the GST rate might be possible for both individual and corporate taxpayers . Such a low tax rate would have two immediate effects: a substantial reduction in tax for most individual taxpayers, which would be diverted to the National Welfare Fund and the making of Australia a favourable destination for foreign capital.

The Taxpayer Continuum

Under the proposed tax system real economic income will be taxed according to its disposition as consumption expenditure or as an addition to savings or investment.

So, a tax on consumption spending (i.e., through a revamped GST) plus a tax on new savings/investment will replace the traditional income tax allowing that system to be repealed in its entirety. Taxpayer spending behaviours change as we move along the income cohorts - those at the lower levels have a propensity to spend that is greater than their propensity to save whilst those at the other end have a propensity to save that is greater than their propensity to spend. Thus low-income earners will pay mostly the GST while more wealthy taxpayers will save more and will attract the tax on new savings/investment. The taxpayer continuum and the proposed taxing regimes can be depicted as per Figure 4

Figure 4 **The Taxpayer Continuum**



The illustration of the Taxpayer Continuum reflects the relationship savings and consumption have with each other in the total income picture. The relationship will differ taxpayer by taxpayer as each will have a different mix of savings and consumption – the lower the income the less the savings.

The long rectangular block represents national income and its ownership shared by individual taxpayers ranked by percentage of income consumed. The income of taxpayers at the Block B end has been used mainly on consumption while Block A taxpayers progressively divert more of their income to savings.

The point of the exercise is that the same income that was previously taxed on derivation and source by our present tax system is now going to be taxed by its disposition. Since income can only be disposed of through consumption spending or by saving it only these two activities need to be monitored. Since taxpayers at the low-income end consume most of their income it would be sensible to exclude these from the monitoring process for the tax on additions to savings.

The Net Assets Threshold is an arbitrary line separating those taxpayers who will be paying the new net assets tax – Block A taxpayers from those taxpayers who will not – Block B taxpayers. For arguments sake the threshold might be set at $500,000 of net assets at current market valuation excluding NWF balances. Although some Block B taxpayers will have some savings, which will be taxed by the new Dividend and Interest Withholding Taxes, they may escape tax on some additions to savings. This might be remedied by some threshold adjustment if thought necessary.

Trusts will be treated as Block A taxpayers but without the benefit of the threshold.

How to Tax Additions to Savings

Our purpose is to levy a tax on income that has been derived by a taxpayer and not consumed by him in the income year. Such income will have found its way into new asset purchases or will have been reflected in enhanced values of existing assets. It might even represent unspent salary that has been left in the bank account. Complicating this picture is the possibility of asset sales with the proceeds being used on consumption.

The simplest and watertight way of identifying ‘additions to savings’ for an income year is to compare the net assets of a taxpayer at the end of the income year at current market values with a similar statement at the end of the previous year. This will reveal either an increase or a decrease in net worth. The increase in net assets plus his consumption expenditure will equal this taxpayer’s true economic income. To identify the net asset position of a taxpayer will be required the submission annually of a simple statement of assets and liabilities. Thus as things stand at present a statement of assets and liabilities would simply replace the traditional income tax return. These statements would require some assessment and processing input and eventually assessment notices would issue with the amount of tax payable.

The new tax return format would still require a bureaucracy to administer but this might be eliminated if instead of identifying and processing each taxpayer's individual income result from a comparison of net assets, an amount of income was deemed to flow from the net assets at the end of the income period. So if a taxpayer's actual rate of return was 10% and the deemed rate 8% that taxpayer would escape tax on 2%. But the higher amount saved by this taxpayer would be included in his net asset balance next year.

Tax Evasion and Avoidance

The proposed replacement income tax system deals conclusively with tax avoidance, the cash economy and non-cash benefits. The aim of taxpayers in every case of tax avoidance under the present regime is to acquire an ability to spend more or to save more. As both aims under the new tax regime will lead to greater tax paid whether the GST or the new tax on additions to savings tax avoidance is no longer possible. Similarly, with the cash economy, assets will be acquired by delinquent taxpayers which will figure in the new tax on additions to savings during an income year. Non-cash benefits, or fringe benefits, provided by an employer will mean that the taxpayer or employee is able to divert funds which would have been spent in the area of the benefit to do other duty and here GST will be paid on this new spending or in acquiring new assets or paying down loan obligations.

* * *

National Welfare Fund (NWF)

The NWF will provide a comprehensive suite of welfare benefits to all taxpayers at the basic level. There will be no bar to taxpayers' supplementing such benefits whether privately elsewhere or as a further contribution to their account in the NWF. The benefit payable will not be means-tested. The most important and critical concept is that every dollar of contribution will be returned to taxpayers with interest either as a benefit or as a balance remaining at date of death.

Every taxpayer will be required to contribute towards a computed capital sum which will provide individual benefits for old age, unemployment, sickness and medical, long service leave, disability etc. (The NWF might also include some state welfare obligations like TAC and Workcare if existing funding arrangements were included as well as the obligations).

The target capital sum will be the same for each taxpayer but individual contributions will not. It is proposed that there will be a sliding scale of contributions with lower income earners contributing less over a longer period. Wealthy taxpayers, although they will have the same target capital sum as lower income taxpayers and will receive the same benefits, they will reach their target sum much sooner and once there will cease making further contributions. The contributions by taxpayers will be facilitated by the windfall generated by the fall in the tax rates discussed earlier. It is believed that the progressivity of present tax scales is more intelligently reflected in contribution scales that have a terminal amount.

The NWF will work like a bank. Individual taxpayers will come in at the front counter with their contributions and make long term fixed deposits, in some cases with a maturity date decades into the future – age pensions, for example. Each deposit will be logged and credited to the taxpayers various accounts, pension, long service leave, sick leave, unemployment, medical etc. The taxpayer will be aware that all these deposits will eventually be returned to him with interest. Federal and state governments will guarantee these funds and the interest and accordingly the interest rate will be reflect that certainty.

Behind the counter the banking function will take over. Incoming funds will be dealt with as the trustees decree. Some will be used by the agencies that are located within the Fund – Centrelink and Medicare. Some will be used to buy federal and state infrastructure bonds while other funds will be on-loaned to trading banks for use in housing loans. The interest flowing back from these investments plus cash flow from new contributions should provide an adequate pool of funds to maintain the payment of existing welfare obligations. It is hoped that the profits on retail lending of the Fund will meet commitments with additional funding from the tax system through the federal budget gradually being eliminated.

As a taxpayer reaches retirement age he will automatically be eligible for the age pension without means testing. At this time if he has any unused balance in his long service leave and unemployment accounts he will be able to either receive a cash payment or be able to fold such balances over into his pension receiving an additional pension. Another option might allow taxpayers to make additional voluntary contributions during their employment to obtain greater benefits on retirement.

As taxpayers access benefits their accounts will be debited and a full statement of benefits taken will be recorded on their periodical statements. Where a taxpayer has insufficient funds in a particular account the benefit will still be paid but debit or overdrawn amounts will not be shown on the periodical statement unless the taxpayer specifically requests it. If this has not been requested the particular account will simply show ‘unfunded’. Where a taxpayer with an ‘unfunded’ balance in, say, his unemployment account recommences work his future contributions will eventually make good this deficit.

The underlying assumption of this proposal is that taxpayers will contribute funds many years before they will access benefits but meanwhile their funds will be used to pay benefits to other taxpayers who may be unfunded or who never worked.

The Centrelink and Medicare functions, located within the National Welfare Fund, will pay benefits that will be debited to the account of each taxpayer. While Centrelink payments are controllable to some extent by the taxpayer Medicare benefits are controllable largely by the medical profession. It may therefore be necessary, for the system to work properly, for Medicare to determine a medical threshold at which benefits will become payable – operations and procedures carried out before then will have to be funded entirely by taxpayers themselves or their private medical insurance fund. Another efficiency might be to require those taxpayers who are in an unfunded state, and require medical treatment to attend in the first instance a Medicare clinic that might be based at a hospital or in the community. Here qualified Medicare nurses or resident Medicare doctors will attend to them. These professionals will refer patients on to private specialists as necessary. This precaution is to protect the fund balances of other taxpayers.

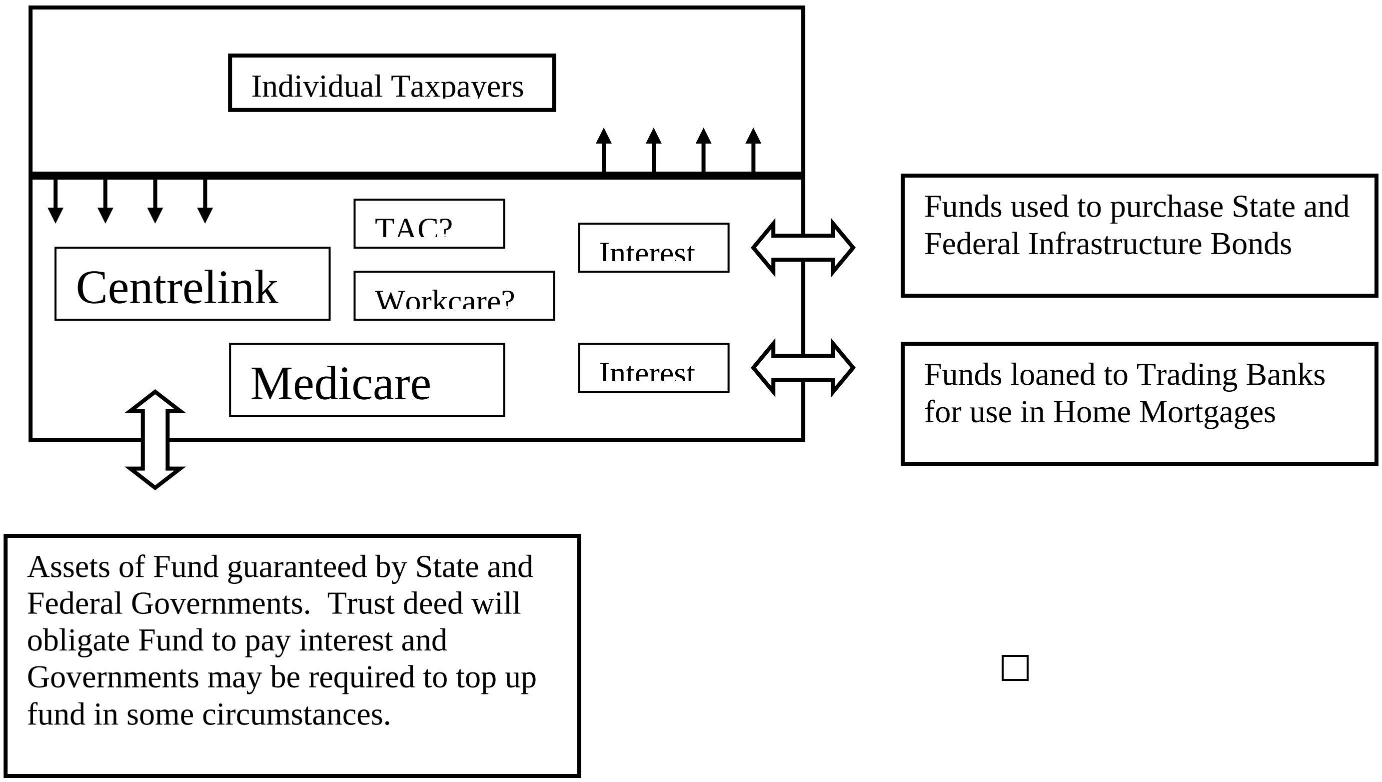
Trustees will have the authority to spend funds to mitigate unfunded obligations. For example, it would be in the interest of taxpayers for the trustees to establish a plan during a period of unemployment under which an employer was encouraged to convert a percentage of jobs from full time to part-time allowing the total number employed to rise. In this event the NWF would pay a bounty to the employer for a certain period with the bounty being debited to the account of each worker becoming employed under the scheme. For example, an employer with 800 full time jobs converts 100 of them to part-time jobs and employers a further 25 permanent part-time workers.

Old workforce:			
	800 full time jobs		
		800 x 5 days	= 4000 days per week
New Workforce:			
	825 jobs		
		700 x 5 days	=3500 days per week
		125 x 4 days	= 500 days per week
	825		4000 days per week

Such a scheme may benefit the employer by eliminating or reducing unjustifiable sick leave or absenteeism and provide an opportunity for full-time workers to obtain a better fit between domestic and work obligations. The NWF will benefit by now having a contributing taxpayer replacing an unfunded one.

There is one sensitive and political issue concerning unfunded age pensioners. If nothing is done the new system will have to absorb the debt. However an opportunity for some redress does present itself on the death of an unfunded pensioner who is the surviving member of a couple who owned their own home. Should the system seek to have accumulated unfunded balance that accrued over a number of years of unfunded age pension, repaid from the proceeds of the couple's only asset? This is something that would have to be considered in the interest of the broader taxpaying community. There are several options available, from full and immediate extinguishment of debt on the death of the surviving partner to a partial contribution ramping up to full compensation over the next say 20 years.

The National Welfare Fund



National Welfare Fund

Basic Features

. Every dollar of contribution made by taxpayers will eventually be returned to them with interest.

. Fund's aim is to provide only a basic age pension, basic unemployment benefit, basic medical care, long service leave for all Australians whether in employment or unemployed

. Taxpayers will not be asked to continue contributions beyond a certain funding level which will be actuarilly based on expectation of life tables and be that capital sum necessary to provide the full age pension and other benefits for life

. Every Australian will have an account and own his share of the fund, if financial or entitlements if unfinancial. And will receive an annual equity statement

. The benefits will be the same for each taxpayer and will not be means tested.

. There will be several levels of contribution. The wealthiest taxpayers will be asked to make their contributions at a higher level and will complete their contribution plan within a few years while other taxpayers will continue to make contributions throughout their working lives.

. The Fund will provide a basic level of interest but the fund balances will be guaranteed by Federal and State governments who will undertake to keep the Fund solvent

. Taxpayers may have an option to increase their level of contribution for the age pension element by a certain percentage and will receive in return that percentage in additional government guaranteed age pension.

. On death any unused balance will form part of the estate assets.

. Where a taxpayer is unfinancial or has an unfunded balance in the fund and is a surviving partner the Fund would have to consider whether, as a matter of policy, it should endeavour to collect the deficit from estate assets eg on the sale of the former residence.

. Existing superannuation fund balances can be retained to provide an independent supplementary private pension on retirement or it may be used to retire NWF obligations early leaving a taxpayer in a fully funded position, or used to purchase additional entitlements in the Fund.

Comment

The above is only a charcoal outline of a national welfare system. It is only one of many possible options. Clearly other alternative models would have to be explored. For example, the crediting of interest might pose a problem in that some taxpayers might end up with a greater balance due to the interest factor alone. Instead it might be more equitable for interest to be credited solely to allow the fund balances to keep pace with inflation beyond that no interest would be payable. Such a refinement would allow greater profits to be earned by the fund which may be sufficient to fund those obligations where a taxpayer is not able to contribute – lessening the need for transfers from consolidated revenue

Corporate Taxpayers

This submission recommends that the Economic Method, in which the economic income of individual taxpayers would be measured and taxed by its disposition rather than by source and derivation, replacing the traditional 'tax return' method. In its purest form the Economic Method would have consumption expenditure taxed separately leaving additions to savings/investment occurring during the financial year to be identified and taxed in some way. Having done this all economic income of a taxpayer would have been taxed. Theoretically, the full Economic Method would preclude a separate tax on companies and on interest as dividends and interest would already be included in asset balances used to determine the amount of new savings and investments of a taxpayer that is to be taxed. However there are significant advantages to be gained from continuing a tax on dividends and interest income. The first of these is that the dividend and interest streams are convenient catch-pots for collecting revenue as the pathways exist already. Secondly, the dividend and interest withholding taxes would allow Australia to present the same tax profile internationally with respect to income flowing to and from abroad. Thirdly, and importantly the withholding taxes would permit taxes to be levied on that part of economic income not consumed by Block B taxpayers. There would be no disadvantage to Block A taxpayers as the deemed income would take withholding taxes payable generally into account in striking a lower deeming rate.

The withholding tax system would require corporate taxpayers as paying agents to break off part of the dividend and remit it as a final withholding tax to the Commissioner. No further action would be required from resident taxpayers.

As part of the new tax regime it would be expected that unincorporated business taxpayers be encouraged to incorporate.

Interest Withholding Tax

All interest payers would be required to deduct interest withholding tax from all interest payments including discount on bills of exchange and remit the amounts to the Commissioner of Taxation.

Comments on The Replacement system

The proposed system applies psychology to the tax system in that it removes the ‘free lunch’ and sends a message to taxpayers that the benefits that they have a right to have to be paid for ultimately by themselves or someone else. If they are unable to fund their own age pension they will receive one automatically without testing or judgment. However if they are able to pay then they will eventually pay. A policy objective might be for every taxpayer to contribute to his or her own welfare to the greatest extent possible. The new regime will focus attention on the present ability of welfare recipients who currently enjoy both an unfunded pension for life and at the same time expect to leave a fully paid up home to their descendents.

Consultation Questions

Q4.1

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

The writer submits that the replacement tax model outlined earlier in Section 4 above would achieve all these goals.

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?

Before discussion can take place on the appropriate distribution of income tax across income levels the tax base itself needs to be adequately defined. Our present tax system does not tax all income and therefore ‘the appropriate distribution of tax’ - implying progressive tax rates – is meaningless in that no social point is being made in the taxing of 50% of a taxpayer’s income progressively while the other 50% is not taxed at all.

The suggested reforms, above, will allow all income to be taxed but at much lower rates and within a flat tax regime.

Q4.3

Is the personal income tax base appropriately defined? Should reforms such as changes to the scope of deductions or other measures be considered?

The personal income tax base should be changed to 'economic income'. This would allow more efficient measurement techniques to be used that would drastically reduce the opportunities for tax avoidance. However the use of 'economic income' – i.e. income that included unrealised gains on all property assets each year – would be 'impractical' unless accompanied by other structural changes.

A change to an economic income tax base would also mean that the benefits currently provided by concessional and special tax deductions would have to be provided some other way. This is because the concept of economic income already takes into account all losses and outgoings necessary to produce the income meaning that there is no concept of a deduction.

Q4.4

Should the tax treatment of transfer payments be reconsidered? Should transfer payments be taxed at the same rate or a lower rate than earned income?

The taxation of transfer payments is double handling. Were welfare benefits available to all taxpayers in a flat tax regime there would be no point to taxing them. In the system being proposed all taxpayers drawing a benefit will merely be accessing their own funds at least notionally.

Q4.5

Should people in different circumstances be taxed differently (for example, by age, occupation, location), and what might be the implications of such arrangements? Are tax offsets the best way to achieve differential taxation?

No comment.

Q4.6

How can fringe benefits tax be simplified while maintaining tax integrity? Would it be better to adopt the general OECD practice of taxing fringe benefits in the hands of employees, rather than employers?

Under conventional tax thinking a fringe benefit can be taxed as a benefit provided by the employer or as a benefit received by an employee. Both approaches require complex monitoring as to valuation and usage. The OECD approach simply recognises the benefit for what it truly is – salary taken in kind. However the question asks how such a tax might be simplified while retaining tax integrity. It is submitted that the replacement tax system (The Economic Method) outlined earlier in this section deals comprehensively with the matter of fringe benefits by doing absolutely nothing. The logic works like this: if an employee is provided with a car fringe benefit of say, $5,000 this benefit will mean that he will not have to provide this facility himself leaving him with an extra $5,000 to spend on other things or he might save it. Now, because an extra $5,000 becomes available for spending or saving it will attract tax under either heading, and so nothing further needs to be done with this fringe benefit. Thus the tax becoming payable by the employee will offset the DWT forgone by the employer in the course of providing this benefit.

Q4.7

Are the current categorical distinctions for income support, including rates of payment and income tests still relevant? If not, would other categories be better? What goals or principles should guide categorical distinctions and associated payment rates?

No comment.

Q4.8

What priority should be given to the different objectives associated with family assistance, such as poverty alleviation, recognising the social value of child rearing, facilitating workforce participation of parents, and early childhood education? Would it be better to provide less family assistance to higher income earners?

No comment.

Q4.9

W*hat are the key factors that should affect rates of transfer payments? What should be the relative importance of duration on income support, costs of work and job search, costs of children, value of home production and the level of the federal minimum wage?*

No comment.

Q4.10

Should transfer payments have a common benchmark? If so, should it be a proportion of a wage measure, and if so, which one? Or is there a better benchmark? Should there be a common indexation arrangement?

No comment.

Q 4.11

Should payments for retired people remain linked to payments for people of working age?

Age pensions should be related to present needs. Working age people have to cater for present needs and future needs. The proposed separation of the tax and welfare systems and the requirement that taxpayers fund their own welfare mean that taxpayers will be obligated to provide only for a basic level of welfare themselves anything above that will have to be provided voluntarily.

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?

Under the proposed National Welfare Fund every working taxpayer will be obliged to provide for a range of welfare benefits at a basic level including unemployment. Their NWF account will follow them around from job to job until retirement. The unemployed will draw on the accumulated balance in their unemployment account and when exhausted their unemployment account will record negative balances. Negative balances will be made good by deposits from new employment, or unused long service leave balances at retirement or unused balances of age pension at death. Thus taxpayers will know that they are funding their own unemployment and that eventually they will have to make good current drawdowns.

Q4.13

What structure of income tests and taxes would best support the increasing diversity of work and the need to increase workforce participation, and where should improved incentives be targeted?

No comment

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?

No comment.

Q4.15

Given the competing demands of targeting assistance to people when they need it and minimising unnecessary transactions, what changes could be made to tax and transfer policies?

No comment.

Q4.16

Should the different bases of assessment for tax and transfers be reconsidered (including the unit of assessment, income definitions, period of assessment and assets treatment?

If every taxpayer was obliged to fund their own basic level of welfare during their working life and on retirement at 65 would be entitled to draw on their basic age pension entitlement then there would be no need to have any means test or assessment. Everyone will receive the age pension. The proposed replacement tax transfer system provides such a system.

*   *   *

5 The Retirement Income System

The notes on the National Welfare System in the previous section convey all my comments on the retirement situation.

6 Taxing Business and Investment

Q 6.1

Can the tax system be structured to better attract investment to Australia in a way that increases national income, and if so how? For any given revenue outcome, what are the relative merits of broader base/lower rate (comprehensive income tax) approaches?

The proposed exemption of companies from taxation and its replacement by a final withholding tax on dividends and deemed dividends will mean that Australia will have possibly the lowest corporate tax rate in the developed world. Because the tax will be related to distributions – dividends (and deemed dividends) - it will effectively be raised on economic income of companies.

With such a low tax rate possibly 10 to 15%, international profit shifting or transfer pricing is expected to be minimal. This is because a controlling foreign corporation would be unlikely to divert expenditure to Australia for deduction against sales revenue here in order to save some part of the 10 to 15% tax revenue where that same expenditure might be used more productively elsewhere. The reverse would be more likely – foreign corporations would seek to have income taxed here and not elsewhere. Similarly Australian based parents would not be interested in profit shifting because, the company, not being subjected to tax itself, would not be able to benefit as any gains from profit shifting would be reflected in greater profits and dividend payments and hence higher withholding taxes.

Q 6.2

What changes, if any, to the tax system would improve the ability of Australian companies to operate internationally orientated businesses? How should tax treatment of companies and shareholders be integrated in an open economy?

By exempting Australian companies from tax entirely they will be able to concentrate their efforts wholly on business affairs knowing that they will no longer have to be concerned about tax planning matters in Australia.

The proposed system will, however, have a negative impact on companies in that special tax deductions and industry incentive deductions will have to be funded another way if indeed they need to be continued with.

Q6.3

Can the tax system be restructured to improve resource allocation within the economy and minimise operating costs, and if so, how? What changes would reduce distortions to risk taking and encourage risk taking and encourage entrepreneurial activity?

It is believed that the proposed tax reform suggestions advocating a flat tax regime and the removal of welfare from the federal budget will make taxation a background issue that will promote and energise entrepreneurial activity.

Q6.4

What principal goals should inform the taxation of capital gains in Australia, and what, if any, changes should be made to capital gains tax as a result?

A capital gain is not an accounting conception. A capital gain is the difference between the historical cost of an item and its ultimate sale price. This difference is the accumulation of incremental unrealised gains over several accounting periods. The accountant would have taken each annual increment into account, if material, in the periods in question.

Insofar as individual taxpayers are concerned, capital gains will cease to be an issue as soon as the income commences to be taxed by its disposition whereby unrealised gains will be included annually in the growth of net assets.

In exempting companies from tax and installing a final withholding tax on dividend distributions the economic income of companies, which will include the accounting version of the capital gain, will effectively be dealt with. The capital gains tax regime will quietly pass into a well-deserved oblivion.

Q6.5

Should the tax system provide a more neutral treatment of different financing arrangements (debt, equity, and retained earnings), and if so, how? What principles should inform approaches to entity taxation?

The writer believes that all foreign investment into Australia should be through a domestic corporate entity subject to corporation’s law. The advantages that are presently available through debt funding over equity funding will be much reduced by the effect of the low withholding tax.

Q6.6

Should the tax system be structured to cater for the specific circumstances of small business, and if so, how?

Under the proposed tax system small business will be encouraged to incorporate. Where a private company, dividend distributions will have to be regulated by a 'retention' rate, which will specify how much of profits can be retained and how much distributed. The small businessman will benefit from the low withholding tax rate.

Q 6.7

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?

Under the proposed replacement tax system taxpayers will be taxed on their income by its disposition i.e., as consumption spending or as additions to savings. If a Block B taxpayer, i.e., a taxpayer whose net assets falls below the threshold, has income from savings and investments he will be subject to tax only insofar as they had been subjected to DWT and IWT. If a Block A taxpayer, he will be subjected to the DWT and IWT as above but also to the proposed tax on additions to new savings and investments made during the year. That is he will be taxed on some part of the growth that has occurred in his net assets over the year through market conditions.

* * *

7 Not-for Profit Organisations

Q7.1

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

Where a NFP organisation conducts substantial business operations it should be forced to perform through a company structure and it should be taxed no differently to any other company.

If it is thought desirable to compensate the NFP organisation for its social role that organisation should be invited to apply for special funding where it will declare its purpose for the funds and be accountable for them. The funding would be restricted to the tax paid. No gifts to be made by the operating company.

Q7.1

See reply to Q7.1

* * *

8. Complexity – Cost, Risk, and Transparency

Q 8.1

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)?

No comment – see earlier exposition of replacement tax regime.

Q8.2

In what ways might the administration of Australia's tax-transfer system be changed to better meet the needs of individuals and businesses? How might the process of personal income tax returns be simplified, including by removing the requirement for some taxpayers to lodge returns? Should the administration of the system be more integrated (across taxes and transfers and between jurisdictions)? How might advances in technology assist?

This question has been fully responded to in the overview to in Section 4. However the following additional comments are offered.

Our tax system does not tax the hundreds of billions of dollars of unrealised gains on shares and real estate and other property assets in the year in which the gains are recorded. These gains are income but they are not 'ordinary income' or 'statutory income' and hence simply escape the tax net. The owners of such gains are those taxpayers who are able to save more than they spend – the wealthy. The writer believes that the complexity, the inefficiency, and inequity of our tax system is caused by the beneficiaries of such non-taxable income stream working to retain this facility. One aim of this submission is to demonstrate how simple and equitable our tax system might be if that loophole was closed.

By uncoupling welfare from the federal budget and by extending the income concept to economic income, tax rates will be able to fall substantially. This fall will provide windfall benefits to lower and middle-income earners, which would enable then to contribute to their share of a national welfare fund. If basic welfare becomes self-funding, draw downs of welfare needs will be booked back to each individual taxpayer. This is recognising welfare for what it truly is – an outlay for taxpayers by taxpayers. Where a taxpayer is able to pay in some part of his life but not in another the system will carry the debt forward until paid. Of course some taxpayers will never work or no longer be able to work and their circumstance will be unlikely to change. The funding of this latter group will partly be met out of profits from the take up of federal and state infrastructure bonds and from loans to trading banks for home mortgages.

Q 8.3

To what extent might policy objectives be traded off to achieve a simpler system? In what areas should efficiency, equity or choice be traded off for simplicity?

No comment.

Q 8.4

How could the governance of the tax-transfer system be reformed to reduce complexity, uncertainty and cost, and to improve transparency, understanding and support for the system?

No comment..

*   *   *

9 State and Local Taxes and Transfers in the Australian Federation

Q9.1

Noting the overall structure of Australia's federal financial arrangements, what changes, if any, should be made to the assignment of revenue raising powers and intergovernmental transfers in Australia?

The writer believes that all welfare type functions of the states like Worksafe and TAC insurance functions could be transferred to a centrally administered National Welfare Fund along with the relevant funding. Refer Section 4 above.
Q9.2

Given the widely held view in submissions that the current state tax arrangements need to be reformed, what changes should be made to state and local government own source revenue instruments? What scope is there for greater use of user charging to bring social, environmental or economic benefits?

Federal and state tax arrangements are marked by duplication: two competing agendas for health, two competing agendas for education, two competing agendas for roads, two competing agendas for environment, two competing agendas for drug control two competing agendas for corporations and so on. This is due in large part to the constitutional responsibility lying in one jurisdiction while the funding ability is in another. The constitution needs to be renegotiated so that responsibility and funding fit together better.

Q 9.3

What is the appropriate allocation of the roles of the Australian and state governments in income redistribution?

No comment

Q 9.4

What opportunities could be pursued to deliver more seamless administrative arrangements of the tax-transfer system across the federation?

No comment

10

Q 10.1

No comment.

Q 10.2
No Comment

Q10.3

No Comment

11 Taxes on Specific Goods and Services

Q11.1
Q11.2
Q11.3
Q11.4
Q11.5
Q11.6
No comments are offered on the above questions.

12 Fuel, Roads and Transport

Q 12.1

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

Road and motor vehicle transport and taxes should not be looked at in isolation from public transport issues. The massive freeway developments in Sydney and Melbourne are there simply because of the 'rush hour'. If workers took the bus or train to work the freeways would be embarrassingly empty.

Tax policies can move people from cars to trains like a lever. If registration, TAC charges etc., were factored into fuel costs, cars would be used less and trains more. If ratepayers had a fixed amount added to their rates to cover metropolitan public transport, and trains, trams and buses were made free for all, the roads would again become empty.

Tax policies can also be used to move containers off the road and on to rail between major centres. Fuel costs are also relevant.

Improved efficiency in the transport of goods and people should be looked at in conjunction with public transport issues but first our community has to decide what role public transport has to play in our lives.

Q12.2

What should be the role, if any, of fuel taxes? What does this mean for how fuels and their uses are taxed and the rates of tax applied?

No Comment

Q 12.3

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

No comment.

13 Tax-transfer impacts on the environment

Q 13.1
Q 13,2
Q13,3

No comments on the above questions.