

TAX REFORM – ROYAL COMMISSION AND REFERENDUM NEEDED

The present Australian taxation system has its genesis in the colonial model ordinance, which was specially drafted by the British for their colonies. Some former colonies still use that model as the basis of their taxation systems.

Income tax was introduced to the British colonies of Victoria and New South Wales in 1895, Western Australia in 1899, Tasmania in 1880 and Queensland in 1902. A federal income tax was introduced in 1915 based on the colonial model.

The 1936 Income Tax Act was merely a consolidation of the tax legislation used from 1915 – 1934, although an effort was made by the Royal Commission in “the drafting to make each section clear and concise, and to avoid, so far as the technicalities of an Income Tax Act will permit, sections or sentences of undue length, which present difficulties of interpretation”.¹

The 1997 Income Tax Assessment Act was similarly introduced to help taxpayers “identify accurately and quickly the provisions that are relevant” to a taxpayer’s “purpose in reading the income tax law”.² The 1997 Act was essentially an attempt to simplify the 1936 Act and no attempt was made to make any radical changes to the basis of income taxation in Australia.

The Ralph Review of Business Taxation undertaken in 1999 produced some changes to business taxation, which were mostly concessions and simpler rules to comply with taxation requirements for business taxpayers. It did not recommend any radical changes to business tax nor was any review undertaken of the whole income taxation system of Australia. The establishment of a Board of Taxation by the review has done very little to improve taxation administration in Australia. The Board has merely raised minor concerns of large businesses and has been an unnecessary additional cost to tax administration.

Australia has essentially retained the original “colonial model” scheme as its basis of income taxation although it has introduced some changes from time to time to deal with emerging issues. A large portion of the current income taxation legislation is essentially made up of provisions to deal with abuse of taxation concessions and compliance of the basic system. In addition, a Goods and Services Tax and a Capital Gains Tax have been added to the taxation system.

¹ R.Ewing, Commissioner of Taxation 31st August. 1936 Preface to Explanatory Handbook to the 1936 Income Tax Assessment Act

² Section 2-1 of the Income Tax Assessment Act 1997.

What Australia urgently needs is a major overhaul of the current Australian income taxation system. The current income taxation system should be abolished and replaced by a better and fairer system. Under the new taxation system (NTS) there should be five independent taxes.

The most urgent reform needed is to remove salary and wage earners including contractors from the mainstream income taxation system and made subject to an independent Employment Tax (ET). Employees should be taxed without any work related deductions, but with tax rates that will have regard to such outgoings incurred by employees in carrying on their employment. Rates at 10% for those earning up to \$50,000, 20% in respect of incomes exceeding \$50,000 to \$100,000 and with a top rate of 30% for any income received in excess of \$100,000 would be appropriate.

ET should be collected at source through the bank accounts of employers, with direct debits. A tax return will only be necessary where an employer has made an error or omission (E&O ET Tax Return). It should operate in a way similar to the current state and territory payroll taxes. ET should also be administered by state and territory revenue agencies. ET should be independent from other taxes with a wide base to cover salary, wages, fringe benefits (the exact amount assigned for such benefits should be included), pensions and contract payments. The current fringe benefits tax would under such a tax be abolished and taxpayers would not be entitled to any artificial "salary sacrifice" arrangements. If the revenue authorities had challenged salary sacrifice arrangements when first introduced they would have had courts confirming that the arrangements were ineffective for income tax purposes. Unfortunately, these arrangements have been allowed and now create an uneven playing field for employees who are not employed by agencies that can offer the arrangements without having to pay any fringe benefits tax.³

In the case of businesses, there should be a simple tax for small businesses (with a turnover of less than 3 million dollars). It should be a turnover tax set at 5% on the gross turnover and paid with their GST payments. The small business tax (SBT) should be easy to administer and small business operators will not need to spend money engaging accountants and tax lawyers to lodge their SBT returns. Again no returns are required except the current GST Return.

Businesses earning income in excess of the 3 million dollars turnover should be subject to a large business tax (LBT). In the case of large businesses, the current three sets of accounts that they are required to maintain should be replaced by one set of accounting. Currently, most businesses keep three sets of accounts. One for the operators to know the truth about their operations, one for the tax office and the third set for its shareholders which

³ There is an argument that the current tax system allows charities and non-profit organizations to employ all level of staff by offering them attractive salary packages. Therefore, under the recommended future income taxation system there will be a need to compensate these organizations by increasing their grants.

are usually the figures in their annual reports. The shareholder account should be the basis of the LBT and the tax should be on the gross income. The rates should be fixed at 10% (first \$10M), 15% (amounts in excess of \$10M up to \$50M) and 20% on amounts of gross income in excess of \$50M.

The fourth tax would be best described as a miscellaneous tax (MT). It will be a flat rate 5% tax to tax rents, interest and dividends. Interest and dividend payments should be taxed at source. Gross rental income should be the base for rents and no deductions should be allowed.

The fifth tax will be a tax on capital gains (CGT) with a tax on all capital gains irrespective when the asset was acquired and at a flat rate of 5%.

No tax reform review is complete without considering the current low rate of GST in relation to further tax cuts and radical changes to the Australian taxation system. It is therefore clearly regrettable that the current review does not include any review of the GST. The current rate is lower than that is charged in other developed countries (for example in Germany the rate is 19%) and there is a very strong case for the rate to be fixed at least at 15%. This would allow the flexibility to reduce the current income tax burden on employees and also provide the nation with funds to ensure that those less advantaged do get a fair go to enjoy a reasonable standard of living (better pensions for example).⁴

Any radical changes to the current Australian taxation system will need the approval of all taxpayers and not just those in Parliament. The current Senate will not allow any radical changes and any negotiated deal with the independent and Green senators will just not be sufficient for future generations. The proper way to deal with such major changes should be a proper inquiry carried out by a well-represented Royal Commission and the final shape of the system approved by the taxpayers through a constitutional referendum.

This new taxation structure would provide very little opportunity for any tax planning. It would also remove from the system artificial rules that have been used to manipulate the current tax system. The system would be better and fairer if the tax is imposed on real figures and not those created by smart accountants and lawyers and with all taxpayers having the same liability. There are too many anomalies in the current tax system – for example, certain taxpayers can share the burden with other members of the family through assignment of income or through trust arrangements, some employees have salary packages which are tax effective and some taxpayers with wealth are able to accumulate more wealth through negative gearing arrangements. All anomalies must be removed from any future Australian income taxation system.

⁴ A 5% increase in GST would mean additional revenue of \$20 billion, which should be used for only Commonwealth purposes.

All tax incentives should be given by government through real grants rather than under the tax system. There is a long history of abuse of such tax incentives; in particular the concessions have been manipulated to obtain unintended tax concessions for the least deserving taxpayers.

The Board of Taxation should be dismantled and replaced by a Taxation Reform Forum, which should have an ongoing brief to monitor tax reform and as independent body provide the government with advice to deal with new financial challenges with appropriate and timely taxation changes.

It will be a tragedy if the outcome of any new review would merely lead to some simplification of the current taxation laws. With a government prepared to embark on change this is a golden opportunity to introduce a new overall taxation system for Australia, which should be designed to operate for the next hundred years. The current global financial tsunami should in fact encourage the government to make radical changes to the tax system so that future generations will have a tax system that will not only operate fairly but act as a deterrent to any financial crisis.

Ultimately, as recommended a long time ago by Justice Asprey in his review of the Australian taxation system carried out in 1975, any new Australian taxation system has to be efficient, simple and neutral. Or as suggested by the Ralph Review of Business Taxation, any new tax system for Australia must be more certain, equitable and durable.

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