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Tim Wilkin-Smith

From: "Tim Wilkin-Smith"
To: "Tim ~~Wilkin-Smith~~"
Sent: Wednesday, 27 August 2008 1:03 PM
Subject: Tax Review Submission

Tim Wilkin-Smith

27/08/2008

Submission to Tax Review

Preamble

Contents:

I appreciate that GST is excluded from consideration in this tax review. However I say it is quite impossible to canvass taxation in principle without reference to it. Most of this submission comprises material assembled in the 90's before and in response to the tax agenda of the previous government. Some allusion is made to the GST as an inappropriate tax. As most of this material is a decade or so old, exists only in physical form and cannot be changed I apologize for GST references. Even so I am going to refer to GST again when discussing taxation principles.

Firstly I wish to state that taxation administration and accounting are not inherently interesting or useful pursuits. They are tidying up professions. Therefore the less need to be preoccupied with them the better. So at the outset an appropriate tax system must have this asset - having the least possible requirement for administrative effort. I therefore suggest an acceptable tax regime should have the following attributes:-

1. A tax system should comprise as few tax types as possible - ideally only one but for practical purposes an absolute minimum.
2. In light of (1) rates of tax must necessarily be as high as possible.
3. For administrative simplicity any appropriate tax should apply on a broad base but have a narrow client base.
4. Social policy should be operated separately from tax.
5. Taxation should as far as possible not be tendentious. Tax breaks or tax incentives should be excluded or minimized.

On these criteria it becomes obvious that Income Tax and GST are monumentally inefficient. The accompanying essay expresses in more detail the inadequacies of Income Tax. In relation to GST it is clear that a single stage consumption tax is superior to a multi-stage one. Our present GST has a whole host of registered clients who effectively don't contribute to the revenue - many, perhaps more than 50%, receive refunds or have very little net tax to pay. It seems to me thoroughly senseless for all these clients to be routinely doing their GST bookeeping for near to no result. The attached material discloses my suggestion for an acceptable consumption tax.

I should acknowledge that I am a former staff member of the Tax Office albeit at a junior level - also I feel compelled to say that in my experience Tax Office staff, even at senior levels, had essentially no interest in assessing the efficacy of the existing system or suggesting reform.

I have already foreshadowed a snail mail submission. I hope you acknowledge receipt of this submission by email and I intend to respond in future by that means. My contact details are above.

Regards
Tim Wilkin-Smith

Dear Neil Warren,

Attached are a couple of items I have written on Tax Reform. The first is a letter to the editor of August 1998 (never published) which outlines some general principles. The second, written in August 1996 before the latest "Tax Reform" push began, argues for a retail sales tax on goods. This latter I may have constructed rather differently had I written it now. It was submitted to the Government's Tax Consultative Taskforce chaired by Senator Gibson.

I realise it is rather late in the piece to be complaining about ANTS. However it absolutely irks me that a decades old Northern Hemisphere tax coupled with the bait of Income Tax cuts could be construed as "visionary" or a recipe for the 21st century. These elements are not obligatory if we are to have tax reform. Howard effectively said at the beginning of the process - "This is the agenda; discuss this only". He could have started an open unfettered debate.

circa 1999

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TIM WILKIN-SMITH

22 AUGUST 1998

THE EDITOR
THE AUSTRALIAN
GPO BOX 4162
SYDNEY NSW 2001

LETTER TO THE EDITOR AS FOLLOWS:

Dear Editor,

May I respond to the Tax package release.

I hesitate to describe this plan as tax reform. It seems to me to blend Northern Hemisphere orthodoxy and Antipodean, or may I say Howardian, flavour - a 20th century tax (the GST) allied with an appeal to cupidity, an encouragement of insular and petty little greeds.

Howard is correct to see that the Wholesale Sales Tax (WST) is decrepit but overlooks the similar state of Income Tax. Income Tax is moribund. It is not something that ails and can be fixed by good medicine. It is chronically bad - a lurks and perks tax, an impediment to decent and sensible commercial and financial arrangements. This condition is exacerbated by the grafting of social policy on to it. Actual tax reform would entail the disposal of both WST and Income Tax.

Taxes of all types, which represent funds withdrawn from the possibility of immediate use on consumption, probably have rather similar economic effects. So to talk of tax changes, apart from change to total tax take, having a definable influence on economic performance is likely to be salesmanship. It follows that what we need from tax changes, after provision for the genuinely needy, is minimization of resources applied to administration.

In an ideal world there would be, for administrative ease, just one tax necessarily pitched at a high rate. In a less ideal but more practical world we would have as few taxes as possible pitched at as high a rate as possible. If we had the opportunity to introduce a new tax why would we choose one involving most businesses in the country and levied at a low rate - the context of the GST proposal. This is a prescription for administrative burden and therefore inefficiency. Your ideal tax would apply on a broad base but rely on a relatively narrow client base, a client base which is reasonably money literate. A possibility along these lines is a single rate retail sales tax on all new finished goods sold in Australia. I calculate that such a tax levied at 25% would raise approximately 70% of present Tax Office receipts. Of course this tax would have to be complemented by policies on incomes, welfare and perhaps prices. It may also have the beneficial effect of inhibiting waste of material resources. Presumably there are other comparably appropriate taxes.

I hope this Tax package is defeated. In the circumstances I say better to have no tax plan than a wrong one.

Yours faithfully,
Tim Wilkin-Smith.

TAX REFORM - A RADICAL BUT REASONABLE OPTION

The present Commonwealth tax regime could almost have been consciously planned to meet a requirement of logistical complexity. Our Income Tax and Sales Tax systems are nightmares to administer. However it is easier to assess the deficiences of this regime than to formulate an improvement. There must, though, be something better. Might there not be a simpler, more straightforward, more honest method of raising the Commonwealth revenue - a method which is transparently elementary and in principle similarly applicable to all.

In the 95 year the Tax Office collected $88 billion. In a rudimentary way this amount can be split into two unequal portions - a 13% slice of Wholesale Sales Tax (WST) receipts and a much larger balance of Income Tax (apart from a few incidentals Tax Office revenue accounts cast everything into these two categories - FBT for instance is classed as Income Tax). Given that Income Tax contributes much the greater part of these receipts, let us examine in a very general yet fundamental manner what this system amounts to.

In terms of structure Income Tax can be considered to be a two-stage system - consisting of a tax at source (or withholding) function at the front end and an assessment/review function at the back end. Money brought in by the front end function is supplied as credits to the back end function, so that the two functions are in part dealing with the same sets of tax affairs (although a number of different clients may be involved in any one set). In addition most withholders, though compulsorily caught up in the Income Tax affairs of others, are independently and on their own account participants in the assessment/review process. Now both of these functions have largely separate but roughly analogous assessment, payment, audit and debt collection elements. Loosely speaking, the kind of ritual intended to ensure compliance for withholding is replicated for assessment/review. All this is further complicated by the subdivision of both functions into a number of revenue types (revenue lines). This elaboration is of course manifest inside and outside the Tax Office.

Now suppose we postulate having a tax system incorporating only one function - logically one comparable to the front end function which is really a precursor to the other. Would not this have the approximate effect of halving the difficulties? Such a system would include only remitters of tax. This tax, although like a tax at source, would not be a tax withheld but a tax added. Tax credits would not be held on behalf of other parties. There would not then be in the system any ordinary taxpayers on behalf of whom the Tax Office presently holds money in trust.

Now the key question begs to be asked. What kind of major new tax would fit this bill? Dare I say this. I believe that a consumption tax is required - not a GST along Fightback lines but a high rate consumption tax on goods only, a goods tax or GT if you like. More precisely, it could be described as a single stage sales tax on goods applied where possible at the retail level. If we are to have such fundamental reform by way of introduction of a major new tax, it is essential that the incumbent but dysfunctional major tax should go - retention of Income Tax at much reduced rates (something that can be achieved at the stroke of a legislative pen) will not particularly affect the cost of collection. The present WST, which is a limited but complicated tax on goods, would obviously be superseded under this new regime. In addition, certain other charges such as the excise on fuel may become outmoded - there may thus be ramifications in State and other Federal jurisdictions.

Now were a GT to overthrow both Income Tax and WST, further quite fundamental issues present themselves apart from the astonishing proposal that one tax, comprising one revenue line, should provide the major part of Tax Office takings. Crucial matters include the percent rate to be applied, the extent of coverage and the point of application. However, perhaps I should first outline more completely why such a GT is preferable to Income Tax and why physical goods only and not services are to be taxed.

The exchange of a physical good for a charge is perhaps the most basic commercial transaction commonly undertaken. Such a transaction at the retail stage will mostly be achieved with the intervention of a cash register. So a levy on goods transactions programmed into registers would in turn offer a simple method of tax collection. This surcharge could be anticipated by all consumers who would know if they chose to purchase a levy would apply. In any instance a choice could be made to buy and pay the levy or forgo both the purchase and the levy - qualified by the understanding that some purchases would be compelled by necessity. The avoidance of GT could then not be achieved by manipulation of financial affairs but only by adjustment of consumer spending on goods. The tax collecting authority and the consuming public would know that any retail seller of goods would by definition be a tax remitting entity - tax remitters would thus be readily identifiable. The taxing points (GT remitters) would be few but the taxing transactions would be many.

In comparison to goods, services are ephemeral and illusory. Purchase of a service can more easily be disguised and denied. A cash register transaction is less likely to be involved. My view is that compliance problems may be rife in taxing services - imagine taxing rents, fares, alternative health services and the like. However, in counter to this, the attempt to distinguish between goods and services may raise difficulties for a goods only tax. In any case all services are backed by the purchase of goods whether of capital or consumption type and these will have been taxed. In cases where goods and services are supplied in conjunction, say the supply/fit of replacement parts to an appliance, the parts would be taxed at acquisition by the serviceman - the consumer's bill would be free of a direct tax but influenced by the tax component on inputs (the parts). Whereas a tax on goods may tend to inhibit resource depletion and waste (a useful influence in the current climate of profligacy), the services component of a GST would have much less such effect.

I have so far been critical of Income Tax mainly on the ground of ponderous administration. Deficiences of style or legislative content must now be dealt with. In contrast to a GT, Income Tax deals with financial affairs which are relatively complex and private. The transactions that make up taxable income may be complex, may be deliberately contrived to be complex, may be contrived to be disguised, may be inaccessable. Let us consider a work related deduction for an employee such as motor vehicle expenses. The minutiae of such expenses can never really be adequately apprehended by a distant third party such as the ATO - the knowledge of the context of motor vehicle usage is contained in the enterprise, so that any assistance or recompense ought to be worked out by the interested parties, the employee and the employer. Without Income Tax the two parties would be compelled to bear the expense without public subsidy and may in consequence be less profligate in their behaviour. Analogously, the business expenses and investment outlays of the self-employed and corporate enterprises would be understood to have to be fully met without assistance or hindrance from Government. Legally acceptable but ethically dubious practices such as negative gearing would disappear. Tax incentives of all kinds would disappear. The era of the tax break would be over. In addition, the problems associated with the determination of assessable income would also vanish. The tax system would approach value neutrality - although a GT may have the effect of suppressing consumption, this influence would be countered to some extent by the general rise in disposable incomes. All of this would entail the injection of a form of honesty into the tax regime. Government assistance to specified groups could be achieved by targeted welfare rather than by subverting a tax system whose sole purpose should be the raising of the revenue.

For a GT to retain simplicity and fairness it must be applied universally. It must apply to all new finished goods in both sectors of the economy. There must be no exceptions. Simplicity also dictates a uniform percent rate on all items. Preferably, the tax should be levied at the retail stage - practicality may however prevent in some circumstances application at the final consumption point. I have already alluded to the supply/fit example. In the case of building and construction, building materials would be taxed at the transaction between supplier and contractor - the value of the finished building would not be taxed. Some shops may sell both goods and services, perhaps combined in one transaction - for example a hairdresser may also sell hair care products. In this instance some decision would have to be made whether the supply/fit case is to be followed or whether goods are to be sold separately.

In order to calculate an appropriate percent rate for the GT the value of the tax base must be established and an estimate of revenue to be derived must be made. This tax base is approximately, for any one year, the value of final consumption and capital spending on goods only for both private and government sectors. There is no precise figure for this in the National Accounts. Some analysis of the National Accounts categories - Private and Government Final Consumption Expenditure and Gross Fixed Capital Expenditure - is required in order to arrive at a suitable figure. With some help from the Australian Bureau of Statistics (ABS) I have established a figure for the 95 year as follows - 15% of Government Final Consumption (70% of this is salaries, half the balance is taken to be goods) plus just over half Private Final Consumption (the goods component relatively easily derived from National Accounts) and all of Gross Fixed Capital except for Real Estate Transfers. The relevant figure for the 95 year is $250 billion.

This figure requires qualification to some extent. As already foreshadowed, some transactions will be taxed prior to final consumption. This will tend to reduce the value of the tax base. However, there may be some effective final consumption by private industry which is presently deemed to be inputs. This will tend to have the opposite effect. Further some part of the black economy not represented in ABS data may be caught. Also ABS data may be inaccurate in other respects. Despite these possibilities $250 billion is the best estimate available.

On this tax base a 35% GT would be required to raise revenue comparable to total Tax Office collections. A 30% GT would, in the 95 year, have raised $75 billion or 85% of ATO receipts. In that same year, a 25% GT would have raised $62.5 billion or about 70% of ATO receipts. I should point out here that government purchases of goods would, by incorporation of a GT levy, be more expensive. Revenue therefore may need to be slightly higher to compensate. However, since all the above figuring is reasonably approximate perhaps such effects may be ignored.

Now it would be nice to have a GT to replace all of Income Tax and WST. However a tax on goods set at 35% would seem to be untenable. A rate of 25% or a quarter added may be a more comfortable and recognizable quantum, although this rate would necessarily entail the production of additional revenue from another source. This question then arises - what kind of tax would be compatible with or complementary to a GT? I suggest a tax on inherited and gifted wealth. Any individual who acquired or maintained wealth by being able to spend a relatively small proportion of substantial income on consumption would then be ultimately caught. If however such a wealth tax were technically or bureaucratically difficult to administer, it should not be considered - these are the tests that should determine whether any tax is worthwhile. I do not know if a wealth tax could provide sufficient revenue to complement GT receipts or whether such a proposal might encroach on State responsibilities. However my present purpose is chiefly to consider the merits of a GT and the demerits of Income Tax rather than to canvass any kind of wealth tax. Therefore I return to further treatment of the GT.

The elimination of Income Tax, a revolutionary proposal, and the incorporation of GT would significantly affect various groups in the community. Some would be advantaged, others disadvantaged in the absence of counter measures. The lowly paid, whether employed or welfare recipients, would be disadvantaged. Perhaps some people in business would also be disadvantaged. Those on high incomes, unless they presently pay little or no income tax, would be advantaged. Income Tax (for individuals) is usually deemed to have fairness on the ground that rates are progressive. The GT is a species of flat tax. Such a monumental change would therefore have to be accompanied by policy prescriptions for welfare, incomes and perhaps prices. Transfer payments for welfare purposes and award wages for the lower paid would have to be lifted. In light of the much enhanced disposable incomes for the well off, some downwards adjustments in specified awards and executive salaries would be appropriate. Gross investment and business incomes may be negatively affected by a GT as capital and recurrent spending may be higher and consumer spending may be lower - thus policy adjustments for private business may be less necessary.

The substitution of GT for Income Tax would presumably engender ripple effects in the economy generally. There would, at the outset, be a once only jump in price inflation on most finished goods and some services - services being affected to the extent that their production involved taxed goods (remember that the disposal of WST will ease some prices). This inflationary effect might take a limited period to work through the economy.

More persistent effects may be unpredictable. The level of revenue receipts would as now be related to the business cycle, although obviously more tightly aligned to retail confidence or retail spending. There may be some tendency to restraint on consumption and hence also on revenue - this would not be altogether bad as we would have the comfort of appreciating a corresponding fall in profligacy and perhaps a rise in economic efficiency.

I have not meant to imply in any of the above that the GT would be without attendant difficulties. Some difficulties that I can foresee are as follows - small traders, market stall holders, corner stores, small manufacturers that retail direct to the public and such like may present a compliance problem as they may lack sophisticated business systems with adequate cash registers; the definition of a good and its distinction from a service will most likely be problematical; the point of application of GT if not at final consumption; without Income Tax we will have difficulties in the international arena as firms and individuals may want to attribute profits to this country.

All tax systems are going to have inherent problems both of a technical and bureaucratic kind. I wish now to remake a point made near the outset. A GT should have in the order of half the elaboration of Income Tax as it involves only one of two structural parts. It is principally on this basis that I recommend it.

Tim Wilkin-Smith
August 1996