Tax discussion leaves debate wide open

Simply titled 'Re:think' the tax paper released by Treasurer Joe Hockey this morning opens the forum for a discussion on Australia's future tax system.

There is a lot of 'conversation' in this document and no recommendations. It is merely a positioning paper for discussion where the Government outlines the issues as they see them and asks a series of questions about how best to address the issues identified. The questions, 66 in all, are extremely broad such as "What should our individuals income tax system look like and why?"

Australia's reliance on income tax from individuals and corporates is a point heavily laboured in the report. The message is clear, if you personally do not want to be paying more in tax then the GST must increase. The report estimates that on current modelling, the percentage of taxpayers in the top two tax brackets (with taxable income in excess of $80,000) will increase from around 27% to 43% by the 2024/2025 financial year.

If the Government acts on the issues raised in this report, the most likely outcomes would be:

- Increase the GST if "unanimous support of the state and territory governments, the endorsement of the Australian Government and the passage of relevant legislation by both Houses of the Australian Parliament" can be achieved. The alternative and potentially more likely scenario is to increase the base of the GST and remove exemptions.
- Increase the Medicare levy
- Index income tax rates
- Reduce company tax – and potentially the removal of a raft of small business concessions replaced with a lower company tax rate
- Remove several tax concessions including capital gains concessions (50% general discount and small business CGT concessions)
- Equalise the way savings and investments are taxed including superannuation – although the Treasurer has said that "certainty" is important
- Equalise how different entity structures are taxed with a particular focus on trust structures
- 'Cash out' the ability to claim work related deductions with an income tax cut or provide a standard deduction - removing the need for many to file a tax return.
- Restructuring of the FBT system and removal or reduction of more concessions including for not for profits
- Potential restructuring of the imputation system
- Restructure taxes on alcohol
- Greater focus on tax benefits received by non-resident individuals, business and investors – where the tax benefit has no investment incentive trade off

Not that the report states any of this. It's simply an observation based on the prominent issues in the report. The problem for Government is once a concession is in place, it's almost impossible to remove.

The report works through 11 areas of the tax system identifying the key tax challenges as:

Australia's tax challenges

- Technological change and the digital economy
- Investment and labour mobility
    - Multi national firms operating across jurisdictions – where their value is intangible and the location where value is added can be difficult to determine.
    - Importation of goods online that do not contribute to the indirect tax base (GST free)
    - New business models not contemplated by the existing tax system
- Taxes with an impact on economic growth:
    - High corporate tax rates deterring investment and encouraging profit shifting and tax planning
    - Stamp duties
- GST revenue declining as a percentage of GDP – 3.9% in 2002/2003 and 3.5% in 2013/2014, $6 bn in dollar terms.
- High effective marginal rates deterring workforce participation (including interaction with the social security system)
- Savings are taxed differently.
- Simplification of tax compliance – it costs around $40bn pa
- "Piecemeal" tax concessions add to complexity – usually apply to a particular group or otherwise to correct an unintended outcome. The cost of administering the concessions often outweighs the economic benefit.
- The incentives for tax planning – concessionally taxed superannuation, fringe benefit concessions, applying losses.

Key data

- Australia's tax revenue is drawn from more than 100 different taxes – the majority from income tax (approx. 81%) and payroll taxes.
    - Our reliance on income tax is the second highest of OECD countries
    - Bracket creep – where wage increases push individuals into a higher tax bracket. The report estimates that taxpayers in the top two tax brackets (with taxable income in excess of $80,000) will increase from around 27% to 43% by the 2024/2025 financial year.
    - 2.3% of taxpayers, those on $180k or above, contributed 26.1% of total tax revenue
    - 14.5% of taxpayers, those earning over $80k to $180k, contributed 37.4% of total tax revenue
    - 37.6% of taxpayers, those earning over $37k to $80k, contributed 32.8% of total tax revenue
- Australia's corporate tax represented 5.2% of GDP in 2012 - the OECD average was 2.9%

    - There are 8000,000 companies in Australia. 2,000 companies paid two thirds of the total company tax take with the mining and financial services sector the largest contributors
- State and Territory Governments collect around 15% of tax revenue through payroll and property taxes such as stamp duty.
    - 31% of State and Territory Government revenue is from taxes they administer. 45% is from the Federal Government
- Local Government collects around 3% of tax revenue (rates)
- Australia's tax burden is higher than our regional trading partners at approx. 27.3% of GDP.
- Australia's GST rate is the 4th lowest value added tax rate in the OECD.
- Medicare levy no longer hypothecated. It raised $10.3bn in 2013/2014 but Medicare cost $64 bn.
- Fringe Benefits Tax contributes around $4.3 bn. Only Australia and New Zealand levy FBT with other countries taxing benefits in the hands of employees with fewer valuation rules, concessions and exemptions.
- Tax from savings:
    - Superannuation raised $6.1 bn to the total tax base in 2013/2014 (1.8%)
    - CGT raised $3 bn
    - Interest on dividends contributed approx. $7bn
- Indirect taxes raised $27 bn, contributing 13% of the total tax take in 2013/2014. $18.3 bn was from fuel tax, $8.5 bn from tobacco, and $5.9 bn from alcohol.
- Investment properties are the third most popular saving vehicle after the family home and superannuation.
- Not for profits account for 3.8% of GDP and generate revenue of $107 bn and hold assets of $176 bn.
    - Government funding contributes around 38% of NFP revenue with 5% from donations, and income from donated goods and services close to half of their revenue

Interestingly, the paper is at pains to remove the focus from who gets what and who pays what in percentage terms. The paper states several times "Tax reform is about how revenue is raised, not just about how much." This continued focus of who pays what and is it fair has scuttled many attempts at reform in the past.

While the tax paper covers numerous areas of the tax system, many of the elements are statements or queries about whether the current system is efficient. Interestingly, the issue of the distinction between revenue and capital is raised for the complexity of the distinction and the interaction with non-resident investors (page 96).

Small business also gets a special mention in Chapter 6. In particular, the trend toward small business taking a company or trust structure. The report states "The different treatment of different legal entities, and the ability of a small business owner to navigate this complexity, can have a significant effect on a business' tax liability, and can lead to different tax outcomes for economically similar activities." And "From a first principles perspective, similar economic activities should be taxed similarly”. It’s these differences in economic outcomes that may trigger a review of trust structures and how they are taxed.

Positioning the tax paper as a national discussion and encouraging Australians to “join the discussion” hints at the broader issues the Government has in getting any reform through the current Parliament. Fundamental reform is almost impossible in the current Parliament unless there is overwhelming public support for change and the minor parties have no political capital in blocking the reforms.

Comments on the discussion paper can be made up until 1 June 2015. The Government intends to release its response to the consultation process in a ‘green paper’ due mid 2015.

More information

- Tax Discussion paper
- Media Release: Time to ‘re:think our tax system