

CHAPTER 8 DIRECTIONS FOR REFORM

Much of the recent commentary and analysis about reform of the Australian tax system has focused selectively on ‘priority’ areas for reform. The Henry Review addressed the overall Australian tax system including Commonwealth, State and local taxes and sought to take into account interactions between different taxes and in the tax and transfer system. It then identified a broad set of taxation arrangements to position Australia for dealing with the social, economic and environmental challenges for the next forty years.

Overall, Australia raises less revenue through taxation than many comparable countries, including Canada and New Zealand, as a percentage of GDP. There is scope, and likely the budgetary need, to increase Australia’s tax take in the future to deliver the goods, services and fair support for those in need that the Australian people expect from government.

The Asprey Review observed that it will always be necessary for governments to utilise a variety of taxes to meet revenue needs. Multiple sources of tax revenue ‘have to be seen to be supplementing each other and their interactions—and sometimes their conflicts—have to be reckoned with’ (Asprey et al 1975, 11). The system-wide approach taken in the Henry Review remains an important guide to tax reform. Taxes should be collected across all tax bases of income, consumption and wealth, and all factors of production including labour, capital and land; however, the global context in which Australia operates and the increasing mobility of labour and capital must be considered in tax system design.

The challenges identified by the Henry Review remain and are discussed in Chapter 2 of this report. The global digital economy, changes in work and consumption patterns, and lower productivity have become more acute in the past five years. The context for tax reform has also become more challenging, as governments do not have fiscal surpluses to return to taxpayers in compensation for tax system changes.

The Henry Review identified key policy and research directions but did not present a package or detailed prescriptions for reform. Its overall approach of broadening the personal income tax base and the consumption tax base, potentially lowering rates, and shifting towards a broad-based land tax remain of crucial relevance.

The goal of increasing workforce participation has become central. Consequently, the way in which the tax and transfer system affects incentives to join or increase engagement with the paid workforce is a critical issue for any future tax reform. The Henry Review tended towards a flatter structure with a moderately high top rate but did not express a concluded view on the ideal progressivity of tax rates. More flexible, temporary and short-term connections of employees to formal employment arrangements cause difficulties for our PAYG system, which depends on withholding from employers and other intermediaries. Complex and differential tax treatment of work, savings and assets generate incoherence and revenue leakage.

The Henry Review raised the issue of how to simplify and manage the many complex boundaries and interactions in the tax system. One of the most important goals in considering reform of the personal income tax is a review of the taxation of savings and investment. Removing distortions in savings decisions and taxing those who have assets more comprehensively will improve efficiency, fairness and resilience in the tax system. The tax treatment of retirement savings and the interaction between this and the age pension requires reform for revenue sustainability and fairness reasons.

In company tax, key tax research and policy areas are level, rate and base of company taxation and how corporate-shareholder taxation should operate, including the imputation system. The case for providing a lower company tax rate must be examined and efficiency gains weighed with other functions of the company tax. The tax treatment of multinational companies whether Australian or foreign owned will be an ongoing issue. Given rapidly changing global business practices and continuing financial innovation, the costs and benefits of utilising complex integrity measures to shore up the company tax system needs further consideration.

The tax treatment of small business including whether there is a case for lower rates or a different tax system for small business relative to large business should be considered. This is important because of high compliance and administration costs generated by business tax structuring combining trusts and private companies, and the close interaction between the personal income tax and company tax system for privately owned enterprises.

The GST is Australia's broad-based consumption tax. However, less than half of the potential tax base is taxed and Australia's GST has a standard rate that is substantially lower than the rate in many comparable countries. To strengthen the system as a whole and to fund the goods and services that the public wishes government to deliver, we need to examine how to improve our taxation of consumption whether by broadening the base or increasing the rate.

State taxes, especially property taxes and payroll taxes, warrant significant reform but this is challenging for political, fairness and revenue reasons. The largest economic benefit is likely to be gained by eliminating duties on real property, increasing broad-based land tax. As illustrated by the ACT reform discussed in Chapter 6, this may require a long transition and may cost revenue in the short term. There is potential for more efficient national tax bases to be used for benefit of the States, especially payroll tax; such a reform would potentially need to be done in conjunction with a broader reform of the federation.

This report has aimed to discuss the key directions for tax reform that arise out of the Henry Review, which remain of key relevance in today's tax reform debate. Significant research and policy analysis is needed on future options for tax reform. Tax reform has potential to enhance Australian economic prosperity and support income-enhancing investment, innovation and productivity growth in Australia. It can also contribute to improving fairness and resilience of the system for the future.