LEADING EDGE REFORM

Introducing forthcoming **book**

BETTER THAN HENRY

2012 EDITION

NOT **JUST** TAX
a blueprint for real reform

Revenue Review Foundation was established in 2006 to act as a catalyst for change to the Taxation System and subsequently made submissions to the Henry Review. I established the Foundation in the firm belief that the necessary revenues can be raised without undue interference or interruption to normal personal and business activities. Analysis suggests that many of our taxes are retrograde; if lowered they would raise more revenue due to the nature of personal and business interaction.

The "first born child" of the Henry Review was the mining tax. Currently we are witnessing the carbon tax. ***Both these taxes indicate that there is no proper architecture or guiding principles in the formation of tax policy despite the Review.***

I believe that discussion and subsequent public and parliamentary debate should be directed to the following issues:

- The effect of high marginal personal rates both in terms of avoidance and net revenues.
- The alteration of the tax points within the superannuation system to better balance both revenue and retiree outcomes as well as significantly enhance national savings.
- The replacement of Capital Gains Tax with a Small Capital Exit Tax.
- The systematic withdrawal of Social Security benefits to enhance incentive.
- Indexation of all thresholds and Social Security benefits.
- Once only tax on interest and dividends and the elimination of dividend franking.
- More appropriate spending of fuel tax revenue (earmarking).
- A lower corporate rate of tax on export earned revenue.
- Company tax concessions, allowances, rebates etc. to be managed outside of the tax act by the appropriate Government Minister and department.
- Examination of a 'turnover tax' as an alternative for some small business and trade sectors in order to reduce non-compliance.

REVENUE
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SYSTEMATIC WITHDRAWAL

People re-entering the workforce are the most highly "taxed" within our current system. It is not uncommon for people climbing back into productive work to find that two thirds of their earnings are being clawed back by taxation and withdrawal. Withdrawal should be uniform and fair. My proposal is that the total of tax and withdrawal should not exceed 40 cents in every dollar earned until earnings equal the gross benefit. Thereafter 50 cents in the dollar earned should be withdrawn until earnings equal twice the gross benefit.

Sudden removal of family benefits regardless of the number of dependants is in most cases inequitable and unfair. I propose that the withdrawal of benefits be uniform and leave the breadwinner with 40 cents in each dollar after tax and withdrawal. Under this proposal a breadwinner with 8 children could still be in receipt of some benefit up to a salary of around $250,000 p.a. depending of course upon the size of future benefits and the commencement of the point of decrease.

CAPITAL GAINS TAX

Capital Gains Tax should be replaced with a small Capital Exit Tax.

My research dates back to 2007, well before the GFC altered regular assumptions concerning CGT revenue. A rate of between 0.5–0.7% would have achieved the then current revenues. The difficulties and inequities of the current system should be eliminated.

BEYOND INDEXATION

If the tax system were to avoid specific numeric values to thresholds, entitlements, spouse benefits, child benefits, pension benefits and unemployment benefits; but that these benefits and thresholds were to be determined as a percentage of average weekly earnings, then indexation would be intrinsic and self adjusting. A modern tax system should avoid a situation were benefits and entitlements are automatically obsolete on the 1st July each year and that whilst some of the benefits are regularly readjusted for inflation, others can become left behind for decades. e.g. Our tax-free threshold would otherwise be between $15,000 and $17,000 and the changeover between the 15% and 30% rates would be around average weekly earnings which would significantly reduce, and in some cases eliminate, the reliance on family benefits and low income tax offsets within the average income range.

Personal income tax rates for residents, 2008-09 income year

Taxable Income	Tax Payable
$0-$6,000	0% or $0
$6,001-$34,000	Nil plus 15 cents for each $1 over $6,000
$34,001-$80,000	$4,200 plus 30 cents for each $1 over $34,000
$80,001-$180,000	$18,000 plus 40 cents for each $1 over $80,000
$180,001 or more	$58,000 plus 45 cents for each $1 over $180,000

Resident individuals' net tax payable, by taxable income, 2008-09 income year

Figures extracted from Taxation Statistics 2008-09

	Taxpayers		Net tax payable	
Taxable income	No.	%	$m	%
$0-$6,000	6,044	0.1	6	<0.1
$6,001-$34,000	2,859,699	31.3	4,864	4.2
$34,001-$80,000	4,868,824	53.2	47,456	41.1
$80,001-$180,000	1,227,804	13.4	36,699	31.8*
$180,001 or more	184,167	2.0	26,372	22.9**
Total	9,146,538	100.0	115,398	100.0

* Of this $36.699b, $14.599b was raised within the 40% bracket; therefore if the 40% rate was exchanged for a 30% rate, then $10.949b would have been received which was only $3.65b less. Note: only 10% of the monies were raised within this tax bracket and not 25% as many people assume and that these taxpayers constitute 13.4% of total but contribute 31.8% to revenue.

** The total tax paid within the 45% top marginal rate was $26.372b. If the 40% and 45% rates were exchanged for a 30% rate, the $19.3b would have been received which was only $7.072b less which is a reduction of 26.8%. These taxpayers constitute only 2% of total but contribute 22.9% to revenue.

MARGINAL TAX RATES *(Retrograde Taxation)**

Real taxation reform is ransomed by the politics of envy. The idea of so-called progressive taxation sounds good in theory to those who are intellectually predisposed to socialist thought processes. The concept also has favour with lower income groups who falsely believe that higher rates, applied to high salary earners, bring about lower taxes for themselves. The Communist Manifesto called for "a heavy progressive or graduated income tax", yet Russia and many of the former Soviet States have abandoned the concept of progressive taxation.

Our total State and Commonwealth revenue approaches about $420b per annum, and the $11b that is obtained through the application of the 40% (recently 38% and now 37%) and 45% rates is only around 2.5% of total taxation revenue. ***However, this is the cause of all manner of complications within the taxation system itself,*** stifles initiative, as well as driving people into offshore taxation arrangements. I am of the opinion that the *$3.650b and the **$7.072b raised in these brackets causes a loss to revenue of between two to three times as much by way of evasion and avoidance (arbitrage).

* Taxes become retrograde when they are applied in such a way as to reduce activity/turnover to such a point where a lower rate can achieve more revenue by increasing activity/turnover and reducing arbitrage.

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THE AGING POPULATION

The clarion call for an increase in the Superannuation Guarantee to 12% and thereafter to 15% is misguided.

Many commentators miss the real point when addressing the issue of the aging population. They digress into subjects like immigration, falsely thinking that a larger future workforce of taxpayers will solve the pension and healthcare costs of the elderly over the coming decades. The fact is that financially independent elderly people are not a burden to the general taxpayer, but in fact the capital that they have accumulated throughout their working lives is the basis for the employment of the current workforce.

A blue collar worker earning the average wage whose only superannuation is derived through the superannuation guarantee, which commenced at 3% in 1992 and increased over the years to 9%, will have accumulated about $129,000. Along with the advent of the Superannuation Guarantee, two taxation strands were introduced. Fund earnings were taxed at 15% and contributions were also taxed at 15%. The 15% tax on contributions was probably introduced with the good intention of reducing the windfall to taxpayers in the higher tax brackets; however, it also neutralised the benefits of superannuation in comparison to other savings for the medium and lower income earners. The removal of this tax alone would increase potential accumulation by 17.65%. Combined with the 15% tax on earnings, these taxes seriously retard the growth potential within our existing superannuation arrangements by more than a third. Compounding interest tables are very sensitive to any reduction, particularly over an extended period such as a person's working life. Had these taxes not existed, then his cash accumulation would be around $171,000. This extra $42,000 would reduce his Social Security dependency, as well as increase his net wealth, as well as increase his net disposable income. Also, his fund earnings would be around $4,500 more; reducing his dependency upon the aged pension by around $2,250, giving him a net disposable income approximately $45 a week greater. The amount of revenue raised under the current system on this retiree's account would be around $1,450 per year which is a far cry from the $2,250 that his pension dependency would otherwise have been reduced by. Robin Hood robbed the rich to give to the poor; this system robs the rich and the poor as well as the country.

The Superannuation Guarantee is, from a political perspective proclaimed to be the saviour of society. Overlooked is the fact the Superannuation industry was alive and well long before the Keating government. The Fisher/Hughes Government of 1915 introduced tax deductibility for companies providing retirement benefits for their employees. In recent decades, Governments of both political persuasions have given scant regard to the effects that taxation has on the cash accumulations for ordinary Australian retirees as well as overlooking the added burden that these taxes place on the aged pension system. White collar and professional workers typically had superannuation for generations, usually at a level of around 10% of salary. Unless stated otherwise, my assumptions are based on a contribution of 10% (and not 9%).

The government has become accustomed to receiving about $27b in revenue from our $1.4 trillion superannuation industry. I am not suggesting that a cash strapped government should necessarily forgo any of the revenues that it is accustomed to receiving. However, I believe the same or better revenues can be obtained *by not applying any tax at all up until a particular point*; and thereafter taxing the fund member's accruals at a greater rate. The "loss" of revenue is insignificant in terms of the benefits that would be derived by accelerating the growth of each and every worker's superannuation by 17.65%. As things now stand, a member's net contributions of 82.35% fails to break even until the passing of up to 4½ years. *The shifting of the tax points will benefit all retirees, whether they are low, medium or high income earners.* It will also benefit the country's investment balances and reduce low income earners partial dependence on the Social Security safety net. Theoretically, for every billion in revenue obtained from fund members, whose personal top marginal rate is in the 45% bracket, under the current arrangements there is a $2b net loss to revenue in the non-superannuation investment sector.

These examples assume an earnings rate of 8.2% net of tax or 7% after 15% tax.

An increase of only 1% to 10% will achieve similar benefits when untaxed to the ultimate Keating objective of 15% taxed under the existing arrangements. Moreover the benefits will start to accrue immediately rather than take several years to come into play.

Taking the example of a baby boomer born in 1950, completing university in 1971 and commencing work in 1972 at a salary equivalent to average weekly earnings with an annual average increase of 1.5%. His earnings would now be about twice AWE. The estimated revenue received from this fund member will be $7,373 (being $1,821 contribution tax and $5,552 tax on earnings). Revenue Review's proposal is that there should be no contributions tax and there should be no tax on earnings until these are equal to 80% of AWE. Also proposed is that the tax applied beyond this point should be 30% (and not 15%). At this point, the taxpayer for the first time would be paying tax of only $83 in 2012. Prima facie, it looks like revenue has been depleted by around $7,300. However it should be noted that the members' asset value is $736,741 instead of $495,120, an increase of $241,621 (67.2% greater). I will leave this up to the reader and the Government economists to analyse the value of the extra $7,300 in revenue versus the $240,000 gain in national savings.

Moving forward to 2020 (at age 70), this retiree will contribute $6,560 in taxes compared with $6,651 had the current arrangements been in place since the 1960's. However the asset value will be $1,045,424 under the Revenue Review proposal instead of $693,935 (66.4% greater).

Now let's get back to our average wage earner and assume that he had the good fortune to work for either a bank, insurance company or pastoral company etc where he would have been superannuated from age 17 at 10% of salary. The estimated revenue received from this fund member, who is still not fully independent from Social Security supplementation, will be $5,631 (being $1,042 contribution tax and $4,589 tax on earnings). Under Revenue Review's proposal this taxpayers would pay no tax in 2012. Prima facie, it looks as if revenue has been depleted by $5,631. However it should be noted that the members' asset value is $633,429 instead of $409,188, an increase of $224,241 (64.6% greater). Again, I will leave this up to the reader and the Government economists to analyse the value of the extra $5,631 in revenue versus the $224,241 gain in national savings.

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TAXATION REVENUE	2011-12 $m	AVG 2011-15 $m
Individuals and other withholding taxation	150,890	172,888
Company tax, FBT, Superannuation Tax, MRRT *(the total of personal and company tax is $225,490)*	89,740	101,310
Total income taxation revenue	240,630	274,198
Sales taxes	51,900	56,955
Excise duty revenue *(Petrol and diesel taxes total $13,480)*	26,330	27,570
Customs duty revenue	7,520	8,270
Other indirect taxation revenue	2,867	3,045
Indirect taxation revenue	88,617	95,840
Total taxation revenue	329,247	370,037
Non-taxation revenue	20,714	20,986
Total Commonwealth Revenue	349,961	391,023
State & Territory Revenue	63,973	69,868
Total Commonwealth State & Territory	413,934	460,891

EXPENSES	2011-12 $m	AVG 2011-15 $m
General public services	20,887	21,964
Defence	21,277	21,664
Public order and safety	3,969	3,977
Education *($15,037 to States)*	29,870	30,859
Health *($15,396 to States)*	59,858	63,472
Social Security and welfare *(aged, unemployed & sickness, disability $76,901, family benefits $32,015)*	121,907	130,534
Housing and community amenities	4,647	4,737
Recreation and culture	3,397	3,357
Fuel and energy	6,302	6,504
Agriculture, forestry and fishing	3,444	2,650
Mining, manufacturing and construction	2,014	1,990
Transport and communication	6,919	6,763
Other economic affairs	9,385	8,605
Other purposes	71,940	82,789
Total expenses	365,817	389,863

Figures derived from the 2011-12 Budget Papers. (E&OE)

It is necessary for those who engage in taxation reform to fully understand the effect of their proposals in relation to existing settings. Therefore for quick reference I have included the above tables.

It is also important that people understand that the first 33 percentile of taxpayers earn less than 15% of total earnings and contribute less than 5% of total taxation. The top 5% of taxpayers contribute one third of total taxation. At the 67th percentile less than 42% of total earnings is reached and the contribution to revenue is less than 25%. At the 75th percentile taxpayers reach 50% of all earnings and contribute 32.5% of all income tax, leaving the remaining 25% of people to contribute 67.5%. These figures are derived from Taxation Statistics 2008-09, Table: 9.

FISCAL FEDERALISM

Health and Education in particular

Commonwealth assistance to States is of such a magnitude that it dwarfs the monies that the States themselves raise. Consequently, it is easy to conclude that adjustments to the Commonwealth/State arrangements should be made in order to reduce the duplication of State and Commonwealth bureaucracies. Departments such as Defence, Trade, Foreign Affairs and Immigration have a national focus and are different from departments such as Health, Education and Primary Industries which could easily be micromanaged by each State under a merged State and Commonwealth public service principally funded by the Commonwealth with the monies that the Commonwealth already provides to the States. This “Federal Public Service” would act under the direction of the State Governments at the local level. Each State would manage the activities of the “Federal” department within its boundaries and would send an equal number of staff to the Commonwealth department or agency in Canberra. Those personnel would operate from standard or uniform procedures, sharing the information in terms of service delivery. It would be easier to identify inefficiencies and wastages and to solve problems quicker as well as formulating better policy. This could be accomplished without compromising States’ rights.

Payroll Tax

The revenues gained in payroll tax should be gained in another manner even though they are state revenues. The system should be uniform between states and uniform throughout the entire workforce. The Commonwealth could raise these monies and distribute on a per capita basis to each state.

(Continued on www.revenuereview.com.au)