State and Commonwealth Government budgets face considerable pressures. Revenues are being hit by slower economic growth and tax concessions introduced in better economic times. At the same time, spending in major areas such as health and welfare, particularly the Age Pension, are growing faster than GDP. And governments will need to find money to fund new policy initiatives such as the NDIS.

Budget repair efforts to date have focussed on reducing spending. But governments will not be able to restore budgets to balance without also boosting revenues.

John Daley, Grattan Institute CEO hosted an expert panel to discuss the most attractive options for repairing Commonwealth and State revenues.

JOHN DALEY: So it’s my pleasure tonight to introduce my fellow panellists here tonight.

Starting on the far right we have Paul Abbey. He is a partner in the International Tax & Transactions Services group of Price Waterhouse Coopers (PwC), he’s got over 20 years of experience advising local and international clients on tax issues, and most recently he’s been leading the work that PwC have been doing talking about tax reform in Australia and a series of publications labelled Protecting Our Prosperity, which have been really quite significant contributions to the tax debate in Australia.

Then next to me I have Miranda Stewart. She has been until relatively recently a resident of Melbourne where she was at the University of Melbourne in the Law School, but was recently appointed as the inaugural director of the Tax & Transfer Policy Institute at the Crawford School, which I think is about the one genuine concrete outcome of the tax summit of a couple of years ago. So this is an institute that’s been set up at the ANU to look at tax and transfer policy in Australia and has already established a record of being very much engaged in the public debate about our tax system.

And then finally on my left here is Danielle Wood. She is a Fellow at the Grattan Institute. She’s been working with me and was my co-author for the Wealth for Generations report and is currently working on a piece of work that we’re doing on tax reform. Previous to Grattan she was the principal economist at the ACCC, a senior consultant at NERA Economic Consulting, and was a senior researcher at the Productivity Commission.

So we have a distinguished panel of people who know a lot about tax and we’re looking forward, all of us, to talking about our favourite subject. Now, that may seem a little odd because many people think
that tax is trivial, tedious and technical and, indeed, I will confess that that was my attitude when I started at Grattan Institute was that tax was to be avoided like the plague because it was trivial, tedious and technical. But what I have learnt over six years at Grattan Institute is that, firstly, tax is not trivial, indeed, if you’re looking for something that makes a big difference to economic growth, tax is usually a pretty good place to start and if you’re looking at dealing with budgetary issues, and they are always a material concern for governments, then inherently tax is about one half of the things that you have to worry about because if you’re trying to do anything on budgets you either have to increase or change taxes or you change spending. There are no other material options in budgets.

So they’re not trivial and in terms of being tedious, for those of us who’ve been involved in the tax debate have discovered actually most of the issues are completely fascinating and go to the core of what people care about and therefore are anything but tedious. And in terms of technical, that’s slightly true, although I would suggest in fact no more technical than any other area that we have to deal with in public policy and, indeed, most of the concepts are things that most people can wrap their minds around with just a little bit of interest. And if only more newspapers picked up these issues people would discover that tax is not trivial or tedious either.

So we’ve had a lot of tax stories this year. We’ve had the government issue its Tax Discussion Paper labelled Rethink or perhaps that should be “Rethunk”. We’ve had everyone here publish or be about to publish one way or another stuff about tax. We’ve had, as I said, the PwC Protecting Prosperity papers. Miranda’s published her stocktake of the tax system. Grattan Institute has published Budget Pressures and also the previous work Balancing Budgets which had a lot of discussion about tax reform in it. There’s been lots of other people putting their oar into the debate: ACOS has published Fuel in the Fire; the Centre for Policy Development has somewhat controversially recently published Budgeting Smarter Not Harder; the Centre for Independent Studies has published Right or Rort: Dissecting Australia’s Tax Concessions; the Australia Institute has had any number of things out there, particularly on superannuation tax concessions; and the list goes on. So it’s certainly in the news.

I guess then the key first question Miranda is, do we really need to talk about tax?

MIRANDA STEWART: Thanks John, and thanks everybody for coming out on this windy evening. I think we’re talking to the converted here actually. I got sick of tax last week and I went to see As You Like It instead. I think tax is like plumbing, it’s something that really it’s better if we don’t see its structure but we see it when it smells bad or it affects us personally, and both things seem to be happening currently. So yes, I think we need to talk about tax.

JOHN DALEY: So we need to talk about tax and then of course the first question is well, what really matters in the tax debate? For those of you who have digested every page of Rethink you will have noted that it’s got something like 66 different issues and I’m expecting all of you personally to make submissions on all 66 of those issues. Realistically of course for mere mortals like us on the stage, that’s going to be a bit difficult and therefore we’re going to need to prioritise, choose out of all of this debate what do we have a go at?

So Paul, when you’re thinking about a tax system and which of the 66 issues you go after, I’m guessing that top of your list is not the one about should we have a flow-through entity, like an...
S corporation, to make it easier for small business to spread income amongst family members - I'm not kidding, that is one of the 66 issues. How do you decide out of all of this? What matters most?

PAUL ABBEY: I'll firstly admit that the good thing about that book is that it's got chapters and the chapter headed "small business" I just flicked to the next one, I admit it entirely. There are a couple of things I think are really going to matter in the tax debate.

The first thing is I think our big challenge is to actually agree in regard to our tax system some principles and some consistency, and I'll explain that to you by way of a story because a story's always easier to remember. Whenever the government changes in New Zealand or, in fact, when you have a new government in New Zealand the New Zealand Treasury has an obligation to publish a paper for the incoming Treasurer which describes the tax system, both how the New Zealand Tax system works and then its context within the world and it has a lot of comparison to the OECD and explains how the New Zealand system works.

And in New Zealand of course they recently had an election and the Treasurer before and after the election is the same person, but he still got the paper. And the paper in the first paragraph seeks to describe immediately to the new and old Treasurer what the New Zealand tax system is and it explicitly states to him we have a BBLR system, which means we have a broad base low rate system. And the important thing about that story is that New Zealand has a simple coherent principle they can use to describe their whole tax system. If you tried to write that paper in Australia you couldn't, firstly, because of the nature of our federation we have both federal and state systems and if you sought to them describe the principles which sat behind those systems you couldn't have a coherent principle which sought to capture what all those systems did.

So the first thing I would say about this whole tax reform thing is that we need to agree our principles. We need to decide do we want a BBLR system? We need to agree between us what the burdens of taxes are and we need to make that an accepted fact between us. And, for the audience, Treasury recently released a discussion paper, a working paper they call it, which talks about the economic burden of all the different taxes and we need to accept that between all the participants in the tax debate and between the political participants in that debate, because that's a foundation principle on how to proceed.

Another principle we need to consider and work out what we're going to do in regard to is that we structure a lot of our tax system to deliver concessions by way of exemptions. But when you deliver concessions by way of exemptions in a tax system what you tend to do is give a whole pile of concession to the people who need it least and to the people who actually need it you tend to give them a small portion of concession, and the fresh food exemption in GST is a classic example of that kind of poor delivery of benefit.

So there are a whole series of issues where we need to decide what's our fundamental principle as to how we're going to proceed and almost not even worry about changing the system, just get the basic platform for what we want to achieve correct. And then when you get crunchy, I would say you get crunchy both in a long term and a short term sense. In a long term sense, unfortunately it all ultimately comes back to GST and you can try and pretend it doesn't and there are lots of people -

JOHN DALEY: Paul, we'll go in a moment to getting crunchy in particular.
PAUL ABBEY: Let me finish on the short term crunchy, is state tax. The short term crunchy and the easiest thing to do something about first, because people have started to do it, is payroll tax, stamp duty and land tax.

JOHN DALEY: Thank you. We’ll be going to the crunchy bits in just a moment and I can assure you we’re going to be spending most of our time tonight talking about specific tax reforms, state tax reform, land tax reform, GST, all of that kind of thing. But before we go on to that I just want to tease out a little bit more about when we’re having this tax debate what are the kinds of things we ought to be worried about?

So Miranda – and this was one of the questions which was submitted in advance by the audience – when you’re designing a tax system from scratch what are the principles? What are you trying to make it look like? Paul said have some basic principles that everyone understands; he’s talked about the way you want it to be broad. What else are you looking for?

MIRANDA STEWART: Probably this audience does now, so those classic principles of tax policy design have become clichéd in the tax world, so efficiency, equity, simplicity as a triumvirate of principles. I think all those are important but I’d translate those a little bit.

When we talk about efficiency we talk about behavioural incentives in the market. Most people don’t think that our governmental tax system is inextricably intertwined with the market, but of course it is. Every market behaviour has some interaction, I suppose, with some government or taxing behaviour and so we do need to be aware of incentives in the market, of the economic cost of some taxes, as Paul said. It’s crucial of course that taxes are fair, both as a matter of principle but also for compliance and trust purposes.

The language I’ve been using with the Tax & Transfer Policy Institute, rather than saying “simplicity”, which I think doesn’t really convey the depth of the issues, we’ve used the word “resilience”. And what we mean by that is both trying to minimise the administrative and compliance cost of tax systems, but also trying to make the system robust against shocks and against planning or marginal behaviour, so wasteful behaviour. And so trying to build a system which is more resilient to those kinds of planning actions, whether they’re multinationals or individuals, and that’s something I would always want to bear in mind with any tax reform.

JOHN DALEY: Thank you. Danielle, so far we’ve glided over one of the points of tax which is that it’s to collect money for government. Clearly it has a major budgetary function. What do you see as the imperatives on that front at the moment?

DANIELLE WOOD: I think thinking more short to medium term, rather than Paul’s grand long term vision, the imperative is that we do need to increase revenues. We’re in a position now where, at least at the Commonwealth level, the government has been running a structural deficit in excess of 2% of GDP for the past five years. No doubt at the next Budget in a couple of weeks we’re going to see forecasts for at least another four years of deficits. That deficit has really come about both on the spending and the revenue side. Spending is now about 1% of GDP higher than it was in the years prior to the GFC, whereas revenues are about 2% of GDP lower.
What we've seen the current government try and do is try and close that gap just looking at spending measures. That's not going to get you there. You're going to have to do something on the revenue side both from an economic perspective, but also from a political perspective.

JOHN DALEY: Danielle, they've talked about the spending measures, but when they project this drift back to surplus over the next four years is it really about the spending side?

DANIELLE WOOD: The spending measures make some contribution, lessened somewhat by the fact that a lot of them have been stalled in the Senate, as we know. But actually the major contribution to budget repair, at least in the forecast, is from bracket creep. So the fact that inflation is pushing people into higher tax brackets, the government's forecasting that that will significantly increase their revenue take. To us those numbers look on the high side when you look at actual nominal wages growth. It's certainly hard to reconcile the type of revenue hit that the government thinks their getting with what they're probably actually likely to collect.

PAUL ABBEY: Can I just make one comment about that? As you know, we, as an organisation, do a lot of economic modelling and we run an economic modelling structure quite similar to what the Federal Treasury runs. And one of the outcomes of us once we modelled last year's Federal budget is if you take last year's Federal Budget and you assume that everything proposed by the Federal Government will be enacted or adopted as proposed, the Federal Budget goes back into surplus over the long term. And when I say the long term – and all modelling is assumption, but we modelled the Federal Budget would sit in surplus of between 0.5% to about 1% of GDP over a 35 year period and the Commonwealth would actually go into a circumstance of being a net lender rather than a net borrower.

The biggest moving item on that was transferring the burden of health and education to the states of the $80bn which if you assume that was going to continue outside to the four or five years they've talked about and that would extend for the full 35 years, that's essentially 1% of GDP per annum. So that was kind of the swing factor. If you didn't have that they would sit at a deficit of about 0.5% of GDP, but if you compare that to their current deficit, which is about 3%+, it would have been a substantial improvement.

JOHN DALEY: So if we take those kind of principles we talked about, you want clear principles in general, you want efficiency, you want fairness, you want resilience, you want something that's hopefully going to make a contribution to the budget, and if you look at the gap between those things and where we are now, what are your nominations for the three specific tax areas that you would go after first? Danielle, what would you go after first?

DANIELLE WOOD: I think GST would be on the list, superannuation tax concessions, both contributions concessions and the earnings concessions, and probably something on capital gains tax.

JOHN DALEY: We'll talk in a moment about whether those are the right answers but before we get to that, what are your three nominations?
MIRANDA STEWART: This is a really hard question and John put us on the spot with this. I should have an answer, I realise that. Before I answer, I did want to say something about short, medium and long term.

So sure, we have a fiscal deficit, we have an ongoing deficit, we have what is described as a structural deficit by the Parliamentary Budget Office. However, if we were going to do tax reform there are important questions about whether it’s revenue raising or revenue neutral. For political reasons, most tax reforms have been revenue neutral or even in some ways revenue negative in the sense that the compensation returned for the reform actually, at least initially, exceeds the revenue raised, and there’s not necessarily anything wrong with that and I would potentially support reform that was revenue neutral, even if that left us potentially in a deficit position, if it’s going to reset our system in a way that would support prosperity or be fairer. So I just want to make that comment.

In terms of revenue raising changes, I do think the GST is a pretty obvious revenue raising measure, but it requires substantial compensation, we can come back to that; and personal tax of certain kinds of savings investment, I’m not sure whether capital gains tax is going to raise us a lot of revenue but there are bits of revenue in personal tax on saving; and potentially some property tax or land tax reform.

JOHN DALEY: Paul, anything that you want to add to those nominations?

PAUL ABBEY: So I’d do it slightly differently. The first thing I’d do is I’d do something in tax expenditures, maybe not substantial from a revenue perspective, but you’d have some effigy in the tax expenditures you wanted to burn because that will essentially buy off substantial portions of the welfare lobby. I did say that, okay?

MIRANDA STEWART: They might be in the room, you never know.

PAUL ABBEY: I know I said that, but in a nice way I think that’s important to show equity, because you’re not going to have reform until you demonstrate equity in the system.

So the first thing you have to do is attack the tax expenditures to demonstrate equity and so that you buy essentially political capital with the broader community to do some other things. And then once you’ve done that you then move on to I think the efficiency moves, and the efficiency moves are all in the state tax base which is changing the payroll tax system from what it is now to a broad base low rate system, so eliminating the thresholds and exemptions and reducing the rate substantially, which small business won’t like but small business bears a lot of the excess burden and economic cost of the system right now, they just don’t perceive it. And payroll tax is ultimately passed on by business either to the consumer or the wage earner, so in the long term it’s not really a burden on them either.

The other thing you’d do in the state tax area is you would do the stamp duty/land tax trade-off, like the ACT has done and like South Australia is talking about doing, and there’s a snowball of momentum growing there, you can see that eventually we’ll get to an inflection point and all the states will just fall into line. That might take a few years, but I think that will happen. So once you’ve done the efficiency moves, then you do the ugly thing and the ugly thing is that you have to do GST change and, at the same time, you have to do income tax change, both on the personal side and on the
corporate side. And the trade-off there is ugly, but if you can do all the other things first then at least when you get to that point it’s a little bit more acceptable.

JOHN DALEY: Alright. So let's start where we finished, I'm keen to talk about state taxes because I’d suggest they’re sort of the forgotten children of the tax debate. We all tend to go straight to income tax and corporate tax and GST and we gloss over property taxes in particularly which, of course, offends all of the Henry George types, for good reason I might add.

Miranda, let’s talk about this and, indeed, one of the questions that came in advance was about the stamp duty for property tax swap. So the idea is that we essentially reduce stamp duties and we increase property taxes in some form, potentially we can even increase property taxes more than we give up in stamp duties. How much does that matter?

MIRANDA STEWART: I think from an economic prosperity perspective, if you like, I think it matters a lot, that and the other thing we tend to forget, because it's less revenue, is state taxes on insurance. Which clearly does seem from an incentive perspective crazy if we think that people should take out insurance we levy a lot of tax on that, so we have less insurance in the system than perhaps we should. So I guess the question here is move it away from a transaction tax to a tax on the benefit of holding that asset or the services of having that asset, being the real estate, the commercial property or the home.

So at the moment, of course, land tax exempts the main residents, you would all know that, that's basically 50% of the base, that's really a very large exemption. Council rates of course, we do pay council rates, they probably could go up. Now people scream at that of course and there are potentially cash flow issues, but in the longer term the idea that we tax you on your mobility decision, your decision that you need to move across town or interstate or you need to transition the size of your property up or down, but we don’t tax you on the actual benefit of having your own home, which only the top 70% of the population have, the other 30% don’t get to own their own home, that seems crazy from a fairness perspective as well.

JOHN DALEY: So Danielle, you've done some work on this. How large is that property tax opportunity? What would it potentially look like?

DANIELLE WOOD: It’s potentially very large if you take the route that Miranda's talking about which is doing it on the broadest possible base, which would be the council rates base which includes owner-occupied housing. So just to give you some idea of magnitude, if you were to put a low rate, so about 0.2% of value, levied across that base you would raise about $15bn across Australia. So if each state and territory government applied that low rate broad base principle they could raise about $15bn. So it’s pretty sizeable in the context of state and territory government projects.

JOHN DALEY: But let's put that in context, if I’ve got a $500,000 house I’d be paying about $1,000 worth of tax, is that right?

PAUL ABBEY: But remember that in that assumption, when you say the $500,000 house you’re talking about the improved value of the property, and one of the issues is do you impose the land tax on the unimproved value of the land or on the improved value of the land? We’ve done the same numbers and the numbers are basically right, that you could entirely replace stamp duty with a
national land tax where you were saying to the public that the rate of the land tax was less than 1%, in fact was less than 0.5%. So you’ve got some scope there in terms of a political equation to make the case.

MIRANDA STEWART: Which makes you think why haven’t we done it yet, right? So the politics of it are actually not at all straightforward and the Henry George supporters would all say we’re all crazy, we could raise billions and millions. And of course we don’t and no country does, so the politics are complex.

PAUL ABBEY: Which is taxing the family home. And you’ve probably done the same thing, you go and have conversations with State Treasurers and they’ll say, “Yes, of course it’s a sensible thing to do, I should do it straight away, except as soon as I do it my opponent is going to say I’ve taxed the family home”. With the obvious observation being, which people don’t understand, is that as soon as you buy the family home and pay stamp duty they tax you lump sum up front immediately, but the public perception is that they don’t see that as a tax, it’s just part of the acquisition equation.

DANIELLE WOOD: But I think the other challenge is of course what you about people that are asset rich and cash poor, so particularly pensioners fall into that category. All of a sudden they’ve got this ongoing tax bill, they don’t necessarily have the income to pay for it. So it needs to be done in conjunction with some sort of arrangement perhaps that allows them to unlock some of that equity in the home so it accumulates as a debt against the house and then eventually, when they sell it or they pass on, then then government can recoup the money at that point in time.

JOHN DALEY: Danielle, digging into two questions on that. Firstly, how do Australian land taxes compare with elsewhere and then, secondly, does it make a big difference if it’s on unimproved versus improved value?

DANIELLE WOOD: Land taxes are generally lower in Australia than elsewhere. So, for example, in Canada they’re probably about twice as high as they are in Australia, so in terms of international comparisons it certainly seems that we’ve got room to move.

On the question of unimproved versus improved value, I think from a tax purist perspective we prefer the unimproved value because it doesn’t change incentives to upgrade or invest in new capital on the land, but when you actually run the numbers, to be honest, it makes very little difference. So at the low rates of tax that we’re talking about you’re not going to get really significant behavioural change.

MIRANDA STEWART: There is one transition question. If you were to do this reform of course there are people who bought their house last week and paid $100,000 stamp duty or $70,000 stamp duty or something and they would feel hard done by. So it takes a fairly long transition to recognise that cost and shift to a rates base.

PAUL ABBEY: And there are the people who haven’t moved house for 20 years who you then impose land tax on and they feel hard done by also.

JOHN DALEY: Yes. I guess we’ve seen in the ACT the classic way of doing this which is you say, “Right, we’re going to bring down the stamp duty very slowly, we’re going to lift up the land tax very
slowly” and that means that if you bought your house last year it’s not going to make much difference and it’ll phase in over the next 20 years.

That’s been an interesting discussion on land tax. Let’s shift to the other big state-based tax which is around payroll tax. Miranda, one of the things that people talk about a lot here is the way that we currently do not count the first — and it varies from state to state, but often roundabout somewhere from $600,000 and $1m worth of payroll. So, in particular, small businesses basically don’t pay payroll tax. Is that a big opportunity from a budgetary point of view? Do you think it will make of a difference from an efficiency point of view?

MIRANDA STEWART: Payroll tax was originally a Federal tax and was passed back to the states in 1971. It was described as the Commonwealth’s least popular tax, so it’s never a popular tax. But if you think of payroll, most other countries levy what they call social security taxes which are really intended to be taxes on workers, and they do cover most workers, to contribute to particular public goods or services, particular public health or pension programs, hospital programs or something like that. They’re not necessarily formally earmarked, but sometimes they are earmarked.

So if you think that our payroll tax has become, with all the exemptions and concessions, perverted away from that idea of a tax on workers via the business that employs them to really a tax on larger businesses and, because of that exemption and some differential rates for different industries, its incidence is no longer really on workers I think. So it would be perceived as a tax on small business if we were to extend the payroll base. But if we were to do it in a way that was lower compliance cost it would give the states a much more powerful lever to actually fund public goods within the state, the State of Victoria, and make that direct connection with workers who are resident in the state. So that’s a potential opportunity.

JOHN DALEY: It's potentially a large budgetary opportunity. Danielle or Paul, do you have a view on how much of a difference it would really make to efficiency?

DANIELLE WOOD: I don’t have a huge idea about that I have to say. I guess the issue would be if you incentivised people to keep companies small or to structure their affairs in such a way so they avoid the payroll tax burden. So potentially there are some efficiency gains, I’m just not sure how strong that incentive effect would actually be.

MIRANDA STEWART: Sorry John, I think you actually asked me that question. I don’t think I answered it. Just jumping back in there, the assumption is that a tax indirectly on workers resident in the jurisdiction is more efficient because workers are less mobile than capital investment, that’s one of the bases for that efficiency analysis. So that would be argued to be a more efficient tax if it covers all workers. But I think to prevent state tax competition it actually needs to be potentially a national base, maybe even a national rate but going back to the states on a per capita basis.

PAUL ABBEY: Just to add a little bit of colour and to provide some context for the audience, if you think about the payroll tax threshold for any of the states which is around $1.5m it means that you can have a circumstance arise where you go from employing, say, your 12th to your 13th person where that person should cost you, say, $60,000 but actually, because they’re going to bring your wages -

JOHN DALEY: But most of the states have a tax free threshold, so it doesn’t have that big an impact.
PAUL ABBEY: Correct, I realise, but if I just simplify down to why. So the point I was trying to make is that payroll tax as it’s currently structured in Australia has an inefficiency and the inefficiency is that eventually you cross the threshold. Now, you do scale in a little bit, but the whole inefficiency in Australia is about crossing the threshold.

So the concept of that is that when you cross the threshold you start to bring your payroll within the system, whereas previously your payroll sat outside the system, so the marginal worker that you’re employing costs more than what they relatively should. And the point is that that creates an inefficiency, or that’s one of the contributors to the inefficiency, the point being that if we had a broad based low rate system so it started on the first dollar you never encounter that decision, so that distortion in employment choice never arises.

JOHN DALEY: Yes. I guess I just want to pull apart how big is that distortion really? Let’s say the rate effectively cuts in from 15 to 16, what that’s saying is a firm of 30 people is going to pay a little bit more tax than two firms of 15 people.

PAUL ABBEY: Yes.

JOHN DALEY: But not by that much. So is it a really big efficiency deal?

PAUL ABBEY: Look, I declare honestly, I don’t know if it’s a really big efficiency deal but the analysis would always be that if you’re adding something on to the marginal cost then there is someone at the limit of the decision who’s not deciding to do it for that particular burden.

MIRANDA STEWART: I think that the Treasury modelling on the dead weight loss of different taxes finds that the current payroll tax settings are more inefficient than other taxes, and BCA of course has found that work as well. The point I would like to make is to redirect it. Ideally it’s not a tax on business; it’s a tax on workers, all of us as individual citizens, and we’ve lost that in the current structure.

JOHN DALEY: That does lead though to the impact of how does this play out for minimum wages, because deeply as I respect Treasury analysis, it’s not always perfectly there. I think one of the issues in particular is around minimum wages. How does the payroll tax intersect with that?

DANIELLE WOOD: That’s right because the tax theory that Miranda is talking about is essentially that the tax falls on workers because you impose the tax on firms, workers do not want to be unemployed so they compete with each other, they undercut wages and so the tax is then borne by workers. The trouble is when you have a floor on wages, because of a minimum wage or because of an award, you can’t get that flexing of the wage rate, and so that pushes some of the incidence back onto firms. It’s a particular issue for small business because they tend to employ a higher proportion of people on the minimum wage and that can mean you do actually get some employment effects because of the tax.

JOHN DALEY: So to spell that out, you get an increase in unemployment?

DANIELLE WOOD: Yes, that’s right.

JOHN DALEY: Yes and I think it would be fair to say the literature is all over the place as to how big that impact is?
DANIELLE WOOD: Yes, the elasticity estimates are all over the shop. So if you’re thinking about a 1% increase in labour costs, estimates suggest anywhere between a 0.04% decrease in employment and a 1% decrease in employment. So economists really don’t have this worked out at the moment, I think it’s fair to say.

JOHN DALEY: Let’s move on from payroll tax, which is at least in theory a tax on workers, to corporate tax, which may or may not be a tax on workers depending how you think about it. So we’ve seen a lot of claims that if Australia were to reduce its corporate tax rate that would have significant improvements in the size of the Australian economy relative to what it might be otherwise. That’s certainly the contention of the work that Treasury has been putting out.

Paul or Miranda, is that right, would it really have a big impact on the Australian economy if we dropped corporate tax rates?

PAUL ABBEY: I think the simple answer really is that Australia is a capital importing economy, we run a capital account deficit, we import capital. So if you think about Australia as a country, at any point in time the capital stock we have which we can generate from our domestic surplus is fixed and essentially to add to that capital stock the advantage is or the opportunity is to seek capital from offshore. And then capital from offshore is obviously going to look at the return it can make from investing in Australia.

So you play that back in a practical circumstance and you say I’m a mining company based in London, say, and I’ve got an opportunity to do a copper mine in Australia or a copper mine in Peru or a copper mine in the Congo. And the choice I’m going to make is going to be dependent upon a range of factors, but one of the factors is going to be return and the tax system will bear upon that return. So the extent to which the return you make on that investment because you say the amount of capital I’ve got is limited, the amount of time and labour and effort I’ve got and the people I’ve got and the technology I’ve got is limited, so therefore I need to invest it in the project which will give me the greatest reward balancing out my risks and if Australia imposes taxes at a higher level than the other places it can bear upon those particularly decisions.

And you say well, does that really happen, but to give you a practical example and it’s a public example and the relevant company has been very public about it, CSL recently in Australia developed a new technology in regard to protecting haemophiliacs from certain diseases. They then looked at where around the world they should develop the technology into manufacture and they chose Switzerland. They had a choice of a range of countries and when you look at the circumstance in Switzerland, the fact is the tax rates there are lower and you’ve got the same educated population, you’ve got the same ability to support a manufacturing base, you’re not that better off in some logistical senses, and tax is in influencer in making decisions like that and organisations like that would well admit it.

So it impacts upon investment here and it impacts upon capital coming into this country to undertake investment.

JOHN DALEY: So there’s a big game around the attractiveness or otherwise of Australia to internationally mobile capital. Are there other things we should think about in this corporate tax debate, Miranda?

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MIRANDA STEWART: Yes, of course there are. Of course, the company tax is not borne by companies, companies are not people, we have to remember that. The question is what’s the function that the company tax is playing in the current system and then what are the incentive effects? So for mobile capital of course that’s true, the marginal investment return is made on an after-tax return analysis looking at competitive jurisdictions. There are a lot of factors. There’s been quite a lot of empirical research that suggests that those other factors tend to dominate, that is the educated workforce, location, benefits, markets, etc. However, sometimes tax can make the difference.

The Australian company tax also of course collects a lot of revenue from less mobile industries, resources being the big one here and we can see that because very time the iron ore price goes own $10 we lose another $1bn or more in revenue. So it’s a very effective collector of resource revenue when we have resource revenue available. It collects other what you might think of as economic rents in the economy, the captive market of our big four banks, the captive monopoly rents of some of our other industry sectors.

PAUL ABBEY: Retailers.

MIRANDA STEWART: Retailers, for example.

PAUL ABBEY: Telcos.

MIRANDA STEWART: So it’s quite effective at doing that.

JOHN DALEY: Glass manufacturers, paint manufacturers, steel manufacturers. Danielle, you used to work at the ACCC, is there a lot of rent in the Australian economy?

DANIELLE WOOD: Thanks John. You guys have listed a lot of them already, but certainly my experience is that because of the size of our market and because of our distance from other countries there are a lot of industries that have that sort of oligopoly structure, so a few large firms. So I think it’s probably reasonable to take away from that that there may well be economic rents in the economy that the company -

PAUL ABBEY: And you see that in the corporate tax collections because there are known corporate taxpayers in Australia which pay corporate tax annually of in excess of a billion dollars. Collectively between a third and two-fifths of the total corporate tax base is out of the nine taxpayers, and if you look at all of those participants they’re essentially the monopoly players or oligopoly players in retail, telco, finance or mining.

JOHN DALEY: Yes.

MIRANDA STEWART: I have to say, the Treasurer keeps saying it as if it was a problem that most of the corporate tax is paid by these four or nine. It’s like well, actually, at least it’s doing something right in collecting some tax from them. So that’s a good thing. However, we do need to worry about this mobile capital thing.

The only other thing that I want to say about what the company tax does in the system is of course it operates as a backstop to the personal income tax and the personal income tax is the most important from a revenue perspective. And, you know, in the end, all of us, as individuals, bear tax and should
be paying it. The company tax helps reduce manipulation and planning and supports the resilience of the personal tax system and if we were to change that, if we were to lower that rate, we would increase planning margins in the personal income tax.

JOHN DALEY: So to spell that out, people would go to Paul and they would –

PAUL ABBEY: No, because they’re small business people and I didn’t read that chapter!

MIRANDA STEWART: But I can recommend some excellent accountants.

JOHN DALEY: So they would go to someone else and they would essentially say, “Well, I’m running my business and I’m going to have all of the income and all of the costs, and all of the costs that I might perhaps otherwise bear personally I’m going to be paying through my corporate vehicle. I’m also going to be then reinvesting via the corporate vehicle and my tax rate’s only 30c in the corporate vehicle and otherwise I’m going to be on the top marginal tax rate of, these days, effectively 49c. I do a lot better if I’m running it through the corporate vehicle”.

PAUL ABBEY: And remember, years ago there was the Ralph Tax Reform process and one of the elements of the Ralph Tax Reform process was to introduce an entity taxation system which was that all trusts and companies and any other entity would all be taxed on the same paradigm, which wasn’t a corporate paradigm, was a unique paradigm which they were proposing, and that proposal ultimately fell away. And since federation when we’ve run income tax systems which recognise and accept the legal paradigms that we use for the operation of commerce within the country and then impose tax rates by reference to that, we don’t have to do that, but to move away from it would be very complex and as a country we have tested the ideas and we’ve walked away from them.

MIRANDA STEWART: I think he’s talking about trusts.

JOHN DALEY: Yes.

MIRANDA STEWART: That would be the entity you’re talking about is trusts and the fact that trusts are used by the SME sector?

PAUL ABBEY: Yes trusts, but trusts and private companies. And Ralph was talking about having an entity tax regime which was not the company tax regime and not the trust tax regime, was a hybrid regime which sort of sat between them and looked at distributions in a particular way and looked at their tax regime in a particular way. And there was a nice colourful discussion paper about that in 1997 with a similar cover to that one and that went through –

MIRANDA STEWART: Then the tax profession got hold of it. Sorry, I was in the tax profession in those days so I -

PAUL ABBEY: But that idea was too hard.

JOHN DALEY: Yes. So let’s talk about another idea which is a little bit hard in the corporate space, which is around dividend imputation. So lots of talk at the moment about the way that dividend imputation particularly tends to benefit people who hold a lot of shares who, no surprises, turn out to be the richer people in Australia. Funnily enough, they’re the people with all the wealth.
Paul, is it a big opportunity to deal away with the imputation system and should we?

PAUL ABBEY: So John asks me the question because he knows that I know the answer.

MIRANDA STEWART: Although you might be wrong.

PAUL ABBEY: I could be wrong, but I do have an answer. I mean, we could be wrong on everything we’ve said this afternoon couldn’t we? So the imputation system is imposed at the 30% corporate tax rate. So one of the things we did as a process was using the taxation statistics which the ATO puts out we looked at where did the benefit of franking credits actually fall and if you took away the imputation system how much could you reduce the company tax rate by by the saving from imputation?

So companies pay, say, between $60 to $70bn in corporate tax per annum, let’s call it $60bn for the purposes of the debate; of that $60bn, about $30bn flows through to shareholders through the imputation system, so about half stays within the corporate system. And then when you work out where that $30bn flows through to, it flows through to a mix of resident taxpayers who are individuals, resident companies, resident super funds and then non-residents. And for individuals and super funds it’s about 12, for non-residents it’s about eight, and for companies it’s about 10. So then the part which goes to companies, there’s no revenue in that because if you took away the imputation you have to stop the double taxation between companies anyway, you reinstate what we used to call the intercompany dividend rebate.

So you get down to okay, you’ve got $20bn to pay with. You can’t impose additional tax on non-residents if you do away with imputation, so there’s no saving there, because that would be entirely counterproductive; we’re trying to attract more foreign capital not tax it more. So imputation protects foreigners from what is called dividend withholding tax. You can’t then impose that in the absence of imputation, so there’s no additional collection in what goes to non-residents. So the only addition collection is what goes to individuals and super funds, that’s the only additional money, and when you finally work out what the incidence of that is, you do some averages of tax rates, you can work out across the income quintiles where imputation mostly goes and it mostly goes to people who are in the top quintile. And when I say mostly goes, about 80% of it goes to people in the top quintile.

So you can then impute what the tax rates are and you can work out how much money you could save by not having imputation and we think you would save about 3% of the corporate tax rate. So the 30% corporate tax rate you could reduce to about 27% or about $6bn you’ve got to play with in terms of saving. So doing away with the imputation system is not a big number to kick back into the system.

JOHN DALEY: Although $6bn a year, it’s not to be sneezed at.

PAUL ABBEY: It’s not to be sneezed at, but it’s a dramatic political change and you’ve seen the impact of this and I have, that as soon as you suggest to the major super funds or the fund managers or the investment companies that you’re going to do away with imputation the storm of challenge is pretty strong.
MIRANDA STEWART: Yes, it’s interesting. I was at a forum at the US about a year ago, because they don’t have imputation, they’re stuck with this relatively high corporate tax rate and a classical system that has a lower rate on dividends. So they have 35% at the corporate level and then a maximum of 15% on distributed profits. As a result of that, all of their large corporates that can keep their money in the Cayman Islands and won’t bring it home. As we know, they keep it outside the country or they try to invert their residence offshore.

So they look at our system, they look at imputation, they look at how much corporate tax we collect, and they wish they had our system and wonder how it is. But I guess the corporate shareholder imputation system, you wouldn’t make that reform so much for revenue if you think it would drive investment really. A sort of prosperity argument that there’s a reason to reduce the corporate tax rate and then, in order to save some of the revenue of that and prevent that benefit going entirely to one sector, you would also potentially reduce or eliminate imputation.

PAUL ABBEY: To give you a little story on the US system, I was talking once to a director of strategy for a US company and their business was to make nuts and bolts and spanners. And they did what Miranda said, which they didn’t distribute their profits because of the US classical system. Their business was entirely in the US, they weren’t in the Caymans, they would make profits, once they’d made the profits they had huge piles of cash in the company and they didn’t distribute the case to the shareholders as dividends. So you say to the director of strategy, “What do you actually do in your job?” and he said, “I buy planes”.

Basically what he did was he bought planes and ships, because he had a huge pile of money, where was he going to invest it? So essentially he bought 747s and leased them to airlines and he bought oil tankers, because he had a big pile of cash.

JOHN DALEY: Yes and possibly not exactly what his shareholders would want to do with it?

PAUL ABBEY: Exactly.

JOHN DALEY: So, as with so many of these things, the trade-off is not immediately obvious. Let’s talk about one other thing in corporate tax that’s had a lot of airplay which is around, whichever way you want to describe it, base erosion, profit shifting, all the kinds of things that have been getting a lot of headlines about whether international companies are paying as much tax as they “should be”. I think, to be fair, there’s no suggestion in any of this that any of them are doing anything that is illegal, the question is whether or not the system has been set up appropriately.

Is this a big deal? Is this something we should do something about?

PAUL ABBEY: I’d better go last.

MIRANDA STEWART: I think this is a big deal, but when I say that I don’t mean that there’s billions and billions of dollars of revenue in it. So I think it’s a big deal because I think that it’s important for national countries and administrators to coordinate. This has been a long time coming, proper coordination internationally, and this is really the first time we’ve ever seen 80 to 100 countries actually agreeing to mutually assist each other in tax administration in relation to cross-border flows. So that’s a big deal.
I think it’s also a big deal because there is a fair amount of shifting, planning, this idea of resilience of the system, which does not match economic activity and so we can tighten the rules up on that, so that’s transfer pricing, mispricing, issues about characterisation of intellectual property type intangibles, putting value into those things. Having said all that, even if we can fix some of those holes and frictions over the next two/three years, even if we see that coordination, which I do think is very important, the final result might just be that we see more actual shifting of economic activity between countries that have lower tax rates, so we see more substantive tax competition and less planning manipulation.

So the question as to whether that might be globally efficient, but whether that’s something that Australia wants is another matter. So then we have to think should we really be looking at reforming the purpose of the corporate tax in the global context, what’s the real base, proper base for the corporate tax?

JOHN DALEY: Paul, how you see this playing out in commercial land?

PAUL ABBEY: I agree entirely with Miranda that there’s not necessarily a whole lot of money in it, but there’s an important equity issue, and it goes to my earlier comment about dealing with the tax expenditures. There are certain things you have to do in the corporate tax system and with the tax expenditures also so that you give the public confidence that no-one’s getting a free ride and there’s no rort, and so when you come to making hard decisions you get political and social engagement. And so I agree utterly with that and I agree utterly that the BEPS Project needs to be done, it needs to be done multilaterally because the one thing we desperately want to avoid is using tax as a stick for a new type of trade war, which would be very damaging for us as a country. So I think that’s important.

The final thing then is that right now in our tax debate - I characterise our tax debate as we have a panacea debate and we also have an easy fix debate. So if you do the easy fix debate, the easy fix debate is people who’ll come out and say, “Just change the GST, that’s the solution to everything. Don’t bother doing anything else; that will solve the problem”. We have a lot of that happening and you can open the Finn Review any day of the week and you’ll get one of those articles, and that doesn’t help the system.

And then the panacea proposal is around corporate tax in particular and because, as Miranda says, companies aren’t people and therefore you allege, “Well, there’s all this missing billions of dollars in the corporate tax base and we need to go out and collect those missing billion dollars and then the whole problem will be solved”. Of course, that panacea doesn’t exist and as much as you can point to high tech companies and their billions of revenue, at the end of the day we have a population of 24 million people and you can’t make that much money out of them by selling them ads which they click on.

MIRANDA STEWART: We can improve that a bit, we should be taxing online.

PAUL ABBEY: We should be doing it better and it’s important, both from an equity perspective and an efficacy perspective to do that better, but it’s not really, really big dollars. It’s a mistake to believe it’s really, really big dollars. So I utterly agree we should do it and in part we should do it so that we can take off the table a really difficult political question and get down to the things which will matter.
JOHN DALEY: We’ve talked a lot, so far we haven’t talked about personal tax and, in particular, about either taxation of capital gains and negative gearing or about taxation of superannuation, which I think various people nominated earlier. But in the interests of time, I thought we should throw it open to the audience and of course if you want to go those topics then please do.

AUDIENCE: I was just wondering if you could comment on how efficient, how much equity there is in reforming negative gearing, perhaps quarantining it to the investment in which it was made or abolishing it or what?

PAUL ABBEY: Can I answer that one?

JOHN DALEY: Danielle’s going to go first Paul.

PAUL ABBEY: I’ve only got one word: zero.

JOHN DALEY: Sorry, zero?

PAUL ABBEY: Zero equity and efficiency.

DANIELLE WOOD: Oh, I don’t agree.

JOHN DALEY: Ooh right. Danielle, off you go.

DANIELLE WOOD: I will disagree with that. I think abolishing it altogether is not a good idea. The principle of negative gearing is that you can write your losses off your earning income against your taxable income, and that’s sort of a standard principle of taxation. It helps preserve the treatment of debt versus equity.

So I think abolishing negative gearing is not a good idea however I think there is merit in the proposal that you might not be able to write losses off against your wage and salary income. At the moment, if you make a capital loss you can only write that off against a capital gain, so there might be a case to say you can’t write it off against your wage and salary income, but you can write it off against future gains associated with that particular asset. That said, my preference would be to do something on capital gains tax before you get to negative gearing because I think the major distortion that we have is that you can write your losses off in full but you’re only taxed on half your gains. A more direct way to do that is by reforming the capital gains tax discount.

JOHN DALEY: And speaking as the former managing director of margin lending for ANZ, we used to put out brochures that basically explained to customers because of that mismatch between income and capital gains essentially you are pushing out on the efficient frontier. I mean, there’s a mismatch and it’s perfectly legitimate and part –

MIRANDA STEWART: It’s called tax arbitrage at the expense of the mass of the population.

JOHN DALEY: Indeed and clearly 1.3 million Australians have figured it out.

AUDIENCE: My question is about the compensation that politically needs to be applied for some difficult tax reforms. Because the personal income tax free threshold has risen so far under the carbon
tax threshold it seems that somehow it’s now more difficult to compensate those who might need it most through difficult tax reforms. Is it possible to be using pensions or other ways of providing that compensation or are we now in a difficult place when it comes to driving those hard trade-offs?

MIRANDA STEWART: I think that’s a really good question actually and it’s one of the funny things, when we did the stock take report, Henry Tax Review had recommended pushing up that tax free threshold very substantially and those carbon tax reforms did do so, not quite as high as the Henry Review. I query now whether that was the right thing to do. It looks very attractive, looks like you take people out of the system. In fact, those people, many of whom are receiving family tax benefits, have to be in the system because they still have to file a tax return to get those benefits.

So one of the odd things is, you’re quite right, we’ve got a system where we have that large tax free element and then one issue is that the rates above that, especially with transfer withdrawal, are quite high. So one possible way for us to think about the personal income tax rate structure is to bite the bullet and rethink whether having that high tax free threshold is the right idea. When New Zealand did its GST reform from 12.5% to 15% they compensated with changes in the personal income tax rate structure, reducing it across the board, but they have zero tax free threshold. They tax from the first dollar including transfer payments, so there’s a lot of revenue there that can be used.

One thing we’ve been looking at is whether a targeted earned income tax credit targeted at moderate wage earners could compensate those people who would not be receiving pensions or other such things which could be indexed, but without giving that compensation to the high income earners who you hope will now pay some more GST.

PAUL ABBEY: To give you a practical example, we did some numbers and we said if you extend GST to food, health and education and raise the rate to 15% how much revenue does that raise in the Commonwealth and in 2019 $50bn. But then if you take the Bureau of Statistics’ household income survey and you there’s all different data sets but you take the one which has got imputed rent for housing, then the bottom quintile in 2018 was earning as a household weekly income of $686 and the additional GST cost on them when you looked at their consumption baskets was about $9. So you had to find a way of delivering back to them effectively about $9 a week and at $686 per week as a household they’re of course way below any kind of tax threshold. And, in fact, of that $686, about 70% of it is government support, so their wages are only about 30% of what they earn once you pick up other things. So there’s a real challenge in trying to get that $9 back.

DANIELLE WOOD: Yes, we ran similar numbers and I think the answer is you probably need to do the conversation via the welfare system because that bottom 20%, almost all of them are receiving some form of government income support. For a lot of them it’s the vast majority of their income, so if you want to talk about targeted compensation rather than giving back everything as tax cuts, I think you need to do it through welfare. And we estimated that if you spent somewhere between 10% and 20% of the total GST revenues that would give you enough to more than compensate those people at the bottom of the income distribution. Obviously you have a bit of leakage for people further up that are also getting welfare benefits.

MIRANDA STEWART: The thing I would like to do though is actually reduce personal income tax rates on low and modest wage earners, because I think actually that’s where the economic bang for the buck is in terms of prosperity as well and they will be facing an increased GST burden that may
not be able to be compensated through transfer payments or not adequately. So one thing is how do you change the rate structure or have some kind of credit for that category of worker?

JOHN DALEY: Which I guess is where this gets quite difficult Miranda and why I guess it’s very appropriate you’re running a Tax & Transfer Institute, because of course the classic theory is, “Oh well, if we do this income tax for GST swap, where we increase GST and we reduce income taxes, that leads to lower marginal rates for people at the bottom, so we’ll get higher rates of workforce participation”. But if as part of this whole deal we have to simultaneously increase welfare payments it may well be that marginal rates of take-home pay don’t change that much. Indeed, you may even wind up in a situation in which you take home even less of your take-home pay because you’re giving up even more in the way of welfare benefits if you work the extra hours.

MIRANDA STEWART: So you’ve got that interaction which generates higher marginal effective tax rates for the interaction of the tax and transfer system, especially I guess families with children receiving family tax benefit.

We have the most progressively targeted tax transfer system in the OCED, the most targeted in terms of welfare payments because we phase everything out and that causes those high marginal rates, and they fall in particular on secondary earners, that is women, who are seeking to increase their work from two days to four or five days. They face very high marginal rates, they also pay GST, they’re in the workforce, they’re buying consumption goods, they will bear the GST burden. So if we can’t deliver some targeted compensation to that group I’d be quite concerned.

AUDIENCE: Your earlier comments about land tax and stamp duty but also payroll tax is focused on state government taxes, and you also talked earlier about the budget issues at a Federal level. How in the tax system can the states and the Federal Government work towards a better outcome?

JOHN DALEY: Well Miranda, I know that federalism and taxes are a favourite bugbear of yours.

MIRANDA STEWART: I’m of the view that the Federal Government actually has to come to the party here and I think that we need to empower our State Governments to remember that they are democratic governments accountable to their state residents and citizens. If they raise greater revenue at the state level then they’re accountable, you know, the Victorian government is accountable to Victorian citizens for the use of that revenue and surely that’s a good thing for democracy?

So when I talk about long transitions and requiring compensation, for example, in the stamp duty property tax reform agenda I would have said that actually the Commonwealth should be providing potentially some funding support bearing some of that political cost. The question of how though, given current government, well, to be honest, given any government at a Federal level is a difficult one.

JOHN DALEY: Yes. The good news is that the Commonwealth doesn’t have to bribe state governments with very much money. As Paul Keating very famously said, do not get between a State Treasurer and a small pile of Commonwealth money.
MIRANDA STEWART: But I am a bit worried, so at a Federal level we expect in the budget of financial institutions duty targeted to protect the banks against some vague future loss in some future recession. Then we have South Australian government saying, “Oh look, we’re going to slap a tax on bank transactions as well because we can”. And we might end up with the situation which we had before the GST which was that every state has its own little bits and pieces of tax which are really inefficient. So I think the Commonwealth can actually take the lead on that.

DANIELLE WOOD: And arguably the Commonwealth should take the lead. So to the extent you’ve got these efficiency dividends from these reforms, then the Commonwealth captures a lot of that back through income tax revenue.

MIRANDA STEWART: Yes, corporate tax and income tax.

AUDIENCE: We need revenue from just about any source we can get and I know there’d be some solvable issues with farms and businesses, but what does the panel think about an inheritance tax of, say, 10%?

PAUL ABBEY: I was going to say that the country which has the highest level of inheritance tax I think is Belgium and it contributes 1.4% of total revenues in Belgium. I think if you imposed a reasonable inheritance tax in Australia you would get about $2bn and out of a total of, I don’t know, $400/$420bn, you’re getting about 0.5% maybe as a total collection. Inheritance tax is theoretically a very, very sensible tax, it’s just you don’t get a lot of money.

MIRANDA STEWART: I think the evidence does support that. I would support some sort of a wealth inheritance tax. You could do something very simple like Canada where they tax accrued capital gain on death, that’s in the income tax; it’s not actually a separate tax. When we had a state tax there was masses of planning and it’s true that in no country in the world do they raise a lot of revenue, but they do raise revenue from people who are rich, so you might want that.

JOHN DALEY: I wonder about that, or do they raise revenue from people who are actually in the middle, because the rich are the people who basically spend a lot of money on various firms figuring out ways not to pay anything?

MIRANDA STEWART: In the US the rich provide a lot of money to philanthropy because it’s deductible against the estate tax, and you might have a view about that large non-government sector and whether that’s a good idea. But that is one incentive response to the US, their state tax.

JOHN DALEY: But as you say, there are lots of other ways of doing this as well, a capital gains tax on death or crystallisation of capital gains on death. I guess one of the points about increasing taxes on property is that in effect it’s a form of wealth tax. One of the reasons for reducing the discounts on capital gains is that in effect a capital gains tax is a form of wealth tax.

AUDIENCE: I had a question when I was reading the Intergenerational Report because it includes a lot of really interesting statistics about the aging of the population and if you look at the statistics around how many workers we’re going to have to pay for the people in retirement in the next 5/10/15/20 years it kind of is pretty frightening reading. We haven’t talked too much tonight about
taxation in retirement, but I’m wondering if the panel have any thoughts on how we might look at perhaps changing the current system?

DANIELLE WOOD: Yes, I think certainly the earnings tax concession for people on superannuation is for people that are over 60. So at the moment if you’re over 60 and you’re drawing down something from your superannuation account you pay no tax on earnings in the account, in contrast if you’re under 60 you’re paying 15% tax on the account. What that means is we’ve got people retiring with potentially very large superannuation balances generating quite large income streams that are not contributing at all to the income tax system. So simply putting that 15% flat tax on earnings in super accounts would raise about $4.5bn a year. It also improves fairness because it means that people with high incomes that are over 60 are now contributing via income tax.

PAUL ABBEY: The one problem is, and you know this too, is that the average super account balance is, what, $250,000?

MIRANDA STEWART: But averages are not that used in this context.

PAUL ABBEY: Yes, I know, but the point is that there’s a lot of that $4bn you’ll simply recycle through the system as additional pension because you’ve got a big population of people who are over 60 and they have a superannuation of, let’s pick a number, $200,000. Let’s say it earns 10%. That gives them $20,000. That’s not enough to live on, so they’ve already got a part-pension. So you then tax that, all that’s going to happen is that part-pension goes up a little bit.

JOHN DALEY: Yes possibly, except Paul if you look at earnings for over 60s – this is a piece of analysis we’ve done – about 75% of the super money is going to people in the top two deciles by wealth. So you’re actually going to recover quite a lot, I’d suggest. Bad news for people in those top two deciles.

The only other thing I would add to that question about what do we do about essentially taxing people over the age of 65, because one of the pieces that came out of the work that Danielle and I did on the wealth of generation sis that households over the age of 65 are actually paying less in income tax today than households over the age of 65 eight years ago. In absolutely terms they’re paying less and that’s partly the superannuation leakage.

PAUL ABBEY: Because of the super change.

JOHN DALEY: Yes, because of the super change.

PAUL ABBEY: Which happened, what, eight years ago?

JOHN DALEY: Yes. So that’s definitely an opportunity. The other one of course is GST, because in effect a GST winds up being a tax on things that you’ve already saved but haven’t yet got around to spending.

MIRANDA STEWART: Especially if you extend it to health, you’ll capture a few of those old folks. On the transfer side the government is looking at, and I think this is sensible, one could change the eligibility for the partial pension rate by changing the asset test to a taper rate. And what would force is more use of assets during the lifetime, so it addresses the accumulation and bequest issue to
some degree, less drawing down of the age pension. So you’re actually using up your savings rather than passing them on to the next generation.

Just one other point on that, the big workforce dividend though is women, right? I mean, women’s workforce participation has trended up. It’s still about 10-15% below men’s, but half of women are working half-time, statistically, averages etc. So there’s a massive wage and income tax dividend there that we’re not tapping because we’ve got incentives in the system that deter women from working.

JOHN DALEY: I think we’re probably going to have to bring it to a close here. Can I thank a number of people, firstly, the State Library of Victoria for their very generous facility and the ongoing Policy Pitch series; secondly, to those from Grattan and the State Library who’ve been busy organising tonight and making it happen behind the scenes, if it all looks very smooth that’s because they’ve done a fantastic job; thirdly, to my panellists, obviously Danielle Wood from the Grattan Institute, Miranda from the Tax & Transfer Institute at the ANU, Paul from PwC and, of course, for very generously smiling every time we said rude things about accountants, which is not difficult when you’re talking about tax; and finally to all of you for coming.

This has obviously a very interesting debate, it is neither tedious nor trivial nor too technical I hope, and I hope that you have enjoyed this and we look forward to seeing you at the next Grattan event. Thank you all very much.

END OF RECORDING