2022 FEDERAL ELECTION POLICY STATEMENTS

TAXATION AND INTERGOVERNMENTAL FINANCIAL ARRANGEMENTS

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Key Points

- Australia faces considerable fiscal pressures for which our current approaches to taxation, transfers and intergovernmental financial arrangements are ill-suited to address.
- There is very strong scope for win-win improvements that can improve the sustainability, efficiency, simplicity, fairness and competitiveness of these arrangements while also boosting the accountability of Australia's governments and improving public sector services.
- Currently, taking full advantage of this scope for improvement is constrained by political timidity, entrenched positions and widespread misapprehension.
- These barriers point to the need to build understanding and support and to expand the boundaries of acceptable reform.
- As a starting point, the general direction of change should involve the removal of the worst taxes, improving the efficiency and simplicity of the less burdensome taxes and ensuring fairness so that system-wide redistribution, including through the transfer system, is retained but financed with less recourse to high rates of tax at moderate levels of personal income.
- Accordingly, the next government should back national efforts to lift community-wide understanding of the options available and the scope for trade-offs, including through adjustments to intergovernmental financial arrangements and changes to Australia's extensive income support arrangements.
- Simultaneously, the federal government should bring together the states and territories to develop actionable approaches to the progressive remodelling of taxation and intergovernmental finances.

Policy Approach

Australia's taxation, transfer and intergovernmental financial arrangements are a brake on our capacity to capitalise on our economic and social opportunities. They are adding uncessarily to the cost of living and the costs of doing business. There is considerable capacity to boost the efficiency, simplicity, sustainability, fairness and competitiveness of taxation while at the same time improving the transparency and accountability of government and the quality and productivity of public sector services.

Despite the extent of the prospective gains, the scope for improvement is constrained by political timidity, entrenched positions and widespread misapprehension.

Against this background, the next government should back national efforts to lift community-wide understanding of the options available and the scope for trade-offs, including through adjustments to intergovernmental financial arrangements and changes to Australia's income support arrangements. Simultaneously, the federal government should bring together the states and territories to develop actionable approaches to the progressive remodelling of taxation and intergovernmental finances.

The fiscal challenge

Australia faces the fiscal challenges of an ageing population. Fiscal pressures also stem from large commitments to government expenditure in areas such as the National Disability Insurance Scheme and defence. Further significant public expenditure will be required by the need to adapt to climate change and to play our part in limiting its severity by reducing emissions to net zero.

On top of these current and emerging pressures on our tax-raising capabilities, meeting the challenges of the COVID-19 pandemic has required extensive public expenditure and, while the economy and the country is in a much better position because of the measures that have been taken, achieving this position has been expensive and, together with the smaller GFC-related stimulus, has near-exhausted the fiscal buffers built up over recent decades.

Shortcomings

These challenges are formidable, and our present tax and intergovernmental relations are not equipped to meet the task. The long list of deficiencies includes:

- Our approach to taxation is too highly dependent on the taxation of the relatively mobile income tax bases and, in particular, on the returns required to attract investment.
- Our taxation of household saving is all over the shop. The returns on interest-bearing investments held by individuals are over-taxed and a range of different taxation arrangements apply to superannuation, owner-occupied residential property, investment properties, bank accounts, dividends and capital gains.[1]
- Our indirect tax bases are eroding. GST collections are falling as a share of total taxation and our excises are in secular decline as a share of GDP.
- Many of our taxes are inefficient or inefficiently designed and impose disproportionate costs on consumers, businesses, economic activity and employment.
- Under current settings, state and territory governments are prone to undermine their own tax bases and they are inhibited from making sensible changes by the operation of our intergovernmental financial arrangements.
- Australia has a severe vertical fiscal imbalance with very large discrepancies between the distribution of taxing powers between the federal and the states and territories and the distribution of responsibilities for service delivery. As a result, responsibilities are clouded; accountability is blunted; and the ability to improve the quality and productivity of the delivery of services is stifled.

Where to from here?

Addressing these and other shortcomings is not easy and at present lacks widespread understanding and support.

Change of this scale and complexity is not suited to a crash-through approach. One alternative is to proceed in a piecemeal fashion. However, the scope for trade-offs under this

[1] Strangely, the current convention is to use the over-taxed approach that applies to interest-bearing investments held by individuals as the benchmark against which the “concessional” treatment of other forms of personal saving is measured.

approach is likely to be severely limited and would be readily undermined by shifting political sands.

A better option is to build understanding and support and to expand the boundaries of acceptable reform. This is much easier said than done and would require a lot of talking, listening and codesign before we were ready commit to the journey.

Even the most daunting journey begins with small steps. There is no good reason for delaying getting preparations underway.

It will take leadership and open-minded participation. We can start by being positive; refraining from rushing to the exits; avoiding ruling options out at media conferences and in the bear pits of party rooms; and leaving behind the slogans deployed last time and the times before that.

Reform directions

As an initial perspective on reform directions from Australia's national employer association, the general direction of change should involve the removal of the worst taxes, improving the efficiency and simplicity of the less burdensome taxes and ensuring fairness so that system-wide redistribution, including through the transfer system, is retained but financed with less recourse to high rates of tax at moderate levels of personal income.

The following directions should be considered:

- We could shift the burden of business taxes away from the returns necessary to attract investment. We should explore how best to do this – including by reducing the company tax rate to at most 25%; or through an allowance for corporate equity or the cash flow taxation of businesses.

- In line with the proposal of the Henry Tax Review, consideration should be given to replacing royalties on natural resources with a tax on rents from realisations. (A rent tax already exist and works efficiently in Australia, i.e. the Petroleum Resource Rent Tax).

- We could reduce the unevenness of the savings playing field while avoiding the overtaxation of savings including for self-provision of retirement incomes, contingency funds and the accumulation of investment capital.

- We could wean ourselves off the rapidly diminishing fuel excise and replace this with more direct road user charges, preferably structured to support efficient usage.

- Where it makes sense to impose "sin taxes" like those we have on alcohol and tobacco, we could do so in ways that are properly reflective of the social harm while rigorously clamping down on any evasion that would undermine their effectiveness.

- We could tax consumption a bit more and as evenly as we can. We should be open to whether that is best achieved by a broader GST, a more direct tax on business cash flow, or some combination of these. The Henry Review came up with an ingenious approach to payroll tax in its approach to a business cash flow tax that is well worth throwing into the mix.

- We could at least preserve the proportion of revenue we raise from property taxes but concentrate our efforts on the unimproved value of land. The broader the use of this base (which we currently use for local government rates and state and territory land taxes) the better. It should certainly be broad enough to finance phasing out the transfer duties that are currently levied on the full market value of residential and commercial property transfers. The benefits of this taxation change could be even greater if state, territory and local regulation made it easier to improve, intensify and densify land use.

- Specific taxes on insurance could be removed.

- There is strong scope for carving out a special regime for a broad range of smaller businesses. We already have moved towards this for micrto businesses and with a few additional steps we could invigorate the important and time-poor small business sector by removing most if not all of the complexities associated with the timing of deductions and income. At least as much assistance could be delivered through this separate regime as the relief from compliance and tax burdens that we currently provide in the form of payroll tax exemptions for smaller employing businesses.

- In any recasting of tax arrangements, we need to build them around the federation in a way that improves accountability for taxation and spending while lifting the scope for innovation and experimentation in service delivery.

    - Within the limits permitted by the constitution, we could assign areas of service provision to the jurisdictions best equipped to administer them.
    - We could concentrate the use of intergovernmental grants to fund the interjurisdictional redistribution requirements that are not met by the general redistribution of income and in-kind support across the country and to assist in meeting appropriate harmonisation objectives.
    - Also within the limits of the constitution, we could assign appropriate taxes to the states and territories and consider sharing of the income tax base matched by an equivalent reduction in income tax levied by the federal government.
    - We could harmonise and fortify the major state and territory tax bases in ways that preserves a competitive tension between states and territories.
    - Where appropriate, we should consider the use of the ATO as an agent for the collection of revenue on behalf of the states and territories.