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National Seniors Australia

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Introduction

National Seniors Australia welcomes the opportunity to respond to the Tax Discussion Paper (*ReThink*) released by the federal Treasurer in March 2015.

National Seniors is Australia's largest organisation representing the interests of those aged 50 and over, with around 200,000 individual fee-paying members nationally. This broad based support enables National Seniors to provide a well informed and representative voice on behalf of its members and contribute to public education, debate and community consultation on issues of direct relevance to older Australians.

In common with all Australians, the over-50s have a strong stake in ensuring that Australia's tax system is fair; encourages growth in productivity and workforce participation; rewards savings; and delivers the revenue needed to meet the economic and fiscal challenges of the future.

1. Overview

Fundamental reform of Australia's taxation system is likely to be required to address the significant economic and demographic trends that are already testing the resilience of our major tax bases. In particular:

- high global mobility of capital and labour, and the impact of the digital economy on the production and distribution of goods and services, are eroding both income and consumption tax bases;

- falling commodity prices are flowing through to declining federal company tax receipts (and state royalties); while at the state level conveyance duty revenues are likely to slump when the current property boom comes to its inevitable end;

- with consumption of items exempt from the GST base outpacing growth in total consumption, the GST base is inexorably shrinking, with receipts failing to keep pace with growth in demand for state services;

- low productivity growth and a shrinking workforce to population ratio are slowing growth in the economy, with a commensurate slowing of growth in government revenues; and

- at the same time, the cost of government is rising as the population ages, with growth in demand for pensions and for health and aged care services outpacing growth in government revenues.

In the context of these challenges, Australia's high reliance on taxes on income and profits, together with a relatively narrow and shrinking GST base, could see taxation revenues decline as a proportion of the economy just when demographic forces are set to fuel growth in demand for government services.

Although action to restrain government spending may help slow the rate of growth in the cost of government, it will not reverse this trend. Strengthening Australia's taxation system is therefore essential if widening structural budget deficits at both federal and state levels are to be avoided.

Reducing Australia's reliance on taxes on income and profits in favour of a more balanced mix of taxes on income, consumption and property has the potential to boost productivity, workforce participation and economic growth, while better ensuring that revenue keeps pace with future expenditure needs.

Broadening Australia's main income, consumption and property tax bases – potentially with offsetting reductions in tax rates – could also deliver a significant economic and fiscal payoff. As the New Zealand experience has shown, broadly based but low rated taxes are far superior in achieving:

- revenue adequacy and buoyancy,
- economic efficiency,
- simplicity, and
- lower administration and compliance costs.

Broadening income and company tax bases could fund a reduction in tax rates to improve Australia's competitiveness and reduce disincentives to work; while broadening the GST base, with or without an increase in the rate, and broadening land tax bases, could enable the phasing out of the most inefficient state taxes, such as conveyance duties, while providing the states with more secure and sustainable sources of revenue to meet ongoing growth in demand for services. In the case of both the GST and land taxes, base broadening reforms would clearly need to be accompanied by measures to compensate those on lower incomes.

Australia must also seize this opportunity to rationalise the taxation of savings.

National Seniors considers there is a compelling case for taxing savings at lower rates than labour income - not only to eliminate the taxation of inflationary gains, but also because incentives are essential to encourage saving and foster greater self-reliance.

If the aim is that in future more Australians will be self–reliant in their post retirement years, there must continue to be concessional treatment of life-long savings in superannuation and in the family home. This does not mean that superannuation tax concessions should be sheltered from reforms that may be required to protect the integrity and improve the fairness of the system. However, any reform of superannuation tax concessions needs to be considered in the context of a more comprehensive review of retirement incomes policy.

Finally, although of lesser importance, the review provides an opportunity to clean up a number of other inefficiencies and anomalies in the tax system, including developing a more consistent approach to alcohol taxes, resuming indexation of fuel excise and phasing out state insurance duties.

All of this amounts to a case for fundamental reform of Australia's tax system, rather than mere refinement. While Australia's federal system presents significant challenge to the achievement of comprehensive tax reform, the Australian people are entitled to expect leadership from their governments to address these fundamental challenges in the national interest.

2. Economic and fiscal challenges

Australia's taxation system must adapt to looming economic and fiscal challenges including:

- increasing global mobility of both capital and labour,
- the transformative effects of the digital economy on business models and on the production and distribution of goods and services, and
- the diverging impacts of population ageing on economic and revenue growth, on the one hand, and on the cost of government on the other.

High global mobility of capital has particular significance for the corporate tax competitiveness of smaller, open economies such as Australia that rely on imported capital to fund investment and growth.

Skilled labour is also becoming more globally mobile. Not only are individuals with skills in demand free to move to jurisdictions that offer the most attractive remuneration and advancement

opportunities, globalisation of supply chains means labour can increasingly be sourced from jurisdictions where labour costs are lower – with implications for both payroll and income tax bases.

The digital economy is also creating new challenges for the collection of taxes on profits and on goods and services. Technology based businesses such as Google are able to log profits on Australian sales in lower tax jurisdictions; more businesses are selling goods direct to customers via the internet; while mobile phones and apps are enabling services such as taxis and accommodation to be negotiated directly between suppliers and customers. All this makes the taxation of profits and goods and services increasingly challenging.

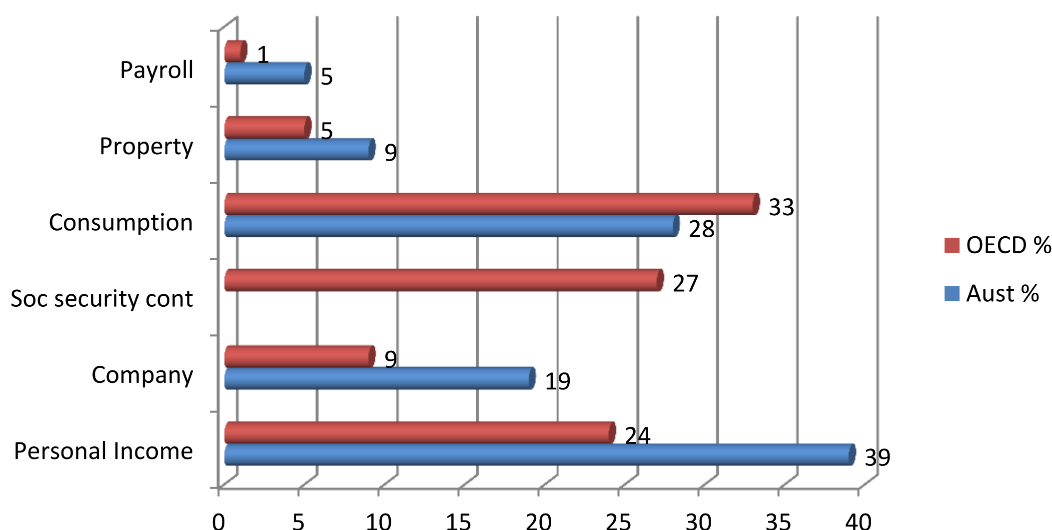
The diverging impacts of population ageing on government revenue and expenditure are well understood. On the expenditure side of the ledger, growth in demand for government services is outpacing growth in the population and the economy as the population ages. On the revenue side, population ageing is reducing the workforce to population ratio, resulting in lower rates of economic growth and a diminishing income tax base.

Together these trends pose a real threat to the future adequacy and sustainability of Australia's main revenue bases and point to widening fiscal deficits at both federal and state levels unless action is taken to improve the overall resilience of the tax system.

Conversely, getting Australia's tax settings right could provide a significant boost to future growth in productivity, participation and living standards which, in turn, could reduce or even eliminate the fiscal gap between government revenue and spending.

3. Australia's present tax structure

Figure 1: Composition of Tax Collections, Australia & OECD 2012



Source: OECD Revenue Statistics 2014

In 2012 Australia collected 58% of tax revenues through taxes on income[1] and profits compared to an OECD average of just 34% (Figure 1). Of this, 39% came from taxes on personal incomes and 19% on company profits (compared to OECD averages of 24% and 9% respectively). [2]

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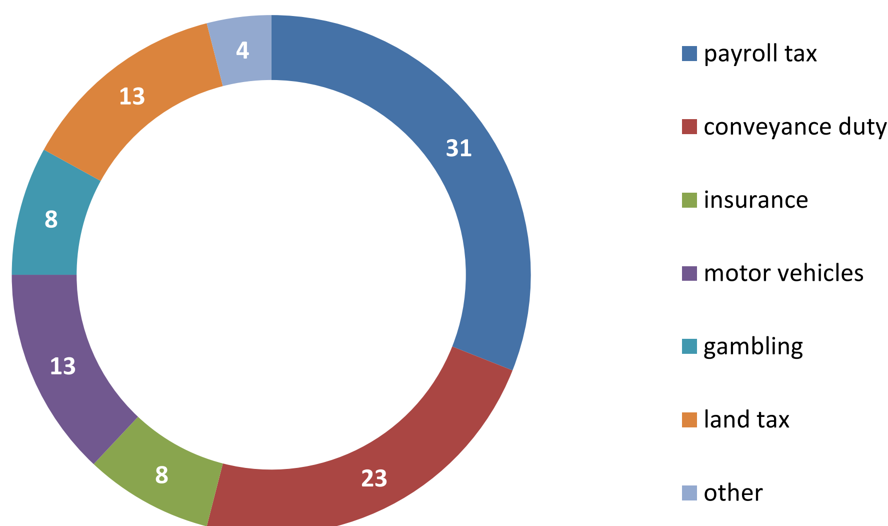
[1] Taxes on income include taxes on labour earnings, interest, dividends and capital gains.

Conversely, taxes on goods and services represent around 28% (with 12% from GST) compared to an OECD average of 33% (20% from GST).

Figure 2: Composition of State Taxes 2013-14 (per cent)



Source: ABS 5506: Taxation Revenue Australia

While the Commonwealth is heavily reliant on income taxes, the federal assignment of tax powers leaves the states substantially reliant on taxes on property and payrolls and on transfers from the Commonwealth (including all GST receipts). Other than the revenue from the GST, the states are heavily reliant on a number of more narrowly based taxes.

As Figure 2 shows, the states' main own-source tax bases are payroll tax, stamp duty on property conveyancing, motor vehicle taxes, insurance duties, land tax and gambling taxes.

3.1. Issues with Australia's tax mix

Among the key issues that previous reviews have identified with Australia's tax structure are:

- overly high reliance on taxes on income and profits,
- a narrow (and shrinking) goods and services tax base,
- over-reliance by the states on narrow and inefficient tax bases, and
- high administration and compliance costs.

A good test of the performance of Australia's tax system is how well it aligns with well-established principles of good tax design. These are:

- **efficiency** – taxes should as far as possible be neutral in their impact on the behaviour of individuals and firms, e.g. as to whether or how much to work, save and consume or where to direct investments;

[2] Although it should be noted that social security contributions represent a further 27% of OECD tax revenues and, if those taxes are included as similar to the income tax, Australia's personal income tax take is more comparable with other countries.

- **revenue adequacy and buoyancy** – taxes should be designed to ensure a secure and sustainable revenue stream to fund the efficient provision of the services the community requires, should grow broadly in line with growth in the economy and the population and should not be overly susceptible to business, asset or commodity price cycles;

- **equity** – taxes should treat those in like circumstances in a similar manner (horizontal equity); and where appropriate should be in proportion to people's ability to pay (vertical equity); and

- **simplicity** – taxes should be easy to comply with and should not impose undue collection or compliance costs.

Because no single tax can fully satisfy all of these objectives, trade-offs between tax principles are best dealt with in the design of the overall tax structure. How well Australia's tax structure manages these trade-offs is discussed below.

3.1.1. Efficiency

High reliance on taxes on income and profits has implications for Australia's international competitiveness, particularly in global markets for capital, but also for skilled labour.

Our tax rates on income and profits are also high relative to many other jurisdictions.

Australia's company tax rate of 30% is above the overall OECD average, which is closer to 25%, and high relative to countries of comparable size. As a small open economy reliant on imported capital to fund investment and growth, Australia cannot indefinitely sustain significantly higher rates of company tax than its competitors. In recognition of this, the Henry tax review (Commonwealth of Australia 2010) recommended lowering the company income tax rate towards the lower end of the small to medium OECD economy average, reducing the rate to 25% over the medium term.

Our top marginal personal income tax rate of 47%[3] (including the Medicare levy) is also relatively high by international standards, while the income level at which the top rate cuts in is lower than in countries such as the US, UK and Singapore. When combined with steep withdrawal rates for working age welfare benefits, our relatively high marginal rates of income tax can act as a disincentive to workforce participation.

In this context it is a matter of concern that the 2015 federal budget estimates show more and more middle income earners entering higher marginal income tax brackets as a result of bracket creep, implying even greater overall reliance on personal income tax receipts in future and increasing disincentives to work.

Consumption taxes are potentially more efficient than taxes on incomes, provided they are sufficiently broadly based not to materially alter relative prices. However, Australia's main consumption tax – the GST – is quite narrowly based, taxing less than 50% of consumption, and this detracts from its efficiency.

And while state and local government taxes combined represent less than a fifth of total tax receipts, overreliance by the states on inefficient taxes significantly detracts from economic efficiency and Australia's overall competitiveness as a place to invest and do business. In particular, stamp duties on property conveyances - the second largest own source tax revenue for the states – have been judged the most inefficient and distortionary of all Australian taxes (Econtech 2011).

Insurance taxes are also highly inefficient and believed to contribute to under-insurance. In the event of a natural disaster, this can lead to increased claims on both state and federal governments where events lead to major property losses.

[3] This rises to 49% when the temporary deficit reduction levy imposed on higher income earners in the 2014-15 Budget is included.

The most efficient tax base available to the states is land tax. However, exemptions for the principal place of residence, along with variations in tax rates depending on land use and aggregation rules, have significantly compromised the efficiency of state land taxes.

A broadly based payroll tax is also a relatively efficient tax - not dissimilar in its effect to a flat rate income or consumption tax. However, small business and other exemptions mean that state payroll taxes are now imposed on a relatively narrow base of employers.

3.1.2. Revenue adequacy and buoyancy

Australia's tax system needs to generate sufficient revenue to meet current and future demand for government payments and services. The adequacy of the tax system to meet future demand for government services is an issue of particular concern to senior Australians. Even were Australia's major tax bases to grow broadly in line with population and the economy, this still might not be sufficient to:

- offset the effects of declining workforce participation rates as the population ages, or
- generate revenues sufficient to meet future growth in age pensions or health and aged care services.

When judged against the objectives of revenue adequacy and buoyancy, Australia's tax bases are already showing significant signs of stress:

- company tax collections have declined sharply following the end of the resources boom and the collapse in commodity prices;
- future growth in income tax receipts largely rely on bracket creep; and
- the GST base is shrinking as a proportion of overall consumption, with receipts failing to keep pace with growth in demand for state government services.

The dramatic fall in federal tax revenues that has followed the collapse in world commodity prices highlights how vulnerable Australia's high reliance on corporate income tax makes us to the boom and bust of commodity price cycles. As the four-year forward estimates published in the 2015 federal budget show, $20 billion of the revenue write-down since the last budget is attributable solely to the drop in iron ore prices (Commonwealth of Australia 2015).

Lower wage and employment growth is also projected to reduce personal income tax receipts by around $2.3 billion in 2014-15 and $8.6 billion over the next four years. Although the budget shows income tax receipts continuing to grow, projected growth is almost solely due to 'bracket creep'. This cannot be regarded as sustainable as it pushes more and more middle income earners into higher income tax brackets.

There are also looming challenges to the adequacy of Australia's income and consumption tax bases as the digital economy enables new business models and new methods of delivery of goods and services; while in the longer term, a shrinking workforce to population ratio as the population ages is likely to see the personal income tax base decline as a proportion of GDP.

At the state level, governments have become increasingly reliant on property conveyance duties to fund ongoing growth in demand for services, yet conveyance duty is one of Australia's most volatile tax bases.

Finally, although the GST was intended to provide the states with a secure and sustainable source of revenue that would grow with growth in the population and the economy, the exemption of food, education, health and financial services has instead meant that GST receipts as a proportion of total

consumption has progressively declined, with growth in exempt items outpacing growth in total consumption.

3.1.3. Equity

The overall equity of the tax structure is affected by many factors, including: the balance of direct and indirect taxation; the degree of progressivity of tax scales; the availability of relief for those with limited means or who face above average cost burdens; and the way in which tax burdens are distributed across the life cycle and between generations.

The preponderance of taxes on income rather than consumption in Australia's tax structure, together with a highly progressive income tax rate scale, may deliver strong equity outcomes[4] but this comes at a cost to efficiency, simplicity and overall revenue adequacy. It also means that savers are more heavily taxed than consumers.

A fair tax system should deliver equitable outcomes in the sense that those in like circumstances face similar tax obligations. However, society's broader redistributive objectives cannot all be satisfied through the tax system. While Australia's progressive income tax scale makes an important contribution, some aspects of the redistributive task are better delivered through transfer payments targeted to those with the least means or the highest cost burdens, or through other social benefit programs (such as assistance with child care, education, housing, medical and pharmaceutical costs) that can be targeted to those who meet the relevant criteria.

While the income tax system is broadly progressive, consumption taxes are generally regressive, imposing a higher tax burden on those with lower incomes[5]. ACOSS has estimated that, in 2010, the bottom 20% of households by income levels paid 3% of their income in income taxes and 21% in consumption taxes, while the top 20% paid 20% in income taxes and 8% in consumption taxes (Australian Council of Social Services 2015).

Today, relatively few state taxes are imposed directly on individuals or households and so do not raise significant equity concerns. Key exceptions are gambling, insurance and motor vehicle taxes. While gambling taxes are generally regressive, they may satisfy other public policy objectives; and most jurisdictions offer concessional tax rates on motor vehicle taxes for those on low incomes. Stamp duties on property conveyances have broadly progressive rate scales that rise with property values. On the other hand, in the context of rapidly rising property values, the progressivity of the conveyance duty tax scale may mean that today's home purchasers face higher effective stamp duty rates than previous generations of home buyers.

3.1.4. Simplicity

Australia is a relatively high cost jurisdiction for tax administration and compliance. For example:

- GST administration costs, at approximately $1.29 per $100 of GST revenue, are high by international standards, and
- More than 75% of individual taxpayers utilised a tax agent in 2011-12, which was among the highest rates of tax agent use in comparable countries (ATO 2014).

A major contributor to high administration and compliance costs is the existence of a multitude of tax concessions and exemptions. The benchmark jurisdiction for low compliance costs is New Zealand which has almost no exemptions from its GST tax base and has also abolished all work-

[4] Reliance on 'bracket creep' to maintain revenue adequacy will however erode income tax progressivity by pushing more low to middle income earners into higher tax brackets.

[5] Thus equity considerations were paramount in the decision to exempt food, health and education from the GST base.

related income tax deductions for employees. This, together with the introduction of a pre-filled 'personal tax statement', has meant that today only around one quarter of New Zealand taxpayers have to file a tax return (Stewart M, Moore A et al. 2015).

4. The case for a change in Australia's tax mix

The foregoing points to a compelling case for a change in Australia's tax structure in order to:

- reduce Australia's reliance on volatile revenue sources and provide for greater revenue adequacy to meet the economic and fiscal challenges of the future, and

- increase the overall efficiency of the system in order to foster growth in productivity and workforce participation and improve Australia's international tax competitiveness.

While there has long been a case on *efficiency* grounds for some change in Australia's tax mix, it is the looming threat to *revenue adequacy* that now makes the case for change more urgent.

This is starkly demonstrated in the 2015 budget projections, which show growth in income tax receipts almost entirely propelled by bracket creep, while on the expenditure side virtually all projected savings in the out-years are due to an $80 billion reduction in federal health and education grants to the states. As middle income earners are unlikely to stand for a projected 5 percentage point increase in their marginal tax rate, and the states have little prospect of making up for the loss of $80 billion in federal grants, the assumptions underpinning the budget projections are clearly unsustainable. Absent these assumptions, the projections would likely show a widening structural deficit.

Further shrinking of the GST base as rising consumption of exempt items outpaces growth in total consumption will also progressively erode the only broad based revenue source available to the states; while the inevitable cooling of property markets will almost certainly cause conveyance duty receipts to fall from their current record high levels, leaving the states with a growing gap between revenue and ongoing spending commitments.

4.1. Broad directions for reform

A shift in the overall balance of Australia's tax structure away from the current high reliance on income taxes and towards greater reliance on consumption taxes would address both efficiency and revenue adequacy objectives while at the same time improving rewards for saving relative to consumption.

Ideally, such a shift would be accompanied by a broadening of tax bases on income and consumption at the federal level, and on land at the state level, by reducing or eliminating a number of current concessions and exemptions. Broadening Australia's major tax bases would contribute significantly to improved revenue adequacy and tax efficiency while at the same time providing opportunities to:

- either fund reductions in tax rates, or generate increased revenue at existing rates;
- reduce reliance on volatile and inefficient taxes such as conveyance duties, and
- greatly simplify the system, lowering compliance costs and reducing scope for tax avoidance.

Options for broadening the income tax base could include extending the coverage of fringe benefits tax and eliminating or streamlining work expense deductions (as occurred in New Zealand). Consideration could also be given to targeted reform of superannuation tax concessions to improve the overall integrity and fairness of the superannuation system and reduce the potential for it to be used as a tax shelter for high wealth individuals. However, any change to the taxation of

superannuation would need to be considered as part of a broader review of the retirement incomes system. Options to improve the taxation of savings are discussed further in Section 5 below.

Broadening the GST base by removing current exemptions for health, education and food would enable GST revenues to grow broadly in line with growth in the economy and the population, providing a more secure basis to fund growth in demand for state provided services, while at the same time increasing its efficiency and reducing business compliance costs. This would need to be accompanied by an increase in transfer payments to lower income households, as outlined in Section 6 below.

Reforming state land tax bases could enable the abolition or substantial reform of conveyance duties to deliver a significant overall boost to efficiency. Careful consideration would, however, need to be given to equity issues arising from removal of principal place of residence exemptions from land tax, particularly in the case of retirees and others who may be asset rich but income poor. Alternative approaches to reform of property based taxes are discussed further in Section 7.

New Zealand's 2010 Tax Reforms

In its comprehensive package of tax reforms introduced in 2010, New Zealand demonstrated that a revenue neutral switch from income to consumption taxes can deliver an overall boost to economic efficiency while at the same time ensuring greater revenue sustainability by reducing government's overall reliance on more mobile or volatile tax bases. By broadening the income tax base and increasing the GST rate on its already very broad consumption tax base, New Zealand was able to fund a 5 percentage point reduction in its top personal marginal tax rate and between 2.5 and 3 percentage points to lower tax brackets and a reduction in the company tax rate from 30% to 28%, while also simplifying the system.

4.2. Tax reform within the federation

A confounding factor in delivering a tax switch between income and consumption taxes is that the entirety of Australia's GST revenues are directed to the states, but it is the federal government that would be required to introduce the legislation to broaden the tax base (and/or increase the rate) and to give effect to any compensation through lower income tax and increased transfer payments. To finance these compensatory adjustments would likely entail the Commonwealth reducing other payments to the states.

In addition, under the intergovernmental agreement that underpins the GST arrangements, any reform to the GST rate or base must be unanimously agreed between the Commonwealth Government and all State and Territory Governments. Such agreement would be politically difficult to achieve unless there were clear and lasting benefits to the states. Reform to the way in which the GST revenue is distributed between the states could be one of the concessions the Commonwealth might have to consider.

Governments at both state and federal level must show leadership in overcoming these challenges given the deteriorating outlook for state revenues if nothing is done to shore up the GST base.

5. Taxation of savings

Differences in Australia's tax treatment of alternative savings vehicles have no clear rationale and, as both the Financial System Inquiry (Financial System Inquiry 2014) and the Henry tax review (Commonwealth of Australia 2010) highlighted, have the potential to distort investment decisions

and encourage households to over-invest in owner occupied housing and to place their savings in more risky, tax-preferred savings vehicles.

Superannuation is the most tax preferred form of saving, followed by the family home, domestic shares and rental property, while interest on savings is the most heavily taxed.

National Seniors considers there is a compelling case for taxation on life-long savings in superannuation and the family home to continue to receive concessional tax treatment. If these vehicles were taxed at the same statutory rates as other income and assets, there would be no incentive for people to provide for their retirement.

There is also a strong case for taxing other forms of savings at a lower rate than labour income, particularly in order to compensate for the effects of inflation. Whereas income tax applies to nominal labour earnings and so compensates for inflation, applying the same tax rates to earnings from savings includes the inflationary component and so makes savings subject to a higher effective tax rate.

On the other hand, there are both efficiency and equity grounds for more consistent treatment of alternative short to medium term savings vehicles to avoid distorting investment decisions and to avoid penalising those who choose to hold their savings in less tax preferred forms.

Issues with the current tax treatment of different savings vehicles are considered further below.

5.1. Life-long savings vehicles

Concessional tax treatment of lifelong savings in superannuation and owner occupied housing is common practice throughout the world. Life-long saving requires consumption from current income to be deferred for many years, when the purchasing power of the saved income will be much less.

5.1.1. Superannuation

As in most OECD countries, superannuation is the most tax-preferred form of life-long savings under Australia's tax system, with both contributions and earnings taxed at a concessional 15% rate, while retirement benefits are tax exempt after age 60.

Although some may argue that tax incentives are not necessary to support the mandatory component of superannuation contributions, the current tax treatment of superannuation contributions appropriately recognises the bias in the income tax system against long term savings while also providing strong incentives for individuals to make voluntary contributions to superannuation, encouraging greater self-reliance among future retirees. Without concessional tax treatment of superannuation, the majority of Australians who are not wealthy will not have sufficient incentive to save for their own retirement and more will be forced to rely on the tax funded pension system.

While there is a broad consensus that tax concessions are necessary to encourage people to save for their retirement, there are concerns that superannuation tax concessions are overly generous to high income earners and high net wealth individuals. This could undermine the integrity of the system, and it comes at a high cost to the federal budget.

However National Seniors considers it crucial that any proposal for change to the taxation treatment of superannuation savings be considered in the broader context of Australia's retirement incomes policy, including the treatment of financial and other assets when determining eligibility for the Age Pension. In addition, any proposed change should be prospective in order to avoid negating past savings decisions made by individuals in good faith.

It is therefore disappointing that both the Government and the Opposition have announced policy positions that fail the first of these tests, with each focusing on only one aspect of the retirement income system:

- Labor has announced its intention to limit superannuation tax concessions for the better off by extending the 30% contributions tax to those on incomes of $250,000 and above (compared to the present $300,000 threshold). Labor would also end the tax-free status of superannuation incomes in excess of $75,000 per annum.
- The Coalition, by contrast, has signalled its intention to leave superannuation tax concessions alone and has instead announced reforms to Age Pension eligibility criteria to reduce access to the pension for those with private assets by adjusting the assets test thresholds and increase the tapering rate.

Regardless of the merits of the proposal there are serious doubts about whether the Labor policy can be implemented – at least not without very significant costs to superannuation funds that would inevitably be passed on to members in the form of higher fees .

The Government's announced changes to Age Pension eligibility also appear to have been poorly thought through.

- First, they reduce benefits to households with relatively modest assets while leaving benefits to high wealth households untouched. Reducing pension eligibility while leaving superannuation tax concessions unchanged has the potential to make Australia's retirement income system one of the most unfair in the world, according to the Australian Institute of Superannuation Trustees. National Seniors could not support reforms that tighten eligibility for the Age Pension while generous tax concessions to high net wealth individuals remain in place.
- Second, the proposed changes will result in unfair treatment of some partially self-funded retirees. According to the Association of Superannuation Funds of Australia (ASFA), the Government's proposed changes would mean that a couple who own their own home and have other assets of only $200,000 would be entitled to a pension generating a higher annual income than a self-funded couple retiring with assets of between $820,000 and $1.1 million[6]. This will create perverse incentives, encouraging middle income households to spend rather than save for their own retirement.

To address concerns that tax concessions provided to high income earners are excessive, consideration could be given to the Henry tax review recommendation that superannuation contributions be taxed as income at normal marginal tax rates, but with flat-rate refundable tax offset. This would increase the effective tax rate on contributions for high income earners while subsidising contributions of low income earners.

Further, if it is agreed that the purpose of superannuation is to provide an adequate income in consideration should be given to limiting access to tax concessions once an individual has accumulated sufficient superannuation to enjoy a reasonably high standard of living in retirement.

5.1.2. *The family home*

Owner occupied housing represents the principal form of lifetime savings for most Australians and is a critical source of security in retirement. As with superannuation, favourable tax treatment of owner occupied housing compensates for bias in the income tax system against longer term savings.

The Henry tax review did not propose any significant change to the favourable income tax treatment of owner occupied housing, noting that it has been long standing practice, has widespread community support and remains an important determinant of people's living standards in retirement.

[6] And for those who also lose access to thousands of dollars of state funded concessions on annual utility bills, transport fares, motor vehicle registration, municipal rates and the like, the comparison becomes even more unfavourable.

Some argue that exemption from capital gains tax leads to over-investment in the family home and inequitably favours the beneficiaries of wealthier families. However, New Zealand found that taxing capital gains could be regressive if the family home was included and that taxing capital gains on the family home would materially influence decisions to sell, creating a significant barrier to moving to more appropriate accommodation. Exempting the family home was considered the most straightforward solution to these issues (The Treasury (NZ) 2009).

The family home also receives concessional treatment under the Age Pension asset test. This is appropriate, not only because it is important to provide incentives for people to save for their retirement but also because all the evidence shows that retirees who do not own their home – particularly those who qualify for full pensions – face a very high risk of living in poverty.

To the extent that concessional tax and social security treatment of the family home enables high wealth individuals to access social security payments, some limit on the value of homes eligible for concessional treatment could be considered. However, this would need to be done as part of a more comprehensive review that considered tax and social security arrangements together.

5.2.Other savings vehicles

Just as long term savings in superannuation and the family home should be taxed more lightly than other forms of savings to compensate for both inflation and deferral of consumption, there is also a case for lower taxation of other forms of savings to at least compensate for the effects of inflation. More consistency between the tax treatment of other savings vehicles is also desirable to avoid distorting savings and investment decisions in favour of more tax-preferred options.

5.2.1. Interest on bank deposits

Interest on bank accounts is the least favourably treated of all savings vehicles. This is of particular concern to senior Australians as many retirees keep at least part of their savings in bank accounts – whether for liquidity reasons, as insurance against rainy day events, or because they believe this is the only way of guaranteeing the safety of their savings.

The fact that all of the interest earned on savings deposits, including inflationary gains, is included in annually taxable income and taxed at the individual's marginal rate effectively penalises those who choose to keep their savings in the least risky form. Moreover, the longer a person saves, the greater is the penalty relative to those who do not save or who choose more tax-preferred savings vehicles.

Punitive taxation of savings deposits discourages thrift and disadvantages those who, for liquidity reasons or because they are more risk averse, choose to keep their savings in the form of bank deposits. Evidence from the Household and Labour Dynamics Australia survey (HILDA) shows that it is those with the least financial resources and people aged 65 and over who are the most risk-averse (Melbourne Institute of Applied Economic and Social Research 2014).

While interest income should be subject to some level of taxation in order to preserve the integrity and comprehensiveness of the income tax system, taxing only real returns would reduce tax distortions on savings, investment and borrowing and would likely lead to higher net savings.

Some reduction in the overall tax burden on savings could also be achieved through a change to the overall tax mix involving a reduction in taxes on income while increasing taxes consumption.

5.2.2. Rental property

Those who invest in rental properties are able to benefit not only from full tax recognition of losses but also discounted tax treatment of capital gains, with the capital gain taxed at only half an individual taxpayer's marginal rate. Through negative gearing, returns on an investment property can be offset against interest payments on borrowing used to finance the asset and also against other income sources.

While negative gearing is a legitimate practice (and applies equally to other investment), concerns have been voiced that the tax advantages from borrowing to invest in rental properties (in combination with high effective marginal tax rates on savings) gives people an incentive to borrow rather than save and leads to investors taking on too much debt.

There are also concerns that the increasingly widespread use of negative gearing on investment properties may be contributing to an over-heated housing market and exacerbating problems of housing affordability, although an alternative view is that declining housing affordability simply reflects restrictions on supply relative to demand.

Options that have been canvassed to address concerns about over-leveraging and over-investment in the property market include:

- allowing investors to write off their losses only against capital gains (as occurs in some other jurisdictions);
- limiting the number of properties that a single investor can negatively gear; or
- limiting loan-to-value ratios for second properties (as is done in Singapore and Hong Kong).

National Seniors considers that any of these options would likely only add further complexity to an already overly complex tax system and may give rise to other anomalies.

However, a more neutral tax treatment of gains and losses associated with property investments could reduce the present bias towards investments that generate capital gains rather than income.

5.2.3. Shares

While investments in both foreign and domestic shares attract a 50% capital gains tax discount (provided they have been held for more than 12 months), domestic shares also benefit from dividend imputation which avoids double taxation of company cash payments to shareholders.

While the recent Financial System Inquiry was concerned that dividend imputation creates a bias in favour of investment in domestic shares and may encourage investors to favour shares over other, less risky investment options, National Seniors would strongly oppose any move to discontinue dividend imputation.

Dividend imputation provides strong incentives for individuals to save for their retirement, encouraging greater self-reliance. For self-funded retirees, income from dividends has become an increasingly important source of retirement income. Without dividend imputation, companies would have little incentive to pay the dividends on which many retirees rely. This could have significant adverse effects on people's retirement income prospects - particularly in today's exceptionally low interest rate environment.

The imputation system encourages stronger capital discipline by companies who must carefully weigh decisions about how much capital to retain and how much to disperse to shareholders in order to maximise value to their shareholders.

Dividend imputation also provides strong incentives for Australian companies to pay tax in Australia. Abolition of dividend imputation would remove the current disincentive for companies to shift their profits to lower tax jurisdictions, with the potential for revenue loss that could far exceed any expected revenue gain.

For a nation that relies on importing capital to fund investment, a strong commitment to Australian shares by domestic investors also helps ensure that a growing pool of superannuation savings supports domestic investment and growth.

There may nevertheless be legitimate concerns that high net worth individuals are able to exploit dividend imputation through their superannuation funds for the purpose of reducing tax obligations

on income from other sources. The purpose of the superannuation system should be to provide income in retirement, not to become a vehicle for tax planning.

5.2.4. Options for reform

Achieving greater consistency in the tax treatment of alternative savings options, whilst also compensating savers for the effects of inflation, presents challenges as these effects will vary depending on the point in time at which tax is incurred. For example, while interest earnings incur tax on an annual basis, capital gains are not taxed until the gains are realised and this partially protects them from the effects of inflation.

In recognition of this, National Seniors suggests further consideration be given to the Henry tax review proposal (Commonwealth of Australia 2010)(Recommendation 14) to apply a standard 40% ''savings income discount'' to earnings from each of the following savings vehicles

- net interest income,
- net residential rental income,
- capital gains (and losses), and
- interest expenses related to listed shared held by individuals as non-business investments.

The choice of a 40% discount - rather than the 50% currently applying to capital gains - was considered a more realistic discount rate to compensate for inflation in today's environment, given the RBA's annual inflation target range of 2-3%.

The adoption of a standard savings income discount would not only remove the current penalty rates on interest earnings but would also moderate the current bias in favour of highly leveraged investments in rental properties that yield capital gains by reducing the disparity between the tax treatment of rental income and capital gains. Highly geared investors in rental property would still receive some tax advantage relative to other investments, but the bias in favour of debt over equity financial for rental properties would be significantly reduced.

As a result, the review contended:

> *'… savings would be allocated more productively, distortions to rental property and other markets would be reduced and household investment and financing choices would better suit their circumstances and risk-preferences. The discount would also provide a means of adjusting for the effect of inflation, which increases the effective rate of tax on savings income (Commonwealth of Australia 2010)(33).*

While not wedded to this model, National Seniors supports the principle of achieving more consistent tax treatment of savings and providing an appropriate discount for inflation.

6. Taxation of consumption and payrolls

Australia has a lower reliance on consumption taxes (28% of total tax receipts) than the OECD average (33%). This suggests that Australia has scope to increase taxes on consumption in order to reduce its reliance on less efficient taxes on income and profits, consistent with international trends.

Australia's chief consumption taxes are:

- goods and services tax (GST)
- insurance taxes
- motor vehicle taxes
- fuel excise
- gambling taxes
- taxes on tobacco and alcohol

Improvements to Australia's consumption tax regime could be achieved by:

- broadening the GST base to improve efficiency, reduce compliance costs and ensure its capacity to generate a secure and growing source of revenue for the states
- abolition of state taxes on insurance once adequate replacement revenues can be sourced,
- restoration of indexation of fuel excise, and
- more uniform taxation of alcohol.

6.1. Goods and Services Tax (GST)

Upon introduction in 2000, the Goods and Services Tax (GST) replaced federal wholesale sales tax and a number of smaller, inefficient state stamp duties. While the GST is levied by the federal government, all of the revenue is distributed to the states. The aim of this was to provide the states with a revenue base that would grow broadly in line with growth in the population and the economy.

From an efficiency point of view, a broad based tax on consumption is generally regarded as superior to a tax on incomes because it does not tax labour effort or savings and, if anything, encourages thrift. In addition, whereas taxes on income and capital only apply to those who earn or save a general consumption tax applies to all consumers and, as the Henry tax review pointed out:

> *'… as the population ages, an indirect broad-based consumption tax is likely to become increasingly important, since it taxes the capital income of retirees as it is spent, which might otherwise largely be untaxed under an income tax.'(Commonwealth of Australia 2010).*

However, the exemption of major categories of household expenditure – including food, education, health, aged care, child care, water, sewerage and financial services - makes Australia's GST base narrower than that of many other countries. This compares with an OECD average of 55% while in New Zealand - the gold standard for a broad based consumption tax - GST applies to 95% of consumption.

Because consumption of a number of these exempt items is growing faster than total consumption, the proportion of total expenditure captured by the GST has fallen from a peak of 56% of consumption and will inevitably continue to decline so long as these items remain exempt. Growth in the use of the internet and mobile apps to purchase goods and services means that the GST base is also under threat from e-commerce and the growth in the 'sharing economy'. (Thus the Commonwealth and the states have recently agreed to extend the GST to cross border supplies of digital products and services imported by consumers, such as downloaded software or movies streamed over the Internet).

The shrinking of the GST base should be a matter of considerable public concern as it undermines the key policy objective of providing the states with a sustainable and growing revenue source to meet growth in demand for state services.

Although the major exemptions in the GST base are widely considered to make it more equitable - especially the exemption of food – this is a costly way to achieve equity because all consumers benefit from the exemptions regardless of income. While lower income households spend a higher proportion of their income on GST-exempt items, higher income households receive the most benefit in dollar terms. This is because consumption of services such as education and health tends to rise with income levels, while wealthier households also tend to consume higher priced food products on which the dollar value of the exemption is greatest.

A better means of addressing the equity effects of GST on lower income households at lower overall cost to the budget would be to target assistance directly to those households through compensatory income supplements.

Exemptions also greatly increase the complexity of the GST and lead to high compliance costs, particularly for businesses in the food industry, where some items are subject to the tax and others are exempt.

Broadening the GST base would improve revenue adequacy for the states while at the same time helping to fund compensatory reductions in personal tax rates to improve Australia's overall tax mix.

There is also scope for some increase in Australia's 10% GST rate, which is low by comparison with the OECD average rate of 19%. While simply increasing the rate without broadening the base would likely compound the efficiency problems arising from the current exemptions, a combination of broadening the base and raising the rate could fund larger reductions in personal income tax while improving overall economic efficiency.

For all these reasons, there is a compelling case for broadening Australia's GST base, and potentially increasing the rate, in order to reduce taxes on income, and for using the transfer system to compensate lower income households for the regressive effects of extending GST to food and other currently exempt items.

In addition, in order to prevent future bracket creep eroding the efficiency benefits of such a tax mix switch, income tax brackets should be indexed, with future policy changes in income tax rates potentially linked to changes in the GST rate.

6.2. Taxes on insurance

Taxes on insurance represent an important source of revenue for the states. However, insurance premiums are already subject to GST and the additional impost of state insurance taxes raises premiums significantly. The widespread tendency for households to under-insure their properties – which can result in additional burdens on taxpayers when disasters occur - has been attributed in part to the impact of insurance taxes. Insurance taxes are also regressive and are therefore undesirable on equity grounds.

There are therefore strong economic and social reasons for the abolition of state insurance taxes, provided a more efficient source of replacement revenue can be found to replace them.

6.3. Motor vehicle taxes

Motor vehicle taxes – comprising motor vehicle stamp duties and registration fees - also raise significant revenues for the states (accounting for around 13% of states' own-source tax receipts).

While the states have the major responsibility for road funding, for constitutional reasons they are unable to levy excise duties on fuel. In this context, motor vehicle taxes may be partially justified on efficiency grounds as an alternative to road use charges and a source of funding for road infrastructure.

6.4. Fuel excise

In the absence of more direct forms of road use charges such as road tolls, federal fuel excise duties represent perhaps the best currently available form of road use tax. As a selective tax on fossil fuels that doesn't apply to other sources of transport energy, fuel excise can also help address greenhouse gas policy objectives.

Since the Howard government suspended indexation of excise on fuel in 2001 this revenue source has been inexorably declining. There would appear to be little point in maintaining this tax if its real value is not maintained over time and the restoration of indexation should therefore be given priority.

6.5.Gambling taxes

State gambling taxes accounted for around 8% of state tax revenues in 2013-14. Gambling is also subject to the GST.

The incidence of gambling taxes is not always easy to identify (i.e. how much is borne by the gambler and how much by the operator). As a tax on a discretionary activity, gambling tax may be viewed as voluntary and therefore issues of fairness do not arise. On the other hand there is evidence that gambling taxes are regressive, and may be becoming more so as more of the gambling dollar goes into gaming machines. Although gambling taxes are sometimes justified as 'sin' taxes, there is little evidence that high rates of taxation discourage people from gambling.

While the states have increased their dependence on gambling taxes over the years, ongoing innovation in information and communication technology is likely eventually to make it more difficult to maintain the integrity of gambling tax bases, pointing to the likely need for states to look to alternative revenue sources in the future.

6.6. Tobacco and alcohol taxes

Selective additional taxes on tobacco and alcohol (over and above the GST) can generally be justified on the grounds that higher rates of taxation will discourage their consumption, consistent with broader public health objectives.

While few would argue about the desirability of high rates of taxation on tobacco, there are periodic calls for rationalisation of the complex and inequitable array of tax and subsidy arrangements that currently apply to alcoholic beverages. According to the Henry tax review, these arrangements '*distort production and consumption decisions with no coherent policy justification*'.

Despite the claims of the wine industry, there seems to be little justification for higher taxation of beer and spirits than of wine of the same alcoholic content. The introduction of a uniform tax on all alcoholic beverages based on alcohol content by volume could increase overall revenue while at the same time improving both the efficiency and the equity of taxes on alcohol.

6.7. Payroll tax

Payroll tax represents the largest single source of state tax revenues, raising over $21 billion in 2013-14 and representing just less than a third of states' own-source tax receipts.

Payroll tax is potentially a relatively efficient tax that operates much like a broad based consumption or income tax - with the ultimate incidence being passed through to consumers in the form of higher prices, or to employees through lower wages. However, exemptions for small businesses and for many areas of public sector and not-for-profit activity have resulted in the situation where it is estimated that over 40% of employee remuneration is exempt. This compromises the efficiency of the payroll tax system as it favours employment in smaller rather than larger businesses regardless of their relative efficiency. The narrowing of the payroll tax base also means that those businesses that are subject to the tax must pay significantly higher tax rates than would be required to generate the same revenue were there no exemptions.

Nevertheless, payroll tax has the virtue of growing broadly in line with aggregate wages and the economy, and thus constitutes a reliable and reasonably buoyant source of revenue to fund state services. Accordingly, while there have been frequent calls for its abolition, this outcome would appear unlikely given its importance as a major source of state revenue.

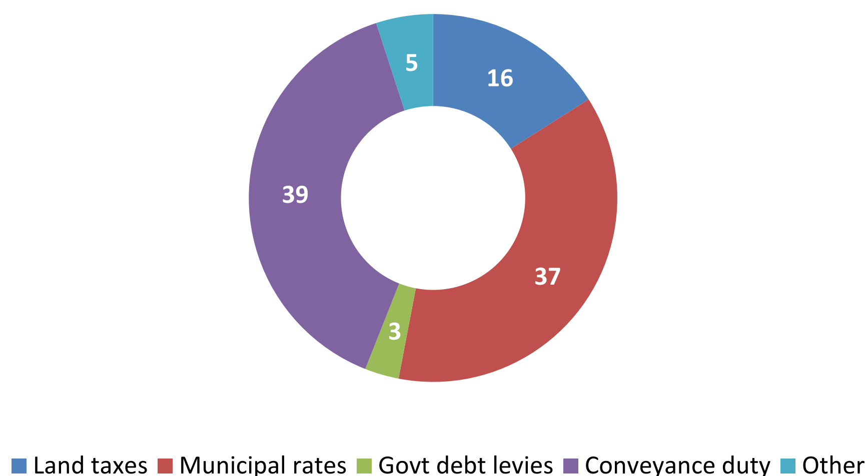
7. Taxation of property

Australia relies more on taxes on property than the OECD average, although less than in the US, UK and Canada. The main taxes on property levied in Australia (Figure 3) are:

- stamp duty on property conveyances
- land tax,
- municipal rates, and
- government debt guarantee levies

This paper deals with the first two of these and considers the case for phasing out conveyance duty and replacing it with a broader based land tax.

Figure 3: State and local government taxes on property, 2013-14



Source: ABS 5506: Taxation Revenue Australia 2013-14

7.1.Stamp duty on property conveyances

In 2013-14 stamp duties on property conveyances contributed 23% of state tax receipts, up from 20% in 2012-13.

Conveyance duties are among the most inefficient and distortionary of all Australian taxes[7].

- conveyance duty on business property transfers adds significantly to transactions costs and may discourage some investments, and
- conveyance duty on residential property contributes to problems of housing affordability[8] and discourages housing mobility.

Because it is such a large impost, conveyance duty may represent a significant barrier to people moving to more appropriate accommodation. In Victoria, for example, the purchase of an existing dwelling at today's median price of $688,000 for metropolitan Melbourne would attract conveyance duty of the order of $36,350, while a median priced unit of $519,500 would attract duty of $23,140 (unless purchased off-the-plan).

At these amounts, conveyance duty will inevitably be factored in to household decisions as to whether to shift to more appropriate accommodation. For retirees it is likely to be a major barrier to downsizing from the family home to a smaller house or unit more in keeping with their needs.

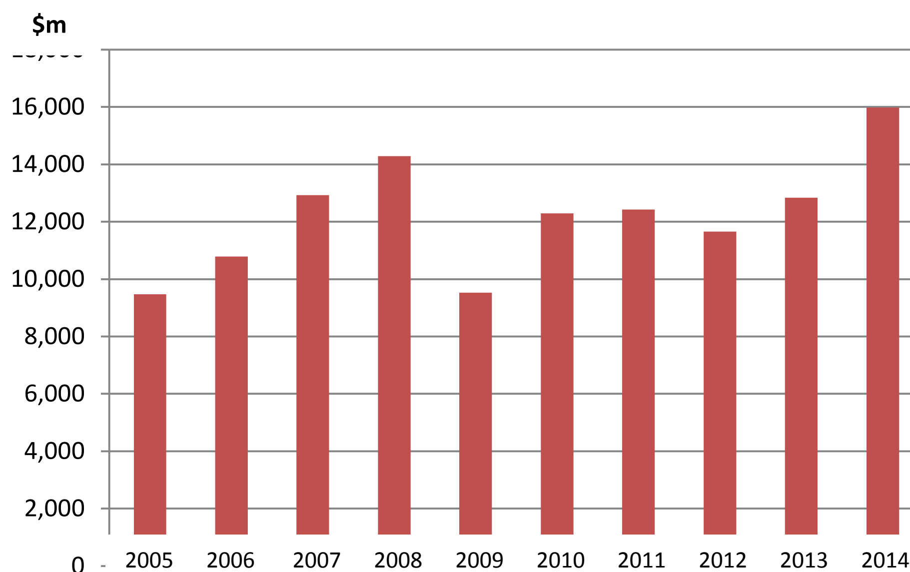
[7] KPMG Econtech assess conveyance duties to impose the highest burden on the economy, while the Henry tax review found taxes on insurance to be the most inefficient, followed by conveyance duty.

[8] Though note that the incidence of conveyance duty may fall on either the buyer or the seller, depending on market conditions. Where demand exceeds supply, conveyance duty will likely add to the price purchasers must pay, while in a buyer's market the burden of the duty may be reflected in lower sales proceeds for the vendor.

Conveyance duty also represents a barrier to labour market mobility where a change of job requires a change of residential location.

On the other hand, analysis undertaken by NATSEM for the South Australian Government's State Tax Review Discussion Paper showed conveyance duty to be more progressive than most other state taxes, with the burden of the duty increasing with income (Government of South Australia 2015).

Figure 4: Conveyance duty receipts, all states, 2004-05 to 2013-14



Source: Taxation Revenue Australia 5506, 2013-14

Stamp duties on property conveyances rate particularly poorly on buoyancy criteria, with revenues highly susceptible to asset price cycles (as shown in Figure 4). Despite this, states have become increasingly reliant on windfall receipts from record volumes of property transactions to fund ongoing growth in demand for their services.

7.2. Land tax

Land tax is potentially the most efficient tax base available to the states. This is because:

- land is immobile and its supply is inelastic, thus land tax cannot easily be avoided, and
- land tax generally applies regardless of the use to which land is put, and so it discourages speculation and encourages landowners to ensure land is applied to its highest value use.

In practice, however, exemptions for the principal place of residence and other specified uses, together with variations in tax rates depending on land use and aggregation rules, have significantly compromised the efficiency of state land taxes. As a result of these exemptions, land tax rates are significantly higher than they would otherwise need to be in order to generate the same overall revenue.

An efficient land tax would apply equally to all land uses and aggregate holdings. This would also enable tax rates to be kept low and affordable while still yielding a similar amount of revenue.

As the value of land holdings generally aligns with income, even a broad based land tax should also rate well on equity criteria. On the other hand, the requirement to meet even relatively modest annual land tax obligations could place financial pressure on households with low or fixed incomes, such as retirees.

7.3.Property tax reform options

A number of previous reviews, including the Henry tax review (Commonwealth of Australia 2010), have recommended that stamp duties on property conveyances be replaced over time by more efficient annual land taxes.

While broadening land tax bases to fund the eventual abolition of conveyance duties would improve economic efficiency, there are important distributional impacts to consider, including that:

- the initial imposition of land tax can impose windfall losses on existing holders of land, because prospective purchasers will factor the obligation to make a future stream of tax payments into the price they are willing to pay,
- landholders who are 'asset rich but income poor' (including many retirees) may not have sufficient annual income to meet land tax obligations without adverse impacts on living standards, and careful consideration would need to be given to how to assist these households, and
- a switch from up-front conveyance duties on the transfer of land to an annual land valuation tax would defer a significant amount of government revenue to future years, creating transitional budgetary problems for states.

To date, the only jurisdiction to have commenced a switch from conveyance duties to general rates and land taxes is the ACT Government. From June 2014 the ACT reduced conveyance duty rates and increased general rates on residential and commercial properties by around 10%, with further rate changes scheduled to be phased in over coming years. To minimise economic, social and revenue impacts from this switch, the reform transition is expected to take up to 20 years.

South Australia is also considering the option of abolishing conveyance duty and funding this by removing exemptions from the existing land tax base, but has identified a number of practical constraints to the implementation of this option, including:

- how government would manage adverse transitional impacts on revenue,
- how 'asset rich but income poor' households would best be assisted, and
- how to avoid double taxation of home owners who have recently incurred conveyance duty on their home.

While the replacement of conveyance duty with revenues from a more efficient, broad based land tax has considerable theoretical appeal, it seems clear that such a reform would need to include safeguards for low income households and be phased in over an extended time period.

Maintaining targeted exemptions from any new land tax obligation for pensioners and retirees on low or fixed incomes would be one solution to the problem of the impact of land tax on the asset rich but income poor.

A case can also be made for maintaining land tax exemptions for land used for primary production, given that farming is relatively land intensive and that land is generally set aside solely for primary production purposes through zoning regulations that do not allow alternative uses. However, to prevent landowners reaping windfall gains on farming land that is subsequently rezoned for other uses, there should be provision for recouping land tax that would have been payable on the rezoned use upon the initial sale of the land into the alternative use.

In the meantime, more immediate steps could be taken to ameliorate some of the adverse effects of conveyance duty on housing mobility. For older Australians, the most obvious of these is the need to reduce barriers to downsizing to more appropriate accommodation in their retirement years.

Some jurisdictions have already take action to address this issue. The ACT's 'Over 60s Home Bonus' scheme provides a stamp duty concession for all home buyers aged over 60, with eligible downsizers in the ACT now able to pay as little as $20 for stamp duty for a property worth less than $595,000, and receive a discounts of some $18,280 on a $550,000 home[9].

In its submission to the Financial System Inquiry (National Seniors Australia 2014), National Seniors put the case for a complete exemption from conveyance duty targeted to eligible retirees wishing to downsize in order to release equity for investment in an eligible retirement income-generating product. While states might argue that this would come at a cost to revenue, additional housing turnover resulting from the removal of this significant disincentive to downsizing could generate additional stamp duty receipts to offset any revenue lost through a tightly targeted exemption.

8. Conclusion

The growing divergence between tax revenues and expenditure at both federal and state levels suggests the time has come for comprehensive tax reform to strengthen the resilience of the tax system. The aim of reform should be to improve revenue adequacy and sustainability while providing a much needed boost to productivity, participation and economic growth. This argues for fundamental reform of Australia's tax mix and its major tax bases, rather than mere refinement.

A more consistent approach to the taxation of savings is also overdue, with particular priority to the removal of taxation on the inflationary component of savings. However, any proposed reform to the taxation of retirement savings (either in the form of superannuation or the family home) must be considered in the context of a more comprehensive review of retirement incomes policy. At the same time, the opportunity could be taken to clean up inefficiencies and inconsistencies in other tax bases, but not at the expense of using up political capital needed for the major reforms.

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