Australian Council of Social Service

Tax reform: purpose, principles and process

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Who we are

ACOSS is the peak body of the community services and welfare sector and the national voice for the needs of people affected by poverty and inequality.

Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

What we do

ACOSS leads and supports initiatives within the community services and welfare sector and acts as an independent non-party political voice.

By drawing on the direct experiences of people affected by poverty and inequality and the expertise of its diverse member base, ACOSS develops and promotes socially and economically responsible public policy and action by government, community and business.

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Purpose

1. The main purpose of taxation is to raise revenue for the services and income supports the community needs. Public revenues should be *adequate* for that purpose.

2. Tax should, as far as possible, be levied *equitably*, according to ability to pay.

The level of income and assets available to an individual are the best measure of ability to pay, and there is a strong case on equity grounds for higher tax rates to apply to people with higher incomes (vertical equity).

Taxes should also, as far as possible be raised at the same level from people in similar circumstances, and people who obtain their income from different sources (horizontal equity).

3. Taxes should be equitable between different generations.

As a general rule, people with the same ability to pay tax should pay the same amount of tax, regardless of their age. The system should, as far as possible, be age-neutral.

4. Taxes should be raised in a way that minimises economic costs through tax-created distortions or bias.

This depends as much on *how* revenue is raised (especially consistency of taxation) as the overall *level* of taxes raised.

5. Taxes should be as simple, transparent and predictable as possible.

The system should be designed to minimise compliance costs and to discourage complex and economically wasteful avoidance strategies (for example, complex private trust and company structures).

6. The community as a whole should have a stake in tax reform.

As far as possible, the community, in all its diversity of interests and views, should be consulted and engaged in the tax reform process. Major reform will not be universally supported, but it is more likely to be accepted if the community is broadly involved in defining the problems and searching for solutions and conflicts of view are openly acknowledged and respected.

Principles

Adequacy:

1. Australian and State Government revenue levels should be restored, and tax reform should be backed by expenditure reform, to meet the basic economic and social needs of the community over the coming decade.

In 2010, the combined revenues of Australian Governments were the third lowest among the OECD countries, as was our ranking in terms of public expenditure. Australian Government revenues have fallen, in proportion to GDP, by 4 percentage points below their pre-GFC level, which is equivalent to over $60 billion in current values.

Given community expectations that gaps in the social safety net such as disability services, inadequate income support payments, and dental and mental health will be closed; and, given the future costs associated with population ageing, public revenue levels should be restored so that Governments can meet the community's needs over the next decade.

Tax reform should be linked to expenditure reform to refocus expenditures on these and other priorities and reduce wasteful expenditures, including wasteful tax expenditures.

2. To restore public revenue without compromising both efficiency and equity, the tax base, especially that relating to personal income, should be broadened.

If revenue is restored simply by increasing tax rates off existing narrow tax bases, equity and economic efficiency could be compromised.

Equity:

3. Tax and related expenditure reform should improve the living standards of people on the lowest incomes and result in a more equitable distribution of public supports between low, middle and high income earners.

Large 'compensation packages' are generally only required if the reform has an inequitable impact on low income households. Such compensation packages are vulnerable to erosion in future Budgets.

4. Equity and public support for the tax system will be strengthened if different forms of tax on saving and investment, and earnings from paid work are taxed more consistently. Currently, individuals with relatively high levels of income and assets who are well advised can avoid paying tax at their marginal rate, leaving others to pay more to plug the resulting revenue gap.

The Henry Report proposals provide a good foundation for this work.

5. Equity between generations would be improved, and Governments could better meet needs of an ageing population for essential services, if people of mature age were taxed as far as possible at the same rates as younger generations on their non-superannuation income, and tax concessions for superannuation contributions and fund earnings were better targeted.

At present, less than 20% of individuals over 65 years pay any income tax and those who do so pay at lower rates than they would in the absence of age related tax concessions. People of mature age can also reduce their tax, without increasing their savings, by 'churning' their income and investment assets through superannuation accounts.

While there is a role for user charges to help finance health and community services, broadly based income taxation is generally a fairer way to pay for essential services, provided everyone (including older people) contribute according to their ability to pay.

Tax reform in this area should be linked with expenditure commitments in areas such as health nd aged care, to enhance people's security in retirement.

Efficiency

6. Economic efficiency would also be improved if different forms of investment and labour income were taxed more consistently.

A good example of this is incentives in our tax system to over-invest in existing housing, inflating its price and diverting investment from more economically useful activities.

This does not mean that all forms of income should be taxed equally, since broadly speaking it is more efficient to tax more mobile factors such as investment at lower rates. The present income tax system does this, but in an inconsistent way (for example, capital gains are taxed at half the standard rates while income from savings accounts is taxed at full marginal rates)

The Henry Report proposals also offer a good starting point for reform in this area.

7. Both economic efficiency and revenue adequacy for State Governments would be improved if stamp duties were reduced or eliminated, and replaced by more robust and efficient tax bases such as broadly based taxes on land and payrolls.

Reform of state taxes should be linked with service guarantees (since a major goal of reform in this area is to improve revenue adequacy) and reform of federal state financial relations (since taxing and spending responsibilities are inefficiently distributed between the two levels of Government and sustainable reform of state taxes is difficult to achieve without resolving this problem).

Processes

1. Successful tax reform is a partnership between Government and the broader community.

Governments should set out their goals for reform and provide a framework for consultation, and then make room for community organisations to respond with their own problem definitions and priorities for reform.

Governments should then develop specific reform proposals for consultation and provide sufficient time and information for people to assess them. Major tax reform statements should not contain 'big surprises', nor should they be released just before elections.

2. Constructive dialogue among diverse interests is needed to smooth the path to reform.

Organisations representing a broad cross section of the community have a key role to play, along with individuals with expertise in taxation.

Genuine discussion of differences is essential and 'false consensus' is counterproductive.

3. We need to agree on the problems before we can agree on solutions

A common flaw in tax reform processes is to begin with solutions and work backwards to justify them.

4. The tax reform process should be open and transparent.

Reform should be guided by a broadly representative and independent advisory and consultative body and/or a series of public events with broad representation at which Governments and community organisations have the opportunity to discuss their proposals.

State and Territory Governments should be invited to fully participate in these processes.

5. It should be informed by the best available evidence.

Governments and other participants in the process should be open to debate over the strengths and weaknesses of their reform proposals.

Governments have a responsibility to provide the data needed for community organisations to properly assess reform proposals, including their revenue and distributional impacts and efficiency costs and benefits. This could be organised through an independent advisory and consultative body.

6. These processes will not avoid conflict over tax reform, which is inevitable.

However, they will strengthen consensus where it exists and make clear to the community the real basis for any differences of opinion so that people can make their own informed assessments.

They also make room for Governments to adjust their proposals before they commit, in response to major concerns raised by stakeholders.

7. Successful tax reform is not always achieved in 'one big package'

It may be best to progress it in a series of packages, each addressing a separate set of problems (for example our steep housing costs and the future costs of population ageing), provided the overall outcome is coherent and based on robust goals and principles.

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