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STATEMENT OF REFORM PRIORITIES

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STATEMENT OF PRIORITIES

Around two or three pages, please. Please address both of these issues:

1. What are your priority reform directions for the tax and transfer system?

The overall goal of reform of the tax system should be to ensure it is sustainable and robust, including able to raise increased tax revenues for the future, so as to ensure that the Australian government can continue to provide the level of services and infrastructure required by the Australian people.

A key element of the tax system is the income tax, including both the progressive personal income tax and company income tax. While other taxes also need reform, and in some cases abolition, a key goal of tax reform should be to strengthen our income tax. It must be fair (and perceived to be fair), simple, efficient and robust. Further, the tax-transfer system must be made increasingly progressive in both nominal and real terms, taking into account the tax rate structure, transfers, and the tax base.

REFORM THE TAX TREATMENT OF HOUSING

The Henry Tax Review identifies the various tax and transfer rules affecting housing as a contributor to the crisis in housing affordability in Australia today. A tax reform that rebalances the tax system so as to tax housing assets more neutrally and fairly would make a significant contribution to easing this crisis.

My first priority is to implement the recommendations of the HTR set out below. These reforms would greatly improve the taxation of housing. They would also, incidentally, significantly improve the federal-state tax system and greatly simplify the income tax system by removing perverse incentives for tax planning and arbitrage.

Recommendation 14: Personal Income Tax: Provide a 40 percent savings income discount for non-business investment income, gains, and assets including net interest income, net residential rental income, capital gains and losses, and interest in respect of share investments. As stated in Recommendation 15, ensure a smooth transition.

The government should consider retaining the 50 percent savings discount, and the ability to "negative gear" interest, for housing assets developed in the NRAS program.

Recommendation 17: Simplify the CGT regime, including removing the grandfathering of the pre-CGT asset exemption by marking to market value. To ensure popular acceptance, values at a high point in the market, or else a reasonable transition time, could be considered. However, retain the CGT exemption for capital gains on the main residence.

Recommendation 51: Eliminate stamp duties of States.

Recommendations 52 and 54: Reform the land tax and expand its base to include home ownership. Reforms include fixing the minimum thresholds, harmonisating valuation methods across states and refocusing them on unimproved value, ensuring that land tax applies on unit holding not on aggregate holding.

Recommendations 69-70: COAG to review zoning and planning arrangement for housing and infrastructure charges for new development.

Recommendations 88, 102-106: The government should work to address inefficiencies in the delivery of housing benefits to the most needy Australians, in particular impediments to work and mobility. However, public housing should be retained as a crucial element of the welfare system.

Recommendations 120, 121: States should allow local governments autonomy in setting the tax rate applicable to property (ie rates) and over time, State land tax and rates should be more integrated so as to become more efficient for home owners and businesses.

Reform to property trust structures, for housing investment: The Government should give detailed policy consideration to remove impediments for institutional investors, including Real Estate Investment Trusts and superannuation funds, from investing in residential property investment and in particular, affordable housing in the NRAS program. Reforms that are needed include:

- Ensure that investment in residential real estate is classified as an “investment” activity of real estate property trusts so as to ensure that they will continue to be taxed as trusts and not companies.
- Reform land tax (as described above) so that it does not increase exponentially as in the current system because of valuation, aggregation and rate structures.
- Introduce a “bright line” income/capital distinction, at least for property trusts, so that residential housing assets held for, say, 5 years or more, are classified as “capital” and their sale will generate capital gain subject to the 40 percent savings discount outlined above (or the special 50 percent discount applicable for NRAS assets).

ABOLISH FRINGE BENEFITS TAX, INCLUDE EMPLOYEE BENEFITS IN THE INCOME TAX AND SIMPLIFY AND STREAMLINE EMPLOYMENT TAXATION IN THE INCOME TAX

The FBT was introduced in 1986 to ensure that non-cash fringe benefits received by employees from employers did not escape taxation. Since its introduction, it has performed that role, but the FBT has also become an increasingly complex vehicle for a range of highly complex and technical tax subsidies and loopholes. An industry of specialist FBT planners has arisen specifically to advise businesses and not for profits on how to best plan their employee remuneration packages including a combination of cash and subsidised non-cash benefits, so as to minimise tax. Many of these subsidies are perverse, including subsidies for cars and carparking and for entertainment and credit card expenses of employees of some not for profits, such as doctors working for hospitals. Most benefits are reportable and concessions are wound back for various other purposes, so complexity is increased.

Today, there is no longer a need for FBT. It would be more efficient and fairer to ensure that non-cash benefits are subject to simple valuation rules and included in the individual employee's income subject to the PAYG system, at their own marginal tax rate. Concessions should be reviewed and where possible, repealed. A clear category of "de minimis" benefits and of "workplace" benefits such as coffee or toilets should be excluded. The opportunity should be taken to dramatically rewrite and simplify the valuation and categorisation rules for employee fringe benefits, in the income tax.

This priority involves implementing Recommendation 9 in the HTR, but taking that recommendation further so as to embed taxation of fringe benefits in the core income tax structure itself.

It will be important to ensure that charities and other NFP organisations that currently rely on FBT subsidies to remunerate their staff at lower wages are not disadvantaged by this reform. The government should give detailed policy attention to this problem, in consultation with the sector. NFP organisations could be compensated for the immediate impact through a combination of a reasonable transition time; increased government grants and direct payments to the sector; and general tax cuts for below-median income earners. Consideration could also be given to a "working tax credit" applicable for workers in the sector.

REFORM THE TAX-TRANSFER SYSTEM TO INCREASE WOMEN'S WORKFORCE PARTICIPATION AND MORE EQUITABLY SHARE THE COST OF CARE

The HTR acknowledges the importance of women's workforce participation for economic growth, for fairness, and for the individual wellbeing of women and their families. Disincentives continue to exist in the tax-transfer system (as well as other issues such as childcare cost and accessibility) and these disincentives discourage women from returning to full time or close to full time work. Increased workforce participation by women will also reduce inequities in saving and assets and help women provide for the long term.

Reforms that should be implemented include:

- Ensure that the income tax rate structure remains progressive, including a reasonably high rate at the top end of the structure.
- *Recommendation 90* of the HTR should be implemented, repealing FTB B and replacing with a single family payment. The phase out of this family payment should be tested on individual income of the mother (secondary earner) in the household. *Recommendation 91* should be implemented to provide for the direct costs of children.
- *Recommendation 92* of the HTR should be subject to detailed policy consideration. The child care rebate is crucial in ensuring that women return to increased hours of part time or full time work. Consideration should be given to a universal, non-means tested child care assistance payment where a child is in a childcare facility (either to the family or the facility).

SIMPLIFY AND STREAMLINE TAXATION OF BUSINESSES AND INVESTMENT, ESPECIALLY IN THE SMALL AND MEDIUM ENTERPRISE SECTOR

The taxation of business needs to be streamlined and simplified. The company tax rate should be lowered, however, it must be recognised that this causes significant arbitrage opportunities between a progressive income tax (with higher top marginal rate) and the company tax rate. This may require additional business tax integrity rules. Perceptions of fairness are crucial to ensuring the robustness of the income tax law. The government should prioritise:

1. Reduce the company tax rate, over time, to 25 percent.
2. Allow one year carry back of tax losses.
3. Rationalise the current trust taxation rules (as has currently commenced). The "flow through" treatment of income, capital gains and franking credits should be retained. However, consideration should be given to a minimum distribution tax to prevent extreme forms of income splitting through trusts and companies. In particular, the use of companies as beneficiaries with a "capped" tax rate, operating as cash boxes, is a problem because businesses are focusing on how to avoid the "top up" tax that would result from distribution of value out of those companies to the ultimate owners or family members. To address this, a minimum distribution requirement may be needed for corporate beneficiaries and for trusts, with funds not appropriately distributed subject to "top up tax".
4. Simplify, but retain concessional treatment of, the small business CGT concession rules.
5. Enact a new flow through limited partnership entity for large widely held passive investment, to align Australia's managed funds industry with the global industry and encourage foreign investment.
6. Review the effectiveness of venture capital funds in particular for early stage and start up investments.

INTRODUCE AN INHERITANCE TAX ON HIGH VALUE ESTATES

The government should give serious policy consideration to introducing a federal inheritance tax phased in on estates of (say) $3 million or more (net asset value), as a way of collecting adequate revenues from asset accumulation in Australia (as recommended by HTR Recommendation 25).

The inheritance tax could apply at a relatively low rate, increasing based on the size of the estate. Detailed consultation in the policy and design of an inheritance tax would be required. The goal should be to design this tax so as to ensure that the top, say, 10,000 wealthy households should be required to pay any significant tax (these numbers would be the subject of detailed consideration). To increase the size of the (currently tiny) philanthropic sector in Australia, qualifying philanthropic contributions of cash or assets to eligible charities or funds would be deductible from the inheritance tax, or during the lifetime of the donor if such gifts were made to qualifying funds. Wealthy Australians should be encouraged to donate to the charitable sector as an alternative to paying inheritance tax on their estates.

2. How are your proposals financed over the short and longer term?

A number of the above proposals have potential to raise tax revenue including the 40 percent savings discount; extending land tax; an inheritance tax; and inclusion of employee benefits in the income tax. However, abolition of stamp duties would cost significant revenue and compensation for some of the above measures may be required. Similarly, the full cost of child care subsidies requires revenue (but should repay this in the long term because of the economic benefit and tax revenues that result from women being in the workforce.

The government should consider the possibility of an increased GST to be paid to states and to raise revenue, in particular to fund the removal of stamp duties.

LIST OF ATTACHMENTS

Feel free to attach supporting papers if you wish. Please list them here.

SELECTED RELEVANT REFERENCES BY THE AUTHOR FOR THE ABOVE PROPOSALS ARE LISTED BELOW. THESE ARE AVAILABLE ON REQUEST.

STEWART, M (ed) (2010) *Housing and Tax Policy* Conference Series No 26 (Australian Tax Research Foundation, Sydney).

Flynn, M and STEWART, M (2009) *Death and Taxes* (3rd ed, Thomson Reuters: Sydney).

STEWART, M (2011) ‘Gender and Tax Policy in Australia’, in Gunnarson, A, Brooks, K, Philipps, L and Wersig, M (eds), *Challenging Gender Inequality in Tax Policy Making: Comparative Perspectives* (Hart Publishing, UK) 53-74.

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STEWART, M (2011) ‘Tax policy for Housing’, , *International Encyclopedia of Housing and Home* (editor in chief: Smith S, Durham University, UK (Elsevier, UK).

Wood, G, Ong, R and STEWART, M (2010) ‘Housing Taxes and the Supply of Private Rental Housing’ in Stewart (ed) *Housing and Tax Policy* (ATRF) 219-239.

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STEWART, M (2010) ‘Women and Tax’ in Easteal, P (ed), *Women and the Law* (Lexisnexis Butterworths: Sydney) 441-463.

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