The Australian Industry Group

Taxation

Post pandemic policy

August 2020

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About Ai Group

The Australian Industry Group (Ai Group®) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for nearly 150 years.

Ai Group is **genuinely representative** of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, the defence industry, civil airlines and ICT.

Our vision is for ***thriving industries and a prosperous community***. We offer our membership strong advocacy and **an effective voice at all levels of government** underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders (domestic and international) we have the **resources and the expertise** to meet the changing needs of our membership. We provide the **practical information, advice and assistance** you need to run your business. Our deep experience of industrial relations and workplace law positions Ai Group as **Australia's leading industrial advocate**. We ***listen*** and we ***support*** our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We ***provide solution-driven*** advice to address business opportunities and risks.

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Executive Summary

Improving Australia's taxation arrangements is no small task. It is nevertheless a critical element in the post-COVID-19 response.

Unless we want to bequeath large public-sector debt burdens to subsequent generations of taxpayers and close off their options in responding to future crises, as we emerge from the COVID-19 recession we will need once again to restore our public finances.

Our current tax system is simply not up to this task and it is ill-suited to ambition of building a stronger and better economy and society.

In this policy paper we set our sights high and set out the fundamentals of the system-wide realignment of taxation that is required if we are to encourage investment, employment creation and high incomes growth while also retaining our commitments to the range of responsibilities we entrust to the public sector and to our national redistribution and poverty-alleviation objectives.

The paper looks at the challenges across the tax system both at the federal and the state and territory levels. It proposes removing the worst taxes; lifting reliance on, and improving the efficiency of less distorting taxes; addressing the imbalances between revenue raising and spending responsibilities across the federation; 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 and relatively high rates of tax on normal returns to business investment.

We make no apology for ambition but neither do we underestimate the size of the challenge. It is not something that can be resolved overnight but that is no reason to delay starting.

This policy paper deals with structural reform of taxation arrangements for which a multi-year time frame is required. Without question taxation policy also has a role to play in assisting in the near-term recovery. With this in mind Ai Group in our Submission to the 2020-21 Commonwealth Budget will propose a range of stimulatory measures which can also serve as a first step in the broader modernisation of taxation arrangements. The near-term stimulus proposals include bringing forward the income tax cuts currently scheduled to commence on 1 July 2022, boosting business demand by extending business income tax relief and for direct stimulus to boost employment and household spending.

Innes Willox

Innes Willox

Chief Executive

Australian Industry Group

PART ONE

1. Analysis

Major changes to taxation arrangements are central to our emerging from the COVID 19 crisis with a stronger, more resilient and better economy and society. Bringing forward scheduled income tax cuts, extending tax relief for businesses and providing further direct support for employment and households are critical to help stimulate the economy in the near term. But genuine advances in our long-term growth rate require a much more comprehensive overhaul of taxation and intergovernmental relations.

1.1. The Fiscal Challenge

Australia is still reaping the benefits of a multi-decade period of fiscal responsibility. We have had our excesses and missteps, but we managed to gradually rebuild the fiscal capacity that was considerably depleted by our successful response to the GFC. This sometimes-painful rebuilding put us in a position where our governments have been able to deploy an even larger amount of fiscal ammunition in response to the COVID-19 crisis.

It is clear the Commonwealth, the states and the territories face a sea of red ink as they prepare their Budgets for 2020-21. Revenue has tanked, fiscal stimulus has seen spending skyrocket and debt has ballooned. We will be adding to it for a while yet – and so we should, while circumstances require it.

"As we emerge from the COVID-19 crisis we will need to move once again to restore the strength of our public finances."

At the same time, building the stronger, more resilient and better economy and society that will pull the country together seems likely to involve additional public spending. On health; on aged care; on training and education; on income support and work-readiness programs for the jobless; on supporting more affordable housing; on public support of child care if we make that choice; and, on a fair few of the ingredients required to build a high productivity and low emissions economy such as research, development and early stage financing. There will be no shortage of ideas and proposals. Some of these will be better met by private sector involvement. But not all.

Money is sure to stay cheap for a while yet although continuing low inflation will mean the real level of public sector debt will not erode at the same pace as it did in the second half of the last century and in the years leading to the GFC. Low inflation also slows down fiscal drag - the other tried and true restorative elixir of budgetary positions.

Thankfully, young Australians have been spared from the most debilitating health effects of COVID-19. While over-represented in the weakness of the labour market, they are also sharing in the insulating effects of household and business fiscal support. But they should not be left to pick up the bill. Nor, if the need were to arise again to deploy public funds to ward off a devastating downturn, should they find the cupboard bare.

In short, as we emerge from the COVID-19 crisis we will need to move once again to restore the strength of our public finances.

More taxation is not the only answer. We also need to build greater productivity right across the board – not only in the private sector but also in the public sector and in the provision of health, aged care and education services. And the more we can achieve on this front – cutting waste, making sensible cost-saving investments, developing new practices and accelerating our use of digital technologies – the less reliant we will be on the revenue side of the budget.

1.2. Our Current Taxation Arrangements

Inevitably though taxation has a role to play. We cannot however afford to stifle private initiative and ingenuity. Our current approach to taxation falls well short of what we need.

- Our major consumption tax - the GST - is eroding before our eyes as expenditure on consumption that is not taxed grows more rapidly than taxed consumption.
- Fuel excise is also in decline and the electrification of transport is going to make this worse.
- Our transfer taxes on commercial and residential property are almost entirely without virtue and, bizarrely, we still overtax insurance.
- Our state land tax base is uneven and discriminatory.
- Our payroll taxes apply discriminately and have built-in barriers to business growth.
- While headway has been made in patching up the Petroleum Resource Rent Tax, other resource rents are untaxed. The plethora of royalties with different bases and rates do considerable harm to the resources industry, the states and territories and the country, especially compared to the overall benefits of efficiently designed resource rent taxes.
- Our taxation of household saving is all over the shop with different arrangements applying to superannuation, owner-occupied residential property, investment properties, bank accounts, dividends and capital gains.
- Our very heavy reliance on income taxation leaves us poorly positioned to attract mobile capital and labour; it imposes comparatively heavy tax burdens at moderate levels of personal income; and in combination with our tightly-targeted approach to income support, it creates debilitating effective marginal tax rates at critical areas of social disadvantage.
- We still have a substantial black economy that is unfair to honest individuals and businesses and undermines confidence in and compliance with tax laws.
- Similar undermining of confidence occurs at the corporate level. While in aggregate our company tax regime is clearly very robust, there is the ever-present threat of misuse and avoidance and a need for constant evolution to match changing business models and technologies.
- Compared with their spending responsibilities, the federal government raises too much revenue and the states and territories don't raise enough. Too often this results in a confusion of responsibilities and accountabilities and all the problems of decision-making from afar.

"Our current approach to taxation falls well short of what we need."

While this is a much longer list than we should be comfortable with, there are also virtues in our tax system. It has long delivered sufficient revenue to allow our different levels of government to provide a myriad of highly valued services. Further, our current taxation arrangements play no small part in the very significant redistribution of income that occurs in Australia with very little by way of either dissent or recognition.

PART TWO

2. Action

A very sound starting point would be to cast aside timidity and plot a course towards a better end point. In imagining the destination, we could do a lot worse than look closely at the draft report of the Thodey Review commissioned by the NSW Government and dust off the Henry Review of Taxation. What follows is largely in line with these reports. Of course, not every suggestion should be pursued and there are sure to be others not included below that have considerable merit.

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

Like the Henry Review we should be mindful of the need to take an integrated approach to the tax and income support systems. While we should commit to at least the existing degree of poverty alleviation and redistribution, we need to put aside entrenched attachments to familiar measures and proposals and look more broadly at measures that, while contributing to equity, are less damaging than adding still higher effective rates of tax on work, investment and saving.

2.1. Policy Directions

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.

- We should shift the burden of business taxes away from the returns necessary to attract investment. We should explore how best to do this – including an allowance for corporate equity or 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.
- We should level the savings playing field while retaining incentives for the self-provision of retirement incomes, contingency funds and the accumulation of investment capital.
- We should wean ourselves off 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 should 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 should tax consumption a bit more and as evenly as we can. We should be open to whether that is best achieved by the convoluted 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 should 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 will be even greater if State and local planning reforms make it easier to improve, intensify and densify land use.

- Taxes on insurance should be removed.
- There is strong scope for carving out a special regime for smaller businesses. We already have moved towards this and with a few additional steps we could invigorate this important and time-poor 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 businesses.
- Greenhouse gas emissions are valued inconsistently, if at all, across the Australian economy, inhibiting investment and encouraging malinvestment. As our companion paper on climate and energy policy notes, there are many ways of correcting this, including options relevant to long-term tax reform. The connections between the tax and energy agendas deserve ongoing consideration.

In any recasting of tax arrangements, we need to build them around the federation.

- We should assign areas of service provision to the jurisdictions best able to administer them.
- We should 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.
- We should assign appropriate taxes to the states and territories and consider sharing of the income tax base.
- We should harmonise the major state and territory tax bases and where appropriate consider the use of the ATO to collect revenue on behalf of the states and territories.

2.2. Getting Started

All this is much easier said than done of course. And it 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 taking these initial steps.

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).

And of those who will think it’s not worth the trouble we should ask ‘what is the alternative’?

Building a stronger, more resilient and better post-COVID-19 economy and society will be much, much harder and more costly if we are saddled with our current tax system. There is a high likelihood we won’t get to the destination.

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