TAX REFORM AND SNAKE-OIL

Address by Gareth Evans, Deputy Leader of the Opposition and Shadow Treasurer, to Chief Executive Women, Sydney, 9 June 1998.

Tax reform is a Good Thing. That's why the Labor Government did so much of it during our thirteen years in office, including:

- dropping Treasurer Howard's top rate from 60 to 47 cents, and bottom rate from 30 to 20 cents, and altering the scales on seven different occasions to address bracket creep and other inequities;

- dropping the company rate from 46 to 36 cents;

- introducing dividend imputation to stop the double taxation of share income, giving in the process a big boost to the equities market; and

- introducing capital gains and fringe benefits taxes, and bringing foreign source income into the net, to make the tax system fairer, including by ensuring that tax-paying was less optional for the rich.

Any government worth its salt must be committed to ensuring the fairness, efficiency and adequacy as a revenue base of the tax system - and must regard the ongoing repair, renovation and on occasion renewal of the tax system as just part of its job. It's not something that's ever guaranteed to win much popularity, but something to just get on with in government. That's what we did in the past, and will do again - and I will spell out a little later our own priorities in this respect.

The Coalition has *not* got on with it in government. It hasn't changed any tax rate or threshold and as a result has pocketed some $4.5 billion dollars in bracket creep - a major contribution to achieving its claimed budget surplus. It has made only the gentlest of assaults on tax avoidance by high wealth individuals, ignoring nearly all of the Tax Office advice it has received on how to deal in particular with avoidance through discretionary trusts. It has not done anything to address alleged anomalies in the wholesales tax system - whether relating to Lear Jets or caviar or anything else - though it has had ample opportunity to do so. It has not made any significant changes to business taxes.

The Howard Government's only significant new tax concession has been the savings rebate - which everyone acknowledges will not do anything to increase savings (and done so at the expense of abandoning Labour's 3 per cent plus 3 per cent superannuation co-contribution scheme, which would have simultaneously massively expanded the national pool of investable funds, and done much to solve our long-term national retirement income problem. And about the only other significant tax change it has made has been the introduction - in flagrant breach of John Howard's pre-election promise not to introduce any new tax or increase any existing tax - of a new 15 per cent surcharge on super contributions by high income earners. Whatever it's defensibility in principle, this has been implemented in the most nightmarishly complicated way possible.

What John Howard *has* done about tax reform is promise that he will do something big and dramatic in his next term of government, after he has been re-elected - with the centrepiece of it all being that GST which just three years ago, before the last election, he said he would "never ever" introduce. The genesis of all this, you will remember, was the totally lacklustre response to his second budget in May last year; a growing perception that the Government itself, in terms both of its competence and integrity, was rather worse than lacklustre; and an apparent felt need to be seen to be doing something.

A year later we have had an army of tax officials and advisers and consultants working full time on analysis and options and models and policy combinations, none of which have yet seen the light of day - so much for an informed, intelligent, public debate! We've had a complete failure to deliver on the Treasurer's explicit promise in the last budget to publish a public discussion paper on the Taxation of Trusts. And we've had a backbench Consultative Committee whose task - when the Prime Minister was finally induced to tell the truth about it - was to function as nothing more elevated than a dead-letter office for the over 600 organisations and individuals naive enough to see this as an opportunity for the Government to hear and take into account their views.

When we do see the Government's tax package, it will be the shortest possible time before the election, and with the minimum time for its impact and implications to be fully understood.

While most of the delay in the appearance of the package has been deliberate, and cynical in the extreme, it has also become obvious that the task of delivering on his big bang tax reform aspiration has been very much harder than John Howard envisaged when he embarked upon his diversionary frolic last year. There is practically no constituency for a major tax mix switch from direct to indirect taxes of the kind that Treasurer Costello, in particular, has been yearning for; there is an inevitable continuing tension between the welfare lobby, who are anxious about the fairness of the system and the adequacy of its revenue base, and the business community, who inevitably are preoccupied with reducing their tax burden; and there is inevitable tension between big and small business over issues like payroll tax, where their interests fundamentally differ, and as between different business sectors.

There was, and remains, a basic choice for the government in relation to the GST it is determined to impose. At one extreme there is the option of a very high rate, minimal exemption, maximum indirect tax replacement, maximum tax mix shift GST, with high direct tax cuts and minimal reliance on drawing down from the budget surplus to pay for them.

At the other end of the spectrum - and now looking rather more likely as the Government gets increasingly panicky about the community reaction - there is the option of a lower rate (perhaps in the range 5-7.5 per cent) GST, with broader exemptions, minimum other indirect tax replacement, and a smaller tax mix shift, and with lower direct tax cuts and a greater reliance on the budget surplus, or Telstra sell-off, to pay for them.

Either way, although the pattern of winners and losers changes a little depending on where on the spectrum the Government finally comes down, the Coalition will stay in trouble, and deserves to. Lower and middle-income Australians will see the choice as being like that between a half-Nelson and a full-Nelson - either way their noses are on their mat and their arms are half-way up their backs: it's only a question of whether it's one arm or both, and whether they're being half-strangled or fully-strangled.

The man who said he'd "never ever" introduce a GST at all hasn't got much credibility when he says now that he'd never ever raise its rate - and the lower the starting rate is the more convinced the community will be that it's only a matter of time before Australia follows the path of the 21 out of 23 recorded OECD countries with a GST, and significantly bumps it up, with little or nothing by way of accompanying compensation. In his more private moments, Mr Howard must be thinking it's about time to be pleading the Streaker's Defence...

You won't be surprised to hear, however, that we in the Opposition are not at all sympathetic with the Howard/Costello plight. If they have created expectations that they cannot now satisfy, especially in the business community, they have only themselves to blame. They have from the outset grotesquely exaggerated the nature and scale of the problems afflicting the Australian tax system, and their chosen central remedy - the GST, by whatever name they choose to call it - simply can't and won't work the various miracles claimed for it. I don't often quote Peter Costello with approval, but he was absolutely right when he said in November 1996 that a GST has "been invested with some snake-oil qualities".

The proper starting point in any debate about what tax reform is needed in Australia is to understand where we sit in comparative terms. It seems hard to argue that our system is in crisis when:

- as to the overall level of our taxes and the services they fund, only three other countries in the OECD raise less revenue than us, and only two others spend less;

- as to the debt and deficit gaps left by our taxes, only one other OECD country has a lower public debt and only a handful have better budget outcomes;

- as to our tax mix, we already raise in indirect taxes almost exactly the OECD average; and

- as to the impact of the tax system on average earners and households, the marginal tax rate for workers on average weekly earnings is significantly below the OECD average, and the average income tax paid by households is the same percentage now that has been for 20 years.

All that is not to say that the present system can't be improved. We say that the personal income tax system in particular needs to be improved in four main ways, about which I'll say a little more now. These reforms, together with some proposals we will be making in the business tax area about which I don't want to comment further at this stage, will be at the heart of our own tax package.

As I said at the National Press Club recently, we won't be drawn into a demeaning tax auction at the next election, trying to outdo the Coalition with bigger and glitzier tax cut bribes, while leaving the Australian community with more and more inadequate services. But we will take action where it's needed, and give help where it's needed.

First, we do need to address - and will address - through the Tax Credit for Working Families recently announced by Kim Beazley - the problem of very high effective marginal tax rates being paid by low to middle-income earners as a result of the interaction of present tax and social security scales, which involve significant poverty traps and disincentives to work. Many families are keeping less than 20 cents of every extra dollar they earn, losing over 30 cents in tax and 50 cents in family payments. Our tax credit will be directly linked to earned family income and number of children; it will be generous; it will reward people who work; and it will encourage people to move from welfare to work.

Secondly, we do need to ensure that average weekly earners do not, as a result of bracket creep, pay higher marginal tax rates than they should. Throughout our term in office we made many target changes to the tax scales to address the bracket creep problem; if we hadn't, we'd be collecting $30 billion more revenue today! Despite the Treasurer's repeated claims to this effect, *nobody* is about to pay one dollar in two in tax: not even honest multi-millionaires pay that. But Average Weekly Ordinary Time Earnings will shortly cross the $38,000 threshold, which means a marginal tax rate of 43 per cent, and that is unacceptably high.

Thirdly, we need to address the erosion of the PAYE system by people who essentially remain employees establishing themselves as independent contractors, often now in the legal guise of trusts, companies, or partnerships. This is partly a matter of better compliance with existing law, but some further legislative changes may be necessary to ensure equal tax treatment of those doing for all practical purposes identical jobs.

Fourthly, there is a need yet again to seriously address the problem of tax avoidance, especially by high wealth individuals through discretionary family trusts like those used by Senator Parer and so many of the Coalition front and back bench, and its financial supporters. But I want to say a little more on this today than the Opposition has before.

It will be recalled that before the last election we announced - on the basis of documented advice from the ATO - that around $800 million annually of additional tax revenue could be obtained from Australia's 100 wealthiest individuals if appropriate measures were put in place to ensure that they paid their fair share of tax. It was also revealed then that only a small percentage of the 200 wealthiest individuals are among the top 200 taxpayers, and that over 80 individuals with a net worth of over $30 million each declared income of less than $20,000.

Despite promises to collect this money if it was there, the current Government has only budgeted for additional collections from high wealth individuals of around $100 million a year. And the reason has become obvious: deliberate foot-dragging by the Treasurer.

This was first evident in the way in which he delayed for two years the enactment of our proposed legislation to prevent trafficking in trust losses, and then allowed a big new exemption for trusts involving a very extended range of family members.

And it was proved beyond doubt when we tested the issue at the Senate Estimates Committee hearings last week, and had confirmed on the record that of the nine specific action measures recommended by the ATO to the Labor Government - and which were also recommended, we can presume, to our successors - only one of the nine has been even partially implemented (ie the more systematic prevention of the creation of artificial capital losses in corporate groups and groups of trusts).

I announce today that an incoming Labor Government will be committed to a legislative strategy involving an additional six measures (with the remaining two ATO recommendations, going to the rate at which trusts should be taxed, are still being considered by us). These six measures are as follows:

(1) Introducing a test of common control or common business for sets of trusts which are related in their operation to ensure that business operations involving multiple entities can be correctly characterised as part of an integrated business, not simply passive unrelated investments.

(2) Treating a change in control of a discretionary trust, which involves a change in its likely beneficiary or beneficiaries, as a disposal of the trusts assets for purposes of the capital gains tax: this will ensure that the de facto disposals of assets held in discretionary trusts are caught by the tax law.

(3) Reducing the scope for non-assessable distributions of capital or income from discretionary trusts: this would address the situation where some distributions from trusts are tax free in the hands of beneficiaries, whereas if the same amounts had been dividends paid by companies the shareholders would have been subject to tax.

(4) Improving the way in which the interests of residents in non-resident trusts are taxed, to the extent there are still avenues available for Australian residents to indefinitely defer tax through this means.

(5) Countering the re-characterisation of trust income through loan arrangements with non-resident beneficiaries: this would address the exploitation of the tax rate differentials between the resident rates of tax and the interest withholding tax by arrangements which involve the streaming of interest income through trusts to non-residents, thereby limiting tax to 10 per cent, when the resident trustee does not relinquish control over the income.

(6) Making assessable a range of presently tax-free life style benefits in kind (eg. housing, travel

and the like) provided through informal arrangements with trusts.

On tax reform generally, we have said repeatedly that we have an open mind on every issue but the imposition of a GST. I should make clear to this audience that we have taken this view for a combination both of good equity reasons and good economic reasons.

The *equity* reasons are these:

> - First, a GST is inherently regressive and unfair to lower and middle income earners: any flat rate tax is, and the unfairness is compounded when one appreciates how much newly taxed goods and services will make up of low income budgets (40 per cent of low income earners' income goes on food, as compared with around 10 per cent for high income earners; one-third goes on rent; unavoidable gas and electricity charges hit harder; so do telephone and postage and public transport costs).
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> - Secondly, if a GST is used to fund a tax mix shift, with income tax cuts being paid for at the checkout counter, the unfairness will be massively compounded.
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> - Thirdly, it is effectively impossible to deliver a compensation package which will fully compensate through the tax and social security systems all those low and middle income earners for the hurt that a GST will cause them. It's not only self-funded retirees - who, as one of them said to me, "got it coming through income tax, and now get it going as their capital is consumed". It's the fact that individuals are different in age, in health, and in where they live, not to mention their gender: there is a story waiting to be told, and we will be telling it, on the differentially harsh impact of this tax on women.
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> - Fourthly, there is the reality that a GST, like yeast or hot air, seems inevitably to rise in just about every country in which it has ever been introduced - eg in the UK from 10 to 171/2 per cent, and in Denmark from 10 to 25 per cent. When that happens it's, as often as not, without much of anything by way of additional compensation, and again the unfairness for the less well-off is compounded.

But it's the *economic* arguments that are just as compelling:

> - First, on jobs and growth: there is no causal link that can credibly be identified between the existence of a GST and lower unemployment. The US, whose experience has been quoted much less often by the Coalition than Swaziland's, is the healthiest economy in the world, but doesn't have a GST. The most compelling consideration for Australia at the moment is that a GST is bound to directly discourage job creation in the services sector, where most of our hope for rapid future employment growth lies.
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> - Secondly, on savings, we have Treasury Secretary Ted Evans's word for it that while every economic text book may tell you that shifting the burden towards indirect tax will significantly aid national saving, you won't find that convincingly demonstrated in studies of international economic experience. As reported last month, he said the more important

tax task here was to remove poverty traps and get people back to work.

- Thirdly, on inflation, we have the word last year of Professor Neil Warren who the Prime Minister, rightly, said in Parliament last week was one of the greatest tax experts in the country - that a 10 per cent GST with a comprehensive base would add 5.6 per cent to the CPI! At a time of looming major current account deficit problems - not to mention the immediate pressures on the Australian dollar - this is hardly the time to be contemplating a major new source of inflationary pressure.

- Fourthly, on exports, we have the 1995 researcher Matthew Ryan - the Treasurer's former senior adviser and now number two on his taskforce - that there is essentially no trade effect in moving to a destination-based tax like the GST from origin-based taxes like payroll tax (not that this is currently proposed to be removed anyway by the Government's GST). And you have the reality that a WST adds only a little over $1 billion in costs to our $110 billion in annual exports - not the $5 billion that the Prime Minister asserted recently in Parliament. There are other less far-reaching and inequitable ways in which the business tax burden can be relieved if this is necessary to further improve our international competitiveness.

- Fifthly, there is no credible basis on which one can assert that a GST will ensure better taxation of the black economy. Again there is no overseas experience which helps the argument for a GST, and plenty - like Canada's - which serves to undermine it. The better view is that whatever may be picked up by people now in the black economy making taxable purchases outside it, this is more than outweighed by new transactions - particularly in the personal and household services area - moving into the black.

- Sixthly, there is the disproportionate burden in compliance costs born by small business with the introduction of a GST. Not only will there be a million new collection points, but the OECD estimates the relative compliance burden at some 30 times greater than that for big business. Even relatively modest dollar costs - although they have been estimated as high at $7,000 per annum for the average small business by the National Tax and Accountants Association - really mean something to small business on very narrow profit margins.

- The seventh deadly economic sin involved in a GST is simply that it may all be a waste of time, in the sense that at the very time the argument is raging most fiercely, indirect taxes of this kind may be on their way to obsolesence. The OECD has just published a paper concluding that "improvements in electronic commerce are likely to make the base for consumption taxes, such as the VAT or sales taxes, more geographically mobile and harder to trace".

So there it is. Our position is in favour of tax reform, but without a GST. Peter Costello was right when he called it "snake oil", and John Howard was absolutely right when he promised he would "never ever" introduce it. We go into this campaign determined to hold them, whether they now like it or not, to that analysis and that commitment.