# LABOR'S TAX REFORM AGENDA

Address by Gareth Evans, Deputy Leader of the Opposition and Shadow Treasurer, to IBC Conference on Tax Reform, Sydney, 22 July 1998.

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When I accepted the invitation last March to speak at this Conference, the organisers and I had every reason to expect that we'd be debating today not rumours but the details of the Government's tax package. But that hasn't been possible. It is now 429 days since John Howard, in a bid to divert attention from his poorly received second Budget, embarked on his "great adventure" of tax reform. We have been waiting breathlessly for over 14 months for that adventure to reach its climax. And still we're waiting. The package is still a fortnight away; maybe a month; or maybe – if we are now to have a December, or March-April-May election – still many months away.

What's driving the delay is obviously not complexity or fine-tuning or anything remotely technically defensible. A large team of highly competent officials has for months identified and quantified and analysed every possible option within an inch of its life. They finished their work months ago. For months the Government has known all about the choices and possibilities and trade-offs available to it. It's the work of days, not weeks or months, to fine-tune and shift around the final elements in the package.

What's driving the delay is pure political opportunism. The Government wants the community to have the least possible time before an election to understand how much of the package will be economic snake oil. It's pinning its hopes on a quick, slick launch of tax cuts and bribes, generating positive newspaper headlines and excitement from the kings and queens of talkback radio. It wants a roller-coaster ride to election day – with no time for Australians to discover the unfairness to lower and middle income earners, and no time to understand how illusory will be compensation promises for the disadvantaged.

There may be another reason for the current delay, quite apart from the Treasurer's pre-occupation with organising his leadership challenge. The Senate's rejection of the Telstra legislation has meant that the Government can't pay for any election bribes out of the so-called "social bonus" from the Telstra sale, and will have to raid the Budget surplus instead, which means less surplus being available for those direct tax cuts which can't be funded by the GST. So it's back to the drawing board – trying to satisfy the competing demands of the National Party, the bush, the business community, the increasingly sceptical public and the economists, and finding it ever more difficult to square the circle.

Whatever the reason, the delay is indefensible, and with each passing day it becomes *more* indefensible. One wonders how long the Business Coalition will feel compelled to keep reaching into its pocket for another week's worth of shamelessly partisan advertising, another million dollars – particularly as the ads, by all accounts, have been so splendidly ineffectual…

Despite the Government's assertions at the outset that it wanted to involve the community in the tax debate to the maximum extent at every stage, it has singlemindedly avoided serious debate at every stage along the way. The only way to have had such debate was to get out onto the table at the earliest possible moment all the relevant options, analysis and information. That's what Peter Costello specifically promised he would do, at least in relation to the taxation of trusts issue, at the time of the 1997 Budget – it's just one of the many promises he has subsequently broken.

With all due respect to Senator Brian Gibson, who was given the unenviable task of explaining yesterday why it has taken 429 days for the Government to produce precisely nothing, the Government's Tax Consultative Taskforce has not been a vehicle for any such worthwhile debate. Rather it has operated as nothing more constructive than a dead-letter office for the over 600 organisations and individuals who were naive enough to see this as an opportunity for the Government to hear and take into account their views.

I make it clear that the Labor Opposition is and always has been willing to take part in a serious debate about tax reform. We don't believe our system is in crisis, but we certainly believe that it needs ongoing repair and renovation. The primary responsibility for that repair and ongoing reform process is that of the government of the day, and we did a mass of it when we were in government ourselves. We just want the phoney war to be over, and the debate to start – with the Coalition Government putting on the table specific proposals that will make serious debate possible.

The proper starting point in any debate about what tax reform is needed in Australia is to understand where we sit in comparative terms. By any international standard, our system is not in "crisis". How can it be, when:

- we're a low taxing, low spending country: only three other countries in the OECD raise less revenue than us, and only two others spend less;

- we have very low debt and deficit gaps: only one other OECD country has a lower public debt and only a handful have better budget outcomes;

- our tax mix is not out of kilter, in that we raise in indirect taxes almost exactly the OECD average; and

- 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, and in particular the income tax system, can't be improved, and I'm happy to take this opportunity to spell out – to the extent I can at this stage – Labor's tax reform agenda.

**Personal Income Tax**

Labor believes that the personal income tax system needs to be improved in four main ways. 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 our proposed Tax Credit for Working Families - 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 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 targeted 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 for this group.

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 will 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. Last month, I announced six specific legislative measures – all of them recommended to us by the Australian Tax Office in our last few months in government, but none of them picked up subsequently by the Coalition – which should go a long way towards solving that problem, and collecting the many hundreds of millions annually which the Tax Office estimates is recoverable just from Australia's 100 wealthiest individuals alone.

**Business Tax**

It's not only personal income tax that is on the ALP's tax reform agenda. We do acknowledge the need for some significant changes to the business tax system, and our tax package will certainly have some specific measures designed to foster economic and employment growth by improving the climate for investment in research and development, infrastructure and plant and equipment.

There is no indication that the Government's own tax package will address any of these matters and there is plenty of indication that it won't, with the extraordinary announcement a few days ago that the business tax front in the tax revolution has been abandoned, and that the business community's sole reward for its slavish devotion to the Coalition's GST ambitions will be a "framework for reform", with the promise of more consultation to come.

Where is the Government's commitment, for example, to address – as only a government in office can – the issue of differential withholding tax rates that has come to prominent attention in recent days? With the dividend imputation system operating to free from Australian withholding tax fully franked dividends paid to non-residents, but with Australian firms in the United States, for example, still having to pay 15 per cent tax on their repatriated profits (at the same time as British and European firms are paying only 5 per cent), the time is obviously overripe for the renegotiation of the relevant Double Taxation Agreements. This is an issue to which Labor will give high priority on our return to office.

We will also engage in government in a more far reaching review of business tax arrangements, in particular an evaluation of the pros and cons of the most far reaching possible reform of all – viz. aligning into a single harmonised system the separate regimes currently applicable in determining "taxable profits" on the one hand and "accounting profits" on the other, with appropriate consequential changes to a raft of present concessions and exemptions, and of course to the company tax rate.

The Australian Society of CPAs has estimated, using ATO data, the potential to reduce compliance costs for business at some $800 million, and argues that the market incentive to report the highest possible profits will at the same time reduce the incentive for tax avoidance. The arguments for this change, of course, are not one way. A completely pure integrated regime implies an end to the use of tax measures as a selective instrument of industry policy, which would not be universally welcomed. Another consideration is that accounting standards would assume much more significance than they have even at the moment, with the tax effects of potential revisions to those standards having the capacity to distort their formulation, as has apparently occurred in jurisdictions such as Germany and Japan which rely more heavily on accounting profits for tax purposes.

But these are all issues that can and will be considered by an incoming Labor Government. We don't promise, here as elsewhere, a tax revolution – just a steady, ongoing process of reform and renovation of the kind in which we engaged in government. We do think tax reform is a Good Thing, which is why we did so much of it in government, including for business:

- dropping the company tax rate from 46 to 36 cents; and

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

More generally, our efforts included:

- 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; 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.

## Indirect Tax

We in the Labor Opposition have said repeatedly that we have an open mind on every tax reform issue except the imposition of a GST. When it comes to indirect tax, we are comfortable with the retention of the wholesale sales tax, but will certainly not seek to rely upon it as a source of additional revenue: the revenue we will need to pay for the personal income tax benefits we introduce, and any change in business tax arrangements, will come from addressing tax avoidance and evasion, closing various loopholes, and addressing various concessions and exemptions that have outlived their usefulness or defensibility.

We may tackle certain items in the WST schedule which are widely seen as anomalous or inconsistent with the tax treatment of comparable items – and Lear jets and caviar have received some attention in this respect – but this will only be for the purpose of addressing anomalies, and will be quite revenue neutral in its impact.

Why *don't* we have an open mind on the question of a GST? I should make clear to this audience that we have taken this view for a combination of both 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.
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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 17½ 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.
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> - Fifthly, the GST that the Government is proposing to introduce will be hidden, embedded in the price of goods and services and not clearly displayed on the price tags. This not only indicates that the Government

hasn't got the courage of its stated convictions: it will make it easier over time for GST increases, with all their inequity, to occur.

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.

- 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.

- Thirdly, on inflation, we have the word last year of Associate Professor Neil Warren who the Prime Minister, rightly, said in Parliament recently 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 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 – concluding that there is essentially no trade effect in moving to a destination-based tax like the GST from origin-based taxes which are embedded in export prices. And you have the reality that a WST adds only a little over one per cent in costs to our $110 billion in annual exports - not the $5 billion that the Prime Minister asserted recently in Parliament. Payroll tax is more significant, but the Coalition – in apparent collusion with the States on this issue – is not proposing to touch that.

- 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 over a million new unpaid tax collection points, but the OECD estimates the relative compliance burden at up to 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, and by no means the least, 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 obsolescence. The OECD has recently 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 what it comes down to is this. Peter Costello was right when he called a GST "snake oil", and John Howard was absolutely right when he promised he would "never ever" introduce it. The Labor Party is in favour of a fairer tax system, but we don't believe that includes a GST. We will continue to oppose outright its introduction – and do so with intellectual and moral as well as political conviction. But that apart, we are in favour of tax reform – of personal income tax; of business tax; where necessary, of present indirect taxes; and where possible, and consistent with a continued capacity by the Commonwealth for effective macro-economic management, of Federal-State taxation relations.

Any government worth its salt must be committed to ensuring the fairness, efficiency and revenue adequacy 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 that's what we'll do again when returned to government. Australia doesn't need a tax revolution. It just needs good government.