



SUBMISSION

to the

Tax Review Discussion Paper

Better tax system, better Australia

5 June 2015

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1. Introduction

Five years ago, the Henry Tax Review started a national conversation about what we needed to do to modernise and strengthen our tax system. Only a few of the report's 138 recommendations were passed. Unfortunately an opportunity for major reform was missed.

The National Welfare Rights Network (NWRN) has been actively involved in the taxation debates. We took part in the 2011 Tax Summit and have made submissions to tax reviews. We were also active participants in the Australian Council of Social Services (ACOSS) and Business Coalition on Tax Reform Forum roundtable that was held in December 2014. This meeting sought to find "common ground" for the reform of our tax and transfer system.

In the 200 page report, *Re:think: Tax Discussion Paper, Better tax system, better Australia*, the Treasurer Joe Hockey asks how we can create a better tax system that delivers taxes that are lower, simpler and fairer.

However, the Government appears to have retreated from real discussions with the Australian community about what needs to be done to get our tax and social security systems working more effectively.

The Government has, at this early stage, sought to "rule out" some areas where many in the community see the need for reform, such as superannuation tax concessions and negative gearing. Tax reform cannot be piecemeal. The initial stages must be broad-ranging, and ruling things out prematurely will just cement people into pre-determined, fixed positions.

We believe that the Government's *Discussion Paper*, along with the detailed *Henry Report* from the former Secretary to the Treasury, are solid foundations for the next rounds of discussion about tax reform in this country.

NWRN's expertise is in social security and family assistance law, that is, the transfer system. Our focus in the tax reform debate is to ensure that there is balance and fairness in the tax and transfer system.

Our tax system must encourage investment, workforce participation and productivity. It must also ensure a sufficient revenue base to meet community expectations and provide an adequate social safety net. NWRN is open to considering all options, although we are naturally cautious about proposals that would seek to broaden the Goods and Services Tax or increase the rate, and require those on low incomes to be "compensated" through tinkering with the tax and transfer system.

The federal government recently adopted ACOSS and NWRN recommendations for pension assets reform, but not recommendations that would address the revenue problem. This means that, once again, it is the people with only relatively modest means are paying for the budget savings. When such changes are unaccompanied by tax reform the result is unfairness. Even worse, measures currently before the Parliament would increase rather than decrease effective marginal tax rates for some people. A copy of our submissions to the bills before parliament can be found [here](#).

The key challenge, as NWRN noted in our 2015-16 Federal Budget submission is that the "Federal Budget was one of lost opportunities; it focused too much on spending cuts which targeted the poorest groups in our community and too little on where the heart of the problem lies – declining revenue."¹

¹ National Welfare Rights Network, *2015-16 Federal Budget Submission*, p. 1.

2. Why is tax reform necessary?

The tax system affects all Australians, and especially those on low incomes. Tax reform is essential to ensuring that as a nation we can meet the needs of a growing population that is also an ageing population, with additional health, aged care and pension costs.

We need a visible, broadly-based community discussion about tax so that we can talk about the many myths and stereotypes that plague our tax and welfare systems.

The community needs to better understand the choices and consequences of supporting some options for reform, and the impacts of rejecting others.

The NWRN starts with the simple proposition that everyone should pay their fair share of tax. And that those who can, should pay more, according to their circumstances and capacity to pay.

We should be talking about progressive taxation methods which are a critical feature of a fairer tax system. Australian taxes are not high when compared to other developed countries.²

3. Our income support system

Our member centres work with people who experience difficulties with Centrelink services and are reliant on social security and family assistance payments. We think that tax reform can help make our social security system fairer so that people are helped into work, and are adequately supported if they cannot find work, or when they are unable to work, or who are studying, are caring for others, or are retired. It is time for the conversation to move beyond stigmatising notions of the 'deserving' and 'undeserving' poor.

Payments must be adequate, and set against established community benchmarks, which include regular indexation.

The Government regularly points to the cost of the Australian social security system and the need to rein in spending. However, with an annual cost of about \$158 billion each year Australia spends much less than other countries. Australia spends just 8.6 per cent of our Gross Domestic Product on income support, while the average for the wealthiest nations in the OECD is higher, at 13.2 per cent.³

The Government's own Inter-Generational Report finds that family tax benefits, and payments to unemployed people on Newstart Allowance, parenting payments, child care benefits, and payments for young people, such as Youth Allowance and Austudy are projected to fall over the next 40 years. It may surprise many to find the numbers of people receiving Disability Support Pension (DSP) are actually falling in real terms, at about 1 per cent each year. Tougher eligibility rules mean that 3-in-every-5 people who apply for DSP have their claims rejected. At December 2014, there were 824,470 on the DSP.⁴

² OECD, *Revenue Statistics 2014 – Australia*, *OECD Consumption Tax Trends*, Centre for Policy and Tax Administration, 2014.

³ OECD, <http://www.oecd.org/social/expenditure.htm>

⁴ Department of Social Services, Data.gov.au: *Payment recipients by state and territory*, December 2014.

Meanwhile, the number of people out of work is increasing significantly. As at April 2015, the total number of Newstart Allowance and Youth Allowance (other) recipients was 873,966.⁵ The key goal around tax reform must be to two-fold in relation to employment. Firstly, tax reform should encourage employment, and the problems of high EMTR's, which we address later, must be examined. Secondly, tax reform must provide the revenue so that we can provide appropriate training, skills and employment assistance to move people into work, and it must also ensure sufficient revenue so that people are adequately supported financially while they are looking for work.

The Government needs to shift its focus from cuts to the transfer system to increasing the revenue base to enable it to ensure longer term sustainability.

4. Taxation: the building blocks for a 'good society'

Taxation should be progressive. It should also raise sufficient revenue to provide programs and services that the population needs, such as social security, health, aged care, education, employment assistance and affordable housing.

Taxation should also be fair across generations and its interaction with withdrawal in the transfer system must be considered. A good example of this is the current debate about the need for superannuation and Age Pension reforms.

Superannuation has long been criticised as mainly benefitting the very wealthy, who may not need generous tax concessions as an incentive to save for their retirement. In 2007, the Howard Government removed the need for those over 60 to pay 15 per cent tax on their superannuation fund earnings.

Research by the Parliamentary Budget Office found that the compounding effects of this and other decisions to allow people to claim "excess" franking credits from the ATO is costing the budget about \$6 billion a year.

Additional analysis by the Association of Superannuation Funds of Australia found that 70,000 people have superannuation balances over \$2.5 million. They also reported that 24,000 people with self-managed funds, with balances of \$2 million received around \$5.2 billion in tax-free income – which equates to an average of around \$216,000 each.

Superannuation concessions provide further benefits and as a result of current arrangements, only 20 per cent of retirees aged over 65 pay income tax. By 2020, the cost of superannuation tax concessions will be more than the entire costs of the Age Pension – which itself costs a tenth of the entire welfare budget.

The Government is engaging with welfare and seniors groups about reforms to the generous assets test, which will replace last year's Budget proposal to index pensions and related payments to a lower benchmark – which was effectively a cut of around \$23 billion over a decade. There are other proposals – including one for a broader review of the entire retirement income system (which NWRN supports) to wind back over-generous tax concessions that are available to people who do not need them.

⁵ Department of Social Services, *Labour Market and Related Payments*, April 2015, May 2015, p. 3.

The discussion about taxation reform and superannuation holds other, more general lessons, in that Government's need to pay as much attention to expenditure through the granting of tax concessions or subsidies to business as they pay to expenditure on the social security system.

Tax rebates and business deductions are significant costs to the taxpayer and the community and should be subject to the same level of budget scrutiny as is given to general expenditure, and should be carefully examined by Senate Committee processes.

5. A tax and social security system that works

The Henry tax proposals provided a sound foundation for reform that can be built upon.⁶ Our income tax arrangements must be progressive. The ability of those on high incomes to avoid or minimise the tax they pay, through taxation measures such as capital gains, negative gearing, superannuation, and private trust arrangements threatens the progressivity of our tax base, and undermines much needed sources of potential revenue that could assist in meeting unmet community need.

It is incorrect, and divisive to split the population into categories of "lifters" or "leaners", or "taxpayers" and "others". People on low incomes pay tax in higher proportions every time they shop or visit a supermarket, as a significant number of the goods and services that they purchase have a GST applied.

6. Consumption taxes and other taxes

Consumption taxes are, by their very nature, regressive. A tax is regressive when it takes a higher proportion of the income of those on low incomes, compared to those on higher incomes. If the GST were to be broadened or the tax raised above 10 per cent, modelling would be needed to determine how much of these goods and services different income groups consume, and how their consumption patterns are affected by any changes in price. There is also the perennial problem for people whose spending is "above" the average, and the risk that people are under-compensated.

The other major problem is that 'compensation' to those poorest households is at risk of being eroded. The NWRN notes many important payments and benefits that are provided through the existing social security system are currently under threat – even without an increase or base-broadening of the Goods and Services Tax (GST).⁷

NWRN argues that the GST, like all flat rate taxes, is regressive hurting the poorest in the community who need to spend a greater share of their income just to survive. According to Treasury, the poorest 20 per cent of the population spend almost 60 per cent of their income on goods and services that are currently exempt, compared to little more than 25 per cent of those people in the highest earning quintile. This is mainly because high income earners save more of their income. Regardless of income, around 40 per cent of total household spending goes on GST exempt items.

Supporters of raising and broadening the base of the GST argue that the unfairness that is inherent in the GST can be addressed by careful crafting of a compensation package. The problem is, it is difficult

⁶ Henry, K, *Australia's Future Tax System - Report to the Treasurer*, 2009.

⁷ Refer to NWRN submissions on the measures contained in the 2014-15 and 2015-16 Federal Budget on p. 3.

to design compensation for low income working people who are not receiving income support payments, but whose wages are so low that they don't pay much income tax. It's hard to avoid losers. The experience in New Zealand recently is that a few years after the GST was increased, the compensation has been whittled away. The big risk for those on fixed and low incomes is that compensation will be both inadequate and short-term.

The Federal Government says that bipartisan support will be needed before it would propose changes to the GST. In addition, all states and territories would need to be onside. So with the Opposition ruling out any changes, there appears to be no consensus about increasing or broadening the GST base.

The Government estimates that tax concessions on superannuation contributions and earnings results in foregone revenue of \$29.7 billion this year with the top 10 per cent of earners receiving a third of the tax benefits under current rules.

The Government's tax paper puts all state and federal taxes on the table but makes no recommendations. Contentious issues like negative gearing and the dividend imputation system are on the table. Currently, more than one million people claim losses against their investment properties. Other state taxes including stamp duty, gambling taxes and land taxes should also be up for discussion.

7. Housing affordability – a taxing problem

One of the more pressing social concerns, which is enshrined with our taxation system, is the testing problem of housing affordability. This issue is of concern to increasing numbers of Australians. Here, we raise two areas: capital gains and related tax breaks for negative gearing, and Rent Assistance.

According to new research released recently by ACOSS the existing tax arrangements are costing the Budget billions of dollars each year, and doing nothing to ease the squeeze on rentals.⁸

In 2011, which is the last year for which tax statistics are available, 1.2 million people reported tax-deductible "losses" of \$14 billion. The capital gains tax discount cost the federal budget \$5 billion, and negative gearing arrangements added another \$2 billion in that year, according to an ACOSS report.⁹

"Negative gearing and capital gains tax discounts for investors together encourage over-investment in existing properties and expensive inner-city apartments which lifts housing prices and does little to promote construction of affordable housing," the report stated.¹⁰

ACOSS pointed out that the impacts the policy had on the wider economy included higher inflation and interest rates caused by asset price booms and high household debt levels as people borrowed to invest.

Given the importance of these issues, tax reforms that assist in addressing housing affordability problems are an urgent priority.

⁸ Australian Council of Social Services, *Fuel on the fire: negative gearing, capital gains tax and housing affordability*, 2015. At: http://www.acoss.org.au/images/uploads/Fuel_on_the_fire.pdf

⁹ Ibid.

¹⁰ Ibid, p. 4.

8. Improving the tax and transfer system

A particular area of interest to the NWRN is when tax arrangements have a significant impact on workforce participation. High Effective Marginal Tax Rates (EMTR) can cause disincentives to work, where people can lose income and pay tax, and it can sometimes mean that people may not be much better off even when they are working.

This has been a particular problem for single parents who, under successive Governments have been shifted onto a lower Newstart Allowance payment, which has a lower 'income free area' and a harsher withdrawal rate. After child care costs are taken care of, they can be left with little extra for all their effort and hard work.

High EMTR can be compounded, particularly for women who are secondary earners, who face the 'stacking' of multiple income tests, from family payments and child care benefits. The benefits of taking extra employment for these families can be minimal.

High EMTR are also an issue for unemployed people on Newstart Allowance. As at December 2014, just over 132,000, or around 18 per cent of the 727,779 Newstart Allowance recipients had earnings. The 'income free area' for the Newstart Allowance was increased by the previous Government, to \$100 per fortnight.

This policy change was welcomed by community advocates, though a priority is for the rate of the single Newstart Allowance to be raised by \$51 per week. Groups like the Business Council of Australia, and Jobs Australia, have joined with the community welfare sector to urge Government to increase the rate of income support for people looking for work. NWRN's experience is that poverty and the stresses caused by lack of resources makes it difficult for people to sustain the search for employment.

Many of those who are currently unemployed have been out of work for over 12 months, and with 5 unemployed people for every job vacancy – the search for employment can be both frustrating and humiliating.

As a result of successive policy changes to the Disability Support Pension, the ranks of Australia's unemployed are now being filled by job seekers with disabilities, who now make up 1-in-4 of those living on just \$260 a week. Hopes are high that the new *jobactive* system will provide the right type of assistance and support to help people into employment.

A related issue is the sheer complexity of the existing tax-transfer system. Some arrangements can not only add complexity, but undermine the fairness of the taxation system.

Tax offsets and the low-income thresholds for older people need careful consideration. In our view, tax should be based on income rather than age, and that removing mature age persons from the taxation system is unfair on younger taxpayers and is financially irresponsible — particularly given the ageing Australian population.

Addressing EMTRs should be a high priority in future tax reform.

9 *A framework for reform*

NWRN notes the important role that the Australian Council of Social Services (ACOSS) is playing in providing an important voice and perspective on taxation reform, and in proposing revenue measures which have also been accepted by Governments.

ACOSS has proposed a 'Framework for reform', which sets out seven major challenges for tax reform.

The key elements of this roadmap for a fairer tax system address the connection between taxation and expenditure reform.

The framework includes:

- Restore and strength Australian government revenue
- Fair and efficient personal; income tax system
- Efficient, growth-friendly business taxes
- Better retirement income products
- Affordable housing
- More sustainable and efficient bases for State governments
- More equitable and sustainable tax treatment for the charitable sector.

The NWRN supports this approach.