It’s Time for Taxpayers to Start Paying Attention to Tax Reform Debate

By Mark Chapman, Director of Tax Communications with H&R Block

Over the last month we have seen some truly radical proposed changes to our tax system, and with evidence emerging that the Turnbull Government is looking closely at many of those proposals, it seems certain that change is coming and that you WILL be affected.

But with many of the discussions happening in closed rooms populated by pontificating politicians, policy nerds, lobby groups, academics and media types, there is a real danger that the conversation is being held in a bubble. How much do you know about the proposals that are on the table? How will you be affected? Why is any of this necessary?

The argument for reform

Depending on your viewpoint, there can be a number of reasons why tax reform is necessary.

Some point to the complexity of our tax system, some argue that the tax system holds back creativity and competitiveness in business; others argue that the tax system needs to be rebalanced to be made fairer for certain groups of taxpayers. Underlying all of this, however, is the question of revenue. Simply put, our tax system doesn’t bring in enough revenue to pay for all of the services the government provides and with expenditure on areas like health, education, aged care and the National Disability Insurance Scheme all expected to increase quickly over the coming years, the problem is becoming more serious, not less.

In short, the government needs to raise cash and much of the argument over tax reform focuses on which parts of society will pay more and how. To quote the old tax truism, “the art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing”. The government will be engaged in a delicate balancing act to produce a set of proposals which maximise the feathers and minimise the hissing!

What proposals are on the table?

There are a number of key areas which are the focus of debate. These areas crop up consistently and at the end of the day, it is highly likely that they will all feature in the reform mix somewhere:

GST
It’s widely acknowledged that our 10% rate of GST is low by international standards. Add to that the various exemptions from GST around fresh food, healthcare, etc. and the argument is often put that we as taxpayers have too good a deal when it comes to our GST.

Some tax experts also point to the fact that GST is a relatively efficient tax, which means that it is cheap and easy to collect and difficult to avoid. As such, they say, we should focus more of our
revenue raising capacity on the GST and either increase the rate or broaden the base by removing some of those exemptions. Some argue we should do both.

Opposing that viewpoint, many community groups point out that the structure of GST is regressive, which means that people at the lower end of the wealth spectrum are proportionately more affected by GST than those at the higher end. Either increasing or broadening the GST would serve to accentuate this regressive impact. In short, they say, the GST is effectively a way of increasing the tax burden on the poor whilst reducing it on the rich.

Nevertheless, there appears to be a consensus building behind GST changes, to the extent that some change looks almost inevitable. Even some Labor politicians (albeit state-based ones, whose states stand to benefit from the increased revenue flowing from the changes) are now on board for GST reform.

Despite that, public opinion as measured by recent polls is strongly against change and with no concerted debate at present to explain to the court of public opinion why change might be needed, that hostility doesn’t look like changing any time soon.

Company Tax

Business groups have strongly advocated cuts to the rate of company tax, which currently sits at 30%. They point out – accurately – that Australia’s rate of company tax is high by international standards. Most commentators suggest a cut to about 25%. A broad degree of consensus is emerging around this proposal. At a recent summit to discuss tax reform, Shadow Treasurer Chris Bowen committed the Labor party to cuts in the company tax rate and even trade union opposition was half-hearted.

Like changes to the GST, however, nobody is explaining to the public why such a cut could be in their interests. Again, the perception is that “tax reform” is code for shifting the tax burden from the top end of town to the bottom. And with many corporations under fire for perceived tax avoidance, many question why corporates should be the primary beneficiaries of tax reform.

In particular, the argument that a lower company tax rate would increase competitiveness with some of our low-taxing neighbours, ultimately benefiting all of us, ignores the fact that cutting our corporate tax rate to 25% wouldn’t come close to making us competitive with, say, Singapore, which has a corporate rate of just 17%, far lower than anyone is suggesting our rate should be cut to.

Negative Gearing

The cost of the tax concessions around negative gearing amounted to over $12bn in lost tax revenue in 2012-13 and many housing economists argue that the impact of those concessions on the housing market – particularly on first time buyers who find themselves priced out by investors – is profoundly negative. Having said that, over 1 million Australians own negatively geared investment properties, a very large constituency to annoy if you’re a politician intent on reform.

So how could negative gearing be reformed to make it more affordable and to decrease its negative impact on the housing market? Firstly, it would be possible to “quarantine” losses arising on negatively geared properties against profits arising on other investment properties in the same year or the same property in future years (which is basically how most other countries allow relief for property losses).
Alternatively, negative gearing losses could be restricted so that they are only available on new properties, not purchases of existing ones (which would achieve the original policy intent of negative gearing, which was to increase the supply of new homes).

Either change would be politically dangerous but much of the poison could be neutralised by “grandfathering” any change such that the new rules only apply to investment properties acquired after the new law comes into force (so existing investors aren’t affected).

**Personal Income Taxes**

Respected economist Saul Eslake has made the point that the tax reform proposals around GST and company tax are politically difficult because the beneficiaries of change are either companies or wealthier individuals. To balance that, he has suggested that many of the loopholes in the personal tax system (which are mainly exploited by the wealthy), such as the use of discretionary trusts to stream income, should be closed and the resulting savings used to cut personal tax rates, with a particular focus on the lower tax rates paid by those at the bottom of the income scale.

**Superannuation**

The growth in the cost of the tax breaks associated with our superannuation savings has been truly phenomenal. Superannuation tax concessions cost the government budget around $35 billion in 2013-14, projected to rise at a staggering 12 per cent annually to $50.7 billion in 2016-17.

The argument for reform is based on the hypothesis that many of the wealthiest Australians are now using superannuation as far more than just a way to save for their retirement. It’s become a de-facto tax avoidance scheme whereby huge sums are put into superannuation purely to save income tax, the result being that superannuation balances are being generated which are far larger than any reasonable person could ever need to fund a comfortable retirement.

Suggestions for reform are many and varied but mostly focus on taxing income paid out of superannuation on retirement which are over and above a certain “reasonable” level.

Those hostile to change argue that tinkering with the tax concessions associated with a program as long-term as superannuation is unfair, akin to changing the rules half way through a game of football. It could, they argue, prove to be a disincentive to future retirement saving.

Nevertheless, even many of the superannuation lobby groups, as well as National Seniors, are now acknowledging that change may be inevitable. The Labor party has already committed to it, and the Liberals may not be far behind.

**Conclusion**

Any tax reform package developed by the government is likely to include all of the above areas. That means that every one of us will find the amount we pay and the way we pay it will change. There will be winners and losers, though at the moment we have no idea which of us will fall into each camp.

Nevertheless, if this is a debate you haven’t so far focussed on, you need to sit up and start paying attention. For better or for worse, the outcome of these discussions will affect your personal finances. That means that you need to understand what’s coming and have your voice heard in the discussion.
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