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Australia's future tax system

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Abstract

The year 2001 marked the centenary of the Australian Federation, and the new century promised fresh opportunities as technology developments and an emerging resources boom drove economic growth and revenues. The consequent strong fiscal position perhaps offered a chance to 'buy' some more tax reform. However, the 2008 global financial crisis (GFC), and associated fiscal stimulus packages, interrupted that momentum. While the Australian economy regained its low-inflation growth path, a fraught political situation further obviated opportunities for tax reform. From early 2020, the COVID-19 crisis then drove Australia into recession and the focus moved to macroeconomic stabilisation.

This paper covers the limited tax reform developments over the last 20 years, in particular the 2009 *Australia's Future Tax System* review and the 2015 tax white paper process with its *Re:think* discussion paper.

Keywords: tax, economic, public finance, government

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AUSTRALIA'S FUTURE TAX SYSTEM

Introduction

The year 2001 marked the centenary of the Australian Federation, and the new century promised fresh opportunities as technology developments and an emerging resources boom drove economic growth and revenues. The consequent strong fiscal position enabled a series of tax cuts and perhaps a chance to 'buy' some more tax reform. However, the 2008 global financial crisis (GFC), and associated fiscal stimulus packages, interrupted that momentum. While the Australian economy regained its low-inflation growth path, a fraught political situation further obviated opportunities for tax reform. From early 2020, the COVID-19 crisis then drove Australia into recession and the focus moved to macroeconomic stabilisation, pushing the Budget deeper into deficit.

This paper covers the limited tax reform developments over the last 20 years, in particular the 2009 *Australia's Future Tax System* review and the 2015 tax white paper process with its *Re:think* discussion paper.

Tax reform criteria

I will use the criteria set out in previous papers to evaluate these tax reviews:

1. The *terms-of-reference and panel* indicate the government's ambition – an open, searching inquiry as opposed to a narrow remit if particular recommendations are expected.
2. The extent of *gathering of evidence and calling of witnesses* indicate the panel's reliance on external experts as opposed to its own expertise/predetermined views.
3. *Timeliness and relevance* indicate likely influence – a quick, focused review for immediate implementation, but a more open one as a platform for subsequent reform exercises.
4. The *approach to analysis of issues* indicates the rigour of the public finance framework and its framing against standard tax policy criteria.
5. The *quality of tax policy outcomes* is the ultimate test of a reform exercise, although this is dependent on government actions.

The Economy

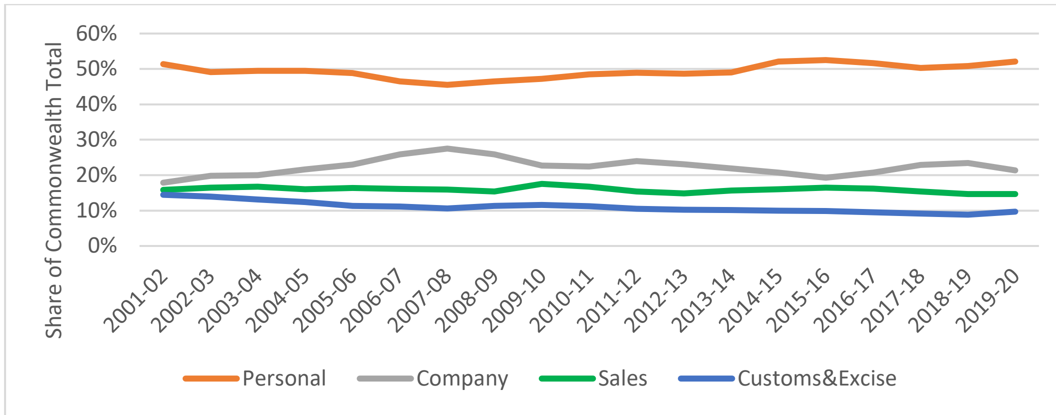
After an unsteady start, this century's first decade saw continued economic growth, with a rising terms-of-trade driven by strong demand for commodities such as iron ore and coal from the developing countries of Asia, particularly China. The GFC then caused a major economic downturn in developed economies, although the impact on Australia was moderated by substantial fiscal and monetary stimulus.

The century's second decade brought continued low-inflation growth. Indeed, inflation fell below the Reserve Bank of Australia's (RBA's) 2–3 per cent target range, leading to a lowering of the official cash rate to close to zero. The COVID-19 health pandemic then led to lockdowns and other measures intended to slow the spread of the virus, pushing Australia's economy into its first recession in 30 years. Large government fiscal packages, along with quantitative easing by the RBA, have ameliorated the extent of the economic downturn but left a large debt legacy.

The Tax System

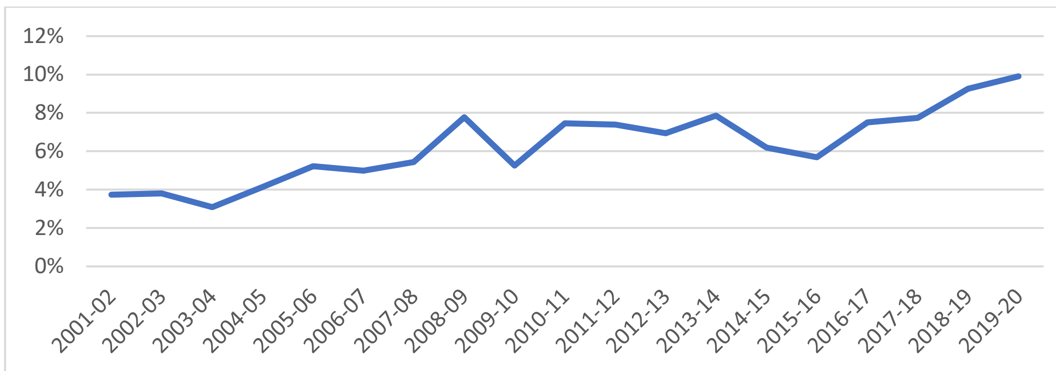
The resources boom, occurring from 2004, drove strong increases in revenues for the Commonwealth, and some states, enabling substantial personal income tax cuts. Company income tax and state mining royalties[1] grew particularly strongly (see figures 1 and 2). The GFC, and associated fiscal stimulus packages, resulted in a temporary fall in revenue, especially at the Commonwealth level (see Figure 3) but also for stamp duties at the state level (see Figure 4).

Figure 1: Commonwealth Tax Mix



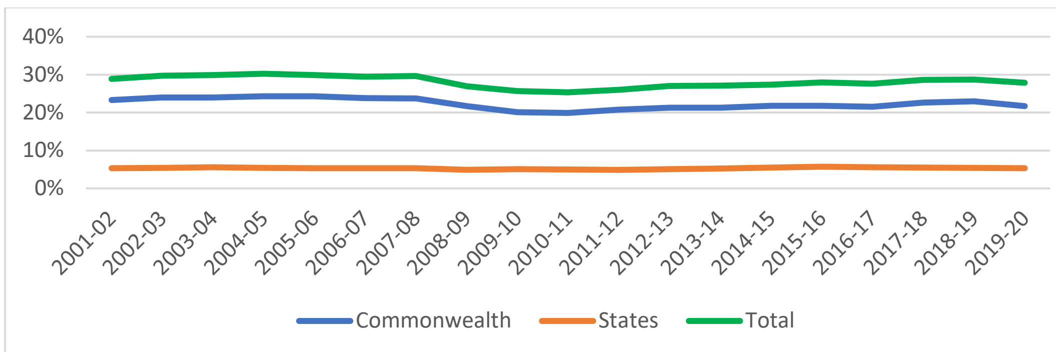
Source: Australian Bureau of Statistics (ABS), Taxation Revenue

Figure 2: Royalties as a Percentage of State Own-Revenue



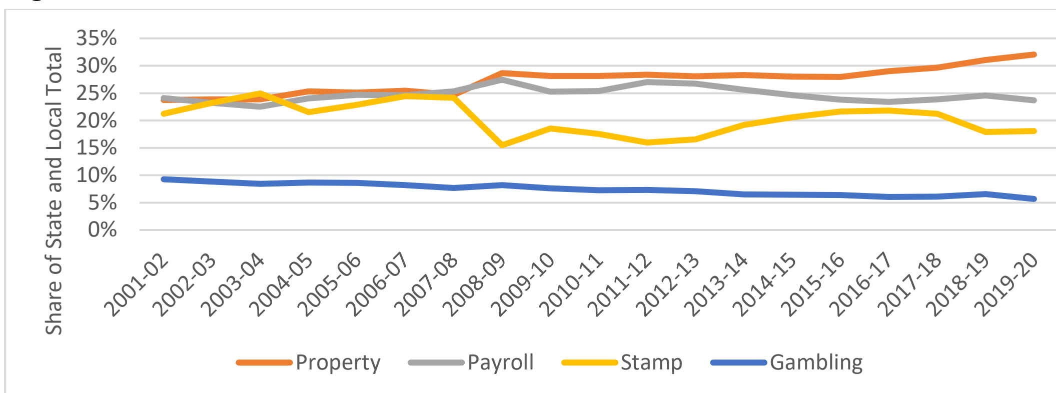
Sources: ABS, Government Finance Statistics (GFS) and state budgets (prior to 2008–09)

Figure 3: Commonwealth and State Tax/GDP Ratios



Source: ABS, Taxation Revenue

Figure 4: State and Local Tax Mix



Source: ABS, Taxation Revenue

Post-GFC, the tax burden was allowed to recover as part of the fiscal consolidation process. At the Commonwealth level, the personal income tax share increased with steady bracket creep. At the state and local levels, property revenue (land tax and rates) held up and has grown substantially more recently with the ongoing strength of the housing market (see Figure 4).

Resources Boom Largesse

In the wake of the 1985 income tax reforms and the 2000 consumption tax reforms, there was a degree of stability in the structure of Australia's tax system. In this century's early years, tax policy was focused on implementation of the *Not a New Tax, a New Tax System* (ANTS) and Ralph reforms, and the tax burden was allowed to rise in a period of fiscal consolidation (see Figure 3).

Personal Income Tax Cuts

The 2003 Budget contained the first of a series of personal income tax cuts. With a stepped marginal tax rate schedule, tax cuts can be delivered by either decreasing the rates or increasing the thresholds at which the rates change. Generally, decreasing the rates provides a smaller marginal tax rate cut for a greater number of people, while increasing the thresholds provides a greater marginal tax rate cut for a smaller number of people. Both actions lower average tax rates. The 2003 Budget tax cuts were delivered by increasing the thresholds.

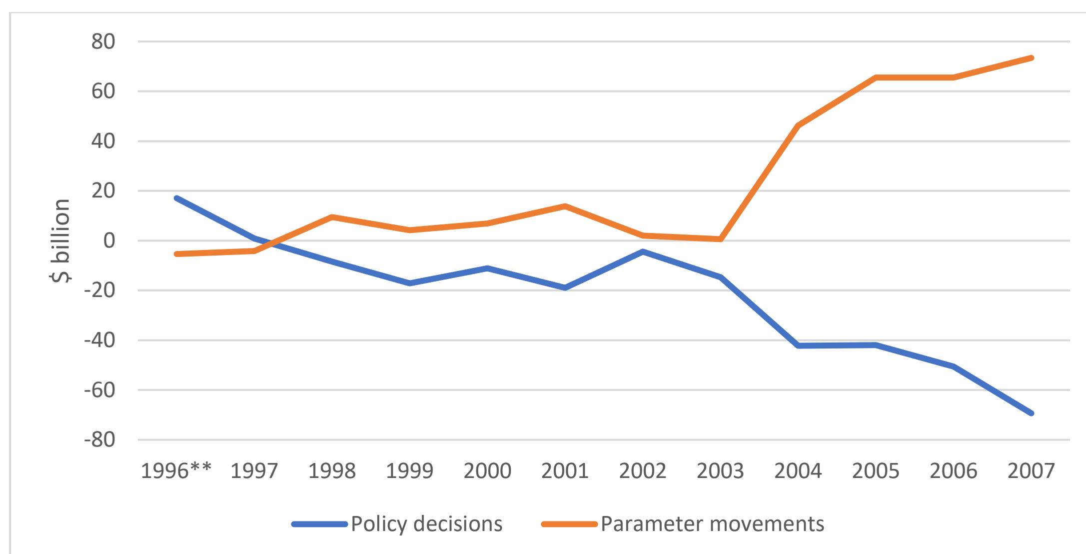
With the resources boom kicking in, the 2004 Budget income tax cuts were again provided by increasing thresholds such that more than 80 per cent of taxpayers would be on a tax rate of 30 per cent or less, not including the Medicare levy (ML). The 2005 Budget tax cuts reduced the lowest tax rate from 17 to 15 per cent and increased other thresholds. The 2006 Budget tax cuts came from a mix of threshold increases and rate cuts, including a cut in the top tax rate from 47 to 45 per cent. The 2007 Budget tax cuts were delivered with further increases in the thresholds.

Throughout this time, there were also significant spending increases. The 2004 Budget increased family assistance spending, building on the baby bonus introduced in 2002.[2] The 2005 and 2006 budgets contained further increases in family benefit payments. The 2007 Budget contained very large, pre-election, across-the-board spending increases.

With the rising terms-of-trade driving economic growth and revenues, the Budget, however, remained in substantial surplus, generating a debate about how best to 'spend the surpluses'. The options were to provide tax cuts, increase spending, or run large surpluses. In the end, all three were possible! With net debt projected to be eliminated, the government established the Future Fund to manage its financial assets, with the stated aim of meeting its unfunded superannuation liabilities.[3]

Figure 5 illustrates the split between policy decisions and parameter movements in this fiscal story. The improvement in the budget bottom line up to 1997 was driven by the government's policy decisions, mainly the 1996 Budget. From 1998, and especially from 2004, positive economic parameter movements drove improvements in the budget position, enabling the provision of substantial tax cuts and spending increases.

Figure 5: Reconciliation Table Results*



* Each year's figure is the summation of the four years of the forward estimates in the Budget (since the previous Budget)
** Starting from the 1996 election

Sources: Budget papers

Simplifying Superannuation

The 2006 Budget contained a significant change in the taxation of superannuation, with the removal, from 1 July 2007, of the tax on withdrawals for people aged over 60 and the abolition of reasonable benefit limits (RBLs). This was effectively a continuation of the 1988 changes that had brought some of the tax on withdrawals forward to tax most contributions and earnings at 15 per cent.

Figure 6 illustrates the three possible tax points with a savings vehicle: contributions, earnings and withdrawals. With savings being the difference between income and consumption, there is a question of whether income tax or consumption tax treatment is sought. Consumption tax treatment entails taxing just withdrawals, with contributions and earnings exempt; this can be depicted as exempt, exempt, taxed (EET). Income tax treatment entails taxing just contributions and earnings, with withdrawals exempt; this can be depicted as taxed, taxed, exempt (TTE).

Figure 6: Three Stages of a Savings Vehicle

Prior to 1988, the taxation of superannuation was something like EET (consumption tax treatment), but after those changes there was some tax at all three points. By removing the tax on withdrawals, the 2007 changes left us with a concessional version TTE (income tax treatment).[4] Table 1 provides a timeline of the changes in the taxation of superannuation.

Table 1: Timeline of Changes in the Taxation of Superannuation

	Contributions	Earnings	Withdrawals
Pre-1983	Exempt	Exempt	Income streams: personal tax rates Lump sums: 5% included in personal income tax
1983	Exempt	Exempt	Income streams: personal tax rates Lump sums: 15% tax up to $50,000, 30% above that

1988	15% (pre-tax contributions)	15% (in accumulation phase)	Income streams: personal tax rates minus 15% rebate Lump sums: exempt up to $135,590, 15% up to RBL
2007	15% (pre-tax contributions)	15% (in accumulation phase)	Exempt
Current*	15% plus low income super tax offset (LISTO) and Division 293	15% (in accumulation phase)	Exempt (up to $1.7 million transfer cap)

* Discussed on pp. 20 and 28-29.

As its name implies, the Australian income tax system takes income tax treatment as its legal benchmark. However, with departures from that in the taxation of the main savings vehicles – superannuation, owner-occupied housing, capital gains – it is effectively a hybrid between income and consumption tax treatment.

The 2007 changes provided some simplification of the superannuation tax arrangements. It may be debatable whether taxing withdrawals (consumption tax treatment) or taxing contributions and earnings (income tax treatment) is superior, but taxing all three points is an unnecessarily complicated approach. Removing tax from the most complex of the three possible taxing points – withdrawals – was a substantial simplification. The changes did, however, also increase the size of the overall tax concession for superannuation.

With RBLs abolished, new caps were introduced on contributions to superannuation. Pre-tax contributions were limited to $50,000 pa and post-tax contributions to $150,000 pa. With an average wage of around $50,000 and a Superannuation Guarantee (SG) rate of 9 per cent, this left significant room for additional voluntary contributions.

To summarise the 2006 Budget changes, they increased the size of the tax concession on superannuation but put greater ringfencing in place. They made it more attractive to get money into superannuation, especially for high-income earners, but restricted the amount that could be contributed.

Rudd Government

The Howard government lost the November 2007 election, marking the end of two long-term governments. The Hawke–Keating and Howard–Costello governments had done a great deal to reform the Australian economy, and tax reform had been a big part of that.

The election of the Kevin Rudd government, with Wayne Swan as treasurer, promised a new reformist zeal. Subsequent to the 2007 Budget, Rudd had said, ‘This sort of reckless spending must stop’,[5] and he presented a relatively modest set of election commitments. The signs at the start were good.

In April 2008, the government held the Australia 2020 Summit to ‘help shape a long term strategy for the nations’ future’.[6] An idea from the summit’s Economy Working Group, co-chaired by David Morgan and Wayne Swan, was for a comprehensive tax review that would ‘increase harmonisation across jurisdictions, reduce administration costs and decrease the number of taxes’.[7] The thinking was that the strong fiscal position provided a chance to ‘buy’ some further tax reform.

Asked about this the day after the summit, and perhaps looking for an actionable item from it, Rudd said, ‘I actually think we are getting to that time where we need to have a top-down look. I think it is time we actually looked at a root-and-branch reform of the Australian taxation system’.[8]

Australia's Future Tax System

The 2008 Budget forecast ongoing large budget surpluses. It also proposed personal income tax cuts over three years that increased thresholds, reduced the 40 per cent tax rate to 37 per cent, and increased the low income tax offset (LITO) to achieve an effective tax-free threshold (TFT) of $16,000.[9] Further 'aspirational' tax cuts were flagged to reduce the number of marginal tax rate steps from four to three, reduce the 45 per cent tax rate to 40 per cent, further reduce the 37 per cent tax rate to 30 per cent, and further increase LITO to achieve an effective TFT of $20,000.[10]

The government also formally announced a 'comprehensive review of Australia's tax system to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century'.[11] The terms-of-reference called for an examination of the impact of the tax system on returns from work, consumption, investment and savings, and the role of environmental taxes. Changes to the goods and services tax (GST) were ruled out. (See the terms-of-reference at Appendix A.)

As opposed to the 1985 and 1998 reviews, which were largely determinative processes seeking to implement the 1975 Asprey tax blueprint, this review's purpose was less clear. It was being asked to contemplate the tax structure that Australia needed in the 21st century. However, coming just eight years after the implementation of ANTS, it was questionable whether there was a sufficient 'burning bridge'. Further, the 1985 and 2000 reforms had substantially dealt with the most obvious tax base gaps, which partly precluded revisiting those issues.

It seemed the government lacked a clear view of what tax reform it wanted from the review. Despite the idea originating from the Australia 2020 Summit Economy Working Group that he co-chaired, Swan was sceptical about such an open review, describing the proposal as a post-summit interview 'brain snap' by Rudd.[12]

With the tax system establishing how the burden of funding government services is shared in a community, Rudd perhaps saw the review as a vehicle to reconfigure this to reflect the priorities of his government's client groups. Having chided the previous government over 'waste' regarding its client groups, the new government was looking for ways to increase the SG rate and fund infrastructure programs.

The review panel was a hybrid of internal and external members. It was chaired by Ken Henry as secretary of Treasury, with the other panel members being Jeff Harmer (secretary of the Department of Families, Housing, Community Services and Indigenous Affairs, or FaHCSIA) plus three externals: Greg Smith (ex-Treasury), Heather Ridout (Australian Industry Group) and John Piggott (University of New South Wales). A 35-person secretariat was based in Treasury and consisted mainly of Treasury officers, headed by Rob Heferen.

The timetable was to report by the end of 2009, within the political window for the next election in late 2010. Two background papers and two consultation papers were published to facilitate public discussion and a preliminary report on the retirement income system was provided in May 2009. A report on the pension system was also provided by Jeff Harmer as secretary of FaHCSIA in February 2009. The final result of the work was the December 2009 report *Australia's Future Tax System* – AFTS for short.

Other Players

With the review being broad in scope, the AFTS consultations were commensurately broad. A series of public meetings was held, based around the background and consultation papers, and over 1500 submissions were received.[13] A number of research papers and consultancies were commissioned, and a tax and transfer policy conference was held involving Australian and international experts.[14] (Appendix B summarises these processes.)

The panel and secretariat met with over 130 stakeholders,[15] including the Australian Council of Trade Unions (ACTU), the Australian Council of Social Services (ACOSS), the Association of Superannuation Funds of Australia (ASFA) and the Business Coalition for Tax Reform (BCTR). There

were also consultations with the Minerals Council of Australia (MCA)[16] – they, in fact, proposed a resource rent tax to replace state royalties (discussed further below).

Tax Review Approach

With the panel having significant tax policy expertise,[17] and the secretariat consisting mainly of Treasury tax policy experts, the review was well placed for an in-depth examination of the Australian tax system. Further, the relationship between the tax and transfer systems was of such importance that a systemic approach to the legal, economic and administrative structure of both systems at all levels of government was considered necessary.[18]

Significant modelling capacity was needed. The main modelling of the economic effects of the proposed reforms was commissioned from Chris Murphy using the KPMG Econtech MM900 general equilibrium model, which was developed for the review and incorporated tax system details.[19] For the retirement income issues, Treasury's RIMHYPO model was used.

The review's first publication, the August 2008 Treasury paper *Architecture of Australia's Tax and Transfer System*, articulated the system's social, environmental and economic challenges. It did not paint a picture of a tax system that was broken but rather looked forward to the reforms needed to equip Australia for the 21st century – in the context of a strong budget position that could support a tax reform package with some initial fiscal costs:

> Australia's economic position provides an ideal opportunity for reform. The boost to national incomes from the significant increase in the terms of trade due to the resources boom, together with Australia's strong fiscal position, provides a platform on which to base a reform agenda.[20]

This context, however, was about to change.

Change of Plan

A crisis in global financial markets and world economies emerged through the course of 2008. The collapse of the US subprime mortgage market in 2007 developed into a banking emergency the following year, with the September 2008 failure of Lehman Brothers signalling a full-blown GFC. The Australian Government, like others around the world, went into crisis-management mode to ameliorate the macroeconomic effects.

Asked for his advice as Treasury secretary, Ken Henry famously advised the government to 'go early, go hard, go to households'.[21] It did that, announcing in October 2008 a $10 billion stimulus package with immediate one-off payments to pensioners, families and first-home buyers.[22] The RBA also cut interest rates, and policies were announced to stabilise the financial system. The combination of the fiscal stimulus package and the monetary policy easing provided a sequenced 'Keynesian' stimulus to the economy in late 2008 and the first half of 2009.

These macroeconomic responses, together with a sound financial system, enabled Australia to avoid a major recession.[23] The package received universal acclaim and the Opposition supported its parliamentary passage.

With global economic assessments continuing to be pessimistic, though, the government announced a second package of $42 billion in February 2009 and a third package of $22 billion in the May 2009 Budget. These packages were largely infrastructure spends in the government's priority areas of the environment, education and housing. The revenue forecasts were also downgraded by $175 billion over the forward estimates and the Budget swung into a large deficit.[24] An intense political debate over the amount of spending and the impact on the budget deficit and debt levels ensued – it would be a dominant issue through to the 2013 election.

The implications for the AFTS review were also profound. The prospect of having significant budget surpluses with which to 'buy' some tax reform had disappeared, and the review panel had to reconsider its approach. Greg Smith recalls they realised the world had changed and that

consequently their approach had to change too. Major tax reform in the short term was no longer realistic, so the report needed to be directed at a more conceptual level concerning the long-term direction of the Australian tax system.[25] The nature of the review needed to change from determinative to foundational.

The structure of the panel and secretariat was also now problematic. Ken Henry recalls that being chair of the panel while serving as Treasury secretary, along with a Treasury-dominated secretariat, made sense when it was expected they would work on a tax package for immediate implementation – Treasury needed to be fully in the tent ready to implement that.[26] Those arrangements, though, would prove less than ideal for a more aspirational review.

The AFTS Package

In this context, the AFTS panel and secretariat continued their work over the course of 2009. The final report sought to define a tax and transfer system that could better equip Australia for the social, economic and environmental challenges of the next 40 years.[27]

Review Approach

AFTS defined five design principles for the tax and transfer system:

1 equity – individuals with similar economic capacity should be treated in the same way (horizontal equity) and the overall system should be progressive (vertical equity)

2 efficiency – while all taxes and transfers affect choices in some way, the system should raise and redistribute revenue at the least possible cost to economic efficiency

3 simplicity – the tax and transfer system should be easy to understand and simple to comply with

4 sustainability – the tax system should be durable, yet flexible enough to meet the changing revenue requirements of government over time

5 policy consistency – tax and transfer policies should be internally consistent, without having rules in one part of the system contradict those in another part.[28]

Conceptually, AFTS distanced itself from the approach taken in the 1975 Asprey review, saying it had taken advantage of ‘better and stronger understandings’ of the way taxes impacted on economic behaviours.[29] The AFTS approach was influenced by optimal tax theory, with the taxation of different forms of income or consumption potentially varying depending on impacts on individual and business behaviours. The Asprey approach was a simpler pursuit of comprehensive tax bases with different items of income or consumption taxed at the same rate – in the Haig–Simons tradition.

To frame its thinking, AFTS sought to identify the mega-trends of coming decades.[30] Technological advances were transforming economic activities, accelerating international integration and capital flows. Australia’s economy and its society were changing with more flexible work arrangements, increased female workforce participation, and rising community expectations of housing and education. Demographic changes were driving increased costs of infrastructure, health and aged care, and environmental pressures were increasing.

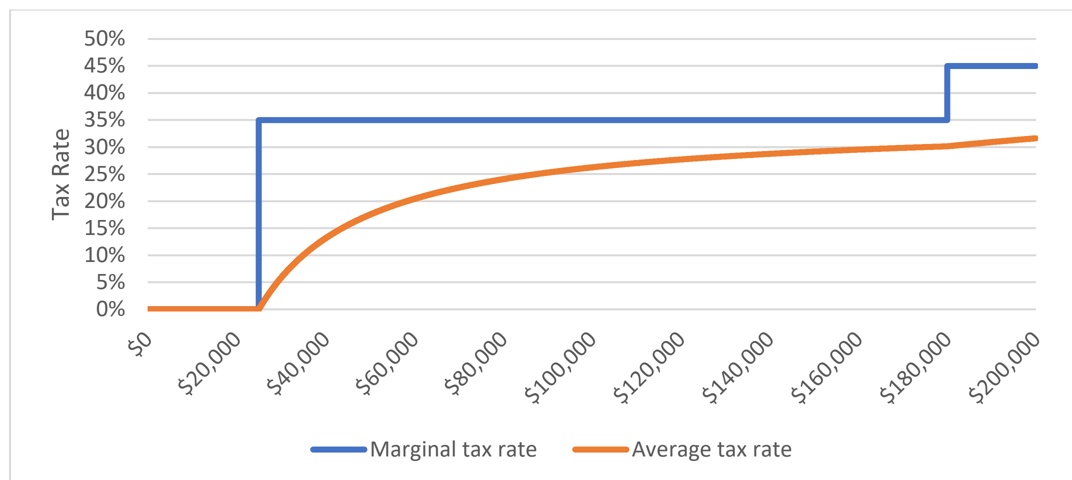
AFTS argued that while the broad architecture of Australia’s tax and transfer system was sound, taxes had become too complex and there were too many of them. Ideally, revenue raising should be concentrated on four broad tax bases: personal income, business income, economic rents and private consumption.[31]

Personal Taxation

AFTS viewed personal income tax as the bedrock of the Australian tax system and considered it the sole means of delivering progressivity in the tax system. However, it sought a simpler tax and improvements to the taxation of savings.

A simple two-step rate structure, without special levies or offsets, was proposed (see Figure 7 for indicative scale). Most taxpayers would face a constant marginal rate, with progressivity delivered through a high TFT and a high top rate. The tax base should be broad with alternative forms of remuneration taxed in a consistent manner, including taxing fringe benefits in the hands of employees. A standard deduction, in lieu of work-related expenses (WREs), would simplify tax returns and enable the greater use of pre-filling.

Figure 7: Indicative Personal Income Tax Rates Scale



Source: Reproduced from AFTS, p. 30

A departure from full income tax treatment, though, was proposed for savings with a hybrid income/consumption tax approach that partially taxed returns. A uniform discount of 40 per cent was recommended for bank deposits, bonds, rental properties and capital gains, while close to full consumption tax treatment was supported for owner-occupied housing and superannuation.[32]

Retirement Income System

In November 2008, the government asked the panel to bring forward its consideration of retirement income issues,[33] and this was addressed in the May 2009 *The Retirement Income System: Report on Strategic Issues*. It supported the three-pillar architecture of Australia's retirement income system – a means-tested age pension, compulsory superannuation contributions, and voluntary savings – but proposed some improvements.

A key, and controversial, recommendation was for the SG rate to remain at 9 per cent.[34] It was argued that, together with the age pension, this provided an adequate retirement income for most people, striking an appropriate balance between working and retired life consumption opportunities. This issue would cause tension in the relationship with government, which was expecting support for, and a way to fund, an increase in the SG rate. However, the report flagged that other features, such as superannuation preservation requirements, could be adjusted to ensure adequate retirement incomes, proposing the eligibility age for both the age pension and superannuation be increased to 67 years.[35]

The final AFTS report addressed the tax issues more fully. It supported continued tax assistance for superannuation but proposed a more equitable distribution, arguing that the 15 per cent flat tax favoured high-income earners. The key recommendation was for abolition of the 15 per cent contributions tax in the fund, with contributions instead included in individuals' assessable income and taxed at their marginal tax rates, but with a uniform (for example, 20 per cent) tax offset.[36] This would reduce a person's current disposable income but increase their retirement income – the equivalent of additional compulsory employee contributions to superannuation.

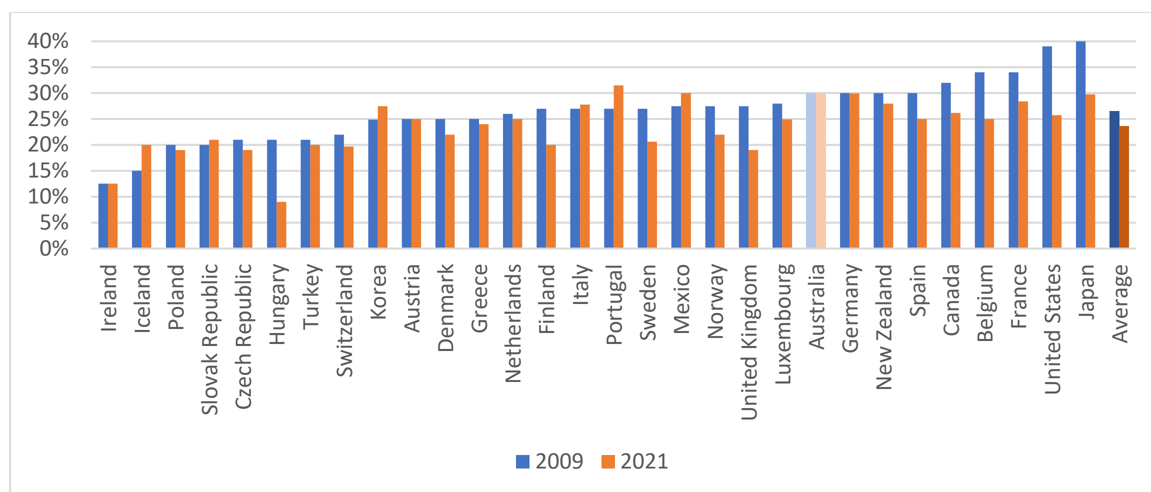
It was also recommended that the tax rate on earnings in the fund be halved to 7.5 per cent but extended to the pension phase.[37]

Investment and Entity Taxation

AFTS observed the profound implications of globalisation for Australia and the taxation of capital. Consistent with an optimal tax approach, it argued that a shift away from taxing capital towards less mobile factors could improve economic growth.[38]

Australia's company tax rate is relatively high amongst Organisation for Economic Co-operation and Development (OECD) countries (see Figure 8), and a reduction to 25 per cent was recommended to encourage highly mobile foreign direct investment. With company tax important in ensuring Australia receives an adequate return for natural resource extraction, though, this should occur in conjunction with improved arrangements for taxing non-renewable resources (discussed below). To improve resource allocation, AFTS also recommended the removal of capital allowance concessions and allowing carry back of losses for companies.[39]

Figure 8: OECD Company Tax Rates, 2009 and 2021



Source: OECD

AFTS questioned whether Australia's dividend imputation system remained appropriate in an increasingly globalised economy. The system provides integrity and neutrality benefits in business entity and domestic financing choices, but it creates biases between domestic and offshore investments.[40] Retention in the medium term was supported, but with exploration of alternative arrangements going forward.[41]

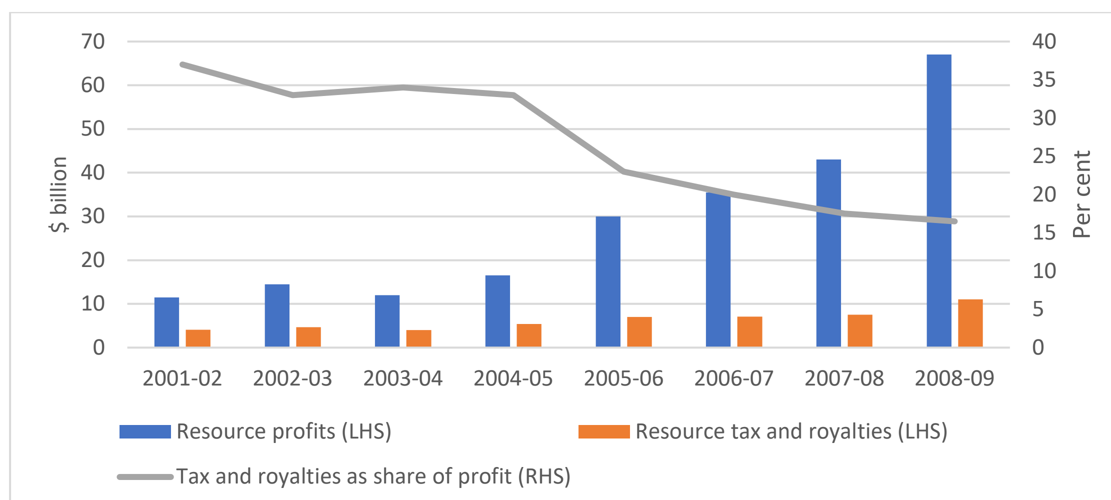
AFTS discussed alternative ways of taxing company income, such as a comprehensive business income tax that would deny deductions for interest expenses to facilitate a substantial reduction in the tax rate, or a business level expenditure tax that would provide an allowance for corporate equity or corporate capital, and so tax economic rents. With limited practical use of such taxes, though, it was recommended that Australia monitor international developments.[42]

Resource and Land Taxes

AFTS argued that well-structured taxes on natural resources and land were relatively efficient means of raising revenue and it identified these as areas with reform opportunities.

Australia's resource-charging provisions were considered inefficient and inadequate. Output-based royalties are unresponsive to changes in profit and so collect a decreasing share of revenue in periods of increasing profitability (see Figure 9). AFTS argued their replacement by a uniform resource rent tax would promote more efficient decisions and give the Australian community a better return on its non-renewable resources. A tax rate of 40 per cent was recommended, with taxable profit equal to net income less an allowance for corporate capital. Revenue would be shared between the Commonwealth and state governments.[43]

Figure 9: Resource Profits and Taxes



Source: Reproduced from AFTS, Chart 6.1, p. 47

Stamp duties on property conveyances are inefficient and inequitable, discouraging people from changing residence as their personal and work circumstances change, and penalising those who need to move more frequently. AFTS proposed greater reliance on land taxes, with the immobile tax base making them a relatively efficient means of raising revenue. It also proposed broadening the tax base to include all land, with a per-square-metre TFT that would exclude most agricultural and other low-value land.[44]

Taxing Consumption

AFTS' terms-of-reference precluded it from considering GST policy, but it contemplated some administration aspects and alternative policy instruments. The GST's invoice-based design makes it operationally complex,[45] so some simplifications were proposed, such as allowing GST-free business-to-business transactions.

More substantively, AFTS noted that the lack of comprehensiveness of the GST's base made it less efficient than it could be and recommended that, over time, a broad-based cash flow tax could replace remaining inefficient consumption taxes and payroll tax.[46]

Enhancing Social and Market Outcomes

Beyond the four broad tax bases favoured by AFTS, other taxes should only be levied to address spillovers, improve price signals or counter self-control problems.

Spillover costs were identified in road transport and the environment. Road congestion charges were supported to utilise price signals to make better use of roads, while fuel tax should apply to all fuels and be indexed to the Consumer Price Index (CPI). Self-control problems are the target of so-called 'sin' taxes that reflect social costs. AFTS proposed that alcohol taxes be levied on a volumetric basis, and tobacco excise be increased and indexed to wages, and it supported taxes on gambling as capturing economic rents created by government regulation.[47] Other taxes that did not meet these purposes, such as insurance duties and luxury car tax, should be phased out.[48]

The Transfer System

The February 2009 *Pension Review Report* found that 'the basic structure of Australia's pension system, with its focus on poverty alleviation, indexation to community standards and prices, and means testing, is sound'.[49] The AFTS report then considered some specific design issues. While it recommended that the tax and transfer systems remain structurally separated, with the tax system based on individual capacity to pay and the transfer system based on household need, there was scope for better coordination between them.[50]

Some rationalisation of payments was proposed in three broad types: pensions to provide an adequate standard of living to those not expected to work; participation payments to those able to work, with means testing that maintained incentives to seek employment; and student assistance at a lower rate.[51] Some supplementary support could be provided to parents and for rent assistance. AFTS proposed replacing the two-part income and assets means test with one comprehensive means test for all income support payments, with deemed income on most assets.[52]

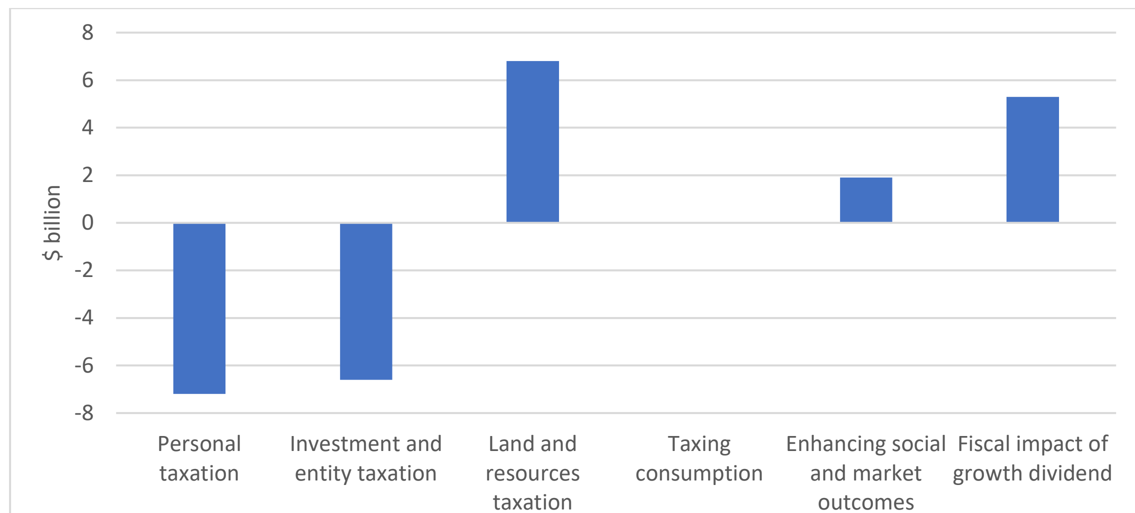
Institutions, Governance and Administration

AFTS observed generally high levels of confidence in, and compliance with, the Australian tax system, but proposed some more inclusive processes for community input, including through the Board of Taxation (BoT) and an advisory board for the Australian Taxation Office (ATO).[53] To improve individual and business client experiences, greater use of information technology plus better design and integration of systems were proposed. Specific initiatives were to provide people with their own tax and transfer client accounts and the default pre-filling of tax returns.[54]

Macroeconomic and Fiscal Impacts

Based on the MM900 economic model projections, a potential gain to output of 2–3 percentage points was estimated for the main policy proposals: reducing the company tax rate, improving resource and land taxation, and improving the structure of other taxes.[55] The reform package was estimated to be broadly revenue-neutral, taking account of the expected growth dividend. The shape of the tax system, however, would change with a tax mix shift away from capital income taxation to taxes on land and resources (see Figure 10).

Figure 10: Indicative Impact of Recommendations on Shape of the Tax System



Source: Reproduced from AFTS, Chart 11.1, p. 76

Recommendations

The final AFTS report, provided to the government on 23 December 2009, made 138 recommendations: 81 related principally to Commonwealth tax policy issues, 29 principally to transfer policy issues, three principally to state and local government tax issues, and 25 principally to tax governance and administration issues. (See Appendix C for a full list.)

The recommendations were a mix of general and specific. Some were high-level or proposals for further reviews. Many, though, were for specific policy changes, such as taxing fringe benefits in the hands of employees, a 40 per cent discount for taxing savings income, taxing superannuation contributions at individuals' marginal tax rates less an offset, cutting the company tax rate to 25 per cent, a 40 per cent resource rent tax, and taxing alcohol on a volumetric basis.

Government Response

Much had changed over the time the AFTS report was being prepared. By late 2009, the Rudd government faced other challenges, including on climate change policy after a disappointing outcome of the UN Climate Change Conference in Copenhagen. There was also a change of leadership of the Opposition, with Tony Abbott replacing Malcolm Turnbull, leaving the government unable to get parliamentary support for its Carbon Pollution Reduction Scheme (CPRS).

Further, it seems the report was not what the government was hoping for. In particular, AFTS had not supported an increase in the SG rate or proposed a way to pay for the associated tax costs. It would be over four months before the report was made public.

The report's release on 2 May 2010 was accompanied by the government's initial response, *Stronger, Fairer, Simpler: A Tax Plan for Our Future*. The centrepiece announcement was a Resource Super Profits Tax (RSPT) to 'ensure Australians get a fair share from our valuable non-renewable resources'.[56] The estimated $9 billion in a full year from the RSPT was to be used to cover the tax costs of increasing the SG rate to 12 per cent; lowering the company tax rate to 28 per cent; and funding infrastructure spending, especially in the 'mining states'.

Other recommendations were expected to be debated 'in the coming years'. Some were flagged as a potential second-term agenda, 'especially making tax time simpler for everyday Australians, improving incentives to save, and improving the governance and transparency of the tax system'.[57] The government made it clear, though, that it was not attracted to much of the report: 'Other recommendations in the review are not government policy'.[58]

Some recommendations were specifically ruled out: 'In the interests of business and community certainty, the Government advises that it will not implement the following policies at any stage'.[59] The list of 19 policy measures, and the associated AFTS recommendations, included applying land tax to the family home, anything that harmed the not-for-profit sector, reducing the capital gains tax (CGT) discount, removing the ML, removing the benefits of dividend imputation, aligning the superannuation preservation age with the age pension age, abolishing the luxury car tax, indexing fuel tax to CPI, and changing alcohol tax in the middle of a wine glut.

Of the report's 106 recommendations relating principally to Commonwealth tax matters, the initial response actioned only three of them (associated with the RSPT) – and even then the government's proposals differed from the AFTS recommendations (discussed below). Having commissioned a root-and-branch review of Australia's tax system, but lacking money to play with and struggling politically, the government now had little appetite for comprehensive tax reform.

Resource Super Profits Tax

The proposed RSPT design was outlined in *The Resource Super Profits Tax: A Fair Return to the Nation*:

- a tax rate of 40 per cent, applied to the difference between resource revenues and costs (including an allowance for capital expenditure), but deductable for income tax purposes
- immediate deductibility of exploration expenditure and a refundable exploration rebate
- losses carried forward and potentially refunded when a project winds up
- all mining and petroleum projects covered, except Petroleum Resource Rent Tax (PRRT) ones
- state royalties to remain, but a credit provided for them to neutralise their effect on investment and production decisions.[60]

The government's RSPT proposal differed in important ways from AFTS' recommendations. The AFTS resource rent tax was proposed in conjunction with the abolition of state royalties and a reduction in the company tax rate to 25 per cent. The RSPT proposal did not specify the abolition of royalties, and the proposed cut in the company tax rate was only to 28 per cent.

While the mining industry had been consulted in the AFTS process, and indeed had proposed a resource rent tax to replace royalties,[61] there was only limited further consultation with them prior to the government's announcement – and this was to be a major problem.

At the time of its RSPT announcement, the government did establish a Resource Tax Consultation Panel, chaired by David Parker as head of Treasury's Revenue Group, with a remit to communicate the design features of the RSPT and to liaise with industry on the best way to achieve the government's policy outcomes (see Figure 11).[62] It was made clear, though, that the consultation would only concern 'technical design issues'.[63] That panel conducted its consultations and reported to government,[64] but a larger political power play was brewing.

Figure 11: Consulting on the RSPT

Source: Nicholson

The mining industry was affronted by the new tax. They had expected some change and accepted the principle of a resource rent tax, but they were aggrieved at the proposed rate and design and felt there was a lack of genuine consultation prior to its announcement. Further, the AFTS consultations had been with the tax teams, but it seems the boards of the big companies were less accepting of any arrangement by which they paid more tax.[65]

There was also no agreement with the states about resource royalties. There had been an initial consultation with the Western Australian Government, but this was overtaken by events with the mining industry.[66] The RSPT design consequently refunded companies for any state royalties, gifting the states an opportunity to increase royalties with impunity.

The federal government's key ministers on the RSPT were Swan, with main carriage of the tax policy process; Rudd, who as prime minister was the final decision-maker; and resources minister Martin Ferguson, who was tasked with industry consultations. It appears, though, that communications among them were dysfunctional and they expressed contradictory messages. Paul Kelly concluded: 'The contradiction was compounded by appalling process. Rudd was disengaged and Ferguson was excluded from the policy decision'.[67]

This was a disaster in the making, especially as the industry had deep pockets. The MCA ran an anti-RSPT advertising campaign for 54 days at a cost of $25 million. It was one of the most effective special interest campaigns of its era.[68]

The government was soon wilting, and Rudd's inability to find a solution, on top of his earlier climate change policy retreat, was becoming part of the political dynamic between him and his deputy, Julia Gillard. As political events played out, Gillard challenged Rudd and became Australia's

first female prime minister on 24 June 2010. One of Gillard's first actions as prime minister was a political fix for the RSPT problem, in full consultation with the mining industry.[69]

The resultant Minerals Resource Rent Tax (MRRT) applied just to iron ore and coal, with the PRRT applying to oil and gas. The rate was 30 per cent of profits calculated at commodities' first saleable point (mine gate), with a 25 per cent extraction allowance to recognise miners' expertise. Depreciation of project assets over five years, with an uplift at the long-term bond rate plus 7 per cent, was allowed, with investment after the 1 July 2012 start date written off immediately. The exploration rebate was dropped, and unutilised losses could be carried forward at the long-term bond rate plus 7 per cent but were not refundable.[70]

Compared to the RSPT, the MRRT, beside applying only to iron ore and coal, had a lower tax rate, an extraction allowance, higher uplift factors and more generous depreciation. The company tax rate would only be cut to 29 per cent but, overall, it was still a major concession to the mining industry.

While the policy design had been watered down, the incorporation of more optimistic forecasts for commodity prices and volumes resulted in the MRRT being estimated to raise only slightly less than previously – $10.5 billion over the forward estimates,[71] compared to $12 billion for the RSPT. The impact of just the policy changes, a detraction of $5 billion over the forward estimates, is shown in Table 2.

Table 2: Budget Impacts of Policy Changes Compared with RSPT Announcement ($ million)

Policy Change	2011–12	2012–13	2013–14	Total
MRRT		−1000	−6500	−7500
Refundable tax offset	522	601	681	1804
Company tax rate			600	600
Small business		200	150	350
Growth dividend		−100	−200	−300
Total	**522**	**−299**	**−5269**	**−5046**

Source: 2010 Mid-Year Economic and Fiscal Outlook, pp. 226-228 and 263

With the industry supporting it, the government was able to legislate this package. As events transpired, though, the MRRT raised little revenue in the following years, due to a combination of the watered-down tax design and a fall in commodity prices. It would subsequently be repealed.

Throughout this torrid period, the AFTS panel played a minimal public role, with its configuration now proving problematic. As Treasury secretary, Henry was obliged in his public remarks to remain within the confines of government policy and stay clear of the political debate.[72] He has said:

> The review didn't have a good chance. There was no-one who could stand up afterwards and be the champion. That was the downside of me as secretary of Treasury chairing the review. But the way it was conceived it wasn't going to be that sort of review. It was going to be a tax package.[73]

Gradual Implementation

While the AFTS recommendation for a resource rent tax was not successfully implemented, over time around a third of its 138 recommendations across the tax and transfer system have been at least partially actioned (see Appendix C for the status of government responses).

Lessons in Tax Reform

AFTS is a difficult reform exercise to assess because of the confusing context of its commissioning, progress and implementation. While substantial reforms were not implemented in the short term, it did provide in-depth analysis of the Australian tax and transfer system and identified directions for

reform in a foundational report that can be drawn on by future, more determinative reviews. I will assess it against the five criteria set out at the start of this paper.

Terms-of-Reference and Panel

The AFTS terms-of-reference sought a forward-looking report with recommendations to position Australia for the challenges of the 21st century. The government's lack of specific direction allowed for an open, searching inquiry, but ultimately led to a mismatch of expectations come reporting time. The exclusion of the GST was unfortunate and compromised the ability to fully review the tax system, although AFTS worked around that to some extent with the idea of a cash-flow tax.

There are broadly three options for a review panel: fully external (independent), hybrid of internal and external, and internal (government control). The AFTS panel was a hybrid, which is generally an attempt to appear external but keep some control. The panel members were strong on tax and transfer policy expertise, which facilitated an in-depth analysis of the issues. Its composition was ultimately problematic, though, with Henry's position as both Treasury secretary and chair of the panel proving awkward once the panel had reported.

It is interesting to contemplate the counterfactual of 'what if' there had been an independent chair. Given the composition of the rest of the panel and the secretariat, one would expect a similar report to have emerged. As Treasury secretary, Henry would then have advised government on it, presumably in a supportive way. The main difference would have been that an independent chair could have played a stronger public advocacy role at the time. Given the state of the political scene, though, realistically this may not have made much difference in the short term.

So perhaps the most important point remains that for the longer term, a strong panel and secretariat produced a high-quality report that can inform future reviews.

Gathering of Evidence and Calling of Witnesses

The review undertook an extensive consultation process, with two background papers, two consultation papers, and a tax and transfer policy conference to facilitate public discussion. A total of 500 people attended consultation meetings and 100 people attended focus groups; 130 stakeholder meetings were held; 30 speeches and presentations were given; over 1500 submissions were received; and 10 research papers and seven consultancies were commissioned.[74]

This extensive consultation and evidence-gathering process gave the review some broad perspectives, which perhaps complemented the Treasury-dominated secretariat. The process worked well for the foundational review that AFTS became.

The mining industry complained of a lack of meaningful consultation, but this related to the government's RSPT processes after AFTS had reported. The MCA was part of the AFTS consultations and in fact proposed a resource rent tax to replace state mining royalties.[75]

Timeliness and Relevance

Being commissioned just eight years after the implementation of ANTS, the AFTS review was somewhat premature. The lack of an immediate 'burning bridge' necessitated a forward-looking review that needed to anticipate the world that lay ahead. The change in context resulting from the GFC and loss of budget surpluses was then a game-changer for AFTS' timeliness and relevance.

Ultimately, the AFTS review happened at a difficult point in global history. The GFC in fact marked the end of the 'Great Moderation' period, with its steady economic growth and relatively stable world relations. In looking forward, AFTS presumed a post-GFC return to that world, but instead we have entered a far more turbulent period with chaotic and unpredictable changes – perhaps an era of 'Tectonic Change'.[76]

The review reported on the timeline stipulated in its terms-of-reference, but this turned out to be inconvenient for the government given its other challenges at that time. A delayed reporting

schedule, until after the 2010 Budget or perhaps after that year's election, might have worked better for a foundational review. Further, while the review was relevant to its open terms-of-reference, it did not match the government's expectations come reporting time. This mismatch was symptomatic of a somewhat chaotic operating mode for the government, with its expectations not well articulated when it commissioned the review.

Approach to Analysis of Issues

The AFTS report is a high-quality document, with comprehensive coverage and in-depth analysis in the main volumes backed up by an excellent synthesis in the overview report. The central proposal to move the tax burden away from relatively mobile or inefficient tax bases, such as capital income and transaction taxes, towards relatively immobile tax bases, such as land and resources, is well argued. The report also provides excellent analysis of specific issues across the tax and transfer systems, with the notable exception of the GST.

A key conceptual issue is the departure from the Asprey comprehensiveness model, with greater reliance on optimal tax theory. This makes for a more sophisticated analysis and is key to the arguments for a shift in the tax mix away from the more mobile capital income to less mobile land and resource rents. It is also a more complicated story, though – one that may not account well for the political economy realities of policymaking, where simple policy prescriptions are desirable.

Quality of Tax Policy Outcomes

The main policy proposal to flow directly from AFTS was the RSPT, but there was a misalignment of expectations. The AFTS report envisaged a resource rent tax as part of a package that removed state royalties and substantially lowered the company tax rate. The government wanted to use the RSPT revenue for superannuation and infrastructure. The ineffectual MRRT then emerged from the political process.

While the AFTS report did not substantially influence tax policy in the short term, around a third of its recommendations have since been actioned (see Appendix C), indicating that it has remained a credible basis for tax policy advice. Further, the review has established the basis for longer-term reform directions, with greater reliance on efficient tax bases such as land and economic rents, and less reliance on more mobile capital and inefficient transaction taxes.

AFTS's support for a cash-flow tax was surprisingly non-controversial at the time. The finding that it 'could be an efficient, simple and sustainable method of taxing domestic consumption'[77] may assist with future consideration of reform, or even replacement, of the GST.

Regarding personal income tax, while the recommendation for a simple two-step rate structure without special levies or offsets was not accepted, AFTS support for it being the bedrock and main source of progressivity of the Australian tax system has helped cement its community acceptance. Its broad base and progressive rate structure, with a high TFT and a high final rate, now appear to have bipartisan support.

Conclusion

Overall, AFTS was an intriguing review process. It was seemingly commissioned by a government without a clear idea of its reform objectives, then had its context changed by the GFC, and ultimately led to a political firestorm that contributed to the demise of a prime minister.

The main value of the AFTS review was the opportunity to consider the Australian tax and transfer system in-depth and chart broad reform directions for the future. While not influential in the short term, its report remains a legacy of the process. As a foundational review, AFTS can inform future, more determinative tax reviews.

Political Turmoil

In the aftermath of the RSPT/MRRT events, Australia's political scene remained fraught, with the August 2010 election producing a hung parliament. The negotiations to form a minority Gillard government brought a high-profile policy change with the introduction of a carbon pricing scheme.[78] Previous attempts by the Howard and Rudd governments to introduce emissions trading schemes (ETSs) had been unsuccessful, and this version would not last long either.

A carbon price of $23 per tonne came into effect from 1 July 2012. Large emitters were required to purchase carbon unit permits at that price, with no cap on quantity. The scheme was intended to transition to an ETS in 2014–15 when a pollution cap would be placed on the available permits, leaving the price flexible. The sale of carbon units was estimated to raise $25.5 billion of revenue over the forward estimates, or around $9 billion pa.

Tax cuts were part of the compensation package for the scheme's price effects. From 2012–13, the TFT was increased to $18,200 and LITO reduced to $445 to give an effective TFT of $20,542 (up from $16,000). Further, the phase-out rate for LITO was reduced from 4 per cent to 1.5 per cent, commencing from $37,000 (up from $30,000). In conjunction with this reduction in the effective tax rate, the bottom marginal tax rate (MTR) of 15 per cent was increased to 19 per cent and the second MTR of 30 per cent was increased to 32.5 per cent. As Table 3 shows, this tax structure has broadly remained in place since, with increases in the middle thresholds.

Table 3: Personal Income Tax Rate Scales, 2012–13 and 2021–22

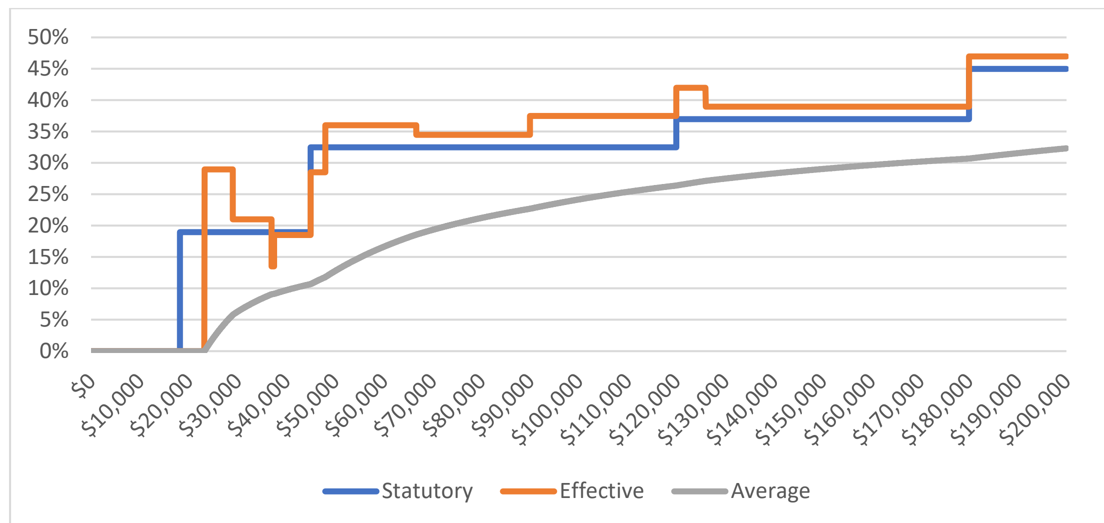
	2012–13		**2021–22**	
	Threshold	**MTR**	**Threshold**	**MTR**
1st rate	$18,200	19%	$18,200	19%
2nd rate	$37,000	32.5%	$45,000	32.5%
3rd rate	$80,000	37%	$120,000	37%
4th rate	$180,000	45%	$180,000	45%
LITO	$445	1.5% withdrawal above $37,000	LITO: $700 LMITO: up to $1080*	LITO: 5% withdrawal above $37,500; 1.5% withdrawal above $45,000 LMITO: 3% withdrawal above $90,000
ML	10% phase-in from $20,542	1.5%	10% phase-in from $23,226**	2%
Effective TFT	$20,542		$23,226	

* Low and middle income tax offset (LMITO) base rate is $255 up to $37,000, then phases up at 7.5% to $1080 by $48,000

** 2020–21 threshold (2021–22 threshold to be indexed for inflation)

The extensive use of tax offsets and levies partly obscures the effective tax rates that individuals face. In addition to the statutory tax rate, the phase in or out of offsets and levies adds to the change in tax as income changes – in the same way that the withdrawal of transfer payments adds to effective marginal tax rates (EMTRs). Figure 12 shows a comparison of the statutory tax rates and the true effective tax rates that individuals face as their income increases.[79]

Figure 12: Effective Personal Income Tax Rate Scale, 2021–22*



* Effective tax rate includes ML, LITO and LMITO effects. Specific groups are also subject to other offsets and levies.

The negotiations to form a minority government also required the convening of a public tax forum,[80] which occurred at Parliament House in October 2011 but generated little tax reform. It did, however, result in the formation of the Tax and Transfer Policy Institute (TTPI), which has been an important catalyst for public policy debate. A business tax working group was also appointed but was 'unable to recommend a revenue neutral package to lower the company tax rate'.[81]

Other Changes

There were also changes to the taxation of superannuation contributions. The 2010 Budget introduced a 15 per cent tax rebate for individuals with incomes up to $37,000 – the low income superannuation contribution (LISC).[82] The 2012 Budget introduced an additional 15 per cent tax on contributions of individuals with incomes over $300,000 a year – the Division 293 tax.[83] These changes lent a measure of progressivity to the taxation of pre-tax superannuation contributions – now tax-exempt for incomes up to $37,000, then 15 per cent, then 30 per cent above $300,000 – partially achieving the model proposed by AFTS.

The 2013 Budget contained a measure where the government, the parliament and the community accepted a specific revenue increase to pay for a specific spending increase, with the ML increased from 1.5 per cent to 2 per cent to help fund the government's disability care package.[84]

The government's time in office, though, ended with more turmoil. Rudd was reinstated as leader of the Labor Party and prime minister in June 2013 but lost the September 2013 election.

Abbott Government

The 2013 election of the Abbott Coalition government, with Joe Hockey as treasurer, promised a return to stability. Again, the signs at the start were good.

Having campaigned against the previous government's 'debt and deficit disaster', the new government framed a tough 2014 Budget. This included a three-year 'budget repair levy' of an additional 2 per cent on high-income earners, and the reintroduction of fuel excise indexation (which had been introduced in 1983 and ceased in 2001). But significant parts of the Budget stumbled in the parliament, causing the government considerable political difficulty.

The Abbott government had also campaigned against the previous government's new taxes. This brought about the demise of the carbon pricing scheme, which Abbott had labelled 'a great big tax on everything'. While some compensation measures associated with it were repealed[85] the 2012 income tax cuts were maintained.

The government also abolished the MRRT and again sought to repeal things funded by it,[86] which delayed the SG rate increases. While the MRRT at that point was raising little revenue, with the accelerated depreciation arrangements wiping out most tax liabilities, if it had continued through to the recent high iron ore prices, it may well now be raising significant revenue.

Announced but Unenacted

Another issue the Abbott government dealt with was the 96 announced tax and superannuation policy measures that had not yet been legislated – the so-called announced but unenacted measures (ABUMs).[87] While this sounds like a lot, it is probably not out of the ordinary.

The nub of the problem is that politicians love making announcements. There are endless minor problems in the tax and superannuation laws, and interest groups constantly lobby for change. Ministers, therefore, find it hard to resist providing an easy fix by getting a government decision and putting out a press release – an 'announceable'.

Unfortunately, the processes for legislating the measures can't cope with the volume. In an already crowded parliamentary agenda, a lot of these minor measures get pushed aside. Some eventually make it through the system, but others don't. Basically, more decisions/announcements are being fed into the legislative machine than the machine is capable of processing.

The Abbott government dealt with the ABUMs by having Treasury go through them and, in some cases, decided to simply not proceed – a very good outcome. In fact, undertaking such a process every so often makes a lot of sense. Or, of course, ministers could stop agreeing to make some of the lower-priority policy decisions and 'announceables' in the first place!

Tax White Paper

The Abbott government also made a half-hearted attempt at a tax white paper (TWP) in the wake of an election commitment to stage a tax review, keying off criticisms of the previous government's lack of action on AFTS. Abbott also had an aspiration to reform the Federation, saying 'now is the time to make each level of government sovereign in its own sphere'.[88]The 2014 National Commission of Audit provided further support for reform of both the Federation and tax arrangements.[89]

In the May 2014 Budget, it was announced that a 'White Paper on the Reform of Australia's Tax System will provide a longer-term considered approach to tax reform that is consistent with the Government's core principles of fairness and simplicity'.[90] In order to address the overlaps in Commonwealth and state government responsibilities, the TWP was to be accompanied by a Federation white paper (FWP). The government declared that the 'white paper processes on Australia's Federation and taxation are proceeding in tandem and, as such, provide a unique opportunity to inform a system-wide approach to taxation'.[91]

The signs for the TWP were bad from the start. There were no terms-of-reference and no panel – this would be a fully internal review. Further, it seemed the main objective was to be able to announce a large personal income tax cut, but that would require either budget surpluses or finding the revenue elsewhere. Neither would materialise.

Re:think

To progress the review, a tax reform team was established in Treasury, led by Roger Brake, to work with a team in the Treasurer's office, led by Robert Jeremenko. In March 2015 the *Re:think Tax Discussion Paper* was published (see Appendix A for the foreword).

In launching *Re:think*, Hockey said, 'Today marks the start of a conversation about how to bring a tax system built before the 1950s into the new century'.[92] While the speech didn't paint a picture of a broken tax system, it questioned whether Australia's heavy reliance on personal income tax was sustainable and argued that high corporate income taxes can impact negatively on

investment and jobs. No indication was given as to where any foregone revenue might come from, but Hockey did say, ‘We must make sure we are not adversely impacting on growth through either having the tax burden set at the wrong level, or getting the tax mix wrong’.[93]

The review’s overall slogan was that taxes should be ‘lower, simpler and fairer’.[94] A time line was belatedly set for a green paper later in 2015 and a TWP with reform proposals for the 2016 election.[95] Neither of these eventuated, so I will focus my comments on *Re:think*. The discussion paper provided an excellent synthesis of the Australian tax system and the challenges it faced going forward. It argued that while Australia’s tax system had served the country well over past decades, it was now outdated and in need of reform to promote growth in a modern global economy.

Framework

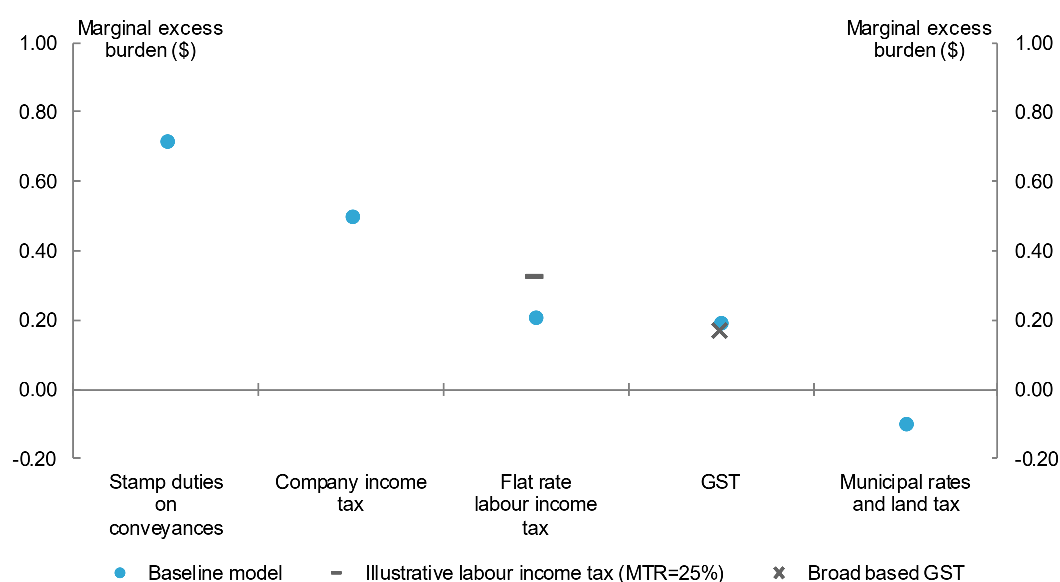
Re:think outlined two sets of challenges facing Australia’s tax system.[96] First, with technological changes enabling multinational enterprises (MNEs) to relocate profits to minimise tax, Australia’s relatively high company tax rate made it harder to attract internationally mobile capital and increased corporate tax-planning incentives. Second, the 2015 *Intergenerational Report* projections of an ageing population and declining workforce participation underscored the need for reforms to boost productivity and participation, including within the tax system.[97]

Re:think identified some specific areas of concern: heavy reliance on income taxes, high economic costs of company tax and stamp duties, differences in the taxation of savings vehicles, growing complexity and compliance costs, and high EMTRs in the tax and transfer system.[98] The tax discussion paper took a similar conceptual approach to AFTS, using a standard public finance framework but influenced by optimal tax theory. It defined the core principles for assessing taxes as equity, efficiency and simplicity, recognising that additional objectives can also be important.[99]

Marginal Excess Burdens

Treasury modelled the economic inefficiency effects of Australia’s main taxes,[100] and as Figure 13 shows, company income tax and stamp duties were estimated to cause the greatest ‘marginal excess burden’.[101] It was also argued that, as the burden of a tax falls disproportionately on less mobile factors of production, much of the company tax incidence falls on Australian workers.[102] Conversely, as land is immobile, broad-based land taxes and municipal rates have low economic costs.

Figure 13: Marginal Excess Burden Estimates of Some Australian Taxes



Source: *Re:think*, Chart 2.9, p. 25

Tax system complexity was also of growing concern, as business structures became more intricate and tax planning efforts expanded. Compliance costs for taxpayers were estimated at around $40 billion per year,[103] in addition to ATO administration costs of $3.6 billion.

Within the above framework, *Re:think* surveyed Australia's main tax bases: individuals, businesses and consumption.

Individuals

Personal income tax has raised around half of Commonwealth tax revenue since the 1970s. It is characterised by a progressive rate scale and a broad base for labour income, but by concessional treatment for some savings and business income.

Re:think assessed personal income tax as generally having only moderately negative impacts on economic growth. Interactions with the means-tested transfer system can result in high EMTRs for some groups, though, such as secondary earners, so tax cuts at lower income levels would likely generate the highest participation responses.[104] Also, high-income earners facing the top marginal tax rate may be more internationally mobile and have increased tax-planning incentives.

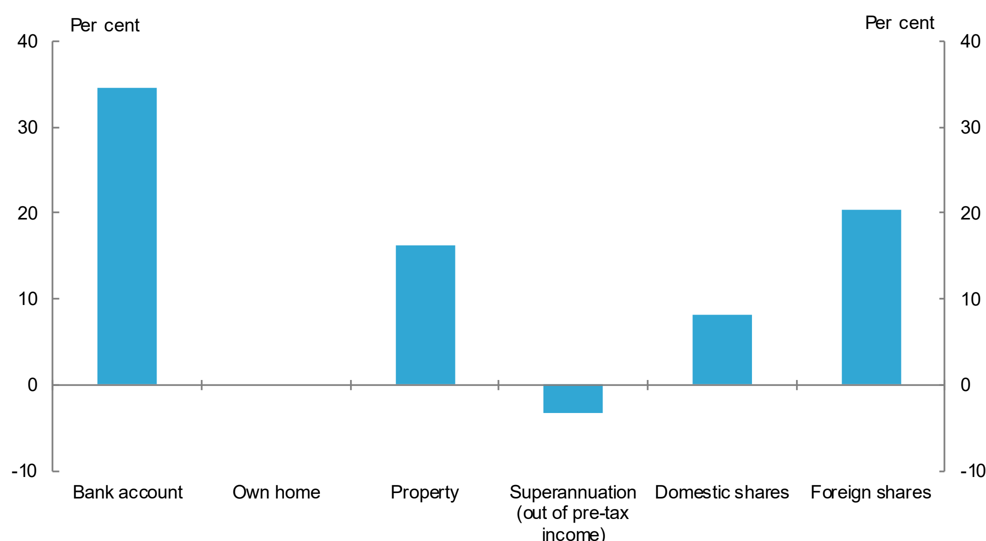
Features that facilitate tax planning include a high TFT, the difference between personal and company tax rates, the capital gains tax discount, the tax treatment of superannuation, and fringe benefits tax (FBT) concessions.[105] Further, Australia's relatively generous approach to WREs is a source of complexity and *Re:think* noted that a standard deduction had been considered previously.[106]

Savings

The taxation of savings is contentious. It can be argued to represent double taxation of future consumption. Against this, savings in aggregate is not very responsive to tax, making it a relatively efficient tax base. *Re:think* concluded: 'Taxing income from savings more lightly than labour income is a way of striking a balance between these competing considerations'.[107]

There are significant differences in the taxation of alternative forms of savings, though, which may distort individuals' choice of savings vehicle (see Figure 14). In general, current income, such as interest, rent and dividends, is subject to tax at full marginal rates, while only half of nominal capital gains is taxed. Shares and investment properties return a mix of current income and capital gains. Returns on owner-occupied housing are exempt from income tax, while superannuation is generally taxed at a flat 15 per cent, making it attractive to high-income earners.

Figure 14: Effective Tax Rates by Savings Vehicles (for Individual on 34.5% Tax Rate)



Source: *Re:think*, Chart 4.1, p. 60

In considering options for more consistent taxation of savings vehicles, *Re:think* critiqued the AFTS approach of providing a 40 per cent savings income discount and the schedular systems used in some countries that tax income from some savings separately at low, flat rates.[108]

Business

Company income tax revenue comprises a relatively high proportion of total revenue in Australia, reflecting a relatively high company tax rate but also a fairly broad tax base and how the dividend imputation system incentivises companies to pay tax to enable the franking of dividends.

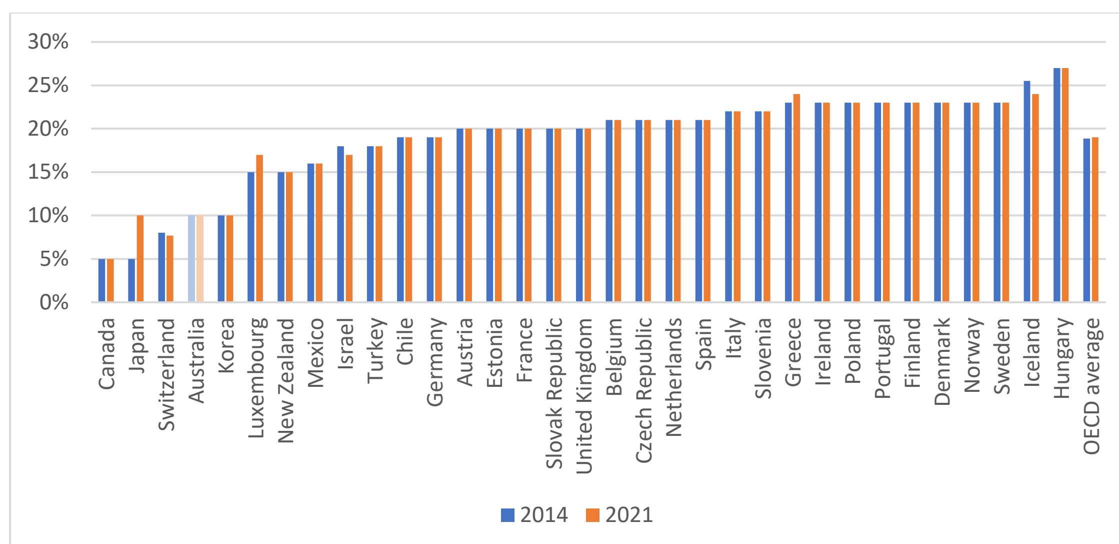
An OECD/G20 focus has been the challenge for national tax systems concerning the digitisation and globalisation of economies and the ability of MNEs to shift profits to minimise tax liabilities. *Re:think* argued that lowering Australia's company tax rate would help attract internationally mobile capital and reduce incentives for MNE tax planning. Against that, it would reduce revenue in the short term and exacerbate the gap with the top personal tax rate.[109]

Australia's dividend imputation system helps integrate the company and personal tax systems, but it creates a bias in favour of Australian over foreign shares and adds complexity to the tax system. *Re:think* queried whether it remained optimal for Australia, noting that other countries had moved to simpler systems providing partial relief from the double taxation of dividends.[110]

GST

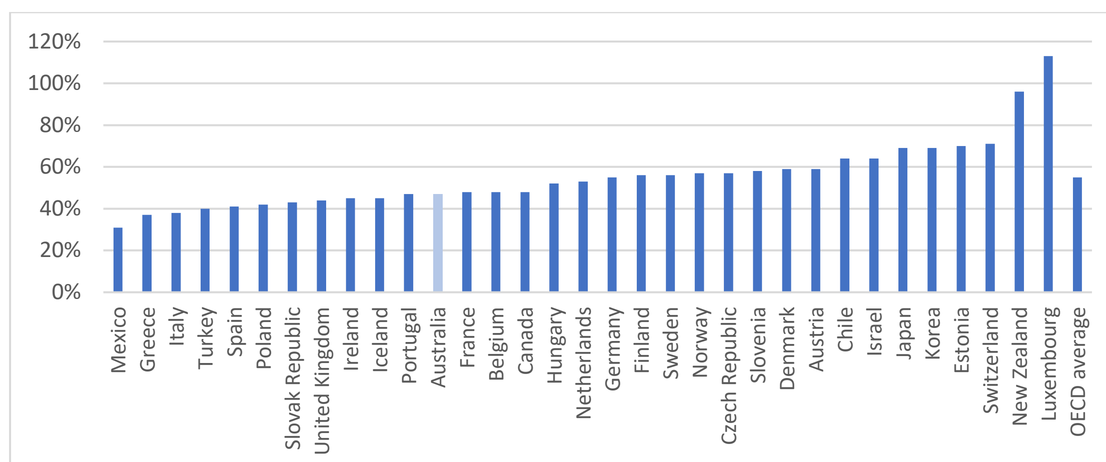
Australia's GST rate is significantly below the OECD average, and its coverage is slightly below (see figures 15 and 16). The proportion of total consumption covered by GST has decreased from a peak of 56 per cent in 2005–06 to 47 per cent by 2012, as the relative prices of exempt categories, mainly health and education, have increased.

Figure 15: OECD VAT Rates, 2014 and 2021



Source: OECD

Figure 16: OECD VAT Consumption Coverage, 2012



Source: OECD

As a fairly broad-based tax, the GST is relatively efficient, although the exemptions compromise that and its invoice design creates high compliance costs.[111] *Re:think* provided little discussion of reform options.

State Taxes

The main state taxes are payroll tax, stamp duties on property conveyances, and land taxes, while mining royalties are significant for some states and local governments levy property rates. The states' taxes generally suffer from design problems.

Broad-based payroll taxes are potentially efficient taxes, but the various exemptions and thresholds compromise that. While the states have harmonised aspects of payroll taxes, remaining differences in thresholds and rates cause complexities for businesses operating across state borders.[112] Stamp duties on property conveyances are among the most inefficient taxes in Australia, discouraging people from moving to more suitable housing for personal or work purposes.[113] Land tax is a potentially efficient tax given the immobile tax base, but exemptions for owner-occupied housing and primary production land, and progressive rate scales, create biases.[114]

Royalties, the price charged by governments for the right to extract mineral resources, are levied on either price or volume. *Re:think* concluded that royalties based on volume are likely to be more stable but may be less economically efficient.[115] There is no discussion of resource rent taxes.

Property rates are levied on residential and commercial land at rates set to provide the necessary funding for local governments. They are generally applied broadly and so are considered a relatively efficient tax.[116]

In the context of its overlap with the FWP, *Re:think* referenced the principle that in a federation, the central government should levy taxes on more mobile tax bases, with the states levying taxes on immobile tax bases such as land.[117]

Administration

Tax system complexity derives from the tax policies underpinning the law, the way the law is drafted and the way it is administered. Complexity often originates from a trade-off with other tax policy criteria, in particular equity and certainty, and artificial boundaries necessitated by concessions.[118]

Re:think critiqued how the digital age has transformed tax administration, enabling it to reduce complexity for taxpayers. The ATO developed its computer-based processing capacities in the 1980s, self-assessment was introduced in 1986, electronic lodgement of tax returns by tax agents in 1989, e-tax for individuals in 1999, and the 1997 launch of the ATO website opened new frontiers in engaging with taxpayers. The introduction of the Australian Business Number and pay-as-you-go

arrangements in 2000 further streamlined taxpayers' interactions with the ATO. The pre-filling of tax returns commenced in 2005, and MyTax with online access for individuals was launched in 2014.[119]

Petering Out

Re:think's analysis was along similar lines to that of AFTS, pointing to the relative inefficiency of company income tax and stamp duties, and the relative efficiency of taxes on immobile bases such as land and property. While its analysis also led to conclusions on GST reforms and a tax mix switch to resource rent taxes, as a discussion paper it did not develop those lines. Nonetheless, it had put the main issues on the table and set up the TWP process and a potential tax reform exercise.

Things did not go well after that, however. The government was struggling politically, unable to legislate significant parts of the 214 Budget, and with parameter movements continuing to detract from the budget position there was little fiscal room to move. Through the remainder of 2015 the TWP process meandered, lacking a consistent direction or drive. A central problem was the absence of a clear reform objective – with no prospect of a large personal income tax cut, there was little political will for hard options.

Basically, the process just petered out. The FWP suffered a similar fate. In September 2015, Malcolm Turnbull replaced Abbott as prime minister and Scott Morrison replaced Hockey as treasurer. There was no further mention of the TWP.

Lessons in Tax Reform

While the TWP process petered out, it still provided an interesting case study of the difficulties of advancing tax reform. I will assess it against the five criteria set out at the start of this paper.

Terms-of-Reference and Panel

The lack of a terms-of-reference and external panel was a core governance failure of the process. The government didn't appear to have a coherent view of why it was commissioning a tax review or what the outcomes might be. The process rather stemmed from criticism of the previous government's AFTS process and the hope of being able to announce a tax cut. There was little commitment from the government to see it through.

Gathering of Evidence and Calling of Witnesses

The excellent *Re:think* discussion paper provided a good basis for consultation. Around 780 submissions were received and substantial stakeholder discussion took place, raising the awareness of tax issues in the community.[120] With the process petering out, though, there wasn't an opportunity to build on that.

Timeliness and Relevance

Formal timelines were only belatedly set for a green paper and a white paper. There wasn't a concerted effort to achieve that, however, and the change of prime minister and treasurer then fully scuttled the process.

Approach to Analysis of Issues

Re:think provided strong analysis of the challenges facing the Australian tax system and excellent synthesis of the issues for discussion. There were, however, some shortcomings.

Bracket creep is presented as one of the great challenges for the tax system and, indeed, economic growth. While bracket creep is an issue with a progressive tax scale, regular tax cuts by governments typically rectify that. Further, the policy problem is readily fixable by indexing the rate scale, as was done temporarily in the 1970s.

Resource rent taxes are not discussed. While no doubt a reality of the political situation, given the government's criticism, and abolition, of the previous government's MRRT, this is an issue that needs to be considered in a genuine tax reform debate, particularly in connection with consideration of a company tax rate cut.

Quality of Tax Policy Outcomes

With the TWP processes petering out, there were no substantive policy outcomes. Some subsequent budget announcements, though, were informed by the work. The 2016 Budget 10-year enterprise tax plan and superannuation package are discussed in the next section.

Some further work was done in late 2015, with Turnbull and Morrison commissioning Treasury modelling on the economic growth effects of a personal income tax/GST tax mix switch. That modelling, which was released in February 2016, found that 'a tax mix switch involving income tax cuts and increasing the GST to 15 per cent would deliver negligible GDP gains'.[121]

Conclusion

Overall, the TWP process was an ineffectual effort at a tax reform exercise. While it was given a good start with the *Re:think* discussion paper, it lacked commitment and momentum from a government that did not have clarity on why it initiated the review and showed little interest in its progress. It did reinforce, though, how dependent tax reform is on having some fiscal room.

The comparison with AFTS is interesting. With both reviews, incoming governments saw tax reform as a way to reconfigure budget allocations to reflect their clients' priorities. Beyond that, they lacked clarity on tax reform objectives or where a genuine review would lead. Commissioning a review was perhaps a way to come up with ideas, but then, almost inevitably, they didn't like the ideas that were produced or were disappointed to discover there wasn't a magic pudding to fund the desired announceables.

The two reviews took similar conceptual approaches, both built on a standard public finance framework but influenced by optimal tax theory. A key difference was in the governance arrangements. *Re:think* petered out at the discussion paper stage, but with a formal panel AFTS proceeded further – it may have faltered when the GFC robbed it of the chance to 'buy' some tax reform, but the panel pushed on with a modified approach. Regardless, the AFTS report and the *Re:think* discussion paper remain as valuable legacies of the processes and will hopefully inform future tax-reform exercises.

Where Are We Now?

Australia's fraught political environment over the last 15 years has made genuine policy reform difficult, especially in an area as sensitive as tax. Despite two attempted tax-reform exercises, there haven't been any major reforms. There have, however, been some tax packages of note.

Base Erosion and Profit Shifting

Australia has been an active participant in OECD/G20 efforts to combat MNE tax avoidance, and as G20 president in 2014 had an opportunity to advance that work. In a leaders' communique, Australia stated: 'Profits should be taxed where economic activities deriving the profits are performed and where value is created. We welcome the significant progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to modernise international tax rules'.[122]

In the 2015 and 2016 budgets, measures were introduced to combat profit shifting by MNEs operating in Australia, including specific multinational anti-avoidance laws,[123] as well as a 40 per cent diverted profits tax.[124]

The OECD BEPS work has continued with the development of a two-pillar package to ensure MNEs pay tax where they operate and earn profits.[125] Pillar One reallocates some taxing rights over

MNEs from their home countries to the markets where they have business activities and earn profits. Pillar Two introduces a global minimum corporate tax to put a floor on corporate income tax competition between countries. 136 countries, including all OECD/G20 members, have now agreed to the two-pillar package[126] and are developing implementation plans.

10-Year Enterprise Tax Plan

The 2016 Budget announced a 'ten-year enterprise tax plan' to cut the company tax rate to 25 per cent, with a schedule that had the tax rate for small companies falling earlier.[127] The Treasury modelling that had been developed for the TWP process was able to be used to model this proposal, estimating a long-term increase in GDP of around 1 per cent.[128] The government, however, was not able to gain parliamentary support for the legislation and the rate cut only proceeded for companies with turnovers of less than $50 million, with their tax rate reaching 25 per cent from 2021–22.[129]

While cutting the company tax rate to 25 per cent was an AFTS recommendation, this was proposed in conjunction with a resource rent tax to ensure maintenance of an appropriate return to Australians for the exploitation of their natural resources.[130]

The 2017 Budget included a major bank levy, at an annualised rate of 0.06 per cent of an institution's financial liabilities, 'to assist with budget repair'.[131] The levy was applied in the context of concerns about financial institution behaviour, but can also be seen as a tax on economic rents associated with banks' regulatory protections.

Superannuation

The 2016 Budget introduced new restrictions on access to superannuation tax concessions, including a $1.6 million cap on the amount that can be transferred into the retirement phase (with its especially generous tax arrangements), lowering the cap for concessional contributions to $25,000 pa, and a lifetime cap of $500,000 for non-concessional contributions.

The basic issue at stake is that Australia's approach of generally taxing superannuation contributions and earnings at a flat 15 per cent is especially generous for higher-income earners. As such it needs to be tightly ringfenced, with restrictions on how much can be contributed to superannuation, and preservation rules about when and how it comes out.

This ringfencing, however, is a second-best approach. The first-best approach is to reduce the tax concessions for higher-income earners. As Table 4 shows, this could be done by applying individuals' MTRs to superannuation contributions, but with a flat tax offset to give everyone the same tax concession. There are already partial measures of this nature, with the LISTO lowering the tax rate for low-income earners,[132] and the Division 293 tax increasing the tax rate for very-high-income earners.

Table 4: Taxation of Superannuation Contributions

Income ($)	MTR (including ML) (%)	Super tax rate (%)	With LISTO and Division 293 (%)	MTR (with 20% flat rebate) (%)
0 to 18,200	0	15	0	0***
18,200 to 45,000	21*	15	15**	1
45,000 to 120,000	34.5	15	15	14.5
120,000 to 180,000	39	15	15	19
180,000 to 250,000	47	15	15	27
250,000 and above	47	15	30	27

* Not including LITO or allowing for the ML shade-in

** Ignoring LISTO shade-out

*** Rebate assumed to be non-refundable

If, however, the government is not able to address the problem at its source by reforming the tax arrangements, it is necessary to ringfence the amounts that can access the tax concessions.

Personal Income Tax Plan

The 2018 Budget announced a ‘personal income tax plan’ for tax cuts over seven years. With the tax/GDP ratio projected to reach the government’s cap of 23. 9 per cent by the end of the forward estimates period, tax cuts could be provided beyond that.

The first steps introduced a LMITO and raised the lower tax rate thresholds. Later steps proposed the removal of the 37 per cent tax rate so that the 32.5 per cent rate would run from $41,000 to $200,000, putting 94 per cent of taxpayers on a MTR of 32.5 per cent or less (not including the ML).[133] This simpler rate structure would be consistent with the AFTS proposal for ‘a high tax-free threshold with a constant marginal rate for most people’.[134]

Announcing tax cuts so far out, though, is quite problematic as the economic and budget projections driving the necessary bracket creep may not play out as expected (as has proved the case with COVID-19). The announcement of long-range tax cuts to gain short-term political advantage is not new (witness the 1977 ‘fistful of dollars’ tax cuts and the 1993 ‘LAW’ tax cuts) but the claims have become more extravagant.

The government was only able to legislate part of these changes – the LMITO and raising the middle thresholds. Other parts have proved politically controversial, with the Opposition saying it will announce its position prior to the next election.

COVID-19

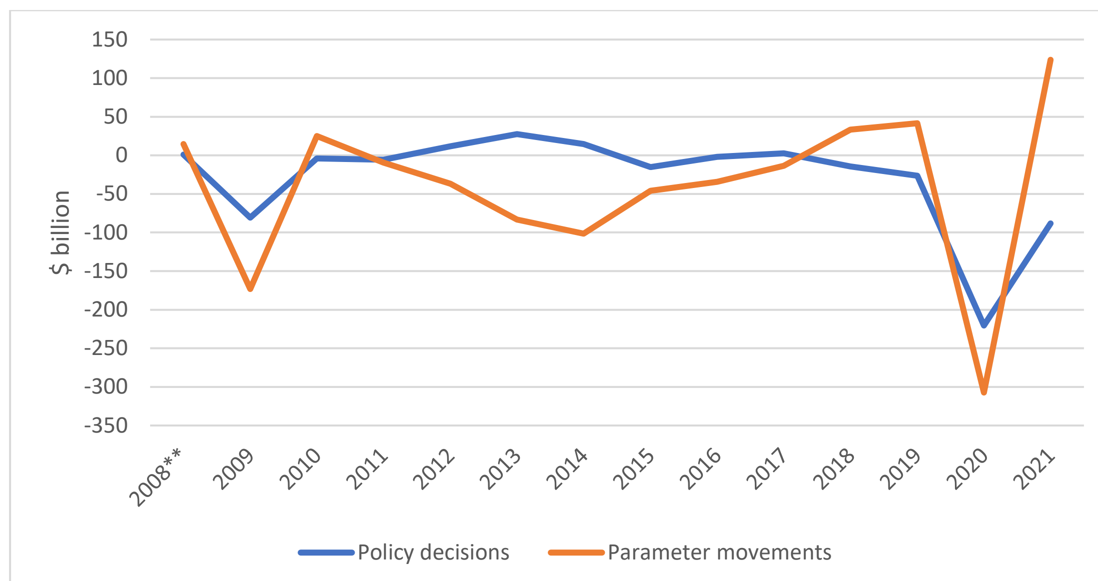
The COVID-19 pandemic hit the world over the course of 2020. In the Australian federation, the states have primary responsibility for the relevant health policy issues, and they generally took a stringent approach to limiting the spread of COVID-19. The Commonwealth, though, has primary responsibility for economic policy and broad-based tax and transfer system issues. To ameliorate the economic impact of the COVID-19 health measures, the Commonwealth provided large fiscal support packages and the RBA undertook a program of quantitative easing.

The fiscal packages were largely expenditures but delivered through the tax system, with the ATO administering the two largest measures: JobKeeper and the cash flow boost. JobKeeper was intended to maintain the connection between employers and employees, and in its first phase it paid eligible employers $1500 per fortnight for each employee.[135] The cash flow boost was intended to help businesses keep operating and was paid via a credit in an employer’s Business Activity Statement for the amount of tax withheld from wages, with a minimum payment of $10,000.[136]

The schemes have proved controversial in that they channelled very large amounts of money to businesses, but being largely untargeted they have provided much of that to businesses that didn’t need it. This has been a recurring issue for Australia with the lack of availability, or use, of administrative architecture to deliver such assistance. While the ATO’s single touch payroll system would have allowed real-time monitoring of changes in companies’ payroll it wasn’t effectively utilised with the priority being the rapid transfer of cash to businesses.[137]

Figure 17 shows that both the policy decisions and the parameter effects associated with COVID-19 have been greater than for the GFC. Policy decision across the 2020 and 2021 budget cycles cost over $300 billion (across the forward estimates), while parameter movements detracted a net $180 billion, with large downward revisions in 2020 partly reversed in 2021. The deficit for 2020–21 was around $130 billion and government debt is forecast to approach $1 trillion.

Figure 17: GFC to COVID-19 Reconciliation Table Results*



* Each year's figure is the summation of the four years of the forward estimates in the budget cycle (since the previous Budget)

** Starting from the 2007 election

Sources: Budget papers

Conclusions

Australia's experience with tax reform over the past 20 years has been lacklustre. Despite two attempted tax-reform exercises, a parlous budget situation and a fraught political environment have mitigated the opportunities for substantial reform. The AFTS report remains, though, as a foundational review that may yet inform a future determinative tax review.

Looking forward, the challenges for the Australian tax system are daunting. Personal income tax will remain the cornerstone of the system, but with an outlook of low wage growth, bracket creep will do less of the revenue heavy lifting. Company income tax is vulnerable to international capital flow and downward pressures on resource prices as our relationship with China changes and the shift to renewable energy continues. With changing consumption patterns, the GST base may continue to erode and excises on tobacco and fuel are likely to fall.

The current COVID-19–related crisis, of course, complicates the picture. While it potentially provides opportunities for boldness in policymaking, it has also left Australia with a severely weakened fiscal position. Strong revenue growth will be required to recover this position and the government may need to consider tax policy measures to help achieve that.

Appendix A

Review Terms-of-Reference

Australia's Future Tax System

Objectives and Scope

1 The tax system serves an important role in funding the quality public services that benefit individual members of the community as well as the economy more broadly. Through its design it can have an important impact on the growth rate and allocation of resources in the economy.

2 Raising revenue should be done so as to do least harm to economic efficiency, provide equity (horizontal, vertical and intergenerational), and minimise complexity for taxpayers and the community.

3 The comprehensive review of Australia's tax system will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes. The review will consider:

- 3.1 the appropriate balance between taxation of the returns from work, investment and savings, consumption (excluding the GST) and the role to be played by environmental taxes;
- 3.2 improvements to the tax and transfer payment system for individuals and working families, including those for retirees;
- 3.3 enhancing the taxation of savings, assets and investments, including the role and structure of company taxation;
- 3.4 enhancing the taxation arrangements on consumption (including excise taxes), property (including housing), and other forms of taxation collected primarily by the States;
- 3.5 simplifying the tax system, including consideration of appropriate administrative arrangements across the Australian Federation; and
- 3.6 the interrelationships between these systems as well as the proposed emissions trading system.

4 The review should make coherent recommendations to enhance overall economic, social and environmental wellbeing, with a particular focus on ensuring there are appropriate incentives for:

- 4.1 workforce participation and skill formation;
- 4.2 individuals to save and provide for their future, including access to affordable housing;
- 4.3 investment and the promotion of efficient resource allocation to enhance productivity and international competitiveness; and
- 4.4 reducing tax system complexity and compliance costs.

5 The review will reflect the Government's policy not to increase the rate or broaden the base of the GST; preserve tax-free superannuation payments for the over 60s; and the announced aspirational personal income tax goals.

6 The review's recommendations should not presume a smaller general government sector and should be consistent with the Government's tax to GDP commitments.

7 The review should take into account the relationships of the tax system with the transfer payments system and other social support payments, rules and concessions, with a view to improving incentives to work, reducing complexity and maintaining cohesion.

8 The review should take into account recent international trends to lower headline rates of tax and apply them across a broader base, as well as domestic and global economic and social developments and their impact on the Australian economy.

9 The review will also incorporate consideration of all relevant tax expenditures.

Composition and Consultation

10 The Review Panel will be chaired by the Secretary to the Treasury, Dr Ken Henry AC and will also comprise Mr Greg Smith (Australian Catholic University); Dr Jeff Harmer (Secretary of the Department of Families, Housing, Community Services and Indigenous Affairs); Mrs Heather Ridout (Australian Industry Group CEO); and Professor John Piggott (University of New South Wales).

11 The Review Panel will be supported by a working group from within the Treasury, with representation from the Department of Families, Housing, Community Services and Indigenous Affairs, and drawing on other Australian government and state agencies as appropriate.

12 The Chair may task members of the Review Panel to oversee programs of work related to their field of expertise.

13 The Review Panel will consult the public to allow for community and business input.

14 The review will also, where necessary, draw on external expertise and shall have the cooperation of state governments and their Treasuries as well as relevant COAG [Council of Australian Governments] working groups.

15 The Minister for Families, Housing, Community Services and Indigenous Affairs will provide input on issues related to transfer payments, family assistance and retirement incomes.

Structure and Timing

16 The review process will be conducted in several stages. These will follow the release of an initial discussion paper by Treasury on the architecture of the tax system and an examination of the existing tax rates and bases (excluding the GST). The paper will be released by the end of July 2008.

17 The Review Panel will provide a final report to the Treasurer by the end of 2009. The Government will respond in a timely way to the tax review's recommendations as they are released.[138]

Re:think

Foreword

Australia has experienced nearly a quarter of a century of uninterrupted economic growth. As a result, Australians continue to have some of the highest living standards in the world.

Over the next few decades, the challenge for Australia is to maintain and improve standards of living through economic growth. The recent *Intergenerational Report* shows that continuing steps to boost productivity and encourage higher workforce participation will be critical to driving future economic growth.

Tax reform is a key part of the Government's policy agenda to build jobs, growth and opportunity.

Last year, the Government abolished the carbon and mining taxes, which were a drag on growth. We also announced changes to the taxation arrangements for employee share schemes to provide generous incentives for new start-ups.

This year, we will deliver a package for small business to expand opportunities for Australian businesses and workers.

The Government is committed to ensuring that everyone is paying their fair share of tax. This year, we are continuing to work with the G20 on the modernisation of international tax rules to address tax avoidance by multinational companies.

But that is just the start. We want to have an open and constructive conversation with the community on how we can create a better tax system that delivers taxes that are lower, simpler, fairer.

To deliver lasting, workable reforms, the community needs to be on board and engaged in the conversation. That's why the Government is committing to a comprehensive and inclusive process. Releasing this tax discussion paper marks the start of what we hope will be a broad conversation about the current tax system and the issues confronting it. All are encouraged to take part. This conversation will support the

development of a tax system to build jobs, growth and opportunity – a better tax system to deliver taxes that are lower, simpler, fairer.[139]

Appendix B

Comparison of Reviews

	Time	Submissions/Witnesses	Hearings	Report Size	Type
AFTS	19 months	1500 submissions Tax and transfer policy conference	130 stakeholder meetings 600 people attended consultations/focus groups 30 speeches	783 pages (main report)	Foundational
Re:think	10 months	780 submissions		196 pages	Discussion

Appendix C

AFTS Measures – Implementation Status

Rec.	Measure	Type	Initial Response	Current Status
1	4 tax bases: personal income; business income; rents; consumption	General		Conceptual
2	Progressivity delivered through personal income tax and transfers	General		Increase TFT to $18,200 (carbon price compensation package, July 2011)
3	Personal income tax primary unit should be individual	General		Conceptual
4	Transfer payments should be tax-exempt	Specific		No
5	Levies and offsets incorporated in personal income tax scale	Specific	Not remove ML	Reject
6	Concessional tax offsets replaced by outlays	Specific	Not reduce remuneration for defence forces	Phase-out dependent spouse rebate (2010) Replace education tax refund with schoolkids bonus (2012) Phase-out mature age worker tax offset (2012)

				Entrepreneurs tax offset replaced (2012)
7	Medical expense tax offset removed and ML surcharge reviewed	Specific		Phase-out net medical expenses tax offset (2013)
8	All forms of wages taxed on an equivalent basis	General	Not reduce remuneration for defence forces	Introduce $2000 cap on self-education expenses (2014)
9	Fringe benefits taxed in hands of employees	Specific	Not harm not-for-profits (NFP) or defence force remuneration	Reform statutory formula for car values (2010), in-house benefits (2012), airfares (2012) Reform living-away-from-home allowance (2012)
10	Regime to prevent alienation of personal services income	Specific		No
11	Standard deduction for WREs	Specific		$5000 standard deduction for WRE and tax affairs (2010)–not legislated (2012)
12	Tighter nexus between tax deductable expenses and income	Specific		No
13	Gift deductable threshold increased to $25	Specific	No tax changes that harm NFPs	Reject
14	40% discount on: interest; rental; capital gains; interest expenses	Specific	Not reduce CGT discount etc.	50% discount on interest (2010) – not legislated (2012)
15	Smooth transition to 40% discount	Specific		No
16	Consider extending discount to other savings income	Specific		No
17	Simplification of CGT regime	Specific	Not reduce CGT discount etc.	Reject
18	Super: tax contributions to individuals with flat offset (up to cap)	Specific		Introduce LISC for low-income earners (2012), introduce Division 293 for high-income earners (2012), $35,000 contributions cap for over 50s (2013)

19	Super: tax all earnings at 7.5%			Tax earnings above $100,000 in drawdown phase at 15% (2014). Not proceeded with.
20	Super: remove restriction on over 75s making contributions	Specific		Abolish the SG age limit (2013)
21	Super: support development of longevity insurance market	Specific		Drawdown phase tax treatment for deferred annuities (2013)
22	Consider offering annuity products	Specific	Not offer government annuity product	Reject
23	Increase awareness and transparency of the superannuation system	Specific		Reporting requirements, account linking, MyGov
24	Increase the preservation age (beyond 60)	Specific	Not align preservation age with pension age	No
25	Promote further study of wealth taxes	Specific	Not introduce a bequest tax	Reject
26	Consider further a business expenditure tax	General		No
27	Reduce company tax rate to 25%	Specific	Part (28%)	28% (2010), 29% (MRRT package), cancel (2012)
28	Streamline capital allowances to align with economic depreciation	Specific		No
29	Streamline small business capital allowances	Specific		Instant asset write-off for small business (2012)
30	Increase small business turnover threshold to $5m	Specific		Small business turnover threshold raised from $2m to $10m (2016)
31	Allow companies to carry back losses	Specific		Company tax loss carry back (2012) Uplift factor for infrastructure project losses (2013)
32	Allow refundable tax offset for exploration expenses	Specific		No

33	Exempt financial institutions from interest withholding tax (IWT)	Specific		IWT exemption for financial institutions (2010) Halve managed investment funds withholding rate (2012)
34	Consider negotiating IWT to zero in future tax treaties	General		No
35	Exempt conduit income of managed funds from Australian tax	Specific		No
36	Rewrite of trust rules to reduce complexity	Specific		Review into modernising taxation of trusts (2010)
37	Retain dividend imputation in medium term but consider alternatives	General	Not remove dividend imputation benefits	Long term
38	Consider flow-thru entity regime for closely held companies and trusts	General		No
39	Imputation credits only provided for Australian company tax	Specific		Close dividend washing loophole (2013)
40	Examine harmonisation of Australian/NZ business taxes	General		No
41	Establish a National Charities Commission	Specific	No tax changes that harm NFPs	Establish Australian Charities and Not-for-profits Commission (ACNC) (2012)
42	Maintain categories of NFPs with tax concessions	General		Yes
43	Replace NFP FBT concessions with direct govt. funding	Specific	No tax changes that harm NFPs	No
44	Establish simple and efficient tax arrangements for clubs	Specific	No tax changes that harm NFPs	No
45	40% uniform resource rent tax (RRT)	Specific	Yes	RSPT/MRRT packages
46	RRT not provide exploration or production concessions	Specific	Part	RSPT/MRRT packages
47	Transfer existing projects into the RRT system	Specific	Yes	RSPT/MRRT packages

48	Australian and state governments negotiate allocation of RRT revenues	Specific	Part	RSPT/MRRT packages
49	Consider cash bidding for exploration permit allocation	Specific		Introduce cash bidding system for offshore petroleum (2014)
50	Abolish fees/stamp duties (SD) on resource project transfers	Specific		Remove SD for offshore petroleum products (2013)
51	Replace SDs with broad consumption or land taxes	Specific		ACT and NSW reforms
52	Consider increasing marginal per m^2 rates for land taxes	Specific	Not include family home (state issue)	No
53	Broaden land tax base to include all land	Specific	Not include family home (state issue)	No
54	Apply land tax per land holding and replace SDs	Specific		ACT and NSW reforms
55	Cash flow tax could finance abolition of other taxes	Specific		No
56	Consider greater use of GST-free bus.-to-bus. transactions	Specific		No
57	Payroll taxes eventually replaced with more efficient taxes	Specific		No
58	Once CPRS in, phase out other measures to reduce emissions	Redundant		Redundant
59	Industry assistance with CPRS to be transitional	Redundant		Redundant
60	Consider replacing environment tax concessions with spending	General		No
61	Analyse variable congestion road pricing	General		No
62	COAG should accelerate mass-distance-location pricing	Specific		No
63	States should improve compulsory 3rd party insurance	Specific		No
64	Road freight should face comparable charges to rail	Specific		No
65	Replace fuel taxes with more efficient taxes	Specific	Not index fuel to CPI	Reform of taxation of fuels towards energy content

				based taxation (2010)
66	State motor vehicle taxes only used to cover related road costs	Specific		No
67	Apply economic assessments to road infrastructure provision	General		No
68	COAG should develop National Road Transport Agreement	Specific		No
69	COAG should review zoning and planning re housing supply	Specific		No
70	COAG should review housing development infrastructure charges	Specific		No
71	All alcoholic beverages should be taxed on volumetric basis	Specific	Not change alcohol tax in wine glut	Reject
72	Administration of alcohol tax should be reviewed	Specific		No
73	Tobacco taxes should be retained and increased	Specific		Increase tobacco excise (2010)
74	Tobacco excise should be indexed to wages	Specific		Index tobacco excise to average weekly ordinary times earnings (AWOTE) (2014)
75	Should be no duty-free allowance on tobacco	Specific		Reduce duty-free allowance for cigarettes (2012)
76	Gambling taxes reviewed to ensure recouping rents	Specific		No
77	Governments should eliminate gambling tax concessions	Specific		No
78	Consider allocation of gambling regulation and taxing responsibilities	Specific		No
79	All specific taxes on insurance should be abolished	Specific		No
80	Luxury car tax should be abolished	Specific	Not abolish luxury car tax	Reject
81	Systematic review of user charges and minor taxes	General		No
82	3 income support categories: pension; participation; student	General		High level
83	More consistent payment relativities within categories	Specific		No

84	Consistent indexation to maintain relativities	Specific	Not reduce age pension indexation	No
85	Parents' income support should encourage work participation	Specific	Not require parents to work when child turns 4	Decrease Newstart taper rate (2012, 2013), realign parenting payment eligibility (2013)
86	Disabled with part work capacity have part work requirement	Specific		Increase hours can work and retain Disability Support Payment (DSP) (2012)
87	Students' income test should not compromise education	General		No
88	Replace income and asset tests with one means test	Specific	Family home not in means test	No
89	Family Allowance (FA) means test use same taxable income measure as income tax	Specific		No
90	Replace Family Tax Benefit (FTB)-A and B with single family payment	Specific		No
91	Cost of children component of FA to be per child payment	Specific		Increase rate of FTB-A for 16–19-year-olds (2012), replace baby bonus with FTB-A increase (2014)
92	Supplement for parents nurturing young children	Specific	Not hit single income families	No
93	Supplement for single parents with children age 6 or older	Specific	Not hit single income families	No
94	Supplement for couples with children age 6 and older	Specific		No
95	Additional support for families with disabled & foster children	Specific		No
96	Single means test for withdraw of total family assistance	Specific		No
97	Youth payments for older children in some circumstances	Specific		No
98	Youth payment the main assistance from 18 to independence	Specific		Align eligibility age for FTB-A and youth allowance (2012)
99	Child Care Benefit (CCB) and Child Care Rebate (CCR) should	Specific		No

	be combined into a single payment			
100	Child care payment means-tested on family income	Specific		No
101	FBT exemption for employer child-care facilities should be removed	Specific		No
102	Rent assistance (RA) increased and indexed to national rents	Specific		No
103	Base RA eligibility on rent paid and income support means test	Specific	Not restrict RA for families	No
104	Develop ways to extend RA to public housing tenants	Specific		No
105	High-need housing payments to social housing providers	Specific		No
106	Phase out income-linked rents in social housing	Specific	Not support market rents for public housing	No
107	Productivity Commission (PC) to review concessions across all governments, report to COAG	Specific	Not hit pensioner and low-income concessions	No
108	PC examine principles of public service delivery, report to COAG	Specific		No
109	Align aged care assistance with user-directed funding principles	Specific		No
110	Governments to determine what adequate level of aged care should be	Specific		No
111	More transparent ways of dealing with community ideas	Specific		No
112	Commit to a principles-based approach to tax law design	Specific		No
113	BoT empowered to initiate own reviews	Specific		No
114	Treasury information to ATO on purpose of tax law should be made public	Specific		No
115	Establish board to advise Tax Commissioner on management	Specific		Tax System Advisory Board (2013)
116	Clarify Inspector General of Taxation (IGT) role to examine systemic tax admin. issues	Specific		No
117	Ensure sufficient resources for IGT, Australian National Audit Office (ANAO), Ombudsman	Specific		High level

118	Joint Committee of Public Accounts and Audit (JCPAA) should monitor ATO compliance with IGT/Ombudsman reports	Specific		No
119	State tax reforms should be coordinated through intergovernmental agreements	Specific		No
120	States should allow local governments autonomy to set property rates	Specific		No
121	State land tax and local government rates should be more integrated	Specific		No
122	A tax and transfer client account should be developed	Specific		MyGov (2014)
123	Pre-filled tax returns provided to most personal taxpayers	Specific		Commenced 2005
124	Reforms to tax and transfer provisions to improve client experience	Specific		No
125	Where possible collect tax and transfer information from 3rd parties	Specific		Pre-filling commenced 2005
126	Further approaches to reduce compliance costs for business	Specific		No
127	Assist small businesses to be business ready when they begin	Specific		No
128	Develop common information standards (building on standard business reporting)	Specific		No
129	Develop modern privacy and secrecy framework	Specific		No
130	Develop method of linking records for single client account	Specific		No
131	Taskforce to progress improving client experience of tax and transfer system	Specific		No
132	Publish Tax and Transfer Analysis Statement every 5 years	Specific		No
133	Collect data on T&T system and make freely available	Specific		ATO ALife project
134	Support institution to undertake independent tax and transfer policy research	Specific		Tax and Transfer Policy Institute established in 2013

135	Budget rules should encourage trade-offs between tax and spending	Specific		No
136	Amend Charter of Budget Honesty to publish Tax Expenditure Statement separate from Mid-Year Economic and Fiscal Outlook	Specific		No
137	Ensure reporting standards developed for measurement of tax expenditures	Specific		No
138	COAG examine ways for states to report tax expenditures	Specific		No

Personal tax
Investment and entity tax
Land and resources taxes
Consumption
Social and market outcomes
Transfer system
Institutions, governance and administration

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Chris Barrett, 4 October 2021

Graeme Davis, 14 September 2021

Rob Heferen, 3 September 2021

Ken Henry, 13 September 2017

David Parker, 22 September 2021

Greg Smith, 15 September 2021

Notes

[1] Non-tax revenue.
[2] The baby bonus allowed a parent leaving the workforce due to the birth of a child to claim, each year for up to five years, $2500 pa of the tax payable in the year prior to the birth of their first child.
[3] 2005 Budget, Budget paper no. 1, Statement 1, pp. 1–15.
[4] But with a flat tax rate of 15 per cent, the tax on contributions and earnings is concessional compared with normal income tax treatment for most taxpayers.
[5] Kevin Rudd, election campaign launch speech, 14 November 2007.
[6] The *Australia 2020 Summit: Final Report* can be found at https://apo.org.au/node/15061 (viewed October 2019).
[7] Davis, p. 45.
[8] Kevin Rudd, Interview with Kerry O'Brien, *The 7.30 Report*, 21 April 2008.
[9] The LITO started as a $100 non-refundable tax rebate introduced in the 1993 Budget that effectively raised the then TFT from $5400 to $5900: 1993 Budget, Budget paper no. 1, Statement 4, p. 4.6.
[10] 2008 Budget, Budget paper no. 1, Statement 1, pp. 1–10.
[11] Ibid., pp. 1–37.
[12] Wayne Swan, quoted in Kelly, p. 296.
[13] Henry, 2009 (b), Appendix D, pp. 117–32.
[14] Ibid., Appendix E, pp. 133–7.
[15] Ibid., pp. 119–20.
[16] Ibid., p. 120.
[17] Henry and Smith were the pre-eminent Treasury tax economists of their time and Piggott was a retirement income expert.
[18] Henry, 2009 (b), p. v.
[19] Ibid, p. 73.
[20] Treasury, p. xii.
[21] Ken Henry, personal interview.
[22] Rudd and Swan, 2008.
[23] Gerard and Kearns, pp. 1–3.
[24] Fiscal balance estimates.
[25] Greg Smith, personal interview.
[26] Ken Henry, personal interview.
[27] Henry, 2009 (b), p. xv.
[28] Ibid., p. 17.
[29] Ibid., p. 16.
[30] Ibid., pp. 3–12.
[31] Ibid., p. 25.
[32] Ibid., pp. 32–3.
[33] Henry, 2009 (a), p. 52.
[34] Ibid., p. 2.
[35] Ibid., p. 3.
[36] Ibid., p. 34.
[37] Ibid., p. 36.
[38] Henry, 2009 (b), Part Two, p. 151.
[39] Ibid., pp. 39–41.
[40] Ibid., pp. 191–8.
[41] Ibid., pp. 41–2.
[42] Ibid., pp. 41–3.
[43] Ibid., p. 89.
[44] Ibid., pp. 48–9.
[45] Ibid., p. 51.
[46] Ibid., pp. 51-2 and 91.
[47] Ibid., pp. 55–8.

[48] Ibid., p. 58.
[49] Harmer, p. xi.
[50] Henry, 2009 (b), p. 24.
[51] Ibid., pp. 59–60.
[52] Ibid., pp. 62–3.
[53] Ibid., pp. 69–70.
[54] Ibid., pp. 71–2.
[55] Ibid., p. 74.
[56] Rudd and Swan, 2010, p. 1.
[57] Ibid., p. 2.
[58] Ibid., p. 2.
[59] Ibid., p. 3.
[60] Commonwealth of Australia.
[61] Rob Heferen and Greg Smith, personal interviews.
[62] Swan, 2010.
[63] Commonwealth of Australia, p. vi.
[64] David Parker, personal interview.
[65] Chris Barrett, personal interview.
[66] Ibid.
[67] Kelly, p. 300.
[68] Ibid., p. 308.
[69] A Policy Transition Group led by Martin Ferguson and Don Argus was appointed to consult with the industry on implementation of the MRRT: Gillard, Swan and Ferguson, p. 2.
[70] Gillard, Swan and Ferguson.
[71] 2014 Budget, Budget paper no. 1, Statement 5, pp. 5–16.
[72] He prefaced a 21 June 2010 speech on 'Tax Reform: Opportunities and Challenges', for example, by saying he would avoid as much as possible any commentary on the debate playing out in the political arena.
[73] Ken Henry, personal interview.
[74] Henry, 2009 (b), appendices D and E, pp. 117–37.
[75] Rob Heferen and Greg Smith, personal interviews.
[76] Greg Smith, personal interview.
[77] Henry, 2009 (b), Part Two, p. 284.
[78] Gillard, Swan and Combet.
[79] Specific groups receive a range of other tax concessions, but the ML, LITO and LMITO are structural features of the tax scale for all taxpayers.
[80] Australian Labor Party & the Independent Members, Annex A.
[81] Business Tax Working Group, p. iii.
[82] 2010 Budget, Budget paper no. 2, p. 40.
[83] 2012 Budget, Budget paper no. 2, p. 41. A 15 per cent surcharge was introduced in the 1996 Budget but was abolished in 2005.
[84] 2013 Budget, Budget paper no. 1, Statement 1, pp. 1–13.
[85] 2013 Mid-Year Economic and Fiscal Outlook, pp. 142–5.
[86] Ibid., pp. 94–6.
[87] Hockey and Sinodinos.
[88] Tony Abbott, address to the 57th Liberal Party Federal Council, 28 June 2014.
[89] Shepherd et al., pp. 68–79.
[90] 2014 Budget, Budget paper no. 1, Statement 1, pp. 1–9.
[91] Australian Government, 2015, p. 2.
[92] Hockey, 2015 (c).
[93] Hockey, 2015 (b), p. 4.
[94] Hockey, 2015 (c).
[95] Australian Government, 2015, p. 5.
[96] Ibid., pp. 7–11.
[97] Hockey, 2015 (a), p. 89.
[98] Australian Government, 2015, p. 13.
[99] Ibid., p. 14.
[100] Revised version of the Independent Economics Computable General Equilibrium (IECGE) model (Cao et al.).

[101] The marginal excess burden is a measure of the economic cost associated with a tax, per additional dollar of tax revenue raised.
[102] Rimmer, Smith and Wende, p. 43.
[103] Australian Government, 2015, p. 28.
[104] Ibid., pp. 41–5.
[105] Ibid., pp. 48–51.
[106] Ibid., pp. 54–5.
[107] Ibid., p. 59.
[108] Ibid., p. 71.
[109] Ibid., pp. 78–81.
[110] Ibid., pp. 82–7.
[111] Ibid., p. 138.
[112] Ibid., pp. 143–4.
[113] Ibid., pp. 145–6.
[114] Ibid., p. 148.
[115] Ibid., pp. 150–1.
[116] Ibid., p. 149.
[117] Ibid., pp. 151–5.
[118] Ibid., pp. 168–76.
[119] Edmonds, pp. 193, 223, 236 and 243; and Australian Government, 2015, pp. 177–8.
[120] See https://treasury.gov.au/consultation/c2015-tax-white-paper-dp
[121] Turnbull and Morrison.
[122] G20 Leaders' Communique, Brisbane Summit, 15–16 November 2014.
[123] 2015 Budget, Budget paper no. 2, p. 14.
[124] 2016 Budget, Budget paper no. 2, p. 31.
[125] Organisation for Economic Co-operation and Development.
[126] OECD/G20 Base Erosion and Profit Shifting Project, Two-Pillar Solution to Address the Tax Challenges Arising from the Digitisation of the Economy, October 2021.
[127] Building on the 2015 Budget measure that reduced the rate for small companies to 28.5 per cent.
[128] Treasury, 2016, p. 4.
[129] 2018 Mid-Year Economic and Fiscal Outlook, p. 121.
[130] Henry, 2009 (b), p. 40.
[131] 2017 Budget, Budget paper no. 1, Statement 1, pp. 1–24.
[132] The 2016 Budget replaced the previous contribution (LISC) with an equivalent tax offset (LISTO): 2016 Budget, Budget paper no. 2, p. 28.
[133] The 2019 Budget sought to reduce the 32.5 per cent rate to 30 per cent.
[134] Henry, 2009 (b), p. 80.
[135] Morrison and Frydenberg, 30 March 2020.
[136] Morrison and Frydenberg, 22 March 2020.
[137] Bob Breunig.
[138] Swan, 2008.
[139] Australian Government, 2015, p. iii.