



# A FIVE YEAR FIVE POINT PLAN FOR TAX REFORM

In the pre-election environment it is timely to focus on how taxation measures can be used to make the economy work better.

Tax plays an essential role in contributing to incentives to work, invest and save and these incentives are essential to oil the wheels of the economy so they turn faster and more smoothly.

Tight macroeconomic circumstances should be ringing warning bells for both parties tempted to engage in populist pump priming in the lead up to the election. The Reserve Bank has its interest rate finger hovering on a hair trigger and is scanning the horizon for any sign of stimulatory largess.

At the same time there are plenty of improvements that can be made over the next three to five years to better align taxation settings with the major medium and longer-term economic opportunities and challenges facing Australia.

Taxation can make significant contributions by:

- Improving Australia's international competitiveness by reducing the burden of company tax and removing obstacles to offshore investment;
- Boosting rewards for workforce participation for lower and middle income earners and sharpening incentives for saving and investment for higher income earners by committing to a remodelling of the personal tax scale;
- Contributing to a more wide-ranging overhaul of Australia's intergovernmental relations to enable further reform of inefficient state taxes;
- Improving the equity and adequacy of Australia's superannuation arrangements; and
- Removing barriers that individuals confront when investing in their own re-skilling.

Ai Group has a five point plan for the government and the opposition ahead of the election.

## 1) Business Tax Reform

The time has come to lower Australia's company tax rate. This is a capacity-expanding initiative that would improve incentives for investment and boost Australia's attractiveness to inbound direct investment. We should move boldly on this and phase down the company tax rate to 25 per cent from its present rate of 30 per cent over the next three to five years.

Unlike a cut to personal tax levels, reducing the company tax rate would not intensify short-term consumer demand pressures. For domestic shareholders, the combined level of tax paid at the company and shareholder levels would not lift after-tax incomes due to the mechanics of our imputation system.

Some purists may argue against dropping the company tax rate on the grounds that a reduced company tax rate would widen the gaps between personal and company tax rates. While, arithmetically there can be no doubt about this, the reality is that the considerable remodelling of the personal income tax scales over recent years means that for many taxpayers, reducing the company tax rate will leave the gap between the company and personal rates at the same level as it was when the company tax rate was lowered to 30 per cent.

While lowering the company tax rate would attract direct foreign investment to Australia, changes should also be introduced to

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remove the long-standing obstacles to offshore investment by Australian companies. Almost half a decade ago the Board of Taxation argued that these obstacles should be removed. It proposed two measures: allowing companies paying dividends from foreign source income to pass a tax credit through to domestic shareholders and allowing companies to stream franked and unfranked dividends paid from foreign source income to different classes of shareholders.

Despite their affordability – particularly in the context of the extraordinary strength of company tax collections, the opportunity to introduce these measures has been overlooked. In the meantime Australian companies are inhibited against a full participation in global business opportunities or are pushed into performing costly organisational gymnastics in order to overcome the tax obstacles imposed in Australia.

## 2) Indirect Tax Reform and Intergovernmental Finances

In addition to these business tax changes, competitiveness could be lifted further if the Commonwealth worked with the States and Territories to take the next step on indirect tax reform. One of the notable achievements of the current Government has been to oversee the removal (or scheduled removal) of a range of state levies and stamp duties, on financial transactions, on share transactions, on hire purchase and leasing agreements and on mortgages. The time has now come to take state tax reform a step further.

The states still levy some of the most inefficient taxes. These include taxes on insurance premiums, on the purchase of commercial property and on payrolls. These taxes distort commercial decisions and embroil business and state governments in unnecessary compliance and administration tasks. They result in a loss of efficiency and slower rates of job creation. Even if governments insisted on a revenue neutral framework, the removal of these taxes could be achieved as part of a more wide-ranging overhaul of federal/state financial arrangements.

There certainly is scope to revisit Australia's intergovernmental financial arrangements as part of a reassessment and realignment of the allocation of responsibilities between the different levels of government in the federation. This reform area goes well beyond taxation. Suffice to say it is an area of reform that is as much about improving the accountability and transparency of government as it is about reducing public sector waste and improving the efficiency of tax imposts.

## 3) Personal Tax Reform

Improving the conditions for business investment by taking action on the business and indirect tax side of things

would boost investment and business's demand for labour. Tax reform can assist also in raising further our rates of workforce participation.

In light of the current macroeconomic environment, these changes to the personal income tax would need to be refined and timed in the light of unfolding circumstances to avoid unduly adding to inflationary pressures. The changes below are put forward for implementation over the course of the next three to five years rather than immediately.

Significant inroads can be achieved by lowering effective marginal tax rates particularly for second income earners in a family and for people transitioning from welfare to work. In recent years progress in these areas has been made by raising the threshold at which the 30% rate cuts in to its current level of \$30,000.

Inflationary expectations permitting, a further increase to \$40,000 over the next three to five years would represent further progress in encouraging greater workforce participation as well as countering the corrosive impacts of fiscal drag on recent changes. Further lower-income tax relief could be achieved by building on the direction of changes of recent budgets and raising the Low Income Tax Offset.

Further cuts at the higher end of the personal income tax scale should be also pursued primarily to lift saving and investment incentives. Raising the threshold at which the 40% rate cuts in (\$80,000 from 1 July 2008) to \$100,000 would complement these other personal income tax measures.

Consideration could also be given to abolishing the top rate - now 45%. This rate will cut in from \$180,000 from 1 July next year and would not be expensive to remove altogether. Against this, arguments will be put forward that retaining the 45% rate assists in maintaining the progressivity of the income tax rate scale.

Nevertheless abolishing this rate altogether and having a top rate of 40% would be a worthwhile reform and while, the changes to higher income tax rates may attract criticism as being too generous, it would be wrong to assert that taxing each extra dollar of income above \$100,000 at 40 cents lets the rich off the hook.

## 4) Superannuation

Another area of tax reform is to use taxation as an instrument to boost the superannuation balances of lower-income people. Many have superannuation account balances of less than \$50,000 and do not have sufficient discretionary income to take advantage of the co-contribution scheme. This is particularly true for those low and middle income earners

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aged over 45 for whom there is a high risk that the system of compulsory superannuation will not accumulate to sufficient levels by the time of their retirement.

A measure such as refunding the 15% contributions tax into lower-income individuals' superannuation accounts would raise post-retirement incomes for large numbers of people and thereby save on future age pension payments. A threshold income of \$40,000 could apply with higher thresholds set for people aged over 50 years.

It may, however be administratively simpler for the Commonwealth to make a contribution direct into lower income individuals' nominated superannuation account as part of their end-of-year tax reconciliation.

These measures would balance recently-introduced changes to superannuation that impact mainly on higher and middle income earners.

## 5) Incentives for Skills

A final area of tax reform is aimed squarely at incentives for individuals to invest in up-skilling and re-skilling. At present we have the absurd situation where deductibility for individuals' self-education expenditure is only permitted if it is directly related to their ability to earn their current source of income and it is made in the current income year.

If such expenditure relates to training to equip a person for a position in a different field in the future, deductibility is not permitted. This sits in direct conflict with the clear need to motivate people to undertake training for new skills.

One measure to address this anomaly could involve extending eligibility for current year deductibility to a wider range of self-education expenses so that expenditure on re-skilling and up-skilling could be claimed as a tax deduction. An alternative approach would break the nexus between the year of expenditure and the year a deduction can be claimed so that earlier-year expenditure could be claimed once an investment in re-skilling or up-skilling bore fruit.

## Conclusion

Taxation has important roles to play as we establish a renewed national agenda for further economic and social advancement. It is not the only area but should complement policies to improve skills, education and training; to establish better approaches to infrastructure planning and coordination; to more effectively encourage the development of a more capable and more innovative business sector; to expand our international engagement and to put in place more effective environmental management while maintaining our international competitiveness.

## Summary of Ai Group Tax Policy Proposals

### Business Tax Reforms

- Phase down the company tax rate from 30% to 25%
- Adopt the proposals made by the Board of Taxation in 2003 to remove barriers to offshore investment

### Indirect Tax and Intergovernmental Finances

- As part of broader re-examination of federal state finances, remove the most inefficient remaining state taxes

### Personal Taxation Superannuation

- Increase the Low Income Tax Offset
- Extend the 15% bracket tax for those earning up to \$40,000
- Raise to \$100,000 the threshold at which the 40% bracket begins
- Consider removing the 45% rate and having a top rate of 40%.

### Superannuation

- Refund the 15% contributions tax into lower-income individuals' superannuation accounts to raise post retirement incomes for large numbers of people and thereby save on future age pension payments.

### Deductibility for Skills

- Remove the anomaly that prevents deductions being claimed for re-skilling and up-skilling beyond narrow limits



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