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Achievable Tax Reform That is Good for All Australians

Introduction

Tax reform has proven to be a hard nut to crack in Australia. The reasons for this are legion, but none is more important than the absence of a relatively simple alternative to the current income and capital-gains based tax systems, augmented by the GST.

The principles of tax reform are non-controversial and well known. Economics has long held that a tax system should be: (i) As simple as possible; (ii) Cost effective; (iii) Productive; and (iv) Equitable, across and between all classes of tax payer.
The tax reform proposal presented below meets each of these four requirements.

Australia has accumulated a heavy overburden of taxes composed of provisions that pander to a range of special interests and public finance goals, but in the process, there has evolved a system that is good for some, not so good for others, but in every case generating pressures that compromise the principles of good government. In this brief policy note, a pathway to a better system is proposed. Adoption of this 'better' system seeks to advance good government by designing an alternative tax system that is simple, unequivocal in its pursuit of productivity, consistent with greater equity for all, and practical in implementation.

Income Vs Receipts

Over time the 'income' base of Australia's tax system has become eroded. Legions of tax 'experts' have successfully managed to blur what is or is not regarded as income for tax purposes, especially the myriad of ways that tax advisers have exploited the gap between *gross-income* and *net-taxable-income.*

Successive governments have aided this process by allowing the list of deductions that can be applied to reduce gross income to net taxable income to grow, thereby reducing the effectiveness of '*income'* as a base for determining tax liability. In too many cases, this has meant that some of the nation's most important income generators and earners have been able to arrange their affairs so as to largely avoid income tax liability, if not totally.

There is an alternative that has the advantage of widening the tax base to include many entities in the economy that currently escape the income tax net. This alternative replaces *income* tax with a *gross receipts* tax. For some enterprises, but not the majority of tax payers, a gross receipts tax will not only replace income as the base for taxes to be paid, but will make capital gains taxation redundant, further simplifying the tax system.

In reforming the income tax system to a gross receipts tax system, there is no compelling economic reason to abandon the concept of tax deductions, but for the sake of simplicity, equity and political astuteness, there the gross receipts based tax system will absorb all current capital gains taxes, but will not impact the GST in any way. Government will be free to collect GST as it does now, though the equity consequences of shifting to gross receipts as the base from which Taxable Receipts are measured may make it politically easier to consider changes to the GST that are long overdue. With respect to tax deductions, it is important for the gross receipts tax to allow all wage and investment expenses to be deducted from *gross receipts* to arrive at *Taxable Receipts*. But, no other deductions need to be entertained. To further simplify the tax system, a uniform tax regime will apply to company and individual *Taxable Receipts*, removing the current incentive to corporatize for tax saving purposes.

Limited Tax Deductions

Governments are always free to legislate whatever package of tax deductions they feel are politically feasible. Here, however, the tax system proposed includes only two classes of tax deductions, all labour costs, (here referred to as wage costs), and all investment costs, including depreciation and borrowing costs. The goal here is to remove any bias that the tax system may have favouring labour or capital, so removing the existing bias which encourages spending in ways that attract tax breaks or deductions.

It has already been mentioned, but it is worth repeating, that the *Taxable Receipts* system proposed here would obviate the need for a separate capital gains regime or any sort of real-estate based tax system. All real estate transactions would now fall under the provisions of the *Taxable Receipts* system. Similarly, share and other asset sales would be similarly captured, with only wage and investment costs allowed as deductions. The crucial decision for government will be the rates that apply, which simple back of the envelope estimates suggest quite low rates compared to those that currently apply.

Low, Progressive and Simple

The rates that could be levied are inevitably a political issue, but here we restrict the decision to rates that would enable the system to generate no less tax revenue than the existing income and capital gains systems. The GST would not be affected as GST applies to what consumers and producers spend, though sellers would be impacted through the *Taxable Receipts* regime.

There is a good deal of research needed to identify the optimal levels or rates to be imposed under a *Taxable Receipts* system, but it is highly probable that *Taxable Receipts* rates could be kept relatively low, possibly below 8% at the highest level. Design of such a system could maintain tax progressivity, with annual receipts up to $60K attracting a zero rate of tax, with eight equal steps to 8% for each successive $60K increment.

The rates implied by this sort of system are low relative to Australia's current tax levels. Inevitably there is a bias favouring those with the lowest taxable receipts, typically those who are in the lowest income tax brackets. However, the rates are also low compared to existing rates on company income and all capital gains tax liabilities. But, for those who currently escape the tax system, the *Taxable Receipts* regime would be a real impost, but at rates that are so low as to minimise the incentive to complain. Indeed, simply paying the *Taxable Receipts* tax may be cheaper than the cost of avoiding the imposts of Australia's existing income and capital gains tax regimes.

The ALP's budgets since 2022 indicate that government priorities are open for negotiation. There is, therefore, unfinished business that the government will wish to address urgently, especially the imbalance between government revenues and spending, real wages growth, productivity trends and issues of equity. Tax reform of the sort proposed here, creates the opportunity to rejig the Ship of State and set the nation upon a different, pro-small business, more equity conscious but sustainable course.
Summarizing:

1. Remove the distinction between personal and company tax.
2. Replace income and capital gains taxes with a *Taxable Receipts* tax, imposed as a simple schedule that is progressive.
3. GST is unaffected.
4. Abolish all tax deductions, excepting spending on labour costs and the cost of investing.
5. Introduce lower, simpler, progressive tax rates.

The *Taxable Receipts* proposal is simple and likely to be highly cost effective. It promotes equity and increases the productivity of the tax system as a whole, taxing those currently escaping the income tax net. It is likely to be highly popular with existing tax payers, but less so with entities or individuals who currently escape the tax net. Consequently, tax reform of this boldness demands courage and vision.

With courage and vision Australia can deliver the core requirements of an efficient, productive, equitable and simple tax broad based tax system. As such, it is likely that a Taxable Receipts system will be politically attractive to the electorate at large, and provide the opportunity for political leadership of a sort not seen in Australia in decades, yet consistent with the equity and 'fair-go' values of Australia's free enterprise society.

The *Taxable Receipts* proposal goes beyond re-arranging the deck chairs, but would deliver a Titanic impact on Australia's world competitiveness.

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