The Tax Issues That Will Not Go Away

Neil Warren*

Abstract

The last decade has seen major changes made to the taxation system in Australia. However, these changes have been primarily concerned with income tax reform. Three areas of the tax reform remain outstanding – wealth taxation, State tax reform and commodity tax reform. Wealth taxation has proven a politically sensitive issue subject to little public discussion, a situation not helped by a lack of data on wealth distribution in Australia. State taxation has been the focus of more public debate through a number of Government funded reviews but despite this, few of these report's recommendations have been implemented. Although the issue of commodity tax reform has been the subject of considerable public debate, it too has resuted in no substantive reforms. This paper argues that until the political dimension of tax reform is taken more fully into account when designing tax reform proposals, the debate on these three tax issues will not move from words to legislation.

1 Introduction

While the debate over the direction of tax reform in Australia has been a steady source of literature and public debate,[1] those reforms which actually have been implemented have had a relatively limited focus. This is despite a wide acceptance that the Federal and State tax systems are failing the basic tenants of a good tax system including being equitable, efficient and simple to administer and to understand.

Any review of the tax reforms implemented over the last two decades would show an almost total preoccupation with changes to the base and rates of the personal and corporate income taxes.[2] This is not to deny that other tax reforms have been discussed – just that they have never found imple-

* School of Economics, The University of New South Wales

mentation. Issues still unresolved include the failure to provide States with an adequate tax base and the failure to reform the much criticised Federal commodity tax system. Not only have needed reforms not found implementation, some reforms have been implemented which have set back progression towards a better tax system. Of importance here is the total abolition by the early 1980s, of all death and gift duties imposed by Federal and State governments.

Although this paper contains little material which is original, its objective is to highlight the parlous state of tax reform in Australia. It will be shown that while the politicians tire of further tax reform, most of the really hard issues remain to be addressed.

Three areas will be examined in this paper:

(1) Federal indirect tax system rationalisation

(2) reform of State Government taxes

(3) the taxation of wealth.

While the list above is by no means inclusive of all unresolved tax issues,[3] these are the three areas with the greatest potential to impact on tax design in Australia. To date, the public debate on these three issues has been more the subject of election campaigns than of rational and informed discussion.

The contribution of this paper is to attempt to breach the apparent void between the protestations of tax economist and the responses by politician on three issues critical to the future of the Australian tax system. In particular, we shall seek to recommend *pathways to tax reform* which could find community and political acceptance.

2 Federal Indirect Tax Rationalisation

Two decades ago, the Asprey Report[4] stated that 'outside the area of motoring, drink and tobacco, Australian taxation of goods and services can be dismissed as a trivial relic'. In response, the Asprey Report recommended in the *Full Report*[5] that a Value Added Tax be introduced (VAT) much like that which had been introduced in the UK (in 1973) and in all European Community countries.

While some of the recommendations in the Asprey Report found implementations (such as the simplification of the personal income tax rate scale), there was no immediate and substantive move designed to reform the indirect tax system.

A decade later in 1985, the Federal Government proposed in a *Draft White Paper*(1985) to implement a 12.5% broad based goods and services tax (GST) levied at the retail level. This was to be combined with a change in the mix of consumption and income taxes. However, the July 1985 National Tax Summit which was designed to discuss this proposal rejected it in favour of a major expansion of the income tax base and a tightening of taxpayer compliance.

Some six years later in November 1991, the Liberal-National Party coalition proposed in their party manifesto (*Fightback!*), the introduction of a package of tax reforms including a major change in the mix of income and consumption taxes centring on the introduction of a 15% GST.

The 1993 Federal election saw the Liberal-National Party coalition lose to the Labor Party. The coalition parties subsequently abandoned *Fightback!*. In effect, the 1993 election outcome has meant that no political party in Australia is currently willing to openly consider any major reforms to the structure of the current indirect tax system.

This does not mean that the indirect tax system is not in need of urgent reform. In reality, the structure is little changed from that reviewed by the Asprey Report some twenty years ago. Probably the only difference is that the political will for change is less now than ever before.

However, if indirect tax reform is so urgently needed, and the political and community will for such change has all but disappeared, is it possible in the short term to get the idea of indirect tax reform back on the agenda for change? The purpose of this section is to address this issue.

2.1 The Problem

The indirect tax system has been criticised primarily for its adverse impact on economic efficiency. Particular attention has been given to its narrow base, multiple rates, administrative complexity and lack of transparency. Less attention has been given to its regressive distributional impact.

These criticisms have been added to in recent years by a concern over the decline in the share by current indirect taxes in the potential indirect tax base (Warren 1993, 1995). The response of government to this problem has been to further increase the tax rates on those goods which are currently taxed. For example, the recent increases in the tax rates on petrol and tobacco are a case in point. As a result, in New South Wales the effective average tax rates on tobacco is now approaching 300% and that on petrol, nearly 130%. In some cases, the same commodity is taxed directly by a range of different taxes. In the case of beer, the effective average tax rate is now around 100% and results from an excise duty which is around $15 per litre of alcohol, a 22% Wholesale Sales Tax, and a 13% State Franchise Tax (in NSW on normal strength beer).

The result of such tax rates is that in 1993-94, nearly 60% of the taxes levied on the use and provision of goods and services in Australia were levied only on tobacco, alcohol and motoring. With the recent (9 May 1995) 10% increase in Federal excise duty on tobacco and the 33% increase in the NSW and Victorian tobacco franchise tax rate to 100% this trend is set to continue apace. In addition, the move to raise the Wholesale Sales Tax (WST) rate on passenger motor cars from 16% to 21% in May 1995 and from 1 July 1995, all WST rates by one percentage point, will see a widening of the gap between the tax and non-tax commodities under the indirect tax system in Australia.

The current Federal and State government response to the declining indirect tax base is clearly flawed – raising the tax rates on an already declining tax base will only exacerbate the current problem with more people substituting the untaxed for the taxed commodities, thus accelerating the decline in the revenue contribution of current indirect taxes.

Clearly, alternatives to the current Federal and State government's policies on indirect tax must be sought but the major constraint on change is politics.

2.2 The Politics of Indirect Tax Reform

The virtues of restructuring the indirect tax system in Australia are clear and well documented (Head 1993, Freebairn 1993, Warren 1987). Less clear is the way this case should be articulated to the community. In the past, the central problem appears to be that the benefits claimed to arise from indirect tax reform have either been wrongly claimed or simply over-stated.

Principal amongst these has been the benefits claimed to arise from a change in the mix of direct and indirect taxes which could accompany a broadening of the indirect tax base. One assertion has been the claim that a higher level of taxes on consumption and reduced taxes on income would encourage savings. The debate is still far from settled on this issue and the claims made by some (as in *Fightback!*) simply cannot sustain the level of scrutiny they deserve.[6]

A second area where the benefits have been overstated is the efficiency gains from a rationalisation of the indirect tax system. The focus has been particularly on the benefits from adopting a destinations principle for the indirect tax system rather than the current origins principle. That is, our current indirect taxes flow through to our export prices whereas a GST which zero-rates exports and taxes imports would ensure our exports are GST free. Currently, around a half of all the WST is levied on intermediate

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inputs or investment goods. A substantial portion of this could potentially flow through to export prices. However, as Freebairn (1993) has argued, these benefits can be overstated since under a floating exchange rate system, the currency may already be devalued as a result of the tax implicit in export prices and subsequently appreciates when the taxes on export prices are removed.

A third area where the benefits are often significantly overstated is the ability of a reformed indirect tax system to tax activity in the black economy which is escaping the income tax net. For example, the Draft White Paper(1985) assumed that the GST would yield a 5% fiscal dividend from the black economy and *Fightback!* assumed a 7.5% black economy fiscal dividend.[7] The fact is that this may simply not arise as those who evade the income tax may just as effectively evade a GST.

Over-stating the case for indirect tax reforms has probably done more than any other factors to damage the case for indirect tax reform. This is because poorly founded arguments make the reforms vulnerable to fundamental criticisms. For instance, the attack mounted on *Fightback!* centred largely on its overstating the benefits from a substantial tax mix change which was revenue-neutral.

Today, probably the only groups left in support of indirect tax reform are the tax administrators (lawyers and accountants), tax economists, industry groups and government Treasury officials – not the broader community.

2.3 The Less Controversial Economic Case for Indirect Reform

If the community debate over the need for indirect tax reforms is to be re-ignited, the case for indirect tax reform must be in more realistic terms such as rationalising the tax rate structure and broadening the tax base. The primary focus should therefore be on designing a more economically efficient indirect tax system. It should not focus on a major change in the tax mix as this has in the past simply acted to divert attention from the substantive arguments for indirect tax reform. The strongest case for change is in relation to the Wholesale Sales Tax.

The WST has a narrow base, taxing just over 10% of private final consumption expenditure, is levied at multiple rates (12%, 22%, 26%, 32% and 45%), and imposed at the wholesale stage in the production and distribution process. The WST is now a product of antiquity. Australia is one of only two OECD countries (the other being the USA), not to either have or plan to have a broad based GST. The current WST is simply not defensible on any reasonable grounds.

One unreasonable argument in favour of the current WST sometimes cited is that 'a bad tax is a good tax' in that it limits the politicians ability to *crank* up the rate of this tax without it posing significant economics problems. These include distortions to resource allocation, particularly through its impact on consumer behaviour through changes in relative prices.

Another unreasonable argument for the WST is the small number of taxpayers under a tax levied at the wholesale level. While this may be the case, this is a weak argument for the WST and a strong argument for a simple and well designed GST which also keeps administration simple and the tax's impact and operation transparent.

2.4 Where to from here?

The recent changes to the base and rate of the WST and attempts to provide a WST exemption for aids to manufacture do not constitute substantive reforms and are in fact moving down a path to nowhere – they are simply a poor substitute for genuine reform of commodity taxes and akin to an admission of the failings of this tax.

If the indirect tax reform debate is to be resurrected, then the lessons from the past must be heeded. These are:

(1) do not link indirect tax reforms to a tax mix change;

(2) reform/repeal only a limited number of other indirect taxes so as to ensure ease of communication and focussed debate;

(3) ensure that any reform package is revenue deficient (not revenue-neutral) and is associated with a generous package of compensation.

The third lesson is important and often overlooked. In both the Draft White Paper(1985) and *Fightback!* tax reform packages, some importance was given to the claim that the reform packages were revenue-neutral. The simple fact is that revenue-neutrality begs the question of 'what is in the reform for the taxpayer?'. Taxpayers are not stupid and Australian governments should never again consider major tax reforms without them being revenue-deficient. Through this approach a win-win outcome can be developed. In the short term, the community is attracted by tax reduction and in the long term the government is attracted by a better designed tax system. This lesson has been learnt in most other countries – it should become accepted parlance in Australia.

Unfortunately, genuine indirect tax reform has been a long time coming in Australia and still appears a long way off. For that we probably thank those who overstated the case for tax mix reforms and the opportunism of politicians who have relished the chance to score quick and easy points in an area where ignorance is too easily exploited.

3 State Tax Reform

The second major tax issue in Australia which has been the subject of much debate but few actual reforms is the issue of State tax design.[8] This debate has raged on two fronts: firstly, the concern over the need for States to fund more of their own expenditure (vertical fiscal imbalance) and secondly, the structure of the current State tax system.

3.1 Vertical Fiscal Imbalance and the Tax Options

Currently, the Federal Government raises 75% of all tax revenue and States 21%. However, States make up some 42% of total general government outlays. State governments are therefore dependent on substantial financial transfer from the Federal Government. Reducing the size of this vertical fiscal imbalance has focussed on the States having available to them taxes capable of raising significant levels of revenue. The problem is that Section 90 of the Australian Constitution, which excludes States from levying duties of customs and excise, has been interpreted by the High Court as excluding States from levying any form of sales tax. In addition, States have been effectively excluded from levying income taxes by Federal Government threats of reducing State grants by an amount equivalent to any revenue raised from a State income tax.

States have therefore become financially dependent on Federal grants and an array of relatively low revenue raising taxes. The Federal Government has provided some assistance by relinquishing the Payroll Tax (in 1971) and the Debits Tax (in December 1990) to the States.

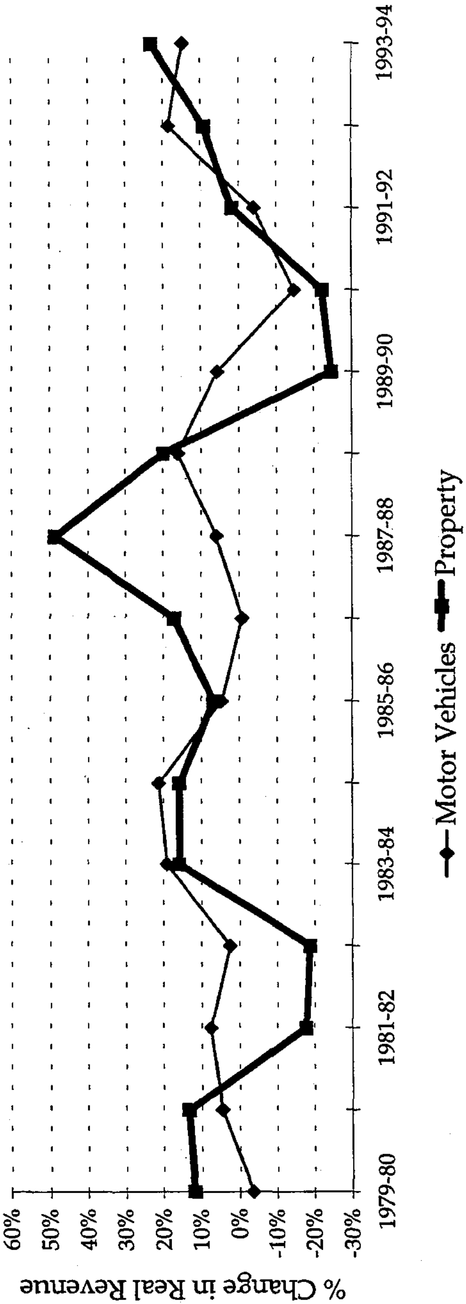
Current State tax design and Federal government attitude to State tax powers therefore acts as a major constraint on States introducing new taxes in their own right to address vertical fiscal imbalance. Ignoring constitutional change[9] only one major course of action is likely to see this problem addressed – the co-ordinated reform of both Federal and State taxes. Two options exist: firstly, Federal income tax revenue sharing (or a State Surtax on the Federal income tax) and secondly, the co-ordinated reform of Federal and State indirect taxes.

Both these changes require a sea-change in attitudes by both the Federal and State governments and on the basis of current attitudes, this is unlikely to be forthcoming.

3.2 Reforming the Structure of Current State Taxes

What then can the State Governments do to improve their current tax system? The fact is little in practice. Compounding these problems is the lack of robustness evident in current State taxes. Figure 1 illustrates the real

Figure 1 State Stamp Duties



growth rate of Stamp Duties collected from property and motor vehicles over the past fifteen years. These are taxes which raised 15.4% and 3.2% respectively of State tax revenue in 1993-94. While this problem occurs to a much lesser extent with the Payroll Tax (which was given to the States by the Federal government in 1971, then levied at a rate of 1%) this tax is now between 5% and 7% and perceived to be at or near its maximum rate.

These problems are further compounded by no one State wanting to 'go it alone' on tax reform, especially those which involve tax increases. While there has been much discussion about tax harmonisation amongst the States,[10] tax competition between the States designed to attract business investment always looms large on the State fiscal horizon. Queensland more than any other State has been the source of most of this competition. Queensland currently does not have a petrol franchise tax (which is 7 cents a litre in NSW), has a lower tobacco franchise tax, has no FID or BADT, and imposes a lower rate of Payroll Tax than other States.

The most recent example of inter-state tax competition is the move by Queensland to cut the Stamp Duty on share transactions from 0.6% to 0.3%, a reform which was matched by NSW at a cost of $125m and also by Victoria for a similar amount. Probably the most dramatic example of inter-State tax competition was that arising from the abolition of Death and Gift Duties in Queensland in 1977. Within three years, all other States and the Federal Government had abolished their death and gift duties.

An important part of the debate on State taxation and the need for State tax reform has been the debate over the level of State grants (general purpose and specific purpose) received by the States. While the Grants Commission which oversees the allocation of general purpose grants will not compensate a State for the effects of tax competition or not implementing a tax that other States have, it has in the past distributed to the less population and more sparse States, a larger share relative to population, of the General Purpose Grants.

The larger States have often argued that this bias has allowed the smaller and faster growing States like Queensland an advantage which is reflected in their lower tax levels and has provided them with a further competitive advantage. Following the recent cut to the rate of Stamp Duty on share transaction by Queensland, NSW and Victoria called for the adoption of a new method of allocating General Purpose Grants which was less favourable to Queensland. This call is likely to gather momentum in the coming years, especially if development in Queensland relative to other States means that its current Grant allocation is unjustifiably generous given its level of development.

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3.3 Tax Options for States

State governments have few tax options available to them in terms of addressing vertical fiscal imbalance or reforming their tax structure. At most they could consider a personal income tax surcharge but it is unlikely that the Federal government would allow this without some response in terms of general revenue grants. There is in fact little that States can do with their current tax system which would dramatically increase their revenue sources. Moreover, given the current tax competition between States, it would appear that States are unlikely to either individually or jointly, move to introduce new taxes or radically reform or harmonise current taxes. Equally, it is unlikely States will cooperate to introduce new taxes given there are eight States and on-going competition between the States.

This leaves one major option at the State level – State co-operation with the Federal government in introducing tax reforms which improve both the State and Federal tax systems. The prime target of any such competition could be one based on the introduction of a Federal GST, the revenue from which is shared between the Federal and State government and results in the repeal of selected Federal and State taxes.

The Liberal-National Party *Fightback!* proposed such a package of reforms, recommending a Federal GST replace the Federal WST, a large part of the Federal petrol excise duty[11] and the State Payroll Tax. Without discussing the merits or otherwise of their proposal, it is this kind of Federal-State cooperation which could offer the greatest scope for major indirect tax reform in Australia. Given that States levy the majority in number of indirect taxes, any genuine attempt to rationalise the indirect tax structure in Australia must involve Federal-State co-operation on indirect taxes. The challenge will be to overcome political difference and parochialism.

4 Wealth Taxation

Australian State and Federal governments currently levy an array of taxes on the stock and transfer of specific categories of wealth as shown in Table 1.

However, although Australia has had over 100 years of experience with general wealth taxes in the form of estate duty, inheritance (or succession) duty[12] and gift duties, such taxes are no longer in force (Saunders 1983, James 1992, Smith 1991). These taxes were once levied by both the Federal and State governments and their demise was precipitated by the abolition of estate and gift duties by Queensland in 1977. By 1981, all other States and the Federal government had followed the Queensland example and abolished all forms of such taxes. At that time, there was some consternation as to why the Federal Government abolished its taxes (Saunders 1983), the feeling being that they should have stepped into the breach and filled the void left by the departure of State governments from this area of taxation.[13]

Table 1 State Taxes on Wealth

Taxes on Wealth Stock
State Property Tax
Municipal Rates
Taxes on Wealth Transfers
Stamp duties on
House purchases
Motor vehicle purchases
Share purchases
Financial Institution Duties (FID) on financial deposits
Bank Accounts Debits Tax (BADT) on withdrawals from financial accounts.

Although estate, inheritance and gift duties were only small contributors to State tax revenue prior to their demise, this was not always the case. In 1948-49, one third of NSW Government revenue and 27% in Victoria came from this source. This had fallen to 16.1% and 17.5% respectively by 1968-69, just prior to the States being transferred responsibility for the Federal Payroll Tax. The situation in 1975-76 is shown in Table 2 just prior to the phased abolition of these taxes.

The Death and Gift Duties raised nearly 6.5% of State tax revenue in 1975-76. In terms of current State taxes, this is equivalent to a tax which raises $1.7b. It is also clear from Table 3 that the Death and Gift Duty imposed by the Commonwealth Government was small even by State Government standards, raising around 40% ($86.9m) of all revenue from such taxes ($227.1m) in 1975-76.

What is clear is that these taxes were a major source of revenue for State Governments but much less so for the Federal Government. However, since the removal of all death and gift duties by 1981, discussion on the possibility of their reintroduction or the possible adoption of a general net wealth tax has become an almost taboo subject. When it has been raised, the discussion has never been either extensive or informed.

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Table 3 Narrow Based State Wealth Related Taxes: 1993-94 ($m)

	State Property Taxes	Stamp Duties		Financial Institution Taxes	Total State Tax Revenue from all Source 1993-94	Wealth Based Taxes/Total State Taxes
		Other	Motor Duties			
New South Wales	519	1694	264	772	10240	31.73%
Victoria	409	1020	260	540	7497	29.73%
Queensland	203	642	126	89	3756	28.22%
South Australia	77	233	76	127	1904	26.94%
Western Australia	122	423	106	150	2397	33.42%
Tasmania	29	61	22	51	598	27.26%
All States	**1359**	**4073**	**854**	**1729**	**26392**	**30.37%**

The one factor which probably limits the scope for progressing the tax debate on this issue is the lack of empirical data which would enable the practical case for such a reform to be argued.[14] Although there is a surfeit of information on aggregate private wealth (The Treasury *Economic Roundup* presents annual updates on private wealth in Australia)[15] there is a paucity of information on the distribution of this wealth. Irregularly, the case for a major survey of private wealth is articulated (such a push which occurred in the late 1980s as a result of the then asset price boom) but the substantial funding for such a study is not forthcoming.

The anecdotal evidence would tend to indicate that governments are reluctant to commission such surveys since the community might perceive it as providing the foundations necessary for the re-introduction of death and gift duties or the introduction of a net wealth taxes.

The push for more information on wealth distribution has also not been helped by statisticians concern that any information obtained from such a survey may suffer from not only poor response rates but (especially if a response is compulsory) unreliable information. The latter could arise from the respondents concern about confidentiality and in particular, the possibility that responses might find their way to the tax man or that the information provided might form the basis of a new tax. In all these cases the respondent has a self interest to either not respond and if forced to respond, to not fully disclose all information.

Combined, these forces have resulted in a positive dearth of information on the distribution of net wealth in Australia and as a consequence, limited the scope for a genuine review of the need for wealth taxes.

4.1 The Case for Net Wealth Taxes

The theoretical case for wealth taxation centres on the potential equity and economic efficiency gains from such a tax. The equity arguments centre on the belief that income alone does not adequately represent ability to pay and therefore that an equitable tax system should tax both wealth and income. This argument is articulated at two levels.

Firstly, it argues that wealth yields benefits to its current owners in the form of a stream of earnings, whether economic or non-economic. For example, studies have shown that households who are owner-occupier are likely to experience much lower poverty rates than those households who are renters. Similarly, income distribution is significantly affected by including the imputed income of home owner-occupiers (Yates 1991).

The second major concern is with inter-generational transfers of wealth through gifts and bequests. Such transfers provide an economic advantage to recipients over non-recipients. A recent ABS study into the financial assistance received by first home buyers from parents and relatives when purchasing a home highlights the magnitude and importance of wealth transfers in assisting with the purchase of the most important asset a person acquires over their lifetime.[16] A wealth tax is therefore an important means of ensuring equality of opportunity between individuals,[17] reducing the importance of the parents you happened to be borne with. It therefore works to limit the importance of inheritance in perpetuating wealth inequality.

While there are sound *equity* reasons for taxing inherited wealth, there is also a strong economic *efficiency* case for such taxes.[18] These efficiency arguments centre on the implications of wealth transfers for labour supply, private household savings and investment behaviour.

In relation to labour supply, the concern is that income generated by wealth transfers could reduce the need for labour market activity. The distinction between earned and unearned income which was evident in many income tax systems until only recently, is built in part on the belief that capital is acquired through no particular effort – which may be the case if it was a bequest or a gift.[19] Structuring the tax system this way acts as a significant disincentive to savings by the current generation from their income and is inferior in approach to a tax specifically targeted on gifts and bequests rather than all capital. Moreover, taxing interest on capital at high rates not only could discourage savings, it is likely to encourage the consumption of gifts and inherited wealth rather than their retention.[20]

The concern over the *efficiency* impact of no wealth taxes on savings centres on the disincentive to save posed by inherited wealth. This is based on the belief that income earned from bequests (or gifts) could reduce a person's need to supply labour to earn income from which to save and accumulate wealth for future consumption (or gifts and bequests). This is one of the arguments which lies behind taxing capital income at differentially higher rates than wages income.

Another efficiency concern is that a person who is the recipient of gifts or bequests may not invest these funds with the same rigour as they would with savings from their own income.

4.2 Current Wealth Taxation:

While Australia does not levy general net wealth taxes, it does levy a number of taxes on wealth transfers and on specific forms of wealth. This is apparent from Table 3. Together, these wealth related taxes contribute nearly one third of all State tax revenue.

The particular taxes imposed on wealth (stock) are mainly restricted to those on property holdings. These are in the form of local government Rates and State government Property Taxes. However, care needs to be taken in

Table 2 Estate, Inheritance and Gift Duties

	Duties 1975-76	Total State Tax Revenue 1975-75	Contribution of Duties to Total Tax Revenue 1975-76 (1)	Total Tax Revenue from all Sources 1993-94 (2)	Revenue from Duties if a contribution to Total Tax Revenue was unchanged (1)*(2)
New South Wales	90.4	1404.4	6.44%	10240	659
Victoria	71.4	1049.7	6.80%	7497	510
Queensland	27.6	404.6	6.82%	3756	256
South Australia	20.5	300.7	6.82%	1904	130
Western Australia	11.7	263	4.45%	2397	107
Tasmania	5.5	79.3	6.94%	598	41
Commonwealth	86.9	16937.8	0.51%	93092	478
All	**227.1**	**3501.7**	**6.49%**	**26392**	**1703**

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relation to local Rates since it could reasonably be argued that they are at least in part user charges – fees for services to property owners. In addition, the recent trend towards a fee for service type of operation by local governments will see the property related component of local Rates decline.[21]

In a sense therefore, selective wealth taxes already exist in Australia. It could also be argued that a general net wealth taxes is already levied. The latter arises in part from moves to broaden the income tax base to include realised real capital gains but probably more importantly, because of the introduction of an assets test and deeming rules under the social security system.[22] The assets test includes the majority of a person's (or income unit's) net wealth and has different schedules depending on whether a person is an owner occupier or not. As a result, the effective wealth tax rate for those groups whose pension is partially withdrawn due to the assets test is 7.8% of wealth,[23] a relatively high rate of wealth tax.

The other method of effectively taxing wealth under the social security system is through the practice of deeming a stream of earning from an asset even though an actual stream may or may not ultimately accrue to the wealth holder. Deeming is applied in two forms. Asset over $2,000 for single pensioners (and $4,000 for couples) held in either cash or on deposit (at banks, building societies or credit unions) which have deemed a rate of interest set by the Minister for Social Security (with the actual rate applying to the first $2,000). Secondly, income is deemed at a minimum of 4% on loans made and on assets gifted where those gifts total less than the annual limit of $10,000 (although this limit does not apply where the assets gifted are to obtain accommodation for life unless the amount gifted is excessive).[24] Deeming clearly has a potential impact on the entitlements of those eligible to social welfare payments.

A far more insidious form of wealth taxation which has had a rapid growth over the past decade is the taxes on capital transfers and financial deposits as shown in Table 3. In particular, the financial institution duty (FID) which is levied on deposits grew at a real annual rate of 11.7% between 1985-86 and 1993-94.

The above evidence would indicate that Australia already has substantial elements of a schedular wealth tax – one where different forms of wealth are taxed under different rate schedules.

While the basic theoretical argument for some form of general wealth tax are widely accepted, what is less easily decided is the design and level of such a tax. A typical response is to argue that Australia already effectively taxes most forms of wealth[25] (as was noted above) and that a more explicit form of tax is not necessary.

Another response is to argue that the case for such a tax in Australia is different to that in Europe where such taxes were in large part designed to address the failures of the income tax system. In particular, the presence of net wealth taxes was partly the result of the schedular system[26] of income taxation imposed by many European countries until recent years. This system meant that many groups experienced very low rates of income tax (such as farmers and small businesses) and the wealth tax was a means of taxing the accumulation of assets from taxed income received by these groups which was taxed at relatively low rates.

Because Australia adopts a global system of income tax,[27] the European argument for a net wealth tax is far less relevant in Australia. However, it might be a case for a wealth tax on those involved in the black economy, but this argument (also mounted for a GST in *Fightback!*) is more an argument for improving the operation of the income tax, not for the introduction of a wealth tax.

4.3 Designing a Net Wealth Tax

In designing a net wealth tax, the first and most important question is the likely revenue expected from such a tax. With an already comprehensive income tax and means tested social welfare system, such a tax is unlikely to be asked to contribute significantly to general revenue. At most it would be highly progressive, resulting largely from a high threshold.

The problem is that a net wealth tax is not an easy tax to administer either for the taxpayer or for tax administrators, requiring all assets to be valued upon its implementation. In this context, a form of general net wealth tax is probably inappropriate for Australia. Australia is already fairly well served by it current net wealth taxes which include the taxing of capital gain under the income tax, the social welfare assets test and the deeming rules under the social welfare system, plus a fairly comprehensive person income tax (although it does exclude capital gains on owner-occupied homes and still concessionally taxes superannuation benefits).

4.4 Revisiting Death and Gift Duties

A more realistic alternative to a general net wealth tax in Australia would be the re-introduction of death and gift duties. This tax would have far fewer taxpayers and pose fewer administrative problems such as the need to regularly value assets duties or the problem of ensuring the taxpayer has the cash flow to pay their annual tax liability.

In designing death and gift duties, three basic issues need to be considered:

(a) Legal Incidence of the Tax – the Estate or the Beneficiary

A debate exists over whether the tax should be applied to the receipts of beneficiaries or the size of the estate. The Asprey Report recommended that it be based on the size of the estate although without substantiating the reason for its case (Saunders 1983). The alternative is to base the tax on the receipts of beneficiaries. The advantage of this approach is that if the tax rate schedule is fixed at levels comparable to that under a death duty, it could encourage the distribution of wealth to a larger number of beneficiaries to ensure the tax burden is minimised. This could do more to minimise the intergenerational distribution of wealth (particularly large sums) than might a death duty.

However, the Asprey Report (and Treasury 1974a,b) argued against a beneficiaries based tax on administrative grounds.[28]

(b) Defining the Tax Base

Typically, the tax base is defined as broadly to include all personal assets. In many cases, special concessions are given to the spouse of a deceased person (allowing transfer without being subject to tax) or to farmers (who are often subject to lower tax rates and higher thresholds).

(c) Determining the Tax Rate Schedule

The rate schedule is determined by the base and method of levying the tax; the approach adopted in *(a)* above; and the social and economic objectives assigned to the death duty. At issue would be the level of any threshold or rate bands and the corresponding tax rates. Australia has in the past adopted different rate schedules for different types of taxpayers, particularly for farmers where a higher threshold has sometime operated.

In all forms of death duties, gift taxes are necessary complements to avoid evasion death duties. These taxes can be levied on their own base and rate schedules or integrated directly into the death duty. This will also ensure horizontal equity is achieved under the death duty. This is because ultimately, the same death duty schedule applies to all persons, irrespective of gifts made over their lifetime.

4.5 The Politics of Death and Gift Duties

In its review of death and gift duties in 1975, the Asprey Report pointed to the avoidance of the taxes and the differing tax rates, tax base and method of administration adopted in each State and by the Federal government (Asprey Report Ch 24, 26). While Asprey supported the Federal Government taking over the administration of both Federal and State death and gift duties, this recommendation was not acted upon. Instead, following the announcement in 1975 that Queensland would abolish all death and gift duties from 1977, the Federal government also abandoned its tax. Since 1981, no death or gift duties have operated in Australia.

It is now time that the whole issue of death duties was again canvassed in Australia. Not only because such taxes should be openly debated, but also because State and Federal governments have been introducing an array of taxes which proxy wealth taxes in terms of their impact.

However, the *pathway to reform* in this area will not be easy nor uncontroversial, nor will it be helped by the current paucity of data on wealth distribution. The latter is of particular concern and it is reasonable to assume that not until a concerted effort is made to collate information on the distribution of net wealth in Australia, will real progress be made on the debate over wealth taxation.[29]

In the interim, an important contribution could be made by a major review of the forms of taxing wealth in Australia and the scope for rationalising the current system or at least informing the community of the path being trod quietly.

5 Conclusion

Despite all the discussion on tax reform in Australia, this paper has shown that there remain three major areas where the discussion on tax reform has brought few signs of real change. It has been shown that each case, much of the reason for this is because the case for these reforms has not been articulated simply, clearly and objectively. In the case of indirect tax reforms, the benefits of the reforms have been overstated and integrated into tax mix changes.

In relation to State tax reforms, the problem has been that the scope for reform is severely constrained by inter-State competition, a reluctance by the Federal government to encourage State reform and an uncompromising interpretation of Section 90 by the High Court.

On the issue of wealth taxation, Australia has moved away from its direct taxation towards taxing it indirectly. While the direct taxation of wealth either annually, through gifts or on death is unlikely to gain much community support, there is a clear need in Australia for the 'taxation by stealth' approach being adopted in this area to be made more apparent. Only when this is done can informed and rational debate proceed.

A major and consistent theme of this paper is that understanding the politics of tax reform is critical to the successful implementation of tax reform. Only by heeding this reality, can the tax debate be progressed. Not heeding it (as was the case with *Fightback!*) will more often than not, see the report and its findings quickly disappear into a void filled by other reports which were motivated by the best of intentions but were lacking attention to communication of the reports findings or to the community response.

Appendix

An Overview of the Income Tax Reforms of the Past Two Decades?

The past two decades have seen major changes to income related taxes. This has included the:

(a) introduction of a Fringe Benefits Tax (FBT) collected from *employers* at an effective rate equivalent to the top personal income marginal tax rate (of 48.5%).[30]

(b) broadening the income tax base[31] to include realised *real* capital gains but excluding from the base, owner-occupied homes and assets purchased on or before 19 September 1985.

(c) the introduction of an imputation system of company taxation in 1987-88 (in place of the previous classical system).

(d) the adoption in the late 1980s of a self-assessment system of income tax administration accompanied by significant penalty provisions.

(e) significantly reducing company tax rates and the higher income marginal tax rates.

(f) reducing tax concessions (or tax-expenditure[32]) offered by Government as incentives for individuals and firms to undertake selected activities.

While the inclusion of realised real capital gains has raised significant revenue this is relatively small compared to the revenue implications of the superannuation reforms. In 1994-95, $1912m was raised from superannuation funds by the Federal government, primarily through the taxation of employer contributions and the income earned by superannuation funds.

This move has been paralleled by a gradual reduction in the concessional tax treatment of superannuation encouraged by the move towards compulsory superannuation and concern over the distribution of the benefits from the tax concessions.[33]

Notes

1. See Head (1983, 1986, 1993), Head and Krever (1990) for a good review of the debate on tax reform over the 1980s and 1990s.
2. An overview of these changes is given in the Appendix.
3. For example, we could also consider here issues such as environmental levies and the tax treatment of the family home.
4. *Australian Taxation Review Committee Preliminary Report*, 1 June 1974, AGPS, p 131.
5. *Australian Taxation Review Committee Full Report*, 31 January 1975, AGPS.
6. See *OECD and Household Savings* (1994) which was reviewed in *Economic Roundup Summer 1995* (AGPS, Canberra).
7. That is, they assumed that the revenue raised from the GST would be higher than that calculated from the official (Australian Bureau of Statistics) data on the base of such taxes.
8. Both New South Wales and Victoria have undertaken comprehensive reviews of their tax systems (Nieuwenhuysen 1983 and Collins 1988) but in practice, we have little to show for these inquiries.
9. Australia has a poor record of success with referendums designed to change sections of the constitution. This is in large part because for success a referendum must receive approval from the majority of people in a majority of States. An alternative method of changing the tax powers of the States is to have the High Court judges change their interpretation of Section 90. This is always a possibility although it cannot be relied upon given the importance attached to legal precedence and a desire sometimes express by the High Court (as in the Capital Duplicators Vs ACT Case in 1993) not to make judgements which radically depart from the *status quo*.
10. See *State Taxation* (1989), Collins (1993), Walsh (1989) and many of the publications of the Centre for Federalism Research at the Australian National University.
11. This also had significant implications for the State petrol Franchise Tax which is levied on the value of petrol sales inclusive of Federal excise duty.
12. Estate Duty is payable on the basis of the total value of the estate after probate has been declared. An inheritance (or succession) tax is based on the value of individual bequests.
13. The *Asprey Report* recommended in 1975 that the Federal government take over the administration of the State death and gift duties and that the base be harmonised while the States were free to set their own rates.
14. See Piggott (1984) and Nevile and Warren (1984)
15. The most recent was in *Economic Roundup Summer 1995* (AGPS, Canberra)
16. See *First Home Buyers: Australia*, Australian Bureau of Statistics, Cat No 4137.0 (various issues).
17. A wealth tax would assist with achieving vertical equity (which requires different persons to be tax differently) and horizontal equity (where similar persons are taxed similarly). A wealth tax would work to reduce the unfair economic advantage accruing to those who receive wealth transfers.
18. At issue here is the use of bequests or the impact such bequests have on individual behaviour which could result in those persons not achieving their personal potential in the market place.

19. For example, in 1978-79, the top marginal tax rates in the UK on 'earned' income was 83% with a surcharge of 15% on 'unearned' income above £5000 (Kay and King 1980, p 24). While this approach was partly explained by unearned income not being subject to National Insurance contributions as was earner income, this does not explain all the difference.
20. It should be noted that if a person has some lifetime target level of wealth, such taxes could act as an incentive to increase savings (see Treasury 1974a, No 12 p 8-10)
21. For example, NSW water boards are increasingly moving towards a user pays type of operation rate than fixed charges related to property value (however determined).
22. Here we are interpreting the social welfare system as akin to a negative income tax just as we could view the current personal income tax as a positive income tax.
23. For example, in August 1995 the asset threshold at which the age pension is withdrawen for single persons was $118,000 homeowners and $202,000 for non-homeowners. The thresholds for couples was $228,500 for homeowners and $312,500 for non-homeowners. Pensions are reduced $1.50pw for each $1000 over these thresholds. This implies an annual tax rate of 7.8% on wealth over the age pension withdrawal range.
24. *Information Handbook – A Guide to Payments and Services 1995*, Department of Social Security, Cat PR004.9504.
25. It is worth noting that this paper has excluded consideration of human capital and focus only on financial capital. We could argue that Australia already taxes human capital through the personal income tax – although even this is open to dispute because it taxes only realised income, not potential income (which would take account of leisure time) or income generated in the black economy or from non-market activities (such as home production).
26. A schedular income tax is one which taxes each type of income according to a different tax rate schedule, often in the form of a series of withholding taxes. In contrast, Australia operates a global system of income taxation where all income sources are aggregated and then taxed according to one schedule.
27. A global system of income taxation is one where all income sources are added together and total income is subject to one income tax schedule.
28. See Treasury (1974a, b) and Saunders (1983) (particularly the bibliography in the latter) for a detailed discussion of the various options.
29. The irony is that already a number of different surveys ask questions on parts of the problem – that is, on aspects of household net wealth. Principal amongst these is the ABS household income survey which includes questions on financial assets (including houses) and consumer debt. Consideration should be given to integrating a number of different surveys (such as those on income, housing, superannuation, consumer debt) into a single larger survey which incorporates questions on all forms of wealth.
30. Ideally, this base broadening should have occurred by including the fringe benefits in the income of employees and then having them subject to personal income tax. The reason why this was not done appears motivated by both political and administrative considerations. Politically, because the impact (or legal incidence) of the tax is not directly on employees (and hence the impact of the tax

is not transparent to voters). Administratively, because it was considered simpler to tax employers at a flat rate on fringe benefits.

31. It should be noted that the inclusion of realised real capital gains is inconsistent with the treatment of other income sources, which are included on an accruals basis and in nominal terms.
32. The Federal Treasury each year releases a statement on 'Tax Expenditures', which is a useful document in gauging the decline in selected tax expenditures over the last decade, particularly on superannuation and investment through accelerated depreciation.
33. Employer contributions to employee superannuation contributions are now taxable at 15% when paid into a fund and 15% (plus Medicare levy) when paid out of the fund to the retiring person. At the same time, the earnings of superannuation funds are taxable at 15%.

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