TAX REFORM FOR A FAIR SOCIETY AND STRONG ECONOMY

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EXECUTIVE SUMMARY

The purpose of the tax system is to generate sufficient revenue to provide the services the community expects and deserves of governments and to support a fair society with decent living standards for all. Australia has a progressive tax system but its progressivity is in decline and inequality is widening. The ACTU's position is that the tax system should support the role of government to provide quality services and investment in high-skilled, high-wage job creation.

Widening inequality in advanced countries has been detrimental to economic growth. As the real wages of lower income earners have stagnated or even gone backwards, as employment has become increasingly insecure and as the middle has hollowed out, consumer demand has weakened and growth has slowed. The world's most respected international economic organisations including the World Bank, the IMF and the OECD have all found that the increase in inequality in many advanced economies in the last three decades has had a negative effect on growth and prosperity.[1] The IMF has concluded that increasing the income share of the poor and the middle class actually increases growth while a rising income share of the top 20 per cent results in lower growth – "that is, when the rich get richer, benefits do not trickle down."[2]

Australia is a low-taxing, low-spending country by OECD standards. Imposing an arbitrary limit on total tax revenue as a share of GDP, as the federal government is insisting on doing, has no sound policy basis. Population ageing and the increasing availability of new life-saving, life-enhancing medical technologies will continue to cause health costs to rise faster than GDP, even with reforms that address any remaining waste and inefficiencies. Meeting these and other pressing needs, including the new school funding system, investment in infrastructure, innovation and job creation while also aiming to reduce the budget deficit over time, will require improvements to overall tax revenue. This was agreed at the National Reform Summit attended by businesses, community and union leaders, which identified tax concessions that were no longer fit for purpose as potential sources of additional revenue, as well as constituting worthwhile reforms in terms of efficiency and equity.[3]

[1] For example, see OECD (2015a).
[2] IMF (2015).
[3] Though the Summit parties disagreed on the relative emphasis to be placed on revenue increases and expenditure savings measures.

The ACTU’s tax reform proposal enables governments to make the necessary investments for equitable and sustainable, long term growth, including:

- a strong, competitive economy and quality jobs;
- skills, education, innovation and infrastructure;
- decent living standards including quality health, disability and aged and child care; and
- the best start in life for our future generations.

Austerity policies have failed both here and abroad as drivers of long-term, sustainable growth. We urge the government not to continue to be driven by cuts to important areas of spending and a spiral of under-investment in the sources of long-term job creation and community wellbeing. The ACTU calls on the federal government to rise to the challenges and opportunities ahead by investing in a better future for all Australians based on growth and shared prosperity.

The ACTU'S TAX POLICY INCLUDES:

1. **Reducing the generosity of tax concessions and deductions which disproportionately benefit high-income households, do not serve sound policy objectives and are a drag on revenue, including:**

    - Applying a Fair Tax Contribution (also known as the Buffett Rule) to ensure high-wealth individuals contribute a minimum rate of income tax;
    - Phasing in limitation of negative gearing concessions to new properties;
    - Halving the 50 per cent discount on the capital gains tax rate on specified investment classes;
    - Reforming the tax treatment of superannuation where tax concessions are skewed to those at the top end of the income range who would otherwise retire very comfortably anyway; and
    - Taxing trusts as companies.

2. **Repairing the company tax base through:**

    - Effective measures to deal with base erosion and profit shifting by multinational corporations;
    - Better targeting the Research and Development (R&D) tax concession to achieve investment in jobs of the future; and
    - Increasing transparency through tax reporting of all companies with annual turnover of more than $100m.

3. **Addressing personal tax rate inequities by:**

    - Reducing high effective marginal tax rates for low-income casual, part-time and insecure workers; and
    - Alleviating bracket creep by modestly increasing the $37,000 income threshold which would deliver benefit to middle income earners.

4. **Addressing vertical fiscal imbalance, reducing the complexity and increasing the efficiency of federal and state taxes by:**

    - Restoring federal government funding for state delivered services, in particular health and education; and
    - Increasing the efficiency of state taxes, including payroll and land taxes; and
    - Conducting a review of taxes with the aim of simplifying the tax system.

5. **Rejecting calls to increase the rate and/or base of the GST** which disproportionately taxes low and middle income households and, with adequate compensation, generates negligible revenue gain.

6. **Increasing the resources available to the Australian Taxation Office** to ensure effective compliance.

    The proceeds of these reforms would be used to fund rising health costs, the legislated needs-based school funding system and other pressing expenditure needs and to the extent possible work towards deficit reduction.

TAX REVENUE IS CRUCIAL TO A STRONG ECONOMY AND A PROSPEROUS SOCIETY

The fundamental purpose of the tax system is to raise revenue, redistribute income equitably and favourably change behaviour. The tax system must be able to raise sufficient revenue to enable all levels of government to meet the community's legitimate needs and expectations, including a decent social safety net to achieve equal opportunity and alleviate poverty and disadvantage.

The tax system should be progressive, based on capacity to pay, regardless of the source of income. It should promote the investment needed for employment growth, job security and wages growth in a diversified and resilient economy. Shrinking the tax base by offering concessions to politically favoured constituencies at the top end misallocates resources and limits economic growth and job creation. Investment and innovation for economic growth requires infrastructure, education, research and skills development, all of which are funded out of tax revenue. An appropriate mix of taxes and regulations is also needed to correct for market failure, for instance in the area of environmental protection. The integrity and fairness of the tax system depends vitally on effective enforcement, which can occur only if tax agencies are equipped with adequate laws, resources and skills.

AUSTRALIA'S CHALLENGES AND OPPORTUNITIES

As Australia seeks to make the transition from the end of the mining boom to a more sustainable future, it confronts several major challenges:

1. A lack of investment and innovation in the industries most capable of providing the high-skill, high-wage jobs of the future;

2. Poor productivity growth, especially multifactor productivity growth which reflects innovation and management skills, with lower government support for innovation than almost all advanced economies;

3. Wages growth at the slowest rate on record and employment increasing predominantly in low-wage sectors and in casual, part-time and insecure employment;

4. Ongoing ageing of the population which will shift the pattern of demand for goods and services towards that age group including: (i) health, aged care, disability services, the age pension as well as demand for recreational and personal services; and (ii) to the extent that older Australians have higher savings and wealth, increase the share of capital income relative to labour income;
5. Rising inequality, as wealth is increasingly concentrated in the hands of a privileged few which the current tax and transfer system is increasingly less able to address;

6. Urban congestion and social alienation which have been exacerbated by development and planning failures, as a large and growing proportion of the population is concentrated in a few major cities on Australia's east coast, especially in under-serviced outer urban and regional areas; and

7. Degradation of the natural environment and climate change and the failure to address these through international protocols, regulation or innovation planning and industry policy.

GUIDING PRINCIPLES

Tax policy is central to meeting Australia's main challenges and to wider economic and social policy. The taxation reforms and investment decisions we make now will determine how successfully we meet these challenges and shape the future prosperity of this nation.

A good tax system should:

- **Provide adequate funds for high-quality public goods our community deserves and expects including health, education, disability services, aged care, child care, innovation, public transport, infrastructure and environmental protection.**

- **Promote social equity and alleviate disadvantage by adequately funding social security, age-pension and low-income transfer payments, and provide incentives and support for entry into the labour market.**

- **Promote optimum levels of investment, savings and consumption across the economy as a whole, and provide incentives for work and investment.**

- **Ensure the equitable and efficient treatment of capital, land (including housing) and labour, with capacity to pay and progressive tax rates as central design features.**

- **Promote investment in sustainable Australian industries and correct market failures through the use of tax-driven price signals and similar measures.** Such signals should appropriately cost negative externalities and reward investment and consumption behaviours that promote better employment, environmental, social and efficiency outcomes. Underinvestment in research and development, urban congestion, water pollution and excessive carbon emissions are key examples of market failure.

- **Reflect consistent policy design,** particularly in its interaction with other government policies. For example, when interacting with a progressive income tax system, a needs-based income support and child-care system with high phase-out rates can create strong work disincentives for women through the imposition of high effective marginal tax rates.

- **Ensure strong compliance measures to uphold the integrity of the tax base and to ensure fairness.** Tax agencies should be adequately funded to discharge their obligations. Inadequate resourcing of tax agencies allows a breakdown in compliance and tax morality that creates justified resentment among honest taxpayers and erodes the tax base. Compliance costs for taxpayers should be kept to a minimum. Simplicity in tax design helps reduce compliance costs and can limit opportunities for aggressive tax avoidance schemes.

These guiding principles are consistent with the general taxation literature and with many elements of the Henry Review (Henry *et al* 2010, Box 2.1) and in subsequent stocktakes and reviews (for example, Stewart *et al* 2015, pp. 1-11; Australian Government 2015, p. 14).

A COMPROMISED DEBATE

We need a tax system that serves everyone. Much of the debate about so-called tax reform is, in fact, thinly disguised pleading for lower taxation on particular interest groups to be funded by higher taxation or reductions in government spending on others, usually working people and the poor.

The genuine efforts of some academics, policy analysts and government officials to improve the tax system with dispassionate policy recommendations are routinely challenged by vested interests armed with paid economic modelling that purports to show fair and measured reforms will devastate the economy. At the same time, the same vested interests use modelling to argue that tax cuts for corporations and top income earners will trickle down to jobs for those in the middle and bottom income ranges. The tax reform debate has been badly compromised by this sort of self-serving behavior masquerading as concern for the public interest. As the tax debate proceeds, these inflated claims of fair tax reform costs and trickle-down benefits based on paid modelling are becoming louder and shriller. Both should be greeted with commensurately greater skepticism.

ACTU TO CONTRIBUTE TO A CONSTRUCTIVE DEBATE

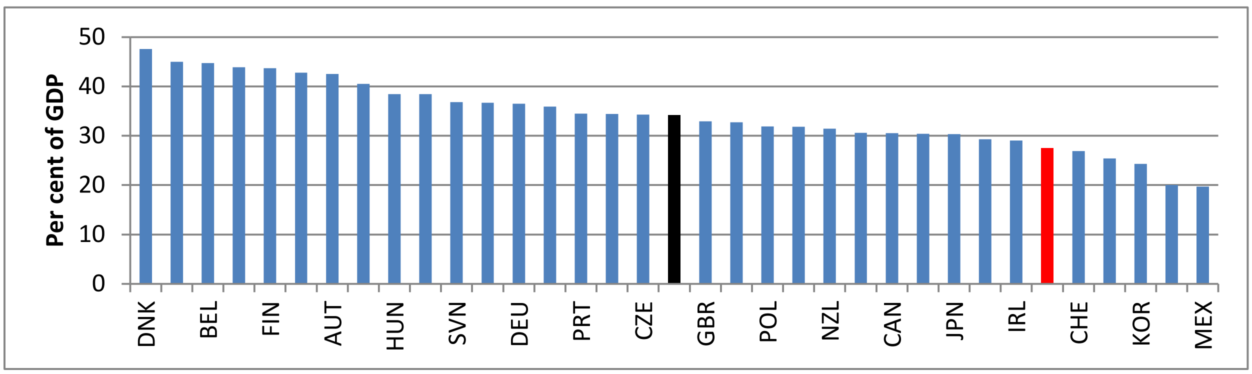
The ACTU has a proud history of representing the interests of the working men and women of Australia and those in need of income support. The ACTU advocates tax policies that take Australia along the high road to a high-skill, high-wage future, a fair society and a sustainable environment. Decent living standards for low and middle income Australians generate local consumer demand and economic growth. Sufficient tax revenue ensures the government can support a healthy and productive community and invest in research, innovation, infrastructure, skills and the jobs of the future. Austerity policies have failed both here and abroad as drivers of long-term, sustainable growth, serving only to exacerbate inequality. We urge the government not to continue to be driven by cuts to important areas of spending and a spiral of under-investment in the sources of long-term job creation and community wellbeing.

FEATURES OF THE AUSTRALIAN TAX SYSTEM

1. AUSTRALIA IS A LOW-TAXING COUNTRY

As acknowledged in the federal government's tax discussion paper, *Re: think,* Australia's overall tax take is low by international standards. At 27.5 per cent of GDP, it is well below the OECD average of 34.2 per cent of GDP.[4] While Australia's tax take as a proportion of GDP is higher than that of some regional trading partners such as China, Malaysia, India, Singapore and Indonesia, these developing and emerging countries do not have the social safety net and health, education and aged care services that Australians legitimately expect to receive.

Chart 1: Total tax revenue as a percentage of GDP, OECD countries (2013)



Source: OECD, http://stats.oecd.org/, tax revenue statistics, accessed 23 Feb 2016. The red column represents Australia and the black column is the OECD average.

Treasury's latest estimates are for federal government tax revenue – the dominant source of total federal and state tax revenue[5] – to increase over the next two years from 22.0 per cent of GDP to 22.5 per cent (Morrison and Cormann 2015, Table D3).[6] This would still be below the average tax take of the previous Coalition government of 23.4 per cent of GDP and well below the OECD average. Any notion that Australia is a high taxing country, as is often claimed, is simply not supported by the facts.

[4] Australian Government (2015, pp. 13 and 16-17); OECDc (2015).

[5] Federal taxes account for around 81 per cent of total taxation revenue, state taxes around 15 per cent and local government around 3 per cent. See Australian government (2015, p. 15).

[6] Projections for the final two years of the forward estimates are for further increases. Projections are not estimates and are based on simplifying assumptions about returning to trend growth and future commodity prices.

2. AUSTRALIA IS A LOW-SPENDING COUNTRY

Given that the government persistently asserts that the Commonwealth has a spending problem not a revenue problem, it may come as a great surprise to most Australians that Australia is not only a low-taxing country it is also a low-spending country. In fact, Australia has the fourth lowest share of government expenditure in GDP in the OECD. Australia's spending by all levels of government of 36.6 per cent of GDP is almost 9-percentage points below the OECD average of 45.3 per cent.

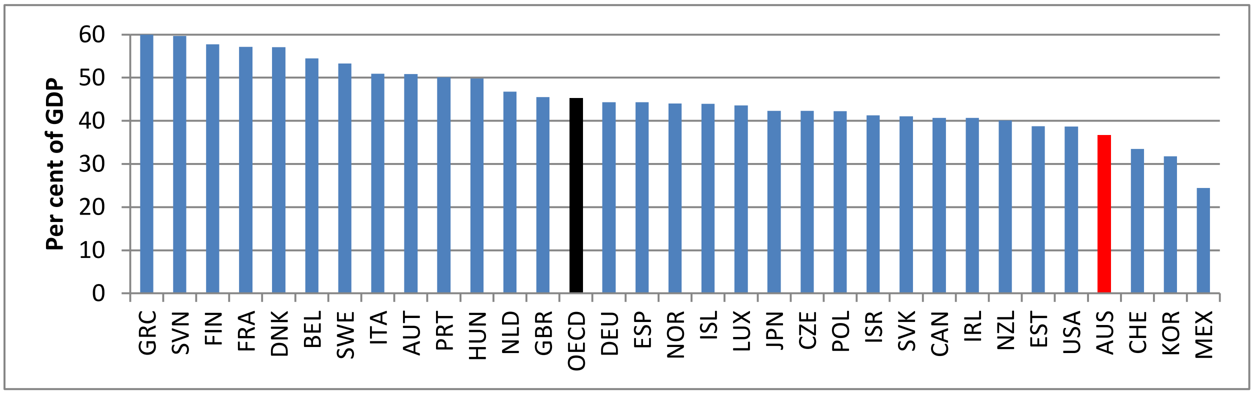


Chart 2: Total government spending as a percentage of GDP, OECD countries (2013)

Source: OECD, from http://stats.oecd.org/#, general government expenditures, accessed 23 Feb 2016.

Australia's public spending on education as a proportion of GDP is the third-lowest in the OECD[7] and Australia's public spending on health as a proportion of GDP is below the OECD average. Moreover, Australians spend more out of pocket on health care than those in the other high-income countries. While the total government health care spend per capita in Australia is about 6 per cent less than the high-income country average, the out-of-pocket spending on health per individual Australian is a full one-third higher than the high-income country average.[8]

[7] OECD (2015c).
[8] See ACTU (2016, p.12).

3. THE FAIRNESS OF OUR PERSONAL TAX SYSTEM IS IN DECLINE

The Australian community has consistently supported a progressive tax system. Australia's tax system has historically been highly progressive. By some measures, Australia has the fifth most progressive income tax system in the OECD.[9] Higher marginal rates of personal tax as incomes rise are the essential feature that gives Australia's tax system its progressivity and hence its fairness. However, the progressivity of the personal income tax system is in decline and inequality has been increasing.[10] Community support for the tax system erodes when it is made less progressive, especially in an environment of widening inequality.

4. PERSONAL INCOME TAX BASE

Australia's personal income tax base is riddled with concessions and loopholes. Australian Taxation Office statistics reveal that in 2012-13 the availability of these tax breaks, combined with highly paid tax planning advice, enabled 55 high-wealth individuals to entirely eliminate their tax liabilities, including the Medicare levy. Each of them earned more than $1 million during the year, reporting a combined pre-tax income of almost $130 million – an average of $2.3 million each. They paid their tax advisers a staggering $42.5 million in fees for managing their affairs. The advice paid off for them, since they ended up reporting combined losses of more than $12 million.[11]

a) A Fair Tax Contribution (Buffett) Rule

A minimum rate of income tax for wealthy individuals.

To deal with aggressive personal tax minimisation by high-wealth individuals, the ACTU supports a Fair Tax Contribution (also known as the Buffett Rule after billionaire Warren Truss famously noted how wrong it was that he paid less tax than his secretary). A Fair Tax Contribution Rule would ensure all Australians contribute toward vital community services by mandating a minimum rate of tax payable by very wealthy individuals. We commend this proposal to the government for further consideration and modelling.

[9] See OECD (2015b).
[10] See Apps (2015).
[11] Peter Martin, "Tax office statistics reveal the 55 millionaires who paid no tax", Fairfax, 30 April 2015, at http://www.smh.com.au/federal-politics/political-news/tax-office-statistics-reveal-the-55-millionaires-who-paid-no-tax-20150429-1mw2zp.html

b) Negative gearing

Limiting negative gearing tax concessions.

The Murray Inquiry found that the existing tax treatment of investment properties encourages debt-financed speculative investment in housing, creating a potential source of systemic risk for the whole economy (Murray 2014, Appendix 2). At a time when Australia needs to make the transition from the end of the mining boom to other industries offering high-skill, high-wage jobs, the tax-preferred channelling of funds into the existing stock of housing is not the best use of scarce savings and credit.

Negative gearing concessions are highly regressive, with NATSEM estimating that 50 per cent of the $3.7 billion annual value of the tax break goes to the top 20 per cent of households while the bottom half only get 20 per cent.[12] At the same time, lack of affordable housing is a critical issue, particularly for new homebuyers struggling to enter the market.

The ACTU supports the proposal to grandfather all existing concessions for properties that have already been purchased and to maintain existing concessions in respect of purchases of newly constructed residential properties only.

c) Capital gains tax

Reducing the discount on the capital gains tax rate.

The capital gains tax discount, operating in tandem with the existing negative gearing concession, has diverted savings and investment into the existing housing rental stock and away from more productive uses.

The benefit of the capital gains tax discount is highly skewed to the top end of the income range. NATSEM estimates that of the $4 billion annual cost of the capital gains tax concession, more than 80 per cent goes to the top 20 per cent of households while just 7 per cent goes to the bottom half.[13]

The ACTU supports the grandfathering of the existing capital gains tax discount for capital gains realised on pre-existing investments, maintaining the current discount for investments made by superannuation funds and small businesses, and retaining the concessions announced in the

[12] Australia Institute (2015b).
[13] Australia Institute (2015b, p. 5).

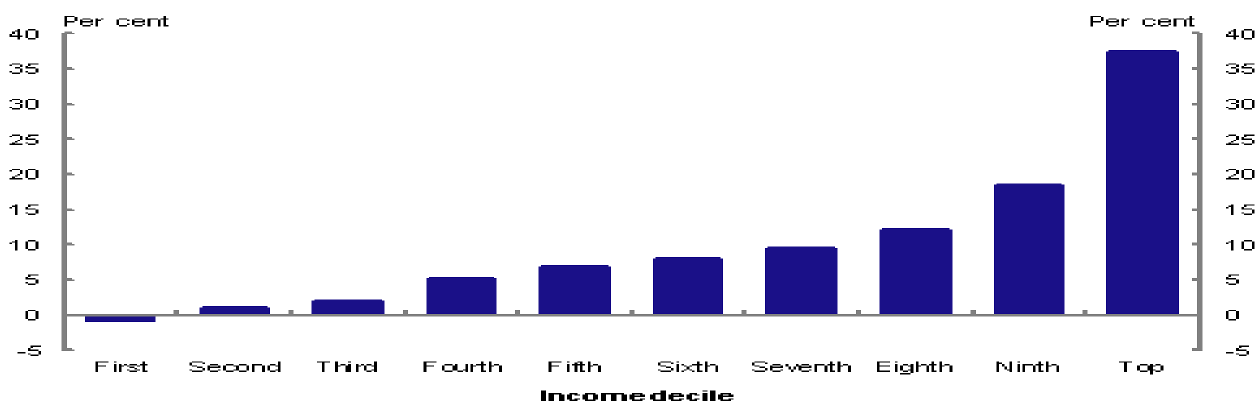
government's innovation statement in December 2015. For other new investments, the ACTU advocates further consideration and modelling of a reduction in the capital gains tax discount from 50 per cent to 25 per cent on particular investment classes.

d) Superannuation tax concessions

Fairer tax concessions for super.

The skewed distributional impact of the existing superannuation tax concessions is clear from Chart 3. It shows that almost 60 per cent of superannuation tax concessions accrue to the top 20 per cent of income earners and that the bottom 10 per cent of income earners are actually made worse off. Since just 2 per cent of the total number of superannuation account holders hold 30 per cent of the total assets and 10 per cent hold 60 per cent of the assets,[14] it is clear that superannuation is being used by the wealthy not as a retirement income scheme but for estate planning and tax minimisation purposes. The generous superannuation tax concessions at the top will not reduce dependence on the age pension and they produce the grossly unfair outcome that those who least need public support for a comfortable retirement receive the most, while those who need the most support receive the least.

Chart 3: Share of total superannuation tax concessions by income decile



Source: Murray (2014b, Chart 6).

[14] Murray (2014a, p 2 – 121)

The ACTU wholly rejects the notion that low-income workers be exempted from the superannuation contributions system. Achieving fair and adequate retirement savings support for all Australians requires reform to the system to lift the savings of low-income workers and workers in insecure employment rather than simply excising them from the system.

The ACTU supports consideration of the proposed reform package released by Industry Super Australia in December 2015 through a proper, independent review of the retirement incomes system.[15] It comprises:

- **Superannuation contributions reform:** Currently all superannuation contributions are taxed at a flat rate of 15 per cent. This generally represents a 30 per cent tax break for high-income earners earning more than $180,000 (paying 45% income tax), but only a 4% tax break for those earning less than $37,000 and *additional* tax for those on incomes below $18,200. A fairer model would tax superannuation contributions at the appropriate marginal tax rate minus a 25 per cent offset.[16] This would apply prospectively and would only reduce the tax concessions currently available to those earning more than $166,000 a year.

- **Superannuation earnings tax reform:** Currently there is no tax payable on superannuation earnings in retirement. A fairer model would tax superannuation earnings at 15 per cent per annum, with all tax rebated for earnings below $50,000 per annum in the retirement phase. This would apply prospectively to individuals with a superannuation balance of around $700,000.[17]

- **"Super Seed":** The government's decision to withdraw the low-income superannuation contributions scheme has ensured that low-income earners will be more disadvantaged in the superannuation system. A direct government contribution of $5,000 into the superannuation accounts of income earners in the bottom three income deciles while aged 27-36 years would go some way to support adequate retirement savings for low-income earners in a critical savings period of their working lives.

[15] Industry Super Australia (2015).
[16] The model takes in to account the Medicare and budget repair levies, caps the offset at $7,500 per annum and caps contributions at $50,000 per annum, with additional "catch up" contributions in limited circumstances.
[17] At 7 per cent earnings

- **Age pension means test:** The changes made by the government last year (which will be effective in 2017) substantially reduce net age pension payments. The modest increase to the assets threshold does not offset the much more significant effect of increases to the 'asset taper rate' – the rate at which the pension is reduced for each $1,000 of assets – from the current $1.50 to $3.00 per fortnight. This will reduce the partial age pension significantly for low and middle-income households. Over the long run, there will be more people affected on below average incomes than above. A fairer model would, in conjunction with the package of reforms outlined above, set an asset taper rate of $2.00, with the asset-free area being set at the midpoint between the old levels and new levels. This achieves fiscal savings that are at the midpoint between the old and new asset test.

This package is not designed to achieve short-term savings. In the long term it could raise the retirement living standards of low-income Australians by more than 75 per cent and the retirement incomes of single women at the bottom of the income range by more than 100 per cent. It would deliver some long-term reductions in outlays for the age pension.

e) Discretionary trusts

Taxing trusts as companies.

When the Federal Treasurer, Peter Costello, considered the report of the 1999 business tax review, he accepted its recommendation that trusts be taxed as companies. This would prevent trustees from streaming dividends to those family members with the lowest or zero marginal rates of income tax as a tax minimisation strategy. In an exchange of letters, the Shadow Treasurer, Simon Crean, agreed with the Treasurer on the 50 per cent capital gains tax discount as part of a package of measures that included accepting the review's recommendation to tax trusts as companies. Treasurer Costello broke that agreement. In 2011, Treasurer Hockey said consideration should be given to taxing trusts as companies.

The ACTU supports the principle of taxing trusts as companies as recommended by the 1999 business tax review and supported by Treasurers Costello and Hockey. The 1999 business tax review estimated this would raise around $900 million per annum in revenue. Today that figure is likely to be closer to $2 billion. Detailed consideration would need to be given as to how the principle of taxing trusts as companies should be best implemented.

5. COMPANY TAX RATE

Corporate tax cuts are not an effective measure to generate jobs or economic growth.

World-class worker and management skills, infrastructure, innovation, technology, legal systems and education and training are more powerful drivers of investment and jobs growth in Australia than corporate tax rates and all of these rely on revenue from the tax system.

Corporate tax cuts would result in significant revenue loss.

Business organisations assert that a cut in the company tax rate to 25 per cent would yield a growth dividend so that it would largely pay for itself. This is the same supply-side economic ideology that the Reagan Administration embraced in the 1980s based on the Laffer curve. However, a US Treasury study found that the Reagan tax cuts caused a decline in government revenue of almost 3 per cent of GDP; they were far from self-financing.

A 5-percentage point cut in the company tax rate, as advocated by business groups, has been estimated to cost more than $5 billion per annum.[18] This would be the signal for the government to justify expenditure cuts to health, education and income support.

Australia is competing against countries with zero or negligible company tax rates.

In the context of the range of factors determining the profitability of investment, there is little or no evidence that investment decisions are significantly influenced by headline company tax rates. It is the widespread profit shifting by large multinational corporations to tax havens such as the Cayman Islands and Singapore that has been recognised by the OECD Base Erosion and Profit Shifting (BEPS) policy as the major issue. For these corporations Australia is effectively competing against countries with zero or negligible company tax rates. Unless the company income tax base is repaired, demands made by Australian business organisations on behalf of foreign-owned corporations will be for ever-lower company tax rates until they are aligned with the negligible or zero rates enjoyed in tax havens.

[18] After taking account of increased personal tax receipts under the dividend imputation system. See Richardson (2015, Table 3).

By far the largest source of foreign investment in Australia is the United States. Where multinational corporations based in the United States do not engage in profit shifting to tax havens, the headline tax rate they face is the US rate of 35 per cent. Australia has double taxation agreements with the United States and numerous other countries. Under these agreements, US-based multinational corporations receive a credit for company tax paid in Australia. On profits earned in Australia they pay Australian company tax at the rate of 30 per cent, receive a credit for the 30 per cent paid in Australia and then pay the extra 5 per cent to the US Treasury. If the Australian company tax rate were lowered to 25 per cent, as advocated by the Business Council of Australia and other business groups, then tax-abiding US-based corporations operating in Australia would pay Australian company tax at the new, lower rate of 25 per cent but would be required to pay a total of 10 per cent to the US Treasury. The company tax rate reduction in Australia would therefore simply be a transfer from the Australian Treasury to the US Treasury, with no benefit to the corporation or to the incentive to invest in Australia but at a large cost to Australian government revenue.

A cut in the company tax rate would be followed by demands to cut the top personal income tax rate.

An argument commonly used by advocates of a cut in the top marginal rate of personal income tax is that the gap between the top personal rate and the company tax rate creates opportunities for individual taxpayers to minimise tax by diverting their earnings into corporate structures. A cut in the company tax rate would widen that gap. If it occurred, the advocates of a company tax rate cut would step up their campaign for a cut in the top marginal rate of personal tax to reduce the incentives for avoidance. For them, a cut in the company tax rate and in the top personal tax rate go hand in hand.

There is no compelling evidence that a reduction in the company tax rate would cause the surge in investment that proponents claim for it.

Much of the new foreign investment entering Australia originates in China and other regional nations with low company tax rates. Australia's 30 per cent company tax rate has not deterred these investments. In a world awash with investible funds and with record low interest rates, there is no compelling evidence that a further reduction in the cost of foreign capital through a reduction in the company tax rate would cause the surge in investment that proponents claim for it.[19] Indeed, this has been the experience in Canada, an economy that shares many characteristics to our own. After

[19] See, for example, the work of the US Congressional Research Service in Gravelle and Hungerford (2011).

several rounds of corporate tax cuts, the Canadian economy saw no increase in corporate investment.[20]

6. COMPANY TAX BASE

Australia's company tax base has been narrowed over time by numerous tax concessions. The current tax system allows many corporations to pay little or no tax. According to the Australian Taxation Office, one in five Australian-owned private companies with more than $100 million in revenue paid no tax last year. Of the top 200 ASX-listed companies, 57 per cent used subsidiaries in tax havens to avoid paying tax in Australia and almost one-third had an average effective tax rate of 10 per cent or less.[21]

While some tax concessions are justified on other policy grounds, such as encouraging research and development (R&D) and new capital investment, it is worth reviewing company tax concessions to determine whether they are fit for purpose, well targeted and not subject to rorting. An invitation to business groups by the previous federal government to identify a set of reductions in company tax concessions to fund a cut in the company tax rate produced no agreement.

The R&D tax incentive is designed to promote business R&D activity. It is broadly good policy that supports around 10,000 businesses in their R&D activities to improve products, processes and competitiveness. But there is significant evidence that at the very top end this incentive is ineffective in contributing to the total amount of R&D that occurs in Australia and that, rather than being used to support additional R&D, it is used as a tax-minimisation strategy by large multinational companies. For example, it has previously been reported that some mining companies were claiming 90 per cent of their costs as R&D.[22]

International evidence is clear that it is small and medium sized enterprises that are most responsive to R&D tax incentives and they are the ones that face genuine constraints in financing R&D. In addition, it is these businesses that have the greatest growth potential.

[20] See for example: https://newmatilda.com/2016/03/03/a-warning-from-canada-how-cutting-corporate-tax-did-more-harm-than-good/
[21] See ACTU (2016, p.16).
[22] http://www.theaustralian.com.au/news/nation/companies-rorting-rd-tax-credits/story-e6frg6nf-1226311027319

The ACTU supports a thorough examination of the eligibility criteria for the R&D tax concession to companies. The tax incentives for innovation need to be reviewed in the context of an overall program for innovation and industry policy. This involves innovation programs where public research works closely with business, targeting key areas such as clean energy and high tech industry. Better targeting this incentive to genuine R&D would boost productivity and job growth, while revenue gains could be diverted to supporting collaborative research and innovation including assistance to small and medium sized enterprises.

In view of revelations of widespread profit shifting by multinational corporations and the large number of Australian companies that pay no tax, the priority must be to improve the integrity of the company tax system.

The ACTU supports the OECD's Base Erosion and Profit Shifting (BEPS) project and would support future improvements in tax enforcement arising out of the project. We also support amending the 'thin capitalisation' rules to reduce the amount of interest that multinational corporations can claim as deductions in Australia. Under this policy, multinational corporations would no longer be able to claim up to a 60 per cent debt-to-equity ratio for their Australian operations. Instead, deductions would be assessed on the debt-to-equity ratio of a corporation's entire global operations. This means that if a company has an average debt-to-equity ratio across its different subsidiaries of less than 60 per cent, it would only be able to claim tax deductions on interest up to that level. The increased complexity of global corporate structures and large-scale movement of money via financial institutions, including speculative activity, requires consideration of more effective taxes on international financial transactions. The Australian Government should also extend whistleblower protection to private sector employees, something the G20 and the OECD Working Group on Bribery in International Business Transactions has called on Australia to do and which has the support of ASIC. If the integrity of the company income tax system is to be restored and public confidence that all companies pay their fair share of tax is to be increased, improved transparency measures are required. The recently legislated transparency measures have gone some way toward shining a light on the very large number of companies that pay little or no tax in Australia. However, it was disappointing that the government recently wound back the public disclosure of limited tax information of Australian private companies with an annual turnover of more than $100 million. The ACTU supports restoring tax reporting transparency for all companies with an annual turnover of more than $100 million.

Resources at the Australian Taxation Office must be increased to the levels needed to effectively investigate and pursue multinational profit shifting. Evidence from the Commissioner of Taxation is that the returns from extra resources in terms of increased revenue are very high.

7. PERSONAL INCOME TAX RATES

Bracket creep

Much has been made of the budget's reliance in the coming years on bracket creep – the effect of inflation pushing taxpayers into higher income tax brackets. But bracket creep is less of an issue when wages growth and inflation are low. The government has itself recognised that the bracket creep problem may not be as severe as it has been claiming, as acknowledged recently by Finance Minister Mathias Cormann:

"But given that wage inflation is comparatively low, that inflation generally is comparatively low, the problem is there but it's not there to the same extent as to what it might have been in the past. [23]

Proposals to address bracket creep tend to be highly regressive. For instance, according to Deloitte economics, a reduction in the 32.5 per cent rate to 30 per cent and an increase in the threshold at which it applies from $80,000 a year to $100,000 a year would give a worker on $100,000 a year a $47 a week tax cut, a worker on $80,000 a year a $20 a week tax cut and a worker earning $60,000 a year a tax cut of $11 a week. If the low-income tax offset were also increased by $100, the lowest-paid workers would receive a tax cut of $2 per week. Tax cuts from this sort of package would clearly be skewed in favour of higher-income earners.

If the government proposes to fund personal tax cuts by cutting expenditure on services such as health and education, families on low and middle incomes would lose out – receiving only a 'sandwich and a milkshake' tax cut in exchange for poorer services and higher out-of-pocket costs for health and education.

Nevertheless, the government should consider implementing a modest increase in the $37,000 per annum income threshold which would deliver benefit to middle income earners.

[23] Interview with Radio National, 18 February 2016.

High effective marginal tax rates (EMTRs)

High EMTRs created by the interaction of the income tax and the means-tested social security systems have far greater financial impact on low and middle income earners than bracket creep.

The government's tax discussion paper, *Re: think* acknowledges that the biggest impacts on work incentives are for casual and part-time workers who receive government income support payments, particularly secondary income earners.[24] For example, a single parent with two children considering increasing her working hours from three to four days a week faces an EMTR of more than 100 per cent by the time she takes account of her marginal rate of personal tax, the withdrawal of child care assistance and the loss of family payments.[25]

The priority tax reform focus should be to alleviate the significant disincentives to work EMTRs create for low and middle income families, particularly those in insecure, part time and casual employment.

8. VERTICAL FISCAL IMBALANCE

The states are responsible for around 40 per cent of total government spending but collect less than 20 per cent of the revenue.[26] This disparity between governing responsibilities of the states and their revenue raising effort, called vertical fiscal imbalance, has been used as an argument for a GST rate rise and the removal of the GST exemptions. But this fiscal imbalance has only been made a problem by the federal government's refusal to sufficiently fund the states for basic services such as health and education. Federal funding for State's delivery of services such as health and education, including Gonski and TAFE must be restored.

Nevertheless, the states do have efficient tax bases at their disposal, including payroll tax and land tax, which could be more fully utilised to mitigate the current vertical fiscal imbalance. Land tax is considered the most efficient state tax which is generally applied at low rates.

[24] See Stewart *et al* (2015, p. 44).
[25] See Productivity Commission (2014, Cameo 1, Box E.3, Appendix E), reproduced as Chart 4.7 in Stewart *et al* (2015, p. 45).
[26] Business Council of Australia (2014, p. 12).

Economic modelling undertaken by Victoria University's Centre of Policy Studies found that removing the payroll tax exemption thresholds would be much less damaging to the economy than an increase in the GST rate to collect the same amount of revenue. Under this proposal, payroll tax would be levied by the Commonwealth on behalf of the states and territories as an extra amount of tax withheld by employers when making their Pay As You Go payments to the Australian Taxation Office, greatly simplifying the administration and reducing compliance costs.

The ACTU supports a review of payroll tax exemptions with a view to broadening the payroll tax base. It is imperative that the state governments agree through the Council of Australian Governments to take competition and the associated race to the bottom out of payroll tax collection.

9. COMPLEXITY

Australia has a very large number of different taxes – around 125 of them – but with 10 taxes raising 90 per cent of the revenue.[27] The ACTU supports a review of taxes with a view to simplifying the tax system by removing administratively costly but ultimately low revenue generating taxes.

10. THE TAX MIX

The GST is an inherently regressive tax.

The ACTU does not support a GST rate rise or the removal of the existing exemptions. The GST is an inherently regressive tax. Increasing the GST rate or applying it to areas currently exempted would be regressive. By the time compensation measures were put in place for people earning low and middle incomes, the net revenue from the GST changes available for other purposes would be relatively small. NATSEM modelling reveals that if the GST rate were increased to 15 per cent and all the proceeds were used to reduce each personal tax rate by 5 per cent, almost two-thirds of households would be worse off while all the gains would accrue to the top 40 per cent of income earners. This tax-mix switch would greatly reduce the progressivity of the tax system and ultimately further drive inequality.[28] Moreover, experience has shown that GST compensation is not safe from subsequent budget cuts and bracket creep, leaving the less well-off to pay more in GST while the

[27] Henry *et al* (2010).
[28] NATSEM (2015b, p.7).

compensation is eroded over time. The government's own modelling confirms that any growth dividend from increasing the GST to pay for personal tax cuts and compensation would be negligible or non-existent.

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