P.O. Box 1101

DICKSON ACT 2602

April 2015

The Right Honourable Tony Abbott, MP

Prime Minister of Australia

The Honourable Joe Hockey, MP

Treasurer of the Australian Government

Dear Ministers,

Thank you for instigating wide-ranging reviews into Australia’s Federation and Tax systems. This contribution is made to both processes, as it bears on each of them. I want to address several issues:

* Goods and Services Tax, Payroll Taxes, Stamp Duties and Vertical Fiscal Imbalance
* Horizontal Fiscal Equity
* Fringe Benefits Tax
* Capital Gains Tax
* Federal Structure
* Conduct of your Reviews

## Goods and Services Tax

The introduction of the GST in July 2000 was a major step forward in the evolution of Australia’s tax system. Replacing the Sales Tax, other revenue measures including some of the State and Territory Governments’ Stamp Duties, and reducing the vertical fiscal imbalance (VFI) were among the greatest benefits.

GST is a tax that neither the rich nor international visitors can do much to avoid. It is our best tax. Of course, nobody likes taxes, but some are far worse than others.

A federal election was fought over the GST, in which I voted and when the VFI problems took front stage. I do not recall one word uttered by the candidates in that election uttered about Horizontal Fiscal Equalisation (HFE), which is addressed in a later section of this document.

After the election, a political deal was made to limit the proposed GST’s base by excluding education, health and unprocessed foodstuffs. Prime Minister Howard and Treasurer Costello deserve kudos for accepting 80% of what they were after from the new broad-based consumption tax, and to my mind they acted in the national interest.

Today, the GST overall works pretty well, and almost all of the concerns that business had before its introduction about the costs the non-government community would incur in collecting it have subsided. The Henry Review made some arguments in favour of a different method of collecting the GST, which would lower the collection costs to businesses, and I would like the Government to trial that method, perhaps in a single State for one year, or as a one-year alternative method opened up to all businesses.

The online commerce revolution has radically altered the way much Australian consumption expenditure is conducted, and I think that the whingeing advanced by many retailers, especially large ones like Harvey Norman who can afford to put their views while other staff attend to their customers, ring true. Reduction in the GST exemption threshold for online purchases from the present $1,000 down to about $200 to $250 should be implemented. This will balance the very reasonable concerns of Australian-based retailers with the administrative costs of collection and compliance of smaller amounts per transaction.

The GST is collected by the Australian Taxation Office (ATO) and remitted to the State and Territory Governments, effectively net of the ATO’s attributable costs. This is an excellent arrangement, to the extent that I have just described it, and I see no cause to change it.

GST revenue does not, therefore, impinge on the Commonwealth Government’s own finances except via indirect pathways. The national Government’s budgetary situation, which has been the victim of scurrilous and unworthy behaviour in the Senate, which has a bodgie and unfixed electoral system, since your election to office, cannot be remediated by changes to the GST.

There is still plenty of impetus for changes to the rate and base of the GST, due to the nature and problems of the State and Territory Governments’ tax systems and their implementations. Those problems have persisted partly due to the political deal to exclude food, health and education from the GST base. They include, first and foremost the Stamp Duties on property conveyancing and insurance premia, and then Payroll Taxes. These are the worst taxes in Australia. The latter tax employment, which is ludicrous. The former are too variable and inequitable.

Mr Hockey, in your Department’s Discussion Paper for the Tax Review, it is asserted that Payroll Tax is a relatively efficient way of raising revenue (page 173). Whilst the Treasury Department does offer there a reasonable critique of the Payroll Taxes’ exemptions and other administrative issues, I am very unhappy with the overall impression given of Payroll Taxes in the Issues Paper. As I see it, Payroll Taxes should be an anathema to the Australian Government and to COAG. They tax employment. Apart from defence and environmental conservation, the first duty of a national government should be to seek to maintain full (non-frictional) employment, through all policy levers, including macro-economic policy. For the Treasury Department, as the Australian Government’s primary advice source on macro-economic policy, to endorse Payroll Taxes in the Discussion Paper in the way that is has there is deeply distressing to me.

For all its support of competition, the Treasury Department does not seem to relish it at all on its own doorstep, at least when it comes to macro-economic policy making and the conduct of its reviews. As former Prime Minister the Right Honourable Malcolm Fraser pointed out in his excellent book *Dangerous Allies*, which is a wonderful gift to our nation that he was under no obligation to write in his final years, exceptionalism is a dangerous thing.

In my view, there is a compelling case to raise more GST revenue provided that at least half of the extra monies are used first to replace State and Territory Governments’ Stamp Duties on property conveyancing and insurance premia and thence to reduce and, over say five years, to eliminate Payroll Taxes. In this way, much of Australia’s national and sub-national remaining VFI can be removed permanently.

I encourage the GST base to be broadened in the first instance to remove all of the current exemptions on food, education and health products’ consumption. But this should only be done with full compensation to the recipients of Commonwealth Government income support.

The Commonwealth should fund this compensation by reducing its Special Purpose Payments to the State and Territory Governments over time, which will further reduce the VFI. So that they are not disadvantaged by that, the State and Territory Governments must therefore be given additional GST monies, beyond those needed to implement the abolition of the Stamp Duties and Payroll Taxes, as part of this overall package.

It these outcomes cannot be reached only by fully extending the GST base as envisaged by the Howard-Costello Government, only then would I favour the GST rate to be increased.

## Horizontal Fiscal Equalisation (HFE)

HFE is addressed in the Chapter 4 of the Department of the Prime Minister and Cabinet’s very well-written Issues Paper 5 on COAG and Federal Financial Relations.

In my view, each dollar of Goods and Services Tax should simply be given to the State and Territory Governments where it is collected, no strings attached, minus only what it cost the ATO to collect that money. This is the system I was led to believe that I voted for in the election before the GST’s introduction, and it is the system I am now prepared to support.

Issues Paper 5 reveals that the Australian Government collects GST on behalf of State & Territory Governments. Then, since the inception of the GST in mid-2000, it has paid the Grants Commission to decide how to split up the GST monies. I never voted for *that*! It looks like political overkill, at our expense, to me. Not to mention needless make-work jobs.

If there is any case at all for equalising payments to States and Territories, surely that has nothing to do with cases when the federal government is simply acting as their collection agency!

I'm embarrassed about the way Western Australia is now being treated by the Commonwealth Grants Commission. Given the choice of keeping one of them, without hesitation I would want WA. I thought the GST was intended to untie the States from many Commonwealth strings, and that I saw as a very good thing. But the Grants Commission seems to have negated that, more or less, and right at the moment I wouldn't blame WA if it decided to secede from Australia and become a separate nation. The mere fact that there is no escape clause in the nation’s Constitution should not stop a determined State from secession.

I'm even more embarrassed that the Australian Capital Territory Government is receiving more than each dollar of GST that is raised in its jurisdiction. The Northern Territory’s allocation just takes my breath away and I repudiate it utterly.

The notion of equalisation, in the context of the GST, is ridiculous. Ministers, as our elected politicians, I think that you should eliminate or at least greatly reduce the money now spent (and wasted) on the Grants Commission. Money that would be far better spent in fixing other Commonwealth Government budget problems, of which as you are well aware there are many.

If we have a Federation, and we have a big tax designed to correct the vertical fiscal imbalance, it should not be subject to Grants Commission meddling. The State and Territory Governments don't need, want or perform well with GST "equalisation". If a State has big GST collections, it should be able to spend them. If that means a weak or poorly managed State or Territory starts losing people and businesses, I can't think of a better way to stimulate its Government to perform better. Time to take 'em out of their cotton wool, along with getting rid of most or all of the remaining VFI, I say!

There will be people who will argue that HFE of GST revenues is a good thing and that it should be retained. Resist them. Point out that the Grants Commission formulae are too complicated and don’t actually lead to identifiably better outcomes for Australia. Point out that, with better revenues, as recommended in this contribution, the State and Territory Governments can indulge in socialist policies if their electors want them to, and that neither the Commonwealth nor the Grants Commission has any monopoly on “redistribution”, which might be a thinly-disguised redefinition of theft anyway. Help simplify our Federation and treat with derision anyone who holds that overall fairness will be lowered just because you have killed off HFE when it comes to the GST. Having a welfare bill occupying so much of the Commonwealth Government Budget should help you!

If there is really a compelling case to keep some HFE, then over time it should only be administered through Special Purpose Grants and any other **non-GST** monies that the Commonwealth Government remits to the State and Territory Governments. If you need some bureaucrats to do that, then keeping some positions in the Grants Commission might be acceptable. But the methodology that it uses should be the subject of an open, public inquiry run by the Productivity Commission first. Don’t hide future HFE policy under a bushel like when the GST was put to the electorate.

If there seems no way to break the political deadlocks over HFE, then I think that the Commonwealth Government should hand over the responsibility for GST policy to the State and Territory Governments. They can then levy the tax at their own rates, and HFE will have the dagger through its heart that it so desperately needs. I note that there is a precedent for ceding a tax from the Commonwealth Government, as it did so with Payroll Tax. Value-added taxes and sales taxes are levied at sub-national levels in some other advanced economies, and it could be done here too. For all that, my preference would be to retain a single national rate and rules, but no HFE on GST collections.

## Fringe Benefits Tax (FBT)

The FBT overall is a very good tax and, as the Department of the Treasury’s Discussion Paper states (on page 43), it has done much to increase the integrity of the personal Income Tax system.

The FBT is necessarily complicated because it intrinsically seeks to apply a tax regime across a very large span of employees’ non-cash benefits. I support its current arrangements to that extent, although I do think that there are substantive integrity issues requiring serious consideration when it comes to:

* fly-in, fly-out workers in remote areas; and
* meals allowances and meal cards.

My main concern is that the FBT creates occupational apartheid in Australia because identically-trained individuals can be taxed differently under it if they happen to work for different employers. The FBT rules vary depending on whether an employer is held to be a public benevolent institution, a rebateable non-profit employer, or a general employer. A concession for one worker is a cost other workers and tax payers. It also creates labour market distortions, with their associated economic costs, which we really don’t need, such as amongst nurses who can choose whether to work in hospitals or in aged care facilities. Through you, I entreat the Parliament to do away with the special rules for particular employers, after say a two-year notice period, in favour of a single nation-wide FBT regime.

If there are morally and electorally sound reasons for the Government to assist benevolent institutions and not-for-profit organisations, then screwing up the labour market is not the right way to go about doing that. It would be better just to give grants to them. If you need a Productivity Commission inquiry and report to help you bring the rest of the community to appreciate this, there is little to prevent you from obtaining it.

## Capital Gains Tax (CGT)

Overall, I think that the CGT has been a sensible and useful addition to the Commonwealth Government’s tax portfolio. The changes since its inception to simplify how it is calculated and to give discounts compared with the taxation of ordinary income should be retained.

The Department of the Treasury’s Discussion Paper states:

Given the central importance of the home for Australian families, there is a strong consensus that it would not be appropriate to tax either the imputed rent on owner-occupied housing or capital gains derived from it. (Page 67.)

This is the type of high-handed, peremptory attitude that exhibits clearly why this Review should have been outsourced to a body which understands how to run a public inquiry, and why the Treasury has continually failed to achieve its potential. It is intrinsic to your Review processes, Ministers, that consensus is achieved by the Australian people including via the submissions process, and **not** by a few of your (really, our) public servants.

The “invisible” elephant in the room when it comes to CGT is the main residence exemption. I do not accept the Treasury line that this should be sacrosanct, and I note that you, Ministers, did not take it off the table for this Tax Review.

As you are well aware, arguments rage in Australia about the cause of our inflated house prices. Many have rejected or minimised propositions that our tax and welfare systems have much to do with that, and have focussed on supply-side issues such as the release of new residential blocks of land. There may be some truth in that, but I cannot help noticing that the proponents of those views overwhelmingly seem to be home owners or home buyers. The views of the large and increasing number of Australians who must rent because of unaffordable private housing don’t get much airplay. Probably because their heads are down while they are working to pay for their rent as well as other living expenses.

It seems to me that a range of Government policies contribute to our inflated housing prices. CGT is one of them, and the Centrelink/Veterans’ Affairs/Human Services assets test exemptions are others. In combination, that group may well have the biggest impact, notwithstanding the effects of State and Territory conveyancing Stamp Duties and Land Taxes, and the negative gearing deductions available in the Income Tax to property investors. I do not accept that negative gearing is the main culprit, and it saddens me that so little evidence about the incidences of the different tax measures on house prices was presented in the Discussion Paper. Perhaps you can remedy that in the Tax Green Paper.

There is a very clear case for the Commonwealth Government to unwind its contribution to the heat in residential house prices by making sensible changes to the CGT and also to its assets testing regime for welfare pensions, benefits and allowances, along with its aged care subventions. Grandfathering will be essential in every case in view of the magnitude of the investment decisions that all home owners and buyers have already made, the footings of which should not be upset.

The Henry Report discussed the rationale for reducing the CGT main residence exemption, including imposing CGT on such properties above a threshold amount of gain. But then it twisted its own arguments in knots by postulating different thresholds for urban versus rural and regional markets, and possibly even for individual cities like Sydney! Any constitutional lawyer worth his or her salt would shoot such a policy down in flames, which perhaps was the intent of the Henry Report’s authors. As citizens, we should expect much better than that.

The variations in residential property markets are there for all to see, and an intelligent way forward is required. It is a pity that the Henry Report’s authors did not suggest one, but your Review can. My suggestion is that, for newly acquired properties, the CGT main residence exemption should be capped at the ***greater*** of $100,000 worth of capital gain or say 30% of the cost base. These thresholds are somewhat arbitrary, and it is the concept of a two-step calculation to determine the main residence CGT incidence that I am proposing. The value threshold will simplify the burden of tax administration, while the percentage threshold will meet concerns about geographic property market differences across Australia.

If implemented, this measure would very substantially increase the Commonwealth Government’s revenue from the CGT over time. It would defuse much of the explosiveness in house prices. It would reduce the tendency to lock up so much of the nation’s useable wealth in otherwise unproductive assets, and it would tilt decisions towards investments which are more likely to boost employment and national income. The extra CGT revenue could be used, in part, to reduce Income Tax rates as well as to fund useful Government expenditures.

I have also suggested in this contribution that the home owner exemptions for the various means tests be removed over time. For the avoidance of doubt, grandfathering would most emphatically be required there. It would be better not to attempt such changes simultaneously with reforming the CGT main residence exemption, but to come to them after the tax reform has been completed.

## Federal Structure

I congratulate you on the breadth of the terms of reference for the Federation review.

I wax and wane on the issue of whether to keep State and Territory Governments. Victorian by birth, I am proud of the stand taken at the Eureka Stockade against a remote Government (in London) which could only respond to issues after many months.

After 40 years in Canberra, I can confirm that the Commonwealth Government isn't perfect, either!

Just imagine how people from Mallacoota to Mataranka and from Bunbury to Bundaberg would howl if all the responsibilities now held by their State Governments were given to the Commonwealth Government which would need to seek “one size fits all” policy settings in all portfolios.

For all that, though, over the decades I’ve heard plenty of discussion about the structure of our Australian federation, and overwhelmingly the views put in my presence have been about getting rid of the State Governments. It only gets tricky when one gets to the next breath! Some eventually recant and suppose that there is really a continuing role for State Governments after all. Others want the State Governments to be replaced by a lot of smaller, regional governments, rather like the County Councils in Britain and Ireland.

I’ve never met anyone who wants to get rid of the existing local government part of our system, although plenty have wanted them to be run better. A stronger system of fines and prison sentences for criminal behaviour by elected local government councillors and their officials would probably help a lot.

On balance, my preference is to keep the State and Territory Governments, and to improve the overall allocation of responsibilities between them and the Commonwealth Government. This is the direction I understand that many COAG participants and officials have been seeking for decades, and perhaps your Federation White Paper will resolve that.

If, however, there should be a consensus towards removing the States and Territories in favour of some kind of County Council approach, which I very much doubt, then I do suggest that their geographic boundaries be set according to water catchment areas (or groups of catchments, more likely). The present State and Territory boundaries are arbitrary, albeit long-standing, and splitting the Murray basin as between much of the New South Wales – Victoria border would make no sense now, even if it was very sensible back in 1851. My reasoning is that environmental policies will be far easier to administer on a catchment basis.

## Conduct of Your Reviews

Ministers, I like the attitudes that you have each expressed about having a national conversation for each of the Federation and Tax Reviews.

But giving these Reviews to be run by your own Departments was a mistake, as is keeping the Inter-Generational Report preparation team in Treasury when it would be much better added to the Parliamentary Budget Office. Treasury won’t let contributors see what others have written to it until the Green Paper is released. And then it will sit on the Green Paper contributions until the White Paper is released. Unnecessarily arrogant, this. No explanation for this behaviour has been revealed.

Treasury appears to have a high-handed approach to defining a “conversation”. What a contrast to the Productivity Commission, which with its predecessor agencies has for over 40 years run public inquiries properly, releasing its submissions for public scrutiny when they are received, except for those which it decides are confidential. It also remains apolitical.

You should have given both of these reviews to the Productivity Commission. That would have provided participants and their submissions with legal protections that your Reviews don’t offer. It would have removed your advising Departments from the coal face of the public and enabled public hearings to be held. Treasury’s best and only counter to this is merely to have a blog!

Your Departments should not be allowed to keep such a stranglehold on important processes like these. It creates conflicts of interest that any Department should avoid, not embrace.

I ask that you instruct your Departments to release each and every non-confidential submission to these Reviews online within three business days of receiving them. Then we can indeed have a real national conversation, not just a silo approach of many-to-one contributions.

Yours sincerely,

**Ian Bruce**