



TAX FORUM

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STATEMENT OF REFORM PRIORITIES

PARTICIPANT NAME AND POSITION

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STATEMENT OF PRIORITIES

1. What are your priority reform directions for the tax and transfer system?

In this statement, I will comment on the areas of State taxation, the tax reform process and public funding of tax research.

I. State Taxation

a. Removing disincentives for States to reform taxes

States will not reform their tax systems until there is a clear incentive for them to embrace change. At present, there are two main inhibitors: (a) the way untied (GST) grants are distributed and (b) the lack of any formal framework where the national benefits (accruing mostly to the Commonwealth Government) from State reform can find their way back to the States.

The current *GST Distribution Review* is an opportunity to address the first of these issues through noting and responding to the adverse way in which untied grants are allocated amongst the States. This should involve explicit recognition of the interaction between grants and a State's own policies and putting in place mechanisms to remove any disincentives which might arise for States to introduce reforms in the national interest (as discussed in Warren (2010) in the case of the Henry Review recommendations for State tax reform).

Also critical to States embracing tax reform is ensuring a proportion of the benefits accruing to the Commonwealth Government from State tax reform pass to the States (such as some share of the increased personal and company income tax collections arising from the reform). This could also involve bringing forward the distribution of benefits which accrue to the Commonwealth beyond the forward estimates period to the States as an incentive for them to reform their taxes.

Recommendation: Attention should be given in (a) interaction of grants and State policies; (b) developing a framework to allocate national benefits from reform to the States; and (c) allocating to States the national fiscal benefits from reforms accruing beyond the forward estimates period, into the current forward estimates period, as an incentive for them to embrace reform.

b. Sharing major tax bases

Sharing the revenue from a tax is only an attractive option for States if they can have some discretion over the rate imposed on that base. With no discretion, the revenue is simply an untied grant linked to revenue from the tax. A risk for States with revenue sharing is that if effective rate changes are made by the Commonwealth, this will directly impact State revenue. Equally, the Commonwealth is not attracted to revenue sharing since it limits its scope to make changes to the tax which impacts on its revenue. As the Henry Review indicated, the preferable option is for States to have access to the base of major taxes and for the Commonwealth to 'make room' for the States

to impose their own tax rates. At the same time, there should be an incentive for States to actively use this tax base to raise revenue through ensuring untied grants are allocated to the States in a way that States are still rewarded from taking on the political risk of embracing difficult tax reforms.

Recommendation: States should have access to major tax bases and the Commonwealth should ‘make room’ for the States to impose these taxes. Grant allocation should be changed to ensure the benefits to States from imposing such taxes are not undermined.

c. Acknowledging the interaction between State tax policies and those of other Governments

State taxes are readily acknowledged as amongst some of the most inefficient taxes imposed in Australia. In response, almost all State taxes find themselves the target of calls for their repeal (property conveyancing duty, insurance taxes and business stamp duties) or reform (land, payroll and gaming taxes). However, what is not often acknowledged is that these criticisms lie not just with State taxes but with taxes and related policies imposed by other levels of government. For example, housing affordability is not just impacted by State taxes but also by Commonwealth and local government policies.

The Henry Review acknowledged the importance of ‘policy consistency’ but there should be a framework developed through COAG to enable all governments to come together to address tax issues which cross jurisdictional boundaries. This would enable reform in one jurisdiction which impact on funding and other policy in another jurisdiction to be considered. Until the interactions between tax and related policies of different levels of government are acknowledged along with their impact on their respective budgets, all the good intentions underlying the call for State tax reform will likely come to little.

Recommendation: A framework should be developed (through COAG) to facilitate reform in areas of tax policy which interact significantly with the policies of all levels of governments and in turn impact on the overall funding of each level of government.

II. A systematic and holistic approach to tax policy development

a. 5P Pathway to tax reform

When considering the need for tax reform, too often there is a lack of completeness in the approach taken often as a result of the pursuit of answers (or fixes) without due consideration to the question that should be asked prior to framing any response. That is, there is too often a focus on a problem arising from taxation and finding a solution rather than on why the tax was introduced and whether there is a superior alternative.

I am currently drafting a paper in this area and it will be proposing that deliberations on tax should involve what I am calling a ‘5P Pathway’. This involves a focus on **Purpose** (Why the need for revenue?); **Parameters** (What are the known constants we must accept and work with (such as the Constitution)?); **Principles** (which guide us such as equity, efficiency, simplicity, sustainability and policy consistency); **Policy Design** (such as the mix of tax types by jurisdiction) and **Process** (which involves the framework for deliberations on design issues, consultation with stakeholders, and implementation and post-implementation review).

Recommendation: A 5P Pathway (**Purpose**, **Parameters**, **Principles**, **Policy Design** and **Process**) should be adopted when considering any tax reform so as to ensure appropriate attention is given to context, options and process.

b. Open and independent tax policy development process

The New Zealand Generic Policy Development Process (GDP)¹ is designed to improve the quality of policy by defining an explicit generic process for all policy development. This is an open and contestable process. Australia has no such process when developing tax policy, instead it has the

¹ See <http://www.med.govt.nz/upload/305/policydevpt.pdf>

Commonwealth Government relying almost exclusively on the Commonwealth Treasury for policy advice. An open and contestable policy development process would do much to improve the scrutiny of this tax policy advice before government responds publicly to it, thus enhancing the scope for the implementation of any ultimate policy recommendations.

At the same time government would need to acknowledge that this approach would imply that the current approach of an 'answer seeking a rationale' is untenable.

Recommendation: Australia should follow NZ and introduce a Generic Policy Development Process (GPDP) for deliberations on tax reform.

III. Independent tax research

a. Independent major tax review

A source of significant public policy failure over the past two years has been an inability to transfer tax policy recommendations to tax practice. A significant cause of this failure is how reform proposals are prepared and then communicated to the community. While a GPDP will assist, there is also the need to accept that in the case of major reforms, that an independent review process is justified. Historically, Australia adopted this approach but since the Asprey Report in 1975, all major tax reviews have been undertaken with the support of a Treasury secretariat. While this is reasonable in the case of narrowly focused or minor reviews, in the case of major all-encompassing reviews, there is a good case for it to be undertaken independent of government and its bureaucracy.

Recommendation: All major tax reviews should be undertaken independent of government agencies. Minor tax reviews should be undertaken in an open contestable environment (based on a GPDP model).

b. Government funding of independent research

In the past year, the failure to educate and communicate to the broader community the importance of environmental taxes and resource rent taxation has come at a high cost to the community. With no significant and ongoing support by government for independent tax research, the government has no ability to draw on a pool of research or expertise in the area of tax which does not come with rent-seeking overtones.

Recommendation: The government should increase funding support for tax research in independent academic institutions to facilitate greater ongoing public education and debate on the need for and direction of tax reform.

2. How are your proposals financed over the short and longer term?

The proposals in (I) above are not so much about cutting taxes but about finding better ways to raise current tax revenue and providing States with some incentive to undertake reform.

In (II) the focus is on the critical issue of how to overcome the apparent failure of the development, consultation and implementation process for tax policy in Australia. There is no substantive cost associated with this proposal, only a requirement to change the tax reform process to ensure better policy outcomes and less opportunity for rent seeking by vested interests.

LIST OF ATTACHMENTS

Links to the papers cited above by the author are available from:

<http://www.asb.unsw.edu.au/schools/Pages/NeilWarren.aspx>