Allegra Spender MP
FEDERAL MEMBER FOR WENTWORTH

TAX GREEN PAPER RELEASE

EMBARGOED UNTIL 10.30am

10.00am
Roundtable conference
Reps Committee Room 1R5
(on the record – media welcome)

10.45am
Media conference
Mural Hall

Statement by Independent MP for Wentworth Allegra Spender:

"Tax reform has never been more urgent.

"When I started this Green Paper process 18 months ago tax reform was off the table, with both major parties so scared of tax that their biggest commitment was to do 'absolutely nothing'.

"Now tax reform is finally in the frame. Not because either of the major parties have shown real courage, but because economic reality is setting the agenda.

"Last week Parliamentary Budget Office analysis[1] was front page news when PBO economists detailed a "half trillion-dollar tax headache"[2] for personal income taxpayers. Today those taxpayers contribute 41.5 % of government revenue, but with bracket creep, ageing population and the shortfall in other tax revenue, it will be 46% in 2030.

"Without reform, this burden will only increase.

"This burden on wages and working income is unsustainable and falls unfairly on young Australians, who already face a housing market which makes the Australian Dream of saving a deposit and paying off a mortgage "basically impossible"[3].

"At the same time, business continually highlights our tax settings as an impediment to productivity growth and competitiveness, and the backing of our most innovative companies.

"We need all our policy levers to tackle the challenge of transition to a net zero economy, but our taxes are helping to prop up reliance on fossil fuels rather than drive investment and expenditure towards a faster, easier and less expensive transition.

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[1] Australia's Tax Mix | pbo
[2] https://www.smh.com.au/politics/federal/the-half-trillion-dollar-tax-headache-facing-australia-20241115-p5kqy1.html
[3] https://www.smh.com.au/property/news/basically-impossible-housing-affordability-is-the-worst-on-record-20241119-p5krtx.html

“This Green Paper argues, that to respond to the three challenges we identified – for younger Australians, for productivity and growth, and for the energy transition – we should have six priorities for tax reform:

1. Lower income taxes on working Australians so they can earn and get ahead
2. Rebalance tax settings in favour of home ownership rather than investing in existing dwellings
3. Incentivise innovation and business investment to increase productivity and economic growth
4. Rebalance tax settings so that the revenue base remains stable with changes to demographics and consumption patterns
5. Adjust tax settings to support our energy transition, rather than work against it; and
6. Implement institutional reform, including a Tax Reform Commission, so we can better manage future challenges as they develop.

“Let me be clear that this is not a policy position paper and is not a representation of my personal views. Instead, like a traditional Green Paper, it seeks to outline challenges as well as the current evidence base to provoke discussion. It does this on the basis of no increase to the current overall tax burden, though ideally you would like to reduce taxes to help achieve reform. We are seeking feedback on this work.

“The full Green Paper is attached. I encourage you to read it. I have shared this paper with the Treasurer, Shadow Treasurer, and the crossbench.

“Tax reform is hard but the problems of young people not getting ahead, of flatlining productivity, and the energy transition are all urgent and we need to bring all tools to challenge.

“The next parliament needs a process for addressing tax reform, and meaningfully engaging the community in this discussion.

“If I am returned at the next election in a minority government setting, a commitment to a process for tax reform will be a key consideration for me in any decision on supporting supply and confidence.”

Media Inquiries: Peter McEvoy 0419274417 **21 November 2024**

Allegra Spender MP
FEDERAL MEMBER FOR WENTWORTH

Tax Green Paper

NOVEMBER 2024

Contents

Executive *Summary*

Australia prides itself on being a place where people can put down roots and raise a family, regardless of their background. Where it doesn't matter where you've come from. Where we leave each generation better off than the last. Where people with great ideas can build great businesses. Where aspiration and hard work pay off. Where in the hard times people don't fall through the cracks. Where our abundant natural resources generate national prosperity.

That's the Australia that gave my mother the opportunities to build her life and business as someone without money or connections.

It's the Australia I want my own children to thrive in, but for many, that vision is fading. A recent survey found that only 8% of Australians think the next generation will have a better standard of living than their parents.

That's pretty bleak.

That's not my mum's Australia, but it's a realistic assessment of the challenge facing Australia today.

Recently a young man came to see me and shared his story.

"I've studied hard and got a good degree in a solid profession, but I've got a $50,000 HECS debt and my rent is going through the roof. At my age my dad and mum had bought their first home, but I don't see how I'll ever do that."

Younger Australians are being left behind, unable to grow their financial security in line with other generations and increasingly locked out of housing that is affordable. This creates a society of haves and have-nots, where your family wealth, and access to the Bank of Mum and Dad, is essential to get ahead.

This divide is having profound impacts on life choices people make, including one of the most fundamental – whether to have children, and how many children to have.

The divide has been accentuated by recent cost of living pressures, that disproportionately impact those renting or with large mortgages and low savings. But it is part of a longer-term trend that is exacerbated by government policy settings, and especially by our tax system.

Our tax system places undue burdens on the earned income of labour which is the major source of income and wealth for young Australians. It places barriers on home ownership. And without reform, the burden on labour income is only going to worsen, through bracket creep, an ageing population and the relative degradation of other sources of tax revenue.

Alongside intergenerational inequality we have lagging productivity and economic growth. Productivity growth is the only long-term source of real wage growth and cheaper prices. But we are not investing sufficiently in capital growth, nor forming and growing our innovative companies to the extent we need to. Once again, our tax system contributes to this.

And finally, we have the challenge of transition to a net zero economy. Failures in bringing the full suite of policy options to this challenge, including taxes, means this transition is more expensive, difficult and slow than it otherwise would be.

Each of these three would be once-in-a-generation challenges and we need all shoulders to the wheel if we're going to solve them all at once. That includes our tax system.

The tax system is unique in its influence over our society. It affects where we live, how we operate a business, how much we choose to work and the jobs we take, what we invest in, and even what goods and services we buy. With such broad impacts, the tax system can help shape a better country or it can actively work against us. Tax reform is not a panacea but ignoring or minimising tax as a policy lever just makes the problems more expensive and more difficult to properly address.

Unfortunately, debate on significant tax reform is missing from the agendas of the major parties. Constituents consistently tell me that they are frustrated that political point-scoring stops us dealing with some of the most important, long-term issues facing the country. They don't like politicians putting politics above what is best for the community. They tell me they don't want band-aids or silver bullets that don't deliver on the promises made.

That is why over the last 18 months I have conducted roundtables with experts and stakeholders on tax reform, have sought community feedback, and have been grateful to receive the engagement of more than 1,300 community members on this topic. Their input has been vital to this Green Paper.

The first purpose of this Paper is to set out the challenges that tax reform should address. We need to agree on what problems we are trying to solve, and therefore our goals for reform. Second, the paper outlines possible ways that experts and stakeholders have suggested to achieve these goals, and highlights some of the pitfalls and complexities. Third, the paper proposes processes that will promote tax reform through the next term of parliament, whatever shape that may take. Most importantly, the purpose of this paper is to provoke debate on all these issues – the challenges, the solutions and the process.

Let me be clear that this is not a policy position paper and is not a representation of my personal views. Instead, like a traditional Green Paper, it seeks to outline challenges as well as the current evidence base to provoke discussion. We are seeking feedback on this work.

This Green Paper argues, that to respond to the three challenges we identified – for younger Australians, for productivity and growth, and for the energy transition – we should have six priorities for tax reform:

1. Lower income taxes on working Australians so they can earn and get ahead
2. Rebalance tax settings in favour of home ownership rather than investing in existing dwellings
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6. Implement institutional reform, including a Tax Reform Commission, so we can better manage future challenges as they develop.

This paper identifies a range of options to do this as suggested by experts, stakeholders and the community, in a revenue neutral way. Australia currently has one of the highest tax burdens in its history. I believe holding the tax burden constant is a minimum aspiration, and we should try to lower the overall burden of tax if we can. However, this requires us to reduce spending – and assessment of spending priorities and effectiveness is beyond the scope of this paper.

This kind of reform won't happen by itself. Consequently, the paper identifies a possible process for significant tax reform in the next parliament. There is the opportunity to unlock reform in the next parliament, and I believe that members of the crossbench can help drive that. Crucially, any process would need community engagement at its heart. Community acceptance is critical for tax reform to stick and was sorely lacking in previous failed tax reforms such as the introduction of the carbon tax.

I hope that this paper builds greater consensus on the need for change and creates space for debate. Tax reform is hard, and the current political incentives preserve the status quo in the face of difficult choices. We need to be less timid, if we are going to deliver on the vision of Australia.

I welcome and encourage experts, stakeholders and the community to continue to engage in this process by providing feedback on this Green Paper. I welcome suggestions for the how the system can be improved, and how the transition can be handled fairly. I also welcome suggestions on institutional best-practice and the most effective ways to address tax reform in the next parliament.

Our country is facing significant challenges, but it is within our power to address them. Australian leaders have faced similar challenges in the past and delivered reform.

The choice we face now is whether we will tackle our challenges, or slip back into politics as usual, waiting for a better window of opportunity which may never come while the problems to grow larger and more intractable. Or whether we create those windows of opportunity.

1 Introduction

1.1 Green Paper purpose

Tax is vital to effective government, shapes our society, economy, and environment, and reflects what we value. Tax policy needs to respond to changes in our society, economy, and environment. Despite enormous changes over the past 25 years – life spans that are 4 years longer, perhaps the largest mining boom in history, the Global Financial Crisis, and the COVID-19 pandemic – tax policy in Australia has barely changed.

This Green Paper is not a policy position. Instead, it's a discussion paper that aims to promote discussion amongst the community, experts, and political parties so that we can improve Australia's tax system. I am inviting responses to the issues that this Green Paper raises so that we can promote a more informed discussion that leads to lasting change.

The Green Paper aims to make three contributions to the debate. Firstly, it identifies key problems that Australia is facing, and which tax reform needs to address. Secondly, it outlines tax changes that have been suggested by experts, stakeholders and community members that would be consistent with these priorities. And thirdly, it proposed process that will promote tax reform through the next term of parliament.

This paper only examines tax proposals that taken together are budget neutral in the short-to-medium term. It does not address how big Australia's government should be. Views differ on this important question, and my personal position is that we should seek to reduce it.

Similarly, this paper does not systematically examine the welfare system. Although tax and welfare systems are closely linked, many aspects of the welfare system involve issues that do not depend on tax design. They should be considered through other processes.

And this paper also does not examine efficiency of government spending. While this is a very important issue, it again raises a huge number of issues that cannot be managed through this process.

1.2 How we got here

In the process of writing this Green Paper I consulted a broad range of people from Wentworth, from the Australian community more widely - eminent experts on tax, and civil society groups representing business, social services, different generations, and environmental concerns. It has benefited enormously from their input, and I'm grateful for the time and expertise they have contributed. Obviously, not all of them agree with everything in this paper but we have tried to represent much of the richness of the debate with these different groups. However, the consultation process has given me much greater confidence that there is significant common ground about the opportunities for delivering tax reform in this country.

This paper has also been informed by over 1,300 of my constituents who have engaged on tax reform through emails, phone calls, meetings and completing surveys. In particular, it was informed by the 85 people who were part of an in-person workshop one wet Wednesday night in Wentworth to debate and share their views about the trade-offs in the tax system.

I am inviting feedback to the issues raised by this Green Paper.

Drafting of this paper has benefited from support from John Daley AM of Correa Consulting, from personnel in my office and from Ken Henry AC, but I am responsible for the paper.

1.3 *Paper outline*

Chapter 2 of this paper outlines what I have heard are Australia's biggest social, economic and environmental challenges that tax reform might help to solve.

Chapter 3 of this paper explains why tax matters, the politics of tax, and how the politics can be navigated to maximise the chances of tax reforms in the public interest. It also outlines the principles of tax design that are important to avoiding the unintended consequences of tax reform.

Chapter 4 outlines a range of tax changes that have been proposed by stakeholders and community members that might help to address Australia's social, economic and environmental challenges. It also highlights some of the issues that will be the most difficult to resolve with the range of tax changes.

Chapter 5 sets out and the process that could be followed in the next parliament to start to address tax reform and the case for Tax Reform Commission to improve our ability to do tax reform in the future and more regularly.

Chapter 6 sets out how feedback can be provided on any of the issues raised by this paper.

2 Social, economic and environmental *priorities for reform*

As I have spoken to my constituents, and to people around Australia, a few issues are consistently top of mind. The statistics show that these concerns are well-founded. I summarise these challenges into three key priorities:

- It's getting harder for young people to get ahead. This is closely related to big problems with housing affordability and will worsen under current tax arrangements and demographic pressures.
- Productivity isn't growing much, partly because businesses aren't investing much, and consequently real incomes aren't growing.
- Australia is not moving fast enough to reduce its carbon emissions, and the energy transition is costing more than it should

The remainder of this Chapter shows that these are real and significant problems. Tax reform is not the complete answer to each of these problems. But as shown in the following chapters, tax reform is an essential part of the toolkit. Stalled tax reform means that we are not moving fast enough on each of these vital social and economic issues. If we ignore or minimise tax as a lever, we just make it more difficult and expensive to address these problems.

2.1 *Lack of opportunity for younger Australians*

Australia has often seen itself as the land of the 'fair go'. Every generation expects that if their children work hard, they will be even better off than their parents. But this is no longer the reality for many.

2.1.1 A generation falling behind

Our young people are more educated than any previous generation but they are not reaching the milestones that previous generations enjoyed. Relative to younger households 50 years ago, they do not graduate debt-free, but with an average HELP debt of over $30,000.[1] Instead of almost two in three owning their own home, now only one in three do so – and this is part of broader problems with home ownership discussed below.

These trends have personal consequences. Younger people are moving out of inner suburbs in Sydney and Melbourne.[2] They are having fewer children than at any other time in Australia's history, with the latest birth rate 1.5 children per woman.[3] They are less likely to own a home.[4] Despite barbs about avocado toast, they are spending less money on non-essentials than previous generations.[5] They are relatively less wealthy than other generations.

[1] Jericho (2024)

[2] Jewell (2024)

[3] Australia's fertility rate has dropped from 1.9 births per woman in 1983 to 1.5 in 2023: Treasury (2023a, p.44); ABS (2024b)

[4] In 1976, those aged under 30 (when 20-29 year olds were 28% of the population aged between 20 and 74) owned 17% of small businesses. In 2021 those aged under 30 (when 20-29 year olds were 20% of the population aged between 20 and 74) owned 8% of small businesses. ASBFEO (2023) p.10; ABS (2021), There are some signs that an increasing number of young people are starting a small business, often as a second income (CBA (2023))

[5] Wood and Griffiths (2019, p.28)

Tax is part of the problem for younger generations. Compared to generations in the past, younger working people today are paying a greater share of total tax, and getting a smaller share of government benefits, despite having a smaller share of total wealth. The share of taxes paid by an average working-age household has increased while the share paid by over 65s has declined.[6] Today only 17% of households over 65 pay income tax, compared to 27% in the mid-1990s.[7]

Older households with an income of $100,000 on average pay less than half the tax of a working age household with the same income of $100,000, even though the typical older household has almost four times as much wealth as the typical household aged 35 to 44.[8] High income older households pay much less tax than high income younger households. Meanwhile, the typical older household receives about 60% more benefits from government now than they did in the late 1980s.[9]

2.1.2 The generational wealth gap

The baby-boomers have benefited from a big jump in asset prices. 30 years ago, the average older household had 2.5 times as much wealth as the average younger household; today it has almost 4 times as much wealth.[10] Taxes on this increase in wealth were relatively light due to a combination of home-owner tax exemptions, the capital gains tax discount, and superannuation tax concessions. This big jump in wealth was largely driven by rising asset prices due to the long-term fall in interest rates, which is unlikely to be repeated.[11] This means younger Australians are unlikely to have similar opportunities to build wealth as previous generations.

And while Australian wealth has soared so that households over the age of 65 are 50% wealthier than older households 12 years ago, younger households got none of the uplift.[12]

Consequently, future generations will have to earn more in labour income to amass similar levels of wealth. Wealth will also depend more on inheritance than it has in the past. As a result, we are becoming a society in which getting ahead increasingly depends on the luck of having rich parents.[13]

Tax policy may widen the generational wealth gap in the future. Taxes on labour income tend to affect younger generations more; taxes on investment income tend to affect older generations more. This balance is even more critical today than in the past because older generations hold a much greater share of wealth in Australia than in the past.

These tax settings make it hard for younger generations to create a prosperous life for themselves. Younger generations are paying a lot of tax on their income from working, and they benefit little from relatively low rates of tax on income from investments. Our personal tax system should reward effort and ingenuity. It should allow people to create a prosperous life for themselves, regardless of the wealth of their families. But instead, it provides bigger rewards for passive income and property investment.

[6] Daley, Coates and Young (2016, p.10)

[7] Wood and Griffiths (2019, p.36)

[8] Wood and Griffiths (2019, p.6, 37)

[9] Younger households are each contributing about one third less – the additional spending for older households is presumably funded through a combination of greater contributions by middle-aged households, and economic growth which has effectively increased the size of the pie; Wood and Griffiths (2019, p.6).

[10] Wood and Griffiths (2019, p.6)

[11] Wood and Griffiths (2019, p.14-15)

[12] Wood and Griffiths (2019, p.12)

[13] PC (2024, p.3)

I want to note I am not blaming one generation or another for the challenges of younger Australians. And I want to recognise there are many older Australians who also face challenging financial conditions. But whatever your generation or personal circumstances, I believe all Australians want our young people to be able to thrive, regardless of their backgrounds. I believe we all want young people who do essential work for our community – perhaps in healthcare or education or law enforcement – to be able to afford to have a good life and raise a family if they choose.

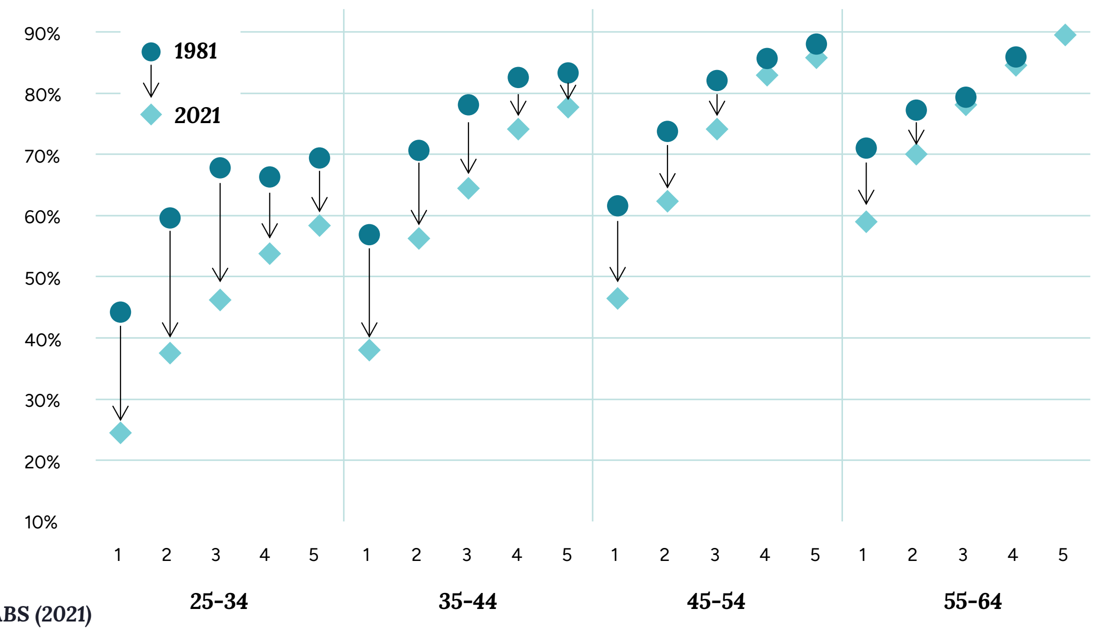
2.1.3 Housing affordability

Housing costs have also risen because, over the long term, Australia's population grew faster than we built additional housing.[14] As a result, housing prices and mortgage payments for a typical home are at record levels relative to typical incomes.[15] Over the past 25 years, home prices in Australia have increased fourfold, but incomes have increased only twofold.[16]

The social consequence is that younger generations are less likely to own their own home than in the past. This is particularly a problem for lower income households. 30 years ago, well over half of low-income households aged under 35 owned their own home. Today, less than one in five of low-income younger households own their own home (Figure 1). Home ownership is increasingly dependent on having wealthy parents – the bank of Mum and Dad. In 1980, 15% of first home buyers relied on money from their parents compared to 40% of first home buyers today[17] and many believe that is underestimating the full extent of support.

Figure 1: Home ownership is falling, particularly for young and lower income groups

Home ownership rates by age group and income quintile, 1981 – 2021, % of cohort



Source: ABS (2021)

The increase in housing prices means an increasing proportion of the population retire still owing money on their mortgage. As a result, many people are being forced to delay their retirement, and a majority of pre-retirees expect to sell their property or use their superannuation to repay their mortgage. This is a recipe for much less secure retirements.[18]

[14] Daley and Coates (2018a), p.29-68

[15] Comparing percent of pre-tax income direct to mortgage for dual average full-time income household buying median priced dwelling; CBA (2024, p.119)

[16] Coates and Moloney (2023a, p.6)

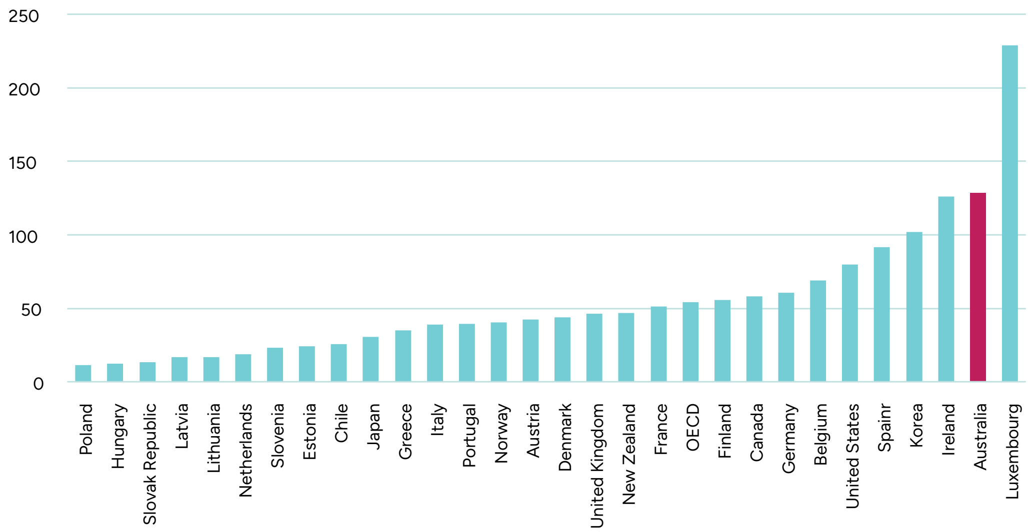
[17] Williams (2024)

[18] Clayton (2024)

Many policy settings influence housing affordability – including planning, industrial relations, migration, and social housing investmen[19] – but tax policies are an important part of the mix. Tax policies particularly affect the attractiveness of investment in housing for owner-occupiers relative to investors. Australians have more invested in investment property than the people of any OECD country except Luxembourg (Figure 2).

Figure 2: Australians invest a lot more in investment property than people in other countries
Average secondary real estate wealth (non-owner-occupied property), $000 per person

Source: OECD (2022)



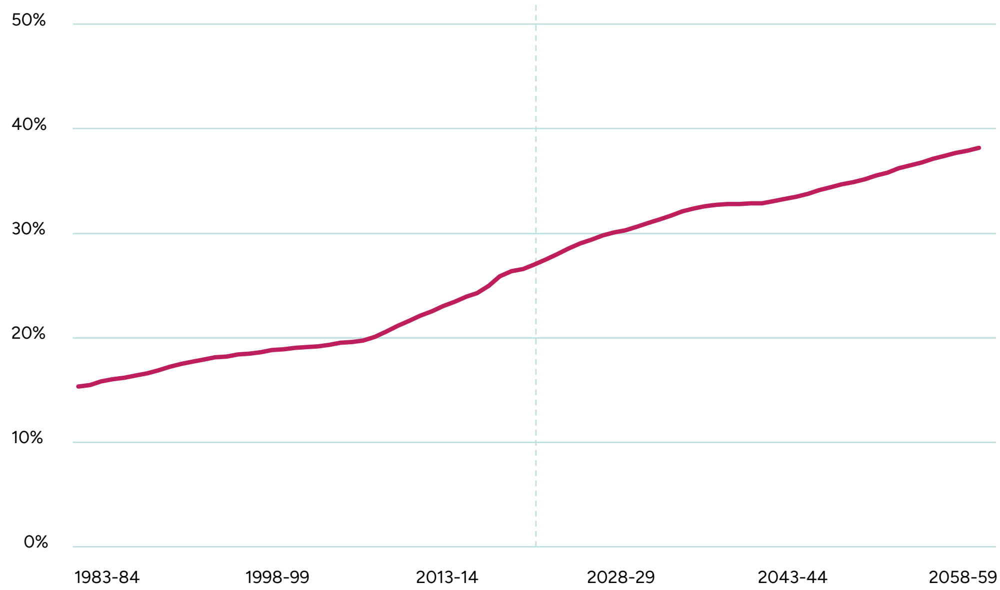
2.1.4 Changing demographics

Changing demographics and weaknesses with the structure of our current tax system mean that without reform, the burden on younger working people is only going to increase.

The number of working age Australians that support each retired Australian is dwindling. In 1983, Australia had 6.6 people of working age for each Australian over the age of 65; today there are about 3.7. By 2060 there are expected to be only 2.7 (Figure 3).[20] This is a profound change in our workforce structure and underlines the challenges of a tax system that relies so much on income taxes on individuals. The 2023 Intergenerational Report found that without tax reform, personal income tax receipts will rise from the current record levels of 50% of tax receipts to 58% in 2063.[21] The budget will not balance unless taxes per younger household go up even further; or benefits (particularly for older households) are cut; or taxes per older household increase.

[19] Daley and Coates (2018a, p.95-96)
[20] Treasury (2023)
[21] Treasury (2023), p.196

Figure 3: The number of retirees per working age Australian is rising
Old-age dependency ratio (retirement age Australians / working age Australians)



Source: Intergenerational Report (2023)

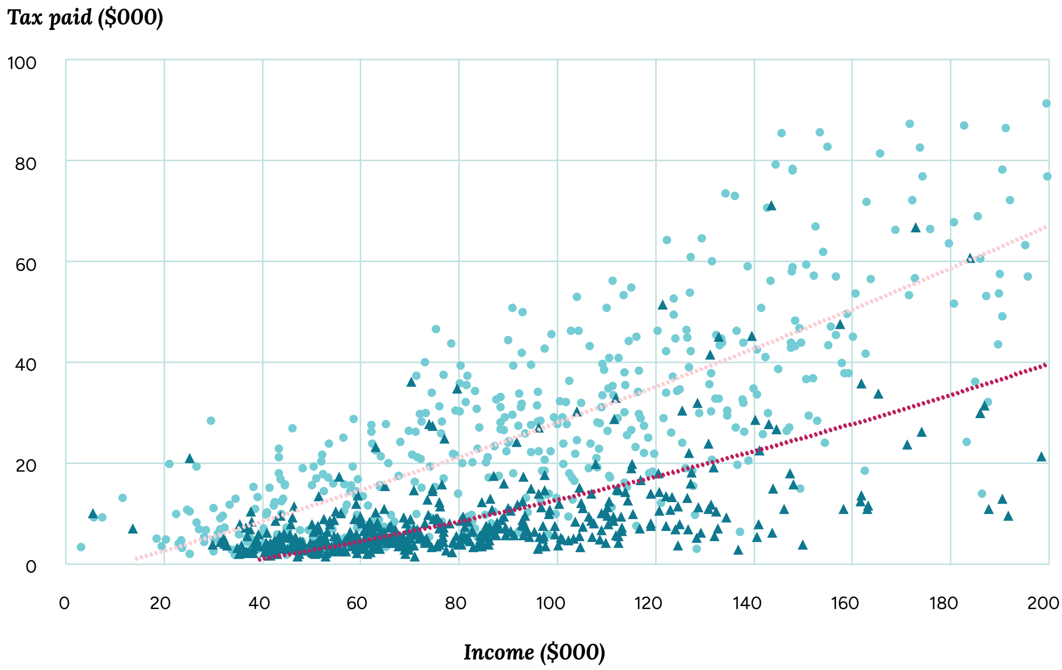
An ageing population creates budget challenges because on average an older Australian consumes more government services than a younger Australian but pays less tax. Older Australians typically cost governments more because the healthcare costs are higher, and the costs of aged care are substantial.

Older Australians typically pay less tax. In part this is because they usually work fewer hours, and so earn less labour income. But they also pay less tax because the tax system is effectively less progressive for older Australians. High income older Australians earn more from investments, and investment earnings are effectively taxed much less than labour income. Consequently, high income older Australians pay significantly less tax than high income younger Australians (Figure 4). This will create an increasing gap in government budgets as the population ages.

[22] PC (2015b, p73)

[23] See below, Section 4.1.2

Figure 4: Over 65s pay much less tax than under 65s for a given level of income
Income and tax paid by age group, 2016



Source: Grattan Institute (2019)

2.2 *Slower economic growth*

2.2.1 Economic growth trends

The generational wealth gap and an ageing population would matter less if there was strong economic growth that translated into rising incomes for people and rising revenues for government.

However, labour productivity – the amount produced per hour worked – is growing more slowly around the world. Productivity growth in Australia is slower than any time in the last 60 years.[24] And participation – the number of hours worked – is likely to grow more slowly with an ageing population.[25] Together these present significant challenges to economic growth in the future. Tax policy can influence both labour productivity and participation, although there are many other factors at play as well.

2.2.2 Labour productivity

Labour productivity is the holy grail of economic growth. It grows when people produce more in the same number of hours worked and for the same capital invested. It is improved by innovation, a better educated workforce, competition, and reducing unproductive activity such as compliance with red tape. It is improved if people work in the job where they will be most productive and it is also improved by greater capital investment per worker. It is improved by young companies that drive new business models.

[24] PC (2023, p.1-2)
[25] Treasury (2023, p.63)

Policies to improve labour productivity require the hard grind of improving education, designing optimal regulation to protect health, the environment and other public interests while minimising compliance costs, and encouraging a dynamic economy.[26]

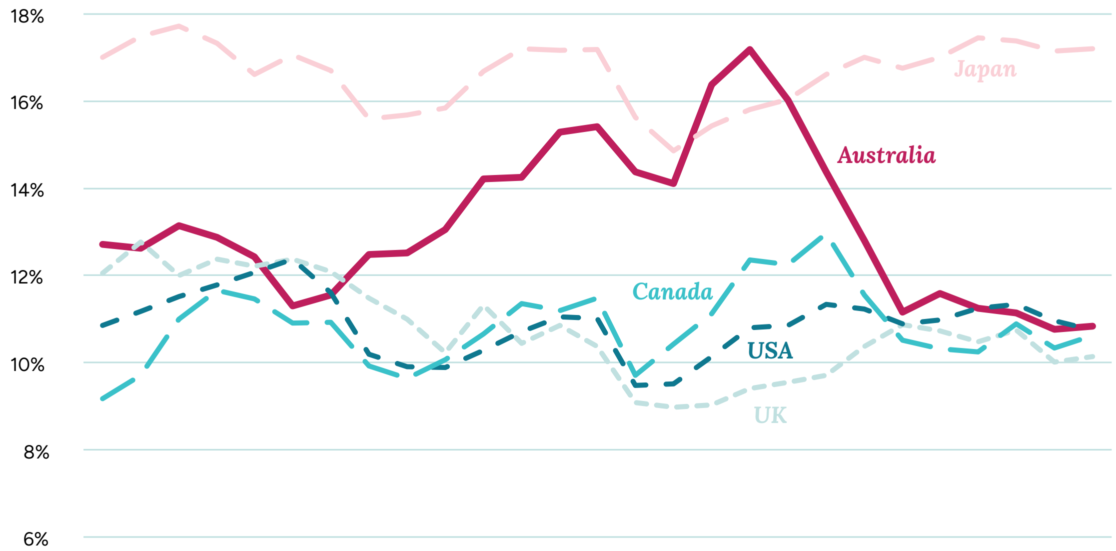
Stamp duty on housing is a key tax policy that affects labour productivity growth. Stamp duty creates disincentives for people to move to locations where there is a job that better matches their skills. The disincentive is large: moving would cost the typical household half of its annual after-tax income in some States.[27] Analysis by New South Wales Treasury estimated the removal of stamp duty would increase the number of property transaction by around 50% over the long-run by removing a significant cost and disincentive to moving house.[28] The New South Wales Treasury estimates that this increase in property transactions could inject around $11 billion into the state economy over four years.[29] The impact that stamp duty has on housing affordability is discussed in Section 4.1.7.

The design of other taxes can also increase compliance costs. For example, definitions of employment that differ between states and territories increase the cost of complying with payroll taxes.

2.2.3 Falling business investment

More capital investment can boost labour productivity. However, capital investment in Australia is close to historic lows, and is now similar to many comparable countries (Figure 5).

Figure 5: Capital investment in Australia is now close to other comparable countries
Corporate gross fixed capital formation (GFCF), % of GDP



Source: OECD (2024)

[26] Treasury (2023b, p.79-80)

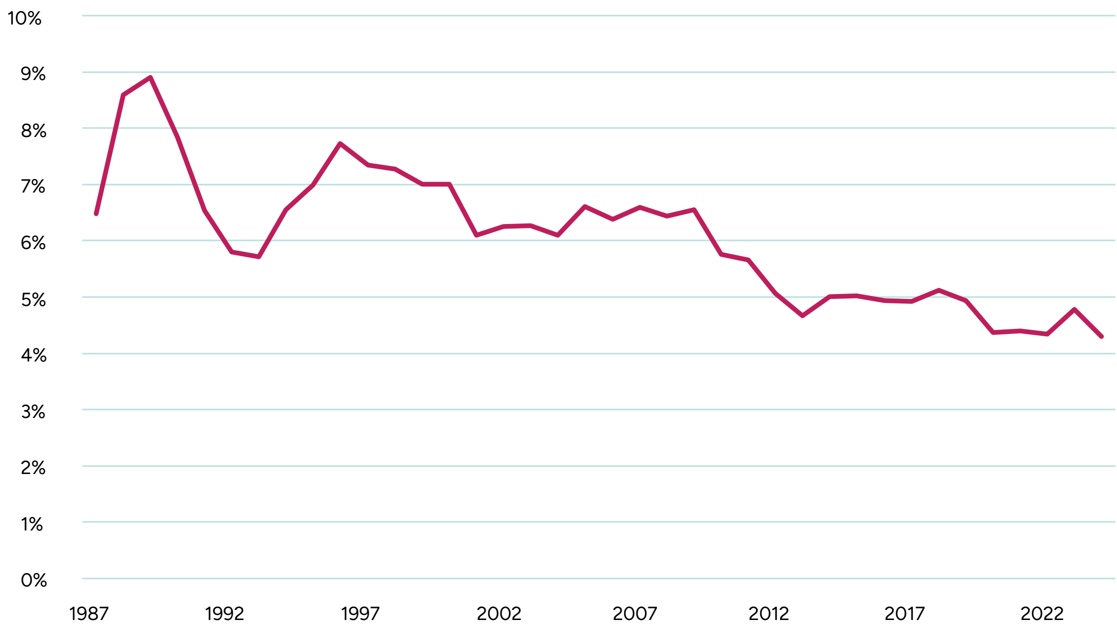
[27] Average household total disposable income is $98,000, Grattan Institute (2023); average dwelling price is $959,000 ABS (2024a), on which stamp duty in Victoria would be $53,000 State Revenue Office (2024).

[28] Malakellis and Warlters (2021, p.22)

[29] NSW Treasury (2020, p.14)

This analysis conceals underlying problems because mining is a large part of private business investment in Australia. Non-mining investment in Australia is much lower than in other developed economies and is at all-time lows (Figure 6).[30] Some factors influence business investment that are beyond the control of government. As services become a bigger share of the economy, they tend to require less capital investment. Capital goods used by businesses (such as computers) have become cheaper.[31] However, these trends do not explain why non-mining investment appears to be holding up in other developed economies but is a shrinking proportion of gross domestic product (GDP)[31] in Australia.

Figure 6: Non-mining investment is at historic lows in Australia
Private non-mining investment, % of GDP



Source: ABS (2024)

Governments can influence business investment by providing a stable political system, efficient approval processes, workforce training, effective competition regulation, and investment incentives such as grants and loans. Tax policies are also significant because they affect the return on investment. These include tax policies such as the corporate tax rate, dividend imputation, investment allowances, accelerated depreciation, and incentives for new investment such as the research and development tax incentive and the proposed Critical Minerals Production Tax Incentive.

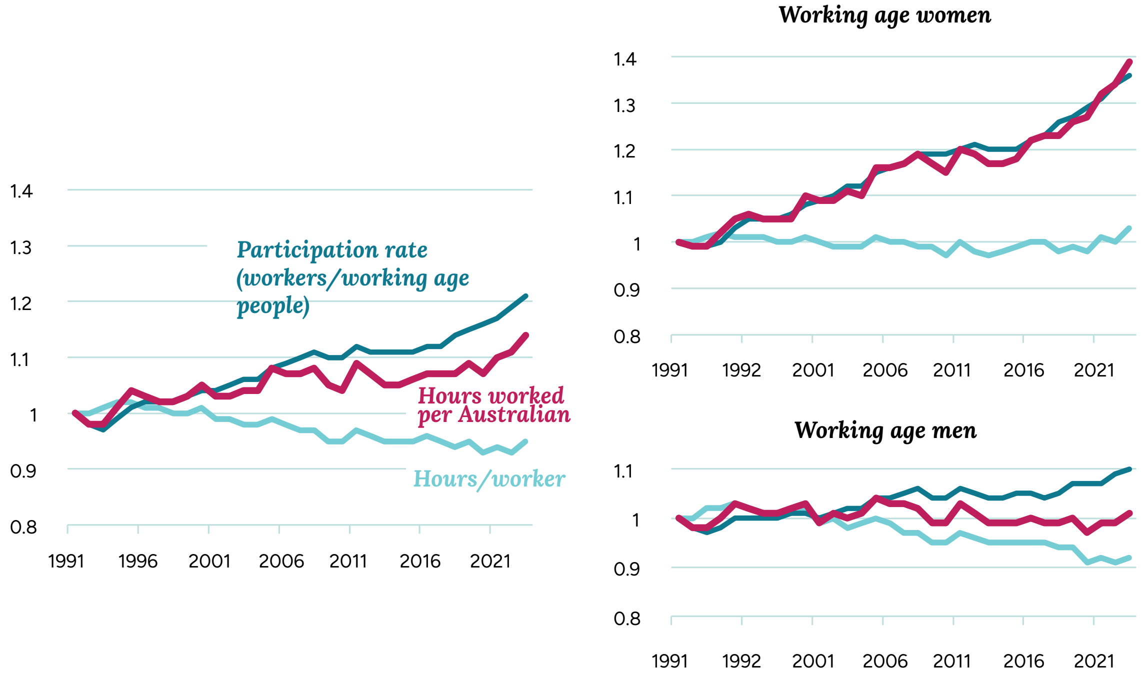
2.2.4 Participation

Participation – hours worked per Australian – also drives economic growth. Over the past decade, continuing trends from the past 30 years, hours worked per resident have risen substantially. While increases in male participation rates have roughly been cancelled out by falling hours per worker, female participation rates have increased significantly, while hours per worker have remained constant. However, in future decades it is likely that more of the population will be retired, dragging on total participation (measured as hours worked per Australian inhabitant)(Figure 7).

[30] See further, BCA (2023)
[31] Minifie (2017, p.23)

Figure 7: Hours worked per Australian have increased due to higher female workforce participation

Participation drivers, indexed to 1991



Source: ABS (2024c); Correa Consulting analysis

To counteract the effect of ageing on participation, Australia would need further increases in workforce participation of women and older Australians. While the proportion of women that work in Australia is higher than the OECD average, the proportion of women who work full-time is amongst the lowest in the OECD.[32] There is broad consensus in the international literature that "effective tax rates" (including childcare costs after subsidies) are a substantial driver of female workforce participation rates.[33] Income taxes are around half of the disincentives to work more hours (net childcare costs are the other half), particularly for women already working two or more days per week, and for those with a full time equivalent salary of more than $90,000.[34]

It is less clear that tax policies can further increase older age workforce participation. Changes to welfare design and the eligibility age for access to the Age Pension and superannuation would have more impact,[35] but these are beyond the scope of this Green Paper.

2.3 Greenhouse gas emissions and the environment

Australia is not reducing its greenhouse gas emissions fast enough. Emissions from electricity have been falling since 2012, but there has been no material reduction in sectors that produce more than two-thirds of Australia's emissions, including:[36]

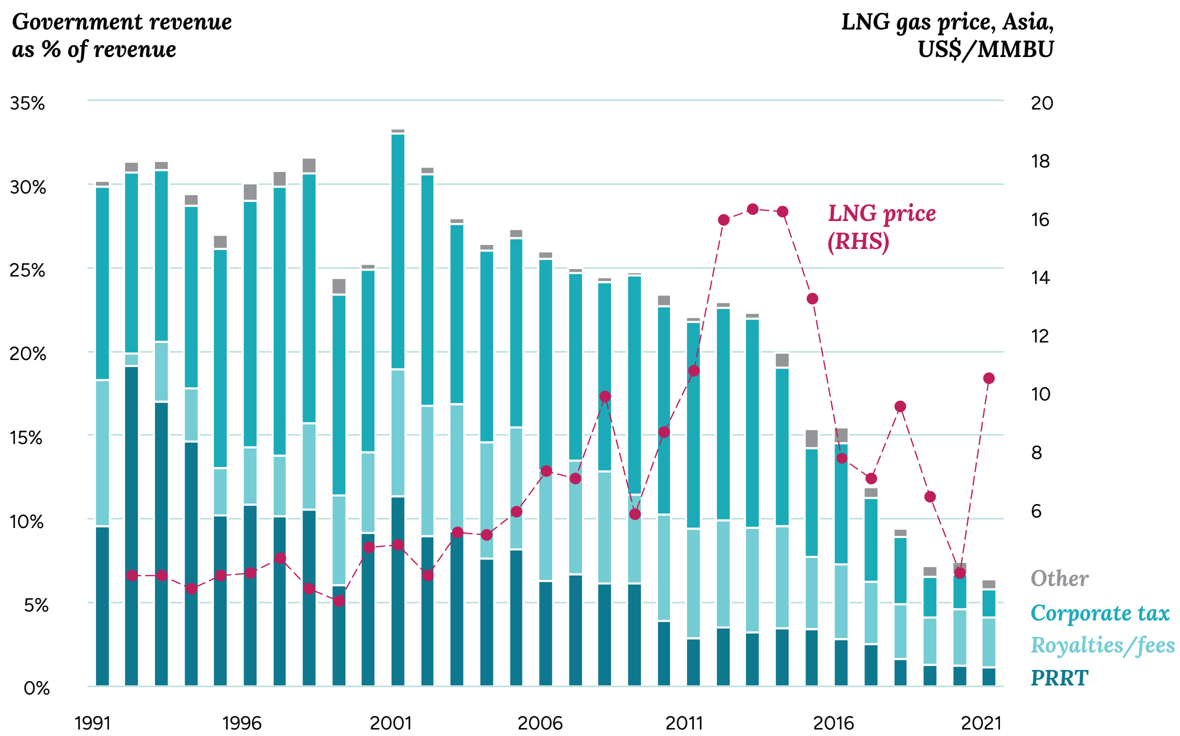
[32] Wood, Griffiths and Emslie (2020, p.8-9)
[33] Wood, Griffiths and Emslie (2020, p.28)
[34] Wood, Griffiths and Emslie (2020, p.72)
[35] Atalay and Barret (2015), PC (2015a, p.51)
[36] DCCEEW (2024a); Quiggin (2023)

- burning fossil fuels for heat – gas to heat homes, and coal and gas to heat industrial production (19% of emissions)
- burning fossil fuels – mostly petrol and diesel for transport (19% of emissions)
- greenhouses gases produced when mining coal and gas (9% of emissions)
- greenhouse gases released by industrial processes such as steelmaking and concrete (6% of emissions); and
- agriculture activities, particularly methane from cattle (15% of emissions).

The fall in electricity emissions reflects a broad range of policy measures that have effectively penalised high-emissions and rewarded low-emissions electricity production as well as the falling cost of renewable energy. The failure to curb emissions in other sectors in part reflects the absence of policies that created substantial incentives to reduce emissions apart from the Carbon Pricing Mechanism introduced by the Gillard government and repealed by the Abbott government. The Safeguard Mechanism now creates incentives to reduce emissions for 219 facilities in Australia that have high emissions.[37] However, there are still minimal incentives to reduce emissions from many sources in Australia.

Even though concern about carbon emissions has grown, government is collecting less from each dollar of revenue earned from producing oil and gas (Figure 8).

Figure 8: Governments now collect a much lower share of the revenue paid for Australian oil and gas

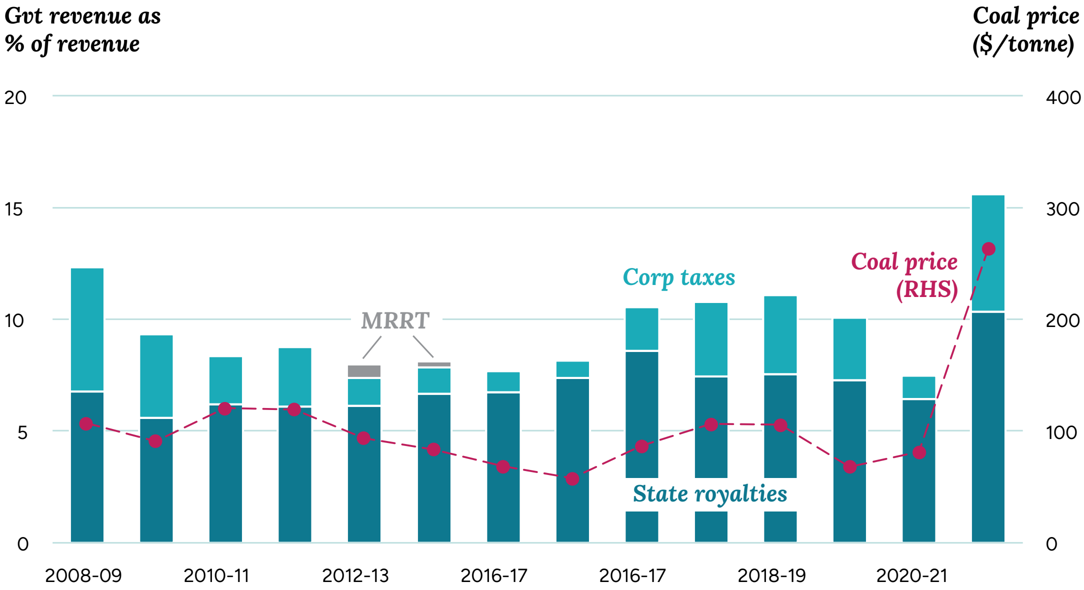


Source: APPEA oil and gas survey (2024), Australia Institute (2023)

At least governments have not increased the incentives to produce coal: government revenues from coal relative to coal producer revenues have remained more constant, with a material increase from 2022 when coal prices increased and Queensland increased its coal royalty, as shown in Figure 10.

[37] Clean Energy Regulator (2024)

Figure 9: When coal prices increased, governments collected a greater share of the revenue paid for Australian coal



Note: *Royalties data from Australian or State/Territory Government Budget estimates and other sources can differ from ABS statistics. For cases where royalties data for coal specifically is not available, assumptions are made about the share of total that is attributable to coal*.
Source: NSW Resources, 'Paying royalties', Resources Victoria ' Earth Resources Regulator Annual Statistical Report' (various years), Queensland Treasury 'State Budget: Budget paper no.2' (various years), Government of Western Australia, Department of Treasury 'Overview of State Taxes and Royalties' (various years) , Government of South Australia 'State Budget, Budget Statement, Budget Paper 3' (various years). ATO Taxation Statistics, Company Table 4 (various years). ABS Series 81550: Australian Industry: time series (Mining by industry subdivision). Federal Reserve Bank of St Louis (2024).

With increasing concern about carbon emissions, there is a powerful argument that government revenue from producing gas and coal should be increasing relative to revenue. This increase in revenue would both discourage emissions and could help to fund tax reductions that encourage investment in activities that produce much lower carbon emissions.

Tax policy is one the most efficient ways to reduce emissions, even if it is not always politically popular. Without a broad-based carbon price, Australia has introduced a wide variety of other policies that aim to reduce emissions, but which do so less efficiently, and which create additional red tape.

If there is no broad-based carbon price, tax reform could help to reduce emissions by reducing exemptions from fuel taxes, and by increasing taxes on the production of fossil fuels, particularly oil, gas, and coal.

Obviously, tax is not the only policy that will help to reduce emissions. Incentives for research, development, and investment into low-carbon technologies will also help, as will incentives to use energy more efficiently. But tax policy has a major role because it provides sharp incentives for producers to reduce emissions. Tax policy is also a potential lever for protecting nature and reducing habitat destruction and animal extinction.

2.4 *Getting Australia back on track*

Australia is a wonderful country: prosperous, diverse, and blessed with beauty, natural resources, and economic opportunity. Until recently, social mobility has been relatively strong.[38] Australia prides itself in being a place where people from all backgrounds can prosper, without their success being predetermined by their parents. We owe a lot to luck – but also to good people making bold but prudent decisions over many years.

Unless we make good decisions now, our future will not resemble our past. The things we have enjoyed will not be accessible to future generations.

But it's not too late to turn this around. We can still get Australia back on track if we act now.

We still can make Australia the best place to build a life and raise a family. Where hard work is encouraged and rewarded, yet where adequate and suitable safety nets exist for those who need them. Where innovative companies and entrepreneurs can develop technologies and services that change the world, as we have done in the past. Where services like aged care, health and disability supports are sustainably funded, not just for now but for the future. Where young and old can be confident in a comfortable retirement. Where young people don't need to choose between a home, a family, an education, a lifestyle, or their career. Where our cities remain vibrant, dynamic, well-serviced and affordable. Where our oceans and landscape remain international drawcards and where our natural endowments provide us with a sustainable and secure energy future.

As the expression goes, the first step is recognising that we have a problem. And the solutions to these challenges are certainly multifaceted; tax reform is not a silver bullet. But by failing to reform our tax system we are, at best, ignoring one of the greatest policy levers we have at our disposal and, at worst, making the implementation of those other solutions much harder and costlier.

This chapter has identified the key problems that we face as:

- It's getting harder for young people to get ahead, and this is closely related to big problems with housing affordability
- Productivity isn't growing much, partly because businesses aren't investing much, and consequently real incomes aren't growing; and
- Australia is not moving fast enough to reduce its carbon emissions, and the energy transition is costing more than it should

[38] PC (2024, p.3)

We have identifies six priorities for tax reform that would address these problems, and that would help Australia to become the country we want it to be:

1. lower income taxes on working Australians so they can earn and get ahead
2. rebalance tax settings in favour of home ownership rather than investing in existing dwellings
3. incentivise innovation and business investment to increase economic growth
4. rebalance tax settings so that the revenue base remains sustainable with changes to demographics and consumption patterns such as fuel consumption
5. adjust tax settings to support our energy transition, rather than work against it; and
6. implement institutional reform so we can better manage future challenges as they develop.

The remainder of this Green Paper looks at potential approaches, suggested by experts and stakeholders, to address these priorities.

3 Tax policy, politics, *and principles*

3.1 *Why tax matters*

Tax is vital to a prosperous modern society. Tax pays for government services, security, and governance that benefit us all. Tax is not a "burden" – it is an essential part of government and the benefits it brings.

Tax policy is part of defining our society. It reflects judgements about what is "fair" between individuals, generations, between workers and investors, and between Australians and those from overseas.

Tax also shapes our society because it influences behaviour. In the 19th century, windows taxes encouraged home-owners to brick-up window spaces.[39] In our time, taxes have influenced the balance of investment between housing and businesses.

3.2 *Why tax reform matters*

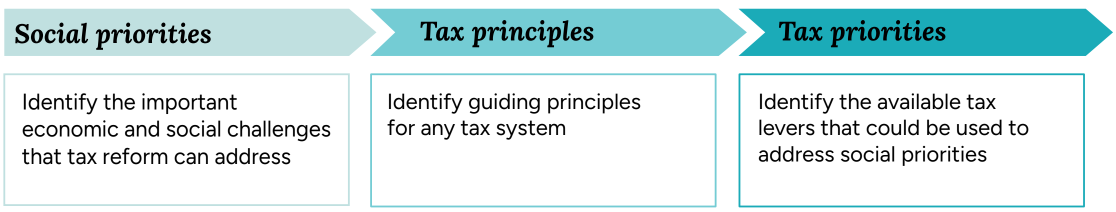
Big social, economic, and environmental challenges require tax reform to be part of the solution. Tax makes a big difference to the shape of our society, our economy, and our environment. Well-designed taxes can promote good social, economic and environmental outcomes. Tax reform is not the only policy lever to improve outcomes, but it is powerful and important.

Historically, tax reform has happened when there is a public perception – often built over many years - that it is needed to solve significant social or economic challenges.[40] Tax reform is seldom the entire answer to social issues, but it can be a powerful lever in contributing to change. So, it is not surprising that, in a survey of 1,068 Wentworth Residents, 75% of people think tax reform should be a high priority for government.[41]

Tax reform should also be thoughtful. Taxes impose costs, and good tax design aims to minimise the costs to individuals and the potential drags on innovation, economic participation and productivity. Tax reform should aim to be consistent with long-established principles of tax system design.

Consequently, this paper starts by identifying the social, economic and environmental problems we are trying to solve and consistent with the guiding principles for tax design, identifies some of the directions for tax reform that could contribute to resolving these problems (Figure 10).

Figure 10: Social priorities and tax principles should drive the direction of tax reform
Process for establishing tax reform priorities



Source: Correa Consulting

[39] Keen and Slemrod (2022, p.17-22)
[40] Tilley (2024a, p.352-357)
[41] Spender (2024)

3.3 *Tax and politics*

3.3.1 Tax is political

Changing tax policy is almost always politically controversial. Almost every tax change results in both winners and losers. Those who will pay more tax are rarely happy about it. To overcome almost inevitable opposition from losers there needs to be a strong case that shows how particular tax changes can contribute to resolving social and economic issues that are widely seen as priorities.

As a result, there is a long history of political wedging and media demands to rule-in rule-out over tax changes. As a result, most politicians seek to avoid discussing tax, and if they do discuss it, they often weaponise it. Too often, discussion focuses on the "losers", and we let slip the social, economic, and environmental outcomes that matter to us all.

3.3.2 Models for successful tax politics

This doesn't make tax reform impossible. Pretty much every major tax reform of the past 124 years of federation has been politically controversial, and was opposed by one of the major political parties – but was pushed through nevertheless. Major tax reforms have always depended on political leadership that explains why we need change, engages with the public and brings most people – if not everyone – onside.

History shows that successful tax reform in Australia usually occurred when there was:[42]

- ongoing debate and foundational reviews to establish a broad acceptance of the direction of reforms
- a government with political capital, with substantial voter trust
- political leadership; and
- fiscal room (often created by bracket creep) that allowed governments to "buy" reform, or a crisis that justified reform.

As with so many other policy areas, policy change often depends on both long-term preparations, and seizing short-term opportunities.

[42] Tilley (2024a, p.352-357)

The political landscape over the past few decades have made tax reform harder. Trust in government has fallen[43] so that governments have less political capital. Governments are less willing to show leadership on policies that are not popular with the electorate.[44] There is no fiscal room because Australia starts with a structural budget deficit, tailwinds from the mining boom are fading, and the population is ageing.

In this unfavourable political environment, tax reform will depend on engaging the community so that people understand the problem, why tax reform needs to be part of the solution, and the broad shape of that reform. I believe that members of the crossbench, more closely connected to the electorate and with higher levels of trust, could have a crucial role in building momentum for tax reform. .

3.3.3 Packages to manage the politics of tax

Packages of tax reform can help to manage the dynamics of opposition to every tax change. If there are multiple changes, then people who lose from one change may win from another and be no worse off overall. And while an individual tax change might serve one tax principle and detract from another; a package with multiple tax changes can result in progress on all of the key principles for tax design. On the other hand, if a package gets too large, it can become too difficult for voters to understand.

This Green Paper, and the process that I will sponsor after it, will focus on "budget neutral" changes – any increase in revenue from one tax change will be matched by a reduction in revenue from other tax changes, at least over the short-term. This aims to keep the process focussed on improving Australian tax policy. Net increases or reductions in tax revenue are effectively judgments about the appropriate size of government. I believe we should not increase tax as a proportion of GDP, and ideally should seek to lower this. However, I recognise this is a separate debate about spending priorities and efficiency of government spending. Consequently, my tax process will focus on improving Australia's tax policy, and leave arguments about the appropriate size of government in Australia to other forums. However, good tax reform should deliver a growth dividend over the medium to long term.

This Green Paper, and the process that I will sponsor after it, will also focus on packages that are budget neutral for taxes on individuals, and budget neutral for taxes on corporate entities. This is not entirely justified by tax theory which points out that the "legal incidence" of a tax – who is legally liable to pay the money – can be different from the "economic incidence" of a tax – who winds up with less money in their pocket. Often when one person pays a tax, they respond by increasing their prices, and it is their purchasers who bear the cost. For example, many economists say that higher corporate income tax may result in less investment, which results in lower wages, so that individuals ultimately bear the cost.[45] However, I do not believe that the Australian community is willing to increase taxes on individuals to pay for lower corporate taxes. I also believe that it is undesirable to increase the overall tax burden on businesses because it will discourage business investment when we are looking to increase economic growth.

[43] While trust in Federal politicians increased between 2021 and 2023, it has declined over the longer term: OECD (2024); Daley (2021, p.40)

[44] Daley (2021)

[45] Treasury (2009, p.152-153)

3.4 *Tax principles*

3.4.1 Why tax principles are relevant

The previous chapter showed that Australia's most significant challenges where tax reform can help include:

- it's getting harder for young people to get ahead, and this is closely related to big problems with housing affordability
- Australia is not generating enough long-term economic growth; and
- Australia is not moving fast enough to reduce its carbon emissions, and the energy transition is costing more than it should

In contributing to solving these challenges, tax reforms should also be consistent as far as possible with the core principles of tax design which aim to ensure that tax policy is consistent with a broad set of public policy aims.

3.4.2 Traditional tax principles

Adam Smith once articulated the principles of good tax design as equity, certainty, convenience, and economy.[46] These principles have been restated in different ways many times since, but their essence remains the same. Typically, tax systems are designed to be:

- **Efficient:** The tax system should levy tax in a way that minimises drags on individual and social well-being and economic productivity, and protects the environment for the benefit of future generations.
- **Fair:** The tax system should reflect the ability of individuals and organisations to pay.
- **Simple:** The tax system should minimise the costs of compliance for taxpayers and administration – and simplicity may also reduce the opportunities for avoidance.
- **Adequate:** A tax system should raise sufficient and sustainable revenues to fund government now and in the future.

Something resembling these principles has been explicitly reaffirmed in every major review of Australian tax policy.[47]

3.4.3 A revised set of principles

Establishing the purpose and principles of the tax system helps to define the objectives of reform. As part of a critical evaluation of Australia's tax system I have come to a revised set of principles that I will use to guide the priorities for tax reform in this Green Paper. These principles are heavily grounded in the traditional tax principles while providing additional detail that reflect some of the discussions we have had with stakeholders, though once again these are my principles, not theirs. More specific principles determining what an effective tax system looks like make it easier to identify where the tax system is not performing as well as it could.

[46] Smith (1784, p.463-464)

[47] Treasury (2009, p.4)

The principles guiding the Green Paper are that our tax system should:

1. encourage economic productivity and growth
2. raise revenue with the least cost to society by minimising distortions to the way we work, consume, save and invest
3. encourage behaviours that benefit individuals, society and the environment and discourage those that don't, provided that tax is the best policy lever to do this
4. treat people and organisations with the same capacity to pay in the same way, and raise more tax from those with greater capacity to pay
5. be easy to understand and simple and cost-effective to comply with; and
6. provide a stable tax base over time given changes in the economy and society

It is not always possible to maximise all of these principles at once. Individual tax changes may serve one principle more than another. Tax reform should aim to ensure that overall, the system moves in the right direction. Tax systems and tax reform should also be assessed in the context of other policies, particularly the welfare system.

A key principle of undertaking tax reform, rather than a principle of taxation itself, which is important to highlight, is that:

7. Tax reform should be thoughtful about transitions, particularly for individuals and businesses.

This principle recognises that individuals and businesses have made decisions based on the tax system at a point in time. Nevertheless, the tax system should evolve and we cannot completely grandfather every change. Consequently, changes need to be thoughtful about how to transition from old to new tax settings. They need to balance the interests of those who have already made decisions with the broader interests that we are trying to promote through tax reform.

4 Tax reform *and Australia's social and economic issues*

This chapter explores potential tax packages for individuals and for corporates that could help to address these social and economic priorities consistent with the core principles of tax design. These packages could be budget neutral for individuals or corporates if designed with appropriate parameters.

4.1 Taxes on Individuals

The critical priority for Australia's personal tax system is to reduce taxes on working people and rebalance the system towards home ownership. This would simultaneously:

- make it easier for younger generations to build prosperity
- improve home ownership affordability for younger generations
- improve long-term budget sustainability; and
- increase incentives for workforce participation.

This direction for tax reform would contribute substantially to resolving many of the social and economic problems identified in Chapter 2.

4.1.1 Lower income taxes

We need to lower the tax burden on working people through lowering income taxes. It would be fairer, encourage productive contributions to the country, and improve the sustainability of the tax system.

Lower taxes on labour income are needed so that each generation has the opportunity to build their own prosperity regardless of their parents' background or contribution. Younger generations that have relatively few assets can only build wealth by working and saving. Earned income from work is the one way open to almost all Australians to provide for their families and build a life for themselves.

Low taxes on labour income would also promote workforce participation, particularly people who work part time and have real choices about whether to increase their hours. They would have greater incentives to work more, and tax cuts on labour income would increase the amount that they take home if they work extra hours.

It is critical economically, but it is also critical socially. Younger people are falling behind relative to older generations. They feel it and so does the broader community. This is having a profound impact on people's life choices, including one of the most important and human, the decision to have a family and what shape that family takes.

A lack of sense of fairness impacts trust in government, trust in institutions and social cohesion. We are seeing that lack of trust amongst younger generations.

Rebalancing tax revenue from income taxes on labour towards other sources of tax is also important for sustainability. Under current settings, as the population ages, the income tax burden on working people will grow even as the number of working aged people declines.

To deliver a revenue neutral individual tax package, three key ways have been suggested by experts and stakeholders to pay for reducing the relative burden of income tax:

- reduce tax concessions for individuals on investment earnings
- increase consumption taxes; and
- reduce tax deductions for individuals, particularly where these are claimed unfairly.

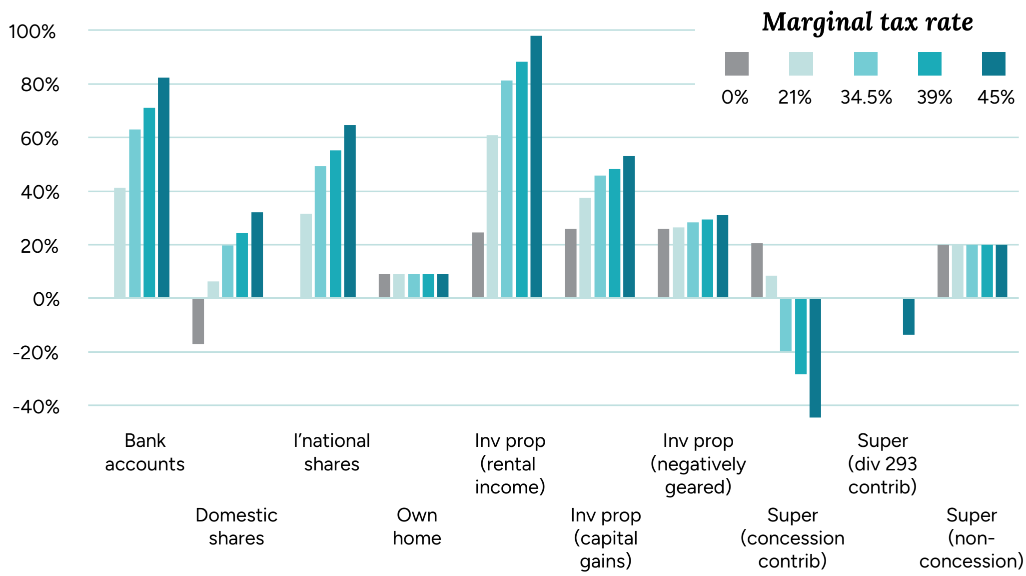
Each of these is difficult. It is hard to deliver meaningful and permanent reductions in income tax levels. But it is also really important. We will consider each in turn.

4.1.2 Tax concessions on investment earnings

The earnings on many investments are effectively taxed at much less than earnings from working because of the capital gains tax discount, the payment of capital gains tax only when an asset is sold, and superannuation tax concessions. The concessions on investment earnings vary a lot depending on where the money is invested (Figure 11).

Figure 11: Variations in taxation by investment class[48]

Marginal tax rates of investments relative to expenditure benchmark



Source: Varela et al (2020)

[48] These calculations overstate the tax rates on investments because they use a benchmark that tax treats all expenditure equally. An "expenditure benchmark" defines the tax rate on the earnings from investments as the cumulative taxes paid on investment earnings as a percentage of the original capital, discounted for inflation (see Treasury (2009, p.32); PC (2015c). In effect, this benchmark assumes that the main question for savers is whether they spend today or spend tomorrow. Many tax economists make this assumption, but it is increasingly contested (as usefully summarised in Mazlish (2024)). The assumption might be justified if the only reason that people saved was to enable spending later. But there are many other reasons for saving: it provides security if future income is uncertain (Golosov, Kocherlakota and Tsyvinki (2003)); it enables larger scale expenditure when borrowing is constrained (Aiyagari (1995)); and some capital investments (particularly housing) may be valued for reasons other than their investment returns (including social status, the value of running one's own business, and the "love of money as a possession" (Saez and Stantcheva (2018, p.124)).

In real life, many people think of saving as a vehicle for future income. They tend to think of this year's investment earnings as in the same pot as this year's labour income, and quite separate to the nominal value they have saved. This is reflected in retirement behaviour where many people are happy to spend investment income from the current year, but very reluctant to spend down the nominal value that they have saved.[49] It is also reflected in savings behaviour – people tend to save about the same amount, irrespective of the tax rate on future investment earnings - although where they save is heavily influenced by which investments will pay the least tax (see Figure 11).[50]

There are also reasons why savings *should* be taxed progressively: people who earn more are also likely to save more;[51] people start out with different amounts of wealth;[52] some people have lower discount rates or higher ability to earn returns on capital;[53] and some income on investments may be disguised labour income.[54]

Reducing tax concessions on investment earnings implies potentially considering capital gains tax discounts, negative gearing, and superannuation tax concessions. Other investment earnings (such as company dividends) are already taxed at marginal rates. These rates are typically high because 59% of dividends paid to individuals (outside of superannuation) are paid to people paying the top marginal tax rate (with taxable incomes over $180,000)(see Figure 12).[55]

Less tax on income from working increases the opportunity to build prosperity. Younger generations that have relatively few assets can only build wealth by working and saving. Less tax on labour income means that workers could save more. Tax rates on labour income affect young people more than tax rates on earnings from investment because they usually have relatively few assets.

Higher taxes on investment earnings will also make home ownership more affordable. In effect they would make housing a bit more attractive to homeowners rather than investors because they would reduce the after-tax return on housing for investors while leaving it unchanged for home-owners.

The switch between tax on labour and tax on investment would also promote long-term budget sustainability. It would better protect tax collections when more of the population is retired.

4.1.3 Capital gains tax and negative gearing

Reducing tax concessions for capital gains tax and negative gearing could both fund cuts to taxes on labour income, and increase home ownership. Studies have estimated that changes might increase the proportion of households that own their own home by between two and four percentage points (so increasing from about 66% today to between 68% and 70%. This improvement might well be concentrated amongst younger households, and if so, home ownership rates for younger households would increase by much more.

[49] Daley and Coates (2018b, p.32)
[50] Treasury (2015a, p.57-58)
[51] Diamond and Spinnewijn (2011)
[52] Cremer, Pestieau and Rochet (2003)
[53] Gerritsen et al (2024)
[54] Reis (2010)
[55] Correa Consulting analysis of ATO, Taxation Statistics, Table 10
[56] Deloitte Access Economics (2019, p.60); Cho et al (2017)

Australia only taxes part of the capital gain when an asset is sold at a profit. Only 50% of the nominal gain is taxed. Given actual inflation and asset price rises over the past 25 years, real capital gains have been taxed at substantially less than marginal tax rates, which implies that the 50% discount is too large even applying the relatively generous expenditure tax benchmark.[57]

A lower capital gains tax discount would effectively increase the tax paid on investment income. Of course, this would only affect capital gains tax discounts for investments, not for the family home, which is exempt from capital gains tax, and this paper does not contemplate changing this exemption for a variety of reasons. With changed tax arrangements for investment but not home ownership, housing would be relatively less attractive to investors, effectively reducing the price of housing a little to homeowners.[58]

However, while the impacts of changes to capital gains tax discounts for investment properties is the subject of significant discussion in the media, the impact of such changes to people starting and growing businesses has had much less discussion. We need to continue to incentivise entrepreneurship and innovation, as they are key for productivity and growth, and so any changes to capital gains taxation need to reflect this. That may be complicated.

Negative gearing occurs when a taxpayer deducts current year losses on an investment from labour income, reducing their tax bill. It is common with property investments, where losses are often driven by the cost of interest on the loan for the property. Deducting losses from gains is unremarkable. However, negative gearing allows the costs of an investment to be claimed against labour income at marginal rates, but not all of the profits on the investment are taxed at marginal rates because of the capital gains tax discount. This mismatch allows negatively geared investors to earn substantially higher after-tax returns.[59]

The proportion of investors negatively gearing increases with interest rates, effectively increasing the cost of investor housing loans. The scale of negative gearing is large - $6.9 billion in forgone revenue in 2024-25.[60] Perversely, in most years Australia would collect more tax overall if the recurrent income and costs of housing investment were both excluded from the tax system.[61] For tax purposes, some Australian residential property investors can pay less tax overall despite making overall investment profits, because the tax system counts all of their costs as expenses, but only counts half of their capital gain as income.[62]

Negative gearing would automatically be less attractive to investors if the capital gains tax discount was reduced suggesting that changes to capital gains discounts should be the priority. Others have proposed limiting negative gearing by only allowing taxpayers to deduct losses on investments from gains on investments (that is, they would not be able to deduct losses on investments from labour income).[63] Other suggestions would limit negative gearing claims to only one or two property investments. Some proposals would continue to allow negative gearing for investments in newly built properties[64] (which would counter the concern that limiting negative gearing would discourage building new dwellings).

[57] Daley and Wood (2016, p.8-9)

[58] Coates and Crowley (2021, p.12)

[59] Daley and Wood (2016, p.27-28)

[60] PBO (2024, p.3)

[61] In other words, the recurrent costs (largely interest costs) are greater than recurrent revenues (i.e. rent). The most recent year for which data is available (2021-22) is an exception – with low interest rates in 2021-22, deductions on property investments were lower than normal.

[62] Daley and Wood (2016, p.21)

[63] E.g. Daley and Wood (2016, p.38-39)

[64] PBO (2019, p.1-2)

Although some argue that changes to capital gains tax and negative gearing would lead landlords to demand higher rents to make up for increased taxes, there is little evidence for this. As a matter of theory, changes to after tax rates of return would only be reflected in property prices, not rents. Rents are largely a result of the balance between supply and demand for housing. If some investors exit the market (effectively selling to first homebuyers), then any reduction in the number of rental properties would be matched by a reduction in the number of renters. As a matter of practice, the short-lived restriction of negative gearing between 1985-1987 did not result in any material increase in rents in Melbourne, Adelaide or Brisbane, although it did coincide with an increase in rents in Sydney and Perth, which was primarily the result of constrained supply relative to demand.[65]

A more plausible claim is that changes to capital gains tax and negative gearing would reduce the flow of investor capital into new housing, reducing overall supply, and therefore pushing up rents in the long-term.[66] This would not be a problem if negative gearing concessions were maintained for new dwellings. The effect would likely be small,[67] and likely be largely offset by greater flow of owner-occupier capital into new housing (attracted by marginally lower housing prices), increasing overall housing supply. However, at a time when we urgently need to increase housing supply, we need greater investigation of this to make sure that the impact on housing and also rents is not substantial.

Any changes to the capital gains tax discount or negative gearing would need to be very thoughtful about the transition. On the one hand, if the changed capital gains discount rate and deductibility of losses apply to properties that have already been purchased, then government is effectively changing the after-tax return on an investment. On the other hand, if the new rules only apply to future investments, then it will be a long time before many of the changes affect the social problems they are designed to fix and could widen the gap in wealth even further between those who have accumulated wealth already and continue to benefit from concessions on the investments they have already made, and younger generations trying to build prosperity whose future investments do not benefit from the same concessions.

Possible transition arrangements that have been suggested that might balance these different considerations for capital gains tax include taxing gains on assets from the date of commencement (allocating any gain pro rata on the basis of the length of time between acquisition and commencement, and commencement and sale), a gradual reduction in the capital gains tax discount each year for all gains on assets acquired before commencement, or a delay so that the lower discount only applies to assets acquired before commencement after several years, giving investors time to sell if they believe that the investment is unattractive under new arrangements.

Possible transition arrangements for negative gearing in respect of an asset bought before commencement include reducing the losses that can be deducted against labour income over time, or only restricting the deduction of losses against labour income some years in the future. In economic theory, both of these arrangements would lead to asset prices being lower than otherwise almost immediately, but the budgetary improvements would flow through more slowly. The design and size of income tax reductions would need to match the revenue that would be raised by changes to capital gains tax, negative gearing, and superannuation tax concessions. Because the reductions in these tax concessions would primarily affect people with higher incomes, it is arguable that income tax reductions should also be shaped to significantly benefit people with higher incomes.

[65] Daley and Wood (2016, p.33)

[66] E.g. Tilley (2024b, p.10-12)

[67] Deloitte Access Economics (2019) estimates a 4% reduction in the volume of new housing, which implies very little change to the total housing stock, and therefore rents.

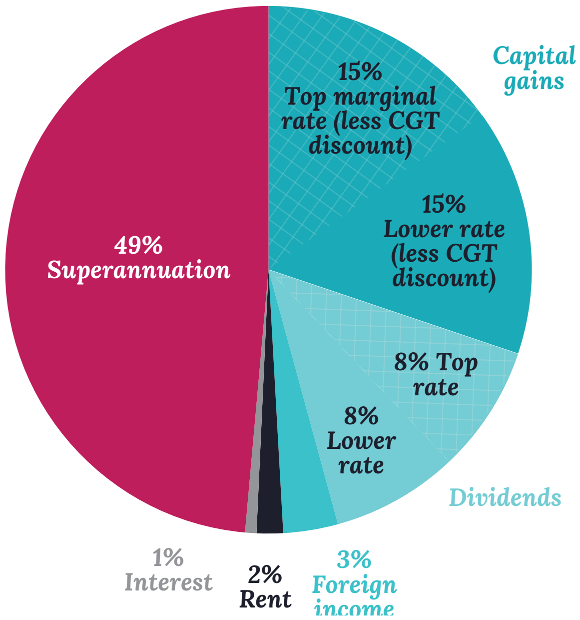
Some economists have argued that Australia should move towards a "dual" approach to taxation of investments. This would have one set of tax thresholds and rates for labour income, and another set for investment income.[68] Australia would effectively move towards this system if we restricted negative gearing so that investment losses can only be claimed against investment gains.

4.1.4 Superannuation tax concessions

Superannuation tax concessions result in much lower taxes on investment earnings than other vehicles (Figure 11). Taxes are low because people can add to super from their pre-tax income. And even for investments from post-tax income, taxes on investment earnings are generally lower, particularly for those on high incomes (who tend to have larger superannuation balances). Before moving to pension phase (in practice, when the investor is aged under 60), superannuation earnings are only taxed at 15%. And in pension phase (which can begin when the investor is aged over 60 even if the investor is still working), no tax at all is paid on the earnings on superannuation balances less than the transfer balance cap of $1.9 million.[69] These concessions generally result in tax rates on investment earnings that are significantly less than the tax rates on similar levels of labour income. Superannuation earnings are about half of all investment earnings (Figure 12).

[68] See e.g. Treasury (2009, p.32-34); Varela et al (2020, p.52)
[69] As of 2024-25: ATO (2024d)

Figure 12: Almost half of all investment earnings for individuals are held in superannuation
Net investment returns to individual taxpayers, proportion of total, 2021-22. Total = $729b



Note: assumes average 7% return on superannuation balances
Source: ATO, (2024a); Correa Consulting analysis

A variety of changes have been proposed to the superannuation system over time, including by Treasury's Australia's Future Tax System Report (the Henry Review).[70] Some have argued that the super system should mirror the progressivity of the income tax system, with rates higher for those with higher superannuation earnings or balances. Some progressivity is required because otherwise people with lower balances (roughly under $250,000 depending on rates of return) would pay more tax on superannuation earnings than if they invested directly, outside of superannuation. These changes might tax earnings (mirroring existing structures) or tax superannuation balances (at a much lower rate). Government might also revisit the "transition to retirement" arrangements that allow individuals to benefit from lower tax rates in pension phase even though they are still working.

Changes to the superannuation concessions are very difficult. Australians feel uncertain about their capacity to pay for their retirement. 52% of older Australians, and 38% of Gen X are not confident of having the money needed to retire.[71] Individuals have planned for their retirements and those close to or already retired reasonably expect a fair degree of certainty around their futures. Rules about superannuation and the Age Pension are changed often, and 60% think they do so too often.[72] On the other hand, superannuation tax concessions are one of the key reasons why retired Australians pay around 50% of the tax of working aged Australians on the same income.

[70] Treasury (2009); Coates and Moloney (2023b)
[71] Games (2023)
[72] BETA (2020, p.23)

4.1.5 Goods and Service Tax (GST)

Many people have proposed increasing or broadening Australia's GST as a key reform to the tax system. It is one area where a significant change would be of the scale that could deliver a substantial reduction in income taxes. However, again there are significant political difficulties of doing so.

International experience suggests that it is easier to increase the rate than to broaden the base.[73] Federalism arrangements in Australia discourage change because under current arrangements the Commonwealth Government would feel most of the political cost, but states and territory governments receive much of the budgetary benefit. This agreement is not constitutionally binding, but it is politically difficult to alter because states and territory governments are likely to vociferously oppose any sharing of GST revenue. Current controversies over the distribution of GST revenue between states and territories would also complicate reform.

GST increases, matched by lower income taxes, could increase the sustainability of the tax system by spreading the tax burden across the whole of the population including people who are not in the workforce.[74] The extent to which it would reduce intergenerational inequality and make the tax system more sustainable with an ageing population depends on the accompanying changes to tax and welfare. There would inevitably be pressures to design welfare changes as part of a GST package to avoid adverse impacts on low-income earners including all those receiving the age pension.[75]

Increasing GST and reducing income taxes could also improve productivity because the GST has a flat rate that applies irrespective of the taxpayer's income and because the change may encourage more saving.[76]

Current high inflation rates mean that changes to the GST are particularly sensitive now and are unrealistic in the short term. The Productivity Commission is due to review the distribution of GST between the States and Territories by the end of 2026.[77] At a minimum, the Productivity Commission's review should be broadened to include consideration of substantial changes to the level and coverage of the GST.

4.1.6 Implementing a standard deduction

Introducing standard income tax deductions for individuals could both raise additional revenue that could fund lower tax rates on labour income, and increase productivity by reducing the time and expense to prepare and administer tax returns.

Tax deductions – claiming expenses to reduce one's taxable income – reduced the tax collected by the Australian Treasury by $42 billion in 2021-22. On average, taxpayers claimed over $3,000 in tax deductions.[78] While tax deductions for genuine expenses are a perfectly reasonable component of the tax system, they create loopholes ripe for exploitation.[79] A random detailed review of 1,090 individual tax returns in 2018-19 and 2019-20 found that 69% of individual returns required adjustment, with 81% of those using a tax agent requiring adjustment.[80] By comparison only 2-3% of all individual tax returns were adjusted in practice. This suggests that a large number of unwarranted deductions are undetected each year.

[73] Miller (2015)

[74] Daley and Wood (2014, p.27)

[75] And the pressure to avoid individuals being worse off can lead to packages that would make the tax and welfare system more progressive and increase tax as a proportion of GDP: see Daley and Wood (2014, p.13-21)

[76] Stewart, M. and Varela, P. (2016, p.4-5)

[77] Treasury Laws Amendment (Making sure every state gets their fair share of GST) Act 2018, Section 4

[78] ATO (2024a)

[79] Breunig, Deutsche, Hamilton (2024, p.2)

[80] ATO (2024g)

The ATO estimates that individual taxpayers avoided paying approximately $10.6 billion in tax in 2021-22,[81] primarily as a result of incorrectly claimed work-related expenses.[82]

Two-thirds of Australians use a tax agent to complete their tax return.[83] This is amongst of the highest in the OECD and highlights the complexity of Australian income tax system,[84] and the costs of compliance.

A standard deduction would set a default amount to reduce the taxable income of each taxpayer.[85] Individuals would retain the option to lodge itemised deductions if these exceeded the standard deduction. This would reduce compliance costs, and make it easier for the ATO to target audits of those who may be claiming deductions incorrectly. The Blueprint Institute found that a standard deduction of $3,000 could fund an income tax cut of between $400-600.[86] It would also reduce administration and compliance costs for both individuals and the ATO.[87]

4.1.7 Rebalancing the system towards home ownership

This paper has already noted that reducing taxes on labour incomes and reducing tax concessions for housing investors will help more Australians to own their own home, potentially increasing home ownership rates by between 2 and 4 percentage points or between half a million and a million people (section 4.1.3).

Reducing stamp duty – funded in the long term through higher land taxes – would help to both increase home ownership and increase economic growth. A study for the NSW Treasury estimated this tax reform would increase home ownership by 2 percentage points – equivalent to around an extra half a million people living in their own home.[88] It would remove a major obstacle to home-owners changing their residence so that they can live closer to where they work. As a result of stamp duty, many people choose not to take a job that better matches their skills, or endure long commutes. This drags on productivity and therefore average incomes.[89] Reducing stamp duty, particularly on the sale of land, and replacing it with an annual property tax, would also improve efficiency more than any other tax change.[90] In the long-run the change could be designed to be budget-neutral with the reduction in stamp duty matched by the increase in property tax revenues.

Such a tax change is primarily the responsibility of state and territory governments. Only the ACT has substantially moved to implement it. Others have been reluctant to act because of the political and budgetary cost of transition. Many consider it unfair to levy an additional annual property tax on new owners who have only just paid a substantial stamp duty charge. To deal with this, most implementation proposals have suggested phasing in the additional property tax over time (often applying property tax only once properties have been sold without incurring stamp duty). Such proposals would result in a substantial reduction in State and Territory revenues for over a decade, even if they will recover in the long-term.

[80] ATO (2024g)
[81] ATO (2024g)
[82] ATO (2024g)
[83] ATO (2024a)
[84] Harb and Morton (2023)
[85] Beal et al (2021, p. 16)
[86] Beal et al (2021, p.15)
[87] ATO (2024a)
[88] Warlters (2022, p.3)
[89] Daley and Coates, (2015, p.12)
[90] NSW Treasury (2021, p.89); Treasury (2015b, p.53)

State and territory governments generally lack budgetary options that would allow them to absorb such a reduction in revenue. They may be particularly reluctant to absorb this cost because many of the economic benefits and accompanying increase in tax collections will flow to the Commonwealth Government through higher income and corporate tax revenues. Progress will probably require the Commonwealth to provide at least the lending headroom for the change, so that the debt would not affect the states' credit ratings, though the states would be responsible for the repayments, if not some up front funding to smooth the budget impacts of the transition.

4.2 Taxes on businesses

The key aims of potential changes to taxes on businesses is to incentivise innovation and business investment to drive productivity, and to support our energy transition. Tax reforms that could meet these aims include:

- Lower taxes on new business investment in productive activities (which should raise Australian living standards in the long term);
- Higher taxes on business activities that cause harm (such as emitting greenhouse gases);
- Lower stamp duties that encourage workers to move to wherever their skills will be best used, so increasing corporate productivity (discussed above); and
- Reduced wasteful regulatory burdens of inconsistent payroll tax definitions and thresholds, and other areas of tax complexity.

Taxes can influence corporate behaviour. Tax reforms that increase the returns on new corporate investment can encourage more investment, which increases productivity. Tax is not the only policy lever that can increase productivity, but it is important. Productivity is responsible for 80% of real wage growth. Without productivity improvements, real incomes cannot sustainably increase in the long term.

Higher tax on harmful activities, such as producing carbon emissions, discourages investment in those activities, and encourages investment in businesses that produce substitutes. For example, higher taxes on producing electricity by burning coal encourages greater investment in producing renewable electricity.

4.2.1 Increasing productive corporate investment

More corporate investment in productive activities would raise Australian living standards. Investing in businesses (whether or not the accountants would classify it as "capital investment") enables companies to produce more for every hour worked. Given budget constraints, a key question is to determine which tax reforms would deliver the biggest uplift in investment relative to the tax revenues given up that have to be raised from additional taxes elsewhere.

Many factors influence corporate investment including the availability of appropriately skilled labour, labour costs, the presence of suppliers, logistics costs, local profitability (often influenced by competitive intensity), robust institutions such as rule of law, and appropriate regulatory regimes that are neither overly onerous nor unduly lax. Tax on investments and returns is also relevant, and all other things being equal, some companies will invest more if they pay less tax on the returns.[91]

[91] Treasury (2012)

The impact of corporate tax rates on corporate investment in Australia is complicated by our dividend imputation regime. Because the tax paid by domestic shareholders on dividends is a consequence of their personal tax rate, the corporate tax rate makes little difference to them. For domestic shareholders, the corporate tax rate primarily affects how much profit a company retains for re-investment. This particularly affects smaller companies for whom raising extra capital may be difficult or expensive.

For foreign shareholders, the impact of corporate tax rates depends on whether the corporate tax rate in their home country is higher or lower than Australia, their personal tax rate, and how the tax rules of their home country treat taxes paid in another jurisdiction. The effect of many international tax treaties is that taxpayers are often given a credit for some or all of the tax they have paid in other jurisdictions.

From an Australian perspective, lower corporate tax rates can encourage more investment from foreign shareholders, increasing Australian labour income, but they also result in more profits flowing to other countries. In theory, over the long run, reductions in tax paid will be outweighed by increases in Australian labour income. Additional competition from foreign investors should also pressure Australian shareholders to reduce their returns in favour of greater labour income.

However, in the short run, the loss of tax revenue from foreign investors would be immediate, whereas the increase in foreign investment and accompanying increase in Australian labour income might take a long time to eventuate. As a result, a general corporate tax cut might reduce Australia's national income overall for many years.[92]

Precisely because tax rates are only one factor amongst many in corporate investment decisions, careful design of tax changes is required to ensure that the value of additional investment outweighs the tax revenue given up – particularly where that revenue instead flows to offshore investors.

A core question for future tax debate is how changes to corporate taxes should be designed to maximise new productive investment relative to the amount of tax foregone. Options that have been suggested during the consultation to date include:

- Investment allowances
- Accelerated depreciation
- Lower general corporate tax rates; and
- Raising the turnover threshold (currently $50 million) below which corporates pay a lower corporate tax (currently 25% instead of 30%).

Investment allowances affect the total amount of tax paid. They typically permit an additional deduction for new investments, reducing the tax otherwise payable on existing and future earnings. The advantage of these allowances is that they focus specifically on new investments and can be designed to support investment in services as well as in capital goods, which is appropriate for services-based industries. They need to be carefully designed to prevent abuse through the reclassification of existing spending so as to qualify for a greater tax deduction.

[92] In this respect our usual measure of economic health - Gross Domestic Product (GDP) – can be misleading. GDP counts everything produced in Australia. But living standards are driven by Gross National Income (GNI), which measures our incomes – the major differences are profits that Australians earn on things produced overseas, and profits that foreigners earn on things produced in Australia: Daley and Coates (2016)

Accelerated depreciation allows corporates to deduct from their taxable income the cost of capital investments earlier than otherwise. This primarily benefits industries with long-lived expensive equipment such as mining. It has much less impact on service-based industries, which are usually entitled under existing rules to immediately deduct the entire cost of a new investment which mostly involves spending on additional employees to build a new business. Accelerated depreciation mostly affects timing – the nominal deduction is the same; but it is claimed earlier (so that less tax is paid in early years, and more in later years).

Many international investors focus on the headline corporate tax rate because the impact of accelerated depreciation and investment allowances is too difficult to incorporate in cross-country models. Consequently, many argue that reductions in the headline rate will attract more additional investment. Australia's headline rate of 30% is significantly higher than the OECD average of 23.5% and this is of great concern to many Australian companies seeking overseas investment. However, because the headline rate affects the tax paid on earnings from past investments, the challenge is that any reduction in the headline rate creates substantial leakage in tax revenue from past investments rather than focusing the tax break on new investment. That increases the overall cost of reducing the headline rate, relative to the increase in investment.

Recent research has investigated the relative impact of accelerated depreciation and general cuts to the headline corporate tax rate by analysing the Tax Cuts and Jobs Act (2017) in the United States. Among other changes, this tax package reduced the headline corporate tax rate from 35% to 21% and introduced accelerated depreciation on capital investments.[93] The initial evidence suggests that the cut in corporate tax rate did promote investment but not by enough to offset the reduction in corporate tax revenue.[94] By contrast, the accelerated depreciation (which is not permanent under the Act) led to more investment per dollar of tax revenue given up because it was focused on new investments.[95]

Increasing the turnover threshold for a lower corporate tax rate primarily benefits medium-sized companies. Its primary justification would be that it would increase the availability of capital for reinvestment. Reducing the corporate tax rate from 30% to 25%, for example, would increase the profit available for reinvestment by around 7% (assuming the company paid no dividends). Such a measure may create additional problems. It creates disincentives for companies to grow if they are just under the turnover threshold, and it increases compliance costs if companies try to classify revenues so that they are not included in the calculation of turnover.

There can be particular value in encouraging new businesses. Younger businesses are typically more innovative and put pressure on existing businesses to become more productive. However, fewer businesses are entering the Australian market, and they now have a smaller share of employees.[96] Of course, there is a danger that incentives for new businesses can distort the allocation of capital.[97] Australia has a number of tax structures in place designed to encourage the creation of new businesses, including Early-Stage Venture Capital Limited Partnerships (ESVCLPs), Venture capital limited partnerships (VCLPs), Managed Investment Trusts (MITs), and other withholding tax regimes.

[93] Chodorow-Reich et al (2024, p.10)

[94] Chodorow-Reich et al (2024, p.4-5)

[95] Chodorow-Reich, Zidar and Zwick (2024, p23-24)

[96] e61 (2023, p.10)

[97] TTI (2021, p106-107)

Consultation held as part of this Green Paper has focussed on the treatment of ESVCLPs and VCLPs. VCLPs allow tax-free capital gains for foreign investors. ESVCLPs allow tax-free capital gains for both domestic and foreign investors, and provide a tax offset for 10% of the initial investment.[98] Substantial venture capital has been committed under these schemes, which have doubled since 2017-2018 to $28bn.[99] However, stakeholders have raised the limits to these schemes, particularly that the tax exemption for profits and capital gains through ESVCLPs are limited on any single investment that grows to have more than $250 million in assets.[100] A Treasury review of the schemes conducted in 2022 found that they probably enhanced the venture capital sector, and increased funding availability for new businesses.[101] However the review did not consider whether there would be net benefits in increasing the thresholds for the schemes.

4.2.2 Fuel rebate concessions, fuel excise taxes and road user charging

Reducing fuel tax concessions would both discourage the production of greenhouse gases and raise additional revenue that could fund reduction in taxes on more productive investments. However, with the shift to electric vehicles reforming the Fuel Excise Tax more broadly is critical if we are to retain the broad revenue stream.

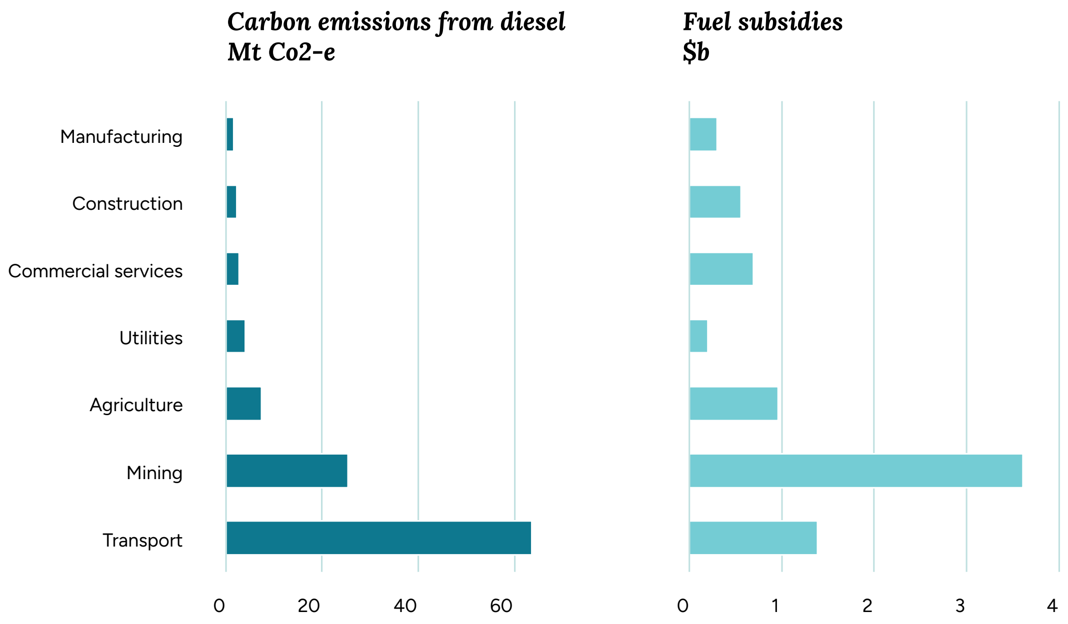
Australia's fuel excise is a tax on the consumption of petroleum fuels. The fuel excise tax is a substantial source of revenue in Australia raising $18 billion in 2021-22 (3% of federal tax).[102] This is similar to the amount that Australian governments spend building and maintaining roads, although there has been no requirement to spend fuel excise revenues on roads since 1959.

Since 1957, when the government first started taxing fuel, rebates have existed for off-road vehicles (which primarily benefits mining and agriculture machinery). The rationale was that such vehicles do not impose any costs on the roads, and it is generally considered good tax design to avoid costs on business inputs because they discourage investment, unless the tax is effectively a price on a cost borne by others. However, in 2006 the rebates were extended to heavy on-road vehicles (over 4.5 tonnes) which primarily benefits heavy transport logistics vehicles. The rationale for this concession was that the fuel excise would be replaced by a new Road User Charge on heavy vehicles that would recover the costs of the greater road damage caused by heavy vehicles. However, the new Road User Charge is less than the additional rebate, so that in total heavy road vehicles pay less per litre even though they do more damage per kilometre.[103] The policy rationale for this outcome is unclear.

The value of these concessions is substantial. Of the $18 billion raised from the fuel tax levy in 2021-22, approximately 40% ($7 billion) was returned in the form of rebates. They primarily benefit the mining industry, as shown in Figure 13.

[98] Treasury (2022, p.14, 39-41)
[99] DISER (2024)
[100] ATO (2024e); ATO (2024f)
[101] Treasury (2022, p.3-4)
[102] ATO (2024b); Parliamentary Budget Office (2022)
[103] Terrill et al (2023, p.7)

Figure 13: Fuel subsidies and diesel emissions are largest in mining, transport and agriculture industries



Note: Mt CO2-e from diesel fuel has been converted from petajoules using conversion factors provided by DCCEW.
Source: DCCEWW (2023), ATO (2024)

The extent of these concessions is hard to justify given the social cost of carbon emissions. The emissions from these activities are unpriced (or at least underpriced in the case where the safeguard mechanism might apply). The current rebate might be replaced by an off-road fuel-excise tax that approximates the cost of the carbon emissions generated. Diesel fuel excise is currently levied at 48c per litre. If a carbon price of $35/tCO2e were applied, that would imply an excise of approximately 10c per litre.[104] Alternatively, this emissions price might not apply to agricultural machinery, at least until carbon pricing is applied to agricultural activities more generally.

As well as raising additional tax revenue, unwinding these concessions would increase the incentives for producers to switch to vehicles and equipment that are lower emissions (either through processes that require less machinery, or from more fuel-efficient equipment, or from equipment that users alternative power sources such as electricity).

Like the fuel excise more generally, the additional revenue from reversing these concessions is likely to fall over time. Consequently, there are dangers in using it to fund other tax reductions or spending increases that are likely to grow in line with the rest of the economy.

[104] Calculation assumes 2.7 kilograms of CO2 in a litre of diesel fuel; NTC (2021, p.10)

This points to a broader need to restructure the fuel excise towards road user charging, with the shift to electric vehicles. The recent High Court case disallowing a Victorian tax on electric vehicles[102] highlighted that this restructure is a federal government responsibility, and is an opportunity to work with the states on appropriate transitions.

4.2.3 Fossil fuel production taxes

Increasing taxes on the production of fossil fuels would both discourage the production of greenhouse gases, and raise additional revenue that could fund reduction in taxes on more productive investments.

As shown above (section 2.3), government revenues from fossil fuel production (including both royalties and state and commonwealth taxes) have fallen relative to the value of the gas and petroleum produced, even though the price of these commodities has been unusually high. Many, including Nobel Prize-winning economist Joseph Stiglitz, have argued that the Australian public is not being paid a fair return for its minerals.[106] The fall in government revenue relative to commodity value is also encouraging additional investment in industries with very high emissions. Inevitably this leads to less investment than otherwise in low-carbon industries that will be more sustainable in the long term.[107] Consequently the Australian economy is heading in the wrong direction even as the effects of climate change become more obvious.

A variety of tax settings might be changed so that government collects more revenue from fossil fuel production. These include:

- Amending the petroleum resource rent tax regime that applies to offshore gas and oil extraction, where the highest profile issues are the deduction allowed for capital investments and the transfer price between gas production and the liquification plant.[108]
- Increasing the applicable rate of income tax for fossil fuel investments when the price for the commodity is unusually high. This has the advantage that it is transparently not retrospective: if companies argue for a reduction in income taxes that would apply to existing investments, they cannot complain about an increase in income taxes that applies to existing investments.
- Levying an additional tax calculated as a proportion of revenue when the price for the commodity is unusually high.
- Levying an additional tax calculated as a fixed amount per volume extracted when the price for the commodity is unusually high (which would be analogous to a royalty).
- Levying an additional tax calculated as a fixed amount per volume exported when the price for the commodity is unusually high. One advantage of an export tax is that it would result in lower domestic prices, which might assist current concerns about the price of gas for Australian consumers.

[105] Vanderstock v Victoria [2023] HCA 30

[106] Treasury (2017, p.4-5)

[107] At the margins, additional investment in high-carbon enterprises drives up the price of factors of production including labour and to some extent capital that would otherwise be available for lower-carbon enterprises.

[108] The "uplift factor" allows a company to deduct from revenue an increasing nominal amount over time relative to its original capital investment; some argue that these uplift factors over-compensate for an investor's actual cost of capital: Richardson (2022)

The interaction between mining levies also needs to be considered. For example, to what extent are royalties, resource rent regimes and other imposts deductible as income tax expenses? And if income tax rates are themselves linked to minerals prices, is the higher tax rate fully incorporated in calculating franking credits?

The best option requires a careful analysis of issues. These include investigating the potential impact on future investment. On the one hand, taxes that only apply when prices are relatively high may have less impact because mining companies typically calculate the attractiveness of investments by applying relatively standardised assumptions about future commodity prices and tax rates so that it is easier to compare alternative investments. On the other hand, taxes that reduce the total future profit on investments that have already been made may increase perceptions of sovereign risk, reducing the appetite at the margin for investment in non-fossil fuel mining projects.

Analysis needs to balance such considerations against the additional tax that will be collected. While such measures are very likely to reduce appetite for investment in fossil fuel projects in the future, it is much less clear how much they will do so. Apart from the benefits of reducing fossil fuel emissions, it is possible that the economic cost of less investment in fossil fuels may be outweighed by greater investment in other industries if the additional revenue on fossil fuel investment is used to pay for reductions in taxes on other investments.

This analysis also needs to consider the impact of carbon border adjustment mechanisms that are either legislated or under consideration in other countries. These may effectively collect carbon taxes on Australian fossil fuels in the importing country to the extent that they are not levied in Australia. Consequently, levying taxes in Australia would have relatively little impact on the volume of these exports but will ensure that the revenue benefits Australian governments rather than overseas governments.[109]

4.2.4 The broader resources sector

Tax changes might also be applied to a variety of non-fossil fuel mining activities. Unlike taxes on fossil fuel production, such changes would have a much smaller effect on carbon emissions. But they could raise additional revenue that could fund tax cuts to encourage other investments. Any changes would need to maintain the incentives to invest, while better capturing economic rents.

Non-fossil fuel mining activities emit much less carbon, and so they are more sustainable in the long-term. Additional tax would be justified if producers were consistently earning economic rents more than their cost of capital, most likely because the combined effect of royalty and tax regimes under-value the minerals. In theory a "resource rent" tax both captures the economic rents, but does not discourage investment. However, designing a resource rent tax so that it steers this middle ground is not easy, and raises difficult questions about the appropriate return on capital, the timing of tax liability, and how tax settings affect investor behaviour in practice as well as in theory. These issues need careful analysis so that any changes result in a net increase in investment.

[109] DCCEEW (2024b)

Taxes on minerals are inherently volatile because they go up and down with volatile minerals prices. Tax revenues are even more volatile if tax rates are higher when minerals prices are higher. Volatility is not a reason to avoid such a design, which has the advantage of collecting more tax precisely when the taxpayer has greater capacity to pay.[110] With very large balance sheets governments are better placed than companies to absorb volatile revenues. However, there are advantages to matching volatile mining revenues with shorter-term spending (such as infrastructure projects). An alternative is to quarantine mining revenues in a special fund, although government accounting rules usually require that revenues are included in the underlying cash budget balance in the year that they fall due, and because headlines tend to focus on this measure, it tends to be the dominant driver of government budgeting behaviour.

4.2.5 Taxation compliance costs

Taxation administration costs are drags on economic productivity. To maximise economic growth (and ultimately individual incomes) tax settings should avoid imposing compliance costs that are high relative to the additional tax collected.

In our consultations, a number of businesses raised areas where our current tax regime imposes high costs of compliance relative to the revenue gained – particularly in aspects of administering Payroll Tax, Fringe-Benefits Tax, and direct company interactions with the ATO.

Many raised concerns that payroll taxes across different states have different definitions of "employee" and different tax-free thresholds. They suggested that there would be substantial savings if states and territories adopted common definitions, even if there was no change in the total amount of tax paid. Given the potential productivity gains available, any Federal-State compacts on tax reform could include incentives or conditions for states to align their payroll tax systems.

Many also raised concerns with the complexity of complying with the fringe benefits tax (FBT) system. The previous government commissioned a report into the FBT system but this has not been released by either the previous or current government. An immediate release of this report would be valuable to this debate.

Many businesses raised issues about their interactions with the ATO. The concerns included that delays in the ATO providing guidance on tax questions, and the ATO's aggressive attitude towards compliance, particularly for small businesses. An example was provided when a business sought ATO guidance on a particular international investment which the business believed would be treated in a particular way, but where ATO confirmation was requested. This guidance was not offered for over a year, so the investment remained in limbo. Further work needs to be done to assess if this is a widespread problem.

[110] See above section 3.4.3

5 Progressing tax reform *in the next parliament*

Articulating the need for reform is one thing. We then need to implement a robust approach to deliver tax reform capable of withstanding the political pressure and vocal opposition that will inevitably seek to preserve the status quo.

Tax reform is always going to be hard, but that doesn't mean it can't be easier.

I believe that three key ingredients can provide us with the best chance of success, not just for the challenges we face today, but the challenges we will face in the future. These are:

- Tax policy development process;
- Community engagement in this process;
- Establishment of a Tax Reform Commission.

5.1 *Tax policy development process*

One of the challenges in implementing tax reform is that the current system requires tax reform to originate from within an environment that discourages hard and difficult conversations - politics. For this reason, the distance between substantial tax reform eras in Australia is long, with more than a few corpses littered along the way.

While this is the reality of the democratic process, there are things that we can do to de-politicise the tax process and give the reform agenda the best chance of success. I believe we need to be pushing for a robust process on tax reform in the next term of parliament, regardless of the shape that parliament may take.

From conducting this research, and learning from both successful and unsuccessful reform eras of the past, I believe that such a process for reform in the next term requires:

- the process must start early in the next term
- the government must be required to respond in a timely manner
- it needs to engage across the parliament, including the opposition of the day
- it must be an open process that deals with practice as well as theory; and
- it needs to have robust community engagement.

Australian parliamentary terms are short, so establishing this process early in the parliamentary term is crucial to ensuring that results are achieved before another election cycle and potential change of government.

Government already has a poor track record of commissioning research and reports and then failing to respond or implement recommendations. For example, the Productivity Commission's 5-yearly report, *Advancing Prosperity*, was released in March 2023,[111] nearly two years ago, and still has not received a government response or suggestion of how the recommendations would be implemented. This is typical for such reports. For this process to work, the government needs some level of accountability for its participation in the process. Any process for the next parliament should require a mandatory Government response in a timely manner, say within six months of the final report being delivered.

This process could take a number of forms. It could be a government process, undertaken by the Treasury. It could be a committee established by the government of the day to include members from across the parliament. Or it could be external, conducted by the Productivity Commission for example, at arm's length from Government and politics.

All have advantages and disadvantages. On the one hand, an internal review provides greater accountability to the Government of the day and benefits from the resources of the Treasury, but increases the likelihood of politics interfering with the process. On the other hand, an external or committee process would de-politicise the process to varying degrees but provide the Government greater scope to reject the outcomes.

Whatever form the process takes, it is important to have the cooperation of the Government and the involvement of members across the parliament including all major parties and independents. Tax reform is challenging because of the personal impact it has on all Australians and therefore there is a strong temptation for an opportunistic Opposition to capitalise on this process for short-term politics. Engaging the Opposition early doesn't remove these risks, but it can help manage them.

Finally, the process needs to be an open process that engages and consults the community, as well as the experts. Community engagement increases the likelihood that the Government will have the confidence to follow through with the process, and mitigates the risk that potential opponents to reform capitalise on community anxieties and uncertainties. Community consultation is discussed in more detail below in Section 5.2.

I will advocate for this kind of process if I am elected in the next parliament.

5.2 Community consultation

If you say the words "tax reform", many people are intimidated and suspicious. Tax affects everyone's lives but most people don't feel very confident talking about the system. Changes can leave some people personally worse off in ways that matter to them. The tax system is also a sort of community values compact – when it is working well, it broadly articulates what the community thinks is fair and the trade-offs we can all live with.

Too often, however, tax policy is developed in isolation from the broader community. As with all public policy, true expertise is necessary to develop robust policies that deliver on the desired outcomes. But it is not sufficient, particularly with tax policy that has such a personal impact on the choices that individuals make, as well as a profound impact on the shape of the economy. Community involvement is also required to reduce the vulnerability of tax reform to political wedging and scare-campaigns.

[111] PC (2023)

If we are going to have successful tax reform, particularly at a time of low trust in politicians, we need to engage and listen to the community differently. This starts with getting agreement on what are the problems we are really trying to solve, and then works through the reasonable solutions and trade-offs.

So as part of the tax policy development process, we need to spend much more effort than is typically spent engaging the community both in the problems and the potential solutions.

This should take a variety of forms including traditional community forums, focus groups and surveys. But we should be willing to try new models of community consultation that build trust across the community that real people are being listened to and involve people who may not otherwise engage. There is innovation across the world in new models of community engagement and deliberative democracy – from Taiwan to Ireland. We have not used these models at a Federal level in Australia and there is a real opportunity and an imperative to try something different. Bringing together randomly selective people from across the country, that broadly represent us in geography, wealth, perspectives, and giving them the opportunity to listen to experts and then try to come to areas of broad agreement, would be a different way of helping develop policy, but one in which I can see real value.

We ran experiments on this sort of engagement as part of the development of this Green Paper. We ran a survey where 1,068 people from Wentworth gave us their views. We invited community members to come to a tax workshop and around 85 turned up one wet evening, to listen to some experts, but then to sit in random groups of 8-10 to discuss the trade-offs with different tax arrangements. Listening to the thoughtful, respectful discussions and concerns people had both for themselves but also for others that would be affected by changes to the tax system, was illuminating. It struck me that there really is no group better to judge appropriate trade-offs than the informed community.

5.3 A Tax Reform Commission

A parliamentary process and community engagement are vital to the tax reform challenges we face today. But without institutional changes to the tax system, we will find ourselves equally ill-equipped to deal with the next set of challenges that arise. Looking beyond our list of immediate priorities, Australia needs to identify a better way of doing tax reform.

Tax systems are not designed to be static – the tax system needs to be regularly assessed against social, economic, and environmental priorities, in the light of the guiding principles of tax design. Institutional reform can promote dynamic tax policy by putting in place independent processes and structures that keep tax reform on the agenda.

The challenges associated with implementing tax reform in Australia, particularly in the last decade, have raised interest among tax stakeholders in a dedicated organisation – independent of parliament and politics – tasked with keeping tax reform on the agenda.[113] Such a model could help to reduce the politicisation of tax reform, alleviate the pressure on Government to initiate a reform agenda, and promote better informed and more ambitious tax policy.[114]

[113] Standing Committee on Economics (2024, p.230)
[114] TTI (2021, p.255-256)

While several organisations in Australia participate in tax reform discussions, there is no dedicated independent agency. Federal Treasury and the ATO are the basis of Australia's public tax administration. Although they are always important to tax reform, it is unlikely that they will initiate significant reform. The ATO typically focuses on very technical aspects of Australia's tax system and does not have a brief to promote more far-reaching reform.[115] Treasury has served this function in the past – Treasury ultimately produced the Henry Review in 2010 – but Treasury is accountable to the Government of the day and does not have the independence to promote its own tax reform agenda. The major Australian reforms produced by Treasury, including the Henry Review, were initiated by political directives from Government at the time.

The Productivity Commission can also contribute to tax policy. It is a respected and frequent contributor to policy discussion within Australia and produces and houses some of Australia's leading public policy experts. But like the Treasury, the bulk of the Productivity Commission's work is only undertaken in response to directives from the Government of the day, and its self-initiated research tends to avoid high profile controversial topics.

Several private sector organisations provide research and thought leadership for tax reform, spanning a spectrum of academic theory to more retail thought leadership. The Tax and Transfer Policy Institute (TTPI), established in 2013 in association with the Australian National University, sits at the intersection between academia and thought leadership and has contributed enormously to evidence gathering and policy discussion.[116] Think tanks, such as Grattan Institute, Blueprint Institute, e61 and others provide very important commentary and analysis on tax as well. However, the Government of the day is not obliged to respond to them.

I think there is an argument for the establishment of a Tax Reform Commission or something of that ilk, that could sit somewhere between the existing organisations discussed above.[117] At a minimum it would require:

- Independence from government and private interest groups: this organisation needs to be able to conduct a policy agenda free of political influence and without directive but with an obligation for the Government of the day to engage with its findings
- Credibility and expertise: this organisation needs to be a trusted source of bi-partisan advice that is capable of communicating complex problems to general public audiences, like the Productivity Commission.
- Specific mandate on tax reform: this organisation needs to be a dedicated organisation that focuses on elevating the topic of tax reform.

Such an institute could also undertake regular reviews of the tax system in key areas – such as the Long-Term Insights Briefings that the NZ Public Service Act requires.[118] At the time of writing, Inland Revenue was seeking public consultation on their second LTIB, "Our tax system: Bases and Regimes", which will explore long-term trends and policy implications for the sustainability of New Zealand's tax base.[119] This departmental discipline alongside a dedicated tax reform commission could build on the insights of the Intergenerational Report for instance, but seek policy responses to it, rather than outline the challenges.

[115] ATO (2023a)

[116] Tilley (2024, p.363)

[117] Economics Committee (2024, p.230)

[118] Inland Revenue (2024b); New Zealand's Public Service Act (2020) requires departmental chief executives to produce a Long-Term Insights Briefing at least once every three years (PMC (2024)). These briefs outline the long-term trends and analyse the risks and opportunities associated with the Department's objectives and provide possible policy options for consideration in response independent of ministers (Inland Revenue (2024b))

[119] Inland Revenue (2024a)

6 Conclusion

Australia is a truly wonderful country, but we are at a juncture. Declining opportunity for younger people necessitates a shift in our tax system away from income taxes on labour and a rebalancing of our system to prioritise owner-occupied housing. Lacklustre productivity requires businesses to reinvest more into innovation and technologies that will underpin the economic opportunities of the future. And our efforts to foster a smooth and cost-effective energy transition will be thwarted unless we can get the tax settings working to discourage, or at the very least, not to encourage, consumption of fossil fuels.

These are three difficult economic challenges, and they will require us to make difficult choices. While the challenges are immense, they are not impossible, and the process of compiling this Green Paper has shown me that there is a willingness and aspiration within the community for Australia to do better.

If we can find a way to navigate the politics of tax reform, we increase our chances of success. Clearly articulating the need and urgency for reform, engaging the community early to de-politicise the topics and taboos, and putting in place a robust and cross-party process will help us get through these immediate challenges. There is an opportunity to do this in the next parliament, and I believe that members of the crossbench can play a very constructive role in promoting this.

But we also need to look to the future. We need institutional reform that continually reviews the effectiveness of the system rather than letting the problems slowly amass until they are seemingly insurmountable. This will help to make the next set of problems easier to deal with.

This is not written as a policy position paper. Rather it is a paper intended to stimulate discussion, debate, ideas and potential solutions as well as outline a potential path forward towards reform. Please engage with me and this paper through the submission process I have outlined. But also attend community events in your local area and engage with your local members, discuss these issues with your friends, family and colleagues and let's build a broader momentum for change.

7 Feedback

The most important purpose of this paper is to promote discussion and debate about the future of Australia's tax system.

Please direct any feedback to:

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