TAXATION IN AUSTRALIA

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Introduction

This paper provides a short survey of some taxation arrangements and reform issues in Australia.

The paper presents information in four sections:

Section 1 Taxation reform

Section 2 Taxation and labour market issues

Section 3 Taxation and fiscal policy

Section 4 Tax competition and harmonisation

1. Taxation reform in Australia

This section makes observations of the Australian tax reform experience at two levels. Firstly, consideration is given to the main influences on the tax reform policy debate. Secondly, a brief survey is provided of several main waves of tax reform in Australia dating since the mid-Eighties.

1.1 Influences on tax reform

The main influences on taxation policies and reforms can be seen as a combination of country-specific factors (such as politics, history, institutions, location, economic development and social values), the application of economic theory to the formulation of public policy, and the application of empirical research to policy questions. The relative strength of these influences varies between countries and, over time, within countries. In Australia's case, country-specific factors and theoretical economic research have generally been the main influences. Some tax issues have been informed by empirical studies, but as often these have been limited or not available.

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The views expressed in this paper are those of the author and do not necessarily reflect those of the Australian Government or Treasury.

1.2 Country-specific factors

Some of the country-specific factors evident in Australia have reinforced the quest for tax reform. Others have operated as a constraint.

Australia is an open, highly urbanised, small-medium developed country. It has a population of almost 20 million (0.3 per cent of the world's total) and an economy that is about 1 per cent of the world's total. In purchasing power parity terms, it currently has similar per capita income to that of the major European countries and Japan. Like the US, Australia has a federal system of Government.

While Australia appears broadly similar to many other OECD countries, it also has special features that can influence aspects of its approach to taxation. For example,

- Although a developed economy with sophisticated industries, Australia also is a major mineral, energy and rural producer and exporter, a structural feature more in common with many developing nations;
- Australia is located close to, has its main export markets in, and has other strong economic links with, East and South East Asia where many countries have relatively small general government sectors and low tax rates; and
- For most of its history (and continuing at the present time) Australia has adopted a development strategy involving substantial net immigration and net inwards foreign investment.

In recent years, these features have combined to emphasise in Australian policy debate the need for public policies that support Australia's productivity potential. There has been a strong focus on ensuring that policies maintain macro-economic balances and support competitive markets and innovation.

This was not always so. When Australia had a smaller population (particularly up until the Sixties) able to exploit highly-valued resources from a seemingly boundless land mass, public policies tended to emphasise distributional goals and other public sector programs or development strategies. These included centralised wage-fixing arrangements, which introduced considerable rigidity into labour markets, together with protective tariffs to promote a manufacturing import replacement development strategy. Many of the attitudes formed in the earlier era have had to be rethought, in the face of the new competitive settings of the economy and also a heightened awareness of the environmental consequences of excessive exploitation of a relatively fragile landscape.

The long traditions of Government involvement in redistributing income and other public sponsorships have not disappeared, however. Distributional concerns in particular continue to play a very major role in attitudes to tax policy. For example, when Australia recently introduced a new goods and services tax, comprehensive measures were found necessary to ensure that adequate compensation was paid to those on lower and middle incomes.

Despite these factors, tax reform has been one part of a culture of policy reform as Australia seeks to adjust to the new realities.

There are, of course, many other specific factors within Australia's history and circumstances that play a major role in tax design even today. Without attempting to be comprehensive, some that may be of interest include:

- Australia has no estate, inheritance or gift taxes. These were abolished in the Seventies largely in the context of concerns about the effect of such taxes on the viability of farming and other small businesses following intergenerational transfers which often required borrowing at relatively high interest rates to pay these taxes.
- Australia has no national social security scheme and hence imposes no social security contributions, either on employees or employers. Instead, Australia has a means-tested "safety net" public pension scheme funded from general revenues. It also imposes a compulsory retirement savings contribution (generally at the rate of 9 per cent of wages) on employers in respect of their employees. These contributions are paid into private sector pension funds for the exclusive purpose of providing greater retirement incomes.
- A high degree of vertical fiscal imbalance has developed under Australia's federal system. The eight States and Territories levy no income tax and are constitutionally prohibited from levying excises or other taxes on sales of goods. As a result they developed a number of relatively inefficient, narrowly based taxes, particularly on property transfers, gambling, financial and insurance transactions and a relatively heavy payroll tax. Since the States and Territories are responsible for many public services (including schools, hospitals and police) these taxes have been inadequate sources of revenue and so very large fiscal transfers are made to the States by the central Government. The greater part of these transfers have now been replaced by the revenues from the new Goods and Services Tax which, although collected under national laws, are wholly paid to the States and Territories.
- In other respects, the Australian taxation system looks very familiar, although it places greater proportional reliance on income taxes compared to indirect taxes than is so in the OECD on average.[1]

1.3 The influence of theoretical analysis and empirical research

I turn now to make some brief observations on the roles of economic theory and empirical research in the Australian tax reform experience.

Whereas some areas of economic policy have been significantly influenced by strongly empirical approaches, notably studies of the broader economic effects of

[1] In 2000, income tax collected from individuals was 11.6 per cent of GDP in Australia compared with 10 per cent on average in the OECD. General consumption taxes in Australia, mainly the GST, were 3.9 per cent of GDP compared with the OECD average of 6.9 per cent.

industry assistance and border protection policies and some aspects of competition policy,[2] Australian taxation policy has a relatively limited quantitative research basis. The revenue effects of alternative policies are estimated, of course, usually through partial first-round analysis, but wider economic effects are much more often adduced by theoretical analysis than empirical study.

The main exceptions to this have been research into income distribution questions, which has often been extensive and included development of a range of simulation models for retirement income policies (including demographic components).[3] Beyond this, the relatively limited recourse to empirical estimation of economic effects reflects a range of factors. These include the difficulty in obtaining sufficiently reliable data to support such research, high research costs often with relatively limited or unreliable results, and long lead times.

However, while reliable empirical measures are often not available, standard economic theory has for some years been highly influential in discussions of public policy, including tax policy, in Australia. Australia has undertaken many economic reforms over the past two decades based largely on theoretically based expectations of potential net gains.

The role of standard economic theory has been reinforced by widespread perceptions that the various institutional arrangements that had built up in Australia in earlier times under different conditions needed considerable adaptation or reform to restore Australia's relative position in the world. Relatively poor economic performances in the Seventies and early Eighties created an appetite for reform and greater acceptance of economic disciplines. Overall national productivity had fallen relative to many other developed nations and there was increasing concern that many Australian industries were not well positioned for global competitiveness.

1.4 Taxation reforms in Australia

The main goal of taxation reform is to reduce the adverse effects of taxation on economic activity and growth. A closely related concern is to ensure that the tax revenue base is robust over time. Consistent with standard economic theory, the main areas of emphasis for such reforms are typically:

- broadening the tax base so that there is less welfare-reducing tax distortion of investment, transaction and consumption choices (these reforms often also meet horizontal equity and revenue security and integrity objectives);
- reducing adverse tax impacts by reducing tax rates (with revenue effects offset by broadening the tax base); and

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[2] The Productivity Commission or its predecessors have undertaken most of this research. Over time, this research has underpinned the substantial dismantling of import tariff and other border protection measures.

[3] This includes considerable published research by the Retirement and Income Modelling Unit of the Treasury's Tax Analysis Division.

- balancing the mix of direct and indirect taxation to enable the burden of each to be minimised (these approaches are often also aimed at reducing “double tax” on savings and securing tax compliance benefits).

At times tax reform has also paid attention to the cost of tax administration and compliance (effectively transaction costs which are a deadweight loss to economic welfare measured by consumption possibilities). It is commonplace however, that the base broadening measures so central to most tax reforms can involve increases in the overall cost of tax system administration and compliance. Optimising tax reform, therefore, often requires some trade-off between allocative efficiency and transaction cost issues. These trade-offs are difficult to judge as they are very rarely reliably informed by comprehensive empirical studies.

The overwhelming emphasis of Australian tax reform over the past two decades has been base broadening and rate reduction. More recently, greater attention has been given also to the need to reduce transaction costs, especially by streamlining tax collection arrangements.

Australia has had several waves of major tax reform as outlined below.

1.5 The reforms of the Eighties

In the Eighties, the main reforms were to the income tax base and rates. In that period, the main income tax innovations were:

- Introduction of a full imputation system for dividends (reducing effective rates of tax on distributed company income);
- Introduction of more comprehensive taxation of long-term capital gains and employee non-cash fringe benefits (broadening the income tax base);
- Other measures to broaden the capital taxation base, removing longstanding special exemptions and reducing concessions for plant and equipment investments;
- Reductions in income tax rates, with the company tax rate falling from 46 per cent (after a short period at 49 per cent) to 36 per cent and the highest personal tax rate from 60 to 49 per cent.

Attempts to reform indirect tax bases were largely unsuccessful in this period, although some limited broadening of the base was achieved.

1.6 Introduction of General Consumption Tax and large income tax cuts

In 1998, the Government proposed new reforms that were ultimately introduced successfully with effect from 1 July 2000. The cornerstone of these reforms was the replacement of former narrowly based indirect taxes with a broadly based Goods and Services Tax (GST). The GST is essentially a value-added tax and was introduced at the single rate of 10 per cent on a broad base (the main exemptions being health and medical goods and services, education and childcare, fresh or certain lightly processed foods and charitable activities).

At the rate of 10 per cent, the GST accounts for only about 12 per cent of total taxation revenues in Australia. Accordingly, its introduction, after offsetting revenues from abolition of wholesale sales taxes and some other inefficient taxes, facilitated large personal tax cuts without fundamentally changing the considerable role of the income tax. The changes in tax schedules, which took effect on 1 July 2000, are set out in Table 1.

The changes to the personal rate scale were fully concentrated on incomes below $60,000 with no reduction in the highest personal tax rate.[4] The Government also increased government pensions, income support allowances and family assistance arrangements in order to fully compensate households for the price effects (estimated at less than 2 percentage points) of the indirect tax reforms.

Table 1

Personal Tax Schedules

Old Scale		**New Scale**	
Taxable Income($)	Tax rate (%)	Taxable Income($)	Tax rate (%)
0 - 5,400	0	0 - 6,000	0
5,401 - 20,700	20	6,001 - 20,000	17
20,701 - 38,000	34	20,001 - 50,000	30
38,001 - 50,000	43	50,001 - 60,000	42
50,000 +	47	60,000+	47

1.7 *Business tax reform*

Soon after the introduction of the GST and associated personal taxation reductions, the Government also implemented a substantial business tax reform. The business tax reform had as its centrepiece a further reduction in the company tax rate from 36 to 30 per cent. This was aimed at giving Australia a company tax rate that was more competitive in its broader economic region (particularly the Asia/Pacific regions).

4 This scale may be compared against annual average full-time ordinary earnings currently of approximately $46,000. At the time of writing $A1 was approximately equivalent to 66 US cents or 57 Eurocents.

The business tax reform also involved a significant change in approach to the taxation of capital gains. The capital gains tax introduced in the Eighties had provided for price indexation of the cost base, but otherwise the real capital gain was assessed as income at full marginal tax rates.

The indexation arrangements were complex. In their place, and at a greater overall level of concession, the Government introduced a capital gains regime based on nominal measures of gains, but with the rate of tax halved under the personal tax system.[5]

Substantially offsetting the revenue costs of these measures were further measures to broaden the business income tax base. In particular, write-off provisions for investments in plant and equipment were modified to remove concessions and (with limited exceptions) write-off rates were aligned with estimates of the effective economic lives of assets.

The business tax reforms also encompassed a number of other areas with lesser revenue implications. These include "consolidation" arrangements whereby groups of companies with common ownership can be treated as a single taxpayer. Intra-group transactions may in general (upon group election) be ignored for tax purposes. These provisions are expected to bring tax integrity benefits, simplify tax compliance, facilitate commercial choices about business structures and restructures, and provide easier utilisation of both tax losses and dividend imputation credits otherwise accumulating within separate companies within a company group.

1.8 Retirement savings and retirement income reforms

Australia does not have a national social security scheme and there are no social security taxes levied either on employees or employers. A base level of retirement income is provided on a means tested basis from general government revenue sources: as a safety net for those who retire without adequate, or any, private means of support. The single person age pension is set effectively at about one quarter of the average weekly male ordinary time wage, and reduces as access to private means increase.

Rather than introduce a national social security system, Australia has supplemented its budget-financed age pension system with a "compulsory" system of private retirement savings for employees. This is not strictly compulsory, but operates by imposing a tax penalty on employers if they fail to make contributions to occupational superannuation (pension saving) funds equivalent to 9 per cent of wages or salary. Generally, these funds accumulate with the employee member taking the investment risk of the scheme (a relatively small number of employers

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5 This is achieved by including only half of the gain in the tax assessment. For superannuation funds, 1/3 of the gain is excluded giving an effective tax rate of 10 per cent The realised capital gains of companies are taxed at the standard rate of 30 per cent, so that for companies there is no difference in the treatment of ordinary income and capital gains.

provide contributions to defined benefit plans). There is no obligation imposed on the self-employed.

The superannuation arrangements have rapidly accumulated large funds since these arrangements commenced in the late Eighties. Superannuation funds may accumulate amounts either compulsorily contributed by employers or additional amounts (up to statutory limits) which may be contributed voluntarily. Thus, both the compulsory and voluntary retirement savings schemes are conducted through the same funds.

The taxation arrangements for these superannuation funds are concessional against an income tax benchmark, generally with a 15 per cent tax rate applying to deductible contributions and investment earnings, although not fully tax-exempt as in most other countries. The benefits paid from such funds are taxed at low rates. Although often controversial, these tax arrangements have the effect of generating some current revenues from superannuation schemes, which reduces their current cost to the budget.

2. Taxation and labour market issues

The main concern about the impact of the taxation system on the labour market is the disincentive to labour force participation associated with high marginal tax rates. Secondary concerns relate to the effect of such high rates on choices between participation in the formal (taxpaying) economy and the informal (tax evading) or so-called "cash" or "shadow" economy. A third concern, which is becoming more prominent, is that high personal tax rates may influence choices of domicile particularly for high-income, high-skilled workers or executives, many of who are increasingly mobile in international labour markets.[6]

Reflecting distributional themes, Australia's taxation system is weighted to income taxes and these are imposed on a progressive basis.

To the extent that income tax is imposed on labour income, the tax system can generate disincentives to workforce participation. In Australia, although there are no national social security contributions in addition to income tax, the means tests in the various elements of the social security and family assistance systems can operate to further increase effective marginal income tax rates.

Social security arrangements in Australia provide means tested entitlements funded by general government revenues. There is no separate social security fund or social security taxation. Pension and family support payments are made on a needs basis – pensions or benefits for the unemployed, disabled, sole parents and the aged and payments to families for children. Virtually all of these payments are means tested, so that amounts are withdrawn as private incomes increase.

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6 In Australia's case, being English-speaking and the proximity within the region of other large English-speaking financial centres probably exacerbate this.

As a result, Australians engaged in the labour force typically face two effective tax rates – one from the progressive income tax and one as a result of the income-linked withdrawal of income support or family assistance.

Recent tax reforms have reduced to some extent both the personal tax rates and the withdrawal rate for social security and family payments. For pensions, the withdrawal rate as private incomes increase was reduced from 50 to 40 per cent, and over relevant ranges the rate for family payments is typically 30 per cent.

In recent years, there have been ongoing debates about the conflicting effects of these arrangements. On the one hand, tax progressivity and benefit means testing achieve vertical distributional goals (that is, greater vertical redistribution at given fiscal cost). On the other hand, they generate disincentive effects for labour force participation (and savings, to the extent the taxes apply to capital income as well) and are sometimes seen as unfair in their impact on working people.

2.1 Approaches to reducing marginal tax rates

There are both specific and broader strategic approaches to tax design that can influence effective marginal tax rates. Specific measures can be used to target particular problems such as workforce participation (or job location) incentives for jobless families, highly skilled internationally mobile workers or the mature aged. More generally, strategic influences on tax rates include the extent to which expenditure tax features are introduced into income tax systems, the comprehensiveness of income tax bases and the balance of direct and indirect taxes in the overall tax mix. Brief illustrations of each of these in the Australian context are now outlined.

2.2 Jobless families

A particular focus in recent years has been on increasing incentives for workforce participation by members of jobless families. One in six Australian families with children have no family member engaged in the workforce. Earned-income tax credits have been suggested as a possible means of dealing with this, but this is fiscally expensive, difficult to tightly target and under means testing, creates new points at which higher effective marginal tax rates are imposed. It has also been suggested that an earned-income tax credit could be linked with reducing real wages for the unskilled (to promote their employment) but it is not clear that effective wage reductions could be achieved. These issues remain open to discussion and the Government currently has a work and family taskforce considering workforce participation issues.

2.3 Top personal tax rate and the internationally mobile

At the other end of the scale, Australia's top personal tax rate (effectively 48.5 per cent including the medicare levy) is often criticised as too high and as having too low a threshold. Some express concern that increasing numbers of professionally qualified young Australians, particularly in the financial and business services sectors, appear to be attracted to jobs in the major Asian capitals where substantially lower personal tax rates can apply. Despite these concerns, there also remain strong political pressures from other quarters against tax relief at higher income levels, and it is unclear at present how these competing viewpoints will be reconciled.

2.4 Workforce participation by older workers

There has been considerable focus in Australia on the fiscal and social pressures likely to result from the ageing of the population. The fertility rate in Australia has long been below replacement level and the population is expected, even with current net immigration levels, to stabilise by around 2040.[7] At this time the proportionally larger older population and higher health funding costs are projected to require, on current trends and policies, an increase in public spending and taxation of about 5 per cent of GDP.

One response is to facilitate or encourage extended workforce participation by those in older age groups. There has been a trend for some years in Australia to earlier retirement, with significant proportions of workers retiring or otherwise leaving the workforce after reaching the age of 55. A range of policy issues including early access to superannuation may be relevant to these decisions.

For those at or greater than the age pension retirement age (65 for males) there is now less tax disincentive for partial workforce participation. Recent policy adjustments raised the effective tax-free threshold for those aged 65 or more to $20,500 (compared with $6,000 under the general tax scale).

Further policy work is continuing on the issues and policies impacting on the participation decisions of older workers.

2.5 Income and expenditure taxation strategies

Income tax is not, of course, exclusively imposed on labour income. It also applies to the returns to capital and this is often seen as contributing to a disincentive to save. Most countries introduce "expenditure tax" features to their income tax systems to provide for a relatively lower tax wedge on capital income and hence to

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7 The Government in May 2002 published an Intergenerational Report setting out demographic, economic and fiscal projections to the year 2042.

reduce the impact of income taxes on saving incentives.[8] While these features have the effect of reducing the tax burden on income that is devoted to savings as opposed to consumption, at the same time for a given revenue yield they require higher primary rates of tax. Expenditure tax features usually thereby increase the effective tax rate on most labour income.

Australia has some expenditure tax features in its income tax arrangements but has sought to limit their impacts on overall revenue raising. For example, superannuation (pension) funds are subject to a 15 per cent tax on receipts of deductible contributions and on investment earnings (substantively offset by lower taxes on final benefits when paid from funds). This has the effect of bringing forward tax revenues without substantively changing the overall tax wedge on superannuation savings. Also to facilitate lower tax rates, Australia has sought to maintain a comprehensive base of personal income taxation. For example, it introduced a comprehensive tax on employee fringe benefits (that is, non-cash forms of income such as the provision of accommodation or motor cars as part of the salary package) when weaknesses in tax coverage emerged in this area. These features of the taxation arrangements have assisted in preventing a need for higher rates of taxation, and to that extent may operate to reduce the adverse disincentive effects of labour income taxation.[9]

3. Taxation and fiscal policy

3.1 Stabilisation and the medium-term framework

The Australian Government is strongly committed to a fiscal policy of budget balance on average over the economic cycle. As Australia has had largely uninterrupted economic growth for the past decade, this fiscal objective has been met with small budget surpluses in nearly all years since 1996-97.

A very small budget deficit was incurred in 2001-02, following a slight economic slowing in 2001, while current forecasts suggest a quick return to small surpluses in 2002-03 and following years. The small movements between these recent years reflect appropriate operation of the automatic stabilisers intrinsic to the fiscal system.[10]

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8 The aim of the "expenditure tax" broadly is to impose tax on income expended on consumption, and to prevent or reduce the so-called "double tax" effect that arises if tax is imposed also on returns to saved income. Expenditure tax features can be introduced into income tax arrangements to relieve this bias (another strategy is to shift the weight of tax in the overall tax mix to consumption taxes).

9 Fringe benefit and capital gains taxes introduced in the mid-Eighties were associated with a reduction in the top personal tax rate from 60 to 49 per cent, since further reduced to 47 per cent exclusive of the medicare levy.

10 There is probably less focus on automatic stabilisers in Australia than in some other countries, because the fiscal position is very sound, the independent monetary authority retains a strong role in the context of a floating currency; and the rate of economic growth has been consistently strong for a prolonged period. That said, it is likely that the tax component of the automatic fiscal stabilisers in Australia has become

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The ongoing surplus means that the Australian taxation system fully meets the cost of Government on a year-by-year basis.

Underlying this fiscal policy is a strong belief that the Government sector should not contribute structurally to Australia's net borrowing requirement. Australia for many years has experienced net capital inflow averaging about 4 per cent of GDP per annum. This inflow now relates entirely to transactions in the private sector as the Government has eliminated its annual net borrowing requirement.

As a result of the succession of budget surpluses since the mid-Nineties, along with asset sales by government, the level of central government net debt has fallen to very low levels – currently about 5 per cent of GDP.

The robust financial positioning of the Australian public sector (broadly matched by the State and Territory governments) has been seen as assisting the national saving effort as well as underpinning a stable, low-interest rate environment notwithstanding continued strong economic growth.

In this setting, there has been relatively little recent use made of taxation policy (or fiscal policy in general) for discretionary economic stabilisation purposes (although there have been several instances where specific expenditure decisions have been matched by revenue measures to maintain the fiscal balance). The fiscal stimulus associated with net tax cuts introduced as part of tax reform in 2000-01 was seen as fortuitously providing some stimulus at the time of economic uncertainty and downturn in late 2000 and early 2001. However, the tax cuts were committed in 1998 and were not explicitly designed for stabilisation reasons.

To date in 2002-03, the Australian economy has shown few signs of slowdown, despite the relative weakness experienced in many international markets, the drought in much of rural Australia and the long expected (but still largely awaited) downswing in the housing cycle. In these conditions, it is likely that Government policy will continue to emphasise medium term fiscal stability and budget balances (small surpluses) rather than active pursuit of stabilisation policy through discretionary fiscal instruments.

3.2 Longer term considerations

Australia published its first Intergenerational Report in the 2002 Budget. This document projected 40 years forward demographic, economic and fiscal outcomes under current policy settings and trends. Legislation provides that an intergenerational report will be published every 5 years.

Whereas the methodology used generated results suggesting that government spending would increase as a share of GDP by about 5 percentage points (mainly on

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more efficient in recent years as tax reforms have involved making tax payment obligations more contemporaneous with underlying economic developments.

the health sector), taxation receipts were simply assumed to be constant as a share of GDP. It is difficult to make meaningful forward projections of taxation receipts, as the Australian taxation system is not indexed for inflation, and so regularly experiences discretionary adjustments.

That said, there has been concern that some elements of the tax base in Australia may risk decline relative to the level of GDP. The Goods and Services Tax (GST) introduced in 2000 (a single 10 per cent rate value added tax) was partly motivated by concerns that the former multiple-rate wholesale tax imposed only on specified goods had experienced, and would continue to experience, relative base decline. The inclusion of most services in the GST base provides a more robust tax base, although health expenditures are excluded and these are generally expected to continue to trend towards an increasing share of aggregate consumption spending.

It is also apparent that on current trends and policies the relative yield of excises on petroleum (both crude oil and fuel products) will fall over time.

The long-term projected trend to higher public spending (on current policies) and, at the margin, risks to some existing taxation bases, presents a potentially considerable tax policy challenge. It is not yet clear how this will be met, or whether the preferred course will be to restructure the relative public and private sector roles to remove the need for a higher public expenditure share. Fortunately, current trends do not identify these as major pressures for at least the next 15 years or so.

Apart from changing tax or expenditure levels, a third way to prevent a structural increase in the relative size of government is to achieve higher rates of GDP growth. Trends in spending or taxing as a share of GDP are driven not only by projections of the numerators (spending or taxing) but also trends in growth of the denominator, GDP.

The combined effects of growth in population, participation and productivity drive GDP growth. The level of GDP attained in an economy can be expressed as follows:

$$GDP = P\,\alpha\,\rho\,(1 - u)\,h\,\pi$$

Population	P is total population
	α is the proportion of population of working age (age structure factor)
Participation	ρ is the participation rate (of the working age cohort)
	u is the unemployment rate (*i.e.* (1–u) is the employment rate)
	h is average hours worked (by those working)
Productivity	π is average labour productivity (of those working).

There is considerable debate and focus in Australia now on whether there is scope to increase GDP growth rates by policy mixes (including tax policy mixes) which encourage growth in any or each of these “three Ps”.

As noted in the previous section, policy is currently being reviewed in areas where the taxation system is thought unduly to restrain workforce participation. At this stage, there has been little support for attempting to use tax or other policies to increase population growth (essentially fertility). The last “P” (productivity) remains, as it long has been, a major focus for policy-makers across a wide field of public policy including tax policy.

4. Tax competition and harmonisation

This subject essentially encompasses most of the issues that arise when considering the international context for taxation policy design.

The traditional focus of international taxation policy is the set of rules to apply to cross border transactions. In particular, it has been recognised that the assertion of both source and residence taxation rights creates the risk of double taxation of income. Similarly, there is a strong case for ensuring that consumption and other sales taxes mesh effectively without creating commercial or economic biases when cross-border transactions are involved.

Added to this has been a long-term concern to prevent the tax advantages often afforded to international transactions, particularly by tax havens, from inappropriately eroding the domestic tax base.

In more recent times however, some new international taxation concerns have become more prominent. There is now greater interest in the economic effects of the more fundamental differences between countries in their taxation structures and arrangements. These differences are now sometimes seen as part of an international competition for globally mobile investment and people.

Australia has become increasingly conscious of taxation competition issues in recent years.

The continued economic advancement of countries in the Asia-Pacific region has increased their attractiveness for investment in fields where previously Australia may have had greater underlying advantages. Advances in communications technology have reduced the barriers to more global approaches to investment and economic activity generally.

4.1 Treatment of international transactions

Given its small relative size, Australia has maintained a robust international taxation regime with full provisions for taxing controlled foreign corporations and for preventing tax benefits on passive income accumulation in foreign investment funds.

To some extent, these provisions have unduly high compliance costs or disadvantage Australia’s competitive position for corporate financial headquarter activities, or for funds management. Following a review of international tax arrangements, the Government has announced in the 2003 Budget a package of measures to reduce the burden of these provisions.

The GST, like other value-added taxes, provides an exemption for exports. Its introduction in 2000 enabled the abolition of several single-stage indirect taxes that had a cascading impact on inputs to the export sector.

4.2 Tax rates

As recently as 1988, the company tax rate in Australia was 49 per cent. It is now 30 per cent. Reductions in the company tax rate have been motivated by a desire to provide a company tax environment more competitive with the rates of tax common in the Asia Pacific region and with other countries generally.

Relatively few taxation policy initiatives have been aimed at reducing specific tax wedges on activities in Australia merely because they face international competition. One example is the special regime for offshore banking introduced in the face of considerable competition from regional centres for financial services business. Australia sees this as a defensive move and not as creating harmful tax competition. Australia does not offer bank secrecy arrangements and actively supports exchange of tax information protocols. While tax holidays and special tax concessions are common within the Asia Pacific region, Australia has generally avoided these arrangements in the wider context of its capital taxation arrangements.

As noted earlier in the discussion of labour income tax issues, there is now also some concern about the impact of the top personal tax rate on international competition issues. The Government has put forward legislative proposals to ameliorate aspects of the personal tax system on persons working in Australia on a short-term basis (particularly to remove taxation on certain foreign source capital income). More comprehensive changes to the personal tax rate scale for reasons of international competition have yet to find substantive support, but remain controversial. There is, however, no foreseeable prospect that reductions in rates could match the lowest tax regimes within the Asia-Pacific region (such as in Hong Kong).

4.3 Dividends and corporate income

Australia introduced a full dividend imputation system in 1987. Under this system, full credit is given to resident shareholders for the underlying Australian company tax paid on income distributed as dividends. No credit is given for foreign taxes, and if there is otherwise no Australian company tax paid the dividend is fully taxable without credit. Franked dividends paid to non-residents carry no credit, but are exempt from dividend withholding tax.

This system removes the main double-tax bias against equity relative to debt, and against company structures relative to unincorporated or flow-through vehicles. As well, imputation improves tax system compliance and integrity, as much of the benefit of any scheme to avoid Australian company tax is lost when the income is distributed to shareholders.

At the same time, from the point of view of resident shareholders, these features create a tax bias in favour of domestic income over foreign source income. This feature has been the subject of considerable debate in recent times. There is a view that the less favourable treatment of distributed foreign source income creates a bias against globalisation by Australian companies. There is also a view that the cost of capital of these companies could be reduced if imputation-style benefits were granted in respect of foreign source income. Others hold the view that these are not significant factors constraining the international growth of Australian businesses.

The treatment of dividends sourced out of foreign income was among the issues considered by the Review of International Taxation Arrangements, but no changes to these arrangements have been made at this time. It is of interest that varied practice and trends are in evidence across different countries. Different countries have classical, exemption and imputation systems. Some allow full income pass-through in particular cases. Some European countries with imputation arrangements appear to be moving away from such schemes, while the United States has recently adopted limited dividend relief proposals.

Global economic welfare may be advantaged by a more uniform and consistent approach to dividends, but it would appear at this stage that there is little consensus, or perhaps even understanding, on the best direction to follow.

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