Current note

25 September 2015

The Hon Scott Morrison MHR
Treasurer of the Commonwealth of Australia
Parliament House
Canberra ACT 2600

Dear Mr Morrison,

Rethinking Taxation

The Treasury recently extended the period for submissions on the tax discussion paper but not, I gather, for matters other than taxation of retirement incomes.

No matter.

I considered making a submission but, having done one for the Henry Review which is on file, I did not relish the task again. It is all there if you wish to read it and I see no reason to repeat things. However, having watched the march of tax reform since the 1960s "Agenda for Reform" from Downing, Arndt et al, through sitting as a Cabinet notetaker in the 1985 reforms, and looking at where we have ended up, may I humbly submit that the last state of Man is clearly worse than the first and that you need much deeper reflection – that we should not aim at tax reform but total abolition?

Realising that Prime Ministers have a time limit of two minutes to read briefing notes and Cabinet Ministers have around ten minutes, I have therefore set out the rudiments of the Crown's revenue problem and its solution as succinctly as I can and addressed it to the Crown and its advisers in general as an open letter for publication.

Yours sincerely,

Terence Dwyer

TAX POLICY IN TWO (OR TEN) MINUTES

A letter to the Sovereign for the assistance of Her Ministers

Most Excellent Majesty,

You and your Ministers, your Parliament and your officials are troubled by the eternal problem of paying for the manifold responsibilities of the Crown (as well as paying for the electoral bribes of those occasional knaves and varlets who attain high office).

You are not alone. You and your Ministers and your Treasury officials (like your fellow sovereigns) face the same problem as William the Conqueror when he had the lands and people of England at his disposal. I humbly suggest you adopt a modernised version of that wise Sovereign's solution – he handed his lands out to his supporters on condition they paid him rent in cash and in kind.

The King then "lived off his own" and taxation was not necessary.

The moral you should draw from his example is that land value (including resource value) taxation based on market values can give any sovereign an enduring, stable, predictable and growing revenue base to fund the Crown's duties and public works which in turn enhance the productivity and rental value of its lands and dominions. Taxation of capital or labour is simply not necessary for an adequately financed Treasury. If you doubt that, look to the princes of the Gulf States or the Sultan of Brunei.

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

So be of good cheer. Tax policy is really quite simple. It can be understood by the meanest intelligence (though there is much profit to be had out of perplexing tax laws, as we lawyers well understand).

All the goods and services the people of a country enjoy are the product of Man and Nature. Man uses Nature to create Capital, the produced means of production. These are the three "factors of production".

I must warn you at the outset that the word "capital" is used in several senses. Its fundamental meaning in economics is "produced means of production" which therefore excludes land (including all natural resources) as land is not man-made. It is confusing that many people also use it in the sense of capitalised value, which, as Böhm-Bawerk, the noted Austrian Finance Minister to the Emperor Franz Joseph observed, is rather like saying the value of a lump of pig iron is the pig iron itself.

A sovereign looking to meet the needs of the Exchequer therefore has to find a means to appropriate to himself or herself some share of the goods and services produced by these three great and original factors of production. Your problem as a sovereign is that your people produce for themselves and their benefit, not directly for yours. As the French economist M Jean-Baptiste Say observed, "consumption is the sole end and purpose of production" and it is to their consumption, not yours, that your subjects look. Your subjects despise any Treasury exhortations about the need for greater productivity to lift living standards if they know in their hearts that taxation will deprive them of the fruits of their labours. Your subjects are not your slaves and the ancient traditions of the common law, still extant 800 years from King John's Great Charter, declare that taxation is not known to the common law.

Therefore, addressing the problem of tax policy from the point of view of the Crown and its Ministers, one ventures the first observation.

Maxim 1: There are only three things you can tax – land, labour or capital.

It takes but little thought to realise its corollary.

There is only one of those three factors of production from which you get tax without it running away, knocking off work, ceasing to breed you more taxpayers, being left to rust away, or being moved offshore or hidden. You happen to be standing on it.

Maxim 2: A universal tax on unimproved land values (which exempts capital structures erected on or in land) is a uniquely efficient tax. It does not retard production, consumption or economic progress.

This is why it is *l'impôt unique* (the exceptional tax) as was recognised by the Physiocrats, Adam Smith and John Stuart Mill, and many successors since from Henry George to Milton Friedman and Joseph Stiglitz. Your subjects may produce for themselves but, in so doing, they cannot help but work for you as they seek ever more access to the land and natural resources vested in the Crown. Make them pay you rent for that privilege in the modern form of a land value tax, just as the barons used to pay your predecessors.

Land value tax cannot be avoided. If one of your landholders sells to try and avoid the tax, the buyer discounts the price paid for the future embedded tax attached. Has anyone ever heard of a successful "rates avoidance" scheme? No tax avoidance or evasion is possible. No inquiry as to beneficial or ultimate ownership and no invasion of your subjects' privacy is required. The tax notice is sent to the registered landholder and operates as a charge upon the land; if it is not paid, the land can be taken back by the Crown in satisfaction and a new tenant found who is willing to pay the rent necessary for the upkeep of a civilised society. The tax base can be shared without co-ordination of rates between your federal, State, local and semi-government authorities: each can set its rate and the land value responds by capitalising the tax. The miserable, moth-eaten State land taxes could be replaced by a common shared taxing and rating base.

The tax base cannot be moved offshore and out of your taxing jurisdiction, as occurs with loans, securities, patents and other "intellectual property". Nor can it be avoided by non-residents buying land and farms within your sovereign jurisdiction: they too must pay.

Here endeth the lesson. If you do not wish to read further you have the question of tax policy understood in its essentials in less than two minutes. But should you wish to consider the matter of the Crown's revenues further, let us examine things a little more.

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

Your own revenues

It is remarkably little known that taxation is not normal. It does not exist at common law. The old maxim at law was that the King should live off his own.

Many sovereigns and states have existed and still exist who look to their own revenues to finance their treasuries before looking to taxes to have the public contribute. The Norman and Plantagenet Kings largely lived off the rents and feudal payments due to them as a quid pro quo from the barons who were their tenants and were permitted to hold and occupy the King's lands.

Even today, oil-rich states from the Kingdom of Saudi Arabia to the Sultanate of Brunei largely live off their oil revenues. Australian State royalties and Crown land lease payments are also examples of the Crown living off its own.

Where a sovereign charges a price for service rendered or a natural resource made available, it is not a tax, but a price. From an economic point of view, there is no tax if the price is fairly set and represents competitive market value for the resource or service.

In one sense, a land value tax can be seen as the Crown re-asserting its paramount right of ownership over the land and, as John Stuart Mill observed, charging rent.

What about other taxes?

Before considering other possible tax bases, it is worth elucidating some general principles.

> *Maxim 3: A tax which induces a change in behaviour must cause excess burden, that is to say, the costs inflicted upon the taxpayer by redirecting his behaviour exceed the revenue to the fisc. A "lump sum" tax is therefore best.*

There are many examples in history of this. Changes in behaviour may be largely in legal form or substantively economic. At its mildest, it may merely mean a person simply decides to shift taxable income from one year to another by deferring sending out invoices or paying bills early. It may mean a person makes more superannuation contributions instead of paying off a mortgage and renders his or her financial position less liquid.

More seriously, it may mean a business closes down its trading operations in your country and shifts its production overseas as many Australian firms have done. At its worst, it can destroy activity altogether and create tax evasion. The 18th century smuggling on the south coast of England to evade the customs duties meant the Crown received little from the duties but induced men to risk life and liberty in stormy seas.

Paradoxically, legal tax avoidance which changes the form of a transaction may mean less social economic loss overall than economic avoidance where behaviour is changed substantively. It is better for your realm if businesses can legally reduce their tax burdens by tax planning to acceptable levels they can live with than close down operations altogether and shift jobs and economic activity offshore.

By a "lump sum" tax is meant a tax which no action of the taxpayer can alter. It does not mean a head tax (which can be avoided by leaving the jurisdiction for the relevant time). It simply means a tax burden *not dependent on any action by the taxpayer*.

Few taxes satisfy this desired objective. For example, income varies with effort or investment or taxable presence within your jurisdiction; capital gains tax and stamp duties may be deferred by holding on.

Where the incidence of a tax depends upon the occurrence of a transaction it can always be avoided by avoiding or deferring the relevant transaction. That, of course, may come at an economic cost to the taxpayers but they may still find themselves better off. This leads us to a corollary.

> *Maxim 4: A holding tax is better than a transaction based tax.*

It is usually better to tax the holding of an asset rather than its sale or the generation of income or gain. Stamp duties are a good example of this problem. Because they are transaction charges, not holding charges like rates, they are not capitalised in lower land values. They are also taxes on improvements to land, such as extra rooms on a house.

Transaction taxes also expose the Crown's revenues to the vagaries of commerce. Commonwealth tax receipts collapse with iron prices, State revenues are hostage to housing market speculation. A

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

holding tax can be computed on a land value as at a given date and the liability – and the Crown's revenues – can be fixed and known in advance instead of being dependent ex post facto on the taxpayer's legal or economic activities or vicissitudes.

What about income tax?

Some will say, but this is too simple. Why should you not tax income, and larger incomes more than lesser ones?

But incomes break themselves down into the incomes of land, labour or capital (or incomes indirectly derived from these). National income is the sum of land rents, the wages of labour and the profits of capital. Interest is merely a sharing of this income with others who may or may not have contributed to its creation and double taxation is avoided by allowing interest to be deducted from profits.

So when you levy an income tax you are really levying three taxes: a profits tax on capital, a labour income tax, and a land rent tax. You are back to the conundrum – capital may leave or be left to rust, labour may leave or cease working or breeding more taxpayers.

Ah, but they say, you can exempt normal people and only "tax the rich", so there will not be adverse effects on labour or most investors. Well, that does not happen for a start (income tax is now a tax on the mass of your subjects, including the working poor and their families, requiring large family payment grants to offset its evil effects) and ignores the fact that rich people who have grown rich by working hard and contributing to society might perhaps deserve to be thanked rather than plundered through social envy, which is no less a sin than avarice.

Economic objections to income tax

It is well established that the optimal tax rate on reproducible capital is nil. Taxing capital reduces capital formation and thus the productivity of labour which needs capital to create things and services consumers desire.

It is also well known that capital is mobile. It can leave your country. As Adam Smith observed, merchants are citizens of the world and apt to take their capital elsewhere should they be exposed to vexatious taxation.

While they may not directly take their buildings and machinery immediately out of your taxing jurisdiction when you impose a tax, they can do it indirectly by using up their existing physical capital and taking the proceeds to create new physical capital elsewhere. You are seeing a like phenomenon now as General Motors and Ford close down their Australian plants to produce cars elsewhere for import into this country. Much as some would like to think no one would ever want to leave Australia, many Australians have left to seek opportunities elsewhere while businesses still here have sent many jobs, from telemarketing to manufacturing, away from your shores to create tax revenues for foreign countries.

Similarly, taxes on labour create distortions. A wage tax, such as income tax or payroll tax, creates a tax wedge between what the client or employer pays and the employee or contractor gets in hand. Some people even leave the country to work in lower tax environments such as Singapore or Hong Kong. For most, their reaction to taxes on wages comes in the form of demands for higher gross wages to compensate, notably when industries are in boom situations. Some persons in skilled and learned professions, such as medicine and law, may be able to pass on much of the tax to those who pay them for their rare skills. This hardly assists the affordability of legal services or health care or legal aid provision by governments. Other workers may react by leaving PAYE employment to offer their services as contractors and claiming a wider range of deductions and sharing income with family members.

It is often argued that the solution to problems of income tax is to flatten the tax rate scale and eliminate tax exemptions or concessions. Having a broader base with a lower rate will reduce the admitted distortions of income tax.

This well-known "broad base, lower rate" Treasury argument is in fact wrong *unless what is being taxed is of the same kind*. But income tax taxes different factors of production which can

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

respond differently. As the Treasury will admit, the argument for cutting the corporate tax rate rests on the idea that capital income is more mobile than labour income. Further, the identification of unwarranted tax concessions to be abolished is not easy. For example, you may abolish superannuation tax concessions if you wish. You will then discover foreign employers may offer offshore unfunded schemes guaranteed by captive insurers to cover Australian executives while uncovered local employees will point to unfunded ministerial and civil service pensions and ask why they are being penalised because their schemes were funded.

Legal objections to income tax

As every tax planner knows, to tax income you must:
(1) identify the taxpayer; and
(2) identify the amount as income.

Income does not exist, unlike land, in a state of nature. It has to be created. Where it is created and in whose hands is often a matter for taxpayers to decide. No sovereign can tax the income arising outside his or her borders for the benefit of a non-resident. True, many countries now try to tax the income of foreign trusts or companies where they think they can attribute such income to their residents but such measures always must have exemptions and limits and, with proper advice, will not apply. For example, it is difficult for a country to tax the income of a deceased estate held offshore.

This brings us to the question of double taxation. If all countries, both those where the income is sourced and those whose residents own it, tax the income, such double taxation destroys international trade and reduces the well-being of both countries. Income tax requires that countries allocate taxing rights, both unilaterally and bilaterally. Tax treaties have to decide source rules and apply lower withholding tax rates or credits to avoid double taxation. As you have seen with Apple, Google and other companies, such rules afford room for planning. Your Ministers (like the young Mr David Cameron) may be foolish enough to think they can stop this unilaterally. I can only wish them good luck when they and their officials come up against the United States Treasury which naturally regards itself as having first claim to the offshore profits of US corporations.

Tax avoidance

Incidentally, one must observe that those of your advisers who complain to you about tax avoidance as if it is some deviant behaviour should reflect that they are the ones who draft the tax laws submitted for your Royal Assent and might perhaps accept some blame for choosing bad tax bases. As Adam Smith remarked, it is rather hard to create a temptation and then abuse a man for succumbing to it. Surprising as it may seem, most taxpayers want to hang on to their own money and not give your Revenue more than their elected representatives in Parliament have unequivocally said they must contribute according to law, and if they can re-arrange their affairs lawfully to reduce a contribution to your revenues they will do so and are within their rights to do so.

Nor should it escape remark that tax avoidance is at times promoted and practised by governments themselves. Foreign governments are not slow to claim sovereign immunity and use it where they can as a shield for their own citizens' public pension funds. I well remember being told by a former senior Sydney tax lawyer of the time he flew to Canberra with New South Wales Treasury officials to have documents signed in Canberra to avoid NSW stamp duty of several millions on a privatisation of a NSW semi-government undertaking. Similarly, the Commonwealth (for good foreign relations reasons) may condone a foreign investment structure for a foreign government entity designed to ensure no Australian tax would ever likely be payable.

Capital gains tax?

Many economists, influenced by 19th century German and 1930s American ideas of income as personal income, rather than national income, have favoured a "comprehensive" income tax – which makes it sound a lot better than Prime Minister Pitt's 1798 income tax aimed at the normal regular sources of income.

In particular, they have argued that "capital gains" should be taxed as if they were ordinary income. They argue that most of the ills of the income system, including tax avoidance would be largely eliminated by taxing all gains of all kinds just as if they were normal income. (Incidentally,

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

"capital gains" has little to do with real economic capital in the sense of plant and equipment etc: it merely means changes in the capitalised value of *any* assets, considered just as an equivalent fund of money.)

But abandon hope, all ye who enter here! For matters are not so simple and their hopes are snares and delusions.

First, one must ask, what do they mean by capital gains? Presumably, they mean to tax either a realised or unrealised increase in the value of assets – is that not so?

It follows that they should mean to allow deductions for unrealised or realised losses in the value of assets – and to allow these as deductions against all other sources of income. If that is not what they propose to do, then it is obvious the tax is neither logical nor fair – not that that ever worried your tax-gatherers, though it ought to worry you. If that is indeed what they propose to do, then you must realise you have opened up a new Pandora's box for tax planning to the detriment of your revenues. A person may make losses to set off against his higher income while gains are diverted to a friendly foreign or domestic taxpayer with losses or a lower income. One can again only wish your Ministers good luck.

But supposing they think themselves clever, by denying capital losses as deductions against ordinary income and quarantining them, there is a more basic problem. Where do capital gains come from? From assets, they say. But, I ask your advisers, what classes of assets are there?

- There are loans, deposits etc, which are fixed money value assets.
- There are plant and equipment.
- There are patents and other legislated monopoly rights, such as taxi licences.
- There is land, and the buildings or the infrastructure built on or in it.
- There is the goodwill of trading businesses.
- There are shares in companies and interests in trusts and other investment vehicles.

Let us consider each class.

Fixed money assets, if at call, never show gain or loss. Longer-term assets such as bonds may rise if interest rates fall but drop in value if interest rates rise but in the end will be paid at face value maturity. One man's gain is another's loss. Who can expect to draw a net revenue by taxing them?

Plant and equipment depreciate by and large, sooner or later, even if there may be temporary rises in value. They will generate tax losses. That is why your advisers excluded motor vehicles from your current capital gains tax since they did not wish to see every car owner claiming deductions by selling each year (again, neither logical nor fair).

As for patents and other monopoly rights, why have them? Is it not better to abolish legislated artificial monopoly rather than foster it? A legislated monopoly is nothing more than a private licence to tax the public, as Queen Elizabeth I was made to realise when the Commons petitioned against her grants. It weakens those subject to them and generates no revenue to you; rather, it diminishes the trade and industry of your subjects.

Land and buildings are two entirely different kinds of assets, wrapped up in one title. Land appreciates in a growing community, but buildings depreciate. They require maintenance and eventually become obsolete and require demolition. So also with infrastructure – poles, wires and pipes need replacement and roads need re-surfacing. The only true rises in value belong to the land.

The goodwill of trading business is a phantom asset. It is merely a current valuation of the expected future income from the business. But that income will be taxed anyway via income tax. So the valuations are of post-tax anticipated income streams. To tax gains in goodwill is thus double taxation. Your advisers know this, which is why your Ministers see concessions are necessary for goodwill or sales of small businesses.

Turning to shares and investment interests (including life assurance or superannuation), these are merely choses in action and indirect claims to assets which fall into the previous categories, so again your advisers are looking at double taxation. Some such assets, such as life assurance and superannuation were therefore excluded from capital gains tax but not shares and other interests.

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

Taxing shares can create cascading of taxes up a corporate chain (which is why your advisers asked Parliament to grant consolidation for large company groups), But, amusingly, it took some years for your avaricious advisers to realise it also created opportunities for cascading losses up a corporate chain. He who plays unfairly should expect to be paid in the same coin.

To sum up, virtually all real enduring capital gains come down to rising land values. The other sources of "capital gains" are either double counting or illusory. Yet a simple federal land value tax would tap these as they accrue with a lot less wasted administrative effort and no chance of avoidance.

The proof that other sources of capital gains are not worth the candle is shown by the need for concessions – small business concessions, rollover and scrip for scrip concessions, death carryovers etc.

To take a common, simple-minded claim, many purported economic "experts" claim the principal residence exemption should be abolished. May I suggest you ask these experts what would happen to labour mobility or urban traffic congestion? Would any of your subjects be so foolish as to sell a house in one place to buy an equivalent house in another place if the capital gains tax meant he would turn up to buy with only, say, 80% of the purchase price left in his or her hand after tax on selling? Already, your Treasury officials rightly tell you state stamp duties are terrible taxes precisely because of such "lock in" effects. They will, if asked, have to tell you in all honesty that the same criticised "lock in" would apply if the capital gains tax exemption for family homes would apply. If you want a flexible workforce, tying workers to the place they live seems about as silly a way to achieve it as the old pre-1830s pre-Poor-Law-reform, parish-based system of relief for the poor and labouring classes.

It should be obvious that a tax such as capital gains tax, which requires so many concessions to make it bearable, ought to be questioned. (That incidentally was the view of several experienced Treasury officials in the 1960s and 1970s).

If, as the late Professor Wheatcroft quipped, a tax system breathes through its loopholes, perhaps you would better advised to free your people from the straightjacket so they can get on with the business of making your country prosperous. You can collect your fiscal dividend from their activities through the rent, that is, the rising land values of a prosperous country which you can tax as you go.

I add that you should also be aware that taxing land values at source avoids the problem of international tax avoidance involved in converting Australian capital gains into trading profits exempt under the permanent establishment provisions in the tax treaties you have increasingly signed, rather foolishly, since the 1960s. In former days, wiser Treasury officials questioned the benefit of such treaties but the rush to make a splash in international affairs and ponce around at G20 media fests or get all-expenses paid junkets to innumerable OECD meetings seems to have seduced your Ministers and their officials from a cold, sober, appreciation of your nation's real interests. Your Australian Ministers should realise that in international tax negotiations, they are just a somewhat bigger dumb mug punter walking into a smoothly run rich boys' club and, far from "shirt-fronting" bigger countries (whatever that strange phrase means), they will walk away worse than empty-handed.

Taxing consumption?

Faced with the mounting evidence that income tax creates distortions in their subjects' behaviour, many foreign countries have embraced "broad based" consumption taxes such as value added tax (VAT) or goods and services tax (GST).

It is fair to say many higher income earners support a move to greater reliance on GST because they think their excessively high marginal income tax rates may thereby be reduced.

Your advisers would be cruelly deluding them to let them think so. In order to see this and see what GST really means as a tax, one must examine tax equivalence theorems. Income equals consumption plus savings or, as the economists write it:

$$Y = C + S$$

It does not matter whether you take money from taxpayers under one name or another or when they earn and before it goes into their pockets or as it comes out to be spent.

In looking at a tax system one must add it all up. If a person pays 20% income tax, that may look not so bad, but if he is also paying 10% payroll tax plus a 25% GST, it is pretty miserable. Thirty per

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

cent plus 25% of what's left comes to 49% of what one started with. If one pays 45 cents income tax and spends the remaining 55 cents under a 10% GST, one is really paying a 50% income tax rate.

Hence, in imposing taxes, you have to look at the TOTAL tax take on average and at the margin of decision-making. This partly explains why Europe is sadly going downhill. For example, in Latvia, when one added it all up, the average tax rate was about 52% and the marginal tax rate on extra income was 56%. No wonder 30,000 people were emigrating each year out of a working population of 900,000 or so and the rest were not breeding! That continues to the present day.

Refining the discussion a little, if Y = C + S, then C = Y – S.

Hence: tC = t(Y – S).

Therefore GST is just a flat rate income tax – but one which exempts savings. GST is thus the same as an income tax surcharge which gives an unlimited tax deduction for savings.

If that is what anyone wants to do, he does not need a GST at all – it's easy, just impose an income tax surcharge, abolish the superannuation concessional contribution caps, and abolish the 15% tax on those contributions, exempt all income accumulations and tax the tax-free threshold!

Such action might actually save many half-educated economic commentators from schizophrenia when they talk in one breadth about the need to crack down on superannuation tax "concessions" while urging in the next breath that you should raise the GST rate.

But there's more. Income generated in this country flows to both residents and non-residents.

So Y = Yr + Ynr and C = Cr + Cnr

But virtually only residents consume locally and GST is only on local consumption. So, looking a little deeper, GST is basically just a tax on your Australian residents and denizens only. Thus, putting it together, one sees that GST is actually an income tax which exempts not only savings but also exempts foreign investors.

That might seems a strange thing for your Ministers to do when your subjects are wondering where the profits from years of mining and property booms have gone and how to stop foreign investors making profits out of Australian urban real estate. Do you really think the Australian people want to exempt foreign investors from paying tax on Australian-derived incomes while increasing taxes on themselves?

It would be a courageous Minister who was willing to so advise.

But it gets worse. GST is not even a tax on consumption as so many pseudo-economists think. It taxes production as well. Remember that production requires labour as well as capital. Yet labour is an input to production as much as machinery or buildings – and labour has to be maintained, repaired and replaced as much as machines.

That is why Adam Smith condemned taxes on wages or on the necessities of life. He saw them as increasing the cost of labour.

But GST is refunded on replacements of machinery but not on money spent to raise up children to replace the labourer. The old doctrine that food, clothing and shelter and the other necessities of life should be exempted because labour is a cost of production was not foolish – it was a major impetus for the manufacturers' support for the abolition of the Corn Laws.

The truth is that income tax should be a tax on *net* income after deducting *all* costs of production.

Thus costs of food, clothing, shelter, health, education and child raising should be deductible if the labour force is to be maintained – which was the reason for a tax-free threshold and child tax allowances. Similarly, costs of food, clothing and shelter, education and medical care should be exempt from GST and many countries do have some exemptions. But whereas virtually all business or capital inputs get GST refunded to exempt them, only some labour inputs (for example, food) are exempt from GST. GST thus represents a tax inherently biased against labour considered as a factor of production.

To sum up, your Ministers should be asked to ask themselves whether they or the Australian people want a tax system that:

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

- taxes the tax-free threshold;
- exempts foreign buyers of their land and resources;
- exempts fodder for farm horses but taxes the food of workers and their families; and
- taxes them on the costs of raising their children – the future taxpayers for your Treasury?

If that is what they want the Crown to do, you do not need to have a GST and waste time on its administration and auditing for millions upon millions of transactions a year. Instead, just:

- put on an income tax surcharge;
- give an unlimited tax deduction for savings; and
- exempt foreigners from income tax.

It comes to about the same difference.

But other sovereigns – and your own subjects – might think that only a seriously stupid country would have a tax system that exempts foreign buyers of its land and resources while taxing the families raising its future taxpayers. The shrewder ones might even do the reverse.

Excise taxes

Excise taxes were inflicted upon your people as a result of the Dutch advisers coming into the realm with William of Orange. They are partial consumption taxes levied, inter alia, against the people's bread and beer. All the criticisms levied against goods and services tax or VAT or against the Corn Laws apply against them with equal force. They were seen as necessary as your feudal tenants threw off the burden of their remaining rents in the *Statute of Tenures* in 1660. Sadly, your predecessors permitted their vassels to throw their proper burdens for the benefits and estates they enjoyed from you onto the working poor, the meanest of your subjects.

Quasi-taxes and monopolies

Bankrupt princes such as the pre-Revolutionary Bourbon Kings of France have often been tempted to gain large one-off revenues by public tender of taxation rights or monopolies. Your predecessor Elizabeth I of happy memory, on being reproached by her Commons, repented of her errors in this regard in the granting of monopolies in her "Golden Speech". Unfortunately, her French cousins did not learn; they failed to heed the warnings of the able Minister Turgot, continued to allow their people to be oppressed by tax-farmers and monopolists, and reaped the whirlwind.

All this would be of little interest, were its errors not being perpetuated in the silent and hidden system of disguised private taxation embedded in electricity, water, gas, telecommunications, airport and toll road pricing. Many public works have been sold off as monopolies and the public which paid to bring them into existence through their taxes, now pay again to give the new monopoly buyers a rate of return on inflated and indexed notional valuations of assets, towards the constructions of which they paid nothing or a fraction of the valuation used to set prices. Worse still, vested interests who are the modern equivalent of the 18th century tax farmers who destroyed the French monarchy, are now practising their rapacious price gouging under the neglectful eyes of your Ministers and officials who are so ignorant as to think that competition to secure the loot of monopoly is somehow related to "free enterprise" and therefore to be protected by "light handed regulation". Your former Ministers who sought to restrain the East India Company's depredations in India would be appalled.

Disguise it as they might, the brutal truth remains that prices set in excess of short run marginal cost act as quasi-taxes.

It is therefore no wonder that manufacturing industry is fleeing your realm of Australia to avoid usurious charges for essential industrial inputs and setting up factories overseas where other sovereigns are less grasping than your State and federal Ministers.

Payroll taxes

Because GST exempts capital investment, it is sometimes seen as equivalent to a payroll tax, the disadvantages of which have already been seen. Like all taxes on labour, payroll taxes drive a wedge between gross and net wages, thereby creating structural unemployment and/or lower living standards, leading to less family formation and fewer future workers. They are also often avoided by persons turning to contracting arrangements to turn labour income into trading profits exempt from such taxes.

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com

Stamp duties

Stamp duties are, of course, transaction taxes and are thus, by definition, avoidable, more or less. Where they are not avoidable, they create market distortions, as in limiting the availability of housing stock. They were well condemned by John Stuart Mill in his *Principles of Political Economy* (Chapter 5, Of Some Other Taxes, emphasis added):

> All taxes must be condemned which throw obstacles in the way of the sale of land, or other instruments of production. Such sales tend naturally to render the property more productive. The seller, whether moved by necessity or choice, is probably some one who is either without the means, or without the capacity, to make the most advantageous use of the property for productive purposes; while the buyer, on the other hand, is at any rate not needy, and is frequently both inclined and able to improve the property, since, as it is worth more to such a person than to any other, he is likely to offer the highest price for it. All taxes, therefore, and all difficulties and expenses, annexed to such contracts, are decidedly detrimental; especially in the case of land, the source of subsistence, and the original foundation of all wealth, on the improvement of which, therefore, so much depends. Too great facilities cannot be given to enable land to pass into the hands, and assume the modes of aggregation or division, most conducive to its productiveness. If landed properties are too large, alienation should be free, in order that they may be subdivided; if too small, in order that they may be united. All taxes on the transfer of landed property should be abolished; but, as the landlords have no claim to be relieved from any reservation which the state has hitherto made in its own favour from the amount of their rent, an annual impost equivalent to the average produce of these taxes should be distributed over the land generally, in the form of a land-tax.

His recommendation thus supports the simple lesson of this epistle.

Death duties and wealth taxes

These taxes depend on defining the taxpayer. They do not necessarily attach to anything found in nature, such as land. All wealth can be put into trusts, companies, joint names, insurance policies etc. None of your subjects needs to hold "his" wealth in his own name to make things easy for what Adam Smith described as your insolent race of tax collectors. Nor does it even have to be held by legal entities created in your realm and under your jurisdiction.

Your State and federal governments have wisely ceased from levying such taxes and Australia is now a death duty tax haven for investors from other countries. That shows you that abolishing taxes brings hidden benefits. Would that you extended the example to other taxes!

Conclusion

You do not need to tax your subjects' property. All you need do is make them pay for using yours. A tax on unimproved land values is not really a tax at all but a rent charge in favour of the Crown as owner.

Such a charge has no adverse economic effects. It does not repress the industry or labour of your people or prevent them from having flourishing families. It requires no vexatious impositions into the private affairs of taxpayers or surveillance of their bank accounts. It does not intrude upon the fiscal prerogatives of foreign powers. It requires no international tax negotiations or inter-State co-ordination save, perhaps, to establish a common valuation base. Its only disadvantages are that it is obvious and cannot be avoided but these are really virtues.

But I confess that, like Adam Smith, I have as little expectation of seeing such a rational reformulation of taxes being proposed by your Ministers as I have of seeing a new Utopia and I, sadly, fully expect my country to sink to a new level of mediocrity in its culture and circumstances. In the meantime, doubtless many of your subjects, both great and humble, will bear in mind the dictum of a wise economist, Professor Mason Gaffney, who long ago advised that "if one is condemned to live in a corrupt system, it is preferable to be a beneficiary rather than a victim" – and consult their lawyers.

Dr Terry Dwyer
Chartered Tax Adviser, Dwyer Lawyers
www.dwyerlawyers.com.au

THOMSON REUTERS

© 2015 Thomson Reuters (Professional) Australia Limited
for further information visit **www.thomsonreuters.com.au**
or send an email to **LTA.service@thomsonreuters.com**

Please note that this article is being provided for research purposes and is not to be reproduced in any way. If you refer to the article, please ensure you acknowledge both the publication and publisher appropriately. The citation for the journal is available in the footline of each page.

Should you wish to reproduce this article, either in part or in its entirety, in any medium, please ensure you seek permission from our permissions officer.

Please email any queries to
LTA.permissions@thomsonreuters.com