

Tax Reform in New Zealand: The Shape of Things to Come in Australia?

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New Zealand had preceded us down the path of tax reform. We can learn from its experience.

OVER a decade ago, New Zealand undertook many of the tax reforms that Australia is currently contemplating. As a result, it gives us first-hand evidence of the benefits of lasting tax reform, the strategies that can be employed to deliver an efficient, fair and simple system, and the problems that can be solved by good reform.

In the late 1970s, tax was a very controversial political issue in New Zealand, reflecting a poorly-constructed tax system. Tax collections were failing to meet government revenue requirements and the system overall was highly distortionary with numerous concessions and high rates of tax.

THE TAX REFORM PACKAGE

The package approach to tax reform adopted by the Labour government elected in 1984 reflected the view of New Zealand's then Finance Minister that rapid reform on a broad front spreads the burden of reform equitably, thus enhancing the legitimacy and acceptability of the programme.

The reforms that made up the tax reform package have stood the test of time because they were linked together by a common theme. That theme was the need to have broad bases (so that if you are taxing income, you want to tax all kinds of income, or if you are taxing goods and services you tax all goods and services) and low rates. This 'broad base/low rate' strategy was not mere political rhetoric, it was reflected in all aspects of the package.

Such an approach recognized that genuine tax reform would allow resources to be used more efficiently because deadweight costs of taxation would be reduced and business would be able to compete on a genuinely equal footing. It meant that New Zealand's national income would be higher, and New Zealand businesses would be better able to compete in the world and at home.

As a result, tax reform was tackled on a wide front with the key elements being:

- reduced reliance on income tax through the introduction of a broad-based value added tax—a GST, including items typically not taxed in Europe such as food, clothing, health and education;
- the removal of tax concessions and the closing of tax loopholes in the income tax; and

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- the reduction of personal rates of tax (the top marginal tax rate was cut from 66 per cent to 33 per cent, and was aligned with the company tax rate).

The catch cry of reform was broad-tax bases, levied at lower and less variable rates of tax. This approach was adopted as the best means to:

- raise sufficient revenue to correct New Zealand's fiscal imbalances;
- increase efficiency by reducing tax differentials that distorted economic behaviour; and
- reduce the tax burden on wages and salaries and thus be seen as fairer.

The GST rate in 1986 was 10 per cent but it was raised to 12.5 per cent in 1989, when further income tax cuts were introduced. Unlike most VAT systems, only one tax rate applies. At 10 per cent, tax may be quickly and easily calculated based on GST-inclusive turnover (this

is equal to one-eleventh) or on tax-exclusive turnover (the tax is one-tenth). Similarly, at 12.5 per cent the tax fraction is one-ninth or one-eighth. The next rate at which tax fractions can be used is at 20 per cent, where the fractions would be one-sixth and one-fifth.

COMPENSATION ISSUES

On its own, the GST can be described as regressive. The revenue from the GST was, however, used to finance substantial reductions in personal income tax as well as financing a compensation package that saw social welfare benefits increased across the board by 5 per cent (overall, at a 10 per cent GST, Treasury calculated that prices would rise by only five per cent because of the elimination of sales tax and the range of goods not subject to GST). In New Zealand, people accepted the GST on the basis that it was part of a system that was fairer than the burdensome income tax system it was, in part, replacing.

Compensation was handled by redistribution through the income tax and benefit system. Providing exclusions was found to be an ineffective way of protecting the poor. For example, it was estimated that households with the lowest 20 per cent of income would have received only 15 per cent of the aggregate benefit of an exclusion for food. The other 80 per cent of households, which were not considered to be poor, would get 85 per cent of the benefit. The same is true of other exclusions—the well-off spend more on everything: therefore they pay the most GST when the base is broad.

Overall, because the revenue base was stronger, it was possible to provide compensation for those who genuinely needed compensation from within the reform package.

It is easy to understand the pressure that politicians were under to give way and, overseas, there are many examples of exclusions for basic foods, children's

clothing, books, health costs and so on. Any exceptions add enormously to the complexity of the system. Much of the pressure applied in New Zealand was countered by providing offsetting relief in the form of tax cuts and benefit increases.

It is interesting to note that booksellers who argued strenuously for an exclusion for books on the basis of a United Nations Convention that books should not be taxed, subsequently applauded the introduction of GST on the basis that high income earners (who tend to read more books than lower income earners) were significantly better off overall as a result of the tax cuts they had received.

COMPLIANCE AND ADMINISTRATION COSTS

It is undoubtedly true that the GST imposed some additional compliance costs on businesses in New Zealand. The GST called for improved accounting systems, improved record-keeping, and in some cases additional skilled administrative staff. There are compensations, however. First, sales tax was scrapped and second—and more importantly—the GST provides cash-flow benefits to registered persons (although this comes at the price of a cash-flow cost for the revenue authorities). For a cash-based supermarket, for example, the GST collected is likely to be held for up to two months and the use of money in that time will far exceed any additional costs incurred in complying with the accounting requirements associated with a GST. One supermarket chain calculated that the use of the money benefit would exceed NZ\$500,000 per annum.

In addition, many businesses in New Zealand found that the requisite record-keeping assisted in making better use of their own resources and business planning.

It must be stressed that it is the broad base applied in New Zealand that has kept the compliance and administration costs to a minimum:

- with any tax, boundary issues will arise—a base that is as broad as that applied in New Zealand keeps these to a minimum;
- for many businesses, especially small ones, the impact of the GST on day-to-day business is relatively minor as simple fractions can be applied to cash book entries or through electronic records. As soon as multiple rates are introduced (including exemptions and exclusions), administration goes up because of the need

to keep separate accounts for supplies taxed at separate rates; and

- it is a fact of life that governments need at least two broad tax bases to fund their revenue needs. The alternative to a GST is not a compliance-cost free world of no indirect taxation.

When accounting, audit and other associated costs of collection are taken together, the GST is expensive to administer. However, the sales tax administrative system was dismantled, and the costs are lower than in countries with multiple rate GST/VAT regimes.

WHAT CAN NEW ZEALAND'S EXPERIENCE TELL US?

Australia undertook its own tax reforms in the mid-1980s and introduced many of the changes that New Zealand has on the income tax side. These included introduction of the fringe benefits tax, introduction of an imputation system and so on. Nevertheless, New Zealand had pursued a broad-based approach to income tax more zealously than Australia with, for example, the removal of accelerated depreciation, that is only now being considered in Australia.

The more incremental approach to reform and the failure to address the shortcomings of the indirect tax base in Australia means, however, that, a decade later, there are strong echoes of Australia's current tax system in what New Zealand left behind when it initiated

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reform. The ramshackle wholesale sales tax system; the relatively high rates of tax which apply to average income earners; the perceptions of unfairness because of the apparent tax planning that is available to non-PAYE taxpayers (due to the different rates that apply to different entities and the holes in the income tax base) are all features of Australia's current system.

There is an increasingly adversarial relationship between the tax office and taxpayers. This is perhaps the best evi-

dence available of the problems faced when the existing tax bases are inadequate to raise the revenue which government considers necessary to meet public demand for government expenditure. There is a growing sense of unfairness when the tax authorities are forced to push every margin to its limit to extract more from the tax base, and some taxpayers are able to get around the more stringent rules while others are not.

The New Zealand experience shows that the road to greater harmony and stability is to broaden bases (so people perceive that the system is fairer) and to lower tax rates (so the incentive to avoid and evade is reduced). Together, they provide a strong revenue base from which adequate compensation can be drawn.

In looking at the application of such a framework for Australia, business groups have come out firmly in favour of a broad-based GST, and welfare groups have traditionally been concerned with broadening the income base to ensure that people pay a fair share of tax on their income. The interesting question now is; can we take something from both of these approaches by adopting the New Zealand model of broad bases and low rates for both our consumption tax and income tax and get the best of both worlds? Could this be the way to real, lasting tax reform in Australia?

Key lessons from the implementation of tax reform in New Zealand suggest:

- a package approach is best—it allows for trade-offs;
- the tax system needs to be directed at raising adequate revenues at the lowest possible economic cost as its main objective—this allows for much greater simplicity in the system, as well as enhanced efficiency;
- providing a single, consistent theme to reform (like the broad-base, low-rate policy) makes it easier for people to see the benefits of reform and provides a degree of certainty in the midst of change; and
- there needs to be a determination to get tax policy right first, with adequate compensation to be delivered outside the tax system.

SPECIAL FEATURES OF THE AUSTRALIAN SYSTEM

While there are many similarities between Australia and New Zealand that make the New Zealand experience of great interest to Australia, two main factors relating to institutional structures ►

have to be kept in mind when translating the New Zealand experience to Australia.

First, New Zealand has a unicameral Parliament and in the days of the introduction of a GST had a first-past-the-post voting system. This meant that once the government of the day had decided it wanted to introduce a GST it could do so. It did not have to be concerned about 'getting the numbers' from minor parties, as it did not have to get the legislation through a chamber in which it did not hold the balance of power.

In addition, sub-national authorities in New Zealand play a comparatively very minor role in terms of functions and revenue-raising powers. Because of that, the New Zealand Government was spared the problems that can arise with State governments.

None of this makes reform any less necessary. But it does make it that much harder to achieve. If Australia chooses to go down the New Zealand path, it means more work has to be done in ensuring broad-based support for the change, and effort has to be put into making sure that everyone is prepared to make changes in the national interest.

The New Zealand tax reform process has many lessons from which Australia can learn. It is a demonstration that even something that seems as politically impossible as a broad-based consumption tax coupled with a broad-based income tax can become accepted—even part of conventional wisdom—over time.



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I P A

Used Anglicans

The Australian Education Union and the Anglican Synod Report

KEVIN DONNELLY

It is not only when supping with the Devil that one needs a long spoon

We ask members to wear a blue ribbon as a symbol of public education. It will be an important sign of our resolve to fight for the survival of public education in this country. Let us not lose what has evolved as a quality, free, secular education system. Let the battle begin, we will defend state education against the conservatives and ensure that future generations will have access to a system based on the principles of equality and social justice.

The AEU News,
June 4, 1998, page 9.

THE Australian Education Union (AEU), if nothing else, is quite open and honest about its intentions to overturn recent changes to the Australian school system. The rhetoric is one of 'battle' and words like 'survival', 'fight' and 'defend' make it perfectly clear that, in the war against so-called 'conservatives' and 'economic rationalists', the AEU will do almost anything to win the day.

Since the national conference in Sydney last year, organized by the AEU and from which the above quotation has been taken, the teacher union has implemented a number of strategies to achieve its ends.

The first relates to a marginal-seats campaign undertaken before and during the recent federal election. Obviously, one very effective way to have the union's policies taken up is to have a Labor government in Canberra willing to repay its debt to the union movement. Not only did the union letterbox drop marginal seats, but a series of anti-GST advertisements were also run on evening television.

A second strategy employed by the AEU is to orchestrate public meetings involving fellow travellers and sympathizers. The union, instead of appearing alone—and thereby being seen as self-interested—brings together a collection of 'independent' academics, commentators

and community groups who, as you would expect, argue the union's case.

One such meeting occurred at the Melbourne Town Hall in June 1998. Described as a 'community summit' (*AEU News*, July 9, 1998), the meeting gave special prominence to those opposed to the Government and those guaranteed to promote the union line. Not surprisingly, the Melbourne meeting concluded with the following:

The final outcome of the Summit was a resolution that condemns the ever-widening gap between the haves and the have nots, rejects the concept of economic rationalism and calls for a society that is tolerant and considers community needs.

The AEU News,
July 9, 1998, page 16.

A second meeting, also held in Melbourne, organized to argue what the union defines as the case for public education, occurred on 2 August 1998. Once again, the meeting involved those sympathetic to the union: including pro-Left politicians, trade union representatives and 'friendly' academics. The meeting agreed on a 'Statement of Principles for Public Education' that endorsed the AEU's policy on education.

Supporting publications willing to argue the union's case is a third strategy the AEU is using to further its cause. The publication of *Going Public: Education Policy and Public Education in Australia* by the Australian Curriculum Studies Association (ACES) and the Centre for the Study of Public Education at the University of South Australia, provides a very recent example of this approach.

The book includes essays opposed to recent changes in the school system and very critical of the so-called 'conservative' agenda in areas like accountability and increased parental choice. The benefits of this particular strategy are that the union appears at arm's length from what is writ-

REVIEW