Tax reforms pose quandary

Tax revenue needs to rise, but is any one option preferable?

NOEL WHITTAKER

Tax reform is back on the agenda, with the usual suspects establishing their positions. This week ACTU head Ged Kearney took a strong position against widening the GST, calling for a higher Medicare levy, a review of negative gearing and increased taxes on superannuation. The employer groups responded with a call for a cut in company tax and the abolition of payroll tax.

Obviously any change will be vigorously opposed by one group or another. But the reality is that massive revenue shortfalls are looming, and this has huge implications for healthcare as the population ages. Today, in the interests of an informed debate, let's look at the implications of the major changes being discussed.

Any changes in GST will be attacked as regressive, which means they hit the poorest the hardest, but that criticism can be applied to any built-in tax. The classic examples now are petrol tax and excise on liquor and cigarettes, which are all regressive. A major benefit of GST is that it's almost impossible to avoid, and is a great way of getting a chunk of the money that is circulating in the cash economy. While it may hurt low-income earners most, it actually hits high spenders the hardest, as they are the ones with the largest disposable income.

A call for a rise in the Medicare levy from 2 per cent to 4 per cent is just another way of asking for an increase in marginal tax rates. The money raised by the Medicare levy now is not all spent on Medicare – in the interests of transparency the term "Medicare levy" should be abolished and incorporated in the current tax rates.

It is ridiculous to be calling for a rise in marginal tax rates when one of the biggest challenges for employees is bracket creep. And higher tax rates make it more attractive for high earners to negative gear for investment, as the government subsidises more of the shortfall than it does for lower income earners.

Q We have a weekender which we use regularly, which is not rented out. Can we use this as our primary residence for tax purposes?

A If you intend to use the property as your primary residence for tax purposes, you will need to be living in it. Evidence of residence includes having your mail sent there, and the property being your address for electoral roll purposes. Once you have established it as your main residence you can move out and continue to cover it with your main residence exemption indefinitely providing it doesn't earn income.

Q I am 57, retired on a small PSS pension, and own two investment properties as well as my own home. I am considering selling an investment property to free up some cash. If I sell and start up a super fund with the proceeds, how will that affect my capital gains tax? Will I be taxed differently if the money is inside a super fund or outside?

A The earnings within a super fund are a flat 15 per cent, whereas earnings in your name will be taxed at personal tax rates. Your accountant should be able to do the calculations for you, and help you decide what would be the best entity to own the asset.

The Henry Review called on states to replace stamp duty with a land tax on every property. The reasoning was that stamp duty is an unreliable source of revenue, as it is dependent on booms and busts, and is also an impediment to moving. The ACT liked the concept so much that they've already implemented it – well, at least partly. They've introduced land tax on the family home, but you guessed it, have retained stamp duty. There have been numerous reports in the press about protests by Canberra home owners who've seen their cost of home ownership rise more than 40 per cent.

The problem with universal land tax is that it takes no account of ability to pay, and hits hardest on retirees who are asset rich and cash poor. The offer of the ACT government to treat outstanding land tax like a HECS debt – capitalise it with repayment due when the house is sold – has not been well received.

Expect to see death duties back on the agenda, but there is little likelihood that they will be implemented. You can't have death duties without gift duties, as older people could simply give their assets away to avoid death duties and, in any event, we have de facto death duties now.

Although death does not trigger capital gains tax, the beneficiaries are liable for capital gains tax on bequeathed assets as soon as they sell them.

Also, there is a tax of 17 per cent now on the taxable proportion of your superannuation that is left to a non-dependant.

The lack of consensus at this week's premiers' tax retreat shows how difficult reform will be, but at least a decent debate is starting.

It is long overdue.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any decisions. Email: noelwhit@gmail.com.

Big banks' shares remain attractive to investors

By **JOHN COLLETT**

WHEN considering the tremendous increase in per capita wealth over the past couple of decades it is little wonder that the managers of wealth, the big banks, have done so well.

They have been able to make the most of the deregulation of the financial system over that time without losing much market share to competitors.

Little wonder the big banks remain the mainstay of DIY super fund trustees' share portfolios.

It is not only their tax-effective dividends when compared with the low rates that can be earned on cash that make bank shares attractive. Their share-price performances have been good as well.

Analysis by CommSec shows that 20 years ago the big four banks were ranked in the top 10 ASX-listed companies by market capitalisation. They now occupy the first four places. Twenty years ago there were three mining companies in the top 10. Now, only one miner, BHP Billiton, remains; though 20 years ago it was BHP, which merged with Billiton in 2001.

While the average wage has more than doubled over the past 20 years, per capita wealth has more than tripled from $97,000 in 1995 to more than $340,000 now. That is mostly due to the performances of shares and property. The median dwelling price nationally stands at almost $500,000, compared with about $130,000 in 1995.

The S&P/ASX 200 Index is now about 5500 points compared with almost 2000 points 20 years ago. When the dividends are included, the total returns from Australian shares are much greater.

Assuming that over the past 20 years all dividends were ploughed back into the market, the investment would have grown sixfold.

I would not worry too much about the higher capital requirements that the Australian Prudential Regulation Authority is imposing on the big banks. It is part of the crackdown by regulators worldwide after the experiences of the GFC when banks in the US and Europe were bailed out by taxpayers.

The extra capital the banks will need is huge, about $11 billion across the big four. But the banks are much bigger with combined capitalisation of about $420 billion and combined annual profits of more than $30 billion.

Big banks are the pillars of super fund trustees' share portfolios.

Among the capital management levers they could press, the banks could slow the growth of their dividends. But it is bank customers who are likely to be making a major contribution. That can be achieved by not passing on any future cash-rate cuts in full to mortgage holders. And when interest rates do start to rise, the banks may not pass on the higher cash rates in full to their depositors. That is what you can get away with when you dominate an industry sector.

The only trouble for the banks' shareholders would occur if there was a marked slowdown in the banks' revenue growth. While there are signs credit growth is slowing, it is likely to remain at healthy levels.