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Reform of the Australian Wholesale Sales Tax

Abstract

This article proposes reform of the Australian Sales Tax legislation. The proposal suggests a tax mix alteration which is not revenue neutral. The purpose of the significant alteration of the system for indirect taxation and the change in the tax mix is to create a less complicated system which causes less distortion to the economy. The extra revenue yielded at the proposed rate of the tax should, ideally, be used for macro economic purposes.

Keywords

Australian, wholesale sales tax, tax

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Reviewed by Darryl Somerville Partner, Indirect Tax Coopers & Lybrand, Brisbane.

REFORM OF THE AUSTRALIAN WHOLESALE SALES TAX



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Introduction

This article proposes reform of the Australian Sales Tax legislation. The proposal suggests a tax mix alteration which is not revenue neutral. The purpose of the significant alteration of the system for indirect taxation and the change in the tax mix is to create a less complicated system which causes less distortion to the economy. The extra revenue yielded at the proposed rate of the tax should, ideally, be used for macro economic purposes.

The implied defeat of the Coalition's tax policy at the last federal election means that the introduction of a VAT/GST consumption tax into Australia in the foreseeable future is a remote possibility. Many have concluded that we will be burdened with the current Wholesale Sales Tax (WST) for many years to come. Despite the fact that the legislation was overhauled as from the 1 January 1993¹ in an attempt to streamline it, the tax remains difficult and costly to implement.

We believe that the current WST needs to be reformed. While the redrafting of the legislation may have made it simpler for ATO officers and advisors to understand, it has not made it any easier for taxpayers to observe. In fact, with the significant increase in the number of rates, the problems have increased recently.

We propose that the reform of the WST should not be revenue neutral. The increased revenue raised should cover the amount currently raised by the state governments from Payroll Tax and would be sufficient to allow the federal government to decrease the reliance on income tax.

¹ When the streamlined Sales Tax legislation was introduced.

The increased amount raised from the reformed WST could be distributed to the states, providing they abolish their current Payroll Tax. The balance could be used to reduce income tax and to achieve certain macro economic goals, most notably the reduction of the national debt. We also propose that low income earners would be compensated for the additional sales tax payable on what have become known as the necessities of life. Exporters will also be compensated for the sales tax reflected in the price of their exports by some form of border rebate which will not offend the GATT.

Overview of the current Wholesale Sales Tax

The current WST has a narrow base, high and many different rates and an initial incidence on business inputs. This causes significant distortions to business decisions on ways to produce and also distorts decisions on consumption. The final incidence of the tax burden is regressive. The lowest 10% of income earners lose 24.8% of their disposable income to indirect taxes while the top 10% lose only 10%.²

The Tax Office's administrative costs may be low but the compliance costs per taxpayer are high and regressively divided among taxpayers. It is generally agreed that something must be done to improve the current system of indirect taxation. Over the past 20 years many attempts have been made to replace the WST and some other indirect taxes with a VAT/GST, a Turnover Tax or a Retail Sales Tax.

The first attempts were made in the context of a global discussion from the mid-1970's to the mid-1980's favouring the VAT. A second option then put forward for an adequate indirect taxation system was a Retail Sales Tax. Professor Due stated in 1984³ that a VAT or a Retail Sales Tax are the only acceptable methods of indirect taxation as opposed to an unacceptable system like the WST. Notwithstanding the fact that no country with a WST has ever tried to reform it rather than replace it, we believe that reforming the current legislation is the best option to achieve a considerable improvement in the Australian indirect taxation system.

² See *ABS Household Expenditure Survey, Australia 1988-89, Benefits and Taxes on Household Income*, Catalogue No 6537.0 and *ABS Household Expenditure Survey, Australia, 1988-89, Summary of Results*, Catalogue No 6530.0

³ See (1984) 1 *Australian Tax Forum* No 4: "Accepted v Controversial Sales Tax Structures - Switzerland, Australia, New Zealand, Canada".

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Replacement?

There is widespread agreement that the current WST legislation does not adequately serve the country as an effective method of indirect taxation. In addition, the Australian reliance on direct taxes compared to its major trading partners is too great and causes extra costs for businesses because the workforce's income taxation costs are direct costs for companies. As stated by Mr Haynes⁴ from ICI in *The Australian* of 20 June 1994: "We probably cannot get it [a VAT/GST] but we ought to think about what we can do to get closer to the benefits that a VAT would have had for Australia".

Notwithstanding the fact that many attempts have been undertaken to replace the WST, we doubt that replacement of the WST will solve the defects of the indirect taxation system. As John Whalley stated in 1989: "It nevertheless remains true that the superiority of a VAT still remains to be empirically demonstrated". Or, as concluded in the federal opposition's election manifesto called the *Fightback* papers:⁵ "The aim was to determine if, other things being equal, a move towards a broad-based consumption tax would improve consumption efficiency. Within the narrow bounds of the assumption made, an efficiency gain of \$760 million or 0.2% of GDP was found for replacing the wholesale sales tax, payroll tax and the revenue raising portion of the petroleum products excise with a broad-based GST". Or, as John F Due stated:⁶ "No sales tax is perfect in its operation but study of the operation of various forms suggest very clearly that the simplicity, greater equity, the overall administrative feasibility and economic neutrality of the single stage taxes far outweigh the effects of higher rate and the greater concentration of the impact." Commentators and experts agree, the advantages of a VAT/consumption style tax, albeit a WST, outweigh its inherent defects.

The first six members of the European Economic Community replaced their multistage cascading indirect taxes by a multistage non-cascading VAT based on the rationale of convenience.⁷ Although they recognised the need for a massive improvement of their system, they did not replace the entire structure. It remained a multiple stage system.

⁴ Mr Haynes is the Chief Economist of ICI in Australia.

⁵ *Fightback: An Economic Assessment*, Australian Tax Research Foundation, Conference Series: No 12, 342.

⁶ See John F Due, *Sales Taxation* (1957) 359.

⁷ See *Choices and Conflicts Tax Policy in OECD Countries*, (International Bureau of Fiscal Documentation, 1993) 359.

The fact that many OECD countries and others have replaced their systems with a VAT or introduced a VAT as their first indirect taxation system, does not automatically mean that a VAT is the solution for a better indirect taxation system. The wealthiest federally structured country, the United States, still does not have a VAT. This indicates that following the international trend is not absolutely necessary in order to keep up with the modern world of indirect taxation. Taking all these considerations into account, it is clear that something has to be done to improve Australia's indirect taxation system. In our view, reform of the legislation would massively improve the indirect taxation system.

Why change the taxation system?

Why does the current indirect taxation system or even the whole tax mix have to be changed? First, as many authors and commissions⁸ have already expressed, the current system is too complex. Besides that, a WST distorts the economy due to vertical integration and differences in relative prices of goods. Vertical integration means that a strong incentive is given to perform an economic activity beyond the point of impact of the tax. A consequence of vertical integration, for example, is that retailers are encouraged to undertake activities such as warehousing and transport. The narrow base of the tax encourages vertical integration because the plentiful exemptions (narrow base) make it easier to push activities beyond the taxing point.

Further, because Australia relies heavily on direct taxes, which cause relatively high labour taxation costs for businesses, this also affects its international competitive position. Another argument related to labour costs involves the abolition of Payroll Tax. Payroll Tax is meant to make up the difference between the tax burden for labour and capital intensive production methods. That difference in the tax burden occurs because labour is not taxed under the WST. Labour intensive companies had (before the introduction of Payroll Tax) an advantage over capital intensive companies because the use of labour was not taxed while the use of capital equipment was taxed with WST.

It goes without saying that, to reduce the number of unemployed, the use of labour must be increased. The federal opposition's *Fightback* papers estimated that abolition of Payroll Tax would create about

⁸ Asprey Committee in 1975, Fraser Government in 1979 and in 1981, and the Hawke-Keating proposals in 1985.

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200,000 new jobs.⁹ Further, as Australia's international competitive position is negatively affected by Payroll Tax, its abolition is advocated. For this abolition to be implemented, at least the same amount of revenue has to be gained, which means extra revenue has to come from other taxes. Reforming the WST legislation is one of the options to achieve that.

The tax mix alteration

Altering the tax mix is proposed in every plan to replace the WST. The yielded extra revenue would be used to lower the rates of income tax and make up for the loss of revenue from the other indirect taxes abolished, such as Payroll Tax. There are many advantages in lowering the rates of income tax. We have not addressed this issue because many others have already done so.¹⁰ It makes sense to achieve those advantages and therefore we take the view that when the WST is significantly changed the income tax rates would be lowered. However, problems arise when changing the tax mix is discussed. States resist the abolition of the Payroll Tax, in particular, because they do not want to lose a significant amount of revenue. In addition, a reformed WST with abolition of the States' Payroll Taxes would increase the current imbalance between the federal revenue from indirect taxes and the state revenue from indirect taxes. In 1990-1991, Payroll Tax revenue Australia-wide was \$5.8 billion while WST yielded \$9.4 billion.¹¹

Since elimination of Payroll Tax would be an enormous incentive for business in general, it is worthwhile considering the challenge of abolishing it. Apart from abolition of Payroll Tax, any further alterations in the tax mix should only take place in relation to federal taxes to avoid problems from the relative imbalance between the Federal and State Government revenues.

Changing the tax mix revenue neutral or not?

Most proposals assume that changes to the tax mix have to be revenue neutral. There are no good reasons, other than political ones, for that

⁹ See *Fightback: An Economic Assessment Introduction and Summary*, 9.

¹⁰ One of the advantages of lowering the payroll tax rates is that export prices can be lowered because labour costs, which are direct costs of production, decrease.

¹¹ See ABS, *Taxation Revenue Australia 1990-91*, Catalogue No 5506.0.

assumption. Some Scandinavian countries, when they introduced their VAT, increased the total tax revenue and used the extra money for social welfare projects.¹² Changing the tax mix on a revenue neutral basis has only marginal efficiency benefits and marginal advantages for each individual taxpayer. Only the tax mix, not the overall tax burden, is changed. As the figures of the revenue neutral *Fightback* proposal show, the efficiency gain of replacement of the WST, the Payroll Tax and the fuel excise with a GST would be 0.2% of GDP.¹³

The tax mix change need not be revenue neutral in order to achieve more than marginal benefits. But the yielded extra revenue, beyond the amount needed for abolition of Payroll Tax and some decrease in the rates of income tax, should be used for macro economic purposes such as decreasing the national debt. Certainly, any extra revenue should not be spent on increased government expenditure because that would not serve the well being of the country. Australia has, compared to countries in its region, a fairly high total tax burden. Increasing that burden by increasing the total tax revenue, without macro economic goals like reduction of the national debt, does not serve Australia's macro economic interests such as economic growth.

Some standards for an indirect taxation system

The three primary standards of a successful WST are: distribution, economic neutrality and administration. **Distribution** of the burden among various individuals in a manner equitable in contemporary society is one of the standards of an optimal indirect taxation system. **Equity** is required to avoid obvious discrimination among individuals without acceptable justification and an overall distribution of burden by income class which conforms with the socially accepted standards of income distribution.

The burden should fall on the ultimate consumers. That avoids any tax on business inputs or capital equipment. The **distribution pattern of the burden** among various consumers must be such that the ratio is deliberately either uniform or non uniform. A uniform distribution pattern of the burden means that every commodity is relatively taxed at the same percentage. A non uniform distribution pattern means that different commodities are relatively taxed at different percentages. It

¹² See *Choices and Conflicts Tax Policy in OECD Countries*, International Bureau of Fiscal Documentation, 368.

¹³ See *Fightback* papers, 342.

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is for politicians to determine which distribution pattern is acceptable.

The standard of **economic neutrality** calls for optimum allocation and utilization of resources. Any alteration in the pattern of allocation or economic conduct will reduce economic well being, because decisions which are influenced on other grounds than those for optimum production distort the allocation of resources. The more a taxation system alters production decisions, the more the distortion of the economy. So an optimum taxation system alters production decisions as slightly as possible. Generally, a consumption tax will attain economic neutrality only if it is imposed in such a way that it does not alter the allocation of resources and the relative costs of various methods of business organisation, and if it has no incentive for vertical integration.

The final standard concerns **administration**. Any consumption tax must be levied in such a manner that compliance and administration costs are as low as possible, or at least at reasonable levels. Effective operation of a tax requires clear definition of taxable transactions and establishment of the tax in such a manner that these transactions are easily identifiable, both to the taxpayer and the administrative authority. In order to achieve this, the taxable value must be clearly defined. It must also be easy to control and check records.

On the whole, the success of the administration of a consumption tax will depend upon several primary considerations. Firstly, there is the relation between the number of taxpayers and the average sales volume. The smaller the number of taxpayers and, simultaneously, the higher the average sales volume, the easier it is to administer.

Secondly, adequate record keeping lowers administration costs. So, the system must provide methods which force taxpayers to keep adequate records. Severe penalties for deliberately not complying with the rules must be considered. Thirdly, the system must be designed in a way that records of different taxpayers can be compared easily to discourage avoidance. Application of a uniform flat rate to all sales simplifies the system. Difficulties with record keeping are decreased by using a uniform flat rate. Fourthly, application of the rate must be to the actual selling price. Generally, any adjustments to the taxable value seriously hinder compliance and enforcement, as deemed values¹⁴ can be hard to determine.

¹⁴ Deemed values are an arm's length value and the notional wholesale selling price.

Finally, the severity of the rates is important to the administration of any consumption taxation system. The higher the rates the more incentive there is to avoid or evade the tax. Related to avoidance and evasion is the relationship between taxpayers and the administration. When taxpayers are provided with sufficient information regarding their liability and the administration is willing to think about taxpayers' problems, taxpayers are more willing to comply with the rules.

No type of consumption tax can fulfil all these requirements. It is important to look for an optimum in the circumstances of a particular country and its economy. Given the fact that a compromise has to be achieved anyway and that an efficiency gain on the replacement of the WST, Payroll Tax and the fuel excise duty is estimated to be 0.2%,¹⁵ it is worthwhile considering reform of the WST instead of replacing the entire system. Also, the economy is accustomed to WST and its defects. Minimising those defects by reforming the legislation will be an improvement for the economy, although it might be argued that other indirect taxation systems are even better than a reformed WST.

Our proposal

The major defects of the current legislation are found in the number of exemptions¹⁶ and difficulties in determining the three normal taxable values.¹⁷ We propose to eliminate all exemptions except those for business inputs for goods producers, small businesses and goods exported or sold to overseas travellers for export. Business inputs should not be taxed for several reasons. The main one is the cascading effect. The cascading effect means that tax is levied on tax. For example when goods are purchased (tax included) and they are used to manufacture new goods on which sales tax is levied, the taxable value of those goods contains then a certain amount of tax on which tax is levied when the new goods are sold through an assessable dealing. The exemption for business inputs would be available only to "goods producers", ie activity related to primary production, mining or production/manufacturing of goods.

When reform of the entire system is considered, the definition of business inputs might have to be changed in order to avoid future

¹⁵ See *Fightback* papers, 342.

¹⁶ See Schedule 1 to the Sales Tax (Exemptions and Classifications) Act, which contains 195 exemption items.

¹⁷ There is "the price (excluding tax) for which the goods were sold", "the notional wholesale selling price" and the "notional wholesale purchase price".

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disputes and to decrease the impact of WST on industrial costs.¹⁸ The classification system for business inputs as mentioned under item 18 of Schedule 1 to the Sales Tax (Exemptions and Classifications) Act could be substantially simplified. For example, all goods used on a goods production site would qualify for exemption. There would be no artificial exclusions as currently exist for employee amenities etc.¹⁹ Some government bodies would also be exempt to avoid the financial cost of funding those bodies and then taxing them. By decreasing the number of exemptions, the base of the tax is significantly broadened. This will affect distribution of the tax burden and the amount of revenue from the tax. The revenue will increase enormously.

The distribution of the burden will be divided among more commodities, which makes the system more equal. However, the regressiveness will be accentuated because more commodities will be taxed in the reformed system. Compensation for that will be made by changes in the tax mix, eg by introducing a higher income tax threshold for low income earners.

Vertical integration

Vertical integration is encouraged by the fact that the tax will still be levied at one point in the production chain. Such integration remains because there will still be an incentive to perform economic activities beyond the taxing point. We do not see that as a problem because the economy and the taxpayers are accustomed to vertical integration.

In addition, keep in mind that the tax benefits of vertical integration are partly lost when WST is replaced by a VAT. Under a VAT, tax is levied at each stage of the production chain of goods, which makes vertical integration for indirect tax purposes unnecessary. Introducing a VAT may lead to problems of liquidating interposed companies solely established for sales tax purposes. These problems extend also to income tax where, for example, problems may arise in relation to capital gains tax and dividends.

Economic neutrality

Economic neutrality will be improved because more commodities are

¹⁸ See Document 25 of the Treasury analysis (released under FOI request March 1992) for the estimated industrial costs of Sales Tax.

¹⁹ See s 12 to the Sales Tax (Exemptions and Classifications) Act.

taxed, which decreases the difference in the relative burden on different commodities. The fact that a difference still exists between goods and services means that optimum neutrality is not reached. However, it is an improvement over the current system. We do not propose an additional system to tax services, because the complexities of such a system outweigh its advantages. The WST legislation was not designed to tax services.

Taxable value

The taxable value is another issue of major concern in the current legislation, because the current taxable values may take several forms due to the use of an arm's length value for the notional wholesale selling price and the notional wholesale purchase price. The determination of the arm's length value of the notional wholesale selling price and the notional wholesale purchase price is difficult. Therefore, we propose the establishment of some form of statutory value as the taxable value. To determine that value, the already available jurisprudence and Rulings can be taken as a starting point. For example, SST Ruling No 2 gives some precedents about taxable values regarding discounts, trade incentive payments etc.

When the statutory taxable value is determined, issues such as whether the value of royalties should continue to be added to the taxable value for the future will need to be addressed. The statutory taxable value must be as comprehensive as possible in order to achieve the simplicity which exists in a VAT, where the tax is generally levied on the actual selling price. The GST/VAT experience in New Zealand has taught that complying with one taxable value is refreshingly simple and avoids the problems associated with artificial calculations of taxable values.

So, we propose one statutory taxable value which would create maximum efficiency and certainty in calculating tax, record keeping and in the ability of the Tax Office to check the records.

Taxable dealing

The event giving rise to sales tax, the taxable or assessable dealing,²⁰ may be determined as at present. The current legislation describes 13

²⁰ As mentioned in s 5(1) of the Sales Tax Assessment Act.

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assessable dealings in Table 1 Part A of the Sales Tax Assessment Act and 10 assessable dealings in Table 1 Part B of the Sales Tax Assessment Act. Despite the wide range of assessable dealings under Table 1 of the Sales Tax Assessment Act, alterations are not necessary because taxpayers are accustomed to this part of the legislation and few disputes have arisen in this area.

Rates

Since the amount of revenue is determined by the taxable value times the applicable rate/rates, we have to address the number of rates to be used. Many researchers have concluded that a single flat or uniform rate is the optimum situation for an indirect taxation system. The European Commission proposed one rate, but the member countries could not agree. They reached a compromise to introduce a high rate and a low rate, in addition to the zero rate and certain exemptions.

Some countries, for example New Zealand and Canada, which recently introduced a VAT or GST, introduced one rate. The current WST legislation has seven rates²¹ of which three are applicable to a very limited range of commodities. The 45% rate is only used for motor vehicles with a value above a certain threshold, while the rate of 22% is solely for certain alcoholic products. Although many countries invited political problems by introducing one rate, we propose one rate of approximately 15% to achieve maximum simplicity.

Avoidance and evasion

The 15% rate, combined with the fact that it is imposed on most commodities, might provide an incentive for avoidance and evasion. The amount of avoidance and evasion are very different from country to country, even when they use the same system and similar rates. For example, Italy had in 1985 an evasion rate of about 40% while the UK had only about 6%. Both countries were using a VAT.²²

Possible levels of avoidance and evasion, because of their very unpredictability, should not influence any proposal for a taxation system. Besides that, it is difficult to measure avoidance and evasion and comparing the figures in an international context is even harder.

²¹ Which are all mentioned in Tables 1 - 8 of the Sales Tax (Exemptions and Classifications) Act.

²² See 4 *Australian Tax Forum* No 4, 359 and 360.

Every country has its own changing interpretation of avoidance and evasion.

Number of taxpayers

Another objective is to reduce the number of taxpayers in order to simplify the administration of the system and thus lower the compliance and administration costs. In that context, attention must be paid to the ratio of the number of taxpayers to average turnover. The optimum system from an administrative point of view is one that has a small number of taxpayers paying a large amount of tax. When designing the small business exemption and other classifications, attention must therefore be paid to this ratio. For example, when the UK enacted a 25% rate for certain luxury goods, 1000 extra officers were needed to administer the new rate. It was estimated that the additional revenue was used up paying for the extra officers. Such problems have to be avoided in the proposed system.

Registration

Registration should be mandatory. In the current system, registration is, in practice, mandatory in order to claim the exemptions classified as (R); these are the so called business input exemptions such as item 18 of Schedule 1 to the Sales Tax (Exemptions and Classifications) Act and several other items which provide exemptions for particular industries, eg mining and agriculture. Thus, for most taxpayers no extra requirements have to be met. The inconvenience to taxpayers of becoming registered is not considered important compared with the proper administration of the system. That the Tax Office knows exactly who is registered and for what purpose is far more important to the total efficiency of the system than the individual reasons for each taxpayer not being registered. Another factor in favour of compulsory registration is that in-system checks are easier for the Tax Office to make.

Exports

Since most of the OECD countries and other important trade partners of Australia have, or are going to have, a VAT/GST, export prices with an element of indirect tax will become rarer. Tax laden Australian exports will become undesirable. Solutions within the rules of GATT can be found to solve this defect, eg a rebate for sales tax at the point

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of export. We do not consider that export prices contain very much WST, simply because very few input commodities²³ create an increase in the export price.

From a practical point of view, cascading elements can mainly be found related to marketing costs and motor vehicles. Many different estimations have been made of the actual amount of WST in export prices. Some say that it is 4% to 5%,²⁴ while the Centre of Policy studies once estimated that it is around 2%. So, before designing a system of compensation which probably makes the system unnecessarily difficult, the average amount of WST in export prices must be determined. We favour a system which would have the option open to taxpayers to either automatically claim the standard rebate (eg 2%) or to actually calculate what they believe is the actual amount of Sales Tax in the cost of goods exported by them. Recently, the value of exports has been rising, not only for primary products like meat and wool but also for high tech commodities, notwithstanding that Australian export prices include a certain amount of WST. Thus, the trade barrier of WST included export prices is not so high that export expansion is significantly impeded.

Self assessment

The self-assessment system will be maintained. Due to improvements in the legislation, many problems with self-assessment will be solved. In addition, a certain amount of the extra revenue yield can be used to employ officers to improve service by the ATO. If the ATO puts more effort into helping taxpayers to determine their liability, even before they enter into transactions, compliance with the legislation will be improved.

Advantages of WST reform

The theoretical advantages are found in a more easily determinable taxable value, less exemptions (and therefore less classification problems with a single rate) and registration of all taxpayers. All these elements lead to lower compliance and administrative costs. The change in the tax mix towards indirect taxes lowers labour costs for

²³ See *Fightback* papers at 322 for a comprehensive list of the first-round incidence of the Wholesale Sales Tax on Business inputs and Final Demand by Industry sectors Supplying Taxed Goods, 1990-1991.

²⁴ See the report by the Business Council of Australia, 15 June 1994.

business which stimulates the economy. Besides that, abolition of Payroll Tax will inevitably lower costs of labour and would be a major stimulus to business, resulting in the creation of new jobs. It is estimated that about 200,000 new jobs will be created if Payroll Tax is abolished.²⁵ The best taxation system is one which disturbs the economy the least. The fact that the proposed change of the tax mix is not revenue neutral may have significant advantages for the economy, when the extra revenue yield is used for macro economic purposes such as decreasing the national debt and creating new jobs.

In relation to the earlier mentioned standards, the following are positively met:

- The distribution of the tax burden is more equally divided among the taxpayers because many more goods are taxed. Assuming that the tax will be accounted for in consumer prices, the tax will be shifted more towards the final consumer which makes the system more equal.
- Economic neutrality is still not optimal compared to a VAT, but it is substantially improved. The allocation of resources will still be disturbed, but less than it is now. The economy is accustomed to these distortions, so any improvement will stimulate the economy by distorting it less.
- Major advantages can be claimed in the administrative area. It is to be expected that the compliance and probably even the administrative costs, which at the moment are very low from an international perspective, will decrease. The fact that the number of disputes may diminish due to fewer rates and exemptions contributes to this.
- The number of taxpayers remains small and they will all be identifiable because registration is mandatory. Tax officers, whose workload is reduced by a reduction in administrative work, would be used to improve the relationship between the Tax Office and taxpayers. The Dutch experience has taught that improving that relationship will lead to better compliance which, of course, yields more revenue.

²⁵ See above n 14.

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Disadvantages of WST reform

The major disadvantages of the proposed reform are the cascading elements,²⁶ regressiveness, vertical integration and taxed exports. However, we believe that the cascading elements which currently occur are not of major concern because they tend to be limited because they relate to a few commodities.²⁷ The regressiveness due to the relative price difference between certain commodities can be dealt with either by changing the tax mix or by introducing more than one rate. However, we propose the introduction of only one rate and compensation through the income tax system. The problems arising from a multiple rate system do not outweigh the decreased regressiveness. So, in our proposal the problem of regressiveness is adequately dealt with.

The fact that vertical integration will still be used to shift the taxing point in the production chain of goods remains a disadvantage of the proposed system, because any incentive for vertical integration distorts the economy. However, the current structure of companies is such that many already have obtained the advantages of vertical integration. So, the disadvantages of vertical integration are not as severe as they seem.

In addition, those disadvantages are relatively even smaller because a VAT exempts a lot of services, which creates an incentive for vertical integration. This decreases the theoretical defects of the WST when the WST is compared with a VAT. Besides that, changing corporate structures,²⁸ which would have to happen if a VAT was introduced, might give rise to fiscal complications for income tax. For example, when an interposed company, solely used for WST purposes, is eliminated, problems may occur in relation to capital gains tax and dividends.

The disadvantages of tax included export prices can be exaggerated. Despite tax included export prices, export volume is increasing, at this point. It is difficult, in any event, to determine the exact amount of tax in export prices. The magnitude of this problem could be significantly reduced by means of a border rebate.

²⁶ Cascading is where tax is levied more than once on the same commodities. Taxed commodities are used to manufacture new commodities which are themselves taxed.

²⁷ *Taxation Statistics 1986-87* (AGPS 1989), Table 2 indicates that those commodities especially are paper, transport commodities and some machinery.

²⁸ Assuming that those structures are solely established for WST purposes.

Political considerations

As the past 20 years have shown, changing the tax mix with the major goal being replacement of the WST and some other indirect taxes, is politically unpalatable in Australia. Governments have not been strong enough to do it and the Coalition lost the 1993 federal election over the issue and hence were unable to enact their proposals.²⁹ As the Canadian and New Zealand experiences have taught, plenty of political courage and salesmanship is needed to effect a massive alteration of the tax mix.

The fact that the general public might have lost faith in vascillating politicians is a reason for considering reform of the WST. "Selling" a massive improvement of the current legislation is much easier than selling an apparently complicated new indirect tax. Related to that, the New Zealand experience has taught that informing and educating the general public is one of the means to win support.³⁰ Educating people on the current legislation and a relatively small alteration in the tax mix is much easier than selling an entirely new system.

In relation to the revenue imbalance between the states and the federal government, the argument for abolishing Payroll Tax to improve the well being of the country and compensating states for the loss of revenue might encourage the states to agree with the changes in the tax mix. For the Senate it must be made clear that broadening the tax base has already been done from 1982 to 1990. It was done in a way which was not clearly visible to the general public. This was unfair and therefore was opposed by the Senate. Our proposal widens the tax base but compensates in more than one way, not only by lowering direct taxes but also by stimulating business by abolition of Payroll Tax. Besides that, the tax mix changes can be used to increase revenue. The extra revenue must, though, be used for macro economic purposes benefiting the entire country and the economy, for example by lowering the national debt. When such objectives are evident, the general public may be convinced of the need for temporarily higher taxes. Further, the politicians who introduce a reformed WST should gain the political advantages of the proposal within the electoral period.

²⁹ Which mainly meant that the WST would be replaced by a GST.

³⁰ See (1993) 3 *Revenue Law Journal* 100-124, Rodger S Muir, "The Goods and Services Tax: Reflections on the New Zealand Experience, Six Years on" and V Beyer and K Ishimura, "The Progress of the Japanese National Consumption Tax".

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Conclusion

Since no taxation system is perfect and reform of the WST legislation leads to an acceptable system of indirect taxation in the Australian economy, reform may be better than replacement of the WST by a VAT/GST. Despite some disadvantages inherent in the proposed system, we conclude that reformed Sales Tax legislation offers greater simplicity, more equity and lower administrative and compliance costs. Economic neutrality is improved compared to the current system. The limited disadvantages do not outweigh the advantages in the administrative area. The proposed statutory value combined with a single rate would remove the majority of the problems with the current legislation. The changes to the tax mix must provide a greater reliance on indirect taxes and abolition of the distorting effects of Payroll Tax. The fact that labour use and thus employment will be favoured over capital investment gives a positive incentive to the economy. The proposed non revenue neutral changed tax mix also provides a positive incentive for the economy, at least in the long term. However, it must be certain that the extra revenue will be used for macro economic purposes.

Low income earners will not be disadvantaged in our proposal, because of the compensating income tax concessions. The position of exporters will be improved by a system of border type rebates, after it has been determined what the impact of the indirect taxes is on their export prices. The political advantages of our proposal are numerous. Their effectiveness depends, however, on overcoming political barriers. The main political barrier is the abolition of Payroll Tax.