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Principles of a good tax

Evaluating our taxation choices

How we tax has a big impact on our society. The decision of what and how much to tax is important. This paper provides policy makers with five principles to evaluate our taxation choices.

Discussion paper

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Summary

Tax is not just the price we pay to live in a civilised society, it's the way we shape the civilisation we want to live in. Tax is a powerful tool that can shape our society and as such it is important that we tax the right things at the right amounts.

This paper sets out five principles that will help evaluate the strengths and weaknesses of different taxes. Using this tool will help policy makers determine how to best use taxation to shape their society.

The five principles of a good tax are:

- Principle 1 – The tax should minimise the change in behaviour unless it is something that we want less of, in which case it should be effective at changing that behaviour
- Principle 2 – The tax should reduce inequality
- Principle 3 – The tax should be levelled on those who are best able to pay
- Principle 4 – The tax should be simple to comply with, simple to administer and easy to understand, and
- Principle 5 – The tax should be difficult to avoid

The paper uses these five principles to evaluate a number of actual and hypothetical taxes and tax concessions. Each tax and tax concession is rated against each of the five principles. The ratings are:

- Yes, it conforms to that principle
- It partially conforms to that principle
- No, it does not conform to that principle

The taxes and tax concessions evaluated are:

- Income tax
- Goods and services tax (GST)
- Estate duties
- Carbon tax
- Super profits tax
- Buffett rule
- Tax concession – GST on food prepared and/or consumed at home
- Tax concession – Capital Gains Tax (CGT) discount
- Tax concession – Superannuation
- Tax concession – Excess franking credits

Tax or tax concession	Desired impact on behaviour	Reduce inequality	Those best able to pay	Simple to administer and understand	Difficult to avoid
Income tax	Partial	Yes	Yes	Partial	Partial
Goods and services tax (GST)	Yes	No	Partial	No	Yes
Estate duties	Yes	Yes	Yes	Partial	No
Carbon tax	Yes	Partial	Partial	Yes	Yes
Super profits tax	Yes	Yes	Yes	Yes	Partial
Buffet rule	Yes	Yes	Yes	Yes	Yes
GST exemption on food prepared and/or consumed at home	Yes	Yes	Yes	Partial	Yes
Capital gains tax discount	No	No	No	Yes	Yes
Superannuation tax concessions	Partial	No	Partial	Partial	Yes
Excess franking credits	No	No	No	Yes	Yes

Introduction

Tax is not just the price we pay to live in a civilised society, it's the way we shape the civilisation we want to live in. What we choose to tax, and how we choose to tax it, plays a central role in the shape not just of our economy, but our society and our environment.

The decision to tax (or not) cigarettes, wealth, or greenhouse gas emissions has an large impact on human health, the distribution of wealth and the extent of climate change.

It is important, both economically and for society, that we tax the right things in the right ways at the right rates. This paper provides five principles of good taxation that can be used to evaluate the relative strengths of different taxes.

These principles can also be used to evaluate the relative strengths of tax concessions. Tax concessions are reductions in the amount of tax that particular groups are required to pay. Examples of tax concessions include the capital gains tax discount or the exemption of some products from the goods and services tax.

There are five principles of a good tax. They are:

- Principle 1 – The tax should minimise the change in behaviour unless it is something that we want less of, in which case it should be effective at changing that behaviour
- Principle 2 – The tax should reduce inequality
- Principle 3 – The tax should be levelled on those who are best able to pay
- Principle 4 – The tax should be simple to comply with, simple to administer and be easily understood, and
- Principle 5 – The tax should be difficult to avoid

The paper will also apply these principles to a number of current and hypothetical taxes and tax concessions. These include:

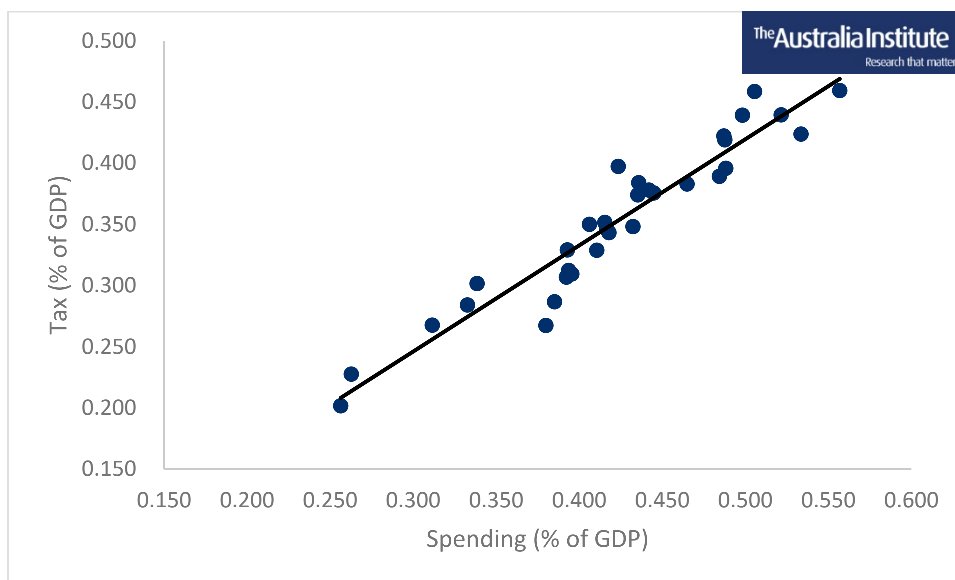
- Income tax
- Goods and services tax (GST)
- Estate duties
- Carbon tax
- Super profits tax
- Buffett rule
- Tax concession – GST on food prepared and/or consumed at home
- Tax concession – Capital Gains Tax (CGT) discount
- Tax concession – Superannuation
- Tax concession – Excess franking credits

The importance of taxation

Taxation is an important tool to shape society. What is taxed or not taxed will discourage or encourage different behaviour. But taxes don’t just discourage some activities, they make room in the economy for other activities. If the Commonwealth Government simultaneously undertook a massive expansion of aged care, childcare, disability care, public housing, public transport and renewable energy they would likely drive up the price of labour and materials, causing inflation and windfall gains for some rather than driving the desired change. To avoid this, taxes can divert resources away from consumption and so create room for additional spending.

Tax is an investment in society. The more tax a government collects, the bigger the public sector it can sustain. And while there is no ‘right’ amount of tax for a government to collect, there’s no right amount of money for the government to spend on public services and nor is there any right balance between revenue and spending. In the long run, as Figure 1 shows, there is a strong link between the amount of tax a nation collects and the size of its public sector.

Figure 1 – Tax and spending by OECD nations



Source: OECD Stat, Income distribution database

Figure 1 shows developed (OECD) country’s tax and spending as a proportion of GDP. Each dot is a developed country.

The amount of tax collected by governments should be adequate to meet the community’s demands for public services and income support. Not only is there no ‘right amount’ of tax that governments should collect, but there is no reason to assume that the optimal amount

of tax for a community would be stable over time. As circumstances, technology and community preferences change then so should the amount of economic activity provided by the state vary. While in Australia the idea that the tax to GDP (Gross Domestic Product) ratio should be capped at 23.9 percent is not based on any economic foundations.[1] On the contrary, were a government to be bound by that cap then it would need to cut tax rates during economic booms (when tax collected from personal income tax and company taxes tend to rise rapidly). Such tax cuts would stimulate economic activity at the time of a boom and cause inflation.

As communities become wealthier it is likely that their tastes and preferences change. If they would like to spend more money on their health, their children's education and/or increasing the physical and environmental amenity of their surrounds then it would make sense for them to purchase more of those services via a larger public sector. The idea that the size of the public sector is, in and of itself, an indicator of the 'efficiency of government' is not based on any economic theory or evidence. An efficient public sector is one that is of a size and shape that meets the needs and desires of the community it serves.

How then should governments choose what to tax and how heavily to tax those things? Economists have considered this question for more than a century, and while there is no consensus opinion on what 'should' be taxed, there is near consensus around things that should not. The following sections discuss these principles in turn.

[1] Richardson D & Browne B (2018) *The arbitrary 23.9 per cent tax revenue to GDP figure*, The Australia Institute, April, <https://australiainstitute.org.au/post/23-9-tax-speed-limit-arbitrary-at-best/>

Principles of taxation

Principle 1 - tax should minimise the change in behaviour unless it is something that we want less of, in which case it should be effective at changing that behaviour

An efficient tax is sometimes defined as a tax that limits the change in people's behaviour. The idea that taxes should be designed to be economically efficient is as widely accepted as it is difficult to define.

An efficient tax system is often defined in terms of minimising the amount of 'distortions' that the tax system introduces into individual decision making. For example, proponents of the Goods and Services Tax (GST) argued that the previous sales tax system created distortions by arbitrarily taxing flavoured milk at different rates to unflavoured milk. Needless to say, some argued that such distributions weren't arbitrary, to the extent that plain milk was a 'necessity' whereas flavoured milk can be considered a 'luxury'. But in what sense is plain milk a necessity when most of the world's population rarely drinks it? This highlighted the difficult choices that had to be made.

While 'broad based consumption taxes' are considered by some to be the least 'distortionary' of taxes, some economists argue that because they discourage consumption and encourage savings they are still 'distorting' individual choice. If the most efficient tax is the tax which distorts individual choice the least then the most efficient tax would be a 'poll tax' or a 'per head' tax whereby each person is required to pay the same amount of tax each year, regardless of their income, their wealth, their consumption pattern or the amount of money they saved. Margaret Thatcher replaced a levy for local councils based on property values with a fixed 'community charge' per person. The poll tax led to riots and was ultimately removed and replaced with a revised property tax.

Sometimes the purpose of a tax is to distort behaviour. For example taxes on cigarettes or greenhouse gas emissions are designed to reduce both of these things by changing consumption and production behaviour. When this is the case the tax should be as effective as possible at changing the behaviour. This can be achieved by taxing as closely as possible the activity that we are trying to discourage.

For example, if the objective is to reduce greenhouse gas emissions and avoid dangerous climate change, taxing the greenhouse gas emissions is more desirable than taxing all electricity. While most electricity in Australia is produced from fossil fuels, a tax on electricity would also apply to electricity produced from sources that don't produce greenhouse gas emissions, like wind and solar. Taxing greenhouse gas emissions directly

would encourage more electricity generation from renewable sources as they would become relatively less expensive than fossil fuel sources.

Principle 2 - Tax should reduce inequality

While economists have, literally, no definition of 'fair' they do have multiple conceptions of what fairness might entail.

Horizontal tax equity refers to the principle that people who earn similar incomes should pay similar amounts of tax. While this may seem uncontroversial, in Australia older people pay significantly less income tax than younger people with similar incomes (thanks to the concessional treatment of capital gains and superannuation) and people who spend a large proportion of their income on private schools or private health insurance will pay significantly less GST than those who spend less or no money on those service (as private school fees and health insurance are exempt from GST).

Vertical tax equity refers to the differences, if any, between the amount and percentage rate of tax that people on different incomes pay in tax. A common, but not universal or uncontroversial, version of vertical tax equity is that people on higher incomes should pay both more tax than those on lower incomes and pay a higher average rate of tax than those on lower incomes. A tax system that taxes higher income earners at a higher rate is called a 'progressive' tax system which can be contrasted with a 'flat rate system' in which all incomes are taxed at the same rate, and a poll tax in which the amount of tax paid does not vary with income (which in turn, means that higher income earners pay a lower rate of tax).

The progressivity of income tax systems varies significantly between countries as does the percentage reliance on income as a tax base. Countries that rely more heavily on consumption based taxes will, all other things equal, have a less progressive overall taxation system than countries that rely heavily on income taxes.

The idea of intergenerational tax equity has not been widely discussed in the economics literature but the debate around intergenerational equity has come to define much of the debate about government tax and spending decisions in Australia in recent decades. While some argue it is inequitable to leave future generations with the 'burden' of public debt,[2] it is also possible to argue that public investment in education, infrastructure and research increases the future incomes of the community. Intriguingly, many of those who express deep concern with the burden of public debt on future generations seem less concerned about the burden of housing debt or HECS-HELP debts on future generations, nor do they

[2] There is in fact no net burden on future generations because in the financial system all debts issued by some entities are equally matched by assets held by others. Some people in the future will owe more money but at the same time some people in the future will be owed more money.

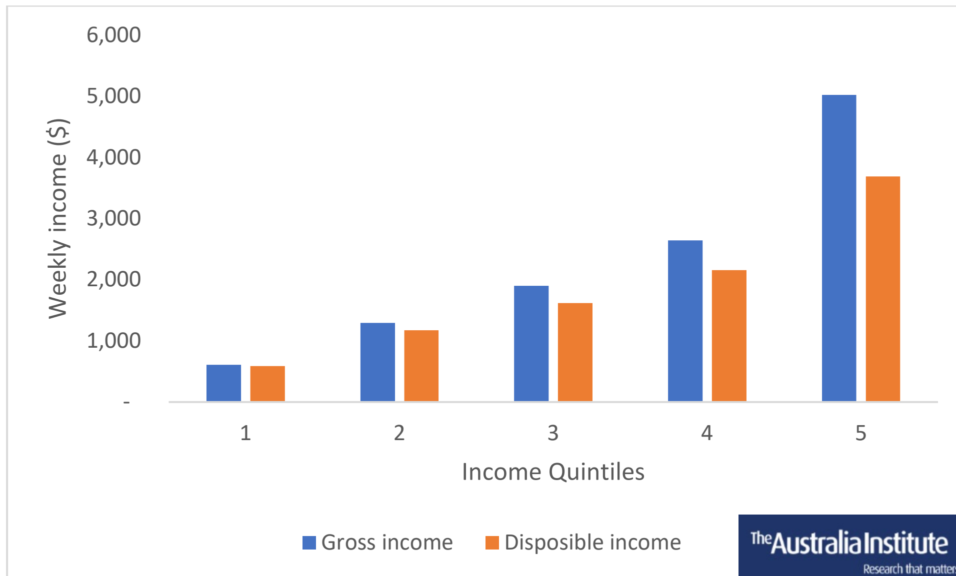
seem particularly concerned about the burden of climate change exacerbated by contemporary policy makers.

To overcome this ambiguity in what is fair, we have considered the implications of fairness and equity on taxation. More recently, economic research, including through the International Monetary Fund, has shown that lower levels of inequality are associated with higher economic growth.[3]

Progressive taxation is one of the most effective tools for reducing inequality. Australia's progressive income tax system collects a higher average rate of tax from those on higher incomes and a lower average rate of tax from those on lower incomes. The effect of this is that disposable income (income after tax has been paid) is more equal than gross income (income before tax is paid).

Looking at average household income quintiles, we can see that tax has made almost no difference between gross and disposable income for the first quintile (lowest 20 per cent). The difference between gross and disposable income then gets larger as we move up the income distribution. The fifth quintile (highest 20 per cent) has the largest difference, meaning that gross income is reduced by the largest amount after tax. This is shown in Figure 2.

Figure 2 – Gross and disposable income by quintiles for 2017-18



Source: Australian Bureau of Statistics (2019) *6523 – Household Income and Wealth, Australia*, Table 5.1, https://www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latest-release

[3] Ostry J, Berg A & Tsangarides C (2014) *Redistribution, Inequality and Growth*, IMF Staff Discussion Note, February, <https://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>

The economic advantages of lower inequality and taxation's ability to achieve that means that an important principle of taxation should be for it to reduce inequality.

Principle 3 - The tax should be levelled on those who are best able to pay

This principle is taken to mean that those who are best able to pay should pay more than those who are less able to pay. Vertical equity implies that those on higher incomes should pay more in tax and that the amount of tax paid should increase with income. In practice most income tax systems impose progressive taxes so that as income goes up not only does the amount of tax increase, but the proportion of tax paid also increases. The argument for progressive taxation has a long history and, for example, was favoured by Adam Smith who put the case for progressive income tax very eloquently when, in 1776, he said:

> The necessaries of life occasion the great expense of the poor. They find it difficult to get food, and the greater part of their little revenue is spent in getting it. The luxuries and vanities of life occasion the principal expense of the rich, and a magnificent house embellishes and sets off to the best advantage all the other luxuries and vanities which they possess. … It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion.[4]

Apart from those moral and ethical considerations, a fair distribution is commonly regarded as a desirable aim of economic policy and redistributive policies assist in overcoming the worsening of the distribution of income and wealth we have observed in Australia over recent decades.[5] Recent figures for 2019-20 show that for example, the richest 20 per cent have 11.3 times the "market income"[6] of the bottom 20 per cent using data for equivalised households. After tax and transfers the top to bottom ratio fell to 5.0.[7]

There is another way of looking at this question. In general, we want to raise a certain amount of revenue from a given population. Adam Smith's argument above suggests that the additional dollar of income for a poor person is worth much more than the additional dollar to a rich person. That suggests the tax system should continue taking money away from the rich person until the value of the last dollar is equal to the value of the last dollar to the poor person. That would minimise the loss welfare for the community as a whole.

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[4] Smith A (1776) An inquiry into the Nature and Causes of the Wealth of Nations – Book V, Chapter 2,

[5] See Grudnoff M (2018) *Gini out of the bottle*, *Discussion paper*, June.

[6] "Market income" here refers to incomes before tax and before any income support and other transfers provided by government.

[7] Figures calculated from ABS (2021) *Australian National Accounts: Distribution of Household Income, Consumption and Wealth*, 18 June.

Stiglitz[8] has argued that Europe should pursue wealth taxes more aggressively both for the revenue potential but also to address concentrations of family wealth built up through inheritance. That would include annual wealth taxes but also estate duties. Stiglitz cites studies that show inherited wealth discourages work on the part of the beneficiaries. That makes sense; people who can live in comfort without working are unlikely to take it up. Of course, that flies in the face of the self-serving argument of the rich that high taxes on inheritance discourage work effort.

This principle becomes complicated when we consider the different circumstances of taxpayers. Two people with the same income may appear to have the same capacity to pay. However, one of them may have young children or other dependents. Another might have health problems that require expensive treatments. For these reasons, the tax system makes other arrangements. For example the family tax benefit pays households for the additional responsibilities that come with children.[9] Until recently Australia's tax system allowed deductions for health expenses. These have been abolished and incorporated into a higher tax-free threshold below which no income tax is payable.

While the principle of taxing according to ability to pay seems straightforward, ability to pay may not always be straight forward such as in the case of people whose income or wealth is in kind. To receive a large proportion of income in kind may be rare but arises in the case of, for example, businesses who buy goods and services by "selling" agreements to supply other goods or services. The issue is more common in the case of property taxes. People who are asset rich but income poor may have all their assets tied up in property the value of which is difficult to realise. The ACT Government is gradually replacing stamp duties on property transfers with higher annual rates on both residential and commercial property. Property taxes like these can have the effect of forcing people out of their homes in the event they do not have other forms of liquid assets and/or are receiving only modest incomes. Someone with a property valued at $2 million in the ACT has to find $20,530 per annum to pay their land tax. That may well include pensioners who bought inner city property many decades ago and are now occupying very valuable real estate.

In other cases, people may have fairly liquid financial assets such as shares which might be appreciating in value. In principle the increase in value, the capital gain, is a new resource that could be treated as assessable income in the hands of the taxpayer. However, capital gains are usually only assessed on realisation. That is, until they are sold the increase in share values are ignored for tax purposes.

Ability to pay may have been reflected in other features of the Australian tax system. There used to be higher tax on unearned income compared with income earned through personal

[8] Stiglitz JE (2020) *Rewriting the rules of the European Economy*, NY: Norton.

[9] This support is now normally made through the payment of benefits to families with certain needs and subject to income tests. However, as the name suggests, these payments had their origin in the tax system.

exertion. An argument for a surcharge on unearned income is that two people with the same income are not otherwise the same if one has to work a full week in order to make the same income as the other does with no effort. The one with unearned income in a sense has more resources available in that he/she may at any time convert the additional leisure into income. In 1974-75 the Whitlam Government introduced a surcharge on property income where the property owner's income exceeded $5,000. The rate was then phased in until it reached 10 per cent at $5,500. A penalty on unearned income applied in the UK which pushed income tax rates on the highest brackets to 98 per cent in 1979.[10]

Principle 4 – The tax should be simple to comply with, simple to administer and be easily understood

This principle seems uncontroversial, but the reality is that over time Australia's tax system and the tax systems of countries around the world have become extremely complex. This complexity sometimes comes about to encourage certain activities, by creating deductions or carve outs. It happens for political reasons, where law makers want to advantage certain groups. The result of this complexity is that some in the tax system can take advantage of it to minimise their tax liability.

When taxation becomes too complex, it can create a number of problems. This includes increasing the cost of complying with the tax system. A tax system that is simple means that it is relatively quick and easy to comply with. A complex tax system might require employing tax specialists or take a considerable amount of time. Both these come with an economic cost.

A more complex tax system also creates the possibility of individuals or businesses rearranging their tax affairs for the purpose of minimising the amount of tax they pay. Advice on how to minimise tax is often expensive, particularly for larger and more complex businesses and for very high-income individuals. For example, the most recent taxation statistics (2018-19) show that there were 55 individuals who earned a gross income of more than a million dollars but paid no tax. They did this by having deductions that reduced their taxable income to below the tax-free threshold. But the advice on how to achieve this did not come cheap. Those who claimed deductions for managing their tax affairs they paid on average $387,108.[11]

A simple taxation system would make minimising tax more difficult and would make expensive taxation advice largely irrelevant. Simple taxation is also more easily understood.

[10] Atkinson A (2004) *Income Tax and Top Incomes over the Twentieth Century*, Hacienda Publica Espanola/Review of Public Economics, IEF, vol. 168(1), March, p. 132

[11] Jericho G (2021) *Some of Australia's highest earners pay no tax, and it costs them a fortune*, The Guardian, 8 June, <https://www.theguardian.com/business/grogonomics/2021/jun/08/some-of-australias-highest-earners-pay-no-tax-and-it-costs-them-a-fortune>

Better understanding of taxation can increase people's willingness to pay tax and reduce tax avoidance.

Simple taxation can sometimes be in conflict with other principles of taxation, such as reducing inequality and changing behaviour. These trade-offs should always be carefully considered, with taxation always being made as simple as possible.

Principle 5 – The tax should be difficult to avoid

In principle a tax should be designed so it is difficult to avoid. A good deal of attention goes into the drafting of tax legislation to ensure that taxpayers cannot easily escape their liability. Design of a tax and its interaction with other taxes is also important. For many years in Australia's history a common strategy among high income earners has been to disguise personal income as corporate income. That strategy relies on a difference in the tax rates applying to the two streams of income and other differences in exemptions and deductions. For that reason, in earlier decades there was an attempt to align the company tax and the tax on the top incomes earned by individuals.

However, a tax that cannot be avoided is not always easy to achieve in practice and so the difficult-to-avoid objective is bound to come into conflict with other priorities. All else being equal income and wealth are the best measures of capacity to pay yet both have huge problems with tax avoidance. The fact that a tax has associated avoidance issues is not necessarily an argument against the tax itself. A lot of tax avoidance arises because taxpayers think they are able to get away with it. So rather than abolishing income tax, the Australian tax office has increased its anti-avoidance activities.[12] As a result it claims to have raised an additional $18.4 billion from targeting avoidance among the top 1,000 public and multinational businesses and the top 500 private groups. It also covers 5,000 high wealth groups that have a net wealth of $50 million and above.

Recent revelations in the US show that "The 25 wealthiest Americans… paid a 'true tax rate' of 3.4 percent between 2014 and 2018, even as their collective wealth grew by $401 billion during that time."[13] We do not know if avoidance has ever got that bad in Australia, but a cynic might suggest that anti-avoidance concerns are not always pursued diligently in some tax jurisdictions.

A lot of interest in the subject of corporate tax avoidance was generated by a paper from the Tax Justice Network[14] which examined the tax minimisation strategies of corporations in

[12] Australian Tax Office (2021) *Tax avoidance taskforce*, at <https://www.ato.gov.au/general/tax-avoidance-taskforce/>

[13] Schechter A (2021) "How Insufficient Enforcement Led to Prevalent Tax Evasion and Contributed to American Inequality", Promarket, 24 June at <https://promarket.org/2021/06/24/tax-evasion-rich-enforcement-inequality/?mc_cid=701f310712&mc_eid=dbeb9ed702>

[14] United Voice & Tax Justice Network (2014) *Who pays for our common wealth? Tax practices of the ASX 200.*

Australia. At the international level, the OECD has established the Base Erosion and Profit Shifting (BEPS) initiative which aims to coordinate measures to counter international tax avoidance that takes place by businesses arranging their affairs so that taxable profits appear to originate in tax havens.[15]

We noted that to counter tax avoidance it is desirable to use a tax base that the taxpayer cannot easily manipulate. The poll tax introduced by Margaret Thatcher is an example of a "pure" tax in that sense. There is almost nothing the taxpayer can do to legally avoid paying the tax yet it is hardly an attractive tax being a single flat-rate tax levied equally on everyone. In principle the poll tax is impossible to avoid. However, it proved deeply unpopular and the BBC has reported it "brought her [Thatcher's] career as prime minister to an ignominious end… it triggered civil disobedience and riots and a rebellion in the Conservative Party."[16] Political feasibility is an important consideration in any tax policy and it may trump a tax that is perfect on one principle.

Australia's tax system once taxed companies at close to the same rate as the top income tax bracket facing high income recipients.[17] During the Menzies period the top marginal tax rate was 67 per cent while the company tax was around 60 per cent without dividend imputation. Today however, the top rate is 47 per cent (with the Medicare levy) while the standard company tax is 30 per cent, and just 25 per cent for smaller companies.[18]

[15] An early document setting out the OECD agenda is OECD (2013) *Addressing Base Erosion and Profit Shifting,* <https://www.oecd.org/tax/beps/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm>

[16] Higham N (2016) *National Archives: Thatcher's poll tax miscalculation*, BBC News, 30 December.

[17] Historic tax rates can be found at Australian Taxation Office (2021) *Individual income tax rates for prior years*, <https://www.ato.gov.au/Rates/Individual-income-tax-for-prior-years/>

[18] The 25 per cent applies to companies with turnovers less than $50 million from 1 July 2021.

Evaluating taxes and tax concessions

We now turn to using our tax principles to evaluate various taxes and tax concessions. We will rate each tax and tax concessions against each principle. The rates are:

- Yes, it conforms to that principle
- It partially conforms to that principle
- No, it does not conform to that principle

Income tax

Income tax is a tax levelled based on an individual's income. It is taxed progressively, with those on higher incomes not only paying a higher amount of tax but also paying a higher proportion of their income in tax. In Australia, income tax collects the most revenue of any tax.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Partial	Income tax has the potential to reduce the incentive to earn more income for second income earners juggling caring responsibilities. High income earners often restructure their tax affairs to minimise paying the tax.
Principle 2 – Reduce inequality	Yes	Income tax is progressive meaning those on higher incomes pay a larger proportion of the tax.
Principle 3 – Those best able to pay	Yes	Because income can be directly used to pay tax, taxing income is the best tax for ability to pay.
Principle 4 – Simple to comply, administer and understand	Partial	Basic income tax is easy to administer but over time it has become more complex with an increasing array of deductions.
Principle 5 – Difficult to avoid	Partial	Some individuals can take advantage of the complexity of income tax deductions to structure their tax affairs in a way that minimises the amount of tax they pay. Cash-in-hand work can also avoid income tax.

Goods and services tax

The goods and services tax is levelled on the sale of final goods and services. In Australia it is charged at a rate of 10% with exemptions for a number of groups of goods and services including some food, health, education, financial services and second hand goods.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	The GST does not have a major impact on behaviour.
Principle 2 – Reduce inequality	No	The GST is regressive because lower income earners spend a larger proportion of their income than high income earners.
Principle 3 – Those best able to pay	Partial	While those on higher incomes who are better able to pay are likely to buy more things and pay more GST, the regressive nature of the tax means a significant proportion of the burden is borne by low income earners.
Principle 4 – Simple to comply, administer and understand	No	The collection of the GST involves significant burden on businesses. The exceptions, introduced to counter the regressive nature of the tax, also add to its complexity.
Principle 5 – Difficult to avoid	Yes	While transactions in the cash or black economy can avoid GST, it is relatively difficult to avoid.

Estate duties

Estate duties or inheritance taxes are taxes that are levelled on people's estates after they die. They are usually charged as a percentage of the estate, often with a tax-free threshold for smaller estates. They are often coupled with gift taxes to prevent people from handing on their assets before they die in order to avoid the taxes.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	It will not change people's behaviour on how long they live
Principle 2 – Reduce inequality	Yes	It is a once in a generation opportunity to redistribute wealth
Principle 3 – Those best able to pay	Yes	
Principle 4 – Simple to comply, administer and understand	Partial	In order to combat tax avoidance, it would need to be paired with taxation on gifts to ensure that wealth is not inherited before death. This would add to its complexity.
Principle 5 – Difficult to avoid	No	Estate duties encourage the wealthy to engage in complex tax arrangements in order to vest themselves of much of their assets before death

Carbon tax

A carbon price is a tax on carbon emissions (which often includes all greenhouse gas emissions). A carbon tax is designed to change behaviour by making products that produce carbon emissions relatively more expensive.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	The purpose of a carbon price is to give producers and consumers an incentive to change their production processes and their consumption choice.
Principle 2 – Reduce inequality	Partial	High income earners spend a large amount of energy but low income earners spend a larger proportion of their income on energy. Well-designed compensation can help with equity concerns.
Principle 3 – Those best able to pay	Partial	As above
Principle 4 – Simple to comply, administer and understand	Yes	The major sources of emissions, coal and oil, are already highly regulated.
Principle 5 – Difficult to avoid	Yes	Yes, coal mines are heavily regulated and oil is already taxed. No 'black markets' for oil or coal have emerged.

Super profits taxes

A super profits tax levels a higher rate of tax if a firm is able to earn super profits. Super profits are profits over and above what can normally be earned in a market. Super profits can only be earned because of some form of market failure like a monopoly on resources or technologies.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	The purpose of a 'super profits tax' is to collect additional tax revenue from the most profitable activities. No rational firm will seek to make less profit in order to pay less tax.
Principle 2 – Reduce inequality	Yes	The lowest income earners do not derive significant income from shares in the most profitable companies.
Principle 3 – Those best able to pay	Yes	By definition those in receipt of dividends from the most profitable companies are among the most able to pay.
Principle 4 – Simple to comply, administer and understand	Yes	The company tax collection regime is already in place. Adding new thresholds would have trivial administrative consequences. But super profits taxes are not well understood by the public.
Principle 5 – Difficult to avoid	Partial	It is a tax on profit, the amount of which some firms can manipulate in order to reduce their tax liability.

Buffett rule

A Buffett rule applies a minimum rate of tax on gross income (that is income before deductions) for high income earners. This means that high income earners cannot use excessive amounts of deductions in order to dramatically reduce the amount of income tax they pay. Once a high-income earner has reached the minimum rate of tax on gross income, all additional deductions are worthless. The Buffett rule is named after billionaire Warren Buffett who believed it was wrong that rich people, like himself could pay a lower rate of tax than the middle class. The Australia Institute wrote about the Buffett rule in the Australian context.[19]

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	This is unlikely to change behaviour as it only impacts high income earners. It is also likely to reduce behaviour to arrange tax affairs in order to minimise tax.
Principle 2 – Reduce inequality	Yes	This will see high income earners pay more tax.
Principle 3 – Those best able to pay	Yes	It will only affect high income earners who are best able to pay.
Principle 4 – Simple to comply, administer and understand	Yes	The Buffet rule will reduce the complexity of high income earners tax affairs as there is less incentive to get additional deductions.
Principle 5 – Difficult to avoid	Yes	It will be more difficult to avoid than current income tax arrangements.

[19] Grudnoff M (2015) *Closing the tax loopholes: A Buffett rule for Australia*, The Australia Institute, 7 April, <https://australiainstitute.org.au/report/closing-the-tax-loopholes-a-buffett-rule-for-australia/>

Tax concession - GST on food prepared and/or consumed at home

Currently many items that are prepared and/or consumed at home are exempt from paying GST. These items include things like fresh fruits and vegetables. This exemption was part of the GST when it was first introduced in Australia.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Yes	The concessional tax treatment of fresh food is designed to encourage the consumption of the most nutritious foods.
Principle 2 – Reduce inequality	Yes	While high income earners may spend a larger proportion of their income on fresh food and other stables, the GST exemption increases the equity of access to such foods.
Principle 3 – Those best able to pay	Yes	
Principle 4 – Simple to comply, administer and understand	Partial	The decision on which foods to include and not include is difficult and at times arbitrary.
Principle 5 – Difficult to avoid	Yes	GST avoidance is significant but more common in the services (e.g. tradespeople) sector than for low value goods

Tax concession - Capital Gains Tax (CGT) discount

Currently income from capital gains is taxed at half the rate of other forms of income. Income from capital gains occurs when an individual sells an asset for more than they bought it for. The discount means that someone earning, for example $100,000 from a capital gain, only adds $50,000 to their income. The other $50,000 does not count as income for tax purposes.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	No	The CGT discount encourages speculation in assets as income from this source is taxed at half the rate.
Principle 2 – Reduce inequality	No	The CGT discount overwhelmingly goes mainly to high income, high wealth households.
Principle 3 – Those best able to pay	No	The tax concession is given to those that least need it.
Principle 4 – Simple to comply, administer and understand	Yes	The CGT discount is currently in place and is calculated automatically by the Australian Tax Office.
Principle 5 – Difficult to avoid	Yes	

Tax concession - Superannuation

A concessional rate of tax that is applied to contributions into superannuation accounts and the earnings from those accounts. The concessional rate for most people is 15 per cent. This means that rather than paying their marginal rate of tax on contributions into their superannuation fund and earnings on the fund, most people only pay 15 per cent tax.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	Partial	The purpose of superannuation tax concessions is to encourage people to save more money in retirement. To a certain extent it achieves this, but it also encourages people to use super as a way of avoiding tax.
Principle 2 – Reduce inequality	No	The majority of superannuation tax concessions go to high income earners. These tax concessions tend to magnify inequalities during people's working life in retirement.
Principle 3 – Those best able to pay	Partial	The tax concession mainly goes to those who need the least help with their retirement incomes.
Principle 4 – Simple to comply, administer and understand	Partial	Superannuation tax concessions are separate tax entities. The tax concession are not widely understood.
Principle 5 – Difficult to avoid	Yes	

Tax concession - Excess franking credits

Excess franking credits allow franking credits that cannot be used because the taxpayer has reduced their taxable income below the tax-free threshold, to be refunded. Australia is the only country in the world with refundable excess franking credits. It effectively means that people who pay no tax can get a tax refund from the Australian Tax Office. Because income from superannuation in retirement is tax free, excess franking credits are predominately used by wealthy pensioners.

Principle	How does it apply	Comment
Principle 1 – Desired impact on behaviour	No	Excess franking credits encourage wealthy superannuants to invest in shares that pay franking credits.
Principle 2 – Reduce inequality	No	Excess franking credits mainly go to households with high wealth and high gross incomes.
Principle 3 – Those best able to pay	No	This tax concession mainly goes to those on high incomes who are best able to pay.
Principle 4 – Simple to comply, administer and understand	Yes	While excess franking credits are easily administered by the Australian Tax Office, they are not well understood outside those who benefit from them.
Principle 5 – Difficult to avoid	Yes	

Conclusion

How we tax can have a big impact on our society. Tax has the ability to make room in the economy for important government services. It can help reduce the things we want less of and through tax concessions, can encourage things we want more of. It is important that we get tax right.

The menu of things and ways we can tax is huge. With such large possibilities it is important to have solid tools to evaluate taxation choices. These five simple principles will help policy makers weed out the inappropriate taxes and focus on those taxes that will give the biggest impact.