What is a good tax system?  
The Mirrlees and Henry Tax Reviews 

Working paper 

1. INTRODUCTION 

This paper first examines and compares the Mirrlees Review and Henry Review reviews, looking at their background; aims; processes and findings. The paper then outlines the Mirrlees Review’s good tax system and compares it to the Henry Review findings. The paper seeks to establish the degree consensus (if any) on what constitutes a good or sensible tax system for a medium to large open OECD economy such as Australia and the UK.

2. HENRY REVIEW 

Background and Aims 

The Henry Review had its origins in the federal Labor Government’s 2008-09 budget which announced a comprehensive ‘root and branch’ review of Australia’s tax system. Commencing on 13 May 2008, the Henry Review panel was chaired by the Secretary to the Treasury, Dr Ken Henry and thus appeared to have a strong government influence. The panel also comprised Mr Greg Smith (Australian Catholic University); Dr Jeff Harmer (Secretary of Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA)), Heather Ridout (Australian Industry Group), and Professor John Piggott (University of New South Wales). The Henry Review was supported by a working group from within the Treasury as well as representation from the FaHCSIA and other Australian Government and state agencies.¹

The Henry Review studied the Australian tax system and made recommendations to create a tax structure to help Australia deal with the social, economic and environmental challenges of the 21st century and enhance Australia’s economic and social outcomes. Whilst the Henry Review, did not provide any over-arching vision for the ideal tax system, it aspired to raising tax revenue so as to do least harm to economic efficiency, provide equity (horizontal, 

¹ Australia’s Future Tax System Report above n 2, Part One at vii.
vertical and inter-generational), and to minimise complexity for taxpayers and the community.

**Processes**

The *Henry Review* produced 1,730 pages of analysis and recommendations that was conducted over a relatively short period of 19 months (May 2008 to December 2009) given its breadth and complexity.

The *Henry Review* produced its first discussion paper, *Architecture of Australia’s tax and transfer system* on 6 August 2008. The discussion paper outlined Australia’s tax and transfer systems to inform public discussion. The paper was not intended to be exhaustive, nor was it intended to limit discussion to the issues raised, and called for public submissions.²

On 10 December 2008 the *Henry Review* published a consultation paper which outlined the key messages from the submissions received. This paper summarised the key messages from submissions.

From December 2008 to 1 May 2009 further public submissions were received in response to the questions raised in the consultation paper. The *Henry Review* then held public meetings in all capital cities and two regional centres from 16 to 27 March 2009.

**The Henry Review Report**

The *Henry Review* provided its report to Treasurer in December 2009. The Henry Report contained 138 recommendations proposing sweeping recommendations to reform Australia's tax system. The Government's initial response, “Stronger-Fairer-Simpler, A tax plan for reform” dealt with less than 50 of the recommendations was released on 2 May 2010. The Government initially focused on the resources sector and superannuation. There were also some benefits for small business and an initial proposal to reduce the company tax rate was abandoned.

Volumes 1 and 2 provided a detailed analysis that examined the following 28 taxation related areas:
• personal taxation
• retirement incomes
• wealth transfer taxes
• investment and entity taxation
• company and other investment taxes
• the treatment of business entities and their owners
• tax concessions for not-for-profit organisations
• land and resources taxes
• charging for non-renewable resources
• land tax and conveyance stamp duty
• taxing consumption
• a cash flow tax
• the goods and services tax
• payroll tax
• taxing financial services
• enhancing social and market outcomes
• user charging
• taxes to improve the environment
• road transport taxes
• alcohol taxation
• tobacco taxation
• rationalising other taxes
• institutions, governance and administration
• a responsive and accountable tax system
• state tax reform
• local government
• client experience of the tax and transfer system
• monitoring and reporting on the system

The Henry Review also examined the following matters:

1 Ibid.
• transfer system;
• housing affordability
• income support payments;
• means testing
• family and youth assistance
• child care assistance
• housing assistance
• transfers tied to goods and services
• funding aged care

Given the large scale of the 138 recommendations that often extend outside the area of taxation, means that it is difficult to synthesize the Henry Review’s interpretation of an ideal tax structure. Consequently, this paper looks at its recommendations in the context of the Mirrlees Review’s good tax system.

3. MIRRLEES REVIEW

Background and Aims

The Mirrlees Review commenced on 4 September 2006 as an independent major collaborative research venture led by the Institute of Fiscal Studies (IFS). The Mirrlees Review was funded by the Nuffield Foundation and the Economic and Social Research Council (ESRC). The review was chaired by Sir James Mirrlees.

The impetus for the Mirrlees Review stemmed from the state of the UK tax system that was the product of a frequently incoherent piecemeal changes and not rather than measured design.3 The tax system has had problems in moving with the significant changes in the economic, social, and institutional environment in which it operates. Given the improvements in theoretical and empirical understanding of the tax systems and impact on people’s behavior there were tax design opportunities to be acted upon. Thus, the Mirrlees Review reviewed the tax system and ascertain the characteristics that would make for a good
tax system in an open economy in the twenty-first century. Further, the *Mirrlees Review* considered how the tax system could move closer to this ideal.

**Processes**

The *Mirrlees Review* was conducted over a period of 5 years (September 2006 to September 2011) producing 1,072 pages of analysis and recommendations. Following an extensive review period the *Mirrlees Review* initially published *Dimensions of Tax Design* in 2010, a book that consisted of a set of specially commissioned chapters dealing with different aspects of the tax system. In 2011, the second publication, *Tax by Design*, set out its conclusions.

**Dimensions of Tax Design**

*Dimensions of Tax Design* involved over fifty international experts and younger researchers. This research resulted in thirteen commissioned studies involving the following topics:

- Taxation in the UK
- Means-testing and Tax Rates on Earnings
- Labour Supply and Taxes
- Value Added Tax and Excises
- Environmental Taxes
- The Base for Direct Taxation
- The Effects on Consumption and Saving of Taxing Asset Returns
- Taxation of Wealth and Wealth Transfers
- Taxing Corporate Income
- International Capital Taxation
- Small Business Taxation
- Administration and Compliance
- The Political Economy of Tax Policy

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Ibid.
Tax by Design

Tax by Design drew upon the findings in the Dimensions of Tax Design to provide an integrated view of tax reform. The aim is to identify the characteristics of a good tax system for any open developed economy, to assess the extent to which the UK tax system conforms to these ideals, and to recommend how it might realistically be reformed in that direction. The following key issues were discussed over 18 chapters:

- The Economic Approach to Tax Design
- The Taxation of Labour Earnings
- Reforming the Taxation of Earnings in the UK
- Integrating Personal Taxes and Benefits
- Taxing Goods and Services
- Implementation of VAT
- VAT and Financial Services
- Broadening the VAT Base
- Environmental Taxation
- Tax and Climate Change
- Taxes on Motoring
- The Taxation of Household Savings
- Reforming the Taxation of Savings
- Taxes on Wealth Transfers
- The Taxation of Land and Property
- Taxing Corporate Income
- Corporate Taxation in an International Context
- Small Business Taxation

Then in the final chapter, the *Mirrlees Review* made its conclusions and recommended policy settings for a good tax system having regard to:

- Taxes on earnings

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6 Ibid.
• Indirect taxes
• Environmental taxes
• Taxation of savings and wealth
• Business taxes
• Resource Rent Taxes
• Social Security Benefits

4. **MIRRLEES REVIEW’S GOOD TAX SYSTEM AND THE HENRY REVIEW**

The *Mirrlees Review’s* good tax system and its rationale is detailed below and compared to the *Henry Review* findings.

4.1 Tax on Earnings

The *Mirrlees Review* found that a progressive broad income tax with a transparent and coherent rate structure would better achieve efficiency, simplicity and redistribution goals. The current system is an opaque jumble of different effective rates as a result of tapered allowances and a separate National Insurance system. The *Henry Review* developed numerous principles and 13 recommendations on the taxation of earnings, and these were in general agreement with the *Mirrlees Review*. The *Henry Review* sought a broad income tax and *Henry Review’s* recommendation 2 called for a progressive income tax.

Also, given the existing rate structure that reduces employment and earnings more than necessary, the *Mirrlees Review* proposed effective tax rates should be adjusted to reflect evidence on behavioural responses. Mothers of school age children and people near retirement are very responsive to work incentives. Whilst the *Henry Review* found that “effective tax rates can be high for some people, including for those likely to reduce their level of work as a result”\(^8\), no recommendations were made though to adjust effective tax rates to reflect evidence on behavioural responses.

4.2 Indirect Taxes

\(^7\) Ibid 478.
The **Mirrlees Review** recommended a largely uniform VAT to maximise efficiency and simplicity. Given the difficulty in imposing VAT on financial services and housing, an economically equivalent tax should be used. The current VAT has extensive zero-rating, reduced rating, and exemptions (financial services exempt; housing). Housing is generally not subject to VAT but is subject to a council tax which is not proportional to current property values.

The **Henry Review** similarly sought a broad tax on private consumption.\(^9\) Given the restrictive terms of reference on examining value added taxes, the **Henry Review** did not elaborate on design issues of such a tax.

The **Mirrlees Review** recommended the elimination of transactions taxes. Presently, stamp duties are imposed on transactions of property and of securities. The **Henry Review** recommended the removal of conveyancing stamp duties to be replaced by a broad land tax.\(^10\) The **Henry Review** also recommended the elimination of specific insurance taxes.\(^11\)

The **Mirrlees Review** recommended additional taxes on alcohol and tobacco in accordance with current policy. The **Henry Review** similarly recommended such additional taxes. The **Henry Review** considered that “all alcoholic beverages should be taxed on a volumetric basis, which, over time, should converge to a single rate, with a low-alcohol threshold introduced for all products.”\(^12\) The rate of alcohol tax should be based on evidence of the net marginal spillover cost of alcohol. The **Henry Review** recommended that tobacco taxation be retained, with the rates of tax substantially increased, depending on further evidence on the costs of harm from tobacco smoking.\(^13\)

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\(^8\) *Henry Review* Report Part Two vol 1 p. 21
\(^9\) Ibid Part One recommendation 1, 80.
\(^10\) Ibid recommendation 51-52, 90.
\(^11\) Ibid recommendation 79, 92.
\(^12\) Ibid recommendation 71, 93.
\(^13\) Ibid recommendation 73, 94.
4.3 Environmental taxes

The Mirrlees Review found that a consistent price on carbon emissions be introduced through extended coverage of the EU Emissions Trading Scheme. Under the current system there are arbitrary and inconsistent prices on emissions from different sources, and others set at zero. The Henry Review similarly found that Australia’s permit trading scheme, the Carbon Pollution Reduction Scheme (CPRS) is the most cost-effective way to reduce Australia’s carbon emissions.\(^\text{14}\)

The Mirrlees Review called for a well-targeted tax on road congestion to replace the ill-targeted tax on fuel consumption. Such a congestion tax corrects market failure. Increasing the price of a good / activity that causes harm can be efficient since it discourages such goods / activity and the changes are made by those who can make them with the least effort. The Henry Review recommended that all congestion charges should apply to all registered vehicles using congested roads.\(^\text{15}\)

4.4 Taxation of savings and wealth

The Mirrlees Review recommended no tax on the normal return to savings. The Mirrlees Review recommended the standard income tax schedule apply to income from all sources after an allowance for the normal rate of return on savings. This treatment is justified on economic grounds since it encourages savings and investment. Currently, the normal return is taxed on many, but not all, forms of savings. There are additional but poorly designed incentives for retirement saving. Income tax, National Insurance contributions, and capital gains tax together imply different rates of tax on different types of income—wages, profits, capital gains, etc.

The Henry Review also supported a tax concession for savings, proposing a 40 per cent savings income discount to individuals for non-business related:

(a) net interest income;
(b) net residential rental income (including related interest expenses);
(c) capital gains (and losses); and

\(^{14}\) Ibid Report Part Two volume 2 p. 345.
\(^{15}\) Ibid Report Part One recommendation 61, 92.
(d) interest expenses related to listed shares held by individuals as non-business investments.\textsuperscript{16}

Further the \textit{Mirrlees Review} recommended lower personal tax rates on income from company shares to reflect corporation tax already paid. Currently, there is some recognition of corporation tax in dividend taxation but not in capital gains tax. The \textit{Henry Review} found that dividend imputation should be retained for the short to medium term.

The \textit{Mirrlees Review} proposed additional incentives for retirement savings. The \textit{Henry Review} also called for further tax incentives for retirement savings.\textsuperscript{17}

The \textit{Mirrlees Review} recommended a lifetime wealth transfer tax to reduce the inequality at birth of life chances as well as for efficiency and equity reasons. The \textit{Mirrlees Review} noted the practical problems of designing such a tax. Currently, an ineffective inheritance tax applies that only applies to certain assets transferred at or near death. However, the \textit{Henry Review} declined to recommend a wealth tax but rather called for the Government to promote further study and community discussion of the options.\textsuperscript{18}

\textbf{4.5 Business Taxes}

The \textit{Mirrlees Review} called for a single rate of corporation tax with no tax on the normal return on investment. The \textit{Henry Review} would retain the existing single rate of corporation tax albeit at a lower rate of 25\% (from 30\%). The normal return on investment would continue to be taxed. Over the medium to long term consideration should be given to an alternative to dividend imputation.

\textsuperscript{16} Ibid recommendations 14-16, 83.
\textsuperscript{17} Ibid recommendations 18-22, 84-85.
\textsuperscript{18} Ibid recommendation 25, 86.
The *Mirrlees Review* sought equal treatment of income derived from employment, self-employment, and running a small company. The *Henry Review* also recommended a comprehensive income tax. 19

The *Mirrlees Review* recommended no tax on intermediate inputs but land value tax at least for business and agricultural land. An input tax would apply on buildings (business rates) but no land value taxes. The *Henry Review* proposed the removal of stamp duties and advocated a broad land tax (on all land) with consideration on using a per square metre basis using an increasing marginal rate schedule. 20 Under a broad land tax, low value land such as farming land would be under the exemption threshold.

### 4.6 Resource Taxes

The *Henry Review* recommended that the current resource charging arrangements imposed on non-renewable resources by the Australian and State governments should be replaced by a uniform resource rent tax imposed and administered by the Australian government. 21

### 4.7 Other *Henry Review* tax reforms

Recommendation 55 provided that eventually a broad-based cash flow tax, applied on a destination basis could be used to finance the abolition of other taxes, including payroll tax and inefficient State consumption taxes, such as insurance taxes.

### 4.8 Benefit System

The *Mirrlees Review* also called for a single integrated benefit for those with low income and/or high needs. The *Henry Review* similarly recommended for integration of the numerous benefits. The *Henry Review* found that there should only be three categories of income support payments: pensions for special needs or aged;

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19 Ibid recommendation 1, 80.
20 Ibid recommendation 51-52, 90.
21 Ibid recommendation 45, 89.
participation support for people of working age (ie unemployed, temporary incapacitation) and student assistance. The payments should be indexed and a comprehensive means test should replace the numerous current tests for eligibility.

4.9 Progressive Income Tax
The Mirrlees Review sought a progressive income tax that would be shaped by the overall package of taxes and benefits. The Henry Review also found that a progressive income tax was warranted.

5. Implementation

The Mirrlees Review considered that certain recommendation could be undertaken immediately whilst other measures would need years of planning and consultation. The Henry Review did not provide a timetable for implementation, finding it was neither possible or desirable to make all of the changes too quickly, but does not advocate a slow boat to reform.22

6. Government Responses

The UK government plans to reform its benefit system in 2017. Otherwise no MR reforms have been implemented to date.

A small number of the many Henry Review recommendation were enacted. The former Labor Government introduced a Mineral Resources Rent Tax (although the current Coalition Government intends to repeal this tax). Also, a number of small business tax changes (immediate write off for deprecating assets under $5,000 and single depreciation write off of 30% in a single pool) were made. Some tax offsets for individuals were rationalised and the income tax free threshold was increased. Also, exemptions for foreign employment income of residents were removed. The tobacco tax was significantly increased.

7. Conclusion

In summary, both reviews sought: a broad personal income tax; broad value added tax; the elimination of transactions taxes; additional taxes on alcohol and tobacco; carbon emissions trading schemes; taxes on road congestion; tax concessions for savings (albeit in different forms); additional incentives for retirement savings; a single rate of corporation tax;

The main differences include Australia’s retention of dividend imputation for the short to medium term. Whilst the *Mirrlees Review* recommended a lifetime wealth transfer tax and called for a single rate of corporation tax with no tax on the normal return on investment

Despite the many differences in the ways the two reviews were conducted and the scope of their recommendations, many common threads emerge in the design of a good tax system as proposed by the *Mirrlees Review*. With consensus on many issues, begs the question what are the blockers to tax reform and how can these be addressed?