A Fair Austrarlia

Tax

Background Paper

ACTU CONGRESS 2003

Quick Fact:

OECD data shows that Australia is a low tax country. The latest available figures (for 2000) show total tax revenue in Australia amounting to 31.5% of GDP. By comparison the OECD average is 37.2% of GDP, Canada has a total tax revenue equal to 38.7% of GDP, and Sweden has a total tax revenue equal to 52.2% of GDP.

CONGRESS 2000

1. Congress 2000 occurred in the midst of the Federal Government's implementation of the GST. Through the Congress policy the ACTU called on the Federal Government to undertake a review of the GST package with a view to its effect on:

    - distributional equity with particular reference to the outcomes for low-paid workers and low-income working families;
    - tax avoidance and evasion activity;
    - national economic performance; and
    - the ability to raise revenue to adequately provide public services and infrastructure.

2. Congress also adopted the following principle about taxation policy:

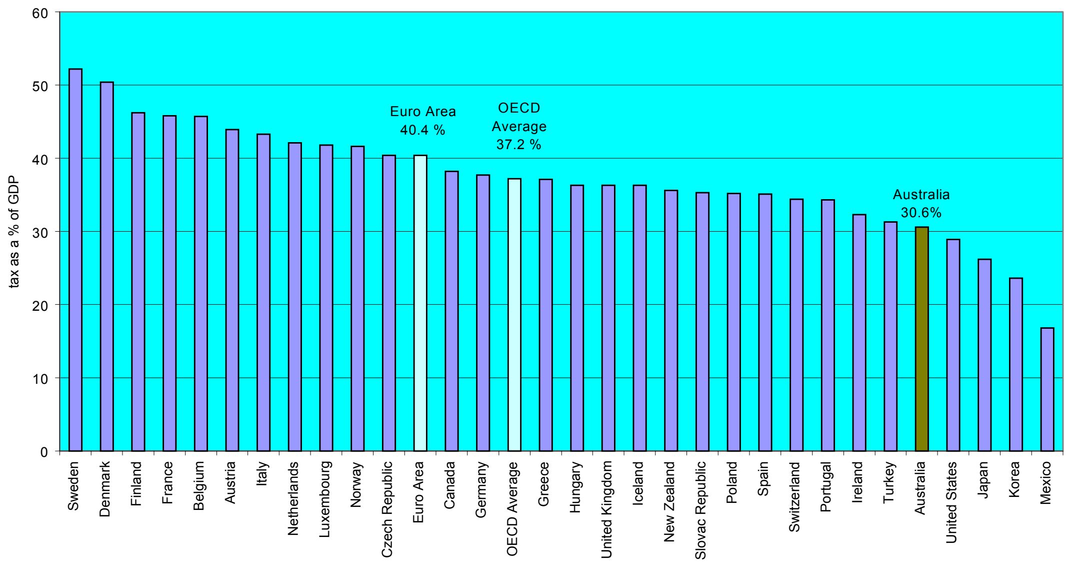
    Spending and taxation policies should be a major instrument in redistributing income and wealth. The burden of taxation should be borne by the corporate sector and high-income earners and not low and middle-income salary earners. The 'social wage' – consisting of expenditure on health, education, public transport, childcare, labour market programs, *infrastructure, environmental programs and the like – should be broadly based across the whole community.*

DEVELOPMENTS SINCE CONGRESS 2000

Australia is a Low-Tax Country

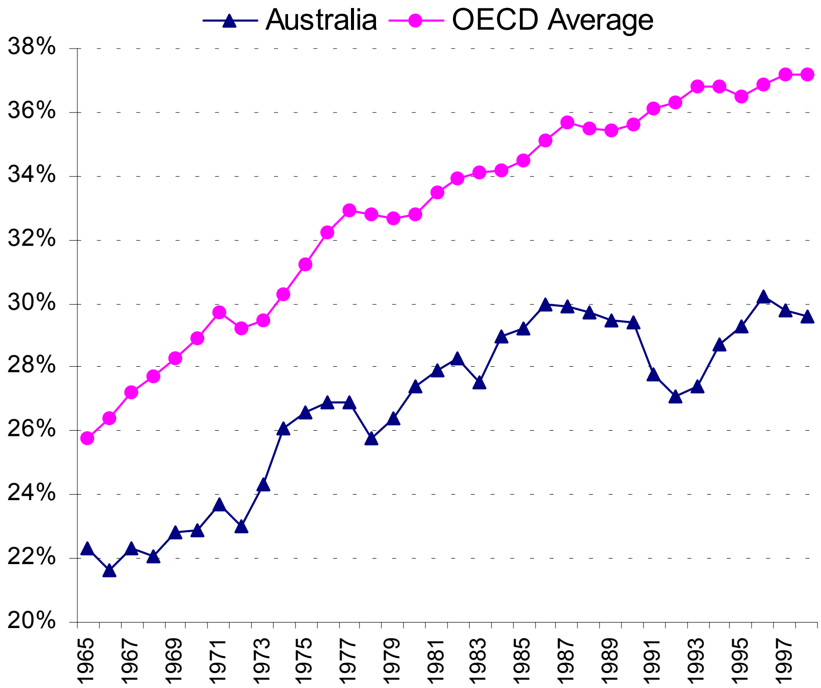
3. OECD data shows that Australia is a low tax country. The latest available figures (for 2000) show total tax revenue in Australia amounting to 31.5% of GDP.

Figure 1: Total Tax Revenue in OECD countries as a % of GDP - 1999



Source: OECD, *Main Economic Indicators*, August 2002.

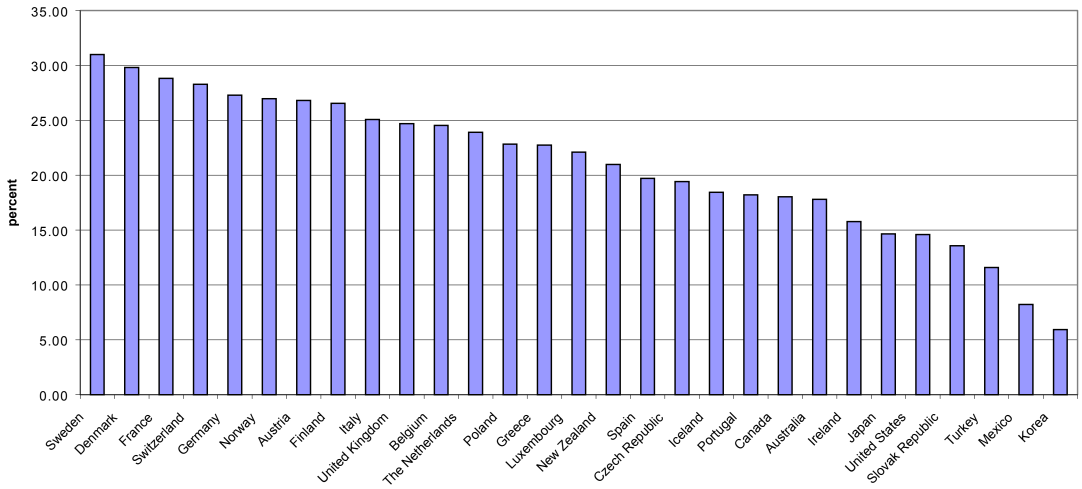
Figure 2: Tax as a percentage of GDP 1965-97 and 1998 estimates



Source: *OECD Revenue Statistics 1965-98*, p. 65-7, Table 3 & p. 120, Table 39.

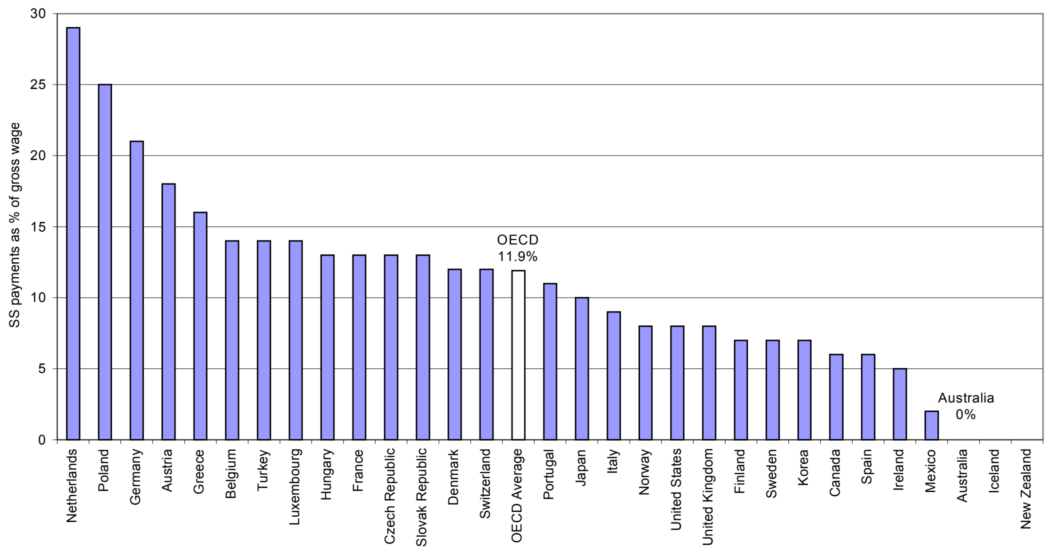
4. Australia is also a low spending country on its welfare programs.

Figure 3: Social Expenditure as % of GDP - OECD Countries 1998



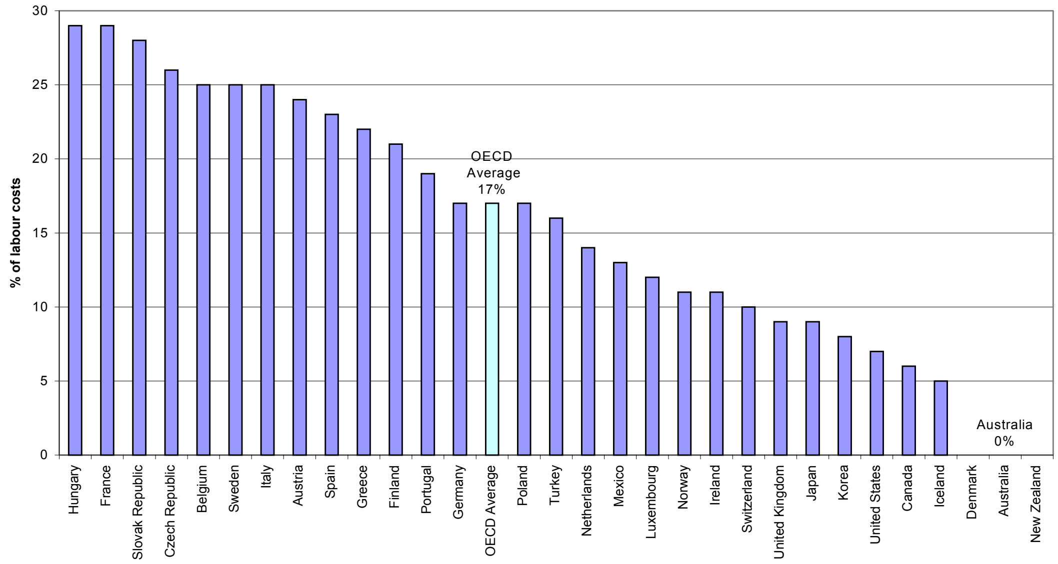
5. Unlike most other OECD countries, no separate social security taxes are levied on employers or employees in Australia.

Figure 4: Employees Social Security Contributions as a percentage of gross wage, OECD countries, 2000



Source: OECD, *Taxing Wages*, 2000-2001.

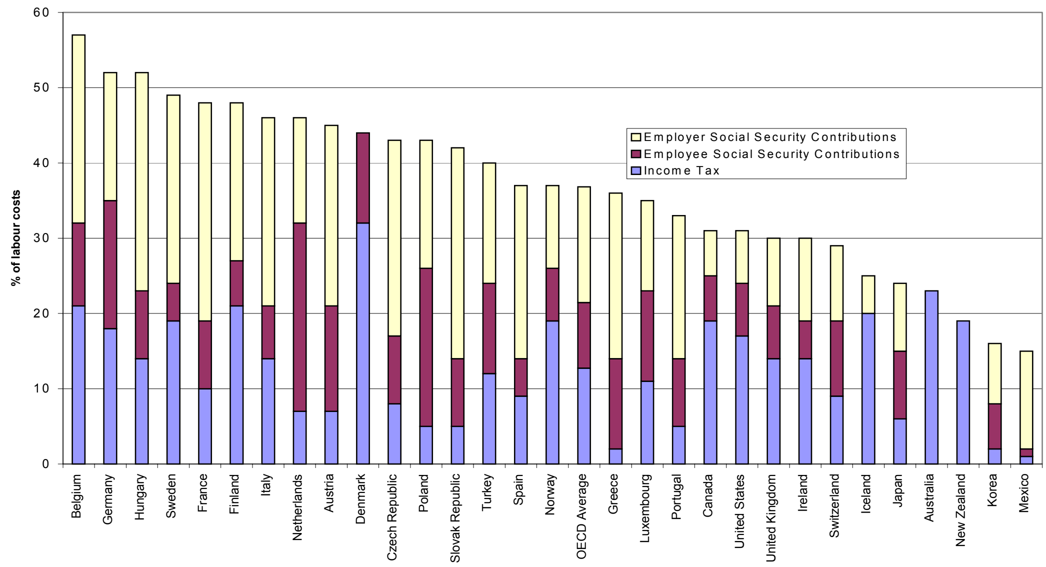
Figure 5: Employer Social Security Contributions (as a % of labour costs) – OECD Countries - 2000



Source: OECD, *Taxing Wages*, 2000-2001.

6. The Superannuation Guarantee Charge (SG) payments by employers to workers' superannuation accounts are outside the tax system. Unlike tax payments, the SG amounts are reinvested by super funds, raising the pool of investment funds in Australia and thereby reducing interest rates. [Were SG payments collected as taxes, they would be returned as pension payments and feed into consumption expenditure.] Social security taxes in Europe and the US are pooled, whereas SG contributions here are vested in workers' individual accounts.

Figure 6: Income Tax, Employee and Employer Social Security Contributions (as % of labour costs), OECD Countries, 2000

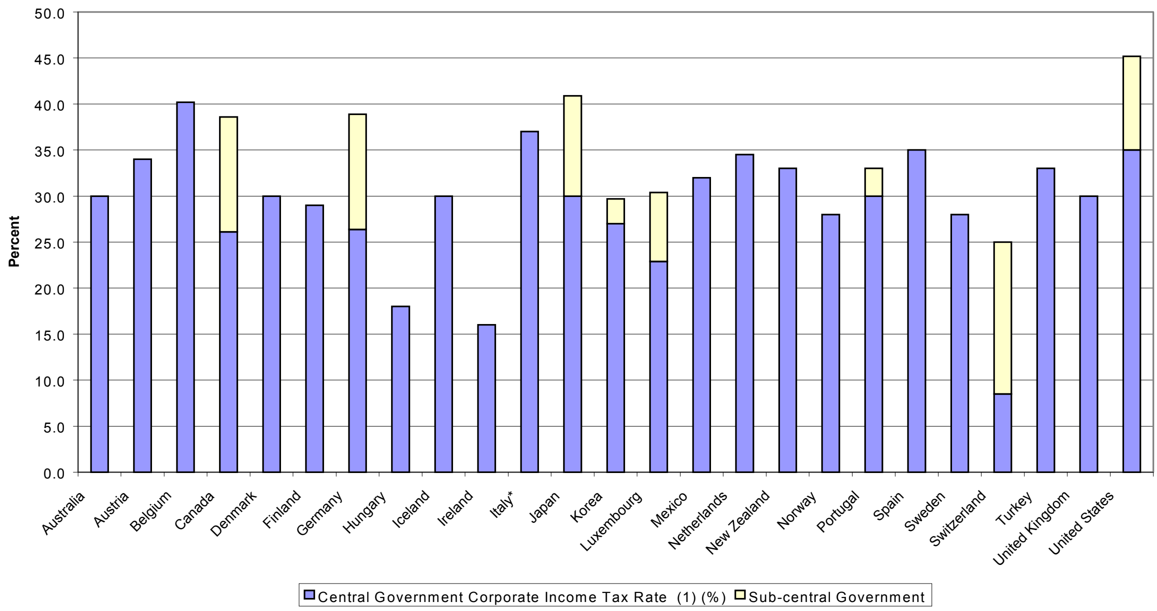


Source: OECD, *Taxing Wages*, 2000-2001.

7. In Australia the Federal Government raises most tax revenue, although state and local governments also raise some. The Federal Government taxes individual and company incomes, as well as consumption [GST], capital gains and other taxes; state governments apply taxes to land and payrolls, and levy other fees and charges; and local government collects rates based on property values.

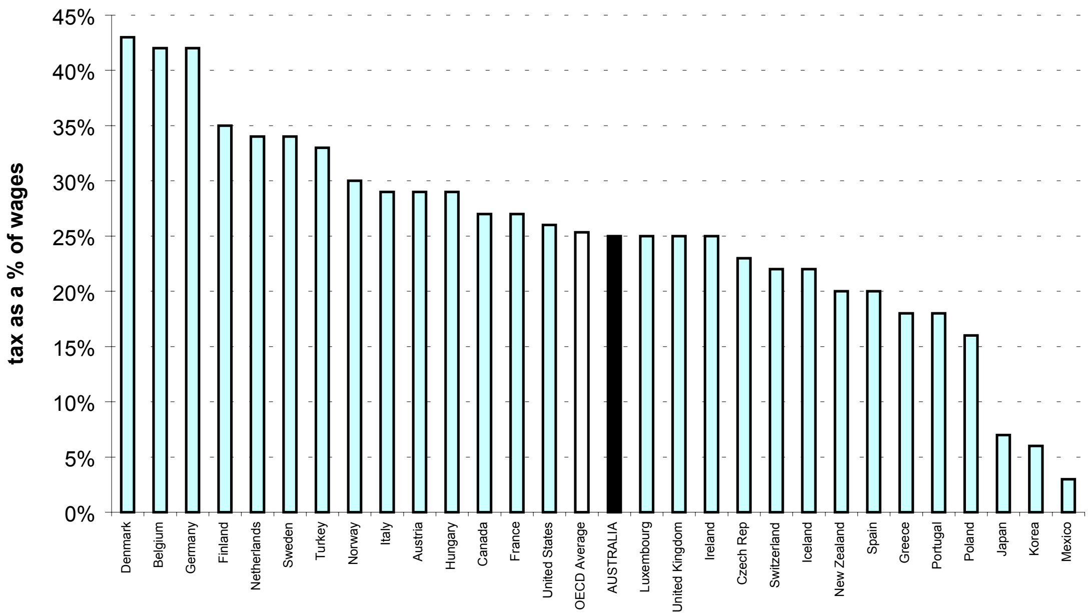
8. The share of company tax in total tax revenue has fallen in Australia over the past several decades. The rate of company tax is low by OECD standards.

Figure 7: Corporate Income Tax Rates – Selected Countries



9. Though Australia is a low tax country, the incidence of tax on ordinary workers is around the average of OECD countries. For higher-income individuals, income tax in Australia is low by OECD standards.

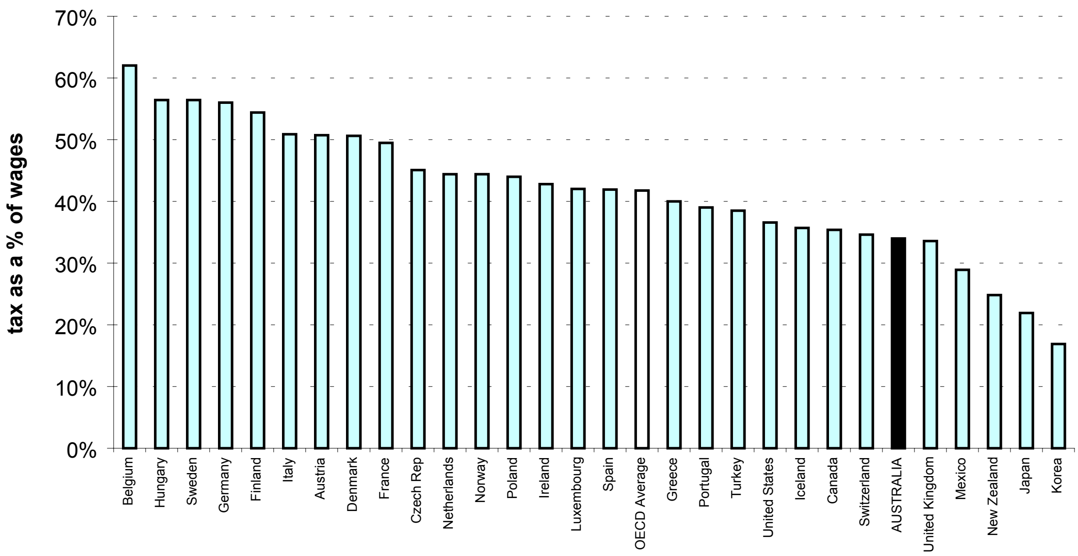
Figure 8: Tax paid by average production workers in the OECD, 1998[1] ($A 39,000)



Source: *Taxing Wages 1998-1999*, p. 12, Table 1.1.

[1] For Australia in 1998 this was calculated on a salary of $38,763 p/a.

Figure 9: Tax paid by employees earning 167% of Average Weekly Earnings ($A64,000) in the OECD, 1998



Source: *Taxing Wages 1998-1999*, pp. 115-175, Part IV Country Tables.

The Australian Tax System Needs Reform

10. The Federal Government pretends that the introduction of the GST is the only tax reform required in Australia. It is not. The tax system needs review and substantial reform.

11. The present tax system is *inequitable*. Low and middle-income workers pay too much tax while high-income earners access tax minimisation schemes to reduce their tax payments.

Figure 10: Income tax paid on $30,000, $50,000, $70,000 and $90,000, 2000-2001

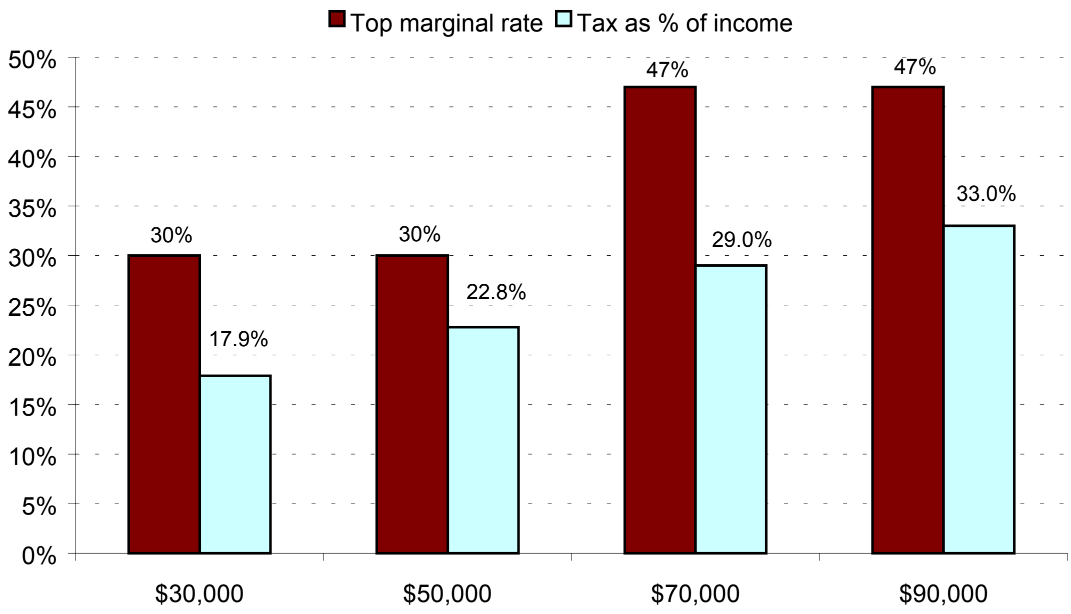
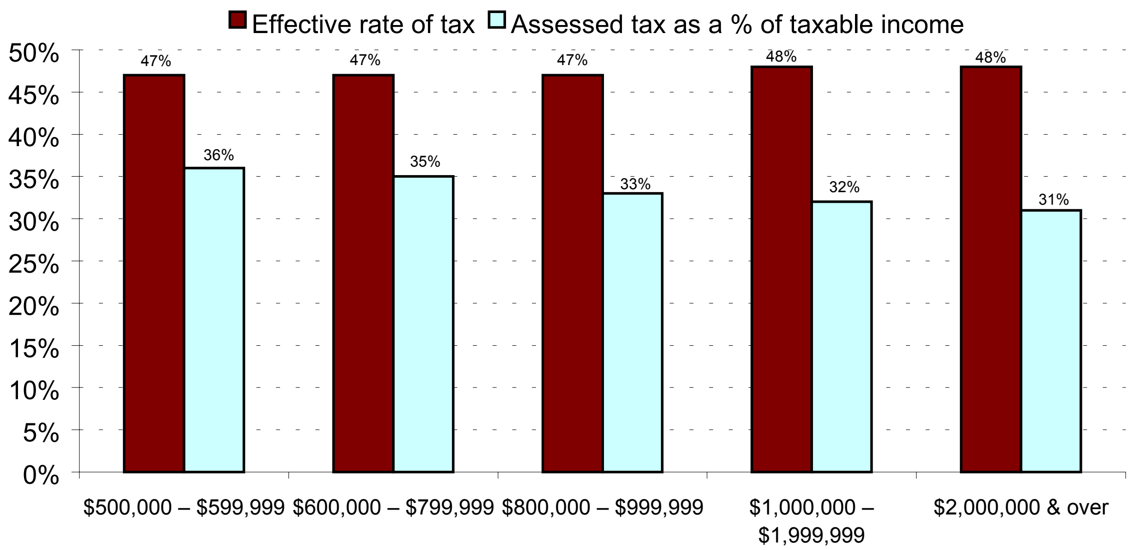


Figure 11: Taxpayers with a taxable income of $500,000 or more, 1998-99

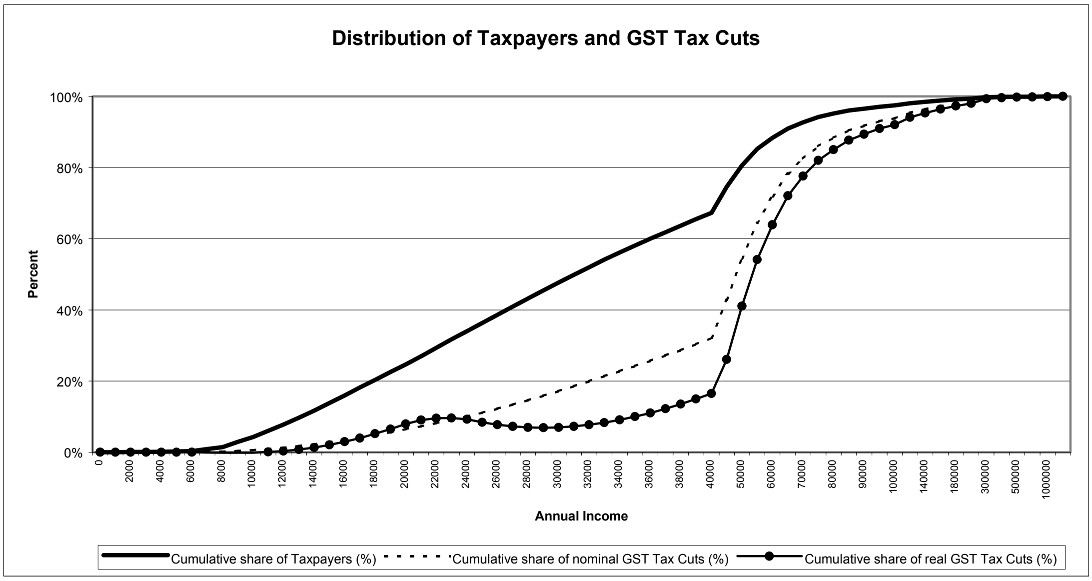


Source: ATO, *Taxation Statistics 1998-99*, Table 14.

NB: Effective Rate of Tax is calculated as (total rebates and credits + net tax assessed)/Taxable income.

12. The GST package cut taxes for high-income individuals and raised taxes for ordinary workers. The GST package included income tax cuts that were claimed to offset the price impact of the GST. However, the GST income tax cuts in June 2000 were the first since November 1993. Taking into account the impact of 'bracket creep'[1] over that seven year stretch, the GST package left low and middle income workers much worse off.

Figure 12:



13. All taxpayers with incomes around or below average earnings (around $40,000 per annum in 2000) were left worse off under the GST package when allowance is made for bracket creep. Notably, 67.3% of individual taxpayers had annual incomes of $40,000 or less, but 32.1% of the GST income tax cuts went to this group of taxpayers. When the GST income tax cuts are adjusted for bracket creep, this figure falls to 16.5% - the bottom two thirds of taxpayers received one eighth of the real GST income tax cuts.

14. The loss of workers' income to bracket creep continues. By the end of last year, bracket creep since the GST income tax scales were introduced was contributing $2.9 billion annually to the federal budget. By the end of 2004 the annual contribution to Federal Government revenue arising from bracket creep will be around $5.6 billion.

15. The GST has dramatically changed the relative shares of direct and indirect tax collected. Direct taxes, such as income tax, are more progressive, collecting relatively more revenue from high-income

[1] 'Bracket creep' affects all taxpayers under a progressive tax scale, not only those for whom a wage rise takes them into a higher marginal tax bracket. For example, the income tax paid by a worker earning $35,000 equates to 19.65% of her income, but following a $20 per week wage rise (taking this worker to an income of $36,000) the tax paid rises to 19.94% of income even though her Marginal Tax Rate is unchanged at 30%.

individuals. Indirect taxes like the GST are regressive, collecting relatively more revenue from low-income individuals.

Figure 13: Estimated income and indirect tax as a proportion of total income household income quintile, 1996-97

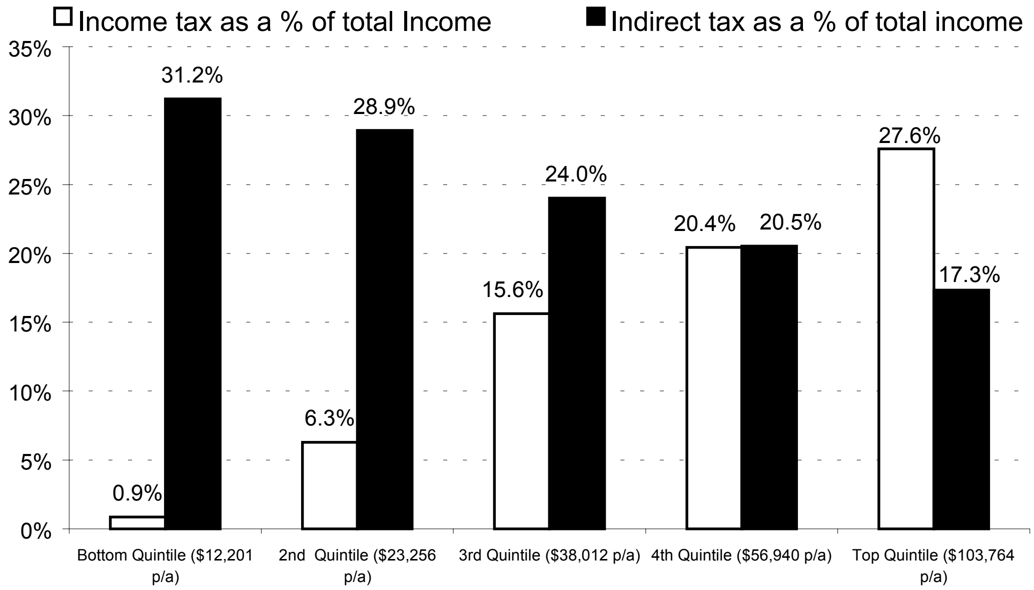
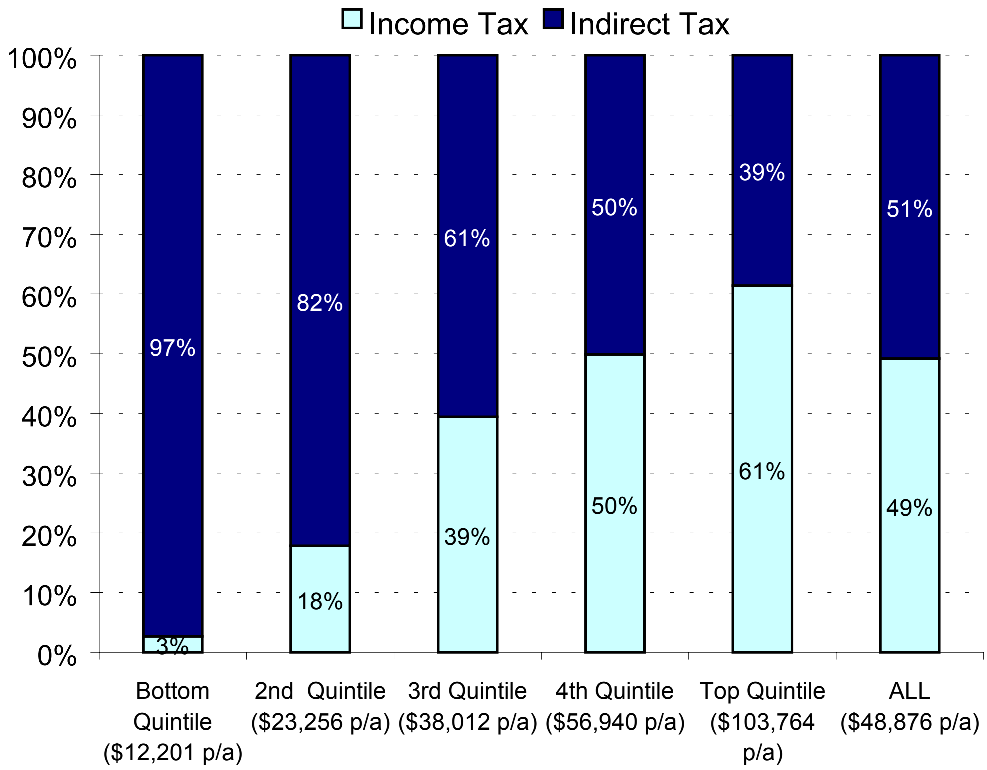


Figure 14: Split between income tax and indirect tax by household income quintile, 1996-97



16. The data in these figures is from 1996-97. While data since the introduction of the GST is not yet available, the picture is sure to have worsened dramatically. It is time to review the impact of the GST package on the distribution of after-tax incomes and on economic performance. Clearly, three years after its introduction and having been tested at the last federal election, the GST is now an established part of Australia's taxation system. The GST should never be extended to basic food and while adjustments to its scope and impact will always be matters for policy consideration the time for supporting repeal or generalised roll-back of the GST has now passed.

17. The Federal Government has reneged on its commitment to reform business taxes, including the tax treatment of discretionary trusts, the use of sham contractors and phoenix companies to avoid and evade tax, and the tax shelter strategies pursued by an identified group of high wealth individuals.

18. With less revenue being raised from customs duties (tariffs) and company tax, the share of tax raised from individuals has risen dramatically over recent decades.

19. Revenue is being leached from the system through the Federal Government's provision of open ended tax concessions. Notorious here is the Private Health Insurance Rebate that sucks public funds into private health insurance funds, draining resources from public hospitals and the public health system and undermining bulk-billing. The Rebate has not delivered better health outcomes nor reduced pressure on public hospitals. The Family Tax benefit similarly fails to deliver the greatest benefits to families that are most in need.

20. Neglect of Australia's social, physical and natural assets under the Federal Government, exacerbated by its fetish with achieving zero net public debt, has delivered a mounting need for overhaul and refurbishment of the nation's economic and social infrastructure. The nation's education and health systems need substantial injections of funds even to maintain service quality.

21. Moreover, the taxation system is always in need of review and calibration, because tax avoidance professionals are always contriving new ways to subvert the system and assist high income and high wealth individuals avoid paying their legitimate tax obligations.

22. The tax system needs review to ensure adequate revenue is raised to meet national needs, and to reduce the burden on ordinary workers so as to achieve a fairer, more progressive taxation system.

ISSUES FOR POLICY AT CONGRESS 2003

The Purpose of Tax

23. The primary reason governments raise tax revenue is to fund community needs. The Australian community wants active government that is responsive to community needs. A market economy with no government will fail to provide for key community needs sufficiently or fairly. These needs include:

    - ensuring all people are able to have a decent and dignified life;
    - redressing poverty and disadvantage;
    - delivering health and education systems of the highest quality available to all citizens;
    - ensuring justice, law and order, public safety and public health through appropriate regulation and administration;
    - providing and/or ensuring the availability of infrastructure, communications and transport services;
    - protecting and preserving our natural environment and built heritage; and
    - maintaining the nation’s defence capacities.

24. Governments can and should use the tax system progressively, to improve equity in opportunity and outcomes across the community. A progressive tax system raises tax revenue in proportion to capacity in order to fund community services and provide economic support to individuals and families according to need. In this way, living standards of low income groups can be raised and their children’s life chances improved, reducing the disparities in wealth, income and opportunity that the market system and inheritance would otherwise deliver.

25. Taxation arrangements can also assist directly in the achievement of social goals by altering market prices and thus behavioural incentives. For example, excise taxes on alcohol and tobacco raise substantial government revenue, as well as reducing the incidence of excessive consumption of these substances and the adverse public health consequences that ensue. Similarly, environmental taxes can reduce pollution and degradation and change consumption patterns while raising revenue.

26. It is to be noted that some taxation measures intended to modify behaviour can conflict with the equity goals that underpin a progressive tax structure. For example, to the extent that low-income

families have more smokers, drive less fuel-efficient cars and live in outer suburbs, the impact of tobacco and fuel excises falls disproportionately on them and is distributionally regressive.

27. For this and other reasons, taxation arrangements need careful design, monitoring, and adjustment.

Options for Reform

Fairness

28. Ordinary workers need a tax cut to improve the fairness of the tax system. High income and high wealth individuals have benefited handsomely from changes to income tax rates and related provisions over the past two decades. They have received tax cuts far in excess of bracket creep through lower marginal rates and dividend imputation, and access the options afforded them by trusts, incorporation, and other avoidance mechanisms.

29. Cuts to the top marginal rate of personal tax would deliver further exorbitant benefits to high-income individuals at great expense to the federal budget, but do nothing for ordinary workers. The top marginal tax rate of 47% cuts in at $62,500. 90% of all employees (and 88% of all full-time adult non-managerial employees) earn less than this, and would gain nothing from a cut in the top marginal rate from 47% to 42%. The cost to the federal budget of cutting the top marginal tax rate in this way is more than $5.6 billion in a full year.

30. The present company tax rate is 30%. Individual taxpayers pay this rate on incomes between $21,600 and $52,000 per year. Cutting the top marginal tax rate to 30% would cost $23.4 billion dollars in a full year. 80% of all employees (and 75% of all full-time adult non-managerial employees) earn less than this and would gain nothing from such a reduction in the top marginal tax rate.

31. The effect of cutting the top marginal tax rate in this way would be to greatly raise pressure to cut services for low and middle-income groups. The top 20% of income earners would benefit directly from sharply lower taxes, and the bottom 80% would lose from sharply reduced services.

32. As incomes rise over time, the large numbers of ordinary workers bunched at or around average earnings will cross the income tax thresholds at $52,000 and $62,500. These income levels are not exorbitant by contemporary standards; many ordinary workers earn these amounts through collective bargaining or working overtime or shift work.

33. A reduction in the marginal tax rate at these thresholds would deliver a small tax cut to this cohort of workers whose increase in income

takes them into the next (higher) tax rate; however the vast bulk of the gains flow to individuals on much higher incomes again. For example, consider two workers: Jenny earning $62,500 and John earning $100,000, both of whom receive a 5% pay rise. At present tax rates, both pay 47% of their wage rise in tax. Reducing the marginal tax rate from 47% to 42% for incomes over $62,500 pa would give Jenny a tax cut of $156.25 per annum ($3.00 per week), while John would gain $2,125 per annum ($40.76 per week).

34. Increasing these income tax thresholds in line with the growth in average earnings, rather than cutting the corresponding marginal tax rates, is a fairer and far more cost-effective way of addressing this issue of genuine concern to ordinary workers. Raising the top threshold from $62,500 to $65,000 would deliver both Jenny and John the same weekly tax cut of $2.40.

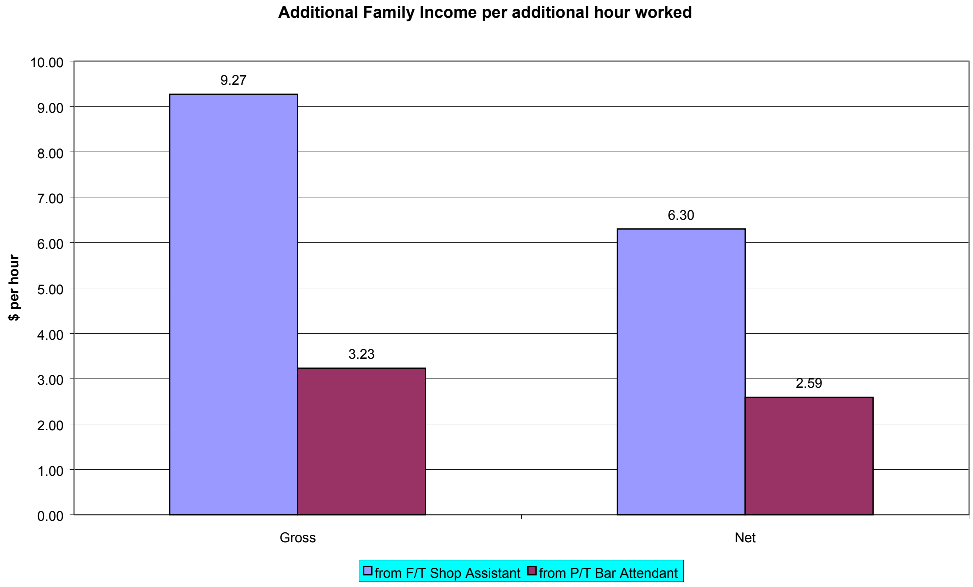
35. A targeted income tax cut is a fair tax cut. A simple and direct way of targeting an income tax cut to ordinary workers at this time is through provision of a Personal Tax Credit (PTC). A PTC package allows for delivery of a much fairer and more targeted tax cut than simple adjustment of income tax thresholds.

36. For example, introduction of a PTC package such as outlined in table A1 would deliver a tax cut of between $8 and $11.75 a week to all full-time workers with incomes up to $52,000. In this example withdrawal of the PTC provides a tax cut for workers with incomes up to $72,000. Workers with incomes exceeding this level would pay a little more tax – less than $5 a week at $80,000, around $10 a week at $90,000 and $15 a week at $100,000 with the maximum increase of $25.50 a week on incomes over $116,667. Implemented next year, at a cost of $2.9 billion in a full year it would return to low and middle income workers the proceeds of bracket creep in that year and greatly improve the fairness of the income tax system.

Needs and Incentives

37. One important purpose of taxation is to raise revenue so that (amongst other things) the social security system can better address unmet need and disadvantage in our community. Critically, the interaction between the tax and social security systems can have perverse consequences for achievement of this goal, including the creation of intergenerational disadvantage and social exclusion in some geographical areas and demographic groups.

38. Where a 'work poor' family relies on social security income, the benefits to them from a family member taking up full or part-time work can be minuscule. This is because the gross income gained from employment is taxed, and the social security income to which the family was previously entitled is withdrawn progressively in line with earnings from employment.



39. The effective marginal tax rate [EMTR] that results from this interaction between social security withdrawal and the income tax system is excessive over large ranges of income – far greater than the top marginal tax rate for high income individuals - and can be prohibitive (over 100%) over some.

40. Addressing this problem is critical. It is also complex, because the income tax system applies to individuals' income and the social security system applies generally to family incomes.

41. A coherent and systematic solution is possible through adoption of a 'golden rule' to govern withdrawal of all sources of social security income as market income rises.

42. One example of such a rule is: no one should face an effective marginal tax rate in excess of (say) 65%. In many instances, this would apply to the second income earner in a family. Under this rule, where the wage earner concerned worked part-time and earned less than $20,000, the withdrawal rate of social security entitlements would be 48% (above a threshold amount). Where the worker concerned earned more than $20,000, the withdrawal rate in remaining social security income would be 35%.

43. Implementing such a 'golden rule' would require fundamental review and overhaul of current social security programs and precepts. This is appropriate and overdue, in light of the wholesale changes in labour market and family structures of recent decades.

44. There may be a role here for a Family Tax Credit (FTC) scheme, which is essentially a targeted tax cut for families with low incomes, but who pay tax because some or all of their income is gained through employment. A suite of FTCs can target family needs according to family composition, size and income. FTCs can bridge the changing nature of social security assistance to families in the modern world, where two income families and single parent working families are much more prevalent than was the case when unemployment assistance and child endowment were initially introduced. The current Family Tax Benefit Part A and B operates as an FTC where social security assistance is delivered through the tax system

45. PTCs and FTCs are complementary instruments. PTCs are predicated on individuals' taxable income and can target income tax cuts to low and middle income workers without scarce revenue being dissipated to high income earners. FTCs are predicated on family income and can target social assistance to low and middle income families according to family circumstance and need. A system of tax credits can assist in integrating the taxation and social security systems, ironing out poverty traps and disincentives while better targeting need.

46. FTCs can be good or bad, depending on their design features.

47. For some working families, feelings of pride and self-esteem can and do inhibit the take-up of entitlements paid as transfer payments, whereas the same amounts provided as tax credits are perceived as the return of hard-earned taxes paid to the government, of money to its 'rightful owner'. This can assist the genuine alleviation of poverty.

48. However, as well as being a mechanism for delivering assistance to families, FTCs can and have been used to define entitlements to social security assistance. In the US, for example, the entitlement arises as an Earned Income Tax Credit (EITC). Without an earned income, the individual has no entitlement to a corresponding social security cash payment. The result has been that the poor have become increasingly prepared to accept employment at very low rates of pay, thus avoiding the need to increase minimum rates to an acceptable level.

49. In the UK, on the other hand, child and working tax credits, together with substantial increases to minimum wages and direct transfer payments, have led to substantial increases in income for poorer families.

50. Unions support a range of government programs to deliver assistance to the poor, whether employed or unemployed. Tax credits are not a goal in themselves, but one of a range of measures which can be used to assist the low paid. Appendix A to this paper provides further information and discussion about tax credits.

Objectives and Purpose

51. A strong and consistent finding from social surveys in Australia is that the community wants adequate and effective services to be provided by governments at all levels. The community also wants low taxes. By better linking the revenue raised by government to the uses to which it is put, community understanding of and support for the taxation system and role of government can be strengthened.

52. In principle, hypothecated taxes can draw a clearer link between the revenue raised and the categories of expenditure supported by it. For example, the Medicare Levy finds strong community support as a means of funding the Medicare system in Australia.

53. A proliferation of small hypothecated taxes will detract from the objective of establishing greater community clarity about government revenue and public expenditure. Too many specific purpose levies just create a fog of detail and cloud the issue rather than clarifying it.

54. There are also constitutional constraints in Australia preventing the use of 'hard' hypothecation, wherein revenue raised is strictly dedicated to a particular category of expenditure. All resources raised by taxes and levies go into consolidated revenue, from which all government expenditure is drawn. The Medicare levy is a notionally hypothecated tax; in fact it raises only a fraction of the total annual public expenditure on the nation's health system.

55. The Federal Government has introduced a series of small hypothecated levies, overtly dedicated to particular expenditure initiatives. These include the Sugar levy (to raise funds to assist sugar producers), the Guns levy (to fund the gun buy-back program following the Port Arthur tragedy), and the Ansett ticket tax (to underwrite the payment of accrued entitlements to former Ansett employees following the company's collapse).

56. The GST was also justified as a hypothecated tax of sorts, with GST revenues promised to be returned in whole to the States to fund State Government expenditures.

57. Specific purpose levies raise community cynicism when the revenues they raise are not deployed for their intended purpose. The ticket tax raised the cost of domestic air travel and generated some $210 million dollars of revenue for the Federal Government, but delivered nothing whatever to the former employees of Ansett. Similarly, the GST raises substantial revenue, but the States remain unconvinced that all of the revenue it raises will be remitted to them at all, let alone with no strings attached.

58. As part of an overhaul of Australia's income tax arrangements, a broad generic partitioning of income taxes into notional particular purpose

streams offers some prospect of enhancing community understanding of and support for the role of government and the purpose of taxation. Table A2 illustrates some of the possibilities here, in the context of the income tax cut set out in Table A1. Clearly this is an area that needs more work.

Tax Rorts and Revenue

59. To raise sufficient revenue to meet community needs while minimising the tax burden on ordinary workers, tax rorts and loopholes available to and accessed by high income and high wealth individuals need to be identified and closed. This is integral to the achievement of a fair tax system that enjoys community respect. It is an ongoing task in a dynamic world where some individuals seek to reap where they have not sowed.

60. Closing these rorts and loopholes would deliver substantial additional revenue to fund needed investment in health, education and social infrastructure without raising new taxes on ordinary workers.

61. Discretionary family trusts provide tax minimisation options, including income splitting among family members and tax deferral opportunities, for high wealth and high income groups. The Federal Government promised to address this issue in implementing the Ralph review of business taxation by taxing trusts as companies, but has subsequently welched on its undertaking.

62. The private health insurance rebate has failed to deliver any improvement to Australia's health system, but has created a new tax rort for high-income individuals and families[2] seeking to avoid the Medicare Levy Surcharge. The rebate has failed to reduce pressure on the public health system. It has not reduced the escalation in private premiums. It is grossly expensive and highly inequitable.

63. Private provision does not deliver fair community health outcomes because individuals' needs do not in general match accumulations and health risks do not correlate closely with personal circumstances. Pooling risks across the whole community delivers more cost effective health care and fairer access to health services.

64. The 30% private health insurance rebate should be scrapped and the savings redirected into public hospitals, bulk-billing, and preventative programs. The option of redirecting a portion of the savings into Family Health Tax Credits requires further investigation.

65. Executive remuneration schemes create and rely on tax minimisation arrangements including share options that allow the indefinite

[2] **Health insurance tax rort,** Clive Hamilton and Richard Denniss, The Australia Institute, November 2002.

postponement of tax. Further, unlimited tax deductibility of executive remuneration effectively means taxpayers subsidise obscene salary hikes or separation payouts for executives.

66. Income in shares or options valued at more than $1,000 per year should be subject to Fringe Benefits Tax. Individuals' salary expenses in excess of $1 million per year should not be deductible against company income. The superannuation surcharge should be retained for high income earners.

67. Phoenix companies are a device used by unscrupulous operators to avoid legitimate tax obligations. Essentially, companies are sent into liquidation with tax and other payments outstanding, with the same operators immediately setting up new company structures to conduct the same business with a clean balance sheet. New provisions enabling the identification of persons having effective control of successive company structures and holding them liable for outstanding tax payments are required.

68. Sham contractors operate similarly to reduce legitimate tax obligations. Purportedly independent contractors who work almost exclusively for a single employer and under close direction doing the same work as employees, pay less tax than employees, cost their employer less, but take home more money in the pocket. This device is a straight tax dodge. The findings and recommendations of the Ralph review should be implemented to close this scam.

69. Duty free shopping is available only to international travellers, who are overwhelmingly high income and high wealth individuals. The top 20% of households spend five times as much on overseas travel on average as the bottom 20%. Business travel is essentially undertaken by higher paid executive and professional employees, but the duty-free shopping concession is available to them as individuals, not to their employer.

70. The predominant duty waived is no longer tariffs levied on imports to this country, but rather GST and excise otherwise payable on luxury goods, notably alcohol (predominantly spirits), tobacco, and perfume[3]. The cost of revenue foregone is estimated to be between $100 million and $300 million per year. There is a strong case on health and equity grounds for review and substantial restriction of the duty-free concession.

Incorporation and Consistency

71. The differential in Australia between the top marginal rate of tax on personal income, and the flat rate of tax applying to company income, provides an incentive and a means for tax minimisation in this country.

[3] See "**Tax Flight**? An analysis of the 'duty free' system in Australia", The Australia Institute, December 2002

In particular, for many years there has been an apparent trend for high income individuals to incorporate themselves and enter a contract for the provision of services, so as to pay company tax rather than personal income tax on their earnings.

72. While there are costs involved in incorporating, these are largely one-off, but the tax advantages of incorporating continue through time. While personal moral precepts may still constrain many individuals from engaging in a straight tax rort at the community's expense, the strength of this consideration has weakened in the age of rampant individualism and should not be overstated.

73. The company tax regime is a flat tax on income after expenses, where the marginal rate of tax is equal to the average rate of tax. Under the nominally progressive personal tax regime the average rate of tax rises with income, approaching the top marginal tax rate from below. There is an income level where the average rate of personal tax equals the company tax rate; under the present income tax rates and thresholds for individuals and companies in Australia, this is approximately $77,500 per year.

74. Consistency of treatment between the personal and company tax regimes could, in principle, be achieved by cutting the top marginal rate of tax for individuals to equal the company tax rate, at that income level where the average rate of tax for individuals equals the company tax rate.

75. The cost to revenue of such an initiative would be wholly prohibitive and utterly inequitable, unless the liability for payment of the tax was simultaneously shifted from the personal tax system to the corporate tax system. This could be achieved by allowing 50% deductibility as expenses incurred in the earning of company income, for all salary amounts in excess of the same threshold.

76. While clearly requiring further analysis, a change of this character offers some prospect of eliminating the incentive to incorporate as a separate tax dodge in Australia.

77. By allowing companies the option of paying tax under the personal or company tax provisions, micro and small businesses would also achieve a tax cut.

78. The rate of company tax in Australia is below that in most other OECD countries. There is little merit in seeking to engage other OECD countries in a race to the bottom with respect to company tax and some scope for more closely aligning Australian rates with OECD standards.

Table A
Basic Personal Tax Credit

Proposed Targetted Tax Cut

ANNUAL SALARY ($)	COMBINED TAX CUT [Credit plus New Rates] /Yr ($)	/Week ($)	TAX CUT AS % POST-TAX EARNINGS (%)
0	0	0.00	0.0
1000	0	0.00	0.0
2000	0	0.00	0.0
3000	0	0.00	0.0
4000	0	0.00	0.0
5000	0	0.00	0.0
6000	0	0.00	0.0
7000	170	3.26	2.5
8000	170	3.26	2.2
9000	170	3.26	2.0
10000	170	3.26	1.8
11000	170	3.26	1.7
12000	170	3.26	1.5
13000	170	3.26	1.4
14000	170	3.26	1.3
15000	170	3.26	1.3
16000	170	3.26	1.2
17000	170	3.26	1.1
18000	170	3.26	1.1
19000	170	3.26	1.0
20000	170	3.26	1.0
21000	170	3.26	0.9
22000	222	4.26	1.2
23000	352	6.75	1.8
24000	482	9.24	2.3
25000	612	11.74	2.9
26000	612	11.74	2.8
27000	612	11.74	2.7
28000	612	11.74	2.6
29000	612	11.74	2.5
30000	612	11.74	2.5
31000	612	11.74	2.4
32000	612	11.74	2.3
33000	612	11.74	2.3
34000	612	11.74	2.2
35000	612	11.74	2.2
36000	612	11.74	2.1
37000	612	11.74	2.1
38000	612	11.74	2.0
39000	612	11.74	2.0
40000	612	11.74	1.9
41000	612	11.74	1.9
42000	612	11.74	1.8
43000	612	11.74	1.8
44000	612	11.74	1.8
45000	612	11.74	1.7
46000	612	11.74	1.7
47000	612	11.74	1.7
48000	612	11.74	1.6
49000	612	11.74	1.6
50000	612	11.74	1.6
51000	612	11.74	1.5
52000	612	11.74	1.5
53000	582	11.16	1.4
54000	552	10.59	1.3
55000	522	10.01	1.2
56000	492	9.44	1.2
57000	462	8.86	1.1
58000	432	8.28	1.0
59000	402	7.71	0.9
60000	372	7.13	0.8
65000	222	4.26	0.5

Current Income Tax Scales

Income Range			MTR
0	-	6000	0
6001	-	21600	17
21601	-	52000	30
52001	-	62500	42
62501	-	62500	47
62501	-	& over	47

Thresholds

6000
21600
52000
62500
62500

Tax Cut Proposal

Income Range			Tax Credit
0	_	7000	20.0%
7001	_	25000	3%
25001	_	52000	0.0%
52001	_	62500	-3%
62501	_	116667	-3%
Over	_	116667	0

Thresholds

7000
25000
52000
62500
116667

Rates and Thresholds

Income Range			
0	_	25000	20
25001	_	52000	30
52001	_	62500	42
62501	_	62500	47
Over	_	62500	47

Thresholds

0
25000
52000
62500
62500

70000	72	1.38	0.1	|
75000	-78	-1.50	-0.1	|
80000	-228	-4.37	-0.4	|
85000	-378	-7.25	-0.6	|
90000	-528	-10.13	-0.9	|
95000	-678	-13.00	-1.1	|
100000	-828	-15.88	-1.3	|
120000	-1328	-25.47	-1.7	|
140000	-1328	-25.47	-1.5	|
160000	-1328	-25.47	-1.4	|
180000	-1328	-25.47	-1.2	|
200000	-1328	-25.47	-1.1	|
300000	-1328	-25.47	-0.8	|
400000	-1328	-25.47	-0.6	|
500000	-1328	-25.47	-0.5	|
600000	-1328	-25.47	-0.4	|
1000000	-1328	-25.47	-0.2	|
over *	-1328	-25.47	-0.1	|

Proposed Targetted Tax Cut - Cost to Budget **$2,917** **Mn**

* assumes average annual income of $2mn

Table B

Illustrative Structure of Hypothecated Income Taxes

Hypothecated Levies		
	Income Threshold	Rate (%)
Health	0	10
Social Security	0	10
Defence	25000	5
Education (additional to GST)	25000	5
Infrastructure & Environment	52000	12
Government Administration and Other	62500	5
GST (to States)	Final Sales	10

Appendix A

Tax Credits

A Fair Distribution of Income and Wealth

Achieving a fairer distribution of national wealth and income has long been a priority for the Australian union movement. Unions have pursued this goal in three main ways:

(i) directly, through the **wages** system, by seeking to raise award (minimum) rates of pay as well as through collective bargaining;

(ii) indirectly, by advocating the delivery of high quality **government services**, prominently including health and education;

(iii) indirectly, by supporting **progressive taxation and transfer payments**.

A Fair Taxation System

As a share of GDP, total tax revenue collected in Australia is low by international standards. However, for 'average workers' (ie the two thirds of workers earning less than average weekly earnings) personal income tax as a share of wage income is close to OECD average; it is the tax burden on high income earners that is particularly low in this country.

Over the past decade, while the ACTU has pursued and won significant increases in award minimum wages, the income tax load carried by 'average workers' has risen, with low paid full-time workers hardest hit. Two-income families on low to median wages in particularly have been squeezed hard.

The GST impact has compounded the problem sharply for the same group of working people. Indirect taxes are inherently regressive. The costs of the GST package fell most heavily on low-paid full-time workers while the benefits went to high-income individuals.

For this reason, unions have called for tax cuts for low paid workers, while recognising that collection of more tax revenue overall would enable the provision of more and better government services, and higher levels of transfer payments to families and individuals in need.

Under Australia's income tax system, the individual (not the family) is the basic unit of taxation; tax is levied on individuals' incomes, not family incomes.

Income Tax Cuts

Traditionally, income tax cuts have been delivered by (1) raising tax thresholds, or (2) lowering income tax marginal rates.

The former provides *a constant-dollar tax cut* - a flat dollar amount over a range of incomes; the latter provides *proportional tax cut* – a higher dollar amount for higher income earners.

However, unless some marginal tax rates are raised and/or some higher tax thresholds reduced, both measures deliver tax cuts to high-income individuals as well as low and middle wage earners.

Personal Tax Credits

A personal tax credit [PTC] is simply a device for delivering a tax cut targeted to lower income earners without the benefits also flowing to high paid individuals.

The existing '*Low Income Tax Offset*' [LITO] is an example of a PTC. The LITO supplements the nominal schedule of income tax rates and thresholds.

Nominally, under present income tax arrangements, no tax is payable on the first $6,000 of income. Tax is payable at 17 cents per dollar on every additional dollar of income from $6,000 up to $21,600 per year.

However, the $235 LITO cancels out the first $235 of income tax payable. Accordingly, no income tax is actually paid on annual incomes up to $7,382.

The ***nominal*** *marginal tax rate* is 30 cents per dollar on incomes from $21,600 to $52,500. The LITO is withdrawn at a rate of 4 cents per dollar of income over $21,600 until it is completely phased out at $27,475.

Withdrawal of the LITO over this range means that the ***effective*** *marginal tax rate [EMTR]* is 34 cents in the dollar for incomes between $21,600 and $27,475. [For more on EMTRs, see below.]

Family Tax Credits

Family Tax Credits [FTC] have been used in the US, the UK and Canada as *a delivery mechanism* for social security assistance.

Traditionally in Australia, social security assistance to families has been delivered 'on budget', with cash payments to eligible families provided by the Department of Social Security out of consolidated revenue. In contrast to the taxation system, the basic unit for social security assistance in Australia is the family, with benefit levels calibrated against family (not individuals) income[4].

This assistance targets families with low income, whether (some or all of) that income is earned as wages, or whether it is received exclusively as transfer payments (for example, unemployment benefits).

So-called 'tax expenditures' are an alternative delivery mechanism. Instead of the social security assistance being received as a cash payment from the government, families with at least one wage earner receive assistance as a tax credit, offsetting their income tax liability.

It is notable that in Australia, Family Tax Benefit Part A and Part B allows social security assistance to be taken through the tax system. Around nine in ten eligible families take their Family Tax Benefit [FTB] as a cash payment, with the remainder accessing their entitlement through the income tax system as a lump sum payment at the end of the financial year.

To this extent, the Family Tax Benefit [Parts A and B] constitutes a FTC mechanism for delivery of social security assistance.

FTCs can be good or bad, depending on their design features.

For some working families, feelings of pride and self-esteem can and do inhibit the take-up of entitlements paid as transfer payments, whereas the same amounts provided as tax credits are perceived as the return of hard-earned taxes paid to the government, of money to its 'rightful owner'. This can assist the genuine alleviation of poverty.

However, as well as being a mechanism for delivering assistance to families, FTCs can and have been used to *define entitlements* to social security assistance. In the US, for example, the entitlement arises as an ***earned income** tax credit [EITC].* Without an earned income, the individual has no entitlement to a corresponding social security cash payment.

4 A recent exception is the Baby Bonus, which provides for payments in cash or through the tax system to all first-time mothers (generally) in the first 5 years after the birth of their child. In this respect the Baby Bonus has some characteristics of a PTC. The annual quantum of Baby Bonus to which the mother is entitled is calculated on the pre-birth tax paid by the mother (subject to a floor available to all first time mothers). Accordingly, the bonus is distributionally regressive, with higher amounts accruing to higher income mothers who do not return to work after the birth. The level of benefit is reduced as the mother's post-birth income increases above $25,000.

Earned Income Tax Credits

Accordingly, EITCs can and have led to the emergence of differing levels of entitlement, with one level of benefit for the 'deserving poor' (ie those with jobs) and a lower level of benefit for the 'undeserving poor' (ie those without jobs). In this form (as in the US) no cash entitlement whatever exists unless the beneficiary is in paid employment.

A direct consequence of the US EITC program is that individuals in dire need are induced to take a job at any wage in order to access the work-contingent cash benefits available under the scheme. This 'free-to-work or free-to-starve' design feature of the US EITC acts to reinforce and entrench low paid jobs in the labour market and keep wages low.

The low-pay road is no way forward for a fair society.

Unions in Australia emphatically oppose the introduction to this country of the US model wherein differing levels of social security entitlement exist for working and non-working families. In this we join with all major non-government organisations in Australia. There is no justification in the fight against poverty and disadvantage, for the introduction of any new scheme that separates working from non-working families[5].

This is increasingly being recognised in other countries that have considered employment-conditional social assistance arrangements over recent years.

Both the UK and Canada introduced EITC-type schemes in the nineties, but both countries have subsequently abandoned them. While FTC schemes remain as social security delivery mechanisms in those countries, the same level of benefit is available to all families irrespective of their working status. In both countries the distributional impact of the schemes has been highly progressive, with substantial cash gains accruing to the lowest income households [see Attachment 2 below].

[5] The 1988 Labor Family Package, which was strongly supported by the union movement, delivered large increases in disposable income for both poor jobless families and poor working families in a simple way, through the family allowance supplement. This single payment is now FTB Part A. It reduced child poverty by over 25% and improved work incentives at the same time. It provided support for children in low-income families based on family costs and family needs, and was not conditioned by whether the parent(s) were employed. This is a long-standing Australian principle embodied in the family allowance systems and, before that, in the child endowment system.

Effective Marginal Tax Rates

The EMTR for any individual is the combination of the nominal income tax rate and the withdrawal rate for any social security assistance and tax credit to which the individual is entitled.

In the LITO example given above, the EMTR on incomes between $21,600 and $27,475 is 34%, being the sum of the nominal tax rate [30%] and the withdrawal of the LITO [4%].

Similar withdrawal provisions apply to FTB entitlements and other social security payments. For example:

- the *maximum rate* of FTB Part A is withdrawn at the rate of 30 cents per dollar for each dollar of family income above $30,806 per year [$590 pw]. This results in an EMTR of 60% on incomes between $30,806 and $38,276 per year (for a family with one child aged less than 13 years) where the primary earner in a couple earns the extra money, and 47% where the incremental income comes from the secondary earner. These are punitive effective tax rates, with the disincentive for secondary earners magnified by the incurring of child-care and other costs that wage employment entails. Withdrawal of the Medicare levy exemption adds to these EMTRs on low-income families.

- A single person aged 21 years or over but under Age Pension Age, with no dependents, is eligible to receive NewStart Allowance [NSA] if they are unemployed but capable of, available for and actively seeking work. The rate of payment is $380.10 per fortnight. Such a NSA recipient may receive 'other income' (eg from part-time work) without loss of their entitlement. However, for every dollar of 'other income' between $62 and $142 per fortnight, their NSA is reduced by 50 cents; and for every dollar of 'other income' in excess of $142 per fortnight, their NSA is reduced by 70 cents.

    - These NSA withdrawal provisions generate EMTRs of 50%, 58% and 76% (because of the complexity entailed in combining income tests and taxation in the case of a taxable benefit) on wage earnings of less than $16,368 per year (ie from part-time employment).

Consequently, for an unemployed person contemplating moving from benefits to part-time work, and from a little part-time work to full-time work, the EMTR can be a strong and often prohibitive disincentive.

This is a critical issue for reform of social security provisions.

Though the existence of high EMTRs has been raised by employer groups and others in arguing against minimum wage increases, it carries little weight in that context. Analysis by the National Centre for Social and Economic Modelling shows that 85% of workers who rely on the ACTU's Minimum Wage Case (including 77% of individuals employed part-time) face effective marginal tax rates of less than 40%.

A Suite of Measures

As part of an integrated package, tax credits can knock the tops off prohibitive EMTRs and assist the transition from no work to work and from insufficient work to more work. So too can direct reduction of withdrawal rates for social security payments.

Whether any particular package of measures actually does so depends on the specific design features of the package. In this respect, the extent to which any package of social security measures *complements* regular, moderate increases in minimum wages – or is intended rather to *substitute* for such adjustments – is a critical consideration.

Minimum Wages and Tax Credits

Over recent years the 'five economists plan' [FEP] has received much favourable attention especially in the Murdoch press.

This plan proposes a freeze on minimum wage increases with a family tax credit to compensate (some) low-income families. The overt goal of the FEP is to create more low-paid jobs by freezing low wages.

There is no evidence to support the claim that freezing low wages will create more jobs. Moreover, the low-wage earners affected by the proposed freeze on award rates and the low-income families entitled to a family tax credit under the FEP, are distinct and different groups. Some low paid workers would suffer a wage freeze but receive no tax credit, while others would be subject to no wage freeze but would receive a tax credit.

The FEP is a dud. It is intellectually dishonest to claim that the Minimum Wage Case decision of 6 May 2003 [Print PR002003] provides support for the FEP as a job creation mechanism [see eg Peter Dawkins, 'Stop pricing the poor out of employment', **The Australian**, 8/5/2003 page 9]

Some commentators have opposed the FEP on the grounds that it represents a transfer from employers to government (taxpayers) of responsibility for paying decent wages.

While this is true of the FEP, it is not true of tax credits *per se*.

"One of my toughest political fights was to bring in Family Endowment. I had promised it in 1925. The electors had approved. But opposition came from the most unexpected quarter. I was asked to receive a deputation from the Trades Hall. It included some of the more powerful industrial leaders. They asked me to drop the plan. They were afraid that it would be used as a lever to reduce the basic wage."

I Remember, J.T. Lang, Invincible Press, Sydney, First Edition, page 220.

Summary – Key Points

Australia's union movement will continue to pursue a fairer distribution of national wealth and income.

All available options will be considered carefully in pursuit of those goals.

Tax credits are one option available. Whether any particular tax credit proposal can be supported will depend on its particular design features.

In this respect, any tax credit proposal which entails a freeze on minimum wage increases, or introduction of a system of work-contingent social security entitlements, or both, will be rejected emphatically and opposed with vigour.

Appendix B

List of Acronyms

EITC	Earned Income Tax Credit
EMTR	Effective Marginal Tax Rate
FEP	Five Economists Plan
FTB	Family Tax Benefit
FTC	Family Tax Credit
GDP	Gross Domestic Product
GST	Goods and Services Tax
LITO	Low Income Tax Offset
NSA	NewStart Allowance
OECD	Organisation for Economic Cooperation and Development
PTC	Personal Tax Credit

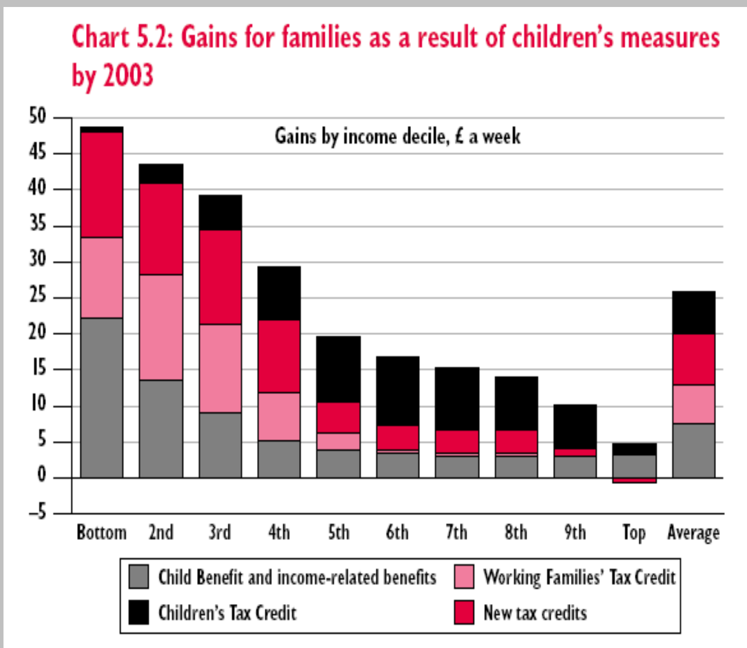
Appendix C

Distributional Impact of UK Tax Credits

In its 2002 Budget the Blair Government established a system of child and working tax credits that provide guaranteed minimum incomes at different levels for different family types.

In 1999 the UK government also introduced a minimum wage. In its most recent review that minimum wage was increased by 13.5% over a three-year period.

The structure of the UK tax credit regime is relatively complex. The working tax credit consists of a basic payment with extra amounts for persons with children, persons working 30 hours or more, persons with a disability and tax deductibility of childcare up to certain levels.



The child tax credit is payable to all persons whether in work or not who have children and consists of a base payment with an additional amount for each child and specific amounts for children with disabilities. Both tax credits are structured so maximum benefit goes to households with the lowest income. As the chart above shows the distributive effect of the tax credit arrangements is progressive.