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Taxation: Which Way Reform?

The recent taxation debate has brought the direction of Australia's present taxation system into question. Michael Evans surveys the recent history of our taxation system to provide a critical examination of the need for genuine reform, not the perpetuation of present inequalities.

An examination of recent government taxation policies in Australia reveals that there has been a steadily increasing emphasis on personal income tax to provide the main basis of government tax revenue. However, that emphasis has fallen disproportionately on low and middle income earners, and specifically those falling under the Pay As You Earn (PAYE) system.

This has happened mainly because the state apparatus, through conservative governments and an even more conservative judiciary, has deliberately allowed a grossly unequal distribution of wealth and income to occur within society. The effects of this have been most notable in the 1970s and '80s, when economic recession, shattering the capitalist dream of Australia being an equitable country for the majority, can be contrasted against massive fortunes gained through tax avoidance and evasion.

- Personal income tax as a percentage of wages, salaries and supplements has increased from 12.7 percent in 1959/60, to 25.3 percent in 1983/84.[1]
- Personal income tax amounted to 35.5 percent of total federal tax revenue in 1959/60, while Budget estimates for 1984/85 indicate that this has now climbed to 53.1 percent.[2]
- The richest five percent of individuals paid 54 percent of personal income tax in 1953/54; now they pay 22 percent.[3]

And yet, in comparison with other O.E.C.D. countries, Australia is not a very highly taxed country. It ranks fifteenth of nineteen O.E.C.D. countries in terms of income tax and social security contributions as a proportion of G.D.P., and eighteenth of twenty-two countries in terms of total tax as a proportion of G.D.P.[4] Why, then, is there both the perception and the reality that personal income tax for the majority is too high? Because the taxation system has consistently aided the process of wealth and income becoming concentrated in fewer and fewer hands, while the burden of providing tax revenue has reverted to low and middle income earners.

Neville R. Norman, in *The Economics of Personal Tax Escalation in Australia*, expounds a theory, from a Friedmanite approach, as to why governments have "of necessity" raised personal income taxes. I do not wish to enter a discussion here concerning the specific method of the economic analysis, but merely to state that I consider the points raised in the analysis to be an accurate historical picture of the approach taken by successive Liberal governments; and, alarmingly, the approach being more and more embraced by the Hawke-Keating forces in the A.L.P.

The theory, in brief, is as follows:

1) The control or reduction of inflation is established as a top priority.

2) Inflation is seen as a problem caused by excessive monetary growth.

3) The government perceives that the only avenue it has to restrict monetary growth is to reduce the domestic deficit.

4) There are mainly political constraints to reducing government expenditures beyond an acceptable "bottom line".

5) This, therefore, necessitates escalation of tax revenues, and those that cause the least political resistance are personal income taxes because they can grow automatically without government action.

The period up to 1970 saw Australia experience sustained economic growth, with low levels of inflation and unemployment. The economic recession and oil price rises of the early 1970s saw successive Australian governments raise personal income taxes. Liberal governments did it to stem inflationary pressures; while the Whitlam government funded increases in mostly socially useful government expenditure. The Mathews Report on the Australian tax system, released in 1975, recommended increasing concessions to business and industry, as well as personal tax indexation. This was subsequently adopted in the 1976 (Liberal) Budget. However, by the 1978 Budget, the Liberal government had increased company tax rates to pay for these concessions, and personal tax indexation was deferred, as well as an income tax surcharge being imposed from 1978 to 1980.

While the Fraser government mouthed expansive rhetoric about fighting inflation and unemployment by aspiring to strict monetarist economic policies, the reality was that total federal tax revenue as a proportion of G.D.P. increased steadily from 1978/79 to 1982/3.[5] The abandonment of full personal tax indexation saw workers take a real wage cut, while personal income tax, and especially PAYE receipts, increased as a percentage of G.D.P. The 1981 Liberal Budget included an attempt to increase indirect taxation by a 2.5 percent general sales tax on a wide range of items including clothing and books; but the Democrats and the ALP defeated it in the Senate. Over the last 20 years there has been a gradually decreasing reliance on indirect taxation as a proportion of total tax revenue, falling from 43 percent at the start of the 1960s to 31 percent in 1983/84.[6]

The ACTU/ALP Accord signed in 1983 just prior to the election of the Labor government gave a commitment to dismantle the tax avoidance and evasion industries, reform corporate taxation, reduce the relative incidence of indirect taxation "because of its regressive and inflationary nature", and annually adjust personal tax rates for inflation. Thus far, the Labor government has given moderate personal income tax cuts, but has not indexed tax rates. It has fundamentally ignored its commitment to the Accord and ALP policy in its approach to economic management and the financial system.

Tax Avoidance

The inconsistencies and loopholes in the Income Tax Assessment Act have spawned a massive growth in the tax avoidance industry in the 1970s. Australia has never had an effective capital gains tax, and tax avoidance has boomed largely as a result of the artificial, yet strictly legal, distinctions certain income earners are able to make to intentionally reduce the level of tax paid. This process was actively aided and abetted by a sympathetic High Court under the reign of Sir Garfield Barwick which, in the mid-1970s, effectively destroyed Section 260 of the Act, the "catch-all" section for dealing with avoidance.

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This signalled the growth of the tax avoidance industry, and large numbers of accountants and lawyers were able to devise highly successful avoidance schemes, thus providing an increasingly profitable service to income earners outside the PAYE system. It was only when the full extent of the sums involved were made public by the Costigan Royal Commission that there was a public outcry to do something about it. Section 260 was replaced by the more effective Part IVA of the Assessment Act in May 1981. However, the Democrats have consistently defeated attempts by both Liberal and Labor governments to introduce retrospective legislation to recoup lost revenue. Former Special Prosecutor Roger Gyles recommended to deaf ears, for a number of years, that an attempt should be made to resurrect Section 260 to combat company stripping. A case was finally put to the High Court and, with the exit of Barwick, received a favourable decision.

But this situation is likely to continue until a) the government has the political courage to implement an **effective** capital gains tax — one which treats net capital gains as ordinary income and taxes them at normal rates; and b) the government recognises the necessity to increase resources in the Australian Tax Office to enforce effectively compliance with the Act.

A Consumption Tax on Staples?

The Administrative and Clerical Officers Association (ACOA) Taxation National Delegates Committee made a detailed submission to the Treasurer in March 1984 on reforms which were necessary to administer the Tax office more efficiently. While suggesting significant changes to the Assessment Act to curb avoidance and evasion (the suggestion of increasing penalties to more realistic deterrent levels was subsequently taken up by the Labor government in the 1984 Budget), the submission conservatively estimated that, even under existing legislation, an increase in staffing levels of some 4,800 people in the Compliance areas would result in a **net** revenue increase of $150 million per year.

The recent Auditor-General's report on tax administration was highly critical of the inefficient use of resources within the Tax office. The report stated that the office was mainly geared to catch the small PAYE taxpayer cheating on deduction claims, while revenue lost from dividend and interest income omitted from returns amounts to $500 million a year. The Taxation Commissioner has recently foreshadowed a change to a "self-assessment" tax system to be introduced from July 1986. Hopefully, this will mean a greater utilisation of resources in order to monitor efficiently compliance with the intention of tax legislation. Other significant changes suggested by ACOA in its Tax Reform submission to EPAC are elimination of "tax perks", the artificial disguising of income as some other benefit which is available to many income earners; also the ridding of the system of all tax expenditures, restoring the Assessment Act to its original purpose of raising revenue rather than providing hidden assistance to certain sections of industry and certain types of taxpayers.

The Corporate Sector

The last 20 years have seen an increasing decline in the share of total tax revenue paid by the corporate sector. Company tax has fallen from 18 percent in 1960/61 to ten percent in 1983/84.[7]

Proposals made by the Communist Party of Australia in its submission to EPAC, *A Case for Radical Tax Reform*, include:

•taxing company profits on a progressive scale based on rate of return on paid-up capital
•eliminating tax deductions and allowances now claimed by corporations. Tax expenditure granted to industry in 1983/84 amounted to $670 million, while advertising costs as a deduction exceed $1 billion a year
•stopping methods used to reduce company tax such as transfer pricing, and the latest concession of allowing losses of subsidiaries to be offset against income of others.

The Rightwing Offensive

The former Secretary to the Treasury, John Stone, recently spelled out the blueprint of what international capital's expectations are of the Australian government's approach to economic management. These include:
a) the breakdown of full wage indexation;
b) specific spending cuts in policy areas which appear ideologically "hard" for a Labor government;
c) restoration of clear monetary targets;
d) deregulation of interest rates.

The implementation of some or all of the above points would see the end of the ACTU/ALP Accord, and an inevitable lowering of living standards for the Australian working class. The massive political, economic and ideological offensive being waged by the international ruling class should not be underestimated.

Now that the Australian dollar is even more susceptible to the whim of overseas financial markets, we are seeing the results of threats being made to force the Australian government to "toe the line". The first was the announcement of massive cuts to the forward spending estimates. Is the next step to be the discounting of full CPI increases to wage earners for the "cost" of devaluation?

Aims of Progressive Tax Reform

The present tax reform debate provides an opportunity to combat this offensive by struggling for progressive reform and starting to redress the present inequities.

The two main principles involved in the achievement of progressive tax reform should be:
a) horizontal equity — that those receiving the same amount of income, **regardless of its source**, pay the same amount of tax;
b) vertical equity — that those receiving higher levels of income, that is, having a greater ability to pay, contribute proportionately more.

The tax reform debate, as far as the government is concerned is presently centred around which method is most appropriate for maintaining existing levels of tax revenue, but without serious examination of the question of who pays, and who doesn't. This is precisely what makes the present arguments about broad-based consumption taxes vs. personal income taxes so significant.

While it is valid to say that the rates of personal income tax are at unacceptably high levels for the majority of people, a switch to a broad-based consumption tax will only increase the inequities which have historically occurred in the tax system.

A prescription for progressive tax reform must include the following:
•an increase in total tax revenue to allow for redistribution of income and wealth in Australia, to provide real employment and improve the living standards of low and middle income earners;
•a more equitable sharing of the tax burden according to ability to pay;
•a recognition of the relationship between the taxation and social security systems, and the importance of guaranteeing economic security for all.

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