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"AVOIDANCE AND EVASION - BROADENING THE INCOME TAX BASE"

BROTHERHOOD OF ST LAURENCE SPEECH TO NATIONAL TAXATION SUMMIT

By Bishop Peter Hollingworth

Tuesday 2 July 1985

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Bishop Peter Hollingworth,
Executive Director,
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Yesterday I advocated three major objectives for tax reform: increasing the real disposable incomes of low income groups; improving the progression of the total tax system; and stimulating economic and employment growth.

These are the essential objectives to make our tax system efficient and equitable and to make possible an attack on poverty and inequality. We do not believe it is possible to achieve our objectives if tax reform proceeds along the path of Option C.

It will be possible if tax reform focuses primarily on income tax.

Current disillusionment with income tax is caused by several problems, including

- the growth of the income tax burden for wage and salary tax payers;
- the fact that people on average weekly earnings and above have been subjected to increasing marginal tax rates; and
- expansion of avoidance and evasion.

The way these problems are diagnosed determines what we do about them. We are concerned that the people with the most influence on defining the current problems are high wage and salary earners who see their peers outside the wage system enjoying the rich rewards of a tax free lifestyle. It is high wage academics, public servants and businessmen who most strongly advocate a shift away from income tax.

We suggest that this somewhat narrow perception of problems is why horizontal rather than vertical equity has been the dominant theme of the tax debate and why high wage and salary earners will be the major winners under the proposals of Option C.

It is true that during the 1970's our income tax system experienced a rapid and demoralising decay. A combination of a narrow base, bewildering legal judgements, poor tax administration and the proliferation of tax concessions and their associated shelters made this almost unavoidable. We do not doubt that tax morality is fragile. What we challenge is that it is irreversible.

The argument for a radical shift in the tax system is based on the unproven assumption that the present system is in tatters and cannot be put together again. The case has not been made as yet and I invite the Treasurer to elaborate on why this drastic measure is necessary. Meanwhile I continue to believe we can re-establish the income tax base and systematically and significantly attack all its problems at the same time. This must be our first priority.

In the past income tax reform has not succeeded because it has been piecemeal.

Option A provides a start to comprehensive reform. The income tax broadening measures would make the tax system more progressive. The White Paper demonstrates that proposals relating to negative gearing; film concessions; capital gains; and farm loss write offs will bring a higher percentage of additional income into the income tax base from higher income earners.

The figures in the White Paper are an indictment^C of the unfairness of the current situation.

We support the income tax broadening suggestions in Option A but suggest they do not go far enough. They need to be complemented by a number of other measures. These are documented in detail in our second submission on tax reform to the Economic Planning Advisory Council and are further discussed in our critique of the White Paper. In summary they involve the following steps:

First, as the Prime Minister has already declared in his principles for tax reform, we must move decisively to smash tax avoidance and evasion. However, it is important that we distinguish between removing the incentives to avoid and evade, and removing the opportunities. Option C, gives greater weight to reducing the incentives. But

it is probably more important to systematically close off the opportunities to evade and avoid. Since coming to office the Government has made some significant steps in this direction, with large revenue gains. The capital gains tax proposed in the White Paper will provide another plug in the leaking direct tax base. A wealth tax would be an important complementary measure to further reduce the opportunities to evade and avoid.

Further steps include:

- reducing the use of provisional taxation and extending withholding taxes more generally to all non-PAYE incomes;
and
- administrative changes within the tax office to improve its capacity to investigate tax avoidance and evasion,
and
- developing a system of self assessment.

Second, action must be taken to reduce income splitting and to reform the tax treatment of trusts. Estimates vary but it has been suggested that another \$500 million can be gained by closing off these loopholes.

The Brotherhood agrees with the Draft White Paper's preference for retaining the individual as the tax unit. This is important because, as the White Paper acknowledges,

- in terms of equity, it can achieve fair treatment as between individuals;
- it minimises distortion of the choice between paid employment and non-taxable activity (especially for married women); and
- it is consistent with Government policy of promoting equal employment opportunity and of furthering the independence of women.

The Government's lack of action on income splitting is inconsistent, however, with its advocacy of the individual as the tax unit.

Third, all tax concessions should be reviewed to determine:

- whether subsidy by the taxpayer of a particular activity or to a group is still required, and
- if it is required, whether it would be more appropriately provided through government outlays.

The Brotherhood supports providing assistance through government expenditure rather than through tax concessions. We believe this is more equitable; provides less opportunities for tax avoidance and therefore increases revenue. Furthermore it allows better targetting of assistance. It also ensures

greater accountability for the benefits gained. I note that the proposed rebate for medical expenses of over \$1,000 per year will provide few benefits for low income earners..

We also believe that the rate scale changes associated with Option A are inequitable and must be changed. Priority must be given to reducing poverty traps and the high effective marginal tax rates facing many low income earners. We will be taking this up in more detail later.

Further tax cuts should concentrate maximum benefits to low income earners.

We believe the best solution to reducing the marginal tax rates facing average weekly earners is to increase the thresholds at which the 46 and 60 per cent rates apply.

Associated with tax indexation this would provide a more lasting solution to the problem of bracket creep. However priority must be given to substantial increases to the tax free threshold so that people on very low incomes do not pay tax.

We acknowledge that our proposals for further broadening the income tax base will create political problems. But we believe the community will find reform of the direct tax base more acceptable than a broad-based consumption tax. Our estimates suggest that the potential revenue from further broadening of the income tax base, plus a wealth tax package, would be more than double the \$2.8 billion estimated in the

White Paper as available within 5 years. In comparison, the broad based consumption tax will deliver only a net additional \$1.3 billion.

An expanded Option A will provide sufficient revenue to provide significant tax cuts to low and middle income earners, to lift almost all pensions and benefits above the Poverty Line and improve the overall equity and efficiency of our tax system.

The Brotherhood does not believe we can expect more from the Government's courageous commitment of tax reform.

The emphasis must be on the longer term. We must not be constrained by the immediate need to give substantial income tax cuts. We are facing the results of decades of neglect. The challenge for the government is to take the longer view and to achieve worthwhile, equitable and lasting reforms. Reform that will serve us well for the decades to come and that will restore people's faith in the certainty and fairness of the taxation system.