TAXATION

The power to tax is the power to destroy.

In to-days society we are everlastingly preoccupied with taxation. Amongst thoughtful people there is mounting concern about how far the redistributive function of the taxation system will be taken. Along with the power to govern we have put in the hands of our elected representatives the power to tax which is, indeed, the power to destroy. It is with the exercise of that power that we are concerned.

In Parliamentary debate, in the media, in books and speeches there is constant reference to the generosity of governments: "The Government provides capital and operational subsidies for a wide range of child care services"; "The Government has made available initial funding to promote the Year of the Family"; "The Government has provided for housing assistance, regional planning and general purpose grants to the States" and so on and on.

All of this is fiction! Government has done no more than to direct aid and grants here there and everywhere. The providing is done by the taxpayers and that without consultation. But so general is the idea that governments scatter all blessings upon us that it seems necessary to establish the fact that governments have no money except that which they demand - with menaces - from the taxpayers.

If that can be kept in mind we might take a different view of the triennial election-auction at which all candidates for office will make lavish and expensive offers in the hope of buying the electors support - but with their own money!

True, in addition to taxes, governments may raise loans. But the interest on those will be paid by the taxpayer who will also be obliged to repay the loans unless, as is customary, they are refinanced so that in the fullness of time the responsibility for repayment will fall on future generations.

Taxation is generally regarded as an instrument for collecting revenues to be distributed to the nation in services and benefits. It is also a most effective system of redistributing incomes via "social transfers", that is, from those who have earned their income to those who haven't. The Tax Office goes so far as to claim it is an instrument of social justice in this Robin Hood exercise although how justice is served by confiscating one person's property to give to another I cannot understand.

But of increasing concern is the evident effects of the tax regime reaching deep into the nations social structure to touch, mostly adversely, the lives and aspirations of an entire people. That we have been raising public revenues in much the same fashion for so long doesn't prove the absence of an alternative. Any objective study of the deleterious effects of the present tax regime on the Australian economy and our people provides powerful inspiration to find it! In searching for effective real reform we must be prepared to break new ground.

Taxation is a necessary evil, but it need not be nearly as evil as it is!

Given that the widely held, but mistaken belief that the present form of taxation is the only one available, there are simple rules for its imposition which any government should follow if they have real concern for the welfare of the people they represent.

First, any tax should inhibit as little as possible the production of the wealth from which it must be paid, its collection should involve a minimum of effort, it should bear as directly as possible on the ultimate taxpayer. It must cost the people as little as possible above what it yields to the government.

Its application should leave no opportunity for avoidance and/or evasion by taxpayers or corruption within the taxing authority. It should bear equitably on all without contrived advantage or disadvantage to any.

Measured against these canons of taxation, all of our present multitude of assorted tax measures fall short on one or all counts.

Meantime there has been tremendous growth in taxation legislation. No session of the Parliament passes without amendments and additions to tax legislation all capable of adding another thirty or forty pages to the volume.

Back in 1991 when there was something of a campaign to have the Income Tax Assessment Act of 1936 rewritten in simple English it was disclosed that the Act had expanded from 127 pages in 1936 to 5,000 pages with annual additions and amendments. Nevertheless it is still only a part of taxation legislation administered by the Australian Tax Office, the total running into more thousands of pages covering some 12 Acts dealing with eleven heads of taxation. In 1992-93 no less than twenty two taxation bills were presented to the Parliament for debate, eleven of them classified as "major". Within that time there were fifty five amendments to various acts within the taxation "stable".

There were sixty changes in tax measures announced in Budget and Treasurer's statements during the 1993 Election period. But as befits Government objectives at election time these were all reductions!!

The University of Sydney, and doubtless other Universities are now offering degree courses in Taxation pointing out that "New taxes and other refinements of the tax system have added an enormous volume of legislation which affects every aspect of business and private affairs". And again, "There is an annual avalanche of official tax material".

How right that is when Butterworths Weekly Tax Bulletin disclosed that in a representative year 2054 pages of new legislation and more thousands of pages of explanatory memoranda joined the Law library.

Where once the administration of the tax affairs of an individual or a company fell easily within the competence of a reasonably qualified accountant he must now be a perpetual student.

The tax law has been added to and amended so widely and so consistently, becoming a system so complex as to challenge the competence of the accountancy and legal professions to keep their knowledge of it in line with its growth. Taxpayers are constantly at risk through uncertainty and genuinely fear the draconian punishments the Tax Office is authorised to apply for misdemeanours.

The call is constantly repeated for simplification and co-ordination but the sheer magnitude of the task must cast doubts on whether it will ever be done.

One characteristic of tax, whatever the measure, is the arbitrary fixing of tax rates. Few question why, for instance, the base income for the payment of 20% tax should be $5,401 or why incomes above $36,000 should now be divided into three rather than two stages. On what basis does bird seed pay 20% sales tax if you feed it to caged birds when you can feed the same bird seed to the yard sparrows tax free! What reason, other than the need for more revenue, has sent the Excise on petrol soaring from 5. 16 cents per litre in 1980 to 25.77 cents per litre in 1991?

Tax on individuals doubled in the ten years to 1994 to contribute about half of Commonwealth tax revenue.

Somewhere in the income tax scales between nil at $5,400 to 47% above $50,000 per annum, there must be a reason for the "rests" perhaps known only to Treasury who have the data to signal the numbers of taxpayers close to the "border of discontent" - the point at which the next higher rate takes over.

But certainly there is an inhibiting factor in the graduated tax scales when taxpayers become unwilling to work harder or longer because of losing what appears to be a disproportionate amount of additional earnings in tax. In dollars and cents it may be of little concern. Psychologically it is a powerful influence against productivity.

As it stands the taxation system is fundamentally destructive regardless of the policies of whatever political party is in government. It destroys not only the inclination but also the ability to save. It reduces the incentive to strive for commercial and financial success by applying increasing tax rates on rising incomes based on the so called ability to pay principle. It imposes on every taxpayer a burden of costly and time wasting administration and an ever rising level of government intrusion into what should be private affairs. Beyond the receipt of unearned increments through activities closer to speculation than investment, higher incomes will be earned, in the main, by those who carry greater responsibility and bring to bear on their work increased capacity, effort and dedication. Amongst them will be the leaders of industry, commerce and the professions, the very powerhouses of our society.

What we are really taxing is their ability to earn and since tax carried to extremes, inhibits effort, our tax system can, and undoubtedly does, discourage effort on the part of those responsible for the management of a significant sector of our economy.

There is broad general acceptance of the idea that the wealthy should pay because of their perceived ability to do so. But equity is not served where the ability to pay principle holds sway.

Clearly, income alone does not accurately reflect one's ability to pay. People on equal incomes may have widely differing financial obligations. For some of these inequities governments will attempt to compensate by deductions, concessions, endowments and so on. There is capacity to tailor these benefits to the electoral advantage of the government in power. Low grade corruption, not of officials, but of government itself is then possible.

Company tax is a battlefield on which competing cohorts are constantly on the alert. On the one side are the cost accountants and the legal profession poring over complex and often poorly drafted tax law, unread by members of the parliament and always inadequately debated. The consequence is potential loopholes permitting the arrangement of company affairs so as to avoid taxation. On the other side are the competent, dedicated and highly experienced men of the tax department now equipped with the power of computers who will also take note of every effort to defeat the legislation and escape the tax. Inevitably, in a regime so complex, there will be loopholes in the tax law but where one is found, the Treasurer will be quick to close it up, all too often by a press statement making the practice illegal forthwith despite the absence of properly constituted law to that effect. Enabling legislation may not issue for six months or more.

For that period the Treasury, not the parliament, will have made the law. Its full provisions must remain unknown to those most affected and the democratic right of the people to be fully informed of their obligations under the law will have been denied.

The shortcomings of the taxation regime as applied to personal income reappear in its application to commercial companies which, while having an identity of their own, are no more that co-operatives of people who contribute the capital necessary to start and carry on a major enterprise. Here the taxgatherer is not interested in companies that make a loss although they may offset losses against future profits, if any, for tax purposes.

But the government does insist on being a 33% shareholder in successful companies no matter how little their profit may represent as a return on shareholders' funds. The claim of the revenue rates ahead of that of the owners of the company, the contributers of the capital. There are no graduated tax scales according to the quantum of profit here.

But again, profits generally reflect efficiency, good management, successful innovation and perhaps fortunate outcome of risk taking, all qualities we need in industry and commerce. Once again it is the ability to earn which is being taxed.

It is relatively recently that the government moved to recognise the long standing and legitimate complaint amongst company shareholders having to meet double taxation on their company's earnings, once in the form of company tax and a second time when the residue reaches them as a dividend. Now there are murmurings of complaint that tax free dividends paid out of already taxed company earnings only benefit major income earners. Company returns will show that up to 80% by number of shareholders in Australian industrial enterprises are small holders. The big investors will be companies administering the funds of thousands of people through insurance, superannuation funds and the like.

Such savings and support of industry through investment should have all the encouragement government can give.

With government constantly calling for more savings and more investment in industry and commerce there are other aspects of the situation which might profitably occupy their attention.

With their earnings falling through the depression of the late 80s, companies have turned increasingly to borrowed funds to support industrial expansion where investors are reluctant to invest for low returns. Borrowed money is easy to come by. The interest paid on it is tax deductible.

Shareholders funds invested in a company stand in precisely the same relation with respect to the company's operations as do borrowed funds. However, whilst interest is a charge against a company's earnings, the shareholder is last in line for a variable return, if any, on his investment. In equity, there is a good case to be made for return on shareholders funds to rate equally with the interest on borrowed funds as deductible from the company's taxable income and to earn an equivalent rate of interest. Nothing would give a greater fillup to industrial investment and promote community savings. The immediate response to the reform would have to be a flood of investment capital available and an upsurge in business activity. Meanwhile the cost of the tax exercise mounts and the taxpayer foots the bill.

Under the tax office's recently introduced self assessment arrangements business may now calculate their own tax payable. But woe betide them if there is a mistake, deliberate or accidental. Detection and penalty will surely follow as the tax office's four thousand experienced tax auditors descend on the business community to hunt down the miscreants. Some of them virtually take up residence in the head offices of major companies. The practice adds new difficulties to company management.

Every company's Boardroom has a notional chair provided for a notional tax officer who is notionally consulted on major decisions. How many great initiatives have been set aside, how many reasonable business risks have been rejected because of their possible effects on company's tax obligations where differing interpretations of confused tax law may land the company in costly litigation, will never be known.

And, of course, companies have to wrestle with other wasteful procedures. Among them is that associated with depreciation of plant and equipment, particularly in times of rapidly developing technology which can render equipment obsolete in a year or two against the much longer period permitted by the tax office to write it off. All too often this results in the retention of inefficient production equipment where government is calling for greater productivity. On the other hand there is some machinery which, even after years of service, can command a resale price in dollars above its new cost entirely due to inflation. The margin over the written down value is a profit and taxable although the same inflation which produced it will have increased even more the cost of the replacement. Here again is the evidence of the baneful effects of arbitrary depreciation rates.

But the Treasurer's job is to collect revenue and in doing so he denies the productive efficiency for which government is constantly calling.

There must be a better way!

Perhaps there is no tax which gives greater concern to business administration than the Sales Tax with its almost universal application at rates fixed in the most arbitrary fashion, its classifications and rates under constant amendment. The use of a product in one industry may render it taxable whereas the same product in another application may be tax free. It is certain that many users will be paying tax on items which, in fact, are not taxable -

so difficult is it to be sure of rates and how they apply despite the enormous manual of rates, classifications and exemptions!

Much of the cost of sales tax is hidden in the final price to the consumer who complains, sighs and pays. It is left to the supplier to do the accounting, to decide between classifications where duality of use is possible, collect the sales tax and remit it to the Tax office. The Tax Office calls for payment of sales tax in 21 days. The business may not recover the amount from the client for 60 or 90 days, perhaps even longer under difficult trading conditions. For that period the business is financing the Tax Office probably out of an overdraft. It's profit falls or it's losses rise and all for the pleasure of being the unpaid tax collector. The popular assumption is that the merchant carries this cost but in fact the cost of all of this administration becomes part of the price of goods to be paid by the consumer.

To operate an equitable three tier Sales Tax scale is, of course, an impossibility. It calls upon bureaucracy to decide appropriate tax rates to be applied to items as diverse as birdseed and tractors. But above all, the government is firm in putting on alleged luxury items a punitive tax assuming, once again greater ability to pay because a buyer dares to buy a higher priced item out of income which has already borne the top rate of personal income tax.

To raise the sales tax on some imported automobiles from 35% to 50% as was done in the 1989 budget could have no noticeable effect on an adverse balance of payments certainly running above $1 million and mostly over $1.5 million dollars a month, nor did it make appreciable contribution to the revenue. It was a politically inspired move to punish the so called rich and, on the way, to collect a little more revenue from a group so small in numbers as to have no effective voice of protest. The early abandonment of the impost, the imprimatur of Government mismanagement, was inevitable. Under the political dictum of "never apologise" the Government withdrew the measure leaving that section of the motor trade disrupted.

Sales tax is unfair in that expenditure in the higher income brackets is from income already taxed at the highest personal rate. By the time all of the taxes imposed on the ability to pay principle have been paid, the ability to pay must surely have disappeared. Over all the fact is that very few of the increases in Sales Tax have ever been publicly declared or debated and most of them have been fixed by executive decision. Sales Tax raised $1.86 billion in 1980. Sales Tax revenue rose to 9.4 billion in1989 and continues upward.

From Sales Tax when originally established in 1930 at a single tax rate with limited exemptions the field has now become a multi rate tax with a large spread of exemptions and with rates that are more apt to rise than fall as the government seeks ever more and more revenue to fund its more exaggerated spending proposals.

Customs and Excise taxes fall into something of the same category as Sales Tax in that thoroughly arbitrary decisions are made in respect of classifications although there is a thin veneer of argument that Customs duties are applied to protect local industry.

The application of an import duty simply increases the price of cheaper imported goods hiding the fact that in Australia we have a high cost of production industrial situation which calls for the protection of inefficient industries. Where there is justification for reserving the local market for our domestic industry on the grounds that it is essential to Australian security in a market which does not support the most economical level of production it is best achieved by bounty.

One particular reference which may not be out of place is the excise duty payable on petroleum products and tobacco. Not only do these two commodities hold a captive market, the first through necessity and the second through addiction, they were always good for an increase in duty in any budget but understandably not without public criticism and complaint. To obviate the annual wail, the government cynically indexed them so that the price rise would be automatic and less subject to public notice. After all the petrol price is always volatile and there is decreasing sympathy for smokers.

Payroll tax is a State instrumentality. But we are dealing with Public revenues including those of the States. As well, the tax has the same punitive effect on the consumer as any other tax. It is perceived as a tax on employment which, of course it is. It can and does, discourage employment as small business employers struggle to keep their payrolls below the tax free threshold.

In periods of economic stringency where price cutting in industry and commerce is rife, maybe the market will not bear the additional cost of payroll tax. The manufacturer or trader must stand the loss.

Not inconsiderable as a contributor to the revenue is the Fringe Benefits Tax. The fact that industry was unable to reward higher achievers without paying an equivalent amount in tax undoubtedly spawned the salary packages in which non taxable fringe benefits loomed so large. But this possibility disappeared with the introduction of Fringe Benefits Tax. It must be accepted that fringe benefits are a part of earnings and should be equitably taxed as such. Fringe benefits tax imposed on employees a clumsy exercise in record keeping and on the employers a responsibility to pay tax on somebody else's earnings. Obviously the government would have in mind that there are relatively fewer contributors than recipients of benefit and hence less complaint.

Anybody who looks for logic in the imposition of tax need only repair to the Commonwealth's Debits Tax and the States Financial Institutions duty where deposits and withdrawals from bank accounts are taxed to raise $360 million for the Federal Treasury. There is neither logic nor equity in this, or indeed in most taxes.

Once people can be made to understand that all taxes, other than personal income tax, filter through to the consumer in prices for goods and services, there will be a volume of complaint that the government will not be able to ignore. But most of the present tax regime does offend the already stated canons of taxation. It is destructive, it discourages production wastes time and effort and diverts peoples attention from production to compliance which is enormously costly.

The Tax Office may refer to the fact that the cost of collecting the tax amounts to only 1.2% of revenue. That is the visible cost. The invisible cost is that of taxpayers' compliance with the multitude of laws, regulations classifications, exemptions and so on which characterise the tax regime.

The major and unrecorded cost of the tax regime lies in compliance both by the department itself and by the multitude of taxpayers both private and corporate who, between them in a representative year, lodged 11.5 million taxation returns and received 7 million notices of assessment as a consequence.

That, and other activities of the tax office produced an administration bill of something over $700 million as reported by the Taxation Commissioner. Unreported is the real cost of compliance with the Tax Office demands now so involved that 7 million taxpayers resort to the services of tax agents to prepare their returns. There is no record of the cost of this service by the 23,000 registered Tax agents throughout the country but it all adds to the cost of compliance.

Nor can there be any real assessment of the undoubtedly high cost of keeping tax practitioners up to date with the everlasting amendment and extension of the Tax Act.

A study commissioned by the recently established Taxation Research Foundation reported that the cost to individual taxpayers of complying with the tax law could run as high as $3.8 billion, the cost of preparing 7.1 million returns through the tax agents must be added to the value of time spent by the average taxpayer either in preparing his own return or in assembling the material on which his tax agent will work. It is estimated that the average taxpayer will spend his own time valued at $300 in this preparation whilst his Tax agents fee will average $240.

These are costs to be borne by the taxpayer and virtually added to his tax account all because of the complexity of tax legislation.

Much the same influence lies behind the growth of the black economy with its avoidance of tax which amounts to minor corruption. Objection to the considerable tax penalty on the earnings of extra effort outside of normal employment is deeply held. Income tax avoided by "cash in hand" agreements between employer and many employees, mostly on casual contracts, would amount to millions of dollars a year and any attempt to control it can hardly be successful when there is financial advantage mostly to both parties to the agreement.

I write not of things as they should be, but of the way things are.

One can only guess at the amount of income unreported by age pensioners and recipients of unemployed and other benefits doing odd jobs and by tradesmen "moonlighting" in after hours private work or even through formal double employment although tax numbering has limited the opportunities for that somewhat. Here reporting would only result in a reduction of income and particularly of pension income, leaving pensioners virtually working for nothing. If either employee or employer were obliged to report such casual payments the availability of labour for these marginal assignments would disappear. Both parties to the agreement would be disadvantaged. Although it has to be admitted that money earned should bear its measure of tax, there is a human dimension to this kind of situation which can hardly be reached by the law.

So the entire picture which emerges is of a great burden of taxation imposed on the multitude of taxpayers with the government distributing the burden in the most arbitrary fashion, constantly changing its format according to its own changing perception of public attitudes, removing a tax here where it appears to be hurting too much and putting it on somewhere else where it will produce less complaint. It is a fact that taxpayers cannot be persuaded to co-ordinate their complaints which leaves the government free to move at it's own discretion. Individual taxes are applied to so many disparate groups that a change in one produces no audible complaint from people who feel themselves not to be involved. This process, continued long enough, will allow the government to increase it revenues almost without serious complaint. It is "plucking the chicken without raising a squawk!".

It is the embodiment of the divide and conquer strategy. It is guerrila warfare!

From the individual trying to keep his head above water where prices rise faster than wages and rising wages may push him into a higher tax bracket, to the business man trying to come to grips with a multitude of ever changing tax laws and rates the situation is becoming chaotic.

The need for tax reform - real tax reform - is obvious. What "reform" we have had has merely moved the pieces on the chessboard redistributing the tax burden amongst the same taxpayers as the overall burden of tax rises from year to year.

We must surely conclude that we are doing something wrong!

Happily there is an alternative.

It is that the present taxation regime should be swept aside completely and in replacement all tax revenues for the three arms of government should be collected from a tax on land values which would be adequate to fund essential government operations, particularly at the substantially reduced cost of government which would result from that reform.