Dr. Ken Henry AC
Chairman Australia's Future Tax System Enquiry
The Treasury
Langton Crescent
Parkes
ACT 2600

Dear Dr. Henry

CONTRIBUTING TO TAX WITH EQUITY

I request that the Committee considers the following two suggestions which fall into social equity & simplicity aspects of your enquiry, specifically addressing Term of Reference: 3.5, 4.4 and 8.

A. Retrospective Tax Law, Countering Tax avoidance
This is addressed in Annex A

and

B. Contiguous Income Tax rate
This is addressed in Annex B.

I thought you might like to consider the subjects for your upcoming discussion paper.

I intend to do more work and research on both but particularly Contiguous Income Tax Rate with respect to its benefits to society, effects on revenue and best fit.

I would therefore propose to put in further written submission(s) and would be willing to discuss the subject with the Secretariat and your Committee.

I would be grateful for feedback in case I have not explained the issues clearly enough.

Yours sincerely,

Simon J Fisk
B.Sc.(Aeronautical Engineering), Dip.Ed., Dip.Comp.St

Saturday, 17 May 2008

Annex:
A. **Retrospective Tax Law Countering Tax Avoidance**
B. **Contiguous Income Tax rate**

<u>RETROSPECTIVE TAX LAW – COUNTERING TAX AVOIDANCE</u>

1) I propose the common use of Retrospective Taxation Law.

2) Our system of government, quite rightly, requires debate and discussion about laws but the delay this implies means that those less "responsible" citizens have the time to contrive systems that minimises their social obligation to pay tax.

3) These schemes might be 'legal' at the time but the Parliament might not think of them as being in the spirit of paying ones fair dues. By the time new legislation is enacted these less than ethical people have moved onto other schemes.

4) This is not only a cost to society in lost revenue but also in compliance costs where Parliaments and the public service are always in 'catch-up'. My suggestion will break that wasteful cycle.

5) Ideally then the taxation law should be stated in principles, in simplest of terms, just say:

> "If your wealth increases you pay tax".

6) Behind that would be law or guidance that clarifies for those who need it about the right thing to do. The quantity of the new law ought to be considerably less than at present. The drafting of such law would not need to be done over night.

7) If there were a common genuine use of Retrospective Tax Law then contrived tax avoidance, bordering on evasion, would be reduced considerable overnight.

8) My reasoning is that if someone was trying to conceive a scheme that minimised their tax obligation they would think carefully whether it fitted the 'principles' and therefore the likelihood of retrospective taxation law being brought in. This would then make them think about the likelihood of paying tax, plus interest/penalties they might incur. They will know that they will get caught in the end.

9) I appreciate that this is perhaps a novel innovative way of looking at taxation and I appreciate there is an enormous industry that makes a living going through the entrails of the present complex tax law. It will be those vested interests and the tax evaders, bordering on avoiders, that will object to such a suggestion and put pressure on the Parliament not to go through with it. The noise will be proportional to the benefit to society.

10) I also appreciate that it would be contrary to our normal law where retrospectivity is not looked upon favourably but the complexity and the propensity of some to avoid paying their dues to society requires these measures.

11) It is not the end of the world because if this system needs fine tuning there is nothing stopping Parliament making those adjustments.

12) In addition and in accordance with the Terms of Reference my suggestion would reduce the 'complexity and compliance costs' (4.4), it would 'simplify' the tax system (3.5) and would be socially responsible (3).

13) I commend **Retrospective Tax Law** for serious consideration by the Committee.

Simon J Fisk

CONTIGUOUS INCOME TAX RATE

1) It seems to be only an historical reason to have income tax as a step-function. A step-function is where there are discontinuities in formula as with the present income tax system i.e. 0%, 15%, 30%, 40% & 45% brackets.

2) A step function makes people either side of the border <u>suddenly</u> less equal with each other, it can and does have an effect. This is clearly shown in Graph B1 below. The graph shows the various % gains in tax for the FYs08-11[1]:
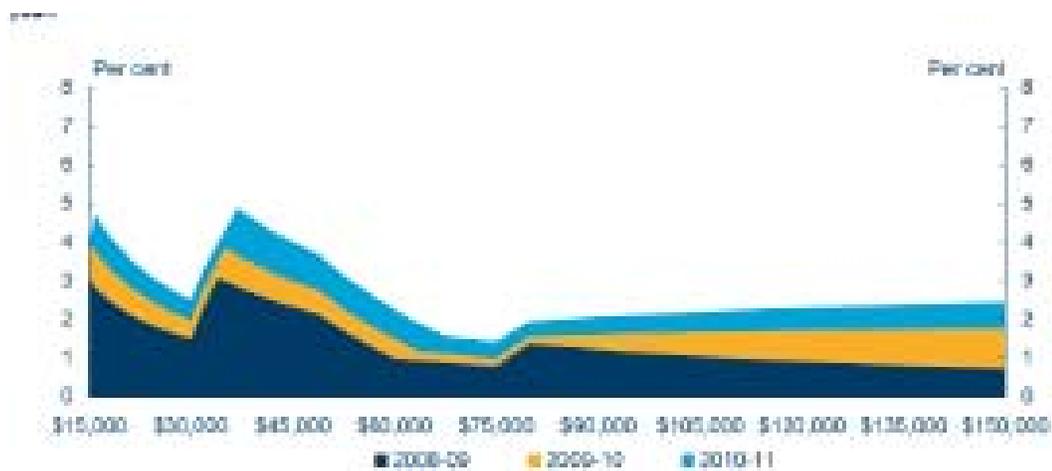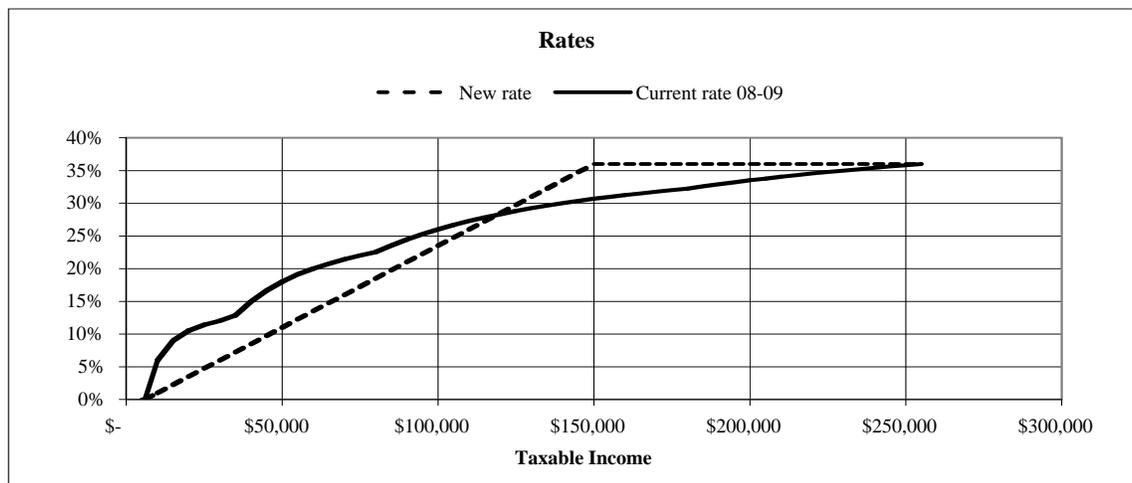

Graph B1

3) Here the percentage savings are not contiguous (equal is something different) across all incomes eg someone on ~ $40000 will be 5% better off where as $30000 2.7%. Similarly someone on ~$75000 will get 1.8% and $150000 with save 2.5%.[2] It's all over the place.

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[1] Reducing personal income tax. www.budget.gov.au/2008-09/content/overview/html/overview_10.htm

[2] These are approximate as the figure does not have great accuracy

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4) Either anomalies have been created by the new tax rates or it was necessary to make adjustments to clear up past anomalies. Whatever the reason there are significant sudden inequalities as people's incomes move across the steps in the tax brackets.

5) That is quite apart from unnecessary complex calculations with step functions.

6) I propose then that the taxation scale is contiguous. It does not equate to a flat rate tax but one that goes up in a continuos line either a straight line or some curve without steps or incontinuities.

7) This would not stop having an initial tax free start and/or a maximum rate at some high point. It would not have any effect on rebates or other social specific tax initiatives.

8) The simplest rate would be a linear relationship between taxable income and tax payable. Graph B2, below, shows the current FY08-09 effective tax rates[3] and my proposed linear relationship.

Rates

- - - New rate   ——— Current rate 08-09

Graph B2

9) Here there is an initial straight line from $6000 - $150 000 at which point those over $150 000 would pay flat rate of 36%.

10) 36% is chosen here as it is the effective rate presently for $250 000 but that is arbitrary point. Whether it is 36% or $250 000 will, in the end, be a political decision. There does not need, though, to be a maximum rate as at present but it

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[3] Effective tax rate is the average rate for income it is not the same as the present marginal rate, eg $35000 income pays $4500 tax therefore the effective rate $4500/35000 = 13% . The marginal rate for this income is 30 %

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could continue to increase at the same incline.

11) The winners, in the example as shown in Graph B2, are those below ~$120 000 and those above paying more than present. The new rate lines approximate the current curve but based on the revenue required or the politics the slope and the maximum could be anything.

12) It is appropriate to clarify whether the Committee wants to mimic the present or wish to recommend what might be best and different in the future?

13) A better contiguous function is that of a parabola[4]. From an implementation viewpoint a parabola fits the existing rates better than the straight line. It has, though, the slight complication that the general public would find it perhaps more cumbersome to calculate.

14) Due the present way that tax is calculated if it was a required to mimic the present system then at a figure of say $500 000 where the effective tax rate as almost flatten off to 43% the rate could at that stage flatten off.

Taxation Rate (Parobola)

——Current rate - - - -New rate
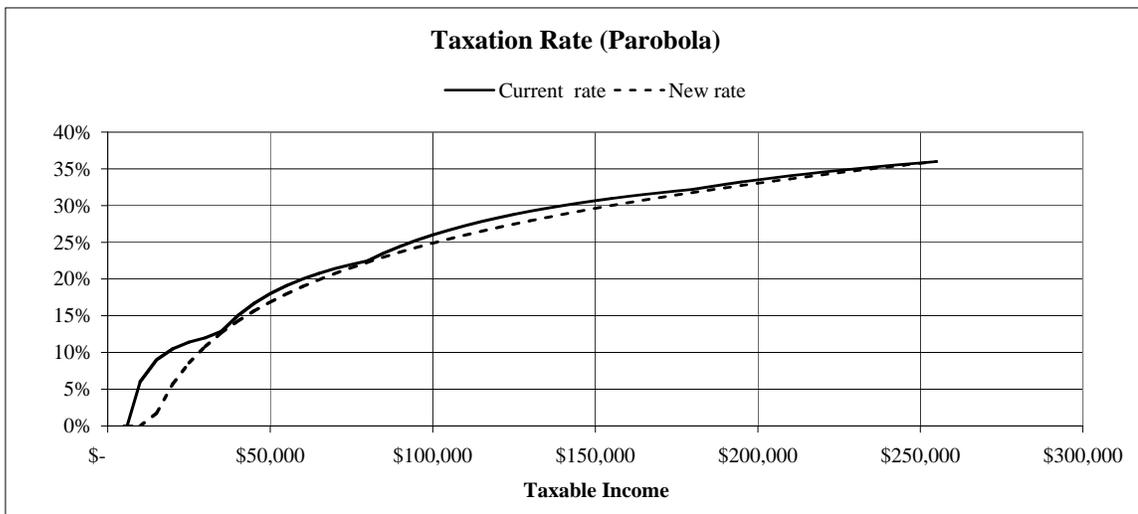
Graph B3

15) Although people might resist a change it will be simpler by far than going from Imperial to SI unit. That change of unit system has been a winner in the end as I maintain my suggestion of a Contiguous Tax Rate will be. People will tend to resist 'funny' numbers but I am reminded that the percentage on unimproved land, for ACT Land Rates, is 0.3513%, which is not exactly a nice round figure.

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[4] Other types of functions did not match the status quo but need not be eliminated just for that reason. I would hope to address this issue in a later submission

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16) A parabolic equation can, through its 3 variables, be made into an infinite number parabolic curves to suit revenue and politics. This particular example, Graph B3, starts at $6000 and reaches it maximum 36% at $250000.

17) The curve, shown in the above graph, has been arranged so that all are winners at varying degrees, but the people with incomes of up to $35 000 will gain the most. This 'all gain' would ease implementation.

18) Graph B3 shows again the sudden discontinuity of the present system at the ~ $34000 mark.

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19) I emphasis that the advantages in equity and ease of calculation if income tax is levied in a smooth increasing way rather the sudden jump to a higher tax bracket as in the present situation. There is a great opportunity now to make this change.

20) I have not done sufficient work on effects on revenue or distribution as I am awaiting population/income statistical data from ATO but I am sure that change can be made revenue neutral if that was required. Again I hope to provide the Committee with further advice if these statistics are made available.

21) Therefore I suggest to the Committee that Income Tax Rate be <u>Contiguous</u> and not the present step function.

    a. A linear relationship would be the simplest, emphasising again this is not same as a flat rate tax;

    b. A parabola curve would give the best for the present system and reduce implementation complexities; but

    c. Any contiguous smooth curve could be used which satisfies the politics.

22) This suggestion would reduce the 'complexity and compliance costs' (4.4), it would 'simplify' the tax system (3.5) and would be socially responsible (3).

23) I commend a **Contiguous Income Tax Rate** to the Committee.

Simon J Fisk