

SUBMISSION URGING A NEGATIVE INCOME TAX

INTRODUCTORY

This supplementary submission deals with an aspect not canvassed in the architecture paper.

BACKGROUND

A completely different approach to designing an income tax system than those considered so far is possible. It involves both a variation of the flat rate tax system sometimes advocated and some significant differences from the present scale.

Such a system would use an income tax formula such as the following:

Income tax equals 40 per cent of taxable income, less \$6000.

This formula would produce zero tax at an income of \$15,000 and negative tax in the case of incomes below this figure. At zero income the effect would be that the government would be paying a benefit of \$6000 as against nil at present (2008-09). At \$100,000 income the tax would go up from \$27,500 to \$34,000.

These negative amounts (which could be paid through either the income tax system or the social security system) would provide a minimum level of income security and would need to be integrated with many of the social security benefits currently available under the headings of age pension, invalid pension, sickness allowance, and so on, or as benefits for unemployed persons.

PRESENTATION ASPECTS

Politicians might, of course, prefer to dress up the formula shown above and to present it as a \$10,000 universal taxable grant and a 40 cents in the dollar flat tax rate calculated on the sum of the normal taxable income and this grant.

Naturally, any new scale would not need to be brought in overnight - the change could be phased in gradually over a period of years to make it more electorally appealing.

ADVANTAGES

Formulae of this type combine the best features of the progressive and flat tax systems and thus would warrant consideration, especially if a flat tax system were ever to be seriously contemplated. They:

- * involve a redistributive element
- * provide particular assistance to the lower income groups
- * produce identical tax collections from couples with any given total income regardless of whether that income is earned by only one partner or by both partners in any proportion

* ensure that persons with fluctuating incomes from year to year are not penalised as under the present system

* make many forms of tax avoidance unnecessary.

Formulae of this type can, of course, also be combined with a greater dependence by the authorities on revenue from indirect taxes.

Such formulae would also enable reductions to be made to the relatively high rates of marginal tax currently applying to larger incomes and to the even higher marginal rates of abatement applying to some social security recipients by virtue of the means test.

Marginal rates of about 50 cents in the dollar can actually be counterproductive, both because they discourage extra effort and because they make the trouble and expense of devising artificial tax minimisation schemes worth while.

In any case, because such a small proportion of all taxpayers earn incomes involving the top marginal rate, reducing this rate - while possibly displeasing those with a "soak the rich" mentality - has little effect on total revenue collections.

DISADVANTAGES

Admittedly, there are also some disadvantages. Such formulae:

- * raise the tax burden for middle income earners
- * involve a relatively high rate of marginal tax
- * necessitate income tax returns from all adult citizens.

CONCLUSION

The above formula is only meant to be illustrative of a recommended approach. The exact figures could be set so as to achieve neutrality in total tax collections.

A universal "negative tax" element would be a better way to assist the poor than the many ad hoc schemes frequently proposed.

Thus, for example, rather than subsidise interest rates on housing loans or provide low rent accommodation at public expense, it would be better to help low income groups through negative taxation and then allow them to purchase goods and services on free market terms.

2008-08-28

Nick Renton AM