SUBMISSION ON PAYROLL TAX

SUMMARY

This supplementary submission strongly urges the abolition of all existing state and territory payroll taxes. It then goes on to advocate the introduction by the Commonwealth of a negative payroll tax.

The arguments are presented under the following headings:

BACKGROUND

The need for governments - state and federal - to tax the Australian people in order to get funds for public purposes is well recognised. However, some methods of revenue raising are much more harmful to the community than others, and this distinction is not generally appreciated.

Probably the most undesirable form of taxation currently being levied in this country is the iniquitous payroll tax.

HISTORICAL ASPECTS

First introduced by the Commonwealth in 1941 under the guise of such a levy being required in order to enable the financing of child endowment, payroll tax is still in use today as a sectional impost on employers levied by each state government. It also applies in the Australian Capital Territory and the Northern Territory.

At the time of its introduction, the reasoning was that differential wages, favouring employees with large families over those with few or no children, while in theory desirable, would have been impracticable. Legislation on such lines would have been most unfair to employers and would have been counter-productive as leading to job discrimination against the very people whom it was meant to assist.

The authorities therefore adopted as a better solution the principle of levying a payroll tax on employers generally, and then using the revenue thus raised in order to finance a social security benefit payable to all mothers in respect of their dependent children.

The principle of linking one specific head of taxation to one specific form of governmental spending is economically unsound, but in any case the nexus between payroll tax and child endowment (later renamed "family allowance") was soon lost sight of, and payroll tax became just one more source of general revenue.

In 1971 the Commonwealth handed payroll tax over to the states in order to give their governments access to a "growth tax". The states promptly increased the rate of payroll tax by 40 per cent - from 2.5 per cent to 3.5 per cent of salaries and wages. The rates have since further escalated, so that some employers now pay this tax at the rate of 6.85 per cent of their payrolls above a threshold.

PHANTOM EMPLOYEES

The phrase "phantom employees" is sometimes used in order to portray one aspect of payroll tax in a graphic fashion.

Using a 5 per cent rate for illustration purposes, an employer would, in effect, be paying wages to one "phantom employee" for every 20 real persons on the staff.

THRESHOLDS

The use of thresholds introduces yet another anomaly.

It acts as a deliberate concession to small businesses and a device to eliminate the collection costs for relatively small amounts - both worthy objectives.

But in a competitive situation it also unfairly penalises large employers.

The legislation also treats related corporations as though they were a single employer for threshold purposes even where they are really separate businesses.

INFLATION AND UNEMPLOYMENT

Payroll tax should now be abolished. In effect, the governments levying it are "fining" employers for the crime of giving workers a job.

Payroll tax is indeed a strange tax in the current economic climate - it makes Australia's two major problems worse:

* It acts as a deterrent to the engaging of labour at a time of unemployment.

* It increases labour costs and thus Australia's rate of inflation.

In addition, it encourages Australian businesses to relocate activities overseas. Not only does this lead to direct job losses here but also it leads to further job losses indirectly as the former employees would have less capacity to spend.

INTERNATIONAL TRADE

Payroll tax also favours imports at the expense of exports - in other words, it acts as a negative tariff and thus exacerbates domestic unemployment. It has to be paid by local enterprises, whereas no corresponding tax is levied in the case of employers in the overseas countries with which Australia trades or competes.

These added difficulties for exporters and potential exporters faced with increased local production costs sit oddly with the nation's declared policies of wishing to increase exports and to reduce imports.

LOSS SITUATIONS

It should be noted that payroll tax is payable by employers even in periods in which they make a loss, in which case it will simply increase the size of that loss. The tax bears particularly harshly on new enterprises during their establishment periods, and thus discourages expansion and development.

The tax can also affect adversely the unfortunate creditors of enterprises which fail.

The levy has no regard to ability to pay in either a "profits" or a "liquidity" sense. Furthermore, the tax is quite inequitable as between employers manufacturing goods or providing services involving a high labour content, and those manufacturing goods or providing services involving a low labour content. It is particularly severe in the case of all labour-intensive service industries.

The position is made worse because the tax is also imposed on payments to certain independent contractors as well as on employee fringe benefits and not only on actual payrolls.

In practice this latter feature amounts to a disguised further increase in the nominal basic level of the tax. All states also impose the tax on penalty rates as well as on normal wages, thus making the total cost of labour prohibitive in many instances.

Payroll tax is, of course, also imposed on annual leave, sick leave and long service leave payments, on bonuses, on annual leave loadings and the like, increasing the cost of all these statutory and contractual obligations.

Under current conditions employers are, naturally enough, very concerned at the total cost of their workforce, including all on-costs.

As payroll tax tends to fall equally on all competitors in any given industry, its cost is inevitably passed on to the ultimate consumer. Payroll tax is thus particularly inflationary, as by the time the tax is actually met by the consumer, the levy represented by the original 5 or 6 per cent of the salary bill will have been further increased by the addition of the normal profit margins and by financing costs added by retailers and intermediaries.

The least inflationary taxes are those that are levied directly on the ultimate taxpayer. Payroll tax does not fall into this category. While nominally imposed on companies and other employers, it is invariably passed on to their customers and is thus eventually borne by all consumers.

Employers who grant wage rises inevitably find that their payroll tax bill goes up as well. This can hardly induce them to try to absorb any wage increases awarded by arbitration tribunals.

EFFECT ON THE COMMONWEALTH

A large portion of the revenue nominally attributed to state payroll tax collections is derived at the expense of federal income tax by virtue of the deductibility of payroll tax from taxable income for income tax purposes.

The abolition of payroll tax would thus have a much smaller effect on public sector tax collections as a whole than on those of state governments only.

Obviously this could be allowed for by adjusting the Commonwealth's grants to the states. The net revenue foregone as a result of abolition would, of course, still need to be replaced in some way, possibly by means of state surcharges on the Commonwealth income tax currently being levied on individuals.

While such a move might not be popular, it would make for a much more efficient system. Broadly speaking, the same persons as now would share the same tax burden as now - only the route taken in order to reach that objective would be different.

To the extent that some payroll tax is paid by state government instrumentalities and is thus only a transfer item, abolition would again cost less than appears on the surface.

GOODS AND SERVICES TAX

When the federal government introduced the goods and services tax (GST) in 2000 this was to be in exchange for its wholesale sales tax and a whole range of state government stamp duties and charges.

However, not a word was said about the most undesirable tax of them all - payroll tax.

The Commonwealth and state governments should really get together and rethink this absurd impost.

A NEGATIVE PAYROLL TAX

Another aspect of this subject is worth discussion. As already mentioned, an economic problem in many parts of Australia today is unemployment.

The immediate personal hardship of those looking for work and their families needs no elaboration. The long term effects on school-leavers who remain on the dole for lengthy periods are yet to be measured. Then there is the trauma of those still in the workforce but who know that they are at risk of retrenchment at any time.

The federal government's main effort to tackle this problem so far has been to try and alter the place in the queue of the unfortunate individuals looking for work, rather than to shorten the overall length of that queue.

Employees naturally lose their jobs when their employer's business fails.

The sad fact is that a business enterprise which goes out of existence does not automatically come back just because the conditions which sent it broke in the first place get reversed.

Any employees who lost their jobs because of such a failure do not then get their jobs back. The former suppliers of goods and services to such a business do not get their customers back.

Destroying an enterprise by bankrupting it can take mere minutes - building up a replacement business, if this is to happen at all, usually takes years.

Any lack of economic activity also adversely affects corporate profitability. Put crudely, if consumers are not spending, then producers and distributors are not getting the chance to make profits. But if individuals have already lost their jobs or are frightened of retrenchment, then they are unlikely to be buying non-essential goods or services.

Even a moderate rate of unemployment can be a human tragedy. Gimmicky training schemes may increase a particular individual's chances of finding a job, but they do nothing whatsoever to alter the aggregate numbers.

Experience shows that the best way to increase the demand for any commodity in oversupply is to reduce its price. This principle would apply even when the "commodity" which happens to be in excess supply is labour.

In Australia the cost of labour to employers is actually being artificially increased by specific government initiatives - for example, the long-standing state payroll taxes mentioned above and the more recent compulsory superannuation guarantee charge imposed by the federal government itself.

The first step should thus be to abolish these imposts. The second step should be to take this reform one stage further and actually give a grant to all private enterprise employers based on their total wages bill - effectively, to introduce a negative payroll tax at the federal level.

If the rate of such a grant were, say, 10 per cent, then this would allow an employer to put on 10 employees but in cash terms pay wages for only nine.

Actual employee pay rates would not fall, but employers would have a significant incentive to put on additional staff.

If all employers were to avail themselves of this opportunity then total employment would rise by 11.1 per cent and the unemployment problem would disappear. Of course, this extreme result would not occur in practice, but even a partial result would be very welcome.

The grants scheme could operate as follows:

* The grant should be taxable, as all corresponding outlays would be deductible.

* The grant should apply to each employer's entire payroll, not just to wages for new employees.

* There should be no strings, so that employers would have perfect freedom to engage whom they chose, not just persons currently on the dole. If persons already in the workforce were induced to move to different employers then not only would that improve national productivity but also it would create vacancies elsewhere in the system which someone else could fill. The intention would be to increase total employment, rather than to focus on the position of individuals in a queue.

* The scheme should apply both to companies and to unincorporated employers.

* The scheme should operate for only three or four years. The period should be long enough to give employers some certainty in regard to their planning.

The period should, however, also be relatively short, so as to encourage prompt action, inducing employers to take advantage of a temporarily available benefit while they can.

* The grant should be available whether or not it is used for direct job creation by the particular employer concerned. The grant would also be usable to reduce debt, thus lessening the risk of business failure and the loss of jobs flowing from this.

The grants could also lead to improved working capital ratios and/or greater profit distributions, enabling increased spending and investment and thus leading to the creation of additional jobs somewhere else.

Such grants would not have to become a permanent feature of the system.

After about three or so years the temporary grants scheme would no longer be necessary and prosperity would continue by virtue of the momentum already generated. New markets would by then have been developed and the skills of the workforce would have increased.

The grants would be particularly attractive to small businesses - for example, an employer now using one employee might even be induced to engage two. Collectively, the small business sector accounts for most of the jobs in the community.

It is highly likely that conservative bureaucrats would oppose the above proposals. On the surface it might indeed appear that the Australian economy could not afford such seemingly generous grants.

The truth is that the nation cannot afford the current waste of resources constituted by a large pool of unemployed. Wealth creation is a function of physical production, not of bookkeeping techniques. Australia cannot possibly be worse off if more people are being usefully employed and additional assets are being created.

However, even in conventional budget terms the "cost" to the revenue would not be nearly as large as the nominal amounts might imply:

* A large portion of the gross cost would be recouped because the grants would themselves be taxable.

* In most cases the additional employees would be able to use existing underutilised facilities, thus earning relatively high profits for their employers, and generating tax on those profits for the government.

* There would be multiplier effects creating further economic activity (and thus further taxation revenue) at both ends - for example, when employers buy raw materials for processing by the additional employees; and when the new employees and their families buy consumption goods and services.

* The resultant rising share market would make it easier for companies to raise further equity.

* The boost to confidence as many unemployed people re-entered the workforce, and the reduced fear of redundancy, would stimulate spending and investment, thus in turn creating further jobs and speeding any recovery.

In any case, a large portion of the apparent cost would be recouped because of the additional economic activity. Instead of receiving social security benefits the new employees entering the workforce would themselves be paying income tax. As they stepped up their spending, they would also be contributing more GST.

Their employers would be making larger profits, and these, too, would generate additional tax revenue. And, of course, there would be multiplier effects.

The market would decide where the new jobs were created. They would thus be genuinely useful positions, rather than artificial jobs specially invented under some "Mickey Mouse" plan.

Of course, in practice not all grants would be translated into additional positions and there would also be lags. But even where grants were taken in the form of additional profits they would generate some offsetting tax revenue. When spent, they would result in additional economic activity.

More significantly, any net additional cost to a national budget would be there for only three or so years, while the gains would be available in perpetuity.

But even if the revenue arguments are not accepted the grants proposal can still be justified:

* on humanitarian grounds, in the same way as in the case of most current social security benefits

* on general "good for the nation" grounds, as in the case of losses on public transport

* as an essential circuit-breaker.

Under some alternative job creation proposals, the composition of the dole queue would have been altered, but not its total length.

In contrast, the above-mentioned negative payroll tax proposal would create brand new jobs, both directly by reducing costs per employee and indirectly because of the stimulus to the economy.

Measures which show a bit of imagination as well as introducing some much-needed major economic reforms would be welcomed by the whole population. For the sake of the community positive action on the above lines is called for as a matter of urgency.

CONCLUSION

As mentioned earlier, continued inflation and mass unemployment are the nation's two major economic problems today. No other tax measure single-handedly hinders their solution as much as does payroll tax.

Sometimes it is suggested that payroll tax should be gradually phased out over, say, a five-year period, rather than abolished overnight. Phasing out would no doubt be better than doing nothing. Certainly, the authorities felt no need to phase in the original 2.5 per cent payroll tax back in 1941.

Finally, one practical point if payroll tax is to be abolished (or even phased out): In order to minimise disruptions, it would be highly desirable for all such changes to payroll tax legislation to be made simultaneously in all states and territories.

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