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Once upon a time only right wing think tanks and shock jocks called for a flat rate of income tax in Australia. The belief that our 'progressive' tax system, a tax system in which people who earn more money pay proportionately more tax, was so well-established that it didn't appear to warrant serious discussion. Unfortunately, as is often the case, when things slip away as opposed to being snatched away, we often don't pay much attention. But despite the lack of debate, the effect is the same.

Australia does not yet have a flat tax system but we are getting pretty close. This unfortunate state of affairs is made worse when you look at the welfare system. Some payments, such as the age pension and unemployment benefits, have been left to wither on the vine while new payments, such as the baby bonus and family tax benefit B, have been introduced over the past decade. There is no doubt that the current Rudd Government has taken some steps towards reining in the generosity of these payments to high-income households but there is also no doubt that much more needs to be done.

Initially, this essay looks at the way that the income tax system has become less and less progressive over time and then explores how government assistance to high-income earners has grown substantially. The net effect of such trends is obvious; reduced equity and reduced capacity to fund investment in government services.

What happened to our progressive income tax system?

The Australian income tax system has become less and less progressive over the past decade in the interests of 'increasing simplicity' and 'providing incentives' to work harder. The benefits of the gradual reduction both in the top tax rate and the percentage of people who pay it have been extolled by both the ALP and the Coalition. Indeed, when then Prime Minister John Howard began the 2007 federal election campaign with a promise to cut taxes by $32 billion and then Opposition Leader Kevin Rudd matched him with a $30 billion promise, both leaders stressed that such tax cuts would stimulate employment growth. Such arguments need to be challenged. Through what mechanism are such tax cuts supposed to stimulate jobs?

- Does the government really believe that there are tens of thousands of people out there declining offers of work because the marginal tax rate is just a bit too high for them?

- Does the government really believe that there are tens of thousands of people who would prefer to stay on the paltry unemployment benefit rather than accept a full-time job?

- Does the government think that high-income earners are saying no to promotions and not working hard to get their enormous bonuses because the tax rate is too high?

- The point is not that no possibility of a relationship between income tax and labour supply exists but rather that the effect is unlikely to be nearly as strong as those who argue for ever lower rates of income tax for high-income earners assert. The question the federal government likes least, of course, is simply, 'If the government is worried about providing incentives to make sure low-income earners "get off their bums", why does it keep cutting the tax rate for high-income earners?'

Table 1 compares both the tax rates and the income thresholds for personal income tax for the first Hawke Budget of 1983–84, the first Howard Budget of 1996–97 and the current Rudd tax rates for 2008–09. For those who wish we had more to invest in health, education and climate change, it makes for grim reading.

Table 1: Comparison of tax rates and income thresholds for personal income tax

Taxable income	**Tax on this income**
1983–84: Average ordinary time earnings were $18,184 per annum	
$1–$4,594	Nil
$4,595–$19,499	30 cents for each $1 over $4,595
$19,500–$35,787	46 cents for each $1 over $19,500
$35,788 and over	60 cents for each $1 over $35,788
1996–97: Average ordinary time earnings were $35,771 per annum	
$1–$5,400	Nil
$5,401–$20,700	20 cents for each $1 over $5,400
$20,701–$38,000	34 cents for each $1 over $20,700
$38,001–$50,000	43 cents for each $1 over $38,000
$50,001 and over	47 cents for each $1 over $50,000

2008–09: Average ordinary time earnings were $59,686 per annum	
$0–$6,000	Nil
$6,001–$34,000	15c for each $1 over $6,000
$34,001–$80,000	30c for each $1 over $34,000
$80,001–$180,000	40c for each $1 over $80,000
$180,001 and over	45c for each $1 over $180,000

Source: ATO

The most striking feature of the tax rates is the virtual lack of increase in the size of the tax-free threshold over the 25-year period. In 1983–84, no tax was payable on the first $4,594 of income; a quarter of a century later, the tax-free threshold has risen to just $6,000 (some of the increase was introduced to offset the impact of the GST on low-income earners). Over the same period, the threshold for the top tax bracket has increased from $35,788 to $180,000.

These figures are even starker when considered in the context of growth in average weekly wages. In 1983–84, when average ordinary time earnings (AOTE) were $18,184 per annum, the tax-free threshold accounted for around 25 per cent of AOTE. However, in 2008–09, the tax free threshold accounts for only around 10 per cent of the AOTE of $59,686 per annum.

At the other end of the spectrum, however, the threshold at which the top tax rate kicks in has risen much faster than the growth in average incomes. For example, in 1983–84 the top tax rate, which was 60 per cent, was paid by those earning around twice AOTE whereas by 2008–09, the top tax rate of 45 per cent is only payable by those earning more than three times AOTE.

So, where can those who wish to make the tax system more equitable go from here?

The first step is to stop the trend towards tax reductions. Australia is a low-tax country; budget after budget has delivered lower and lower tax rates. Consider the following tax cuts announced by the Howard Government:

- In 2004–05, they increased the thresholds for the top two income tax rates at a cost of $14.7 billion over four years.

- In 2005–06, they reduced taxes across the income distribution at a cost of $21.7 billion over four years. While low-income earners received some benefit, the largest benefits accrued to those earning over $125,000 per annum.

- In 2006–07, they announced further tax cuts of $36.7 billion over four years, including a reduction in the top two tax rates of 47 and 42 per cent to 45 and 40 per cent respectively.

- In 2007–08, they reduced revenue by $34 billion over the following four years. Those earning $75,000 or less received a benefit of only $14 a week while those earning $180,000 or more received around $58 per week.

It is in the context of these enormous tax cuts that the promises made by Howard and Rudd for a further $32 billion and $30 billion must be assessed.

After halting the decline in tax rates, the second step is to introduce some more progressivity back into the system. A simple way to achieve such a goal would be to introduce a new tax threshold and rate aimed at increasing the amount of tax paid by very high-income earners.

For example, if a new tax threshold of $1 million were to be created and a new top tax rate of 50 per cent introduced for income over that threshold, it has been estimated that $435 million a year would be raised. By increasing the tax rate for incomes over $1 million a year to 60 per cent, the Rudd government could earn around $1.5 billion a year. Significantly, all of this increase in revenue would come from a very small number of people. According to the Australian Tax Office, there are only around 6,000 people who earn more than $1 million per year.

The third step towards an equitable tax/transfer system is to rein in the generosity of tax concessions and direct payments that deliver benefits to high- income earners. The next section of this paper outlines some of the most inequitable of these transfers.

Why do we give so much to those who have the most?

The primary role of the tax system is to collect revenue with the pursuit of equity a secondary goal. However, there can be little doubt that the role of tax concessions and direct payments to individuals is to distribute money according to the wishes of the government of the day. An analysis of such concessions and payments therefore provides a clear window through which the priorities of the government can be viewed. Unfortunately for those concerned with equity, the view through this window is not a very attractive one.

This section looks briefly at three significant spending policies: the tax concessions provided for superannuation, the fringe benefits tax concessions provided for those with company cars and Family Tax Benefit B.

Superannuation

It is estimated that tax concessions for superannuation will cost the Commonwealth budget $24.6 billion in 2008–09, an item of expenditure that is rapidly approaching the $26.7 billion annual cost of the age pension and one that is likely to continue unless major changes to the current tax arrangements are made.

The alarming extent of the benefit to high-income earners of tax concessions for superannuation was outlined in a recent paper by Dr David Ingles entitled, *The great superannuation tax concession rort.* The key findings of that report include:

- Tax concessions flow overwhelmingly towards the well-off, with those earning less than $34,000 per annum receiving almost no assistance and those earning over $180,000 per annum receiving the most.

- The wealthiest five per cent of individuals accounts for 37 per cent of concessional contributions.

- While low-income earners receive virtually no assistance from the Commonwealth in relation to their contributions to superannuation, an executive earning $300,000 per annum with a million dollar retirement account can receive $37,000 of concessions a year, 2.5 times the value of the age pension, for every year of their working life.

- Tax concessions for superannuation provide substantially greater benefits for men than women and this disparity will continue under current arrangements.

- The system has become so skewed that the annual cost of providing superannuation tax concessions to high-income earners is much greater than the cost of simply paying those same individuals the age pension. Providing tax concessions for superannuation as a mechanism to help insulate the budget from the cost of providing for an ageing population is neither efficient nor equitable.

Reducing the generosity, and inequity, of tax concessions should be a priority for any government concerned with raising revenue equitably. The sheer size of the concessions, which are fast approaching $30 billion per year, should make them central to the ambitions of a reforming government.

Fringe benefits tax concessions for company cars

In order to provide assistance to the Australian car industry and financial support to those who are provided with a company car, the Commonwealth government sacrificed $1.8 billion in revenue in 2008–09 because of the concessional fringe benefits tax (FBT) treatment of company cars.

Most fringe benefits, such as employers paying for employees' school fees, are taxed in such a way that the amount of tax paid by the recipient is no different from the amount that would have been paid if the employee had simply received cash. However, there are FBT concessions associated with the provision of a small range of products, including laptop computers, mobile phones and company cars.

The cost to the government of the FBT concessions has been rising rapidly in recent years and, in addition to the inequity, these concessions also provide perverse incentives to individuals in relation to both the choice and use of the car. For example, the formula used to determine the size of the tax concession granted to people with company cars is based, in part, on the number of kilometres driven. This often results in HR departments promoting what is called the 'March rally', when people with company cars are encouraged to ensure that they have driven more than 25,000 kilometres during the year in order to claim the largest possible tax concessions.

The solution to this inefficient and ineffective tax policy is simply to abolish it. There is no strong policy reason for introducing a distortion into the tax system to encourage people to take their remuneration in the form of cars rather than cash. The case for abolition is strengthened by the fact that high-income earners are far more likely to be able to avail themselves of this benefit than lower-income earners.

Family Tax Benefit B

Family Tax Benefit Part B is available only to single parents and families where most of the income is earned by a single breadwinner. It evolved from the dependent spouse rebate and provides most of its assistance to families in which there is a full-time employee and a full-time carer.

The feature of this payment that makes it inequitable is the way in which the income of the main breadwinner is ignored unless it is greater than $150,000 a year. Consider the following examples:

- If a household has a breadwinner earning $140,000 a year and one parent staying at home full-time to care for children, they would be eligible for a payment of $128.80 a fortnight

- If a household has two income earners who earn $70,000 each, they will not be eligible for any Family Tax Benefit B payment even though their combined household income is less than $150,000 a year.

A simple solution to the inequities associated with Family Tax Benefit B would be to abolish it and direct the funding into an increase in Family Tax Benefit Part A. Unlike Family Tax Benefit Part B, Part A is provided to families with children but is means-tested according to household income rather than the income of individuals.

Conclusions

Australia is a wealthy country. Although the current slowdown in the rate of economic growth has had a substantial impact on the government's finances, the fact is that much of the 'boom' preceding this downturn was squandered through round after round of tax cuts. This occurred to such an extent that, despite the fact that GDP has almost doubled in the past 20 years, we still hear our governments say that we lack the resources to invest in indigenous health, to educate our young, to care for our elderly or to protect ourselves from climate change.

The only reason that we lack the funds to tackle these challenges is that we have chosen instead to make our income tax system less progressive both by lowering the tax rates and increasing the thresholds at which the highest rates of tax kick in. Exacerbating this is the fact that this government has chosen to persist in spending billions of dollars to fund tax concessions and direct payments that improve the wellbeing of those with the least need for assistance.

Tackling these problems does not require complex policy solutions; it simply requires the political will to do so. Unfortunately, judging by the first two Rudd Government budgets, that will does not currently exist.