The case for a new top tax rate

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1. Introduction

Until recently, the idea that executive salaries might be 'too high' was dismissed as evidence that the proponent didn't understand how the 'global market for talent' works. In the wake of the global financial crisis, however, limiting executive salaries is increasingly seen as being evidence of good common sense. The Prime Minister, Kevin Rudd, has recently called for an end to 'extreme capitalism' and has proposed to rein in 'excessive' executive remuneration.

Mr Rudd recently announced that:

> APRA will now develop a template, not just for this nation for the future but also for examination by the G20 and other international institutions, of how excessive executive compensation can be reined in (cited in Coorey 2008).

This paper discusses the benefits of introducing a new tax threshold specifically aimed at very high income earners. It argues that the current top tax rate of 45 per cent, which applies to incomes of over $180,000 per year, is inadequate in a corporate environment where CEOs can be paid very large salaries indeed, for example Macquarie Bank's Allan Moss, who received more than $33,000,000 in 2007, or nearly $130,000 per day.

2. Income distribution in Australia

Australia's income tax system is described as 'progressive' because the marginal tax rate (that is, the tax rate paid on any extra income earned) increases as income rises. The current marginal tax rates, and the income thresholds at which they are applied, are summarised in Table 1. It shows that from July 2008, the top tax rate in Australia of 45 per cent applies to those earning over $180,000 per year.

Table 1 Income tax rates and thresholds, 2008–09

Taxable income	Tax on this income
$0 – $6,000	Nil
$6,001 – $34,000	15c for each $1 over $6,000
$34,001 – $80,000	$4,200 plus 30c for each $1 over $34,000
$80,001 – $180,000	$18,000 plus 40c for each $1 over $80,000
$180,001 and over	$58,000 plus 45c for each $1 over $180,000

Source: ATO (2008)

As can be seen in Table 2, the very high income earners account for a significant percentage of all the income earned in Australia each year. For example, the top one per cent of income earners received twice as much in salaries and wages in 2006–07 as the bottom 20 per cent. The disparity is even starker for dividend income, with the top one per cent of income earners receiving 35 per cent of all dividends paid, more than 10 times the amount received by the bottom 20 per cent.

Table 2 Estimated distribution of income, by source, 2006–07

	Bottom 20%	Bottom 50%	Top 20%	Top 10%	Top 1%
Salary or wages	2.4	17.6	45.9	28	5.3
Gross interest	8.4	34.7	39.4	28.2	9.4
Dividend income	3.2	11.7	75.2	64.4	35.7
Net capital gain	4.2	13.3	73.7	64.2	38.6

Source: Treasury (2008)

There is no doubt that $180,000 represents a high income in a country where the single pension is less than $15,000 per year and average weekly earnings for a full-time adult were $1,180 per week in May 2008 (ABS 2008). That said, individuals who earn 20 times average weekly earnings and, in extreme cases, 300 times, are in a different league from those earning $180,000 per year. If the objective of the taxation system is to be truly progressive by requiring a larger contribution, both in percentage and absolute terms, from those with a greater capacity to pay, the creation of a new, higher tax threshold is necessary.

3. CEO income in Australia

CEO salaries have grown rapidly in Australia in recent years, with the *Australian Financial Review* estimating that earnings of the chief executives of Australia's largest 300 listed companies rose by 28 per cent in 2006–07 (Kirk 2007). This was compared to average full-time income growth of 3.4 per cent over the same period (ABS 2008).

Table 3 shows the earnings of some of Australia's highest-paid executives in 2006–07 and the amount of extra tax that each of them would pay if a new 50 per cent tax on income over $1 million per annum were to be introduced.

Table 3 Highly-paid CEOs in Australia, 2006–07

Name	Industry	Millions received	Extra tax payable with 50% tax rate on income over $1 million
Allan Moss	Banking	$33.90	$1,645,000
Phil Green	Banking	$17.00	$800,000
Greg Gailey	Mining	$16.70	$785,000
Frank Lowy	Property	$14.40	$670,000
Wal King	Leighton Holdings	$13.90	$645,000
Paul Little	Transport	$13.40	$620,000
Greg Clarke	Property	$12.20	$560,000
Sol Trujillo	Communications	$11.80	$540,000
David Morgan	Banking	$10.60	$480,000
JM Stewart	Banking	$8.80	$390,000
J McFarlane	Banking	$6.80	$290,000
Ralph Norris	Banking	$6.50	$275,000

Source; Kirk (2007) and annual reports

While it is commonly argued that unless their CEOs are paid such large salaries Australian firms will be unable to compete, it is important to note that the trend towards CEOs receiving such large multiples of average incomes is not universal. For example, as was recently discussed by Verrender (2008), the CEO of Toyota, the world's most profitable carmaker, earned $903,000 in 2004 while the head of the poorly performing General Motors received $10.19 million in 2006. Similarly, Verrender compares the $20 million paid to Telstra's Sol Trujillo to the income of his counterparts at Japan's NTT ($382,000) and French Telecom ($1.52 million).

The recent financial crisis highlights the lack of correlation between ability and pay. While Australian and international financial executives have received enormous salaries, they have not protected their shareholders from billions of dollars worth of risky investments. Meanwhile, the much-lauded regulators in Australia receive significantly smaller remuneration than those they are responsible for regulating.

4. Revenue-raising

Creating a new 50 per cent tax rate for incomes over $1 million per year would not only increase the equity of the Australian tax system, it would also significantly increase tax revenue.

Table 4 provides data on the income and tax paid by those Australians earning over $1 million per year in 2005–06, the latest year for which detailed data are available. It shows that while only 5,605 people declared incomes in excess of $1 million, together their combined income was more than $10.7 billion, or an average of more than $1.9 million each.

Table 4 Data on incomes over $1 million and tax payable, 2005–06

	2005–06
Number of people earning over $1 million	5,605
Taxable income of those earning over $1 million	$10.76 billion
Tax payable by those earning over $1 million per year	$2.15 billion

Source: ATO *Taxation Statistics 2005–06*

If each of these high-income earners had paid an additional five per cent of any income over $1 million per year in 2005–06, the total amount of additional tax collected would have been in excess of $250 million. If it is assumed that those earning over $1 million per year have enjoyed faster-than-average income increases of 10 per cent per annum, the amount of additional income raised from a five per cent tax increase would be more than $435 million in 2008–09.

5. Conclusion

The underlying principle of a progressive tax system is that those who have the greatest capacity to pay tax should pay both a higher amount and a higher rate of tax. The Australian income tax system has some progressive features, with the marginal tax rate paid by those earning over $180,000 per year significantly higher than the marginal tax rate paid by those earning $30,000 per year. However, it is unclear why someone earning $180,000 per year should pay the same marginal tax rate as someone earning $1,800,000 per year or, as in the case of some CEOs, $18,000,000 per year.

The creation of an additional tax bracket with a tax rate of 50 per cent would enhance the equity, and progressivity, of the Australian tax system while, at the same time, raising a significant amount of revenue. Although in the current macroeconomic climate the contractionary effects of an increase in taxation are unwarranted, this could easily be overcome by increasing expenditure on a range of other measures, which would inject money into the communities that need it most.

References

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