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Income Tax

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The catalogue of bad taxes is not short. Income tax, however, surely deserves a special place within it. Income tax is a exceptionally unfair tax---it penalises hard work, double-jeopardises saving and is relatively easily evaded by some people. It is intrusive, requiring very detailed knowledge of taxpayers' affairs for its effective administration. And it is extremely costly to collect. Its one virtue, a not inconsiderable one, is that people do know that they are paying it.

Three Australian academics, J. Pope, R. Fayle and M. Duncanson, writing for the Australian Tax Research Foundation, have looked at just part of the cost of collecting income tax, the so-called compliance costs. These costs alone are enough to condemn the tax.

'Compliance costs' are the costs imposed upon taxpayers in meeting the requirements of the tax system. They do not include the Government's cost of collecting the tax. And they also leave out the cost of economic distortion---that is, the losses to the whole economy caused when taxpayers re-order their affairs to substitute leisure for work, capital gains for income, tomorrow's income for today's income, tax deductible perks and other status symbols for taxed income, and so on.

This study, which is confined to the costs borne by individual taxpayers, does not include the costs to employers of collecting PAYE tax. And, although worry is, strictly speaking, part of an individual's cost of complying with the tax laws, that too is left out. One third of all taxpayers claim to have difficulty completing the tax form. The considerable anxiety that the complexity of the system and the arbitrary, bullying tactics of the department cause most taxpayers is an important omission.

Despite all these limitations, the narrowly-defined cost alone of complying with Australian income-tax law is estimated to be between 7.9% and 10.8% of income-tax revenue. (For reasons that I find convincing, the authors believe that 10.8% is the better estimate.) Would any sensible person deposit $1000 with a bank that required him to keep records that cost over $100? Hardly! Yet between them Australian taxpayers are forced by law, each year, to devote some 90 million hours of their own time and pay $1,224 million to accountants and tax advisers so that they can comply with the Tax Commissioner's requirements. Together, the time and the fees are worth between $2,780 million and $3,809 million. If, instead of record keeping and form filling, that effort were to be applied to producing tradable goods and services, it would eliminate a fifth of the current account deficit.

This huge expenditure is dead weight; it produces nothing; it is wealth forgone. If the waste could be eliminated, Australia's economic growth might rival that of better-managed economies.

Remember that compliance costs are only part of the dead-weight burden of tax collection. The Taxation Department has administrative costs equal to a further 0.48% of income-tax revenues and the unmeasured cost of economic distortion is likely to be high, although not necessarily higher than for other forms of tax.

The authors don't discuss the tendency of governments to waste the taxpayers' money. They are concerned only with the costs of collection.

Compared with the United Kingdom, where the taxpayers' compliance costs are only 3.6% of income-tax revenue, Australian compliance costs are exceptionally high. On the other hand, administration costs are low in Australia---0.48% of revenue compared with 1.49% in the UK. The reason for both disparities would appear to be that in Australia the cost of running the tax system has been shifted from the government to the taxpayer. Increasingly, Australian taxpayers are being required to work out what they owe the government and face stiffer penalties for getting the calculation wrong.

That is one way to run a tax system. Mr Boucher and his Merry Men have undoubtedly stamped out much tax avoidance and, because of that, the income tax is fairer than it was ten years ago. However, other forms of injustice have replaced the loop-holes that were common then. It has now become extremely difficult for the average taxpayer, even if he takes expensive professional advice, to know where he stands with the tax law. He is paying more to accountants and tax agents, and using more of his own time (and very often his wife's time) merely to ensure that he does not incur the Commissioner's heavy penalties. Australian Tax Office staff, who often understand the complex law no better than the taxpayer, are refusing to give rulings that will bind the Commissioner. Taxpayers, because of their fear of penalties (which are, from their positions of ignorance, arbitrary and Draconian) are self-

assessing their liabilities in the Commissioner's favour. Despite this tendency, the Tax Office is holding sums of disputed taxes which taxpayers often cannot afford to do without. The tax police have taken to making 'raids' on firms demanding detailed information and wasting everybody's time at high cost. In short, taxation by fear has replaced the 'discretionary' income taxation of the 1970s and it is still virtually impossible to tax cash-in-the-hand or income received in 'tax havens'.

Yet I doubt that Mr Boucher, the Tax Commissioner, is a vindictive man. Indeed, I have some sympathy for him. He is being asked to collect a very bad tax.

Taxpayers and voters will not put up with legal uncertainty and the high-handed behaviour of tax officers. The current situation would, therefore, not be politically sustainable even if there were not the dead-weight costs estimated by Pope, Fayle and Duncanson. Most taxpayers, however, do not wish to return to the era of the tax schemes with esoteric names.

Consumption is a better tax base than income, although any base to which rates of 40 to 50 per cent are applied is bound to be difficult to administer. The incentives to avoid such a tax are too great. The best solution to a taxation problem, as always, lies with reduced government outlays.

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