ON THE DRY SIDE

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TAX 2. CONSUMPTION TAXES

For an academic, Professor Russell Matthews uses high-flown language to describe Australian income tax. He wrote, "... taxpayers who are actually paying the income taxes for which they are nominally liable .... should recognise that they are being manipulated for political purposes, just as surely as the tax system itself is being manipulated by those whom the political parties seem to be united in protecting." and "Except for wage and salary earners the progressive income tax is a costly, deceitful and ineffective sham."

Colourful phrases have impact and it is in part due to Russell Matthews' persistence that some people are coming to accept that consumption and capital gains taxation are unlikely to be worse than income tax. That nothing has yet been done to change the tax laws is because the majority of voters still think that in tax matters things only get worse. This is not an altogether unreasonable belief, since in the living memory of the average taxpayer, things have only got worse. Any new tax or change of emphasis is seen as an additional impost and quickly becomes the victim of political gamesmanship.

The matter is further complicated by the National Country Party's opposition to capital gains taxation and the Labor Party's superstition that consumption taxes are regressive. By design consumption taxes may be regressive or progressive. They are regressive in Australia only because they rely so heavily on tobacco and beer taxes which do absorb more of the poor man's budget than the rich man's. A flat rate consumption tax levied on all but the basic foodstuffs would be progressive. If a high rate were imposed on luxuries, like boats, housing and wine, which are preferred by the wealthy, then they would be even more progressive. It can be as progressive as politicians want to make it until the taxed goods become too expensive even for the wealthy to buy.

Before we are again standing on the sidelines of yet another political scrimmage over tax, we can arm ourselves with at least some hard facts by which to assess the wilder accusations and the more promiscuous promises. The Centre for Policy Studies at Monash has done some figuring, which should help.

They calculate the trade-off of income tax for consumption tax by comparing the combinations of personal income tax, company tax and sales tax needed to yield the revenue presently raised by these three taxes. They make no allowance for removal of the more outrageous loopholes from income tax law, nor for the probability, that when income tax rates are lower than they are now, that the more complicated and risky avoidance and evasion schemes will not be worth while.

The simplest combination is one rate for all three taxes. A 15.7% flat income tax, 15.7% company tax and 15.7% sales tax, levied on all goods and services but dwelling rents, will raise present revenue. At present 71% of the money comes from personal income tax, 20% from company tax and 9% from sales tax. The proportions change to 46% personal income, 7% company and 47% sales.

Dwelling rents are excluded from the sales tax because it would be difficult and costly to impute and tax a notional rent paid by owner occupiers; while to tax rents alone would be unfair to tenants in a world where home owners already get all the best breaks.

However, it is not practical or reasonable to take even 15.7% from very small incomes. A tax threshold must be allowed, to remove small incomes from the tax system, and to introduce an element of progressivity. If the present threshold is retained then 18.3% tax will produce the necessary amount and the proportionate division becomes personal income 36%, company 8% and sales 56%.

Bearing in mind what Professor Matthews has had to say about the ability of the rich to avoid personal income taxation, it may be that this system is more progressive than the one we have now, but if it is not, or if we wish to make taxes more progressive than now, then sales tax can be made progressive.

The Centre for Policy Studies simulated a progressive sales tax by eliminating food for home consumption, children's clothes, rail tram and bus fares, and education expenses from the tax base. 20.5% tax on all three elements will now do the job and personal incomes would bear 40% of the burden, companies 9% and sales 51%. I think we now have a tax which is within the range which is workable.

While the share allocated to each of the three taxes can be varied to the extent that either sales or income taxes could in theory be asked for all the money, in practice it will pay government to divide its revenue collections between sales and incomes, dividing the rewards for avoiding or evading each. On the whole it seems more difficult to avoid consumption taxes and a VAT is designed to be self policing making even evasion rather difficult.

In all the above examples corporate income attracts less tax than now but dividends remain double taxed. In the last example dividend income attracts 36.8% tax. Professor Laffer made the rather obvious point that as taxes are increased, eventually a stage is reached where each increase in tax rates collects less revenue because people no longer have enough incentive to be in business - the tax base evaporates. He constructed the famous - or infamous- Laffer Curve to illustrate his point. The Laffer Curve is not very helpful because neither Laffer nor another has told us how to calculate where on the curve we sit. However, for what it is worth, I think corporate income is now around the end of the Laffer Curve, at a point where more revenue would be collected after a year or so if the rate of tax were reduced. The corporate tax base is evaporating and employment and economic growth are evaporating with it. Current poor investment lends support to my contention.

In the long run, my greatest concern as we change to consumption taxation is that a less visible tax may be chosen. No tax is painless and pain is no less if not identifiable, but it is more difficult to cure !