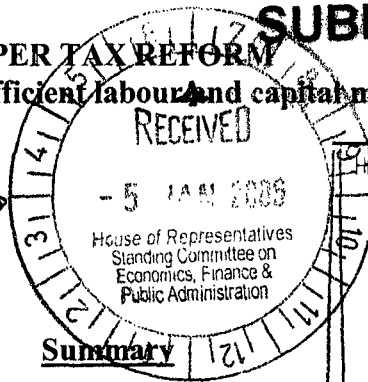


**SUBMISSION 60**

**SUPER TAX REFORM**  
for flexible and efficient labour and capital markets

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Current superannuation policy fails to support the flexible labour market espoused by Government and aspired to by younger generations (career breaks/changes, early retirement, semi-retirement etc.). Simple, more flexible and efficient regulation and taxation of superannuation and higher rate tax is required. I propose that:

- Superannuation funds are taxed only on withdrawal, at standard income tax rates (funds would be formed from pre-tax income and have tax-free earnings up to a maximum fund balance),
- Funds can be withdrawn at any time, subject to a minimum balance being maintained (where that minimum rises with age).

This would:

- Make superannuation savings more flexible and available to help people through mid-career, pre-retirement needs (e.g. career break/sabbaticals or unexpected unemployment).
- Thereby encourage more voluntary saving (thus improving people's retirement income) and productive investment in the Australian economy (with reduced investment tax distortions)
- Allow people to reduce their liability for higher rate tax by deferring income withdrawal to years with lower pay (whether mid career or retirement). This would remove current distortions in the progressive income tax system, which discourage flexible earning patterns and careers.
  - Thereby also encourage "job chum", increase job opportunities and encourage more varied, interesting and productive careers.
- Provide greatest reward (reductions in higher-rate tax) to those that adopt flexible careers, including those that work hard and then take career breaks or adopt more family-friendly or socially-beneficial (but lower paid) careers.

*In short, these policies would be a powerful platform for facilitating and rewarding flexible working and saving patterns, for the benefit of individuals, families, the community and the economy. These benefits from structural reform contrast with current proposals to simply reduce the top rate of tax.*

To more clearly present the separate (but related) ideas, this paper consists of two parts:

1. Proposals for simpler and more flexible superannuation, with funds able to be withdrawn at any time (subject to a minimum balance being maintained), tax-free earnings (up to a maximum fund balance), and tax either applied only on contributions (i.e. funds formed from post income-tax contributions) or only on withdrawals (at standard income tax rates).<sup>1</sup>
2. Argument that the best option above is to only tax withdrawals, in order to create a more efficient progressive income tax system, without the current bias against flexible careers (page 11).

<sup>1</sup> Part 1 of this paper is a modified version of my entry to the Australian Superannuation Funds Association "Simply Super" competition in September 2005, which argued for funds formed from post-tax contributions. The winning paper of that competition, by Paul Collins of Superpartners, proposed tax only be applied to withdrawals, but did not suggest the more flexible withdrawal rules of this paper, nor recognise the wider opportunities and benefits from linking such reforms with higher-rate tax reform.

## Part 1 – SIMPLE AND FLEXIBLE SUPER

### Summary

Current superannuation policy fails to support the flexible labour market espoused by Government and aspired to by younger generations, and industry antipathy to “choice of super” exemplifies a lack of customer focus that underlies many problems with current regulation.

The single biggest barrier to increased voluntary savings (and productive investment) is the inability to withdraw contributions before retirement. And this inflexibility is in large part a result of the complex and inefficient taxation of super, which provides significant tax benefits regardless of the period that funds are saved for.

**Reform needs to link tax benefits to the duration that funds are saved for, by restricting tax benefits to investment earnings (i.e. tax-free earnings). Funds may then be withdrawn at any time (subject to a minimum balance being maintained) without abusing tax benefits.**

Funds could be formed from post income tax contributions, or pre-tax contributions with standard income tax rates applied to withdrawals (for a given tax rate, the two policy options are financially equivalent).

The benefits (and specific policy settings) would be:

1. Ability to withdraw funds at any time, for example to support a planned or unplanned career break, career change, or unexpected redundancy or expenses.
  - Any person with funds below a minimum level (specified for their age) would have to contribute 10% of their income to the fund<sup>10</sup> (perhaps, if the balance is very low, supported by Government co-contributions).
  - Any person with funds above the minimum would not have to make *any* contributions, but if they did, they would enjoy tax-free earnings (up to a maximum fund level).
2. Removal of the biggest barrier to voluntary contributions (lack of access in case of need), thus encouraging increased saving.
3. Overcoming current investment tax distortions biasing towards property and capital gains speculation, thus encouraging more productive investments in the Australian economy,
  - also ensure equal tax treatment of emerging “customer shareholder” super products, which can reduce investment risk, thereby increasing savings and economic growth.<sup>8</sup>
4. No change in current superannuation tax receipts for standard rate taxpayers (benefits for higher rate taxpayers would be reduced, but may be balanced by a lower marginal tax rate if taxed on withdrawal in a year of lower income – see part 2 of this paper).
  - But more effectively use tax benefits by rewarding contributions earlier in people’s careers with greater total earnings tax benefit (received over the longer time in the fund) than contributions made close to retirement (and soon withdrawn).
5. Simpler taxation, allowing easier comparison of the tax treatment and potential returns with alternative investments. Decisions on voluntary contributions would also no longer be complicated by differing tax benefits/co-contributions depending on whether they’re made before or after receiving income.<sup>2</sup>

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<sup>2</sup> If funds are formed from pre-tax contributions (and taxed only on withdrawal), then the current co-contribution for additional voluntary post income tax contributions could be replaced with tax deductions for these contributions in the contributors’ annual income tax assessment.

## Part 1 - Contents

<b>The problem – barriers to efficient investment</b>	<b>Solutions</b>
Complex, distorting and inefficient tax incentives	Tax-free earnings
Inflexible, locked-in savings	Flexible, voluntary contributions and withdrawals

### **THE PROBLEM**

Superficial policy analysis may diagnose “the problem” as inadequate retirement savings. With an underlying, paternalistic view that “people don’t know what’s good for them”, the solutions proposed are correspondingly simplistic and authoritarian. Namely, increase compulsory savings, or provide ever larger tax breaks to compensate for people’s bad decisions.

This is a crude and expensive sledge-hammer approach to compensate for a structurally flawed system. It’s time to adopt a more customer-focussed approach.

If we assume people *are* behaving rationally, and examine the underlying factors influencing their behaviour, we might get to the heart of the underlying problems. We can then devise more fundamental, effective, and popular solutions.

The following sub-sections discuss some underlying barriers to greater superannuation savings:

#### a) Complex, distorting and inefficient tax incentives

The investment market is seriously distorted by current tax treatment of property and capital gains. Capital gains are taxed at half rate (under some circumstances), whilst dividends are fully taxed, so we preferentially encourage the promise of future value over demonstrable value being delivered today.

Capital gains on owner-occupied homes are tax free, which diverts significant “investment” into property speculation, even though rising house prices are primarily based on increasing wealth in the rest of the economy (driven by more productive investment in ever-better systems of production and service). The problem is exacerbated by tax treatment of negative gearing on investment properties.

Yet whilst those that can afford to get into the housing market receive tax benefits, the superannuation system makes it even harder for low income earners to find funds for a first house, because 9% of their income (which could have funded a deposit or loan) is diverted to super. Ironically then, low income earners may reach retirement without even the asset of a home, and will have even greater need of a reasonable retirement income (to pay the rent). Those people in most need are pushed even further by the superannuation system from the first rung of the wealth ladder.

With its preferential treatment of (often speculative) property and capital gains, the tax system is biased towards the “get rich quick” outlook on life. The Sydney economy (and especially its less wealthy residents) may pay a heavy price for it.

Whilst it may not be realistic to directly reduce these tax incentives, superannuation can help level the playing field. Unfortunately, the current superannuation tax regime does a messy job of it.

Current policy provides a partial tax credit on contributions,<sup>3</sup> but also taxes earnings and then potentially taxes funds yet again when withdrawn (depending on the complicated rules and detailed circumstances).<sup>4</sup> The “co-contribution” only adds to the confusion. **For the average person it is impossible to comprehend the overall tax rate and far from clear whether (or to what extent) it is more favourable than other, more flexible, tax-effective investments** (such as home ownership and investments entitled to reduced capital gains tax).

Income tax deductions on super contributions are also an inefficient use of tax incentives as they provide the same incentive for super contributions even one year from retirement (hardly a personal sacrifice) as for contributions made by people early in their careers. Efficient tax incentives would provide bigger incentives for contributions made in early years.

#### b) Inflexible, locked-in savings

Probably the biggest barrier to greater voluntary savings is that funds are locked in until retirement age. This means a potential contributor must be *extremely confident* that they will not need these funds until retirement before they commit additional voluntary contributions. Even if they don't *expect* to need the funds, they are likely to keep them available, out of a super fund, *just in case* they may need the funds for the unexpected (e.g. losing their job).

Superannuation policy makers need to learn a lesson from the investment markets that they purport to advise on. Shares are the longest term investment possible (businesses rarely pay back the capital, except through buy-backs), but the stock market encourages people to make such investments by providing an option out – the ability to sell. **Providing investors with the flexibility to change their mind and withdraw their funds is critical to encouraging the investment in the first place.**

**Current super policy, locking voluntary contributions in until retirement, is guaranteed to minimise any voluntary contributions being made at all.**

Why is superannuation policy like this? One reason is directly related to the flawed taxation treatment. If the Government provides an up-front lump tax benefit (income tax deduction) then it would be a gross waste of taxes if people were allowed to withdraw their funds soon afterwards.<sup>5</sup> The need to lock-in savings also requires regulation to define an inflexible retirement age (when funds can be released). This makes superannuation poorly suited to emerging trends of people *wanting* an earlier and more gradual transition through a part-time “working retirement”.

The current model for compulsory contributions – based on a fixed percentage of income – also fails to provide the flexibility desired by young “aspirational employees”. Increasingly, people these days *want* a flexible career, where they may work hard and earn a significant income early on, but then perhaps take a mid-career break, where they may wish to draw on hard-earned savings for a while. Conversely, many people now find they want to keep working at “retirement” age (often part time). These flexible career practices are blurring the prior distinction between the full time employment stage of life, and full time retirement. But current superannuation policy is incapable of responding to these changing needs.

Current tax deductions on voluntary contributions also reduce flexibility because in practice they require employees to decide whether to commit to regular contributions before receiving their pay. Given only the *possibility* of other unexpected needs for after-tax income, this reduces the chances

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<sup>3</sup> Although compulsory contributions are administered as *employer* contributions taxed at 15%, the economic impact is the same as *employee* contributions out of income taxed at a reduced rate.

<sup>4</sup> Also, because of the uncertain tax treatment on leaving the fund, dollars in the fund cannot be easily compared with dollars in the bank. For the average person, this simply adds to the confusion.

<sup>5</sup> and a retrospective tax adjustment on withdrawal, even if practical, would only add to current complexity

of voluntary contributions being made. Contributions may be more likely if employees were able to continuously re-appraise their financial position before committing more funds to super.

Although the Government's co-contribution scheme helps to address this problem (by effectively adding back a tax benefit if occasional contributions are made from after-tax income), it does so at the expense of more complex, confusing and inefficient administration. **It would be simpler and more efficient to have superannuation tax benefits that apply equally regardless of when an employee decides to make a voluntary contribution.**

Clearly, encouraging increased voluntary super contributions requires a different approach to taxation.

## SOLUTIONS

With a clearer identification of "the problem(s)", the solutions become almost obvious.

What is equally clear is that solutions derived from superficial observation of the problem do nothing to address the underlying barriers to investment, and in fact, actually worsen them. Increasing compulsory savings levels will even further reduce the ability of individuals to manage their overall finances flexibly, and increasing the up-front tax benefit for contributions only reinforces the need to prohibit withdrawals before retirement (which eliminates flexibility).

A more fundamental solution to the underlying problems is offered by the UK system, where there are no tax benefits for contributions to voluntary saving funds, but earnings (up to a limit) and withdrawals are tax free. We should however be cautious about abandoning all compulsory savings legislation. The lack of compulsion in the UK is exposing the most vulnerable members of society to greater risk of living old age in poverty.<sup>6</sup>

A more optimal approach lies in a combination of changing the *form* (but not magnitude) of Australian superannuation tax benefits (to be more like the UK), and adopting a new, more flexible approach to compulsory savings. Specifically, I recommend:

- a) providing tax benefits on earnings only (tax free), and,
- b) allowing funds to be withdrawn at any time, subject to a minimum balance being maintained (where that minimum rises with age).

Funds could be established from post-income tax contributions (with no tax on withdrawals), or pre-tax contributions with standard income tax rates applied to withdrawals. Although perhaps not obvious to the layperson (the latter option appears to eventually tax earnings, once withdrawn), the two policy options are financially equivalent for both investor and Treasury (because with the latter policy, the larger pre-tax contributions earn more earnings before being taxed on withdrawal). In either case, there is no tax benefit from the combination of tax on contributions and withdrawals, which is a necessary requirement to ensure tax benefits depend on the period for which savings are kept in super (so that withdrawals can be allowed at any time without abusing tax benefits).

Part 2 of this paper argues why the best option is to only tax withdrawals (in order to create a more efficient progressive income tax system, without the current bias against flexible careers).

Further details on a more flexible regime for voluntary contributions and withdrawals, and the advantages with respect to the underlying problems noted above, are set out following.

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<sup>6</sup> This is because poorer members of society tend to have least bargaining power in employment, and are more likely to accept bare minimum wages to cover only the present day cost of living. Statistically, poorer people also tend to be less well educated on matters of personal financial planning.

a) Simplified tax benefits – tax free earnings

The model proposed above – with tax-free earnings as the sole tax benefit – can help address the problems of current distorting, inefficient, inflexible and complex tax incentives, but at no cost to taxpayers. Specifically:

- Tax benefits are accrued gradually over time. The longer you leave funds in, the greater the tax benefit. There is therefore an incentive (rather than compulsion) to keep savings in for longer (ultimately until retirement, which may no longer need to be specified as a particular, inflexible regulatory age).
- Because tax benefits are not all given away up-front, it is more reasonable (from a Treasury perspective) to allow contributions to be subsequently withdrawn at any time (refer below). This in turn encourages voluntary investment in the first place (refer above).
- The tax-free earnings can be easily understood and compared to other investments. They also overcome the bias of the current tax system towards property and capital growth.
  - Tax free earnings also ensure equal treatment with another form of investor returns – discounts on company products for shareholders.<sup>7</sup> Such discounts were growing in popularity in anticipation of “super choice” legislation,<sup>8</sup> and are likely to regain momentum now with the implementation of “choice”. They effectively reduce investment risk by enabling customer investors to *control* their returns through their own level of product consumption, and thereby may reduce one of the biggest intrinsic barriers to greater saving (and in turn promote increased economic growth).
- For a person paying 30% income tax, simple financial analysis indicates that for a typical 30-40 year savings plan, the present-value of total tax benefits to the investor (& cost to Government) are the same as under the current system (with 15% tax on super contributions (made from pre-tax income) and 15% tax on earnings). However, tax benefits are greater for earnings on contributions made in early years, and negligible for contributions made near to retirement (and subsequent withdrawal).
- For a person paying higher rate tax, who currently enjoys 15% tax on contributions from pre-tax income (excluding the super surcharge) instead of a marginal income tax rate of 42% or 48%, the tax benefits are reduced with this proposed policy. However, as part 2 of this paper argues, if tax is applied on withdrawals (only) at standard income tax rates, then these taxpayers have an ability to reduce their tax liability by withdrawing their funds during subsequent years in which their income is below the higher rate tax threshold (i.e. deferring access to their income to years with lower pay, whether mid career or at retirement). This would remove current distortions in the progressive income tax system, which discourage flexible earning patterns and careers.
  - In addition, higher rate taxpayers will benefit from the greater flexibility of this proposed model. And in any case, it may be argued that higher rate tax payers have less need for tax benefits to encourage saving, and should not be a community priority for tax relief.

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<sup>7</sup> Which, if not declared as income, effectively provide tax-free dividends

<sup>8</sup> I consider the demise of the prominent Coles-Myer shareholder discount card to be a (large) blip on this trend. To the extent that this card failed, it did so because the discounts were excessive and were in addition to, rather than *instead of* regular shareholder dividends. Economic logic suggests that although an additional “free lunch” (such as the Coles discounts) for consumers/investors may not be viable, it does make sense for the consumer to bear sales risk (since they can best control it), which can be done by linking that element of share dividend risk to their own personal consumption. Shareholder discounts are also a variant on more efficient “access” or “Ramsey” pricing widely adopted by utilities (but with the purchase of shares equivalent to a monthly access fee covering fixed investment costs), which allows marginal prices to be reduced closer to marginal costs, thereby increasing economically beneficial sales.

b) Flexible, voluntary contributions and withdrawals

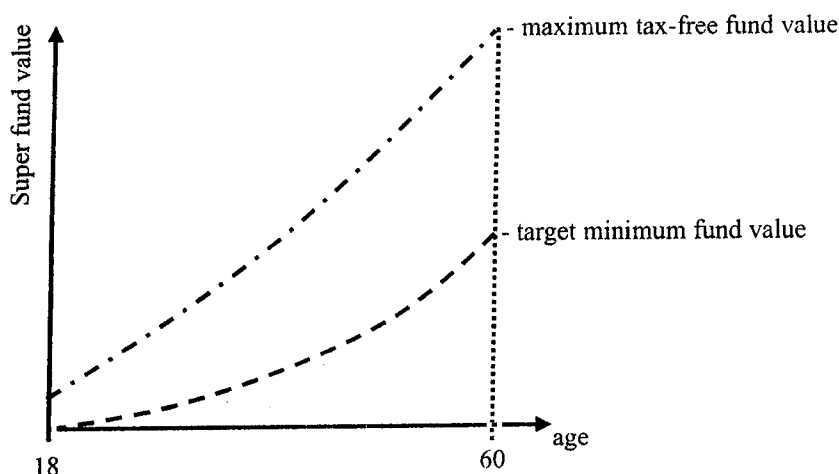
The simplified tax model above allows for a more flexible approach to compulsory and voluntary contributions and withdrawals. An improved model for compulsory savings can be devised by going back to fundamentals and focussing on what employees want:

- The desire for a minimum retirement income. This requires that at any given age, an individual needs to have assets of a minimum value – taking into account a reasonable expected asset growth and minimal expected contributions in the future (“minimal”, to be risk averse). This can define a minimum regulatory fund value target that increases with age.
- The desire to save more than this minimum, for a “rainy day”, a mid career break, and/or a better than minimum standard of retirement, and with the flexibility to withdraw funds as and when each need arises.

The simple solution to this desire is that any amount saved above the minimum fund value defined above may be withdrawn at any time. Up to a maximum limit, these excess, voluntary savings will enjoy the same tax-free earnings as those below the minimum.

These policies, and their benefits for employees, may be best illustrated graphically, and through a number of employee lifetime earning scenarios:

## The “Super Policy Graph”



The policy is defined by two lines on the graph:

- The lower line defines a minimum value of savings that any person should aim to have at any given age (based on contributing 10%<sup>10</sup> of a “minimal” income to fund a minimal retirement income).
- The upper line defines the maximum value of funds entitled to tax-free earnings (based on establishing a “comfortable” retirement income). Any earnings on funds in excess of this will be taxed at the individual’s marginal rate.

The policy may be implemented as follows:

- Any person with assets below the minimum level for their age<sup>9</sup> must contribute 10%<sup>10</sup> of income to the fund.<sup>11</sup>
- Any person with funds above the minimum would not have to make *any* contributions,<sup>11</sup> but if they did, they would enjoy tax-free earnings on them.
  - Funds in excess of the minimum can be withdrawn at any time.

The above “policy graph” may initially appear more complicated than a simple policy of 9% contributions. But the graph itself actually simplifies and explains superannuation for the average member of the public. If distributed to members with annual fund reporting,<sup>12</sup> the graph can help inform people:

- How much they must save in the coming year (subject to available income)
- How much extra they can voluntarily save that will enjoy tax-free earnings
- How much they can currently withdraw
- What their expected savings and income will be at retirement, for a range of future contribution levels.<sup>13</sup>

<sup>9</sup> The measure of a person’s total assets could include estimated home equity. This would reduce barriers to low-income households getting on the first rung of the “wealth ladder”. This policy option requires further detailed consideration.

<sup>10</sup> I recommend 10% rather than the current 9% as the increase is unlikely to be a significant barrier to uptake of the scheme, but has the advantage of making it easier for customers to calculate the amount deducted.

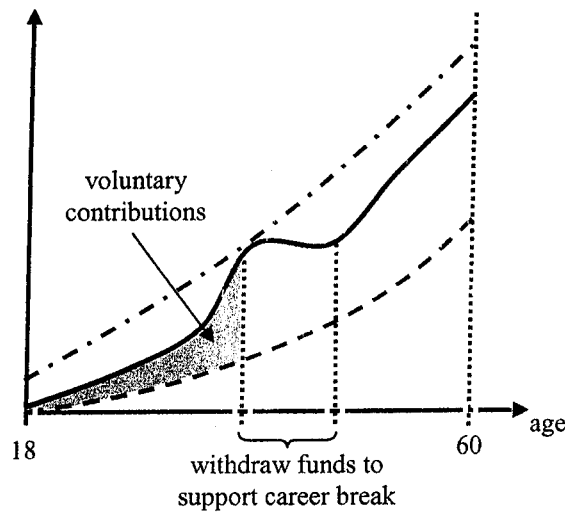
<sup>11</sup> To reduce business administration costs, contributions could be made regardless of fund balances, but then subsequently made available by super funds for withdrawal (at least half-yearly).

<sup>12</sup> with values updated annually for inflation

<sup>13</sup> Separately tabulated by current age vs current fund value for a range of future contribution rates.

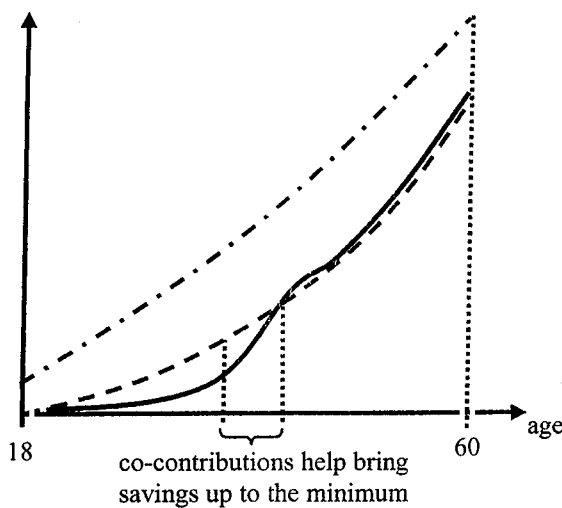


An example savings profile follows for an “aspirational” employee taking a mid-career break (when funds reach the maximum tax-free threshold):



An alternative scenario similar to above could involve an unplanned career break, due to redundancy.

Another example follows for a low-income worker:



In this example (as an optional policy position), the co-contribution scheme could be made available to employees aged over 30 (say) who, despite making minimum 10% contributions of their (low) wages, still have fund balances less than the target minimum (at an additional cost to taxpayers). Larger co-contributions could also be offered with further voluntary contributions.

Once funds reach the minimum, co-contributions (and probably voluntary contributions) cease, and in this scenario the fund grows in line with minimum compulsory contributions and expected investment earnings.

### *What happens at retirement?*

The details of how to regulate funds at retirement requires further consideration, including options for a more gradual transition through semi to full retirement. However, one reason for having statutory savings is that as people age, their health and income-earning capacity will diminish, and if we assume the State will never turn its back on impoverished old people then this creates an incentive for people to avoid saving and “exploit the system” in old age (albeit for a meagre State

pension). By the same logic, there would be good argument to compel the purchase of a lifetime minimum-level annuity pension at retirement age (at a cost in line with minimum savings targets), to prevent people withdrawing their savings too rapidly (e.g. as a lump sum). Any remaining voluntary savings could then be withdrawn at any time.

Compulsory purchase of an annuity could be debated however, as there are already good market incentives for people to do this. This is because individual “accumulation” superannuation, though beneficial in early years as it aligns saving incentives with the individual’s future benefits, can be inefficient in later years, as many people would excessively reduce their expenditure (to minimise the gradual drop in savings) to cater for the “worst case” (!) outcome of a very long life, rather than their *expected* remaining life. Hence many people find purchasing a lifetime annuity with their superannuation savings an attractive option. The insurance company then pools the risk of many, so that those that die early fund the extended retirement of those that live longer than average.

Alternatively, as part 2 of this paper explains, if funds are taxed on withdrawal (rather than contributions being from post-tax income), this creates a disincentive for people withdrawing their savings too rapidly (as a lump sum), as tax will be minimised if savings are withdrawn over more years (with a lower income and lower marginal tax rate in each year).

#### *Regulatory transition - choice of tax treatment?*

A final element of flexibility in this proposal is that people could have the *option* to invest in super funds that are taxed and regulated in the way described, but they could, if they wish, continue to save through the current system. The reasons for this are:

- a) Over a full working life, tax free investment earnings offer the same overall tax benefits as the current system, but with a greater proportion of benefits accrued during earlier years. However, someone who is aged 55 (say) will have based their life savings plan on an expectation of continued tax benefits on contributions made in the final years of their working life. A switch to a system with tax benefits on earnings only – where those earnings may be minimal over the final few working years – may not fully compensate a loss of tax benefits on these final contributions.

Allowing people to choose how their funds continue to be regulated guarantees there will be no losers from reform.

- b) Depending on their own personal career patterns (see part 2), higher-rate taxpayers may not receive the same total tax benefits as at present (since they currently enjoy a bigger tax benefit on contributions). However, even if this is the case, they may choose to invest in the new system anyway, due to the greater flexibility (if so, this would yield tax savings, which could fund co-contributions for low-income earners and benefit social equity).

Full transition to the new regime could be accelerated by allowing those with current savings to convert them to funds under the new regime. In the case of tax being applied on withdrawals,<sup>14</sup> converted funds could have tax credits equal to 15% of the fund value attributed to them, which could be offset against tax payable on withdrawal (credits would not be funded until cashed in as tax offsets). These tax credits would also notionally earn interest (more tax credits) equal to the recorded earnings of actual savings in the fund.

By allowing existing funds to be converted to funds regulated as proposed in this paper, the minimum threshold of the new fund’s balance would more readily be exceeded, thus allowing partial withdrawal of existing funds. This could appeal strongly to many in the community.

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<sup>14</sup> If tax were applied on contributions only (i.e. all contributions made from after tax income), then funds held under the existing system could (optionally) be transferred to a new tax-free earnings fund by paying tax equal to the present value of expected tax (at 15%) on investment earnings until retirement (discounted at a commercial rate, since the risk on earnings tax is transferred from Government to the individual).

## Part 2 – Higher-Rate Tax Reform for Flexible Careers

### Summary

Current annual income tax assessments under the progressive tax system may distort people's career choices, by biasing against flexible careers with major fluctuations in income. The current system encourages uniform income from year-to-year over more lumpy earnings with career breaks. For example, someone who earns \$45k p.a. for 2 years will pay less tax than someone who earns \$90k in one year (paying a higher marginal tax rate) and then takes a year off. This is distortionary and inefficient.

Rather than discouraging flexible careers, it may actually be considered socially beneficial to reward people who work hard and then take career breaks to adopt more family-friendly or socially-beneficial (but lower paid) careers. Encouraging career breaks could also have wider community and economic benefits, by encouraging "job churn" and thereby increasing job opportunities for others, in turn encouraging others to also have more varied, interesting and consequently productive careers (see below).

**The superannuation policy reforms proposed in part 1 of this paper, with standard income tax only applied on superannuation withdrawals, and withdrawals also allowed at any time before retirement (subject to maintaining a minimum balance), would simultaneously remove the current tax bias against flexible careers.** Within maximum savings limits (as defined in part 1 above), people could choose to save gross (pre-tax) income earned during years of high income (when a high marginal rate would otherwise be incurred), and withdraw it during subsequent years of lower income (before or after "retirement"), when a lower marginal tax rate may apply.

**The wider benefits from this proposed structural reform contrast with current proposals from business groups to simply reduce the top rate of tax. With the proposals in this paper, the greatest reductions in higher-rate tax would go to those that adopt flexible careers with benefits for their families and the wider community.**

Similar issues arise at lower income levels, although here the issue is more one of fairness. If someone earns \$40k in one year, but then becomes unemployed for a year, they will currently pay almost \$4k more tax than someone who earns \$20k in each of 2 years (benefiting from two tax-free thresholds and twice as much income taxed at 17% rather than 30%). Although low income earners may have little spare income to save, any savings they can make may, with the policies proposed in this paper, be withdrawn during subsequent periods of unemployment, without paying as much tax as would otherwise have been incurred. This may increase the incentive (or rather, reduce current disincentives) for people to take the risk of switching to a more productive and higher paid job, even though it may have less job security.

### The benefits of flexible careers

The UK management consulting guru, Charles Handy, notes how the 1980's wave of workplace and productivity reform was based on "*Paying half as many people twice as much to work three times harder.*"

The same logic explains why companies prefer to employ one full time person than two part time people, even though the progressive tax system means that two part timers will receive more net pay for the same total gross pay. It is simply much more efficient to have one person working hard full time.

Handy advocates a more efficient means for achieving a better work-life balance, which he terms "chunking". This means working hard for a period of time, then taking a break and subsequently returning to a different job.

*“External” (or knock-on) benefits of career breaks (“chunking”)*

“Chunking” facilitates high productivity when working. Taking career breaks may also increase productivity further, by refreshing the worker, to be more enthusiastic on his return to the workforce (just as weekends and holidays do), whereas a lack of breaks can lead to “burn out”.

But besides benefiting the employee taking a break, chunking can also provide knock-on benefits to families, other members of the workforce, and the unemployed.

Encouraging high income earners to adopt more flexible, changing careers (or rather, reducing current tax disincentives to do so) will increase “job churn” in these higher paid jobs. This will provide more opportunities for others to gain experience in these positions, which in turn will increase job churn at lower levels, and ultimately increase opportunities for the unemployed.

Increased job churn will also make it less risky to leave a job (as there is greater chance of finding a new opening when wanting to return to the workforce), which, in a virtuous cycle, will further increase job churn.

**These knock-on benefits could justify a tax incentive. But currently we have a disincentive to chunking. It should be rectified.**