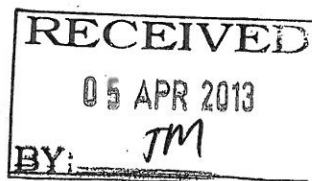


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The Hon John Murphy MP
Chair
Standing Committee on Petitions
PO Box 6021
PARLIAMENT HOUSE ACT 2600

26 MAR 2013

Dear Mr ~~Murphy~~

Thank you for your letter of 17 September 2012 concerning a petition presenting a proposal for a new formula for determining tax liability in the Australian taxation system. I sincerely apologise for the delay in responding to you.

The petitioner has suggested that the current stepped personal marginal tax rate scale be replaced with a formulaic approach that achieves a smooth increase in marginal tax rates as taxable income increases up to a top marginal tax rate of 65 per cent. Such an approach would be closer to the personal marginal tax rate scale that applied up until the early 1970s, which consisted of a large number of small stepped increases in marginal tax rates as taxable income increased, than to the current small number of larger stepped increases in marginal tax rates.

The merits of the current type of marginal tax rate scale and the old type of marginal tax rate scale were considered by the Taxation Review (Asprey) Committee in the 1970s (the Committee). The Committee considered that the sole defence for the large number of steps that had been in place before the 1970s in the Australian tax rate scale was that it provided a nearly continuously graduated set of rates, and was thus capable of moving nearly continuously with the size of income and hence also with ability to pay.

However, the Committee considered that 'ability to pay' in the vertical equity sense was not a quantifiable concept bearing an exact relationship with income. Wider steps in marginal rates mean that average rates still rise with income, and this is the prime requirement for vertical equity. (Vertical equity is the idea that persons with higher incomes should pay a higher proportion of their income in tax than those on lower incomes.) To require that the marginal tax rate should rise smoothly is to try to be precise about something that is essentially imprecise.

It could also be argued that a formulaic approach could confuse taxpayers. To determine the marginal tax rate faced a taxpayer would need to apply the formula to his or her particular taxable income. This is less transparent and more difficult than looking up the current marginal tax rate scale and noting the marginal tax rate that applies to his or her current taxable income. It would also confirm fears of 'moving into a higher tax bracket' whenever income increases, which is a much less important issue with marginal tax rates that apply to a broad range of taxable income.

The government considers that the current progressive rates and thresholds ensure that those with greater capacity pay more tax, while balancing complexity and transparency for taxpayers.

With reference to the company tax system, the Government is not in favour of a tiered company tax system as this would add complexity to the system. It would also encourage inefficient activity from large businesses seeking to restructure themselves into several smaller businesses and could also encourage successful larger businesses to relocate to lower tax countries.

I trust this information will be of assistance to you.

Yours sincerely

WAYNE SWAN