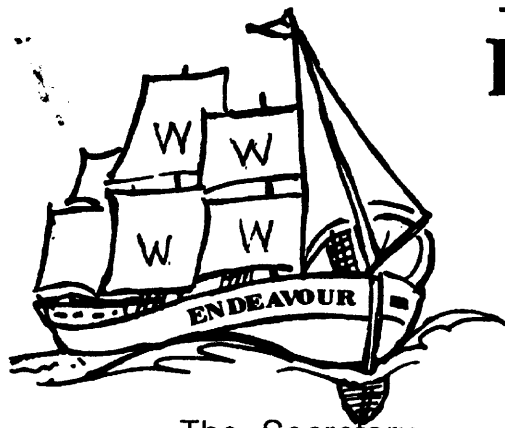


# ENDEAVOUR FORUM Inc.

Member Organisation, World Council for Life & Family

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14 April 2003

The Secretary,  
Senate Economics References Committee,  
Parliament House, Canberra ACT 2600

Dear Sir,

## Submission on Taxation Reform



1. The present taxation system hurts and disadvantages families because it taxes wage earners as individuals whereas their dependents are excluded from social welfare benefits on the basis that they are being supported by a wage earner. **THE DICHOTOMY BETWEEN THE TAX SYSTEM AND THE SOCIAL SECURITY SYSTEM MUST BE ELIMINATED.**

2. Because the tax system leaves wage earners with little possibility of discretionary spending after they have paid for essentials for themselves and their dependents, business is also hurt because families are unable to buy any non-essential goods. **Often they have to forego even essential goods and services.**

3. We recommend reform of the tax system in regard to families as outlined in **Attachment A**. Our organisation represents women, many of whom are full-time homemakers and who have more than the average 1.7 children. As a below-replacement level birth rate is not in the best interests of Australia, we ask that tax discrimination against families and children cease.

4. We further recommend that **income-splitting** between spouses be an option. The argument that this will benefit higher-income groups is a red herring as such couples either already split their income through business partnerships and trusts, or both spouses are already paying at the top level of tax and income-splitting is of no benefit to them. Income-splitting is not only a justice measure but it would help to enhance the status of wives in the marriage. If they are not in the paid workforce, their role is denigrated and they are often asked "Do you work?" If women are working in a child care centre, their work is recognised, but not if they are doing the same task in their homes.

Enc:l

*Babette A Francis*

Mrs. Babette Francis

National & Overseas Co-ordinator

# Attachment A

## Endeavour Forum 2e Submission

### HOW TAXATION HURTS FAMILIES

#### **Bracket-creep**

An Australian editorial (10 December 2002) headed, "Axe the taxes for a fair go", pointed out:

"Australia is supposed to be the land of the fair go. Back in 1996 John Howard was elected on the promise of introducing a fair tax system. But the ABC of tax reform is not limited to the GST. If you study hard to get a good education and work hard to gain promotion or build your own business what happens? You do enough to receive some reward for your efforts and the tax office confiscates half of every dollar you earn.

"The tax gospel according to Mr Howard and Peter Costello calculates that a couple with two kids on \$60,000 repaying about \$2,000 a month on the \$300,000 they borrowed to buy an averaged priced unit in Sydney, (don't even think about a house), are part of the super rich. Think again Mr Howard, because high tax rates meant for the better off are hitting ordinary Australians, close to one million in fact — whose income levels are catapulting them into the 47¢ in the dollar range (48.5 ¢ when the medicare levy is factored in).

"And the debate as to whether they are just whingers because they can't afford to upgrade to a plasma TV will soon become irrelevant. If tax cuts are promised ahead of the next election they won't appear in our pay packets until 2005, by which time the top rate will begin to kick in just above average weekly earnings."

Bracket-creep has been identified as being part of the great taxation inequity that has developed in the last 20 years, but not been addressed by government.

Bracket-creep is only half the story, however it is the one which is focused on most by journalists. It is easy to understand that if marginal tax rates are not adjusted from time to time they create inequities for income tax earners.

#### **Individuals vs Families**

The second component of the problem relates to the manner in which taxation affects families. The manner in which income tax is conceived is that individuals pay income tax. The concept that income is the property of the family before it becomes the property of the government has been lost. Ability to pay is a notion which is not part of the tax office vocabulary. It has not always been so.

In the first half of the 20th Century, adequate family income was ensured by means of the adult male basic wage, assessed as sufficient for a family consisting of a couple with three children. For most of this period, average earnings were not subject to income tax. This in fact was entrenched in the law when in a decision known as the Harvester judgment, Mr Justice Higgins decided that an adult male wage was that which is necessary to support a family of about five in frugal comfort. However, by the commencement of the 1950s income tax thresholds were substantially lowered in circumstances where an average male wage was reduced by taxation.

To redress this imbalance, the government introduced the notion of Child Endowment which was paid on a per child basis. In addition, family deductions were introduced as part of the income tax system. Deductions from taxable income were allowed for a dependant wife and each child, for education and medical expenses, for home and water rates and various

other expenses. The principle of ability to pay lay behind this system as it did behind that of rising marginal rates. There is clearly less ability to pay tax from a given income which supports several people than from the same income enjoyed by only one.

### **Horizontal equity**

In her book, *Tax Injustice: Keeping the Family Cap in Hand*, Lucy Sullivan describes the plight of the family:

"In the 1950s, '60s, and '70s families were shielded from taxation, in that tax was reduced in proportion to the number of family members dependent on a single income. This policy, based on the understanding that effective income is reduced by multidependency, is known as horizontal equity. The recognition in the tax system that both low initial earnings and multidependency on a single income result in reduced ability to pay was seen as fair and progressive..."

"In 1960 virtually no tax was paid by the family earner until 150% average weekly earnings (AWE) was passed, and that tax on moderately high-income family earners (shown up to 200% AWE) was considerably less than that on single earners at the same income level. Thus the sharing of the family income among five members was, in 1960, recognised as a factor in ability to pay across the income range.

"By contrast, in 1997 there was virtually no difference in tax paid by the single and the family earner (again with wife and three children) at any level of income. Today tax simply rises with rising income and no recognition is given of the fact that members of the family on 150% AWE have less income per head than the single earner on 50% AWE.

"The small gap in tax paid represents the raised tax-free threshold (on a per child basis) of the 1997 family tax initiative. No adequate recognition is given to the share children take out of nominally individual income."

The problem has arisen because in the 1980s with the Hawke Government, the principle of taxation moved away from the notion of ability to pay as the basis for taxation, to the more lugubrious notion of social justice. It was at this point that welfare payments became the manner in which low incomes were raised rather than by tax relief. Sullivan again says:

"The array of family deductions of the previous three decades was completely withdrawn in the early 1980s. The vestigial child endowment and per child deductions had been replaced in 1976 by a family allowance, a flat rate per child payment, which was realistic at first but rapidly lost value with inflation. Initially it was universal but in the course of the 1980s an upper income threshold at about twice average weekly earnings was introduced.

"Thus horizontal equity too was largely eliminated. The combination of large tax calls on average incomes as a result of the new proportional taxation, and loss of recompense for the cost of dependants, immediately plunged many families into real poverty. This created a large field for welfare payments to restore livable incomes to families which were formerly self-supporting."

The loss of horizontal equity in the tax system and the selective targeting of welfare at unemployed and low income families meant that, to rise much above the welfare level of income, mothers were forced to join the workforce and if the father's income was merely average, even substantial part-time work would not raise the family income above the

\$45,000 needed if the family was to gain much financially from its extra efforts.

### **Reform**

This theme was identified by Tony Abbott at the Young Liberals Annual Conference in Adelaide (January 11) in a speech entitled "Reform with a Social Conscience". Mr Abbott was able to identify families as the new poor:

"The interaction of a needs based, highly targeted welfare system with a progressive tax system becomes even more complex for low to middle income families receiving multiple benefits (with accumulative and often different threshold withdrawal rates). For families the worst poverty traps can occur when moving from low to middle levels of earned income."

Mr Abbott cited several examples:

- o A couple renting privately whose earned income increases from \$285 to \$585 a week is just \$29 better off after paying tax and losing benefits.

- o A couple renting privately with three children whose earned income increases from \$610 to \$860 a week is actually \$28.00 a week worse off after paying tax and losing part or all of their rent assistance, family payments and Austudy.

- o Single people whose earned income increases from \$20,000 to \$30,000 a year keep \$6,700 of their extra \$10,000. By contrast couples with two children whose earned income increases from \$20,000 to \$30,000 a year only keep \$2,542.

- o Single people whose earned income increases from \$30,000 to \$40,000 a year keeps \$6,850 of their extra \$10,000. Couples with two children enjoying the same income boost only keep \$3,834.

The way the system works, families of four earning \$30,000 a year are only \$8,959 better off than families with no earned income at all!

The social consequence of 850,000 children living in 435,000 jobless families is not so much a dramatic increase in poverty (thanks to a tightly targetted welfare system) but a significantly greater incidence of early school leaving, unemployment and teenage parenting in the next generation.

Quoting Barry Maley, Abbott goes on to say:

"A one income couple with three dependent children earning 150% of average weekly earnings paid no tax in 1960 and had a final disposable income of 3% above earned income."

"By contrast, the same family today loses about 20% of its earned income after tax and family payments leaving Maley to conclude that such families are 23% worse off than a generation ago. Because of tax and welfare claw-back Maley thinks families on average weekly earnings with two or three children are hardly better off than similar families on welfare. Yet to maintain parity of living standards, a couple with three children requires more than two and a half times the income of a child free individual, hence the perception that middle income families with children are Australia's new poor!"

Abbott goes on to say, "Because there is no lobby group to assert this inconvenient truth, it's not sufficiently understood that Australia has a progressive tax system but a regressive personal income tax system through the interaction of tax and welfare for people with low and middle incomes."

To put it simply, a single income earner earning \$60,000 a year supporting a wife and two dependent children pays \$15,580 in taxation without taking into account family tax benefits.

In the same family where two incomes are coming into the family of \$30,000 each (making a total of \$60,000), the tax payable by that family is \$10,760.

The anomaly is self evident.

Because of this inequity, Lucy Sullivan concluded:

"Equity for families must embrace equity vis-a-vis single earners. It is unjust and inaccurate to place family incomes on a scale which does not discriminate in terms of the number of persons supported. The discourse of income must include recognition of its per-capital reality of its sharing among many within the family".

It should be added that what families need is not more welfare payments but tax equity.

### **A proposal should be twofold.**

First, the tax brackets should be adjusted over a three year period so that the marginal tax rates closely resemble the real tax rates which apply to average weekly earnings at the commencement of the 1980's. At the same time it would be necessary to index the rates to the consumer price index so that they are annually adjusted to take account of inflation.

**Second, horizontal equity as a notion needs to be reincorporated in the tax system.** This would involve recognising the dependants of spouses, children, people with disabilities and the aged as dependant upon the income being earned by a family. This could be achieved in one of two ways.

One alternative would be that total family income could be divided by the number of people who are dependent upon it. Therefore, for example, if one unit is attributed to each dependent adult and a half unit is attributed to each dependent child, then the tax payable by a family with two dependent children and a dependent spouse earning \$60,000 would be \$7140 i.e. the tax payable by three income earners earning \$20,000.

Then consider if there are three children under eighteen the number of tax free thresholds would be 3.5 giving a tax bill of \$4679.

Alternatively, a system of rebates could be paid to families to acknowledge the dependency on the family wage which, for example, might be set at \$5,000 for a dependent adult and \$3,000 per dependent child.

Potentially, such a model may have the effect of making the whole debate on paid maternity leave disappear because this system would allow a taxation claim to be made for those who are dependent on the family income in much the same way paid maternity leave seeks to achieve through a notional welfare payment.