PRIME MINISTER

Press Statement No.346

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REPORT OF COMMITTEE APPOINTED BY CABINET ON TAXATION MATTERS

The Prime Minister, Mr. Whitlam, today released the report of a committee appointed by Cabinet.

The report is attached.

CANBERRA, A.C.T.

TAXATION MATTERS

REPORT OF COMMITTEE APPOINTED BY CABINET

1. The Committee was asked to report on what may be done through the taxation system -

a. to restrain cost inflation, including the possibility of excluding wage and salary increases beyond an established norm from acceptable costs for the assessment of company income;

b. to encourage saving and investment, including the possibility of imposing a tax on income for which a rebate is given for saving;

c. to prepare for a possible balance of payments problem.

2. We took these references to be concerned with particular modifications of the system of taxation and not with the structure of rates within the present system or with the outcome of the Budget as a whole. At the same time, we were aware that these more general matters were of great relevance to the Committee's work and accepted that the possibilities we were asked to examine were to be seen in a Budget context in which, we understand, the Government was seeking to limit the growth of its own expenditure.

3. A detailed consideration of proposals to index tax schedules was outside the Committee's terms of reference, since such proposals relate more to desirable levels of rates than to the system of taxation itself. However, since informal

representations were made to us on this matter, perhaps two specific comments on tax indexation might be made. First, such an approach eliminates the stabilising properties of a progressive tax system in an inflationary situation. Secondly, as most proposals for tax indexation envisage at most annual revision of rates, tax brackets and concessions in line with an approximate formula, whatever decisions need be made could be made consciously with the Budget, and in the light of the Government's own judgments, rather than automatically.

4. We were also acutely aware of the limits to the Committee's considerations set by the time available. It has therefore been necessary to leave many issues for further investigation.

5. The Committee met on August 19, 20, 21 and 22.

6. For convenience, our comments appear in a different order from that set out in paragraph 1 above.

SAVING AND INVESTMENT

Saving

7. From an overall viewpoint, the object of most taxes is to restrain private spending in general, whether on consumption or investment, so as to make room for Government claims on resources and for outlays on social services etc. At the same time considerations of equity point to placing the heaviest tax burdens on the relatively "rich", who do most of the private saving. Given the present income distribution, a tax system designed to encourage saving would tend to run counter to the

equity objective (even though in no particular case is it certain that a "rich" person, if relieved of tax burdens, would save more rather than spend more).

8. Against this background, it has been suggested by some that there would be net advantage in replacing all income taxation by progressively graduated expenditure taxation. The Committee considered a less ambitious suggestion that there should be a special tax or surcharge on income, progressively graduated, but subject to rebate to the extent that a taxpayer could show by the net addition made to his assets (less debts) that he had saved in the course of the year. To the extent that the introduction of the special tax and rebate resulted in an increase in savings, it should permit other tax rates to be reduced below the levels otherwise necessary.

9. The Committee agreed that -

(i) the task of determining and policing the rebate would be a new administrative enterprise of great complexity; and

(ii) personal incomes, as currently determined for income tax purposes, inadequately reflect "capacity to save" to such an extent that the introduction of a special tax related to saving would be likely to cause serious anomalies and widespread evasion, e.g. through intra-family gifts.

10. The objection under (ii) would remain even after the now-contemplated restructuring of tax rates and concessions, including the provisions to benefit low-income, single-income families.

11. Finally, it was acknowledged that the suggested special tax and rebate, although possibly important for long-run taxation policy, would not make a direct impact on the cost aspects of the present inflation. The Committee concluded that such a tax should not be introduced at the present time.

Investment

12. Measures to encourage private investment in the aggregate are inherently in conflict with the objective of restraining private spending and partly inconsistent with the idea that Government capital-formation should play an increasing role in the economy. The Committee noted that action against inflation might discourage private investment and that conventional accounting in a period of inflation might also work against investment.

13. If it were desired to mitigate any possible reduction, provisions such as accelerated depreciation or investment allowances could be considered but they would reduce tax revenue and increase company profits without necessarily increasing investment. For directing investment towards particular avenues, the taxation system is not an appropriate instrument.

14. The Committee thought that the worst danger to investment levels was not in action against inflation, but in fear of what action the Government might take, and equally of the consequences if the Government failed to take action.

15. If business men believed that effective action was being taken against inflation and were confident also that

demand generally would be sustained at adequate levels, private investment decisions would be made in the light of normal long-term considerations of economic advantage. There should then be little need for special measures to boost private investment generally.

COST INFLATION

16. The Committee agreed that a tax penalty on wage and salary increases beyond an established norm could, if practicable, be a valuable supplement to demand management in slowing down price increases as the pressure on capacity, labour, imports and other resources eases.

17. Equally, such a penalty or other like device cannot work unless that pressure of demand is limited. The penalty can only stiffen the resistance of employers to excessive wage claims by increasing the cost of meeting those claims in the event that the employer is unable to pass on a cost increase in full. If an employer is confident that he can pass his costs on, then he could not care less what wages he is asked to pay, regardless of the tax penalties placed upon him if he pays.

18. In a sellers' market, such as we have had in recent years and which for the most part we still have, all anti-inflationary efforts will be frustrated. Similarly, the comfortable expectation that international competition would be eased by exchange depreciation and/or controls on imports when domestic inflation makes that competition uncomfortable would be a green light for cost increases and would undermine measures to restrain inflation.

19. With this background, the Committee considered a mechanism for excluding wage and salary increases beyond an established norm from acceptable costs for the assessment of company income, a possibility to which attention was directed in our terms of reference.

20. It would be necessary for the Government to lay down a norm for permissible wage increases. The Committee carried on its discussions in terms of a norm which in any quarter would be the level of the Consumer Price Index in the preceding quarter related to a fixed base after adjustment for a predetermined "betterment factor" of, say, 0.5 or 0.6 per cent per quarter. It would also be necessary, but more difficult, to arrive at a figure for an actual average wage being paid by an individual employer for comparison with the norm and so to provide a basis for the determination of tax penalty.

21. The Australian Bureau of Statistics estimates each month the Average Weekly Earnings per Employed Male Unit by States for Australia as a whole, largely on the basis of Pay-Roll Tax statistics. A similar method is used to establish Average Wage Earnings for application in the formula for Reimbursement Grants to the States.

22. Greater difficulties arise in an attempt to produce a corresponding figure for individual firms which might be used to determine what are "excessive" wage and salary payments. The Committee agreed that, despite the difficulties, such a figure could be produced for each firm concerned. However, if this figure were to be used as the basis for a penal tax, there

would be many anomalies and the Government would be enforcing penalties which in many instances would clearly be unjust.

23. It would be necessary to rely on an over-simple formula in considering whether individual firms are paying "excessive" wages and salaries because it is impossible, from award determinations or other sources, to determine how changes in pay rates, occupation by occupation, will affect pay-rolls, firm by firm, and quarter by quarter. No formula, even if valid statistically, will accurately represent the situation of any individual firm with a labour force the relationship of which to its average in the base period is changing as time goes on. Even if no wage rate increased, the average might rise because of a different mix of sexes, skills etc. and because of variation in overtime, holiday pay etc. Some of these changes could reflect developments planned earlier but only now coming into effect. A firm in which such changes occur could be penalised for an average pay increase which did not arise from any change in rates to which it had agreed.

24. Just as bad would be the plight of a firm affected by large award increases resulting from a meaningfully contested case before a statutory wage-fixing authority. An example is the progress of women towards equal pay, which could heavily penalise employers with a large proportion of female staff.

25. Similar problems would arise for firms which find it necessary to work an unusual amount of overtime (e.g. after oil industry strikes).

26. Accidental factors such as weather, strikes, shortages of material, components or power might also impair the validity of the formula for an individual firm and call in question the usefulness of the base period.

27. For every firm disadvantaged by such factors there would probably be another firm receiving a positive advantage. But this may only increase the protests of the first set of firms without attracting fan mail from the second.

28. No doubt some of these defects could be set right in the course of administration but it would be impossible to hope for more than the roughest of justice. It may be that rough and ready justice can be tolerated if it is the price of coping with the inflationary situation. But if the injustices were sufficiently common and glaring there would be widespread resentment against the scheme even if it would help keep prices down. There might also be industrial unrest and unexpected failures of businesses.

29. Coming closer to home, the Australian Government must consider how best to deal with remuneration in its own employment. Much of this employment would not be subject to company income tax and therefore not subject to penalties in the course of the scheme. However, a Government which imposed the scheme and set the norm by which penalties were determined for other employers would presumably be obliged to conform. The same considerations apply to State Governments.

30. We have been advised by the Commissioner of Taxation that it would be practicable to administer a penalty scheme along these lines within and through the assessment of company

income. Further, it is his opinion that, if such a plan is to be introduced, it would be preferable to give effect to it through the company income tax system rather than to use the State Pay-Roll Tax or a revived Australian Government Pay-Roll Tax. He emphasises that its administration would be costly, in money and in skilled personnel, even if the firms to be covered were confined to a few thousand large employers. To achieve this limitation it would be necessary to exempt a large proportion of the 80-90,000 firms at present subject to State Pay-Roll Tax. This would not exempt a corresponding proportion of employment. It would perhaps lead firms included to seek exemption by splitting their enterprise into separate smaller units.

31. Again, these difficulties could perhaps be dealt with in a rough and ready manner but not without protest. Furthermore, it seems desirable to repeat that there will be most serious anomalies and inequities that no tax law, if it is to retain community respect, should permit. These will exist as between firms to which the scheme applies and between those firms and firms outside the scheme. They cannot be eliminated legislatively and it is to be expected that some affected firms will try to take matters into their own hands as far as possible by manipulating pay-rolls and labour to avoid them.

32. We have emphasised the anomalies and injustices because the Government would wish, in considering whether to set out on a new path, to do so with its eyes open. If these anomalies and injustices could be countenanced by the Government it would be possible to give effect to the measure we have

outlined and if applied as part of a total program it could help contain cost inflation. It would, however, be impossible to sustain such a plan for any considerable period of time. If it is to be employed, it should be seen essentially as a short-term measure.

33. The Committee considered various suggestions, including those put forward by the Institute of Applied Economic Research and a group of Adelaide economists. These suggestions have included a tax similar in objective to that referred to in paragraphs 16 to 28 above and a suggested tax on profit margins in excess of those in a base period. We saw no reason to prefer their suggestion for taxes on excess wage and salary payments to that we have examined in detail. While the proposal for a tax on excess profit margins is seen by the Adelaide economists as a desirable complement to a tax on excess wage and salary payments we found it necessary to reject it both conceptually and because of acute administrative difficulties.

THE BALANCE OF PAYMENTS

34. Generally the Committee felt that the tax system was not an appropriate instrument for dealing with general balance of payments problems whether they exist currently or are anticipated. There may be a case for encouraging Australian industries to involve themselves to a greater extent in exports, for instance, to take advantage of previously unrealised opportunities, or of possible economies of scale, and to expose the industries concerned to the competitive and technological stimulus of international markets. Such encouragement should therefore be selective, outside the tax system, and follow examination of the

circumstances of each case. Desirably, the form and extent of the encouragement should be subject to Government and parliamentary scrutiny. Experience with the previous Government's export incentives schemes suggests that the tax concessions involved tended to reduce revenue without necessarily achieving significant results.

H. C. Coombs (Chairman)
F. H. Wheeler
E. T. Cain
T. W. Swan
F. H. Gruen
Brian Brogan

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