

# **THE UNIFORM PERSONAL INCOME TAX–TRANSFER PROPOSAL: A PRELIMINARY ASSESSMENT\***

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## **Abstract**

The current Australian personal income tax–transfer (PITT) system suffers from serious defects relating to the traditional criteria for good tax policy, namely, equity, efficiency and simplicity. This paper puts forward and examines a Uniform Income Tax–Transfer (UITT) Package. The principal aims of this proposal are three-fold: (i) to simplify the personal income tax system; (ii) to eliminate the incentives to engage in tax arbitrage activities; and (iii) to promote labour supply. This is achieved by imposing the company tax rate of 30% on most sources of personal income, introducing a new tax-free threshold for each Australian citizen and extending some types of social security benefits for low-income taxpayers. STINMOD, a microsimulation model of the Australian tax and transfer system, is used to test the revenue and distributional impact of the UITT proposal. Although such a package will generally outperform the current PITT system in terms of distributional impact, efficiency and simplicity, it will cost the government a non-trivial amount of tax revenue loss. This loss in revenue can be funded from various sources, which include a greater tax base (due to efficiency gains), a decline in taxpayers' claims for deductions, a decrease in social security payments, increased GST revenue and budget surplus.

\* Paper prepared for the Australasian Tax Teachers Association (ATTA) Conference to be held at the University of Queensland, 22-24 January 2007. It is derived from a research project funded by the Revenue Review Foundation.

## **1. INTRODUCTION**

In recent years Australia has undergone a significant but incomplete reform of its taxation system. The principal focus of the recent wave of reforms has been on business and indirect taxation. On personal income tax, other than moderate income tax cuts (in the form of higher tax brackets) and changes to the low income rebates, there has yet to be a genuine attempt to develop a regime that can properly address a number of defects in the current system (see, for example, Drum and Evans, 2006).

The weaknesses of the current Australian personal income tax–transfer (PITT) in terms of the traditional criteria for good tax policy, namely, equity, efficiency, and simplicity, are well documented in the literature (see, for example, Tran-Nam et al 2006). First, the PITT system has become excessively complex over time, irrespective of how complexity is measured. Secondly, the PITT system does not reward additional labour efforts of high-income taxpayers adequately. Further, it provides both incentives and opportunities for high-income taxpayers to engage in artificial tax minimisation. Thirdly, the interaction of the transfer and personal income tax systems generates high effective marginal tax rates (EMTRs, ie, the combined rates of personal income tax and social security benefit withdrawal) faced by the middle- and low-income earners. The high EMTRs create a disincentive to find work or to work longer hours, which can lead to the poverty traps for low-income individuals/families and a lower level of GDP in the aggregate.

To meet future challenges and to remain internationally competitive, the Australian PITT system needs not only to achieve improved equity, efficiency, and simplicity, but also to command greater community acceptance and support. To this end, this paper introduces and examines a PITT reform proposal known as the Uniform Income Tax–Transfer (UITT) package. The principal aims of this proposal are three-fold: (i) to simplify the personal income tax system; (ii) to eliminate the incentives to engage in tax arbitrage activities; and (iii) to promote labour supply. This can be achieved by imposing the company tax rate of 30% on most sources of personal income, introducing a new tax-free threshold for each citizen and extending some types of social security benefits for low-income taxpayers.

The remainder of the paper is organised as follows. Section 2 discusses the motivation for PITT reform. Section 3 presents the UITT package in details. Section 4 describes the method of analysing the aggregate revenue and the distributional impacts of the proposed UITT. All relevant assumptions are clearly stated. Section 5 examines the modeling results and policy implications of the proposed UITT. Summary remarks are then given in the concluding section.

## **2. THE NEED FOR PITT REFORM**

### **2.1 Efficiency**

Efficiency is one of the most important criteria used in assessing a tax system. The efficiency criterion requires the minimisation of the excess burden or efficiency losses associated with taxation. Accordingly taxes should be designed to distort economic behaviour and allocation of scarce resources as little as possible. More specifically, the tax system should be as neutral as possible and should not interfere with the functioning of the market system (Stiglitz, 2000).

Concerning the Australian PITT system, the current defects in terms of efficiency have been considered by academics, tax practitioners, tax professional organisations and politicians (see, for example, Tran-Nam et al, 2006; Turnbull and Temple, 2005). Despite the recent tax cuts, the top marginal tax rates in Australia remain high compared with those top rates in other OECD countries. This encourages the motive for tax planning and/or tax avoidance among the high-income groups. This also disadvantages Australia in the international competition for skilled labour. Further, as in many industrialised countries, the separation of the personal income tax (PIT) and the social security system in Australia has generated high effective marginal tax rates (EMTRs) for middle and low income earners (Harding and Polette, 1995). As incomes rise, wage and salary earners not only subsequently lose their social security benefits but also face personal income tax. This creates poverty traps that discourage poor people from seeking work or working longer hours.

With regard to saving, the lack of integration of means tests pensions, superannuation schemes and the PIT system has caused a number of distortions. For example, pensioners are discouraged to work part-time. Further, in terms of investment, Capital Gains Tax (CGT) discount and negative gearing seem to create an overinvestment in investment housing, with potential harmful consequences of high level of debts.

## **2.2 Equity**

Equity is seen to be another important criterion for good tax policy. While horizontal equity means equal tax treatment for taxpayers with equal capacity to pay; vertical equity implies that higher tax amounts should be levied on taxpayers with higher ability to pay.

A variety of tax exemptions and deductions in the Australian PIT system has given rise to violations of both horizontal and vertical equity. For many high income earners, their marginal tax rate is closer to 30%, which is much lower than the current maximum statutory rate of 46.5% (including Medicare levy), due to the use of private trusts, partnerships and companies, salary sacrifice, negative gearing and income splitting (ACOSS, 2003, pp. 20-22). The Treasury forecasted that all the exemptions and concessions in the tax system would generate a \$50 billion revenue loss in the tax system within three years. It is estimated that the cost of CGT discounts would increase to \$6 billion (Garnaut, 2006). Without these exemptions and deductions the marginal tax rates could be lower which benefits all people rather than a group of taxpayers who could take advantage of the current loopholes.

In addition, the recent Government tax cut and removal of superannuation surcharge relatively appears to favour high-income earners more than low-income taxpayers. At the same time, as mentioned above, the middle and low-income earners face high EMTRs due to the interaction of the PIT and social security system. All of these factors are combined to increase the inequity of the current PITT system.

## **2.3 Simplicity**

In recent years, simplicity has been increasingly recognised as an important criterion in assessing tax reform. A less complex tax system will reduce the operating costs (defined as the sum of compliance and administrative costs), therefore improving efficiency and

productivity of the economy as a whole. The simplicity criterion of tax policy therefore calls for the minimisation of operating costs in raising any given amount of tax revenue. Since tax compliance costs constitute the bulk of tax operating costs, it is helpful to focus on compliance costs for the time being. Tax compliance costs are those opportunity costs incurred by taxpayers in fulfilling their tax obligations such as value of taxpayers' time spent on tax affairs, value of time spent by their unpaid helpers, payments to professional tax adviser and other incidental costs. They are defined to encompass both tax computational and tax planning costs. In principle, the deductions, exemptions and concessions in the Australian PIT system may give rise to both high tax computational and planning costs.

In a (now dated) comprehensive study of the compliance costs arising from federal taxes, Evans et al (1997, p. 20) found that, in 1994–95, personal taxpayers (excluding sole traders), spent, on average, 8.5 hours per annum on tax affairs and almost \$100 on tax adviser costs. In aggregate terms, the compliance costs accounted for 4% of the net income tax revenue collected from personal taxpayers. This does not include the tax compliance costs to the PAYE system of trusts, companies, partnerships used for tax planning purposes. When sole traders were included, individual compliance costs accounted for 5.6% of the relevant tax revenue (Evans et al 1997, p. 65). In the absence of any updated study of PIT compliance costs, it seems plausible to examine the use of tax agents as a proxy for tax compliance costs.

The proportion of individual taxpayers relying on the services of tax practitioners for the completion and lodgment of their returns ratio has increased tremendously from approximately 38%–40% in 1977–78 (McKinstry and Baldry 1997) to around 74%–77% from 1996–97 to 2003–04 (ATO 2006). An OECD survey conducted in 2004 (and relating to the financial year immediately before the survey year) showed that Australia was the second highest practitioner-dependent in the developed world (OECD 2005, Table 9).<sup>1</sup> The growth in the use of tax practitioners suggests that tax legislation has become longer and more difficult to comprehend. The corresponding revenue loss to the government is not trivial. Individual taxpayers using tax practitioners claim a large amount (about \$1b in 2002–03) in deductions for costs of managing their personal tax affairs (ATO 2005). Despite the latest Government decision to repeal a large number of pages, approximately 30%, of inoperative 1936 and 1997 Tax Acts, the legislation still requires further simplification.

In addition, tax administrative costs are government's spending on collecting taxes. In Australia, tax administrative costs account for approximately 1.1% of tax revenue. These costs include the relatively high costs of the annual ATO audit to ensure taxpayers meeting their obligations.

Besides the PIT, the social security system is quickly catching up in terms of complexity. In order to receive social security benefits, individuals and/or families must pass the means tests under which their benefits will be tapered out or stopped after reaching some certain amount of income (income test) or some certain value of assets (asset test). Recently different rules for eligibility and means tests have led to growing strains within the current transfer system (Dawkins et al., 1998, p. 238). Recent calls for simplification of PITT have

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<sup>1</sup> According to this report, 77% of all individual income tax returns in Australia were prepared with the assistance of tax agents. Only Italy (with 96%) had a higher figure than Australia. The percentages for other jurisdictions included: Canada: 45%; Ireland: 70%; Korea: 46%; New Zealand: 30%; UK: 53%; and USA: 56%.

consequently started to gain some momentum. However, reform in this direction still lacks consideration from politicians and economic advisers who often play critical roles in terms of policy planning and design.

### **3. THE PROPOSED UNIFORM PERSONAL INCOME TAX–TRANSFER REFORM PACKAGE**

To contribute to the current tax reform debate, the Tax Revenue Foundation proposes a UITT package. This package aims at improving the efficiency and simplicity of the current PITT system. More specifically, the objectives of the UITT package are three-fold:

- (i) to simplify the PIT system;
- (ii) to eliminate the incentives to engage in tax arbitrage activities; and
- (iii) to promote labour supply by ensuring that the EMTRs remain lower than 40% in most situations.

In order to achieve its stated objectives, the UITT Package possesses the following essential features:

- (i) The current company tax rate of 30% is imposed on most, if not all, sources of personal income;
- (ii) A tax-free threshold of \$8,000 per annum for each and every Australian citizen is introduced.
- (iii) Some specific types of social security benefit for low-income individuals are extended.

While the meaning of (i) is unambiguous, it seems worthwhile to elaborate on (ii) and (iii) further. Under (ii), each and every Australian citizen (or permanent resident) is entitled to a tax free threshold of \$8,000 per annum, regardless of his/her age. Thus, for example, a single, independent adult (aged 18 years or more) will have a tax-free threshold of \$8,000 per annum and a family of three, regardless the age of the child(ren), will have a combined tax-free threshold of \$24,000 per annum. For every family, the breadwinner (i.e., income taxpayer) commences to pay income tax only from the point of the family combined tax-free threshold.

All income in excess of the combined tax-free threshold will be taxed at a flat rate of 30%. Symmetrically, where a family's combined tax-free threshold entitlement exceeds the family's combined income then 30% of the gap should be paid as a social security nucleus to this family. For example, if the total annual private income of a family of three is \$14,000 then that family will receive \$3,000 (= 30% of the excess of the combined tax-free threshold of \$24,000 over the private family income of \$14,000) transfer under the UITT proposal. This also applies to single adults.

Under (iii), some existing social security benefits (i.e., Family Tax Benefits, Pensions and Unemployment Benefits) paid to individuals and families will be reduced more slowly (than the current situation) as the recipients' income increase in order to ensure that their EMTRs remain no higher than 40% in most situations.

## **4. METHOD OF ANALYSIS AND ASSUMPTIONS**

In order to quantitatively assess the feasibility and benefits of the proposed UITT reform package, the aggregate revenue and distributional impact of this proposal will be modelled with the aid of STINMOD Version 05B. STINMOD is a static microsimulation model of the Australian tax and transfer system, developed by NATSEM at the University of Canberra. This model can be used to assess the immediate impact of policy changes on family incomes and government expenditures. As a policy tool, STINMOD can produce simulated results at the individual level. Thus, the distributional impact of a policy measure across different types of families can be assessed. At the same time, estimates of the aggregate outcomes can still be derived by summing the individual results. It is widely used by the Treasury and other departments to estimate the impact of public policy changes. Details about some elements and assumptions of this model are presented in Lambert (1994).

### **4.1 Major Elements of the Income Tax Program**

*Assessable income* refers to income from sources that are taxable.

*Deductions* are offsets against assessable income which reduce the amount of assessable income that is taxable.

*Taxable income* is total assessable income minus deductions. Gross Income tax is levied on taxable income through the application of an income tax scale. For example, the current government tax scale is: taxable income between \$6,001 and \$25,000 is taxed at the marginal tax rate (MTR) of 15%, taxable income between \$25,001 and \$75,000 is taxed at MTR of 30%, and so on.

*Income tax rebates* are offsets against income tax. Rebates are provided for a variety of reasons. Some are for dependency. Others are provided to ensure that the tax liability of pension and allowance recipients is not too high. Some rebates are income-tested (e.g. dependent spouse rebate), while others are not (e.g. sole parent rebate). In order to get maximum value from a rebate an individual must have sufficient taxable income to generate an income tax liability which is equal to or greater than the value of the rebate.

*Net income tax* is gross income tax minus total rebates.

### **4.2 Unit for Income Tax and Social Security**

The primary unit in the Australian income tax system is the individual. However, there are a number of tax rebates that reflect the family circumstances of an individual – including the dependent spouse rebate, the sole parent rebate and the pension rebate. On the other hand, the primary unit of the Australian social security system is family based. Dependency is established through the application of a tapered income test or a sudden death income test on the dependant's income.

### **4.3 Generating the EMTRs**

An EMTR for a particular family is determined by calculating its current disposable income. Disposable income is defined as the total amount of income – including government benefits – received by a family, less any tax paid. This is the amount that the

family can spend. Once this has been determined, the earnings of one person in the family are increased by \$1. The disposable income for the family is then recalculated with this \$1 increase in earnings. The EMTR is calculated using the following formula:

$$\text{EMTR} = 1 - \frac{\text{Change in family disposable income}}{\text{Change in earnings}}$$

The change in disposable income is the difference between the ‘new’ disposable income and the current disposable income. The change in earnings is the amount by which the earnings of one person in the family increased. The EMTR shows the proportion of the extra income lost by way of taxation and means tests. An EMTR of 70% means that a \$1 increase in earnings results in a \$0.3 increase in family disposable income. Because of the interaction between income tax and social security system, the EMTR can be close to or exceed 100% at present.

#### 4.4 Assumptions

STINMOD contains most of significant tax and social security elements, and its database is drawn from the last population census. It is based on a number of assumptions such as an inflation rate of 2.5% per annum, a population growth rate of 1.6% per annum and a taxable income growth rate at 3.5% per annum. STINMOD is a static model in the sense that it does not take into account changes in labour supply (second round effects) in response to changes in the PIT–transfer system. As a result, the costing of any efficiency-enhancing PIT package tends to be overstated.

The modeling results will be generated based on some hypothetical families provided by STINMOD. The base data for the year 2006–07 will be employed. The changes in the tax structures and social security payments are also estimated starting from a great number of income reports generated by STINMOD. However, the Medicare levy will remain unchanged.

## 5. MODELLING RESULTS AND POLICY IMPLICATIONS

### 5.1 The Benchmark

The benchmark for all modelling results will be the government’s PIT structure for the financial year 2006–07, as displayed in Table 1 below.

**Table 1: Government’s PIT Structure for 2006–07\***

Annual Taxable Income	MTR (%)
\$0 – \$6,000	0
\$6,001 – \$25,000	15
\$25,001 – \$75,000	30
\$75,001 – \$150,000	40
> \$150,000	45
Low Income Rebate	\$600 for annual taxable income < \$25,000

Source: Treasury (2006, Table 1)

\*excluding Medicare levy.

## 5.2 The Proposed Uniform Income Tax–Transfer Package

The proposed UITT package has a tax free threshold of \$8,000 per person. The company tax rate of 30% will be imposed on any taxable income greater than \$8,000. The withdrawal rates of tax rebates and social security payments will be reduced to improve the high EMTR problem. Details of this reform package are summarised in Table 2 below.

**Table 2: Proposed UITT Package**

Annual Taxable Income	MTR (%)
\$0 – \$8,000	0
> \$8,000	30
Social Security Withdrawal Rate	To be reduced more slowly

## 5.3 Modelling Approaches

The revenue and distributional impacts of the proposed reform package will be estimated for a variety of family types with different income tax brackets. Those families will cover from Single Adult to Married without Children, Married with 1, 2 or 3 children and Sole Parents with 1, 2 or 3 children. Table 3 shows all family types to be considered in this paper.

**Table 3: Family Types**

Family type	(Number of Adults, Number of Children)		
Single Adult	(1, 0)		
Married without Children	(2, 0)		
Married with Children	(2, 1)	(2, 2)	(2, 3)
Sole Parent	(1, 1)	(1, 2)	(1, 3)

First, the revenue impact of the proposed package will be the aggregate outcome of the changes indicated below.

**Table 4: Revenue Categories**

Category	Description
1	Changes from reducing the withdrawal rates of tax rebates and social security payments
2	Changes in the tax structures
3	Changes from providing social security nucleus (30% of the gap between a family's combined income and their combined threshold entitlement will be paid out)

Secondly, the distributional impact will measure the difference between the total disposable income each family will be entitled under the reform package and the amount they used to obtain under the benchmark. The range of private incomes will be chosen in a way that best represents the whole population of taxpayers.

## 5.4 Modelling Results of the Proposed Package

### 5.4.1 Revenue Impact

The revenue impact from Category 1 (*Changes from reducing the withdrawal rates of tax rebates and social security payments*) was generated directly from STINMOD. These withdrawal rates were reduced slowly each time by 1% point. After a large number of simulations, these withdrawal rates had to be reduced to 0% to 1% to maintain the EMTRs lower than 40%. When some of the main withdrawal rates such as withdrawal rates of low income rebate and reduction partner income test are reduced to 0% to 1%, the government will lose about \$2.7 billion in tax revenue. Tables 5a and 5b show some of the main reductions.

**Table 5a: Reduction of Tax Rebate Withdrawal Rates**

Category	Original Withdrawal Rate	Simulation Withdrawal Rate
Pension rebate	0.125	0.001
Low income rebate	0.04	0.001
Mature age worker tax offset	0.05	0.01

Source: STINMOD and authors' own calculations.

**Table 5b: Reduction of Social Security Withdrawal Rates**

Category	Original Withdrawal Rate	Simulation Withdrawal Rate
Youth Allowances – Reduction step 1	0.50	0.00
Youth Allowances – Reduction step 2	0.60	0.01
Adult Allowances – Reduction step 1	0.50	0.00
Adult Allowances – Reduction step 2	0.60	0.01
Partner Allowances – Reduction partner income test	0.60	0.01
Parental income test – Reduction for excess income	0.25	0.01
Pension – Pension reduction step 2	0.10	0.01

Source: STINMOD and authors' own calculations.

While the revenue impact from Category 1 can be generated directly from STINMOD, the revenue impact from Categories 2 and 3 (*Changes in the tax structures and Changes from providing social security nucleus*) is indirectly estimated with some information extracted from the income reports produced by STINMOD. The tax revenue obtained from the proposed reform package was estimated. This figure was then compared with the tax revenue collected under the current government tax structure. The difference between these two figures is the revenue impact under Categories 2 and 3. The reform package will cost the government another \$8 billion from changing the tax structure and \$65 million from providing social security nucleus.

The total revenue impact of the proposed uniform tax-transfer reform package is summarised in Table 6 below.

**Table 6: Aggregate Revenue Impact**

Category	Short Description	\$ million
1	Changes from reducing the withdrawal rates of tax rebates and social security payments	-2,716.86
2	Changes in the tax structures	-8,050.72
3	Changes from providing social security nucleus	-65.33
<b>Total</b>		<b>-10,832.91</b>

Source: STINMOD and authors' own calculations

#### 5.4.2 *Distributional Impact*

Under the reform package, the family will have a higher tax-free threshold when it has more members. For example, the tax-free threshold for a Single Adult is only \$8,000, but a family of three such as Married with one child or Sole Parent with two children will have a tax free threshold triple times higher (\$24,000). Therefore most of the Single Adult groups are worse off under the reform package while all other groups are better off. Table 7 summarises the distributional impact by family type and disposable income under the reform package.

**Table 7: Distributional Impact (Change in Disposable Income, \$ per week)**

Weekly Taxable Income (\$)	Single Adult	Married with no children	Married with 1 child	Married with 2 children	Married with 3 children	Sole Parent with 1 child	Sole Parent with 2 children	Sole Parent with 3 children
< 150	-1.63	18.74	45.42	77.95	176.20	3.14	42.21	66.63
150-299	-6.84	17.96	45.06	85.53	123.35	2.74	34.33	66.63
300-449	-22.68	11.24	34.57	66.63	101.89	2.02	34.33	66.63
450-599	-30.29	2.88	34.33	66.63	98.94	2.02	34.33	66.63
600-749	-30.29	2.88	34.33	66.63	98.94	2.02	34.33	66.63
750-899	-30.29	2.88	34.33	66.63	98.94	2.02	34.33	66.63
900-1049	-30.29	2.88	34.33	66.63	98.94	2.02	34.33	66.63
1050-1199	-30.29	2.88	39.43	66.63	100.05	2.79	34.33	66.63
1200-1349	-30.29	2.88	52.65	68.20	106.80	6.40	46.46	91.75
1350-1499	-29.98	15.17	62.96	76.08	112.80	9.73	47.09	91.75
> 1500	26.73	50.80	103.94	129.65	172.66	24.13	72.54	94.48

Source: STINMOD and authors' own calculations

#### 5.4.3 *Effective Marginal Tax Rates (EMTRs)*

One of the main objectives of the reform package is to improve the high EMTR problem. Table 8 to Table 15 below show the EMTRs estimated for all types of families under the proposed package (all income and taxes are in \$ per week). The modelling results indicate that all families with different sizes and in different income brackets will have EMTRs lower than 40% (the majority of them vary from 30% to 35%). Therefore, the reform package definitely achieves this particular objective.

**Table 8: EMTRs of Single Adults**

Private Income	Allowance Income	Taxable Income	Income Tax	Total Offsets	Total Tax	Disposable Income	EMTR (%)
6.95	207.87	214.82	18.29	25.41	0.00	221.94	
53.13	207.87	261.00	32.15	25.41	6.74	254.26	30.00
183.12	206.38	389.50	70.70	25.39	45.31	344.19	30.82
294.02	206.38	500.40	103.97	25.39	78.58	421.82	30.00
389.42	206.38	595.80	132.59	25.39	107.20	488.60	30.00
503.18	201.52	704.70	165.26	25.19	140.07	564.63	33.17
602.98	201.52	804.50	195.20	25.19	170.01	634.49	30.00
716.48	201.52	918.00	229.25	25.19	204.06	713.94	30.00
821.83	196.67	1,018.50	259.40	23.98	235.42	783.08	34.37
925.53	196.67	1,122.20	290.51	22.77	267.74	854.46	31.17
1,417.78	189.12	1,606.90	435.92	20.89	415.03	1,191.87	31.46

**Table 9: EMTRs of Married Couples without Children**

Private Income	Allowance Income	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
5.31	375.10	380.41	21.82	0.00	76.12	0.00	434.71	
10.14	375.10	385.24	23.26	0.00	76.12	0.00	438.10	30.00
79.69	375.10	454.79	44.13	0.00	76.12	0.00	486.78	30.00
218.19	373.41	591.60	85.17	0.00	76.12	9.05	582.55	30.85
371.09	373.41	744.50	131.04	0.00	76.12	54.92	689.58	30.00
474.49	373.41	847.90	162.06	0.00	76.12	85.94	761.96	30.00
563.39	373.41	936.80	188.73	0.00	76.12	112.61	824.19	30.00
684.71	363.69	1,048.40	222.21	0.00	76.12	146.09	902.31	35.61
784.11	363.69	1,147.80	252.03	0.00	73.70	178.33	969.47	32.43
885.51	363.69	1,249.20	282.45	0.00	72.96	209.49	1,039.71	30.73
1,565.15	356.35	1,921.50	484.14	0.00	71.87	412.27	1,509.23	30.92

**Table 10: EMTRs of Married Couples with One Child**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
24.09	375.10	110.03	399.19	0.00	18.70	44.47	0.00	572.39	
95.49	375.10	110.03	470.59	2.72	0.00	44.47	0.00	622.37	30.00
200.39	374.02	110.03	574.41	33.86	0.00	44.47	0.00	695.05	30.72
379.89	374.02	110.03	753.91	87.71	0.00	44.47	43.24	820.70	30.00
563.59	374.02	110.03	937.61	142.82	0.00	44.47	98.35	949.29	30.00
684.89	374.02	110.03	1,058.91	179.21	0.00	44.47	134.74	1,034.20	30.00
798.09	374.02	110.03	1,172.11	213.17	0.00	44.47	168.70	1,113.44	30.00
938.81	374.02	110.03	1,312.83	255.39	0.00	44.47	210.92	1,211.94	30.00
1,049.41	374.02	110.03	1,423.43	288.57	0.00	42.05	246.52	1,286.94	32.19
1,141.57	374.02	110.03	1,515.59	316.22	0.00	41.32	274.90	1,350.72	30.79
1,893.45	356.35	110.03	2,249.80	536.48	0.00	40.23	496.25	1,863.58	31.79

**Table 11: EMTRs of Married Couples with Two Children**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
188.36	373.14	193.00	561.50	0.00	16.16	44.41	0.00	815.08	
152.26	373.14	193.00	525.40	0.00	26.99	44.41	0.00	789.81	30.00
264.46	373.14	193.00	637.60	6.66	0.00	44.41	0.00	868.35	30.00
508.16	373.14	193.00	881.30	79.77	0.00	44.41	35.36	1,038.94	30.00
633.09	373.14	193.00	1,006.23	117.25	0.00	44.41	72.84	1,126.39	30.00
782.01	363.69	193.00	1,145.70	159.09	0.00	44.41	114.68	1,224.02	34.44
889.11	363.69	193.00	1,252.80	191.22	0.00	44.41	146.81	1,298.99	30.00
986.71	363.69	193.00	1,350.40	220.50	0.00	44.41	176.09	1,367.31	30.00
1,100.91	363.69	193.00	1,464.60	254.76	0.00	42.05	212.71	1,444.89	32.07
1,216.86	360.44	\$193.00	1,577.30	288.57	0.00	41.24	247.33	1,522.97	32.66
1,986.15	356.35	\$193.00	2,342.50	518.13	0.00	40.23	477.90	2,057.60	30.50

**Table 12: EMTRs of Married Couples with Three Children**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
52.70	375.10	275.97	427.80	0.00	102.43	44.73	0.00	850.93	
280.41	372.59	275.97	653.00	0.00	34.87	44.27	0.00	1,008.11	30.97
382.61	372.59	275.97	755.20	0.00	4.21	44.27	0.00	1,079.65	30.00
524.61	372.59	275.97	897.20	38.39	0.00	44.27	0.00	1,179.05	30.00
739.71	363.69	275.97	1,103.40	100.25	0.00	44.27	55.98	1,323.39	32.90
858.91	363.69	275.97	1,222.60	136.01	0.00	44.27	91.74	1,406.83	30.00
957.01	363.69	275.97	1,320.70	165.44	0.00	44.27	121.17	1,475.50	30.00
1,094.41	363.69	275.97	1,458.10	206.66	0.00	44.27	162.39	1,571.68	30.00
1,194.35	360.15	275.97	1,554.50	235.58	0.00	42.05	193.53	1,636.94	34.70
1,280.15	360.15	275.97	1,640.30	261.32	0.00	41.17	220.15	1,696.12	31.03
2,139.05	356.35	275.97	2,495.40	517.85	0.00	40.23	477.62	2,293.75	30.42

**Table 13: EMTRs of Sole Parent with One Child**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
248.17	221.93	131.26	470.10	48.72	0.00	27.36	21.36	580.00	
251.97	221.93	131.26	473.90	49.86	0.00	27.36	22.50	582.66	30.00
427.77	221.93	131.26	649.70	102.60	0.00	27.36	75.24	705.72	30.00
595.47	221.93	131.26	817.40	152.91	0.00	27.36	125.55	823.11	30.00
758.87	221.93	131.26	980.80	201.93	0.00	27.36	174.57	937.49	30.00
903.67	221.93	131.26	1,125.60	245.37	0.00	27.36	218.01	1,038.85	30.00
1,002.46	213.84	131.26	1,216.30	272.58	0.00	25.35	247.23	1,100.33	37.77
1,239.46	213.84	131.26	1,453.30	343.68	0.00	25.35	318.33	1,266.23	30.00
1,291.06	213.84	131.26	1,504.90	359.16	0.00	25.35	333.81	1,302.35	30.00
1,343.42	208.98	131.26	1,552.40	373.41	0.00	25.35	348.06	1,335.60	36.50
1,552.08	206.12	131.26	1,758.20	435.15	0.00	24.14	411.01	1,478.45	31.54

**Table 14: EMTRs of Sole Parent with Two Children**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
183.79	221.91	214.23	405.70	0.00	16.75	27.96	0.00	664.64	
354.61	221.39	214.23	576.00	34.34	0.00	27.23	7.11	783.12	30.64
517.61	221.39	214.23	739.00	83.24	0.00	27.23	56.01	897.22	30.00
741.11	221.39	214.23	962.50	150.29	0.00	27.23	123.06	1,053.67	30.00
845.81	221.39	214.23	1,067.20	181.70	0.00	27.23	154.47	1,126.96	30.00
1,033.76	213.84	214.23	1,247.60	235.82	0.00	25.35	210.47	1,251.36	33.81
1,107.66	213.84	214.23	1,321.50	257.99	0.00	25.35	232.64	1,303.09	30.00
1,184.96	213.84	214.23	1,398.80	281.18	0.00	25.35	255.83	1,357.20	30.00
1,401.76	213.84	214.23	1,615.60	346.22	0.00	25.35	320.87	1,508.96	30.00
1,410.76	213.84	214.23	1,624.60	348.92	0.00	25.35	323.57	1,515.26	30.00
1,782.08	206.12	214.23	1,988.20	458.00	0.00	23.42	434.58	1,767.85	31.98

**Table 15: EMTRs of Sole Parent with Three Children**

Private Income	Allowance Income	Family Benefit	Taxable Income	Income Tax	Social Security Nucleus	Total Offsets	Total Tax	Disposable Income	EMTR (%)
399.72	255.28	297.19	652.00	10.98	0.00	49.73	0.00	987.94	
418.42	255.28	297.19	670.70	16.59	0.00	49.73	0.00	1,001.03	30.00
657.82	255.28	297.19	910.10	88.41	0.00	49.62	38.79	1,168.50	30.05
764.42	255.28	297.19	1,016.70	120.39	0.00	49.62	70.77	1,243.12	30.00
944.62	248.28	297.19	1,189.90	172.35	0.00	49.62	122.73	1,364.36	32.72
1,101.92	248.28	297.19	1,347.20	219.54	0.00	49.62	169.92	1,474.47	30.00
1,136.22	248.28	297.19	1,381.50	229.83	0.00	48.23	181.60	1,497.09	34.05
1,561.26	242.84	297.19	1,801.10	355.71	0.00	47.16	308.55	1,789.74	31.15
1,602.86	240.24	297.19	1,840.10	367.41	0.00	46.64	320.77	1,816.52	35.62

Sources: STINMOD and authors' own calculations

## 5.5 Policy Implications

The proposed UITT package can achieve its three main objectives. First, the 30% tax rate applied to most or all sources of personal income helps to simplify the current PITT structure. Secondly, the uniform tax rate applied to both personal and company tax helps to eliminate individual taxpayers' opportunity and incentive to engage in tax arbitrage activities. The tax compliance costs relating to tax avoidance and/or tax planning will be accordingly reduced. Some corresponding decreases in tax administrative costs can also be reasonably expected.

Thirdly, the modelling results show that the EMTR problem will be improved. The substantial reduction in EMTRs will generate more work incentives to both those people who are already in the labour force and those who are seeking jobs. From the labour supply side perspective, the unemployment rate can be expected to fall and the poverty trap may therefore be lessened.

The modelling results also indicate that the proposed UITT package decreases the tax burden borne by most family types, except single adults. In particular, individuals/families

having disposable income in excess of \$1,500 per week will all be better off. This improves Australia's ability to compete internationally for skilled labour. On the other hand, the proposed social security nucleus provides low-income individuals/families with extra income compared with the current PITT system. However, as noted previously, most of the Single Adult groups turn out to be worse off under the reform package. The allowance for these groups may be increased to compensate for their losses.

However, this reform package will cost the federal government about \$10.8 bil in revenue in 2006–07. This considerable loss in revenue can be funded from various sources, which are outlined below:

- The revenue gap between the benchmark and the proposed package tends to be overstated due to the static nature of STINMOD. Since STINMOD does not capture the efficiency enhancement of the proposed package, the forecast revenue of the proposed UITT package would be understated, causing the revenue gap to be overstated.
- The STINMOD simulation does not take into account two further sources of revenue gain to the government: a decrease in personal taxpayers' claims of deduction for costs of managing their personal tax affairs and a decrease in social security payments due to improved labour participation of low-income individuals.
- Since the GST has yielded more revenue than forecast, the overall tax burden in Australia has increased slightly as a result of the GST-based reform.<sup>2</sup> Thus, a reduction in PIT revenue (as proposed by the UITT package) would return the overall tax burden in Australia to the pre-2000 level (which was about 30% of GDP).
- The current situation of federal budget surplus is another source of funding for the proposed package.

In summary, it seems plausible to expect that, under the reform package, there will be social net gains in the long term, arising from a more transparent, simpler and robust PITT system.

## 6. CONCLUSIONS

The proposed UITT package certainly achieves two important criteria of good tax policy, namely, simplicity and efficiency. This is so because the proposal helps to simplify the PIT structure, eliminate the incentive and opportunity to engage in tax arbitrage activities and improve the EMTR problem. This pro-family proposal will also bring a long-term benefit to Australia's ageing problem.

The feasibility and implementability of the proposal will depend on the cost–benefit analysis of the real situation to determine whether or not it is fiscally sustainable in a longer term. However, the idea of making every worker having at least 60 cents of every dollar they earn (and receive from the government) can expect to generate widespread acceptance and support from the community at large. It provides a plausible alternative for personal income tax and transfer reform in Australia.

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<sup>2</sup> The overall tax burden (tax revenue relative to GDP) in Australia increased from 31.5% in 1999–2000 to 32.0% in 2000–01, but fell to 31.6% in 2003–04 (ABS 2006, Table 27.13, p. 647 and Table 29.5, p. 670).

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