



A Discussion Paper

# THE TAX DEBATE AND WAGES POLICY



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DISCUSSION  
PAPER

## **DISCUSSION PAPER: THE TAX DEBATE AND WAGES POLICY**

1. In September 2005 the Australian Catholic Commission for Employment Relations (“ACCER”) published a briefing paper on the Commonwealth’s proposals for the reform of workplace relations; *Briefing Paper No 1 on the Commonwealth Government’s Proposals to Reform Workplace Relations in Australia*. One of the matters raised in that briefing paper was the impact of income taxation on the living standards of the low paid and on their job prospects. Since the drafting of that paper there has been a substantial increase in the public debate about tax reform in Australia.
2. There are two notable features of the taxation debate that we wish to address in this discussion paper. First, the debate has failed to recognise the need to integrate taxation policy with wages and work-related welfare policies. The three are inextricably linked. Second, the interests of the low paid have barely rated a mention in a debate dominated by proposals for a reduction in the top rate of taxation. We deal with this aspect in the context of the unequal treatment of high and low income earners in recent years and over the longer term.

### ***Wages, Taxation and Welfare Policies***

3. As we explained in Briefing Paper No 1, the Commonwealth has proposed a fundamental change to the setting of wages in Australia. It wants wages to be fixed by reference to the single employee. Briefing Paper No 1 sets out some of the history of wage fixation in Australia, the historical importance of the family wage and the continuing relevance of the employee’s need to support his or her dependants. In recent years there has been a drift away from the family wage in award rates of pay. However, this does not mean that wages have been fixed by reference to the single employee. Wage rates have been fixed by reference to needs that are greater than the needs of the single person. Importantly, there has been continued recognition that the needs of employees include the needs of their dependants. Briefing Paper No. 1 refers to the present inadequacy of the Federal Minimum Wage, together with welfare payments (family benefits), to support a family at an appropriate standard of living. It argues for the family wage.
4. The proposal to introduce the single worker wage and depart from the family wage altogether will have substantial budgetary consequences if implemented. It would mean that, over time, the families of low paid employees will need to be wholly supported by the public purse, and not partly supported by it, as is currently the case.
5. A financial impact assessment of the Commonwealth’s single person proposal should include the further cost to the taxpayer of supporting the second parent and dependent children. A financial impact assessment would also include an estimate of the costs of supporting the dependents of low paid single parents,

- especially the high cost of childcare. Taxation, welfare and wages policies have to be integrated when the government seeks to encourage single parents to undertake work that is remunerated on the basis of the needs of the single person. Many single parents are unable to secure the kind of jobs that provide an income sufficient for themselves *and* their children.
6. The relationship between wages policy and the Commonwealth Government's budgetary policy hasn't only emerged with this proposed change to wage-fixation. For some years there has been a debate about the respective merits of tax cuts and wage increases. Employers have regularly told the Australian Industrial Relations Commission ("the AIRC") that tax cuts are a better way of meeting the needs of low paid employees. The proper target of this argument is the Commonwealth, but to date it has not engaged in the development of co-coordinated and adequate wages and welfare policies for working families.
  7. The Commonwealth Government claimed in the AIRC's 2005 Safety Net Review Case that safety net wage increases "are a poor means of addressing the needs of the low paid". The only alternatives to these wage increases are in the Commonwealth's own hands: i.e. taxes and transfer payments. It has not responded to the implications of its own position. The 2005 Budget delivered across the board tax cuts of \$6.00 per week, not enough to cover the *bracket creep* of recent years.
  8. The Commonwealth should address wages, tax cuts and transfer payments in the course of the tax debate. The taxation debate should consider the capacity of tax relief and improved transfer payments to provide an alternative to wage increases. The other political parties, employers and the union movement should state also their positions on this aspect.
  9. Another budgetary matter calling for reform is the high effective marginal rates of taxation that apply to low income earners. The provision of various kinds of income support to low income earners must involve means-testing, with the benefits being progressively withdrawn as their wages increase.
  10. The combination of the underlying tax rates and the progressive withdrawal of those benefits produce the effective marginal tax rate. The marginal rate of taxation for a full time worker on the Federal Minimum Wage of \$484.40 per week is 30%. Because the low income tax offset is means-tested, the effective rate is 34%. This is a very high burden when compared to the position of those who are paying the highest rate of 47%. Effective marginal rates of taxation are also affected by welfare to work policies that withdraw benefits as workers undertake more employment. Poverty traps, where workers get little or no effective benefit from increased employment and are unable to move out of poverty, need to be addressed through the expenditure side of the Budget.

11. An example of these dysfunctional policies is the *Parenting Payment (Partnered)*. This is income support for a parent who has a partner, unlike the single parent. The income of the partner is taken into account, as one would expect, in calculating the benefit to be paid. However, the breadwinner's wage increases have an excessive effect on the parenting payment. The combination of the working partner's effective taxation rate of 34% (if low paid) and the withdrawal of the income support from the recipient produce an effective marginal tax rate of 104%. A wage increase for the breadwinner actually leads to a loss of household income. This loss occurs where the wage increase comes from, for example, an arbitrated safety net decision, a workplace agreement, a promotion or the working of overtime. The impact on household income is reduced by indexed adjustments to the amount of the income support payment and the range over which it is phased-out, but there is a time lag and the effective marginal rate of taxation remains at 104% for earnings in excess of these adjustments.
12. The necessary reform of effective marginal tax rates will come at a cost to the Budget. The income range over which welfare is needed for various groups of workers and their families and the rates at which benefits are phased-out need to be addressed. The proper balance may not be easy to find. But the search needs to be undertaken in a proper review of budgetary policies. It must be part of the taxation debate.
13. Finally on this aspect, a critical requirement for informed and appropriate wages and budgetary policies to support low paid working families is sound research on the financial needs of those families. Better information on this aspect will facilitate discussion on the balance between the respective contributions of the wage packet and the public purse. The imposition of taxation on low paid employees without a proper consideration of their needs runs the risk of taxing them into poverty.

#### ***Taxes on the Low Paid***

14. The tax debate should scrutinize the competing claims of various income earners to tax relief. To date, the debate has not turned on the respective capacities of groups of income earners to pay the current levels of taxation. Nor has it given sufficient consideration to the needs of the low paid and the impact of income tax on the costs of employing them. There are moral and economic arguments in support of tax relief for low income earners.
15. In dealing with economic arguments, it must be borne in mind that the wages of the low paid, and, therefore, the cost to employers of their labour, include a substantial amount of income tax. In the Federal Minimum Wage of \$484.40 per week the proportion of income tax is 13.27%. It amounts to \$64.29 per week. This substantial figure has implications for the standard of living of low paid employees and the cost to employers of engaging them.

16. The relationship between wage levels and employment prospects in an economy is a vexed question amongst economists. To the extent that there is a negative relationship between the level of minimum wages and employment prospects, the Commonwealth's taxation of low paid employees is a factor that is detrimental to employment prospects. Those who argue that minimum wage levels are too high or that arbitrated wage increases are excessive should also address the consequences of taxation rates on low paid employees. Governments must address the economic impact of their own taxation policies.
17. The progressive reduction of this tax burden would *tend* to reduce the costs of employment, stimulate employment and assist Australia in maintaining its international competitiveness. There is an economic case for increasing the amount of government transfers to low income working families so as to reduce their reliance on wages. This point is not a novel one: it is the basis of the past claims by employers that tax reductions are to be preferred to wage increases. There is also an economic case for moving towards zero taxation for minimum wage employees. This might be achieved by tax offsets for low income earners, earned income tax credits, changes to taxation thresholds or by a combination of these and other measures. The tax debate should address these measures.
18. The tax debate should also address the balance between the respective contributions of the public purse and the wage packet in meeting the needs of low paid working families. The wage packet alone is presently insufficient to meet the needs of low paid working families. The substantial amount paid by way of family payments is evidence of that. There needs to be debate about the appropriate balance between the wage packet and the public purse in meeting the needs of an employee's dependents. It should recognise that this kind of welfare provides economic value to the country as well as meeting the ongoing needs of working families. That debate will involve economic and value judgements.

### ***Progressive taxation***

19. Taxation levels should also take into account the capacity of various income groups to pay tax. Progressive taxation seeks to do that. The progressiveness of the Australian taxation system has been reduced and further reductions are proposed. This is demonstrated by reference to changes that have occurred over the past forty years and, in particular, the last five years. It is illustrated in a comparison between the taxation payable by the Federal Minimum Wage employee (and the earlier Basic Wage employee) and by an employee who is paid five times that minimum wage.

### ***Taxation changes over 40 years***

20. Attachment 1 shows a comparison between the tax payable by minimum wage employees, being those earning the Basic Wage in 1965 and those on the Federal Minimum Wage in 2005, and employees earning five times those minimum

- wages. It demonstrates that changes in taxation rates over the last forty years have advantaged high income earners and disadvantaged low income earners relative to each other.
21. In the past 40 years the tax paid by minimum wage employees has increased from 8.71% to 13.27% of their wage packet, an increase of over 52.4%. Furthermore, their marginal tax rate has almost doubled, rising from 17.6% to 34%. This is especially relevant to considerations of work incentives and rewards. For example, in 1965 17.6% of the pay for the first hour of overtime was lost in tax, now 34% is lost in tax.
  22. Employees who are paid five times the minimum wage rate have seen their tax rise from 29.77% to 33.98%, an increase of 14.14%. From July 2006 their tax will fall to 32.13% of their income as a result of announced budgetary changes. Importantly, their marginal tax rate has actually decreased: from 48.7% to 47% over the 40 years. Taxpayers receiving higher incomes than this group have received significant benefits because the marginal tax rates on higher incomes (which were as high as 66.7% in 1965) have been reduced to 47%.
  23. Changes in the marginal tax rates over the past 40 years have had a greater negative impact on low income earners. Under the 1965 tax scales the employee on the Basic Wage could earn a further 12% before moving into the next tax bracket, which was then 19.3%. At double the Basic Wage the marginal tax rate was only 29.6%. By contrast, the 30% marginal rate under the current scales (which equates to 34% for those in receipt of the low income tax offset) commences at \$21,600, a wage substantially less than the Federal Minimum Wage for a full time employee.
  24. The increasing burden of income tax on low paid employees has negative effects: it can reduce their standard of living and/or it can make their labour more expensive than it would otherwise have been. The relative impact of the tax increases over the past 40 years on each of these aspects is uncertain and will be contentious. Whether one or both, the impact of increased taxation has been substantial.

#### ***Taxation changes since July 2000***

25. The trend identified over the past 40 years has also been evident over the past five years. Attachment 2 shows the changes that were introduced by the *New Tax System* (GST etc) on 1 July 2000. Those changes followed an extensive public debate and are an appropriate reference point for identifying and considering changes in relative tax burdens. This is not to suggest that changes should not be made to relative tax burdens. However, the onus is on those who advocate changes in these relativities.

26. Federal Minimum Wage employees are paying more tax than they were five years ago. If they were paying the same percentage as they were on 1 July 2000, they would now be paying \$3,031 per year in tax, not \$3,355 as they do. This loss amounts to \$324 per year or \$6.21 per week.
27. By contrast, employees on five times the Federal Minimum Wage have seen their tax decline from 34.92% to 33.98% of their income, with a further reduction to 32.13% from 1 July 2006. By reference to the earlier percentage, the changes amount to an effective reduction in tax of \$1,184 per year or \$22.69 per week during 2005/06. From 1 July 2006, the effective reduction will be \$3,523 or \$67.52 per week.
28. These figures demonstrate that the taxation changes since 1 July 2000 have widened the after tax earnings gap between the employees on the Federal Minimum Wage and those who earn five times more. Taking into account the respective changes the gap now amounts to \$28.90 per week. From 1 July 2006 it will be \$73.73 per week.
29. Various proposals and models have been put advanced in recent months. A particularly detailed one was set out in a September 2005 report commissioned by the Victorian Government. The Government has noted that the report represents the views of its authors and does not purport to be a statement of Victorian Government policy.
30. In effect, the Victorian report proposes substantial benefits to high-income earners, with limited gains to low paid employees. The Victorian report's proposals mean that Federal Minimum Wage employees would pay receive a tax cut of \$512 per year, or \$9.81 per week, on the current scales. However, this amounts to a benefit of only \$3.61 per week when compared with the position five years ago. Compare this with the proposals for high-income earners. The Victorian report's proposals mean that those on five times the Federal Minimum Wage would receive a further tax cut on top of those commencing 1 July 2006. The report proposes that they receive a tax reduction of \$6,080 per year, or \$116.52 per week, when compared with the tax rate at 1 July 2000. The differential treatment of these low and high-income employees is not consistent with equity and fairness or any proper economic analysis.

### ***Trends in Pre-Tax earnings***

31. It should also be appreciated that the taxation changes for low income earners have occurred over a period in which the wages of many of them have changed relative to other employees. Many low-income earners are dependent upon the pay and conditions prescribed in awards arbitrated by the AIRC and various State tribunals. About 20% of employees are "award only" workers who do not have the capacity to bargain for better terms of employment. They are more likely to be found in low paid jobs.

32. We can compare the Federal Minimum Wage with average weekly ordinary time earnings for full time adult employees ("AWOTE"). AWOTE includes the earnings of those under workplace agreements. In the period 1983 to 2004 the Federal Minimum Wage (and its predecessors) fell from 61% to 49% of AWOTE. In the period 1996 to 2004 the Federal Minimum Wage increased by 33.8% and AWOTE by 41.2%. The discrepancy is more marked for those who are in more skilled jobs, but who do not have the power to bargain for increased pay. Over those eight years the tradesperson's award rate increased by only 27.2%. (These aspects are considered in a paper presented by the President of the Australian Industrial Relations Commission, Justice Giudice, on 2 September 2005. It is found at [www.airc.gov.au/research/speeches](http://www.airc.gov.au/research/speeches))

### ***Conclusion***

33. The low paid have been the losers in the tax changes over the past 40 years and the trend has been reinforced since the introduction of the *New Tax System* on 1 July 2000. The trend may continue unless there is a reorientation of the current taxation debate. We are also confronted with proposals to change Australia's wage-fixing procedures in a way that threatens to exacerbate the burden on low paid working families. These developments call for a broad and informed debate and decisions by the Commonwealth that integrate wage, employment, taxation and welfare policies in a way that will promote economic growth and social justice.

## ATTACHMENT 1

### Taxation changes over 40 years

#### September 1965

##### Basic Wage:

\$30.80 per week

Tax on Basic Wage: \$2.68 per week

Tax as proportion of wage: 8.71%

Marginal tax rate: 17.6%

##### Five times Basic Wage:

\$154 per week

Tax payable: \$45.85 per week

Tax as proportion of wage: 29.77%

Marginal tax rate: 48.7%

#### September 2005

##### Federal Minimum Wage (FMW):

\$484.40 per week

Tax on FMW: \$64.29 per week.

Tax as proportion of wage: 13.27%

Marginal tax rate: 34%

##### Five times FMW:

\$2,422 per week

Tax payable: \$823.07

Tax as proportion of wage: 33.98%

Marginal Tax rate: 47%

### Footnotes

1. The September 1965 rates have been converted to decimal currency. Decimal currency was introduced on 14 February 1966.
2. Taxation calculations for 2005 do not include the Medicare Levy, but include, where applicable, the low income tax offset.
3. Annual calculations are based on 52.18 weeks.
4. In 1965 there were six further marginal tax rates beyond 48.7%. The top marginal tax rate was 66.7%, a rate payable on income in excess of \$612 per week, i.e. 19.8 times the Basic Wage.
5. The taxation payable by the higher wage earners will be reduced from 1 July 2006. From that date the tax payable at an income five times the FMW will be \$778.23 per week, 33.13% of the gross wage. From that date the highest marginal tax rate of 47% will be payable on income in excess of \$125,000 per year or \$2,395.55 per week, i.e. 4.9 times the current FMW.
6. The rate of 34% for FMW employees in 2005 includes the progressive withdrawal of the low income tax offset, which equates to 4%.
7. The 1965-66 tax scales are found in the **Income Tax Act** No. 104 of 1965.

## ATTACHMENT 2

### **Taxation changes since 1 July 2000 and the Victorian proposals**

#### **1 July 2000**

Federal Minimum Wage: \$400.40 per week and \$20,893 per year  
 Tax payable: \$2,505.58, or 11.99%

Five times Federal Minimum Wage: \$104,464  
 Tax payable: \$36,478, or 34.92%

#### **1 July 2005**

Federal Minimum Wage: \$484.40 per week and \$25,276 per year  
 Tax payable: \$3,355, or 13.27 %

Five times Federal Minimum Wage: \$126,380  
 Tax payable: \$42,948, or 33.98%

#### **Rates to commence 1 July 2006 applied to current wage levels**

Federal Minimum Wage: \$484.40 per week and \$25,276 per year  
 Tax payable: \$3,355, or 13.27%

Five times Federal Minimum Wage: \$126,380  
 Tax payable: \$40,609, or 32.13%

#### **Rates proposed by the Victorian report applied to current wage levels**

Federal Minimum Wage: \$484.40 per week and \$25,276 per year  
 Tax payable: \$7,583 (30%) less rebate of \$4,740 = \$2,843, or 11.25%

Five times Federal Minimum Wage: \$126,380  
 Tax payable: 30% up to 125,000 and 40% on the balance = \$38,052, or 30.11%

#### **Footnotes**

1. Taxation calculations do not include the Medicare Levy, but include, where applicable, the low income tax offset.
2. Annual calculations are based on 52.18 weeks.
3. The Victorian report is a report commissioned by the Victorian Government and published in September 2005.