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Special Edition: Tribute to the late Professor John Tiley

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Progressivity in the tax transfer system: changes in family support from Whitlam to Howard and beyond

Helen Hodgson¹

Abstract

Since the 1970s personal income tax rates have become less progressive throughout the OECD. During this period inequality has also increased. This is also true of Australia, where over the same period transfer payments have been more closely targeted to those in need. Accordingly over this time the Australian tax-transfer system has shifted from a system with highly progressive tax rates coupled with universal benefits in respect of children and pensioners to a system of flatter tax rates and transfer payments that are recognised as among the most targeted in the OECD. In this paper I will explore the relationship between personal income tax rates and means tested transfer payments in developing a progressive tax-transfer system since the 1970s, in the context of support for families.

Keywords: Tax-transfer; Family Tax benefit; Universal benefits; Progressive tax rates

¹ Helen Hodgson is an Associate Professor at Curtin Law School, Curtin University, GPO Box U1987, Perth, WA 6845, Australia. Tel. +61 8 9266 5620; Fax + 61 8 9266 3222. Email address: helen.hodgson@curtin.edu.au. This paper is drawn from analysis in her PhD thesis, awarded in June 2013, "A Comparative Historical Analysis of the Family Tax Transfer System in Australia and the UK, 1972 – 2007".

1 INTRODUCTION

One of the principles of tax policy design is equity, or the ability to pay principle. This is generally implemented through a progressive tax system in which the rates of tax increase as the income (or wealth) of the taxpayer increases. However over the past thirty years the progressivity of the personal income tax system has decreased in Australia, as in most OECD countries. This has been criticised by some commentators who advocate a return to more progressive income tax rates coupled with a universal welfare system.²

Tax and transfer systems are both used to redistribute income, although they work through different means.³ Tax systems redistribute through several main mechanisms: progressive tax rates, tax expenditures and the choice of the tax base. Progressive income tax rates apply the ability to pay principle effectively, but are based solely on income with taxpayers reporting higher incomes paying higher rates of tax than lower income earners. However, progressive tax rates cannot discriminate between categories of taxpayers, and accordingly tax expenditures have been devised to recognise taxpayers that meet the specified criteria. These tax expenditures may include tax offsets, rebates or credits that reduce the tax payable; tax deductions or allowances that reduce income subject to tax; modified tax thresholds or reduced tax rates. The effect of tax expenditures is to reduce tax collections, and accordingly the annual Budget Papers do not show tax expenditures as a direct expenditure,⁴ although details of the lost revenue attributable to tax expenditures may be available through annual tax expenditure statements.⁵

The major limitation of redistributing through the tax system is that the recipient must be a taxpayer. Accordingly, the tax system is not able to distribute to persons who are not within the tax system, whereas transfer payments can be more specifically targeted to recipients. A direct cash transfer payment may be made to a person who is not earning enough income to be required to pay tax, or to a non-working parent who is outside the tax system. The ability to pay principle may be applied through the application of means or asset testing. Unlike tax expenditures, transfer payments do show as a direct expenditure in the annual Budget Papers.

In contrast to a progressive tax rate schedule, a universal benefit is a tool of horizontal equity because it provides benefits to all eligible recipients: the issue is determining the criteria for eligibility. Welfare regimes can be classified by the features of that regime⁶: in a liberal welfare state universal benefits are modest with means testing being used to target benefits, while in a social democracy many, but not all, benefits are universal with higher income tax rates. In a social democracy support from the state through subsidised services is an entitlement that comes with citizenship,⁷

² P. Apps and R. Rees, 'Australian Family Tax Reform and the Targeting Fallacy' (2010) 43(2) *Australian Economic Review* 153.

³ Alison McClelland and Rick Krever, 'Social Security, Taxation Law, and Redistribution: Directions for Reform' (1993) 31(65) *Osgoode Hall Law Journal* 63.

⁴ Kerrie Sadiq, 'The Implementation of Social and Economic Policy Through the Tax Regime: A Review of Australia's Tax Expenditures Program' (2008) 23(4) *Australian Tax Forum* 339.

⁵ Charter of Budget Honesty Act, 1988 (Cth).

⁶ G. Esping-Andersen, *Three worlds of welfare capitalism* (Cambridge Polity Press, first published The Three Worlds of Welfare Capitalism, Polity Press, 1990, 2006).

⁷ Walter Korpi and Joakim Palme, 'The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality, and Poverty in the Western Countries' (1998) 63(5) *American Sociological Review* 661.

regardless of a person's means, but those deemed able to afford to pay make a higher contribution to the state. Further, if the benefit is also included in taxable income, a proportion of the benefit is clawed back which effectively applies a means test to that benefit. In contrast Australia is usually classified as a liberal welfare regime, in which the state and private enterprise work together: the state will subsidise the private sector in the provision of goods and services that are social goods, but does not usually provide the services directly, or may charge a fee for service where the user can afford to pay for that service.

While the tax and transfer systems coexist as a means of redistributing income in accordance with government priorities and programmes, they need to be considered as an integrated system. The major tax system reviews that have been undertaken over the past thirty years⁸ have regarded the two systems as two parts of the same redistributive system, which is the approach taken in this article.

Although the redistributive function of the tax-transfer system is a tool to address inequality there is evidence that disposable income is influenced more strongly by market income than by the tax-transfer system and the tax-transfer system is becoming less effective at moderating the effect of inequality in market income.⁹ Although transfers remain effective at reducing poverty among low income families, they are less effective in reducing income gaps between the highest and lowest income groups, as these are market driven, and the global flattening of personal income tax rates since the 1980s has reduced the progressivity of the tax system. Over the period of this study, western liberal democracies followed market-based economic policies that allowed disparities between the income and wealth of the highest and lowest income earners to flourish. OECD data show that from the mid 1980s to mid 1990s there was a general widening of income distribution disparity across the OECD.¹⁰ While Australian data for the earlier period are not reflected in the OECD tables, Australian studies reflect a similar pattern,¹¹ although less pronounced.

This paper considers those elements of the tax-transfer system that were available to families from time to time over this period, including both child-contingent benefits, which consist of benefits that are based on a family structure that includes dependent children and spousal benefits, which are dependent on the marital (or couple) status of the claimant.

The main categories of payments reviewed are universal payments, available to all families with children; means tested benefits that are targeted to low income families with children and benefits available to single income families, with either a sole parent or where only one parent participates in the paid labour force. Income support transfer payments, such as the Parenting Payment are not generally included, except to the

⁸ Kenneth W Asprey et al, 'Taxation Review Committee Full Report' (AGPS, 21 Jan 1975 1975) <<http://setis.library.usyd.edu.au/oztexts/parsons.html>; Ken Henry et al, 'Australia's Future Tax System: Final Report' (Commonwealth of Australia, 2010) <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/pubs_reports.htm; James Edward Meade, 'The Structure and Reform of Direct Taxation' (Allen & Unwin, 1978; Sir James Mirrlees et al, *Tax by Design*, The Mirrlees Review (Oxford University Press, 2011).

⁹ OECD, *Divided We Stand: Why Inequality Keeps Rising* (OECD, 2011); Grace Anyaegbu, 'The Effects of Taxes and Benefits on Household Income, 2009/10' (Office for National Statistics, 2011) <www.ons.gov.uk>.

¹⁰ OECD, Above.

¹¹ Roger Wilkins, 'What Really Happened to Income Inequality in Australia over the Past Decade' (2012) (31 July 2012) *SPRC Public Seminar Series*.

extent that payments in respect of dependants are included in these benefit entitlements.

The benefits may be available as a tax concession, resulting in a reduction of personal income tax that would otherwise be payable by the taxpayer, or as a transfer payment paid directly to the claimants, but direct provision of services and consumption taxes are not discussed in this article.

2 THE 1970S: THE WHITLAM ERA

In the 1970s the Australian tax and transfer systems were not integrated, with family benefits within both systems. The predominant policy rationale was based on horizontal equity in order to recognise that families with children, compared with people without children at the same income levels, had greater calls on their available income. Hence family payments recognised this and increased the disposable income of all families with children. Vertical equity was delivered through a highly progressive tax system with personal tax rates ranging from 0.3% to 66.7% in 1972.

Family benefits consisted of tax deductions in respect of a taxpayer's dependant spouse and children; additional pension or benefit payments for parents on income support; and Child Endowment. Child Endowment was a universal payment, payable to all families with children, and based on the number of children in the family. It was intended to complement the minimum wage as the basis of ensuring that families received an adequate income; however, evidence was emerging that certain groups in the community, including low income families, large families and sole parents, were at a high risk of poverty.

Child Endowment was paid to the primary carer while tax deductions or additional income support payments were paid through the pay packet to the breadwinner. Taxpayers could claim concessional deductions through the tax system¹² concurrently with the universal Child Endowment for taxpayers. Families receiving pensions or benefits through the transfer system received additional payments for children, added to the basic pension or benefit, in addition to the Child Endowment.

A dependant deduction was available for spouse, daughter-housekeeper (where the taxpayer did not have a spouse), child under 16 and full-time student up to 25 years of age.¹³ There was no means testing on the income of the taxpayer, although the income of the family member was relevant in determining the dependency of that family member.

The use of tax deductions to deliver benefits was regressive, providing higher benefits to higher income families. Accordingly, the most significant proportion of family benefits, whether in relation to a taxpayer or a recipient of social security benefits, was paid to the primary breadwinner, generally the male partner. Further there was no indexation of benefits and over time the real value of the benefits had decreased.

These deficiencies were highlighted in the two major reform proposals of this period. Although the Whitlam government introduced a number of important social reforms, credit for reform in relation to the family tax-transfer system is more appropriately

¹² *Income Tax Assessment Act 1936*: s.82B.

¹³ Deductions were also available for an invalid relative or parent, but these categories of dependant are beyond the scope of this paper.

shared by the three governments of the period: McMahon, Whitlam and Fraser. The Henderson Commission¹⁴ and the Asprey Committee¹⁵ were both established by the McMahon government in 1972, although the Henderson Commission was expanded by the Whitlam government after its election. Reforms to the tax deductions in relation to families were implemented under Whitlam, but further reforms to Child Endowment were implemented by the Fraser government as the Family Allowance.

The government responded promptly to the recommendations of the Asprey Committee and Henderson Commission reports. The 1974–75 Budget guaranteed taxpayers a minimum tax reduction of 40% of the value of any deductions for children, and in the following year the deductions were replaced with a system of concessional rebates. Spouse rebates replaced spouse deductions, and the child deduction was repealed to be firstly replaced by rebates then incorporated in the Family Allowance. With effect from 1 July 1976, the Fraser (Coalition) government replaced Child Endowment with Family Allowance, which was a non-means-tested payment, available in respect of children or students up to the age of 25. The increased rates were a substantial increase on the former Child Endowment, but there was also a substantial increase in the rates, particularly in respect of the second and third child in the family, recognising that payments did not provide adequate support to larger families. However these increased rates were not indexed to inflation, which resulted in a substantial loss in value over this period of increasing prices.

3 THE ACCORD: HAWKE AND KEATING

Changing economic conditions which led to the recession of the early 1980s placed families under financial stress, with an increase in the number of children living in poverty. This was exacerbated by the failure of payments to keep pace with inflation and the increasing number of sole parent families. In 1983 the first means tested payment, the Family Income Supplement, was introduced in addition to the Child Endowment to assist low income families. Following the increase in benefit recipients under the previous government, the number of recipients and expenditure levelled off over the first term of the Hawke government, although the report of the Cass Review highlighted the problems faced by low income families.¹⁶

When elected in 1983 the Hawke government entered into an Accord with the union movement, under which the government agreed to maintain the social wage.¹⁷ Accordingly, from 1983 changes to the tax-transfer system were made that directed higher rates of payments to families in need, with the transfer system moving from a focus on horizontal equity to vertical equity. This was implemented through means testing family payments and increasing payment rates to low income families. To some extent this compensated for concurrent changes to the tax system that resulted in a flatter structure for personal tax rates, with lower marginal rates and wider tax bands that reduced the progressivity of the tax system. Indexation of family benefits was introduced to ensure that payments were adjusted for inflation.

¹⁴ Ronald F Henderson, 'Poverty in Australia: Australian Government Commission of Inquiry into Poverty: 1st Main Report' (AGPS, 1975).

¹⁵ Above note 8.

¹⁶ Bettina Cass, 'Income Support for Families with Children' (Issue Paper No 1, Department of Social Security, 1986).

¹⁷ Lloyd Cox, 'The Antipodean Social Laboratory, Labour and the Transformation of the Welfare State' (2006) 42(2) (June 2006) *Journal of Sociology* 107 :112.

In 1985 the tax reforms proposed in the RATS White Paper¹⁸ were debated at the National Tax Summit. This tax summit was established by the Hawke (Labor) government following the 1984 election in order to facilitate debate on future tax reforms. In the spirit of the Accord, the government was seeking consensus among the invited stakeholders, particularly business and the union movement. The major issues addressed in the RATS White Paper were related to broadening the tax base and tax avoidance issues. In many respects the paper followed up on reforms proposed by the Asprey Committee a decade earlier: the introduction of a broad-based consumption tax (although this did not eventuate for another 15 years, and was implemented by the Howard (Coalition) government); a capital gains tax; dividend imputation and a fringe benefits tax.

The RATS White Paper included a review of the relationship between the social security and income tax systems¹⁹; particularly the structural problems that arose from 'bracket creep', which could push the recipient of an indexed payment above the tax-free threshold; and the effective marginal tax rates (EMTRs) that applied where withdrawal rates for pensions and benefits combined with personal income tax rates.

While the first problem had been substantially addressed by the beneficiary and pensioner tax rebates introduced in 1983, the problems arising from the withdrawal rates of benefits was noted as being 'rather more intractable'.²⁰ The proposal of the Henderson Commission for a guaranteed minimum income scheme was reviewed, as were the Asprey Committee proposals for a separate tax scale for social security recipients, relaxing the means tests imposed under social security law and exempting pensions or benefits from tax.

The RATS White Paper recommendations to reduce income tax rates relied substantially on comprehensive reform that included the introduction of a broad-based consumption tax that would fund reductions in income tax rates for lower income earners, and compensatory packages for lower income earners (Options B and C). One form of compensation that was contemplated was the extension of family income support. The White Paper made no specific proposals regarding reform of withdrawal rates of means-tested payments, as the drafters relied on the proposed income tax rate reductions to address the high EMTRs imposed by the combined effects of the two systems.²¹

The proposed options incorporating the consumption tax were rejected at the National Tax Summit held in June 1985. The government proceeded with a number of base-broadening measures that did not include a consumption tax; accordingly, the personal income tax cuts, as set out below, were not in the order contemplated by Option C, which would have seen a tax rate of 20% applying on the lowest incomes, up to \$19,500 pa. The cuts were phased in over a number of years, with the new structure emerging by the 1987–88 year. As shown in Table 1 the biggest personal income tax cuts were to the highest tax brackets, which were reduced from 60% to 49%. Corporate tax rates were also reduced from 49% to 36%.

¹⁸ Australian Treasury, *Reform of the Australian Tax System - Draft White Paper* (AGPS, 1985).

¹⁹ Above, chapter 10.

²⁰ Above note 18 at p 104.

²¹ Australian Treasury, above n 18: 250; A 1985 proposal to reduce the withdrawal rate applied to pensions (*The Social Security (Poverty Traps Reduction) Act 1985*) was deferred to 1987 and overtaken by other changes to the pension system: Bob Dapre, *A Compendium of Legislative Changes in Social Security 1983 - 2000*, FACSIA Occasional Paper Series (FACSIA, 2006).

Table 1 Change in Personal Marginal Tax Rates Following RATS

1983–84: Before RATS Reforms		1987–88: After RATS Reforms	
Annual Income	Marginal Rates	Annual Income	Marginal Rates
1–\$4, 594	Nil	\$1–\$5, 100	Nil
\$4, 595–\$19, 499	30%	\$5, 101–\$12, 600	24%
		\$12, 601–\$19, 500	29%
\$19, 500–\$35, 787	46%	\$19, 501–\$35, 000	40%
\$35, 788 and over	60%	\$35, 001 and over	49%
	Medicare levy		Medicare levy
Over \$7, 050	0.416%	Over \$8, 980	1.25%

The effect of these changes was to reduce the progressivity of tax rates. High income earners received more benefit from the rate cuts than lower income families, but the base broadening measures captured fringe benefits, capital gains and other amounts frequently received by high income earners that had not previously been taxed effectively, and overall the changes were initially progressive.

However inflation was not recognised in either the tax or the transfer system and the progressive effect of the changes was eroded as family payments were not adjusted and bracket creep pushed low and middle income earners into higher tax brackets.

Although the outcomes of the 1985 Tax Summit did not produce any direct outcomes to assist families with children, in February 1986 the government established the Review of Social Security (Cass Review).²²

This review addressed a number of aspects of the social security system including income support for families with children including sole parent families; people with disability; the unemployed; and the aged. The interaction of social security with labour force issues for sole parents and unemployed people was also addressed.

The Cass Review progressed through the publication of a series of issues papers, the first of which considered the question of family income support. The paper used the framework of equity and adequacy to examine the effectiveness of the system and whether lower income families had adequate income to fulfil the needs of their children. In particular, the review highlighted the effect of the lack of indexation of benefits in a period of high inflation. Some of the proposals endorsed by the Cass Review included:

²² Cass, above n 16.

- a supplement for low income families, with additional supplements for families in specified circumstances;
- indexation of child-related payments;
- income payments to sole parent families, which are particularly vulnerable;
- income testing of dependant spouse rebates;
- positive steps to assist parents returning to the labour force;
- ensuring that the primary carer receives income support through directing payments to the carer; and
- retention of the universal family allowance as a base level of payment.

The Review also examined the option of income testing or taxing family allowances, but rejected that proposal. It highlighted the issues faced by families who were outside the paid labour force, or in low-paid employment.²³ In particular, it noted that the lack of indexation had eroded the increases that had been achieved in 1977 by about 30%.²⁴ It recommended the retention of a universal benefit with the addition of a means-tested layer to assist families in need.

The Cass Review heralded the introduction of reforms that targeted the Family Allowance to those families in most need, specifically low income families regardless of their work status. However, in implementing this targeted system the government went beyond the recommendations of the report to impose general means testing of benefits: a step not recommended by the Cass Review.

Reforms to the transfer system to target benefits to low income families were introduced in Australia when greater targeting of Family Allowance was introduced by the Hawke Labor government. In 1987 Hawke placed child poverty on the political agenda with his pledge to address child poverty.²⁵ In context, the government linked the welfare of the nation to the welfare of families, and the pledge to support families was a pledge to maximise that resource. Regardless of the outcome, the policy signal was unambiguous. Although the targeting of benefits was linked to expenditure restraint, and benefits were income tested from 1987, there was a significant trend upwards in the overall expenditure on family benefits. Over the next decade spending on family programs increased as a percentage of GDP from 1% in 1986 to 2.8% in 1996.

In the 1993–94 tax year the Low Income Tax Offset (LITO) was introduced to provide further assistance through the tax system. This offset, initially \$150, was available to low income earners, then phased out at 12.5% for each dollar earned over the threshold of \$20, 700, thus giving a tax cut that did not flow through to higher income earners, but increasing the EMTR over the taper range.

²³ Above at p 10.

²⁴ Above note 22 at p 51.

²⁵ Robert J Hawke, 'Election Speech' (1987) *Museum of Australian Democracy* <<http://electionspeeches.moadoph.gov.au/speeches/1987-bob-hawke>>.

4 ANTS AND BEYOND: THE HOWARD YEARS

The third period of reform was linked to the introduction of the GST in 2000. Following the election of the Howard (Coalition) government in 1996, this period was one of relative economic and political stability with relatively low and stable unemployment and inflation rates. The new Government introduced the Family Tax Initiative (FTI) in 1997 which partially returned family transfer payments to the tax system, although the Family Payment continued to be paid as a transfer payment to the primary carer in accordance with the Coalition's 1998 election campaign commitment to maintain the family components built into the existing social security system. In particular, this meant that the Family Allowance and Supplement continued to be paid to the principal carer as a transfer payment. To address criticisms of previous systems that providing family relief through the tax system ignored the needs of families that did not pay tax, a parallel payment, the Family Tax Payment (FTP), was made through the transfer system for families that earned less than \$20, 700 pa.

The FTI was soon replaced with the introduction of the GST reform package labelled as A New Tax System (ANTS). ANTS was the most significant tax reform during this period, and in addition to the introduction of the GST it incorporated adjustments to the income tax scales and a more substantial restructure of the family tax-transfer system through the introduction of the Family Tax Benefit (FTB) and rationalising childcare benefits.

The change to the income tax scales included a reduction in the rates and the thresholds, however the original proposals taken to the 1999 election were modified when the legislation was passed:

Table 2 Change in Personal Marginal Tax Rates Following ANTS

1997 - 1998 Rates		ANTS Proposal		Enacted 2000 – 2001 Rates	
Income \$	Rate %	Income \$	Rate %	Income \$	Rate %
0 – 5, 400	0	0 – 6, 000	0	0 – 6, 000	0
5, 401 – 20, 700	20	6, 001 – 20,000	17	6, 001 – 20, 000	17
20, 701 – 38, 000	34	20, 001 – 50, 000	30	20, 001 – 50, 000	30
38, 001 – 50, 000	43	50, 001 – 75, 000	43	50, 001 – 60, 000	42
Over 50, 001	47	Over 75, 000	47	Over 60, 000	47

The Low Income Tax Offset and Medicare Levy remained unchanged at \$150 and 1.5% respectively. The effect of this restructuring was to pass an income tax cut to all taxpayers through the reduction in rates at the lower levels but high income earners received a greater benefit through the increased threshold for the highest tax rates. This was justified on the basis that the higher consumption of these taxpayers would result in an increased tax burden through the GST.

The extension of thresholds and reduction in withdrawal rates extended family payments to more families with higher incomes, although they did not return to the universality of the 1970s. While family benefits increased during this period, there was an increasing emphasis on the use of the income support system to encourage jobless workers back into the labour force. The Howard government linked the FTB to tax cuts for families when it claimed to have achieved its policy objective of

reducing the tax paid by families.²⁶ However, although the tax payable by low income families may have reduced, the taper rates resulted in increased EMTRs over this period.

From 2000 the FTB could be claimed either as a tax benefit or a transfer payment, although it was clearly linked to the tax system by the government and promoted as reducing the effective tax rates paid by families.²⁷ However, from its inception over 90% of FTB payments were claimed by instalments as a transfer payment, not as an annual lump sum through the tax system. Income support recipients, who represented about 25% of FTB recipients in 2007, were required to claim the benefit on a fortnightly basis.

Unlike the GST component of the package, the changes to family benefits were evolutionary change, as the new system was based on the child-related payments in place before 2000: child-related payments remained means tested and affluence tested, with low income families being entitled to higher payments while high income earners lost entitlement. The dependant spouse rebate was removed from the tax system in relation to families with dependent children, being replaced by the FTB Part B. However, this development was also consistent with the Home Child Care Allowance that had been in place between 1994 and 1997, which had also paid the spouse-related benefit to the primary carer.

A more significant development was the increased rates of child-related payments payable to middle income families. This was a function of the increased payment rates and the lower withdrawal rates at both the upper and lower income thresholds that allowed more families to qualify for FTB, but the longer taper range meant that more families experienced increased EMTRs as FTB was withdrawn.

Analysis of the impact of the ANTS package on tax and benefits concluded that the package was, overall, redistributive towards lower income households.²⁸

However there were later adjustments to personal income tax rates that clearly benefitted higher income earners. Between 2001 and 2006 the thresholds for the higher income tax rates were increased, culminating in a substantial lift in the year ended 30 June 2006:

²⁶ Peter Costello, 'Costello Hands Down Ninth Budget' (2004) *ABC Lateline* 11/05/2004 <<http://www.abc.net.au/lateline/content/2004/s1106256.htm>>

²⁷ Australian Treasury, *Not A New Tax: A New Tax System* (AGPS, 1998): 52; Peter Costello, 'Meet the Press' (2006) 30/04/2006 <<http://legacy.ten.com.au/promo.aspx?currentpage=2&factSheetYear=2006&factSheetMonth=4&factSheetDate=0&promoID=22&promoSubSectionID=4&searchwords=Costello>> ; *ibid*

²⁸ Ann Harding, Rachel Lloyd and Neil Warren, 'The Distribution of Taxes and Government Benefits in Australia' in Dimitri Papadimitriou (ed), *The Distributional Effects of Government Spending and Taxation* (Palgrave Macmillan, 2006)

Table 3 Change in Personal Marginal Tax Rates Following ANTS

2000 – 2001		2005 – 2006		2006-2007		2012-2013	
Income \$	Rate %	Income \$	Rate %	Income \$	Rate %	Income \$	Rate %
0 – 6, 000	0	0 – 6, 000	0	0 – 6, 000	0	0 – 18, 200	0
6, 001 – 20, 000	17	6, 001 – 21, 600	15	6, 001 – 25, 000	15	18, 201 – 37, 000	19
20, 001 – 50, 000	30	21, 601 – 63, 000	30	25, 001 – 75, 000	30	37, 001 – 80, 000	32.5
50, 001 – 60, 000	42	63, 001 – 95, 000	42	75, 001 – 150, 000	40	80, 001 – 180, 000	37
Over 60, 000	47	Over 95, 000	47	Over 150, 000	45	Over 180, 000	45

In another measure designed to assist low income earners the Low Income Tax Offset was also adjusted during this period. Until the 2006 year the maximum claim threshold was aligned to the lowest income tax rate, and the rate increased progressively from \$150 to \$235. However there were significant increases over the next five years until by the 2011 year the offset was \$1500, with a taper range from \$30, 000 to \$67, 500. This extended eligibility to any taxpayer on less than average weekly earnings,²⁹ and increased the EMTR of any person within the taper range by 4%. The policy reason for the initial introduction of the LITO was to target tax cuts at low income earners in a form that would not flow on to reduce the overall tax payable by high income earners. Over the period from 2006 to 2011 the form of the tax reduction became harder to justify as the top tax rates continued to be reduced while middle income earners faced a higher EMTR as the LITO was withdrawn. In 2012-2013 income tax rates were restructured as part of the compensation package associated with the introduction of the Carbon Tax, resulting in an increase in the tax threshold and a reduction in the LITO. Under the restructured package the LITO was again targeted towards the lowest bracket of taxpayers, with the withdrawal reflected in the official tax rates which were increased by 4% in the income brackets that had been affected by the taper to reflect the EMTR. Eligibility for FTB Part A was also used to test eligibility for a range of other benefits throughout this period, the most relevant being to assist parents with the cost of education. A tax rebate was available from 2008 until 2011, but this was moved to the transfer system as the ‘Schoolkids Bonus’ with effect from the 2011-2012 year. This was to be funded by the Minerals Resources Rents Tax (MRRT), and the current (Abbott) government has introduced legislation to repeal this payment in conjunction with the repeal of the MRRT.

The changes to the FTB since its introduction in 2000 have left the basic structure substantially unchanged. There have been changes to the taper rates to decrease EMTRs and increases to childcare rebates with the goal of increasing female workforce participation rates; and a family income threshold placed on FTBB. Significantly, since 2009 full indexation of FTBA has been abandoned. The loss of

²⁹ Full-time adult ordinary time earnings May 2011 were \$1, 305.40 pw: ABS, '6202.0, Labour Force Australia' (2012) (08/11/2012).

indexation of payments places financial pressure on low income families as the cost of living increases, while the freezing of the upper family income threshold for FTBA results in a form of bracket creep.

The FTB was within the terms of reference of the Henry Review,³⁰ which made a number of recommendations.³¹ The report recommended changes to child-contingent payments that would adopt a base level of payment that would be increased by a range of supplementary elements, including new-born, young child, sole parent of a child over six and a range of special circumstances. There would then be a single means test applied to the total of these elements. Importantly the income support system would remain separate. A sole parent supplement would be contingent on meeting a work test, but the child component would not be contingent on this work test. To date there has been no adoption of the recommendations of the Henry Review in relation to the family tax-transfer system.

As the family tax-transfer system evolved over the period of the study it became more complex. The application of means tests, particularly the tiered structure adopted in the Family Allowance and retained in the FTB, introduces complexity when compared to a universal benefit. Other complexities arose from measures to ensure that different groups of claimants, including sole parents and families in low-paid work, were able to access appropriate levels of income support: an example of how the quest for an equitable system can increase the complexity of the system. The move to targeted benefits also made the system less efficient as increased ETRs can create a labour force disincentive, which may be counter-productive when trying to increase workforce participation levels among low income families. However this is only one factor in the decision to participate in the paid workforce, and labour market participation rates have increased among low income families since 2000.³²

5 ANALYSIS

There are several reason put forward for supporting families through the tax-transfer system. Applying the principles of horizontal equity, all families should receive some level of support as the income earned by the parents must support a larger family unit; and supporting families is a social good. However the principle of vertical equity takes account of the ability of the parents to provide for their family from earned income and targets family payments to families that need additional assistance. Over the period examined in this paper the increase in targeted payments has had a redistributive effect, with the OECD recognising that the Australian system has long been the most targeted welfare system in the OECD.³³

The distributional goals of the family tax-transfer system can be clearly distinguished over the three periods discussed, which align approximately with changes of Government. The key changes, or critical junctures, were the restructuring of tax deductions in 1975–76 and the introduction of means testing in 1987. The first period, from the 1970s until 1983, adopted the principles of horizontal equity to provide

³⁰ Above note 8

³¹ Recommendations 90 - 96

³² Peter Whiteford, 'Family Joblessness in Australia' (Dept of Prime Minister & Cabinet, 2009) <http://www.socialinclusion.gov.au/sites/www.socialinclusion.gov.au/files/publications/pdf/family_joblessness_Jan2009.pdf>

³³ Peter Whiteford, 'The Australian Tax-Transfer System: Architecture and Outcomes' (2010) 86(275) *Economic Record* 528

assistance to families without reference to income levels, although the removal of tax concessions to the transfer system in 1975–76 addressed the regressivity in the system. Sole parent families also benefited from policies introduced during this period. During the second period, from about 1983 until 1996, vertical equity was given priority with the progressive introduction of means testing completed by 1987. Payments were firstly removed from high income earners then targeted to low income earners to address the rising family poverty rates. During the third period, from 1996, a hybrid approach was adopted, with families being the focus of redistribution. While family payments retained the targeted structure, the higher income tests and taper rates allowed more families to qualify for income support.

There are some clear differences in the political philosophy of the major political parties, particularly in relation to economic management and labour relations policies, which have influenced the direction of policy reforms when each party is in government, although these differences have less impact than expected in the area of family income support policies. The tendency for party policy to converge, regardless of the rhetoric and ideology, has been observed since before the commencement of this study.³⁴ The reasons for convergence in family transfer payments may lie in the role of such payments to support families during difficult economic periods, the lag time required to change tax-transfer systems, and the political imperative to ensure that transitions are accepted by recipients of benefits.

These considerations are not the same as those that are taken into account in setting personal income tax rates. The most commonly cited reasons for the lowering of corporate and maximum personal tax rates is based on the mobility of capital and income. The first argument is that capital is more mobile than labour, and that investment is driven by the after-tax rate of return. The trend across the OECD has been for declining corporate tax rates, from an average of 47.5% in 1981 to 27% in 2007.³⁵ Concurrently there has been downward pressure on top personal marginal tax rates. Where there is a significant difference between corporate and personal income tax rates, there is the opportunity for taxpayers who are earning income that is not from their personal labour to structure their affairs to take advantage of the lower corporate tax rate. While corporate tax systems have been redesigned over the period of this study to address the potential for double tax of corporate income or arbitrage of tax rates, significant deferral and alienation opportunities remain.

There is also some debate about the impact of increased mobility of labour in the personal tax-transfer system. Under a comprehensive income tax, income from investment is taxed to an individual at the same marginal rates of tax as income from labour. There are arguments that skilled labour can more easily obtain work overseas, and that 'people's choices about where to work may become more sensitive to tax'.³⁶ However, decisions on where to live and work are more complex than decisions on where to invest capital, involving personal as well as economic decisions. In the context of transfer payments, although capital investments and income from those investments are relevant in the application of income tests, the most significant impact

³⁴ Brian Head and Allan Patience, 'Labor and Liberal: How Different Are They?' in Allan Patience and Brian Head (eds), *From Whitlam to Fraser* (Oxford University Press, 1979).

³⁵ Simon Loretz, 'Corporate Taxation in the OECD in a Wider Context' (2008) 24(4) *Oxford Review of Economic Policy* 639; OECD, *OECD Tax Statistics* (OECD Publishing, 2011). Note that BEPS are not discussed in this article as it focusses on personal tax issues.

³⁶ Henry et al (2010). Above note 8 at page 6.

of the EMTR is the labour force participation impact. High income earners are more likely to be in receipt of investment income and are also more likely to be highly skilled and able to relocate to obtain or change employment. Accordingly, they are more likely to be responsive to changes in income tax rates at the highest marginal tax rates. The withdrawal rates for transfer payments are not likely to be a major consideration for high income earners because the application of the income test would limit any entitlement.

Evidence suggests that domestic tax policy is less sensitive to the effect of globalisation than predicted by globalisation theory. Swank and Steinmo³⁷ argue that the evidence shows that although statutory tax rates of developed capitalist countries have been cut in anticipation of the effects of increased capital mobility, the tax burden in these countries has not been significantly affected by these changes. They show that the effects of globalisation are moderated by domestic economic change, fiscal constraints and internationalisation. Although globalisation exerts downward pressure on tax rates, domestic conditions generate demand for increased spending, requiring governments to maintain the overall tax burden. Accordingly, this must come from other tax policy changes, for example the rationalisation of tax expenditures. They note a significant cut in general investment incentives between 1981 and 1992 across the countries examined, and that lower nominal tax rates have not resulted in a lower tax burden.³⁸

Over the period examined by Swank and Steinmo, which was based on data from 1981 to 1995, the developed economies were dealing with adverse economic conditions with structural unemployment the most significant domestic economic policy issue. During the 2000s but prior to the downturn of 2007–08 global economic conditions improved, however more recent OECD data on the tax burden bear out their conclusion.³⁹ This can be seen in Table 4, which shows that in Australia tax revenues have remained relatively stable as a percentage of GDP over the period from the early 1990s.

Table 4 Tax Revenue as % of GDP: Australia⁴⁰

	1990	1995	2005	2011
Total tax revenue	28	29	31	26
Personal income taxes	12	12	11	10
Other taxes	16	17	19	16

Table 4 also shows that in the Australian context the tax mix shifted with the implementation of the GST in 2000. However, the overall increase in tax collections as a % of GDP arose from the resources boom through increased corporate tax collections and mining taxes.

³⁷ Swank & Steinmo 2002.

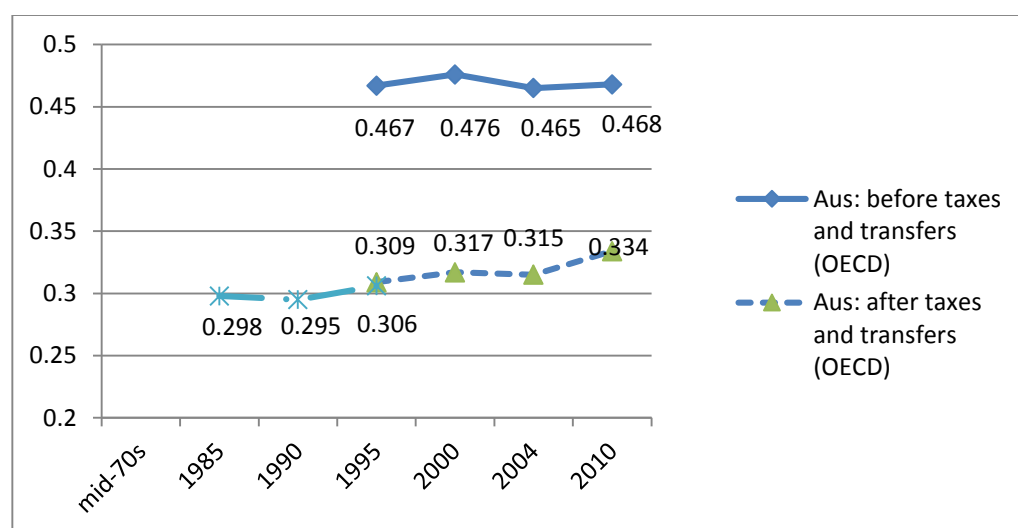
³⁸ Above at 642, Table 1.

³⁹ OECD, *Taxing Wages 2007-2008* (OECD Publishing, 2009).

⁴⁰ Above at 476, Table A1.

A further implication of the flattening of tax rates since the 1980s is that inequality in disposable income has increased, as high income earners retain more of those earnings as tax rates are reduced.⁴¹ In this context the role of the transfer system as a means of redistribution is increased. A number of measures can be applied to assess changes in policy priorities over the period of this analysis, including the Gini coefficient. Trends in the Gini coefficient over the period of this study are shown in Figure 1 below:

Figure 1 Changes in Income Inequality: Gini Co-efficient: ⁴²



Inequality in Australia before taxes and transfer payments was fairly steady over this period at around 0.47. The effect of the tax-transfer system was to moderate the impact of the market, reducing inequality by redistributing income within the community, but due to changes over this period, inequality after taxes and transfers increased from 0.298 to 0.334, particularly over the period of the 1990s. However, the Gini coefficient only looks at the overall inequality within society, and does not look at the redistribution between particular groups within society, for example from taxpayers without children to families.

An alternative method of examining the expenditure on families is the outlay on family benefits. To some extent it can be seen that over the period of this study all governments, but particularly the Fraser and Howard Liberal governments placed a higher priority on economic management than social policy. The 1970s saw the recognition that poverty rates had increased and that certain groups within society were more likely to live in poverty. Reforms to the tax-transfer system were implemented in order to address some of the inequity. However, the economic disruption of the mid 1970s created new pressures for government, particularly through the imposition of fiscal restraint.

⁴¹ Above note 9.

⁴²OECD series: OECD.Stat, *OECD.Stat* (OECD Publishing, 2012)

ABS Series: Senate Community Affairs References Committee, *A Hand Up Not a Hand Out: Renewing the Fight against Poverty. Report on Poverty and Financial Hardship* (Parliament of Australia, 2004). Note that OECD data is not available pre 1995: the ABS data has been used over the early part of this study. Although there are some differences in the methodology including the definition of income, the data is broadly comparable.

In Australia, the early 1970s represented a low point in relative spending on family benefits. The first significant increase in spending on family benefits over the period of this study was in 1977, when Child Endowment was restructured as Family Allowance.⁴³ This adjustment restored the historical balance of family payments against other forms of income support.⁴⁴ Among the commitments of the conservative Fraser government was reduced government spending, which could be expected to flow through into reduced spending on social welfare policies.⁴⁵ However, analysis of what actually occurred during the term of the Fraser government showed an ambivalent approach to social welfare.⁴⁶ In particular the recommendations of the Henderson Commission⁴⁷ were adopted with significant increases in spending on Commonwealth income support payments including pensions, benefits and family payments. Notably the Family Allowance was not adjusted for inflation, which quickly eroded the increase that had been achieved in 1977.

Over the Fraser years from 1975 to 1983 the economic recession resulted in a 50% increase in the proportion of the population receiving benefits to 19% of the total population. This was reflected in families, with 18% of children being in families reliant on social security payments, although the number of families receiving family benefits remained stable at 2.1 million families, comprising 4.3 million children. Accordingly expenditure on cash payments increased from 4.5% of GDP to 6.8%.⁴⁸ The amount expended on Family Allowance to 1983 remained fairly constant, partly due to the lack of indexation, but the amount expended on means-tested benefits, primarily as dependant allowances paid to social security recipients, increased by 70% between 1976 and 1983.⁴⁹

Political philosophy was also reflected in the justification for family benefits. The rhetoric of Liberal governments extolling personal responsibility and family values was carried over into welfare reform, but this was moderated by the electoral cycle that allowed the mass public to judge the performance of the government every three years. Accordingly the government responded promptly to economic and social change, and the changes to the tax-transfer system introduced by Fraser and by Howard were effective in increasing family incomes. Although committed to fiscal restraint, spending on family benefits increased under these governments, largely driven by economic factors that caused an increase in the number of low income families claiming benefits. Fraser implemented substantial increases to family benefits with the introduction of the Family Allowance; while Howard increased family payments with the introduction of the FTB as compensation for the impact of the GST. Payments were less targeted under the Coalition governments than under the ALP: Family Allowance was not means tested under Fraser, and the FTB retained the tiered structure of the former Family Allowance, but the thresholds and taper tests

⁴³ This also resulted in the restructuring of a tax expenditure as a cash benefit, thus part of the increase is attributable to this restructuring.

⁴⁴ Peter Saunders, *Equity and the Impact on Families of the Australian Tax-Transfer System*, Institute of Family Studies Monograph No 2 (Institute of Family Studies, 1982).

⁴⁵ Grant Elliott and Adam Graycar, 'Social Welfare' in Allan Patience and Brian Head (eds), *From Whitlam to Fraser* (Oxford University Press, 1979).

⁴⁶ Bettina Cass and Peter Whiteford, 'Social Security Policies' in Brian Head and Allan Patience (eds), *From Fraser to Hawke* (Longman Cheshire, 1989).

⁴⁷ Henderson, Above note 14.

⁴⁸ Above note 46.

⁴⁹ Above note 16:20.

allowed more families to qualify under each tier.⁵⁰ Notably, the Howard government responded to the concerns of working mothers by improving childcare rebates for two-income families and through its withdrawal of the First Child Tax Offset and replacement with the Baby Bonus.

In contrast, in 1987 as Prime Minister Bob Hawke made a political commitment to reduce child poverty. As the government was committed to fiscal responsibility, this was to be achieved through targeted payments that would redistribute payments from better-off households to poorer families. Although the Hawke Government did not fully achieve the stated goal, the commitment ensured that alleviating child poverty became a government objective, with a range of policies, including tax-transfer policies, being co-ordinated to achieve the goal, and the evidence showed that child poverty rates were reduced. The Hawke Government inherited the problem, coming to government during an economic downturn, during which unemployment had placed families at a higher risk of poverty.

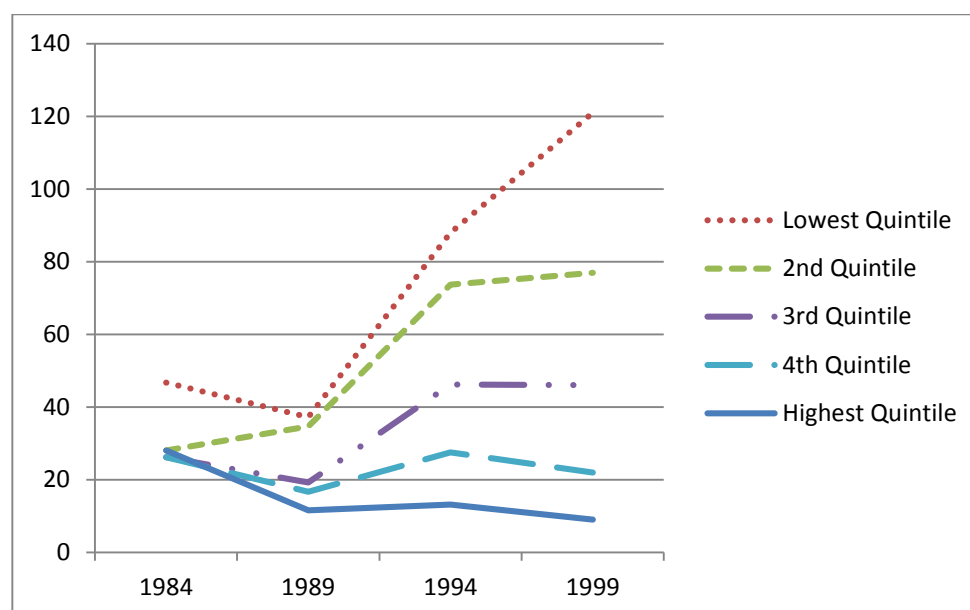
Under the Howard government Australia experienced a long period of economic growth, although poverty was concentrated around joblessness. Accordingly, from the late 1990s joblessness became the focus of government policy and the income support system focused more on improving levels of labour force participation.⁵¹ Over the period of the Howard government the benefits paid to families were maintained – although as a percentage of GDP they did not grow significantly after the overcompensation paid as part of the GST reforms. The extended thresholds and taper rates available under the FTB extended base benefits to more families, although the highest benefits were still targeted toward the poorest families, resulting in some redistribution of benefits to middle income families although this was an intended design feature, as compensation for the GST.

The effect of these changes can be seen in Figure 2 which shows the distribution of family transfer payments.

⁵⁰ Matthew Toohey and Gillian Beer, 'Financial Incentives to Work for Married Mothers under A New Tax System' (2004) 7(No. 1) *Australian Journal of Labour Economics, Special Issue: Microsimulation Models in Policy Making* 53

⁵¹ Patrick McClure, 'Participation Support for a More Equitable Society' (Reference Group on Welfare Reform, 2000) (30/10/2006)

Figure 2 Couple Family Benefits in Australia 1984 - 1999, by Quintile \$ per week 1999 prices⁵²



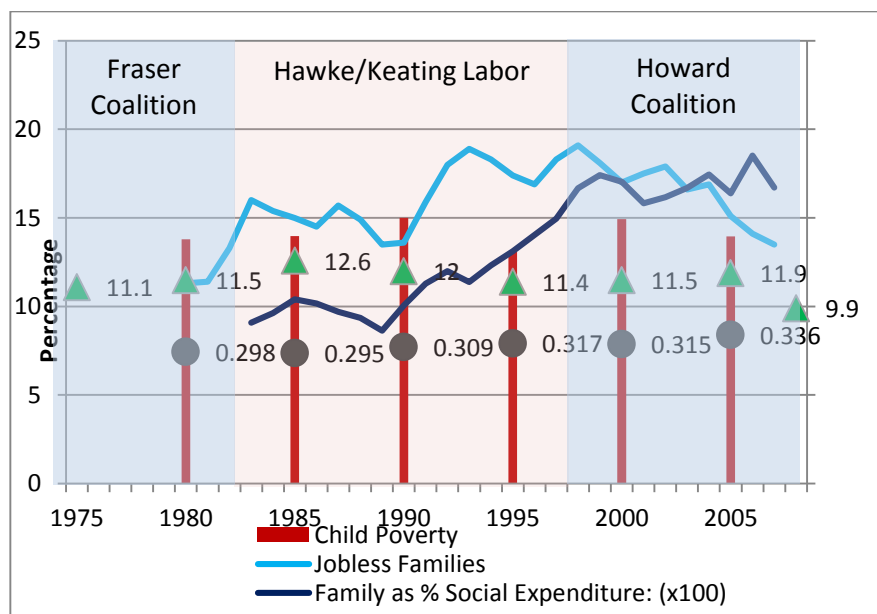
The biggest distributional shift followed the reforms to Family Allowance from the late 1980s. Although the 1983 Family Income Supplement had assisted low income families when introduced, the low rate eroded its effectiveness until the 1987 reforms directed increased Family Allowance and FAS to families in the lowest quintiles.

The effect of the 2000 reforms is not reflected in Figure 2 because data from the 2004 Housing and Income Survey are not directly comparable with data for the previous surveys due to changes in measurement. However, Harding et al.⁵³ found that when analysed on the basis of income quintiles, substantial redistribution occurred following the introduction of ANTS, including the FTB, in 2000 through both direct and indirect benefits. Sole parents and lower income families were better off, although on average couples with children did not gain under the 2000 reforms.

Applying a range of key indicators applicable to families, the effect of changes in the tax-transfer system from the early 1970s until the mid 2000s is set out in Figure 3 below:

⁵²ABS, 6537.0, *Household Expenditure Survey Australia: Effects of Government Benefits and Taxes on Household Income* (Australian Bureau of Statistics, 1984; 1986; 1989; 1994; 1999)

⁵³Harding, Lloyd and Warren, above n 28

Figure 3 Trends in Key Indicators: Australia ⁵⁴

Inflation and employment trends reflected those apparent throughout the OECD⁵⁵ and were largely the result of globalisation of economic and trade policies and cultural change resulting from changing attitudes among the ‘baby boomer’ generation. The rate of jobless families fell from about 2000 as a result of the increasing women’s employment rate, but many of these jobs were part-time, and many families in low-paid or part-time work earned an inadequate market income. The response to the inflationary pressure of the 1970s to 1980s was fiscal tightening, with a move away from Keynesian economic policies based on direct government intervention in the economy to other, more market-based philosophies. Means testing of transfer benefits was initially justified on the grounds that scarce resources could be better targeted through means testing, although the actual cost was dictated by economic conditions and the anticipated savings were illusory.

The most significant developments in the tax transfer system, as it affected families, were the transfer of family assistance from the tax system to the transfer system in the mid 1970s; the introduction of means-tested benefits in the late 1980s; and the integration of the administration of the tax and transfer systems in the late 1990s.

The first significant change, the transfer of benefits from the tax to the transfer system, was an endogenous response that grew from the acknowledgement that the system was no longer meeting its core function of protecting low income families from poverty. The family tax-transfer had been stable, without significant change for many years, which had resulted in stasis in the system. The ‘rediscovery of poverty’ in the 1960s

⁵⁴ Child Poverty Series: LIS, ‘Luxembourg Inequality and Poverty Key Figures’ (LIS, 06/11/2012 <<http://www.lisdatacenter.org>>

Family as % of Social Expenditure: OECD.Stat, above n 42
 Gini after Taxes and Transfers: OECD.Stat, above n 42
 Jobless Families: ABS, 6291.0.55.001, *Labour Force, Australia, Detailed* (Australian Bureau of Statistics, 2012)

Personal Income Tax as % GDP: OECD.Stat, above n 42.

⁵⁵ OECD, *OECD Historical Statistics 2000* (OECD Publishing, 2002).

was a trigger that signalled the need to address the redistributive effect of the tax-transfer system.

In contrast the second significant change, the application of means and affluence tests to target benefits to low income families, was a response to exogenous economic and political factors. The economic shocks of the 1970s were followed by structural change to the global economy that was reflected in the Australian economy from the 1980s, with an impact on poverty levels.

The political philosophy of the government affected the policy design: the Hawke Labor government in Australia used the transfer system in conjunction with the social wage as an income support strategy.

In the late 1990s the Howard Liberal government increased integration of the tax and transfer systems, providing compensation to low and middle income families for the impact of the GST. Although increases in rates were linked to the GST in Australia the increased integration of family benefits with the tax system was an endogenous change triggered by feedback within the system. It had become clear that the family tax transfer system was not effectively redistributing resources to needy families; accordingly the system was adjusted in an attempt to align the tax and transfer aspects of the system.⁵⁶

6 CONCLUSIONS

Change to the basic structure of the family tax transfer system has been incremental as a response to feedback within the system, although successive governments have shown a tendency to badge change as reform, and to rename the benefits in question regardless of the extent of change: for example in 1983 the Family Income Supplement was redesigned and renamed as the Family Allowance Supplement.

The ability of the system to adapt without resulting in major policy failure shows the flexibility of the system. The most notable policy breakdown in Australia was when the First Child Tax Offset was abandoned in 2004; it was restructured into the Baby Bonus, which was more in tune with economic and social trends. Accordingly the main distinguishing exogenous factors that impacted on the reform pathway in Australia were political factors. The political response to global economic factors was different depending on the government in power at the time of the critical juncture.

Overall, the system has been effective in compensating for the restructured tax rates, as shown by the comparison of the Gini index before and after taxes and transfers are taken into account (Figure 1) and the quintile analysis showing the distribution of family benefits (Figure 2). While a system of universal benefits coupled with progressive tax rates should result in a redistribution to low income earners, given the evolution of the system in Australia it is unlikely that there will be any political will or public interest in reverting to a system of higher personal tax rates coupled with universal benefits.

⁵⁶ Although this alignment resulted in administrative issues relating to the timing and recovery of payments: Helen Hodgson and Rebecca Boden, 'Not So Distant Cousins' (2008) 61(3) (July 2008) *International Social Security Review* 29; Commonwealth Ombudsman, 'Own Motion Investigation into Family Assistance Administration and Impacts on Family Assistance Office Customers' (Commonwealth Ombudsman, February 2003) .