



PAYROLL TAX

- THE CASE FOR ABOLITION

If we are serious about tax reform, and we should be, then we should be dead serious about finally getting rid of payroll tax.

Australia is one of the few economies in the world to levy substantial payroll taxes for general revenue raising. This affects Australia's ability to attract business and investment and causes pressure on State and Territory governments to offer tax concessions. It raises the cost of labour and keeps people out of jobs.

Payroll taxes impose significant compliance costs, especially on smaller firms. While the current tax-free threshold exempts many small businesses, it creates distortions to efficient resource allocation and hence reduces levels of employment and living standards.

Consistent with Australia's indirect tax system in general, payroll tax is distortionary and inefficient. Because of the tax-free threshold and because of the different State and Territory regimes, the payroll tax burden is spread unevenly across industries and regions.

This unequal burden leads to input and final price and wage distortions that negatively impact on production and employment and impose deadweight costs on the Australian economy. The payroll tax component of input prices reduces the competitiveness of Australia's export and import-competing industries.

Payroll tax is, in a direct sense, a tax on jobs - even though, in terms of ultimate incidence, it may end up largely being borne by employees. In practice, rigidities in the labour market mean that the imposition of a payroll tax increases the cost of hiring labour and hence reduces jobs. In Australia, the existence of inflexible labour market and wage arrangements increases the disemployment effects of payroll taxes levied on businesses.

Because of the "discouraged worker" effect and skills loss, the undeniable short-term negative impact of an increase in payroll tax on employment may last into the long run and become permanent. Workers that become unemployed in the short-run because of payroll tax may leave the workforce as they become discouraged or lose their skills.

Negative perceptions of payroll tax in themselves may be responsible for reducing employment quite apart from the substantive economic impacts of the tax.



STATE AND TERRITORY TAX BASE

Payroll taxes were transferred to the States in 1971 and are now the largest component of State and Territory own-source revenue. Payroll tax rates, bases and methods of calculation differ by State and Territory.

Tax-free thresholds, which exist in various forms in all Australian States and Territories, and which have been progressively raised, create a narrow payroll tax base that spreads the tax burden unevenly both between and within industry according to firm size. This anomaly has adverse implications for Australia's economic efficiency and welfare.

The disparities in the payroll tax regimes across the States and Territories create significant compliance costs, particularly for national firms operating in more than one jurisdiction. Inconsistencies may also influence and distort location and expansion decisions by firms.

PAYROLL TAX REPORTS

Two reports released by ACCI this month clearly demonstrate that the case for abolition of payroll tax is just as strong as for the abolition of sales tax. Compared with revenue raised, scrapping sales tax would provide a boost to the economy of 6 cents in each dollar of sales tax revenue. Abolishing payroll tax would gain 7-1/2 cents in every dollar of payroll tax revenue.

The studies show the payroll tax regimes applied in Australia are inefficient, complex, costly to administer and inequitable. The reports support business views that payroll tax should be abolished and replaced as part of the introduction of a broad-based consumption tax (BBCT).

ACCI and its members have been at the forefront of calls for fundamental tax reform. All serious observers of the Australian taxation system agree that it is in serious disrepair and operates as a drawback to incentive, saving and international competitiveness.

What is needed is a tax system that is:

- fairer for all Australians;
- more efficient;
- transparent;
- easier to comply with;
- improves overall competitiveness of Australian goods and services; and
- does not discourage employment, savings and productive investment.

To achieve these ends will require a **package** of reforms that addresses the major shortcomings of the existing systems. The package of necessary reforms include the introduction of a (BBCT) on the broadest base possible to facilitate the removal of a range of existing but often hidden Federal and State indirect taxes that distort



economic activity and tax business inputs. These include wholesale sales tax, payroll tax, stamp duties and fuel excises.

As part of this process it was decided to examine in detail the difficulties which payroll tax regimes, as they operate in Australia, cause for business competitiveness and the case for its removal as part of a tax reform package. Two pieces of work were commissioned.

- **The Allen Consulting Group Report “The Impact of Payroll Taxation and the Benefits of its Abolition”** fully documents and evaluates how the regimes operate and impact on efficiency, productivity and equity in both a domestic and international context. The Allen’s work was directed by Vince Fitzgerald with the analysis undertaken by Jerome Fahrer and Gerard Brown
- **The Chris Murphy of Econtech Report “Payroll Tax: Is it as Good as a VAT or as Bad as a Sales Tax”** drew on modelling work to measure the gains from replacing the payroll tax regimes with a BBCT, using both his single industry and multi-industry model

The modelling results show that abolition of payroll tax with replacement by a BBCT will, in the short to medium term, result in gains in employment peaking at close to half a percent and improvement in the trade balance equivalent to about half a percent of GDP.

In the longer term, the savings by collecting the current level of payroll tax through a BBCT are measured at close to \$600 million per annum. Added to this would be a substantial further gain from eliminating the compliance costs associated with payroll tax.

The Econtech modelling debunks past claims of equivalence between payroll tax and a BBCT. This is because the tax-free thresholds which exist in each of the States and Territories create a narrow payroll tax base that spreads the tax burden unevenly between and within industry according to firm size.

In this way payroll tax acts as a drain on national living standards because the small business exemption provides an inducement for businesses to be inefficiently small. As noted by Mr Murphy “the small business exemption is not a policy for small business, rather it is a policy for making businesses smaller!”

In addition, the payroll tax component of input prices reduces the competitiveness of Australia’s export and import-competing industries. Australia is one of the few economies in the world to levy substantial payroll taxes for general revenue raising. This affects Australia’s ability to attract business and investment and causes pressure on State and Territory governments to offer tax concessions.

Payroll tax as it stands therefore reduces employment and production, worsens the current account, and, as a tax on business inputs, has a cascading effect on prices. Labour and product markets, as well as international trade, are distorted and operate inefficiently because of payroll tax. A BBCT imposed as well as a payroll tax would result in a ‘tax on tax’.



The output of this work also dispels the myth that payroll tax is a good tax particularly as it applies in Australia. Yet there is no political will and certainly total opposition from ACCI to trying to make it “pure” by withdrawing the small business exemption and making hundreds of thousands of small business meet an unjustifiable compliance burden

Anyway, if as the experts say a “pure” payroll tax is the same as a BBCT, why would we have the extra compliance of two similar impact taxes?

PRODUCTIVITY COMMISSION REPORT ON STATE TAXES

The Productivity Commission recently released a Report on *Directions for State Tax Reform* which is somewhat ambivalent in its findings. In the Executive Summary the Commission states a preference for lowering the threshold, ie. bringing more businesses into the payroll tax net, which as previously stated is politically not workable and would add unnecessary compliance costs for small business.

However, the Commission takes a more pragmatic view at the end of the Payroll Tax Chapter identifying the potential for replacing payroll tax with either a secured portion of income tax or a share of a BBCT.

COMMONWEALTH STATE ARRANGEMENTS

As part of a comprehensive package of tax reform which abolishes inefficient taxes like payroll tax and replaces them with a BBCT - there must be a fundamental change to Commonwealth and State revenue raising which gives States and Territories access to a sustainable revenue base.

The payroll tax studies support ACCI’s position that States should be provided secure access to a portion of the income tax base (albeit collected by the Commonwealth on the States’ behalf) which would substitute for indirect taxes abolished (eg payroll tax) and also replace a large proportion of general purpose grants.

INDUSTRY SURVEYS

The findings of these reports are backed by a recent survey conducted by Australian Business which showed that 73% of medium sized employers ranked payroll tax in their “top three taxes for abolition” compared to 69% for wholesale sales tax. It is most encouraging that 54% of the respondents indicate they would take on extra employees if payroll tax were removed.

It is notable that 95% supported the introduction of a BBCT which is consistent with strong support for a reform package including BBCT in surveys by other ACCI members.

CONCLUDING REMARKS FROM BUSINESS PRACTITIONERS

The extent of business frustration that the Federal and State Governments do not consider the abolition of payroll tax as a major priority is best illustrated in the words of real business people who responded to the survey. A director of a furniture maker says:



“Having to pay payroll tax is like being fined for providing jobs for Australians.

“Payroll tax is a hidden tax. Most people don’t know about it because they don’t pay it.

“Politics is about buying votes. Because payroll tax is hidden from view, silently destroying jobs, politicians don’t want to know about it”

These views echoed the thoughts of other people in the survey. One manufacturer stated he was considering closing his furniture factory and importing from Asia. His factory employs 72 people. He could import furniture and achieve the same turnover with just 12 workers - a loss of 60 jobs. This employer, who pays more than \$2000 a week in payroll tax, said if it was scrapped he could provide another four jobs.

A director of a knitting mill employing 30 people, voiced her frustration at having to pay payroll tax.

“We are fighting against a flood of cheap imports and payroll tax is just killing us. We have to try and compete against these imports saddled with such an unnecessary tax as payroll tax.

“This is made even worse because on most of the imports there is no sales tax or payroll tax.

“I feel like I am being punished by the Government for employing people. Payroll tax is a punishment tax, it’s nothing more than a tax on jobs.”

She said she sometimes thought of quitting, closing her mill and importing.

“It would be easier to import, but who will provide jobs for Australians? I am a fighter”.

The director of a consulting engineering company, which employs 250 people in Australia and sells its design building services in Asia, said payroll tax was a big factor in making it uncompetitive.

“Payroll tax is a big issue for service industries like ours. It is a shocker”.

He effectively summed up the business view when he said scrapping payroll tax would make his firm more competitive, allowing it to win more contracts and offer more jobs.

ACCI Review – July 1998.