Relative tax burdens of wage and salary earners and the self-employed

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There are many facets to any consideration of tax reform. I should commence by outlining the reasons why I regard the facet discussed in this paper as an important one.

Broadly speaking, the Task Force on Tax Reform was charged with presenting options for tax reform which would be self-financing. This provoked some cogent and some emotive protest that this was the wrong task, and that an overall reduction in taxation should be achieved by reducing government expenditure. But setting this aside, there was general advocacy for, and expectation of, a package that would provide a switch from direct to indirect tax. This was not because anybody really wanted higher indirect taxes, but because almost everybody wanted lower personal income taxes. It is not my purpose to rehearse the arguments for such a shift, but I should note that the Task Force did not find them compelling in an economic sense. However, it accepted the public expectation, and it is probably fair to say that, in the upshot, the options for reform which it presents take the shift as given. Most — though by no means all — of the report therefore deals with the personal income tax scale and the personal tax unit, on the one hand, and various sorts of personal consumption taxes, on the other.

Personal income tax was a popular candidate for reduction not only because of public perception that it was too high, but for other reasons, such as:

(a) We gain an unusually high proportion of tax revenue from personal income tax (in 1978, for example, 65% in New Zealand, 52% in the United Kingdom and 44% in Australia);

(b) The average tax rate on average wages was seen to be high (29.5% in February 1982) and to have risen (from 22.6% in 1974);

(c) The marginal tax rate on average wages was 48%, and would soon be 55% if no action were taken.

These sorts of factors compelled attention to the tax scale to bring marginal, and average, rates down.

Yet when the Task Force looked into some other statistics about personal income tax, it found data which gave additional and grave cause for concern. It found, for instance, that wage and salary earners were paying 80% of all personal income

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tax in 1978 (the latest year for which data is available) compared with 63% in 1960 and 74% in 1970. At the same time, personal income tax, as a percentage of total tax, had grown from 43% in 1960 to 47% in 1970 and 62% in 1978. Thus the percentage of the total tax take paid by salary and wage earners as income tax (and before their share of sales tax and the like) rose from just over a quarter (27.4%) in 1960 to one third (34.4%) in 1970 and to nearly one half (49.7%) in 1978. In fact, the increase of income tax paid by wage and salary earners more than accounted for the whole increase in total taxation as a percentage of gross domestic product over the eighteen year period.

With these statistics in mind, let us now consider what happened to various other groups of personal income tax payers over the same period — if "payers" is the right word. Consider the following tables:

Table 1

PERCENTAGES OF PERSONAL INCOME TAX

	Wage and Salary Earners	Self-Employed Non-Farm	Self-Employed Farm	Total	Investment Income	Total Non-Wage and Salary Earners
1960	63	13	19	32	4	36
1970	74	11	9	20	6	26
1978	80	8	5	13	7	20

Table 2

PERCENTAGES OF ASSESSABLE PERSONAL INCOME

	Wage and Salary Earners	Self-Employed Non-Farm	Self-Employed Farm	Total	Investment Income	Total Non-Wage and Salary Earners
1960	72	10	14	24	4	28
1970	79	7.5	7.5	15	6	21
1978	81	6.5	4.5	11	8	19

Table 3

PERSONAL INCOME TAX PAID AS PERCENTAGE OF GDP

	Wage and Salary Earners	Self-Employed Non-Farm	Self-Employed Farm	Total	Investment Income	Total Non-Wage and Salary Earners
1960	6.5	1.4	2.0	3.4	0.4	3.8
1970	8.5	1.3	1.0	2.3	0.7	3.0
1978	15.1	1.6	1.0	2.6	1.4	3.9

(Totals for wage and salary earners and non-wage and salary earners for 1960 and 1970 assumed to be the same as 1961 and 1971 — see Report of the Task Force on Tax Reform (Government Printer, Wellington, 1982) Table 2.13).

Table 4

PERSONAL INCOME TAX AS PERCENTAGE OF TOTAL TAX REVENUE

	Wage and Salary Earners	Self-Employed Non-Farm	Farm	Total	Invest-ment Income	Total Non-Wage and Salary Earners	Total Personal Income Tax
1960	27.4	5.7	8.3	14.0	1.8	15.8	43.3
1970	34.4	5.2	4.2	9.4	2.8	12.2	46.6
1978	49.7	5.1	3.2	8.3	4.4	12.7	62.4

(Totals for wage and salary earners and non-wage and salary earners for 1960 and 1970 assumed to be the same as 1961 and 1971 — see Report of the Task Force on Tax Reform (Government Printer, Wellington, 1982) Table 2.13).

Table 5

AVERAGE EFFECTIVE TAX RATES ON ASSESSABLE INCOME

	Wage and Salary Earners	Self-Employed Non-Farm	Farm	Total	Investment Income	All Personal Income Tax
1960	14.2	21.4	22.5	22.0	14.9	16.1
1970	14.9	24.1	19.6	21.9	15.7	16.4
1978	24.8	32.5	30.3	30.7	22.2	25.2

Table 6

PERCENTAGE INCREASES IN RATES

	Wage and Salary Earners	Self-Employed Non-Farm	Farm	Total	Investment Income	All Personal Income Tax
1960-78	74.6	51.9	34.6	39.6	49.0	56.5
1970-78	66.4	34.9	49.5	40.2	41.4	53.7

On the face of it, if we were to believe that changes in assessable incomes reflect relative changes in "true" incomes, we would conclude that, while wages and salaries were three times self-employed incomes in 1960, they had risen to seven and one half times self-employed incomes by 1978. Certainly, a large part of the decline is shown to have occurred in farm incomes, which were one fifth of wages in 1960 but only one eighteenth in 1978. But the relative changes seem too great to swallow as indicators of changes in true incomes.

On the other hand, if the changes in assessable income are largely due to concessions and so-called incentives to the self-employed, one might expect it would be possible to identify the concessions and quantify their effects, but our fiscal management information system gives no help here. Furthermore, much of the decline in (relative) self-employed assessable incomes, both farm and non-farm, occurred during the 1960s when, broadly, tax "incentives" were probably not so prevalent as in the 1970s. One might well therefore be excused for suspecting that some part of the change is due to avoidance and straight out evasion of tax by the self-employed. At the same time, one must gaze in awe at the efficiency of the Pay-As-You-Earn system in tapping wage and salary incomes, and wonder what the statistics in respect of wage and salary earners would show if the allegedly rampant tax-dodging on second jobs were caught and if company cars and other fringe benefits of salaried employees were also taxed.

I mentioned that the Task Force could not obtain adequate explanations of these changes, and I draw attention to the comments of the Task Force as follows:[1]

> **1.7** . . . The fact remains however that we were both surprised and frustrated by the lack of reasonably up to date statistical information which could be made available to us. In our view this is a serious weakness which must be rectified.
> **1.8** If one section of our community is to be asked to shoulder a greater share of the taxation burden, it is entitled to clear evidence of the cause and justification. If the reason is because of tax incentives to the business sector, the cost of those incentives, together with an indication of value received, should be clear. Unless this information is available, together with evidence that any unsatisfactory features thereby disclosed are being properly dealt with, the willingness of taxpayers to meet their share of taxes will be steadily undermined. The serious effects that such a trend would have upon our traditional social structure cannot be overestimated.
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> **2.22** The Task Force could not find a satisfactory explanation for this development. It is submitted that a full and detailed enquiry should be undertaken as a matter of urgency. If the apparent decline in the economic significance of the self-employed sector is confirmed to have occurred, no action in the tax field would necessarily be indicated, but presumably the finding would be relevant to other fields of policy. If, on the other hand, the enquiry shows that significant amounts of actual income are being excluded from the tax base, some tax changes would be indicated.
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> **2.28** The Task Force is of the view that the changes and trends indicated in the tables are so substantial that immediate steps should be taken to identify the reasons and to remedy any unsatisfactory features revealed. In addition an adequate data base providing for effective monitoring and evaluation on a continuing basis should be developed without delay.

The implications of the statistics for broad economic and social policy are serious. At a more or less technical level, it is of concern that national accounting aggregates — measurement of gross domestic product and so on — are found to be roughly reconciled with assessable income figures. Some adjustments for some identifiable concessions are necessary for this purpose; but there is enough similarity in the sources of information about both assessable income and national accounting figures to suspect them both.

Secondly, the increasing share of personal income tax borne by wage and salary earners may be seen as a potent factor in propagating and perpetuating inflation. It seems to be established with reasonable reliability that wage increases have generally covered cost of living increases after tax, now at high marginal rates. If, within a given total personal tax take, wage earners were to bear a smaller proportion, rates of all personal income tax could be lower, and so could inflation.

1 *Report of the Task Force on Tax Reform* (Government Printer, Wellington, 1982) 2, 22.

There must be concern about the ability of any society to sustain (though "restore" might be a better word) co-operation and goodwill when one section of the community visibly carries the bulk of the burden of taxation. Indeed, it is amazing that we have not had strong evidence of open conflict before this. Perhaps it is only the willingness of all sections to speed us along the inflationary path to perdition by allowing after-tax wage indexation that has staved off more overt social problems.

The Task Force could not tackle the problem comprehensively for lack of information, as I have said. For my own part our inability to do so provided a more compelling argument, as an ad hoc and interim measure, for a shift from direct to indirect taxation than did most of those adduced in public comment and submissions.

At first, it had seemed to me that a reduction in the personal income tax scale, offset by a fairly broad-based consumption tax, would be more likely to increase the already heavy burden of the whole tax system on wage and salary earners, and should be rejected on that count. On further consideration, however, I concluded that, as assessable incomes of the self-employed seem to be much lower than their true incomes, the benefit they would gain as a proportion of real incomes from personal tax rate reduction would be relatively low; on the other hand, given that true incomes of wage and salary earners are substantially identical with their assessable incomes, they would gain greater benefit from a personal income tax cut relative to true incomes. As a further point, and an important one, I considered that some part of the relief apparently obtained by the self-employed has been through various devices of income splitting. Therefore, my own preferred package of personal income tax reform would include voluntary income splitting for all couples. This would also ease the regressive effect on many families of a consumption tax. Finally, a broad consumption tax would be paid in a way roughly proportionate to expenditure, thus catching at least the outlay of the non-assessable income of the self-employed at the rate of the consumption tax.

I stress that these were considerations in my own mind, and that they should not be taken as in any way reflecting the consensus views of the Task Force as a whole, which views are conveyed in the text of the report.