Tax Injustice: Keeping the Family Cap-in-Hand

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Executive Summary

There is a growing awareness of financial pressure on the family, together with anomalies in the interaction of family earnings, taxation and welfare benefits. Increasingly generous welfare benefits appear incapable of alleviating or resolving these problems.

An historical analysis shows a change in the course of the 1980s from a two-faceted system of child-related tax deductions and universal child-related welfare benefits to a single-faceted system of targeted welfare.

In 1960, as a result of child-related deductions, a family earner with wife and three children paid no tax until income passed 120% average weekly earnings (AWE). When Child Endowment of that period was added to earnings, only families above 150% AWE paid any effective tax. By contrast, single earners at every level from the basic wage upwards paid tax.

In 1997, there was very little difference in tax paid by family and single earners at every level above the tax-free threshold. When welfare benefits are added to earnings, family taxation still begins at below AWE. Average income families have almost no income advantage, post-tax and welfare, in recognition of the costs of supporting children, as compared with single earners.

Under the current system, net family income fails to rise with increased earnings, across the range from 50% to 120% AWE. All families with three teenage children in this range end up with somewhere around $33,000 p.a., although actual earnings at 50% AWE are $18,000 p.a. and at 120% AWE are $43,500 p.a.

Average income families can escape welfare levels of ‘poverty’ only by multiple job holding, which is often not in the family's best interests as a rearer of children. This also creates job competition for less-skilled workers. Heavy taxation of families both restricts choices in use of income and creates an impression of welfare dependency in the employed.

A return to major modulation of family versus single net incomes via tax provisions is required in order to release families from the welfare trap. A tax rebate (or payment) of $3,000 to $5,000 per dependent child or student, matching child benefits for the unemployed, is recommended, to replace all current family benefits, including childcare subsidies and Austudy.

Despite an ever more complex and apparently generous system of social security benefits, something is seriously wrong with Australian family finances. In 1995 the Sydney Morning Herald (2/11/95, quoting National Centre for Social and Economic Modelling figures) reported that family payments now contributed an extra 43% to the earnings of workers at the lower end of the income spectrum, while 20 years previously such payments added only 8% to the family wage. Yet in the same year it was reported that one in ten Australian children lived in poverty.

According to the Director of the Australian Institute of Family Studies, in 1990, ‘Many families need[ed] two full-time jobs to meet housing costs, particularly in

Sydney …' (SMH 18/10/90); he noted an acceleration in the move to full-time work by both parents – 20% of families in 1988 and 24% in 1990. Five years later a spokesperson for the Smith Family told the Herald (SMH 2/11/95) that many families could not exist on a full-time wage.

In 1993, 65% of Australians thought that mothers of pre-school children should not work at all.1 And yet government expenditure on childcare (permitting mothers of pre-school children to work) rose from $63 million in 1982/3 to $1,239 million in 1995/6. The 442,000 children receiving childcare in 1995/6 cost taxpayers on average $5,430 each. Choice for Families, a community lobby group which came into being in response to the financial pressure on families who choose parent-care for their children, has calculated that, in 1998, a two-parent, two-child, single-income family earning $30,000 per annum (well below average weekly earnings of $36,000) receives $4,368 p.a. ($84 per week) in government benefits, while a two-parent, two-child family with both parents earning $30,000 p.a. – a family income of $60,000, and about 170% AWE – receives total government benefits of $8,580 p.a. ($165 p.w.).2 The high income family receives twice the benefits of the low income family.

A survey by Australian Family Circle, reported in the Sydney Morning Herald in 1996 (13/2/96), found that for 36% of parents, the biggest issue facing their family was lack of money. For only 6% was health the biggest issue, and job security for only 12%. In another survey, inadequate income topped the list of stress factors for mothers of young families, but not for the elderly, single persons, or couples without children.

How is one to make sense of this failure of large increases in welfare payments to repair the financial crisis of the family in the nineties? Is it low wages, inadequate welfare, poorly targeted welfare, or perhaps a combination of these?

In the analysis that follows we might bear in mind the case of an employed security guard with wife and three children, earning $29,000 a year, who told the Sydney Morning Herald in 1995 (2/11/95) that his family could barely live on his salary. 'If my wages dropped lower,' he said, 'I would consider going on the dole.' The family received social security payments of $137 per week – $7,124 a year. However, they also paid approximately $5,900 in tax, so that most of what they received in welfare they had actually paid for in their tax bill. A single person earning $29,000 would have paid this same amount in tax but we do not hear of the inadequacy of wages or of welfare payments for employed single people.

Might tax, then, and its failure to differentiate between the single and the family earner, be a major factor in the stressed condition of the family, and the inability of welfare to help?

Tax and welfare policy disregard the average family

The Liberal Party has produced a neat, multi-page leaflet entitled The Hidden Tax System which, in its text, draws attention to a range of anomalies, injustices, and flaws in the present tax system (not least its outrageous complexity). But in its visuals it concentrates on just one – the inconsistency of current indirect taxation, which taxes soap but not caviar. This juxtaposition carries the implication that the introduction of a flat-rate GST will introduce fairness into the tax system, and remove the tax-induced financial worries which are troubling so many Australians.

The brochure admits the raw deal handed to Australian families:

The average tax rate for families with one child has doubled in the last thirty years. That's bad enough, but it's more than doubled for families with two children and has increased six-fold for families with three children.

But this increase, this degradation of the financial position of the family via taxation, owes very little to the anomalies of indirect taxation, and therefore the introduction of a 'fair' GST will do little to relieve the pressure felt by families. To understand how the financial oppression of the family, or more specifically of the middle-income family, by the tax system can be remedied, it is necessary to understand how it came into being in the first place, and the parameters that maintain it.

In the 1950s, '60s, and '70s families were shielded from taxation, in that tax was reduced in proportion to the number of family members dependent on a single income. This policy, based on the understanding that effective income is reduced by multidependency, is known as horizontal equity. The recognition in the tax system that both low initial earnings and multidependency on a single income result in reduced ability to pay was seen as fair and progressive. A tax threshold and rising marginal rates accommodated the first, while deductions from taxable income in proportion to number and expenses of dependants accommodated the second. This system was radically modified in the course of the 1980s. Fewer marginal rates cutting in at lower income levels resulted in a much-reduced shielding of low earnings, and the withdrawal of all child-related deductions eliminated recognition of child dependency as a factor in tax equity.

Graphs 1 and 2 show tax payable on various percentages of average weekly earnings (AWE) in 1960 and in 1997 for a family earner supporting a wife and three children as compared with a single earner (an earner without dependants, who may be a member of a two income couple without dependants) on the same income.3 It can be seen that in 1960 virtually no tax was paid by the family earner until 150% AWE was passed, and that tax on moderately high-income family earners (shown up to 200% AWE) was considerably less than that on single earners at the same income level. Thus the sharing of the family income among five members was, in 1960, recognised as a factor in ability to pay across the income range.

By contrast, in 1997 there was virtually no difference in tax paid by the single and the family earner (again with wife and three children) at any level of income. Today tax simply rises with rising income and no recognition is given of the fact that members of the family on 150% AWE have less income per head than the single earner on 50% AWE. The small gap in tax paid represents the raised tax-free threshold (on a per child basis) of the 1997 family tax initiative. No adequate recognition is given to the share children take out of nominally individual income.

Of course, taxation is not the whole story, and since the 1940s 'welfare' payments have been made to families in recognition of the costs of children. Child Endowment was universal in 1960, but changes in the 1980s and '90s, while increasing the variety and value of family payments at low income levels, reduced them to minimal levels for average incomes, and withdrew them entirely for many families. Graphs 3 and 4 show net tax payable by family (three children, as above) and single earners in 1960 and 1997 – that is, when welfare payments received on behalf of children are deducted from tax paid, so that real levels of post-tax income are reflected in the figures.4

Again, in 1960, only families with incomes above 150% AWE paid tax at all, and, at all levels of income, single earners paid considerably more tax than equivalent family earners. In 1997, by contrast, the family of five on only 100% AWE is paying tax, and from 120% AWE the difference between net tax paid by the family earner and the single earner is minimal. The effect of child dependency on real income per person within the family is virtually disregarded.

What were the changes in tax policy and regulation which created this parlous situation for the family? Before 1976, in addition to the payment of Child Endowment, a generous tax deduction was available for each dependent child of the family. In addition, a series of deductions were claimable (much as work-related deductions are available today) for essential personal expenses incurred by family members on a per capita basis – medical, dental and chemist expenses, costs of schooling (fees, books, uniforms), and also council and water rates – with modest per capita ceilings. Thus the taxable income of the family earner was reduced compared with that of his or her single-earner equivalent. This accounted for a large part of the tax differential between family and single earners in 1960. It, together with rising marginal tax rates, made the tax system progressive and fair on both counts of multidependency and level of earnings.

In 1976, the Fraser government decided to remove recognition via tax deductions of the extra costs of families and to substitute a much increased Child Endowment, renamed Family Allowance, which would leave the family, on average, in much the same post-tax income situation, vis a vis the single earner, as before. This payment, like the previous Child Endowment and deductions, was available to all families, regardless of income level, on a per child basis. Unlike deductions, it was not tailored to actual family expenditure on essential goods and services. Being a flat rate, it meant slightly higher net benefit to lower income families and lower net benefit to higher income families, and it took no account of the tendency for higher income families to assume responsibility for health and educational expenses themselves, rather than devolving them on the state.

Then the Hawke government, in the late 1980s, without warning delivered the staggering blow of withdrawing most of the, by then, much-elaborated set of child-related payments from the majority of Australian families. Under the rubric of 'needs-based' welfare, payments to the minority of families on less than AWE, and to families on welfare (sole parents and unemployed), became increasingly generous, while those to families on and above AWE became minimal. We found ourselves in a condition, which has lasted close to a decade, in which families on AWE and well above it are struggling financially, due to the withdrawal of recognition, in both tax and 'workforce welfare,' of the costs of raising children.

In 1997, 120% average annual earnings for male full-time workers was $43,500. After tax-plus-welfare, the income of a family (couple plus three children, aged 12, 15 and 18) at this level of earnings was $35,000. The single person's post-tax income at the same pre-tax income level was $31,500 – for one person compared with a family of five. No amount of two-can-live-cheaper-than-one philosophy will reduce the extra costs of four people to a mere $3,500, above a base for one of $31,500.

Rising wages due to inflation, together with reform in the direction of fewer marginal tax rates in the mid-'80s, resulted in high rates of taxation on comparatively low levels of income. In 1960, the top marginal rate came in at 14 times AWE; in 1997 it came in at 1·4 times AWE. Nevertheless, current levels of taxation in relation to wage levels may not be unduly harsh for the single earner. Obviously if the family can survive at all on $35,000, the single person on $31,500 is not too badly off.

A consistent or 'logical' GST will not remove this inequity. The tax-induced financial stress placed on families will not be relieved until recognition of multidependency is reintroduced into the tax system at all but the highest levels of income (over 90% of Australians earn less than 200% AWE). Only this will roll back the increases in family tax rates of the last three decades, and reintroduce some sort of parity for family members compared with single earners.

Tax-induced family poverty

At present, the tax and welfare systems are co-ordinated in such a way that family income, except when it rises well above AWE, is compressed, and there is little difference in family net income across the range of earnings from 50% AWE to 120% AWE.

Graph 5 shows post-tax + welfare incomes in 1997 for a couple family with three children across the range from 50% to 200% AWE. It can be seen that from 50% to 120% AWE, income per annum is in the region of $33,000. Average weekly earnings ($36,000) are reduced to an income level similar to that of families earning 50% AWE (raised by welfare to almost $34,000). Families on $43,000 (120% AWE), modest earnings for a family of five, are, at $35,000, not greatly above the 50% AWE post-tax + welfare level. This is a result of the manner in which social security benefits (the various Family Payments and Austudy) are tapered off as earned income rises. Even equivalent unemployed families, entirely on welfare, receive a comparable income of about $31,000. Similar adjustments are made for two-child and one-child families, to maintain parity of final income, in keeping with the philosophy of 'needs-based' welfare.

As middle-income earners (75%-120% AWE) take in the majority of primary earners in Australian families, this is no light matter. We are regularly told of the numbers of children living in poverty because our welfare system is insufficiently generous. A recent report from the University of New South Wales Social Policy Research Unit, Development of Indicative Budget Standards for Australia, for example, claims to show that Australia's welfare budget of $42 billion fails to provide basic living standards for some of the poorest families.

But our minimum levels of family welfare payments provide incomes equivalent to those retained after tax by average families, and so we must conclude that, if indeed families at the lower end of the income scale are living in poverty, then average-income employed families are equally poor. This would lead to the conclusion that the majority of Australian families, largely by the action of a tax system which reduces their incomes to welfare levels, are also unable to provide basic living standards for their families with one parent in employment. They would serve their families just as well, in terms of income, if they worked half-time, or not at all.

The joint action of tax and targeted welfare ensures that families remain at the welfare-determined level of income until their earnings top 120% AWE, or about $45,000. Single earners, by contrast, retain rising incomes with rising earnings across the scale, and at AWE enjoy a financial condition considerably above that of the single worker on 50% AWE (Graph 5). Only when family earners pass 120% AWE, when they join the relatively elite in terms of earnings, can their post-tax incomes begin to rise. Graph 6 shows that families were not discriminated against in this way in 1980, before Labor's tax and welfare reforms of the late '80s. In 1980, as in 1950, 1960, and 1970, both family and single post-tax incomes rose in similar proportions with rises in earnings.

The large gap (see Graph 5) between the welfare-boosted income of a family with three children at 50% AWE and that of a single person on the same earnings shows a just recognition of the greater expense of financing the living costs of five people as compared with one, but this recognition is progressively withdrawn as earnings rise, and is minimal beyond AWE. At this point our tax-plus-welfare system almost entirely ceases to acknowledge the real condition of income per person within the family. The family of five on even 120% AWE is worse off after tax, per member, than the single person on the dole ($7,000 each, compared with $8,000).

Two categories of families have, perversely, been able to evade the reductive effects of selective targeting of welfare benefits and the removal of tax deductions for dependent children. Higher salaried professionals are able to income-split by placing income-earning investments in the name of a spouse, or by incorporating their activities so that surplus income that they do not receive as an employee of their own company is taxed at only 36% (the company tax rate) rather than at the top personal rate of 48.5%. Self-employed families, typically tradesmen and their wives, trade as partnerships and obtain the benefit of two tax-free thresholds, although only one spouse may be engaged full-time in the business. But middle-income employees are unable to income-split for tax purposes.

Dependency *versus* autonomy for the family

The manipulation of welfare payments, together with withdrawal of tax recognition of multidependency, has ensured that the large majority of families are unable to rise above the level of 50% AWE family income, despite rises in earnings, and has entrenched a situation in which the majority of families must abandon the expectation that they will be able to:

- assume full care of their pre-school children at home
- supervise their school-age children after school
- buy a home

- afford non-compulsory superannuation
- afford private medical insurance
- save
- afford holidays
- send their children for extra-curricular cultural activities
- support their children's tertiary education.

That is, they are denied personal choice in many of the most important of family concerns, and instead must accept what the state offers. With increasing prevalence of this forced reliance on the state, its dysfunctionality is becoming apparent. Although the deductions system created larger differentials in tax paid by single and family earners at moderate than at lower income levels, this had the virtue of allowing moderate income families to take responsibility for themselves in these many matters of family costs that are increasingly over-burdening state services.

The only way out of this no-win situation for the average working family is to raise its earnings above the 120% AWE level, beyond which gains in net income can occur. This can only be achieved if one parent takes a second job, or if both parents work, or both. Both childcare, reflecting the movement of mothers of pre-school children into the workforce, and multiple job holding, have doubled in the last decade. Teenage children, too, are increasingly forced into the workforce while they study. Couples are also delaying parenthood, or restricting their families to one child, which diminishes the care-load on working parents and does not leave them at quite such a disadvantage under the tax/welfare system as the larger family.

All these coping mechanisms are detrimental to the aspirations of family and the welfare of the family. If both parents work, children are less well-cared for. If parents work longer hours, this deprivation is exacerbated. If school children work to help provide for themselves, their education suffers and they are given an independence of parental control which may not be in their best interests. These pressures fragment the family. The political response has been to sue for further family welfare payments, which will merely increase taxation and continue, under current policies, the wasteful 'churning' of the tax-welfare system, returning little more to middle-income families than has been taken from them in the first place.

All families in the flat section of Graph 5, between 50% and 100% AWE, pay tax which reduces their earned income to the level shown for single earners, while at the same time most receive welfare payments which then push it up to the family welfare level. Yet a large percentage of these families – all those earning above 90% AWE – are earning at least this final amount in the first place. Money is taken from them in tax and then returned as welfare. If families are struggling financially, it is largely due to too much taxation, rather than to wages which are much too low to support them in the first place or to too little welfare. A return to the old approach of horizontal equity for families, using tax deductions to achieve proportionally lower taxation of incomes supporting more than one person, rather than the present policy of targeted welfare, would reform this situation.

Ten years ago, policies were put in place which ensure that families will be dysfunctional in one way or the other:

- If the family is intact and capable of supporting itself, we withdraw all monetary recognition of the fact that its income must support several persons' needs and so force it into an unnecessary financial stress and into recuperative efforts (e.g. children in childcare while both parents work) which pick at its foundations and raison d'etre.
- If it does not survive this treatment, we give welfare payments that indict families as not economically self-sustaining, and that persuade family members to see themselves as dependent, or potentially dependent, on the state, rather than as members of a self-reliant economic unit.

The movement of mothers and students into the workforce has obviously increased the competition for certain jobs. One of the effects of stressing the middle classes financially has been to make them take, part-time, service jobs of a semi-skilled nature which formerly belonged, as full-time employment, to working-class and lower-middle-class employees. Inadequate family income has also resulted in multiple job holding, in the effort to get above that $45,000 threshold. If some of the present 5.1 million multiple job holders were to give up their second jobs, the unemployed would have their options increased.

The welfare gearing of most primary family incomes to post-tax levels which do not differ substantially from those of part-time and unskilled-earner families has backfired, making things worse rather than better, for the less skilled. The proficient middle classes will always win in a competition for non-manual jobs. If unskilled-worker well-being, rather than an abstract 'social justice,' were the goal, it would be better to permit middle-income earners to retain incomes on which they can maintain their standards of living and their independence, without the need to encroach on the job pastures of the less skilled.

The movement of mothers into the workforce has also resulted in a large increase in welfare claims for costs of childcare (reaching $1,239 million in 1995/6), the tax burden for which is partially borne by single-income families on their lower incomes. This benefit, too, is largely a case of churning – of taking in tax from the second parental income what will be returned as childcare benefits.

The current welfare approach gives power and jobs to the welfare sector, whereas the taxation approach is minimalist in bureaucratic terms and promotes family autonomy. Money is wasted in its recycling away from families only to be returned in direct payments and in childcare for parents who only need to work because income has been taken from their families in the first place. There is an element of demoralisation, too, as the growth of family payments as 'workforce welfare' creates a perception of families as dependent on the state for their well-being, when in fact, given tax justice, they could be self-sufficient.

Family rebates

The family in Australia can no longer care for its children adequately. This is the result of a tax system which takes no account of multidependency, and a system of social security benefits which ensures that most families on single incomes will exist at welfare income levels. The majority of families must either live in welfare poverty, or hand over the supervision of their children to others and neglect their rearing, while they seek extra employment. The condition of young people in Australia is not good. They show all the signs of loss of parental care – high rates of suicide, mental health disorders, violence, and alcohol and drug abuse.

The welfare management of family equity has been a wasteful failure, and a return to the moderation, via taxation, of our family-blind wage system is overdue. Rather than reinstating the deductions system of the Menzies era, which is somewhat regressive, we should institute a system of PAYE rebates on a per child basis at a level (in the region of $3,000 to $5,000 p.a. per child, depending on age) that would substantially eliminate taxation for middle-income family earners with several children. Positive PAYE payments (i.e, negative income tax) could be made to families whose tax was less than their rebate entitlement.

It is unlikely that this would necessitate rises in current tax rates, as what was lost in tax would be balanced by the removal of all social security, childcare and Austudy benefits to working families, and the administrative savings would be considerable. Ideally, the tax rebate per child should be at the same level as welfare payments per child to unemployed families, which recognise their irreducible cost. Families earning in the middle range of pay scales could again begin to enjoy the fruits of their labour on a par with single earners.

Families with pre-school children would no longer be forced to keep both parents in the workforce. Those who chose to work could defray childcare costs out of their enhanced earnings, since the primary family income would now be adequate. There would be less pressure on parents of older children to work beyond comfort levels for adequate attention to their growing families. Multiple job holding should diminish, with all the benefits for family well-being that implies. And we could expect a reduction in unemployment benefit costs as jobs were freed, permitting a lowering of tax rates in the longer term.

Improved retention of family income will give those with modestly higher than average earnings the opportunity to fund for themselves the aspects of child rearing and family security which originally government took on by default, but which have become an increasingly heavy call on its budget.

True social justice is not served by artificially gearing families' perceptions of themselves to dependence on the ministrations of the state – by taking from them what must be given back, reducing them to lobbying for assistance, and restricting their choices to what the state chooses to deliver. There can now be no doubt that this condition engenders a sense of social malaise which was not present when, in the 1960s, the family's self-perception was of independence and autonomy, albeit in what were in many ways less materially endowed circumstances than today.

Endnotes

1 M.D.R. Evans, 'Norms on women's employment over the life course: Australia 1989-93', Worldwide Attitudes, 6 November 1995.

2 These benefits are made up as follows: single income family: parenting payment $33 pw, family tax initiative $17 pw, family allowance $34 pw; two income family: child care allowance $71 pw, child care rebate $63 pw, family tax initiative $8 pw, family allowance $23 pw.

3 Calculations are derived from Australian Bureau of Statistics labour force statistics, tax forms for the years in question and a variety of published government and academic sources on welfare policy. Details of calculations are available from the author. Figures throughout are for a one income, two parent family, with three children aged 12, 15 and 18 (five persons dependent on a given salary), versus an earner without dependants (one person dependent on the same salary). About a quarter of Australian families have three or more children and will continue to support them into their late teens, if not longer. In about half of Australian households there are no dependent children.

4 Only direct benefits are included in the calculations. In the 1990s, indirect benefits of considerable value are also available to families on welfare and at 50% AWE.