

A POSITION PAPER
OF THE CENTRAL COMMISSION
OF THE AUSTRALIAN CATHOLIC BISHOPS
ON THE MORAL REFERENCE POINTS
FOR TAX REFORM

Members of the Central Commission:

Cardinal E Clancy	SYDNEY	Spokesperson:	Telephone: Office & A/H 02 9390 5188 02 9220 0400
Archbishop F P Carroll	CANBERRA		
Archbishop L A Faulkner	ADELAIDE		
Archbishop G Pell	MELBOURNE		
Archbishop E D'Arcy	TASMANIA		
Archbishop Hickey	PERTH		
Archbishop J A Bathersby	BRISBANE		
Bishop G Robinson	SYDNEY		

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1. Preamble

1.1 The Catholic Bishops of Australia recognise the need to reform Australia's taxation system. Our interests are essentially linked to issues of morality and justice, rather than any party political agenda.

1.2 Our concern is to maintain the principle of the common good of society and the enhancement of prosperity for the Australian community. We have a special concern for the poorer sections of our community and for reducing the differences between rich and poor.

1.3 We seek to outline a broad framework, based on specific moral principles, in the light of which proposals for taxation reform can be analysed.

1.4 Through our many agencies, services, institutions and community involvements, we are in daily contact with the ambitions, challenges and problems of many Australians. The Bishops draw on this experience and a long tradition of social teaching in their wish to contribute constructively to public dialogue by asking some of the moral questions that need to be addressed in relation to tax reform.

1.5 The discussion of issues connected with tax reform is not limited to those with technical expertise in accounting or economics, nor to government officials nor to politicians. Since this fundamental matter of social policy has a moral dimension, the Bishops seek to raise issues which will assist in promoting the common good.

1.6 Since the national Tax Summit convened in 1985, the Bishops, through their agencies, have been actively engaged in the discussion on reform of the taxation system. Our document *Common Wealth for the Common Good*, published in 1992, made recommendations on taxation including the following:

That the State and Federal governments review the taxation system, examining such matters as the incidence of taxation (especially indirect taxes), tax avoidance and tax shelters (used especially by the corporate sector).

That the taxation system be based on scales that are progressive in their effect, rather than flat or regressive.

That more effective financial recognition be given through the taxation system to the service provided to the nation by those who work at home rearing children and managing a household¹.

1.7 The Bishops are heartened by the widespread recognition of the need to address the complex issue of comprehensive tax reform. Some national agencies of the Bishops have already made contributions to the reform process². The Bishops are willing to continue to involve their various organisations and structures in an ongoing discussion of how suitable tax reform can be achieved.

1.8 This present statement is predicated upon three fundamental principles that the Catholic Church holds as essential to achieving a just society. The statement then highlights some of the specific issues the Bishops believe need to be considered in the present discussion on comprehensive reform of our taxation system.

2. Three Principles Underpinning Comments on Tax Reform

Principle One : ‘The Common Good’

2.1 People live in community rather than in isolation. In community, one person’s essential wellbeing becomes the responsibility of others. This principle of the common good refers to ‘... the sum total of social conditions which allow people, either as groups or as individuals, to reach their fulfilment more fully and more easily’.³

2.2 Individual fulfilment can never be at the expense of the social wellbeing and development of other people living in community. Hence the common good concerns the life of all⁴ and must take account of the needs and aspirations of all members of the community³. ‘[I]t is the proper function of public authorities to arbitrate, in the name of the common good, between various particular interests; but it should make accessible to each what is needed to lead a truly human life: food, clothing, health, work, education and culture, suitable information, the right to establish a family, and so on.’⁶

The human person achieves his or her potential as a member of society, where the needs and rights of others have to be respected. It is wrong to pursue one’s own interests without regard to this fact. It is essential for the health of any society that most of its members have a moral commitment to work together to promote the common good. As a consequence of the limits placed by social morality on the right to own and use property, there is a need to examine the morality of owning a large surplus of material goods while others lack the necessities of life.⁷

2.3 Citizens have an obligation to pay tax in order that the common good is promoted and the welfare of the community is maintained.

Principle Two: ‘Distributive Justice’

2.4 Catholic tradition holds that the goods and the burdens of a community are to be distributed on the basis that not all persons can contribute in the same way⁸. Whilst the value of individual merit, effort and utility are recognised, society’s burdens should be distributed equitably with due emphasis on a person’s capacity to contribute. In a system of taxation based on justice and equity it is fundamental that the burdens be proportioned to the capacity of the people contributing.⁹ This is an example of what is known as the principle of distributive justice.

2.5 The principle of distributive justice essentially relates to the manner in which the individual and the State interact. In the light of this principle the State is obliged to treat each citizen according to their means and capacity to pay tax, taking into account individual differences and inequalities. It is to be distinguished from the principle of commutative justice which is concerned about equality between citizens.

2.6 Furthermore, authorities have a responsibility to ensure that the taxation system, together with other economic mechanisms available to Governments, are managed in a way which promotes the common good. This is not a matter of welfare or charity but of justice.

Principle Three : ‘Preferential Option for the Poor’

2.7 The greater the needs of people, the greater the responsibility of authorities and of those with a capacity to meet those needs. This is one means by which the human dignity of the poor is protected. Pope Paul VI articulated :

In teaching us charity, the Gospel instructs us in the preferential respect due to the poor and the special situation they have in society; the more fortunate should renounce some of their rights so as to place their goods more generously at the service of others.¹¹

2.8 This principle reflects the Church’s primary commitment to be at the service of the poor, the disadvantaged and the marginalised members of our community. In turn, the Church seeks to encourage civil authorities to also share this commitment, for the common good of society.

... consideration of justice and equity can at times demand that those in power pay more attention to the weaker members of society, since these are at a disadvantage when it comes to defending their own rights and asserting their legitimate interests.¹²

3. The Socio-Economic Context of Tax Reform

3.1 The efficiency, effectiveness and justice of our taxation system are crucial to ensuring that Australia remains both a competitive and a compassionate society.

3.2 Australia’s economy is undergoing significant restructuring and adjustment largely due to global influences. These influences place considerable pressures on public services, private sector activities and the capacity of governments to meet their civic duties.

3.3 In keeping with other modern economies, there is increasing concern over the level of foreign debt. Recent events in the Asian region demonstrate the necessity to manage national debt exposures.

3.4 Job security and economic certainty are increasingly elusive for many. Cost pressures on businesses inhibit their capacity to remain viable. The social fabric of regional Australia, and other parts of the community is under strain. The loss of services, both private and government owned, decreases job opportunities and the impact of world markets on primary production have left local communities struggling.

3.5 The manufacturing sector competes within an intense international marketplace, where taxes and compliance costs can hamper both the sale of goods and the employment opportunities for Australians. Taxes on business inputs can reduce exports and return on investments. Australian companies have raised concerns over the present level of company tax inputs, which hampers their competitiveness in world markets. In addition, international investment opportunities that generate Australian jobs can be discouraged by tax disincentives. Ultimately these conditions may lead to loss of revenue for Government.

3.6 At the same time, multinational corporations have the capacity to minimise their taxation liabilities, across their investment portfolios.

3.7 Australia's small business community is seeking to reduce the costs of complying with Australia's increasingly complex tax system. The continued strength and financial viability of the small business community, the country's major employment sector, is important in achieving sustained employment growth.

3.8 The capacity for governments to finance necessary human services, such as health care, education, housing and family support, is diminishing as the taxation base is eroded. 'User charges' are being introduced to supplement the loss of public funding. In many cases these charges burden those less able to cope.

3.9 State and territory governments resort to regressive taxes, partly to redress the consequences of constrained federal funding. The access of the Federal Government to the bulk of total taxation revenue, known as vertical fiscal imbalance, impacts directly and negatively on essential human services in local communities.

3.10 Across the community the erosion of the income tax base and the consequential reliance on indirect taxes is having a negative effect on production decisions, employment opportunities and the sustainable funding of essential human services and living standards of middle and low income families and individuals.

3.11 Many commentators suggest, for the benefit and prosperity of the whole community, a simplification of the myriad of regulations governing the Australian tax system.

3.12 The Bishops support the comprehensive evaluation and just reform of the taxation system, not simply the consideration of any single tax measure in isolation from the system in total.

4. Implications For Tax Reform

The tax system should be continually evaluated in terms of its impact upon the poor.. [T]he tax system should raise adequate revenues to pay for the public needs of society, especially to meet the basic needs of the poor... [T]he tax system should be structured according to the principle of progressivity so that those with relatively greater financial resources pay a higher rate of taxation.¹³

4.1 The Australian taxation system is in need of reform. Everyone who is concerned about the common good must be prepared to consider with an open mind all proposals to improve the taxation system. As it presently operates, the taxation system raises significant questions. Without overstating the case, it has elements that are unfair, inefficient and ineffective.

4.2 Public debate ought not focus on the advantages and disadvantages of any one particular element of a total reform package. The negative impact of one measure may be balanced by the positive impact of another. The whole package must be seen and assessed on its merit. Proposed amendments to one element of a reform package should be analysed for their possible effect on the capacity of other elements to enhance our economic performance and social cohesion.

4.3 Aspects of the system are **unfair** because they impose a higher burden on low-income families and individuals while allowing those who are better off opportunities to minimise their tax. Currently in Australia the poorest fifth of the population pays 36% of its income in taxes, while the wealthiest fifth pays 51% of its income in taxes¹⁴. Within the context of revenue neutral reform, this implies that to reduce the tax burden on low and middle-income families and individuals a higher tax burden may well have to be borne by those on higher income levels.

4.4 Aspects of the system are **ineffective** because they fail to raise sufficient revenue to fund the wide range of community services in health, welfare and education that are the hallmarks of an acceptable society. In the interest of promoting the common good, the taxation collection system should generate sufficient revenue to fund essential human services.

4.5 Aspects of the system are **inefficient** because they are overly complex and encourage investment in unproductive activities. To improve the opportunities for sustainable employment and community development, the tax system should provide incentives to foster productivity, economic growth and job creation.

4.6 It follows that tax reform should aim to achieve three things:

- Improvement in the prosperity and life circumstances of low-income families and individuals ensuring that each citizen contributes tax according to the capacity to pay;
- A robust tax revenue base; and
- The encouragement of employment generating investment.

4.7 Therefore, tax reform should have three priorities:

- First and foremost, it should aim to remove 'poverty traps' and 'work traps' that are created by the way the income tax system relates to the social security system.
- Secondly, the income tax systems needs to be reformed to deliver a fairer deal to low-income households and families with dependants and to minimise opportunities for the affluent to avoid paying their fair share of tax.
- Thirdly, the indirect tax system needs to be reformed to ensure a more robust revenue base for funding the nation's social and economic needs.

Priority One : Eliminating Poverty Traps and Work Traps

4.8 Australia should be a nation which offers its less well-off citizens the chance to improve their opportunities and those of their children. People who wish to enter the workforce and earn income should not face disincentives for doing so. A 'poverty trap' is a situation where the interaction between the tax system and the social security system creates financial disincentives to take up paid employment or increase working hours.

4.9 This happens when there is little or no financial benefit to be gained by entering the workforce owing to the high effective marginal tax rates. For each additional dollar of income earned a person's eligibility for various support payments diminishes rapidly. This additional income and the various support payments further combines with their marginal tax rates to make their effective tax rate so high that their disposable income in fact reduces.

4.10 Consequently, it is preferable to reform the interplay between the **tax/social security system** rather than only the tax system. If the interface between the two is not addressed, the 'high tax' trap will continue. It would be preferable to consider social security payments as equivalent to tax rebates. Reform must enhance the progressivity of the overall tax/social security system.

4.11 There are also many families with young children who would prefer to have at least one parent at home caring for the children and making other unpaid contributions to the community, but financial pressure forces both into the labour-market. In these situations, many families are effectively 'trapped' in the workforce, in what might be termed a 'work trap'.

4.12 The overall result is inefficient. Some parents who wish to enter the workforce are prevented from doing so, whilst others wishing to leave it or reduce their hours of work, are likewise prevented. Reform of the social security and income tax systems would make it easier for members of families to enter and to leave the workforce according to their financial and other needs. There may be a variety of ways of achieving this, but below are some suggestions.

4.13 Poverty traps could be eliminated by reducing the taper rates and liberalising income tests on social security benefits¹⁵. These initiatives would reduce the effective marginal tax rates faced by parents wanting to enter the workforce.

4.14 In addition, work traps could be eliminated by increasing the actual amount paid in Parenting Payment, Family Allowance and Youth Allowances. This would ease the necessity felt by parents to enter the workforce to generate income, when they would prefer to be providing various forms of unpaid caring and community work.

4.15 These or similar measures would improve the progressivity of the overall tax/social security system and alleviate poverty. These are the highest priorities for reform.

Priority Two : Reforming the Income Tax/Social Security System

4.16 There are a number of problems with the current income tax system that make it unfair, ineffective and inefficient.

4.17 Firstly, the tax base is eroding. Because of the structure of the income tax system, and changes to the structure of the workforce, fewer and fewer people are actually paying tax through the Pay As You Earn ('PAYE') withholding system. The result is that an increasing number of people who previously were employees are now contracting through incorporated companies paying company tax at a flat rate of 36 per cent rather than marginal personal income tax rates of 43 per cent or 47 per cent. There has been a significant growth in trusts and private companies in recent years, which has afforded many people the opportunity to minimise their tax.¹⁶

4.18 Secondly, 'bracket-creep'¹⁷ over the years has meant that workers on average weekly incomes are now paying the second-highest marginal rate of personal income tax. The burden of personal income tax for middle and low-income families must be reduced, and the loss of revenue must be reclaimed by raising more revenue from those with a greater capacity to pay. This will help restore the justice of the overall tax system. Serious consideration to the indexation of income tax rates, similar to the scale employed for Capital Gains Tax, should be given. This will safeguard middle and low-income families from the 'high tax' trap of bracket creep. As discussed in the section on poverty and work traps, personal tax cuts to this sector of the community do not have to be made by cutting marginal tax rates, but by reforming the social security system.

4.19 Thirdly is the treatment of families with dependent children. Notwithstanding the improvement in this area made through the Government's Family Tax Initiative, the current tax system still treats families with dependent children unfairly. The system treats dependent children as if they were objects that 'belong' to their parents. 'Having' children is not about procuring a certain type of consumer good, but about creating a society. If one wanted to speak in purely economic terms about the costs of raising children, it would be more accurate to speak about investment in human capital that will generate income, and therefore tax revenue. Any tax assistance given to families with children now will be more than paid back in future years. Families are net contributors to, not net drawers upon, the public purse. Justice demands that more must be done through the income tax/social security system to support families with dependent children.¹⁸

Priority Three : Reforming Indirect Tax

4.20 Many people think the only tax they pay is income tax because they see it on their pay slip and because they have to fill out an annual tax return. However, there are a variety of indirect taxes that are invisible to the ordinary consumer that result in higher prices being paid for goods and services. These taxes include sales tax, customs duties, financial institutions duties, petrol excise, payroll tax and company tax. In fact, the average household pays more in indirect taxes than it does in income tax.¹⁹

¹ *'Bracket creep' is the phenomenon whereby as a person's wage rises over time, they move into a higher tax bracket without any reference to movements in the Consumer Price Index.*

4.21 Since many households spend their full weekly income a strong case can be made that the essentials of life, such as basic foods, residential rents and domestic usage of water and other utilities should be exempt from taxation. A similarly strong case can be made for the exemption from taxation of spending on health, education and social welfare which might quite properly be regarded as investment in the productivity and social cohesion of the community.

4.22 Indirect taxes are regressive. Because most indirect taxes levy the same dollar amount on each consumer regardless of their income, they take a higher proportion of a low-income person's income than a high-income person's income.

4.23 To a large extent, the regressive nature of the indirect tax system is unavoidable. It would be impractical to attempt to levy different levels of sales tax on the same item according to the income of the person who purchases it. This regressivity can be partially offset if the overall distribution of the tax burden, that is, the combination of direct and indirect taxes and social security transfers, is sufficiently progressive in total.

4.24 A reform of the indirect tax system should aim to increase the overall progressive nature of the tax/social security system. Any reform of the indirect tax structure which exacerbates inequality will create an even greater emphasis on the need for reform of the income tax and social security systems to ensure that the demands of distributive justice are met.

4.25 It is sometimes argued that an increase in the indirect tax burden is only one factor that should be taken into account when assessing the desirability of a reform that has that result. For example, those who advocate broadening the base of consumption taxes to include currently untaxed services argue that although it may have immediate detrimental impact on the purchasing power of low-income households, it will have long-term economic benefits that will improve employment opportunities and job security. Furthermore, if the Government were to compensate low-income households for their reduced purchasing power through income tax cuts and/or benefit increases, then those households need not be any worse off at all.

4.26 There are two problems with this solution. Firstly, such compensation packages may be eroded over time, as in New Zealand. Secondly, the income tax cuts would not actually be enhancing the overall progressivity of the system, but only maintaining it by balancing the increased use of regressive consumption taxes. The introduction of indexed income tax rates to alleviate the incidents of bracket creep would lessen this problem and, on this scenario, would be an important aspect of reform.

4.27 This of itself is not to say that a broad-based consumption tax could not be introduced. There is a strong case for taxing services more effectively, since the economy is growing more strongly in that area and since high income people are greater consumers of services than low-income people. If long-term economic benefits of a broad-based consumption tax do flow through to the most disadvantaged, these gains may outweigh the short-term costs. This is an outcome however about which it is difficult to be certain.

4.28 Therefore, confronted, on the one hand, with the uncertainty about the long-term benefits of broadening the consumption tax base and, on the other hand, with the likelihood of increased prices resulting from such a measure, the ordinary Australian is understandably wary of reform which has a broad-based consumption tax as its centrepiece. The Bishops, because of their daily contact with ordinary Australians through their ministry in the spheres of health, education and social welfare, cannot help but share in this anxiety.

4.29 At the same time, the Bishops are aware, that without some attempt at comprehensive tax reform, those same Australians for whose welfare the Bishops are most concerned - the unemployed, the poor and those in need of strong social support from the community - will have little hope of improving their life prospects. As has been declared by all participants in the current debate doing nothing is not an option.

4.30 The Bishops acknowledge the proposition that a broad-based consumption tax could be part of an overall tax package that meets the needs of Australian society. They recognise also, however, that some argue that many of the benefits claimed for a GST can be achieved through other reforms including the extension of the present wholesale sales tax. All approaches have advantages and disadvantages. In the selection of reform options, the Bishops' main concern is to ensure that the common good and distributive justice are respected in the process and that the poor and disadvantaged benefit from the reforms.

Having carefully considered the many arguments that have been made about broadening the consumption tax base, the Bishops consider such a measure could only be introduced on condition that it :

- offer the opportunity for the long-term economic benefits its advocates claim,
- explore the possibilities of applying differential rates to particular luxury goods and services to enhance the progressivity of the tax system, and
- avoid an unjust increase in the indirect tax burden and cost of living for low-income Australians.

4.31 This might conceivably be achieved if those goods and services which are essential to full participation in the economic and social life of the community are not taxable, in other words, if health, education and social welfare (including childcare) services and food are classified as zero-rated, and if residential rents are exempt.²

4.32 Taxing public benevolent and charitable services would change fundamentally the character of the community and the charity sector. These services would be treated no differently from other consumer goods when in effect they contribute to the common good of society. They warrant special treatment. They are essential to the development of both 'human capital' and social cohesiveness. Tax reform should promote the increased provision of such services to all the community, especially the most disadvantaged.

² *If goods and services are zero-rated, that means that a GST is paid on inputs into the production process, but a full refund is paid to the producer, and no tax is paid by the consumer. Exempt status means tax is paid on inputs but not on outputs, however there is no refund on the input tax for the producer.*

5. Desired Outcomes For Tax Reform

5.1 The Bishops ask both the Government and the Opposition parties, in developing their tax reform packages, to demonstrate that the reforms can achieve the following outcomes.

1. That low-income families and individuals are better off in absolute terms.
2. That disincentives to workforce participation which arise from the interrelationship of the tax and social security systems are eliminated.
3. That those on modest incomes who wish to reduce workforce participation to care for dependents do not suffer significant financial hardship arising from that choice.
4. That the tax system is strengthened to raise sufficient revenue to fund essential social services.
5. That opportunities for companies and wealthy individuals to avoid paying their fair share of tax through artificial contrivances are eliminated.
6. That a tax environment is created which is conducive to savings, investment and employment growth.
7. That a tax environment is created which does not place small business at a disadvantage relative to large business.
8. That public benevolent and charitable services suffer no detriment in a new tax regime.
9. That to the maximum extent possible the essentials of life remain free of tax.
10. That compensatory measures introduced to counter the negative impact of tax reform are sustainable.

5.2 The Bishops urge all participants in the reform debate, particularly the Government and the Opposition, to have the common good and justice for the disadvantaged as their primary considerations when formulating and commenting on proposed policy.

ENDNOTES

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