

SUBMISSION TO THE REVIEW OF BUSINESS TAXATION (RBT) BY M.ROSS VENNER F.C.A.

DATED 11 April 1999

INTRODUCTION - TAXATION AS AGENT FOR UNEMPLOYMENT

Taxation has the primary purpose of raising revenue. Without revenue governments can not provide services and their activities are reduced to irrelevance, if not tyranny. It is sometimes overlooked that all taxation has secondary effects. It is the contention of this submission that the largest secondary effect of the current business taxation regime is to discourage employment.

Employment is discouraged because of the intersection between taxation and corporate reporting which focus on year by year results and management remuneration which is largely focused on the same short term outcomes.

Business managers know that a defensive decision, "Cut ten jobs and save \$500,000" will have the same or better effect on their remuneration and tenure as the risk decision "Invest \$1M create ten jobs and earn \$500,000 extra". Managers' goals are sometimes brutally expressed as "make 20% compound on capital employed and don't get sued". Unfortunately, managers know that one bad year can permanently blight their careers but also that they will be moving-on before the overall effect of their defensive, job destroying, decision making is identifiable.

Thus, defensive strategies reducing employment become the "good business" decisions applauded by the community and rewarded in the boardrooms. From this perspective, the scarcity/high price of venture capital and the rapid decline of employment in the manufacturing sector are logical outcomes.

This submission proposes the incorporation of a mechanism in the business tax system to compensate for these intrinsic disincentives to employment.

DECISION MAKER FOCUSED INCENTIVES FOR EMPLOYMENT CREATION

EXECUTIVE SUMMARY

This submission sets out an incentive structure to promote the growth of employment, particularly permanent full-time employment, in Australia. These incentives are based on the application of non-monetary "Points" awarded to employers, on the basis of numbers employed.

- Companies achieving fewer points than in the preceding year would not be able to claim "exorbitant" remuneration as an expense against tax.
- Points would be transferable for value, but would be valued at a discount in the hands of a purchaser.
- Points would not be carried forward to future periods.
- The points awarded would be weighted in favour of permanent full-time employment and of disadvantaged job seekers

The budget would define "Exorbitant remuneration" and the discount on transferred points for each fiscal year.

The proposal would have the following effects: -

- Business managers will have a significant incentive to reinvest in already profitable enterprises.
- Profitable businesses, which wished to cut their workforce, may buy Points from businesses with surplus points. This will provide capital for start-ups, actively encourage venture capital investment and provide additional incentives to invest in and rehabilitate struggling businesses.
- Overseas investors considering Australia as a site for international operations will benefit from the sale of points during the growth phase of their operations in Australia.

The table of Points awarded would be structured to favour recruitment of members of the community over-represented among the unemployed. Specifically, the beneficiaries will be; the young, elderly, aborigines, migrants and particularly the long-term unemployed. Two benefits flow from this policy: -

- Reduced welfare cost to the budget as people with marginal skills are integrated into the workforce and by their participation have their skills and employability reinforced.
- Greater security for persons in the workforce. Contributing to greater economic activity and social well-being.

HOW POINTS WORKS

Points are awarded on the basis of numbers employed; incentives are structured by weighting the points in favour of outcomes deemed desirable. A possible basic Points structure is summarised in the accompanying table.

Description	Week	Month	Quarter	Year
Full time employment	1	4	13	70
Full time – Eligible for disadvantage points	1	4	15	90
Part time Permanent employment > 20 hrs	½	2	6½	35
Full time Casual employment > 34 hrs	½	2	6½	35
Part time or casual (disadvantaged)	½	2	7½	45

An essential feature of the Points system is inherent in the weighting of the full year employment value.

Weighting of incentive points allowed for the recruitment of disadvantaged individuals is the second element of the Point process. On recruitment of an individual receiving benefit, the employer would receive a notification of the Points score of the individual. Points for different disadvantages may be added together to a maximum of say, 10 points.

Disadvantage	Points	Aggregate Points
Unemployed one month	2	3
Unemployed two months	3	6
Unemployed X months	X + 1	
Non-English Speaking Background	3	6
Aboriginal	3	6
Under 22 (Or first job)	3	6
Over 50	2	3
Over 58	5	15
50 YO NESB 3 months unemployed	9	45

Disadvantage points for a new recruit decrease by one for each week of employment.

THE PHILOSOPHICAL PERSPECTIVE

It is proper for a government to influence the market of its community. Its activity will, in practice, influence the market whether it wishes or not.

It is implicit to the operation of capitalism that the owners of businesses will and should seek to maximise their profits.

The Points system is based on the belief that the community is a stakeholder in the activity of its economy and has an obligation to provide price signals which reward the decision makers who assist the community in achieving its highest priorities. The creation of jobs, which provide the most effective mechanism of reducing poverty and hardship should be rewarded and the wilful destruction of jobs discouraged.

IMPACT ON BUSINESS DECISION MAKERS

Jobs are not created as a direct result of economic settings in the economy. They increase or decrease as a result of the decisions of individual business managers. Those business managers must achieve compound growth on the capital they deploy. Their bonuses, even their positions depend on growth.

The opportunities to achieve profit growth come from the following areas: -

1. Increased capital
2. Increased efficiency
3. Increased margins
4. Reduction of expenses – jobs

1 to 3 (above) can only be achieved by incurring risks which typically combining all three elements (and take years to provide positive results), but managers themselves can control the reduction of cost. Faced by market demands for profit growth at rates far exceeding growth in GDP, can it be any surprise that managers frequently focus on reducing jobs.

The Points system will redress the balance in favour of investment and against retrenchment. It would also actively reward companies.

(This analysis was developed from Gareth Powell's analysis of the impact of profit expectations in the Sydney Morning Herald)

The Points System will also reward companies which adopt non-discriminator policies

As individual managers make recruitment choices, the Points system gives a powerful justification for decisions, which favour those who are disadvantaged, by the present employment market. Many managers will recognise occasions when they must choose between individual candidates and instinctively choose the non-controversial, low risk individual. Under the Points System a decision to give a disadvantaged candidate "a fair go" will become laudable for the manager who made it, not stupid.

FISCAL OVERVIEW

- Revenue positive – No tax expenditure is required. Companies which cut employment irresponsibly may pay higher taxes. On implementation, the system need not allow the purchase of points as a business expense thus insulating the tax base (but reducing the overall power of the incentive).
- Tax savings would be achieved in welfare and employment promotion sectors. Any increase in overall economic activity resulting from increased individual confidence would increase government revenues.
- Capital Provision – One of the major failures of Australian markets, the difficulty of providing venture capital to companies at crucial stages of business, (start-up and recovery) would be powerfully addressed. Under the points system such companies when they could trade points for cash and achieving financial stability and taxable profitability earlier in their development.
- Encourages creative management – The points system rewards entrepreneurial managers and their businesses. Managers applying the short-term approach of "down sizing" will reduce the dividends of their investors, not increase them. In the long term "down-sizing" reduces overall economic activity and thus tax revenues.
- The points system will be a powerful incentive to ensure that employees are properly recorded and taxed under the PAYE system. The cost of Welfare fraud will reduce, as a result.

OTHER USES FOR "POINTS"

Once the points mechanism was established other opportunities would exist to utilise the paradigm. Two examples are offered.

Employment agencies are used by some recruiters to achieve discriminatory outcomes.

1. State governments could impose Point targets per placement as a condition of licensing employment agencies
2. The achievement of such targets would be difficult for those agencies that act as a cut out to facilitate discrimination by certain employers. To continue to function they would need to acquire the points and even

businesses of service providers now assisted by government. The resultant cash flow would reduce the cost of service delivery to government.

Employment creation targets incorporated in government contracts are widely regarded with derision. With the Points system in place such outcomes become highly measurable and thus enforceable.

ECONOMIC ANALYSIS

1. Insecurity of employment felt by many employees is a major disincentive to spending and directly reduces economic activity in many sectors, notably housing.
2. Unemployment, particularly long-term unemployment markedly reduces the ability of those effected to contribute to the national economic activity through loss of skills, confidence and morale. It also prevents many Australians saving for their retirement in the later years of what should be their careers.
3. The Points system redresses market disadvantage. The greater confidence with which persons would be able to move into and out of the workforce would promote training and skill improvement initiatives and thereby increase the net competitive advantage of the Australian workforce.

SOCIAL EQUITY

1. The bedrock of a just and stable society is the ability of all its members to participate. Participation without money from employment is extremely restricted. The Points system will assist in the distribution of stable employment to all members of the community.
2. Social inequity has become characterised by regional disadvantage as well as individual disadvantage. Individual decision-makers can be powerfully influenced to create employment opportunities in disadvantaged areas by the Points system.
3. With the desire of governments to ensure that the "baby boomers" save for their retirements the provision of greater job security for older Australians is a major benefit.
4. Social disadvantage is not one but a cluster of problems, of which unemployment is but one. To enable large blocks of the community move out of its shadow should be a principal goal of any government. The Points system offers the opportunity for government to directly benefit several areas of disadvantage through one policy.
5. The welfare system is tainted by fraud. The extent of such fraud is debatable, but providing employers with a clear benefit in ensuring that their employees and bona fide tax payers will significantly reduce the opportunities for welfare fraud and the "black economy".

ANTICIPATING THE IMMEDIATE CRITISMS

Ease of administration.

1. A candidate claiming disadvantage would obtain a document specifying the points available to the employer. This would be evidence for setting the points for the employee on joining. Additional documentation and returns would be negligible.
2. Computer payroll systems would have to be modified. True, but the amendments would be negligible and minor amendments to reflect tax systems changes are routine occurrences.

Privacy – No candidate would be compelled to apply for disadvantage points.

International competitiveness of the tax system – Australia already offers incentives to overseas companies to set up operations in Australia. If such companies intend to generate employment in Australia, they will be net beneficiaries of the system.

Avoidance and manipulation – An anti avoidance mechanism would be required to ensure that disadvantaged workers were not employed for brief periods so that unscrupulous employers could "cream off" their disadvantage points. All tax systems require anti avoidance mechanisms, the points system is no different.

CONCLUSION

The effect of the Points system would be:-

1. Promotion of employment, with a focus on secure long term employment.
2. Alleviate disadvantage in the labour market
3. Increase economic activity
4. Increase the availability of venture capital
5. Increase tax compliance and reduce welfare fraud.

The Points System would be revenue positive itself and provide other revenue positive benefits.

The Points System would be easy to administer and require no additional bureaucracy.