

GST Equivalence Theorems

Understanding what the GST really means as tax policy

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GST Equivalence Theorems

- It does not matter whether the money is taken under one name or another or when you earn it or spend it.
- In looking at a tax system you must add it all up.
- If I pay 20% income tax that may look not so bad, but if I am also paying 10% payroll tax plus a 25% GST, it is pretty miserable.
- 30% plus 25% of what's left comes to 49% of what you started with.
- You have to look at the TOTAL tax take on average and at the margin of decision making
- That partly explains why Europe is sadly going downhill.
- For example in Latvia, the average tax rate was about 52% and the marginal tax rate on extra income was 56%
- No wonder 30,000 people were emigrating each year out of a working population of 900,000 or so and the rest were not breeding!

GST Equivalence Theorems 1

* Income equals consumption plus savings

- $Y = C + S$
- $C = Y - S$
- $tC = t(Y - S)$
- Therefore GST is just a flat rate income tax
- But one which does not tax savings
- If you pay 45 cents income tax and spend the remaining 55 cents under a 10% GST, you are paying a true 50% income tax rate
- GST is thus the same as an income tax surcharge which gives an unlimited tax deduction for savings.
- If that's what anyone wants to do – it's easy, just abolish the super concessional contribution caps , tax the tax-free threshold!
- Politicians might save themselves from schizophrenia

GST Equivalence Theorems 2

- But income goes to both residents and non-residents
- So $Y = Y_r + Y_{nr}$ and $C = C_r + C_{nr}$
- But virtually only residents consume locally and GST is only on local consumption
- GST is therefore basically a tax on Australian residents only
- So GST is actually an income tax which exempts not only savings but also exempts foreign investors
- That is strange when we are wondering where the profits from years of mining and property booms have gone
- Do Australian want to exempt foreign investors from paying tax on Australian-derived incomes while increasing taxes on themselves? Go figure!

GST Equivalence Theorems 3

- GST is a tax on production. It is not a consumption tax as so many pseudo-economists think.
- Production requires labour as well as capital.
- Labour is an input to production as much as machinery or buildings.
- Labour has to be repaired and replaced as much as machines.
- That is why Adam Smith condemned taxes on wages or on the necessities of life.
- Yet GST is refunded on replacements of machinery but not on money spent to raise up children to replace the labourer.

GST Equivalence Theorems 4

- Income tax should be a tax on net income after costs
- Costs of food, clothing, shelter, health, education and child raising should be deductible if the labour force is to be maintained – the reason for a tax-free threshold
- Similarly these should be exempt from GST and many countries do have some exemptions.
- But whereas virtually all business or capital inputs are exempt from GST, only some labour inputs e.g. food are exempt from GST.
- GST becomes a tax inherently biased against labour considered as a factor of production.

GST Equivalence Theorems – in sum

- Do the Australian people want a tax system that
 - taxes the tax-free threshold
 - exempts foreign buyers of their land and resources
 - exempts fodder for farm horses but taxes the food of workers and their families
 - and taxes them on the costs of raising their children – the future taxpayers for the Treasury?
- If they do, no need to have a GST, just
 - put on an income tax surcharge
 - give a deduction for savings; and
 - exempt foreigners from income tax – same difference.
- But only a seriously stupid country would have a tax system which exempts foreign buyers of its land and resources while taxing the families raising its future taxpayers.
- A smart one might even do the reverse.