

Why Not a Flat Tax?

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Would you like your tax return to be able to fit on a postcard? Does a system where a person who earns ten times the income pays ten times the tax seem fair? Then a flat tax is for you.

LIKE the US, Australia is considering fundamental tax reform. Much of the Australian debate revolves around a plan to replace various consumption taxes with a broad-based Goods and Services Tax (GST), with the possibility that some of the extra revenue from this new levy will be used to reduce marginal income tax rates. This type of proposal could stimulate growth by increasing incentives and also clean up some of the complexity weighing down the tax code.

That is the good news. The bad news is that Australian policy-makers could enact a plan that would have far greater benefits. If Australians want a tax code that maximizes prosperity and treats all citizens fairly, they should completely repeal the current system and replace it with a flat tax.

The guiding principle of a flat tax is equality. All taxpayers and all income would be treated the same. With the exception of a generous tax-free allowance based on family size, all income would be taxed, but only one time, and at one low rate. Such a proposal has five major advantages. They are:

1. *Maximize incentives to create wealth for the Australian economy*—the single, low rate in a flat tax regime means that the penalty on work, risk-taking and entrepreneurship is minimized. This environment would result in a dynamic, fast-growing economy since individuals know that they—rather than the government—would reap the lion's share of the benefit from successful economic decisions.
2. *Boost savings and investment*—the flat tax does not discriminate against income that is saved and invested. This means, for instance, that there would be no second layer of tax on after-tax income that is saved or invested. The government would also be prohibited from taxing assets acquired with after-tax income, which would mean the abolition of capital gains taxes. Eliminating the bias against savings and investment would have a big economic

payoff since every economic theory—even Marxism—teaches that capital formation is the key to long-term growth and rising wages.

3. *Simplicity*—a big advantage of a single-tax system that taxes income only once is that all the complexities of the current code vanish. The only things that individuals need to know are the amount of their income and the size of their family. Businesses, meanwhile, would be subject to an extremely simple cash-flow expenditure tax. Both the individual and business tax returns could fit on a postcard.
4. *Fairness*—politicians no longer would be allowed to discriminate in a flat-tax environment. No matter the use of income, the source of income, or level of income, the same rules would apply. If your neighbour makes ten times as much income, he would pay ten times as much tax.
5. *Political honesty*—in most nations, politicians frequently use the tax code as a means of extorting money for their campaigns by promising (or threatening) to make changes in the tax code that will reduce (or increase) the tax burden of selected groups. This corrupting process works to the advantage of the rich and powerful. Under a flat tax, needless to say, such shenanigans would disappear.

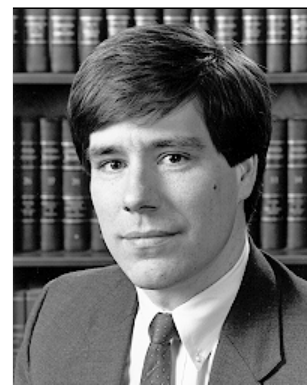
Opposition to a flat tax, at least in the US, comes from two major sources. The most significant opposition is from interest groups that have placed loopholes in the tax code. Ideologues on the left are the other major group opposing tax reform. They believe taxes are first and foremost a means of redistributing income, and therefore strenuously oppose any system that lowers tax rates at upper income levels.

Neither argument is justified. Well-connected and politically powerful interest groups should not be allowed to use the tax code to tilt the playing field in their direction. A flat tax ensures that the ordinary working man and small business are treated the same as the economic elite.

The class warfare hostility to the flat tax is also misplaced. The tax code should not punish the creation of wealth. If some citizens prosper by offering goods and services that consumers value, they are acquiring their wealth in a moral fashion and the tax system should not penalize them. Even more important, however, is the fact that high tax rates and excessive taxes on capital will drive successful people to hide, shelter and under-report their income. These practices are not only economically inefficient, but they also reduce tax collections. In short, a flat tax may be good news for the government's coffers since it is better to get a little slice of a big pie than it is to grab too much of a shrinking pie.

Places that have flat-tax regimes, such as Hong Kong and Bermuda, are economic success stories. True, these are isolated examples, but world economic evidence demonstrates a close correlation between a nation's prosperity and the degree to which its tax code contains low and reasonable treatment of capital.

There is every reason to believe that Australia would benefit from a flat tax. The country already benefits from an outward-looking, pro-trade mindset. Enacting the right kind of tax code would cement Australia's role as a leading economic power in the Asia-Pacific region.



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