

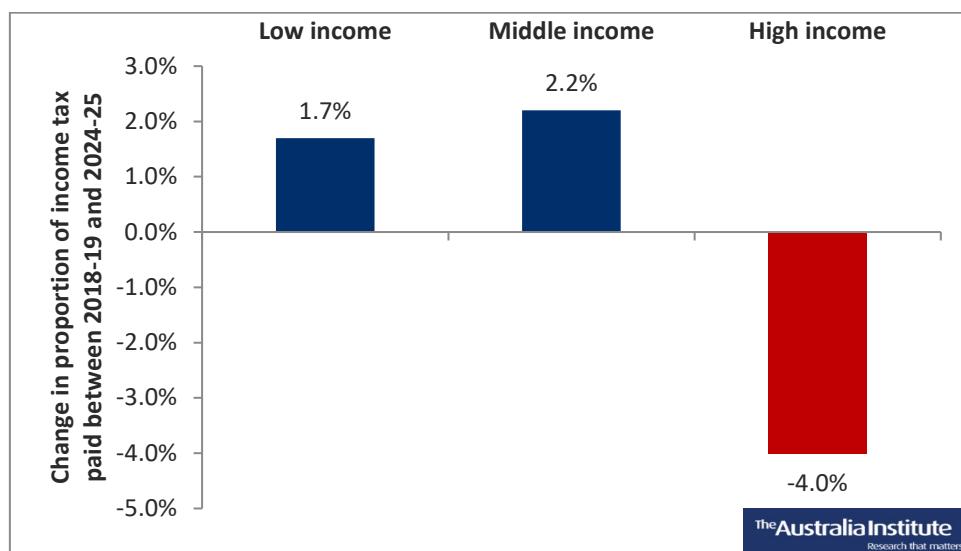
A bit rich: A Government plan to make tax less progressive

The Government's tax plan will make income tax less progressive, with most of the benefit going to those on high incomes. The tax plan will see the proportion of tax paid by high income earners fall and the proportion of tax paid by low and middle income earners rise.

Matt Grudnoff
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If the Government's tax plan is introduced it will reduce the progressive nature of the income tax system and will mean that high income earners will pay a smaller proportion of tax than they do now. It will also mean that low and middle income earners will pay a higher proportion of tax.

Figure 1 – Change in proportion of tax paid by high, middle and low income earners



Source: ATO (2019) *Individual Detailed Table 16: Percentile distribution of taxable individuals*, Australian Taxation Office, available at <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2016-17/?anchor=Individualsdetailedtables#Individualsdetailedtables>> and Australia Institute Modelling (see Appendix 2)

The Government's income tax plan in the 2019-20 budget extends its tax plan from the 2018 budget. Its plan to flatten the income tax rates would reshape Australia's progressive income tax system.

A substantial proportion of the income tax cut will go to those in the top income tax bracket. Those earning more than \$180,000 will get at least \$77 billion in tax cuts over the next 10 years. The top income tax bracket will increase in 2024-25 to apply only to those earning more than \$200,000. Those earning more than \$200,000 will get at least \$64 billion in tax cuts over the next 10 years.

The Government has claimed that its tax cut is designed to compensate for bracket creep but previous Australia Institute research has shown that most of the tax cut (54 per cent) goes to those in the top 20 per cent of taxpayers.¹ The Australia Institute has also shown that this group has already been overcompensated for bracket creep.² This tax plan will further overcompensate them. Over a 25 year period from when the GST was introduced to when the Government's tax plan is fully implemented in 2024-25, high income earners will see their average rate of tax paid fall by 5.3 per cent.

BENEFIT OF TAX CUT FLOWING TO THOSE IN THE HIGHEST TAX BRACKET

This election sees large differences between the Government and Opposition on tax. The Government has repeatedly focused their election campaign on the issue of tax.³ The Government has released new figures from Treasury that they claim show the difference between their income tax plan and opposition's income tax plan over 10 years.⁴ The Government is claiming that the difference between the Government's and Opposition's tax plan will be \$230 billion.

The Government has not yet provided any detail about how the figure was calculated nor a year-by-year breakdown over the ten years. No official information has yet been

¹ Grudnoff M (2019) *Regressing on tax*, The Australia Institute, 4 April, available at [<http://www.tai.org.au/content/regressing-tax>](http://www.tai.org.au/content/regressing-tax)

² Grudnoff M (2018) *Bracket Creep: The Imaginary Monster*, The Australia Institute, 18 June, available at [<http://www.tai.org.au/content/bracket-creep-imaginary-monster>](http://www.tai.org.au/content/bracket-creep-imaginary-monster)

³ Crowe D (2019) *Scott Morrison uses fresh Treasury costings to launch \$387 billion tax assault on Bill Shorten*, Canberra Times, 12 April, available at <https://www.canberratimes.com.au/story/6031106/scott-morrison-uses-fresh-treasury-costings-to-launch-387-billion-tax-assault-on-bill-shorten/>

⁴ Frydenberg J (2019) *Labor would be the highest taxing Australian Government on record with \$387 billion in new taxes*, Liberal Party of Australia, available at <<https://www.liberal.org.au/latest-news/2019/04/12/labor-would-be-highest-taxing-australian-government-record-387-billion-new>>

provided on the distribution of the tax cut. There is no detail about the costings of the two parties' different treatments of the Low and Middle Income Tax Offset (LMITO), the Low Income Tax Offset (LITO) or other changes to the 32.5 cent tax bracket. While there is some ambiguity about the differences between the Government and Opposition's income tax plans at the lower end of the income distribution, most of the differences in dollar terms are to do with the impact on high income taxpayers.

To better understand the impacts of the tax cuts, the Australia Institute has previously modelled the distributional impacts of the Government's proposed tax plan.⁵ This paper adds to that analysis by modelling the difference between the Government's and Opposition's income tax plan, to see how much of the Government's tax cut goes to those on very high incomes.

Using The Australia Institutes tax model we have calculated that 34 per cent of the tax cut will go to those earning over \$180,000; 28 per cent of the tax cut will go to those earning more than \$200,000.⁶ If the government's figures on the difference between the two tax plans are correct, that means that at least \$77 billion will go to those earning over \$180,000, including at least \$64 billion going to those earning above \$200,000. For more information on the assumptions behind these figures and why they are conservative, more detail is provided in the methodology section below.

PROGRESSIVE INCOME TAX

When the Government has been asked about the impact of its tax plan on the progressive nature of income tax, it has said that income tax will continue to remain progressive and that high-income earners will continue to pay a significant proportion of total income tax revenue.⁷ On Sky News the Finance Minister, Mathias Cormann said:

⁵ Grudnoff M (2019) *Regressing on tax*, The Australia Institute, 4 April, available at <<http://www.tai.org.au/content/regressing-tax>>

⁶ See appendix 2 for information on the tax model

⁷ Chang C & Clench S (2019) *Federal Election campaign: Minister's Awkward Sky Interview*, news.com.au, 14 April, available at <<https://www.news.com.au/national/federal-election/federal-election-campaign-day-three/news-story/46cfe6198469518a31c7102712eb8085>>

The top 20 per cent income earners continue to pay 60 per cent of all income tax revenue once our plan is fully legislated. The top 5 per cent of income earners continue to pay a third.⁸

The Government's claim that the income tax system will remain progressive is correct in the sense it will not lead to a completely flat income tax system but what has not been explained is whether the income tax system will become *less* progressive.

A progressive tax system means that people on higher incomes pay a higher proportion of their income in tax. Progressive taxation means that those most able to pay, pay most of the tax. This in turn underpins important Government spending for things like universal healthcare and education.

Any income tax system with tax brackets with rising tax rates is technically progressive, even if those tax brackets are relatively flat and rates of tax are close together. For example, a tax system that had two tax brackets, one from \$1 to \$500,000 at 20 cents and the other for those above \$500,000 at 21 cents, is technically progressive. But it is far less progressive than our current income tax system.

The Government's claims that the income tax system will still be progressive after the introduction of its income tax plan tells us only that it does not intend to get rid of all tax brackets and make income tax into a completely flat tax. If the income tax system has at least two tax brackets, that is it is not a completely flat tax, then it is progressive.

It is important to understand what impact the Government's tax plan will have on the progressive nature of income tax. To understand that we need to look at the impact the Government's income tax plan will have on the proportion of tax paid by high income earners.

TAX PLAN MAKES INCOME TAX LESS PROGRESSIVE

As the quote from Mathias Cormann above shows, the government has been claiming that when the Government's tax plan is fully implemented, those on high incomes will pay the majority of income tax. Mr Cormann's claim that the top five per cent will pay a third is slightly exaggerated; they will pay 31 per cent. His claim that the top 20 per

⁸ Chang C & Clench S (2019) *Federal Election campaign: Minister's Awkward Sky Interview*, news.com.au, 14 April, available at <<https://www.news.com.au/national/federal-election/federal-election-campaign-day-three/news-story/46cf6198469518a31c7102712eb8085>>

cent of taxpayers will pay 60 per cent is also slightly out; they will pay 57 per cent according to The Australia Institute's model.⁹

To understand the impact the income tax plan has on the progressive nature of the tax system we need to look at what will happen to the proportion of tax paid now and the proportion that will be paid in 2024-25 when the tax plan is fully implemented.

Table 1 shows taxpayers in the top 20 percent, 10 percent and five per cent will all be paying a smaller percentage of total income tax in 2024-25. It shows that the proportion of tax paid by high income earners is going to drop because of this tax cut.

Table 1 – Change in proportion of tax paid by high income taxpayers

	Top 20% of taxpayers	Top 10% of taxpayers	Top 5% of taxpayers
2018-19	60.6%	44.5%	32.6%
2024-25	56.6%	41.8%	31.1%
Change in proportion of tax	-4.0%	-2.7%	-1.5%

Source: Australia Institute modelling (see Appendix 2)

In this paper we will define high income as the top 20 per cent. Low income as the bottom 30 per cent and middle income as the 50 per cent between high and low income earners. This definition has the advantage of capturing all taxpayers and roughly equates to how the Australian Bureau of Statistics defines high, middle and low incomes.

A fall in the proportion of tax paid by high income earners means that low and middle income earners will be forced to pay a larger proportion of income tax. Low, middle and high income earners are shown in Table 2.

Table 2 – Change in the proportion of tax paid by low, middle and high income taxpayers

	Low income earners	Middle income earners	High income earners
2018-19	4.6%	34.9%	60.6%
2024-25	6.3%	37.1%	56.6%
Change in proportion of tax	1.7%	2.2%	-4.0%

Source: Australia Institute modelling (see Appendix 2)

⁹ Chang C & Clench S (2019) *Federal Election campaign: Minister's Awkward Sky Interview*, news.com.au, 14 April, available at <<https://www.news.com.au/national/federal-election/federal-election-campaign-day-three/news-story/46cf6198469518a31c7102712eb8085>>

A higher proportion of tax paid by low and middle income earners coupled with a lower proportion of tax paid by high income earners means the income tax system has become less progressive. This is exactly what we would expect to see from the Government's tax plan, which flattens the tax rates by removing a tax bracket and introduces a large income tax cut where the bulk of the benefit goes to high income earners.

BRACKET CREEP

The Government has also claimed that its tax plan is designed to reduce the impact of bracket creep.¹⁰ Bracket creep occurs when people's income rises due to general inflation and this pushes a larger proportion of their income into higher tax brackets. It is the increase in a person's average rate of tax because of inflation. It is a problem because while someone is paying a higher average rate of tax they are not able to buy more goods and services.

When measuring bracket creep in the Australian context it is important to take a longer term view. Bracket creep in Australia is addressed with ad hoc income tax cuts, so to measure the impact of bracket creep it is important to look a longer time period in order to capture the periods where inflation has impacted incomes and the periods where income tax has been cut.

The Australia Institute has previously quantified the size of bracket creep and found that from the introduction of the GST in 2000-01 until 2017-18 all income levels had been not only been fully compensated for bracket creep, but overcompensated.¹¹ The overcompensation was highest for those on high incomes and smallest for those on middle incomes. This means that there was no justification for any further income tax cuts because of bracket creep, and in the future compensation to prevent bracket creep would need to be targeted at middle income earners.

We will now look at the impact of bracket creep including the Government's recent changes to its income tax plan in the 2019 budget. To do this we compare average tax rates for low, middle and high income levels for three different time periods. We will look at 2000-01 (just after the introduction of the GST), 2018-19 (just before the

¹⁰ Chang C & Clench S (2019) *Federal Election campaign: Minister's Awkward Sky Interview*, news.com.au, 14 April, available at <<https://www.news.com.au/national/federal-election/federal-election-campaign-day-three/news-story/46cfe6198469518a31c7102712eb8085>>

¹¹ Grudnoff M (2018) *Bracket Creep: The Imaginary Monster*, The Australia Institute, 18 June, available at <<http://www.tai.org.au/content/bracket-creep-imaginary-monster>>

introduction of the Government's income tax plan) and 2024-25 (the first year the Government's income tax plan is fully implemented).

We will look at three relative income levels.

Average Ordinary Full Time Earnings (AOFTE)¹² – Today (2018-19) this is \$83,486, which we will call middle income earners.

Half AOFTE – Today (2018-19) this is \$41,743, which is just above the income of a full-time worker on minimum wage and what we will call low income earners.

Double AOFTE – Today (2018-19) this is \$166,972, which represents those who are likely to benefit the most from the government's income tax plan and we will refer to as high income earners.

Table 3 shows AOFTE (middle income), half AOFTE (low income) and double AOFTE (high income) for the years 2000-01, 2018-19 and estimated for 2024-25.

Table 3 – Various income levels for 2000-01, 2018-19 and 2024-25

	Low income earners	Middle income earners	High income earners
2000-01	\$20,886	\$41,772	\$83,543
2018-19	\$41,743	\$83,486	\$166,972
2024-25 (estimated)	\$50,818	\$101,636	\$203,272

Source: ABS (2019) 6302.0 - Average Weekly Earnings, Australia, Nov 2018, Australian Bureau of Statistics, available at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6302.0Nov%202018?OpenDocument> and Australia Institute modelling (see Appendix 2)

We can now calculate the average tax paid by these three income levels and compare them. We're able to compare them because each of the income levels is linked over time by changes in wages. If bracket creep has occurred then the average rate of tax paid by these three income groups should rise over time. If bracket creep has largely been adjusted for, then their average rates of tax should remain unchanged. If their average rates of tax have fallen, then they have been overcompensated for bracket creep.

It is important to realise that this method of looking at bracket creep will actually overestimate the impact of bracket creep because brackets have been effectively inflated by the growth in AOFTE or wages, and not just inflation.

¹² ABS (2019) 6302.0 - Average Weekly Earnings, Australia, Nov 2018, Australian Bureau of Statistics, available at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/6302.0Nov%202018?OpenDocument>

Table 4 shows the average rates of tax for each of the three income groups

Table 4 – Average tax rates for various income levels over three time periods

	Low income earners	Middle income earners	High income earners
2000-01	13.6%	16.1%	33.4%
2018-19	12.7%	16.9%	31.5%
2024-25 (estimated)	14.2%	17.6%	28.1%
Change 2000-01 to 2024-25	+0.6%	+1.5%	-5.3%

Source: ABS (2019) 6302.0 - *Average Weekly Earnings, Australia, Nov 2018*, ATO (2018)

Individual income tax rates, ATO (2018) *Individual income tax rates for prior years*, Treasury (2019) *Budget 2019-20: Budget Paper No. 1*, and Australia Institute modelling (see Appendix 2)

The results show that for low income earners, the average rate of tax fell from 2000-01 to 2018-19. This means that they were over compensated for bracket creep. It then rises from 2018-19 to 2024-25 showing that the Government's income tax plan does not fully compensate low income earners for the impact of bracket creep. Overall from 2000-01 to 2024-25 their average tax rate rises slightly from 13.6 per cent to 14.2 per cent.

Middle income earners see their average rate of tax increases from 2000-01 to 2018-19 meaning that they have not been fully compensated for bracket creep. The tax rate then increases again from 2018-19 to 2024-25, showing that the Government's income tax plan does not compensate middle income earners for bracket creep.

Finally high income earners see their average rate of tax fall from 2000-01 to today, which shows they were overcompensated for bracket creep. It then falls again from 2018-19 to 2024-25. This shows that the Government's tax plan over compensates high income earners who have already been overcompensated for bracket creep.

METHODOLOGY

Comparing the tax plans

Over the next three years the Government and Opposition's tax plans are very similar. In dollar terms this part of the tax cut is relatively small and is primarily aimed at middle income taxpayers. In 2022-23 and 2023-24 the Government introduces stage two of its tax plan, which the Opposition does not match. In this stage the Government gets rid of the LIMTO and compensates low and middle income earners by increasing the LITO and increasing the 32.5 cent tax bracket from \$37,000 to \$45,000. They also

give those on higher incomes a sizable tax cut by increasing the 37 cent threshold from \$90,000 to \$120,000.

In 2024-25 the Government introduces the final stage, stage three, of its tax plan. This involves increasing the top tax threshold from \$180,000 to \$200,000, removing the whole 37 cent tax bracket and dropping the tax rate for the 32.5 cent bracket to 30 cents.

Comparing dollar values of the tax cut

The Government has not released year by year figures for the difference between the tax cuts or the various elements of the tax cuts, but they have instead released only the aggregate figure over 10 years. In calculating the amount of money going to those earning over \$180,000 and those earning over \$200,000 we have assumed that the income distribution in 2024-25 is the same as the average distribution for all 10 years. We believe this is a conservative assumption for a number of reasons.

As the Government and Labor's tax plans are largely the same for the first three years, the difference for those years is likely to be close to zero. For the two years 2022-23 and 2023-24, which are the two years of stage two of the government's tax plan, the 2024-25 distribution figures are likely to overestimate the amount going to high income earners. This is because the top income threshold has not been increased and the 37 cent rate has not been removed. But very high income taxpayers are still going to benefit by the full amount from the increase in the threshold of the 32.5 cent bracket to \$45,000 and the increase in the 37 cent bracket to \$120,000.

For the four years after 2024-25, the 2024-25 distribution is likely to underestimate the proportion going to high income earners. This is because growth in income will increase the number of people who earn more than \$180,000 and the number who earn more than \$200,000. These four years will also be ones that make up the biggest proportion of the \$230 billion figure. This is because as incomes rise the size of the tax cuts will also rise.

The Australia Institute believes that its assumption about the proportion of the tax cut going to high income taxpayers is conservative and the actual proportion is likely to be higher. However if the Government were to release a year-by-year breakdown of the figures, it would allow a more accurate calculation.

APPENDIX 1 - TAX RATES IN 2000-01, 2018-19 AND 2024-25

Tax rates in 2000-01

Taxable income	Tax on this income
\$0 - \$6,000	Nil
\$6,001 - \$20,000	17 cents for each \$1 over \$6,000
\$20,001 - \$50,000	30 cents for each \$1 over \$20,000
\$50,001 - \$60,000	42 cents for each \$1 over \$50,000
\$60,001 and over	47 cents for each \$1 over \$60,000

Tax rates in 2018-19

Taxable income	Tax on this income
\$0 - \$18,200	Nil
\$18,201 - \$37,000	19 cents for each \$1 over \$18,200
\$37,001 - \$90,000	32.5 cents for each \$1 over \$37,000
\$90,001 - \$180,000	42 cents for each \$1 over \$90,000
\$180,001 and over	47 cents for each \$1 over \$180,000

Tax rates in 2024-25

Taxable income	Tax on this income
\$0 - \$18,200	Nil
\$18,201 - \$45,000	19 cents for each \$1 over \$18,200
\$45,001 - \$200,000	30 cents for each \$1 over \$45,000
\$200,001 and over	47 cents for each \$1 over \$200,000

APPENDIX 2 - AUSTRALIA INSTITUTE TAX MODEL

We have calculated the benefit of the tax cut by income deciles using the latest taxation statistics. Using the taxation statistics, we have constructed a model of Australia's income tax system. We then broke down all taxpayers into 100 groups from the lowest income earners to the highest. By inflating income by nominal GDP and calculating how much tax each group pays as the income tax cut is introduced, we then calculated how much of the tax cut went to each income decile.

The model inflates incomes over time. By 2024-25, when the government's tax cuts are fully implemented, it shows that those earning more than \$180,000 make up the top 10% of taxpayers. It also shows that those earning more than \$200,000 a year are in the top 8% of taxpayers. It then calculates how much of the benefit of the tax cut goes to the top 10% and how much goes to the top 8%.