The distribution of the Government's stage 3(a) tax cuts

The benefit of the final stage of the Government's income tax plan will flow overwhelmingly to high income earners with almost a third going to the top 10% and more than half going to the top 20%

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THE COMBINED TAX PLAN

The Government's tax plan has been put forward in the 2018 budget (2018 tax plan) and built on in the 2019 budget (2019 tax plan). The 2018 tax plan has already been legislated. None of the additional tax cuts in the 2019 tax plan have yet been passed parliament. The 2018 tax plan had three stages.

Stage 1: This part of the plan comes into effect in 2018-19. It introduces a Low and Middle Income Tax Offset (LMITO) for a four year period from 2018-19 to 2021-22. It also increased the threshold for the 32.5 per cent personal income tax bracket from $87,000 to $90,000.

Stage 2: This stage comes into effect in 2022-23, the year that the LMITO ends. It increases the Low Income Tax Offset (LITO) which increases the maximum rate from $445 to $645. Stage 2 also increases the 19 per cent personal income tax bracket from $37,000 to $41,000. It also increases the 32.5 per cent personal income tax bracket from $90,000 to $120,000.

Stage 3: This stage comes into effect in 2024-25. It increases the upper bound of the 32.5 per cent personal income tax bracket from $120,000 to $200,000, which eliminates the 37 per cent personal income tax bracket and increases the threshold at which the top tax bracket of 45 per cent begins (previously it started at $180,001, now it starts at $200,001).

The 2019 tax plan introduced an expansion to the 2018 tax plan. It made changes to all three stages of the tax plan. For simplicity we will call these stages 1(a), 2(a) and 3(a) in order to differentiate them from stages 1, 2 and 3 in the 2018 tax plan.

Stage 1(a): This increases the amount of money available through the LMITO, increasing the maximum payment from $530 to $1080. The period that the LMITO has been legislated for (the four years 2018-19 to 2021-22) remains unchanged.

Stage 2(a): This stage still comes into effect in 2022-23. It increases the LITO further so the maximum rate is now $700 (stage 2 increased it to $645). It adds to the increase in the 19 per cent personal income tax bracket by increasing it to $45,000 (stage 2 increased it to $41,000).

Stage 3(a): This stage decreases the 32.5 per cent personal income tax rate to 30 per cent.

PASSING THE TAX CUT

While stage 1, 2 and 3 of the 2018 tax plan were legislated last year, stage 1(a), 2(a) and 3(a) are yet to pass parliament. The Labor party have previously said that they will pass stage 1(a) (the increase in the LMITO). The Labor party took an increased LMITO broadly similar to the Government's proposal to the last election. Stage 1(a) looks to have majority support in both houses of parliament.

It is unclear if stage 2(a) will be controversial. The Government claims that stage 2 and stage 2(a) are compensation for the removal of the LMITO. While this is true for low and middle income earners, this stage also extends benefits to those on higher incomes. In contrast, the LMITO reduced to zero for anyone earning over $126,000.

The Labor party's stance at the last election was to keep with the traditional method of discussing tax cuts over the budget forward estimates (the next four years). This meant that it was not clear if they planned to remove the LMITO or leave it in place. This means that it is not clear if the Labor party was proposing to keep stage 2 of the tax plan. As such it is not clear if they will support stage 2(a) of the tax plan.

The Labor party have strongly opposed stages 3 and 3(a) of the tax plan. If the Labor party chooses to vote against any part of the 2019 tax plan then it will most likely be stage 3(a).

In order to facilitate a more informed debate we will look at the distributional impacts of just stage 3(a) because this is the part of the tax cut that is most likely to face opposition in parliament.

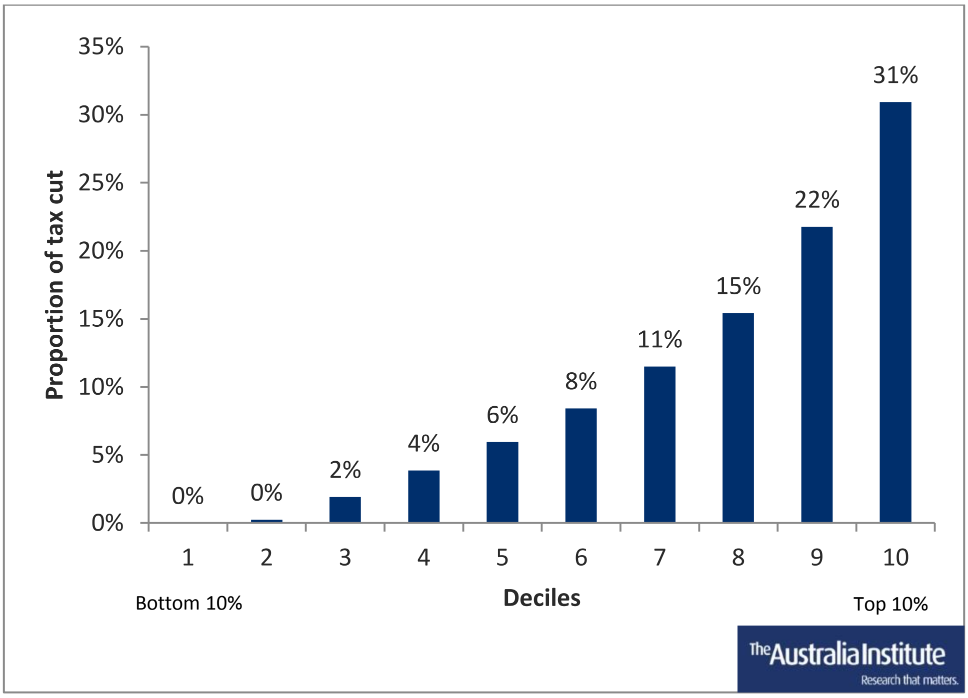
DISTRIBUTIONAL IMPACTS OF STAGE 3(A)

Stage 3(a) of the tax cut will come into effect in 2024-25. It will see the tax rate of the newly created $45,001 to $200,000 tax bracket fall from 32.5 per cent to 30 per cent.

The Government has previously said that the cost of stage 3(a) will be $95 billion over the next 10 years, which most likely means from 2019-20 to 2028-29. Since stage 3(a) does not come into effect until 2024-25, it will only affect the budget for five years of that 10-year costing. That means the cost to the budget of $95 billion is really over five years from 2024-25 to 2028-29.

The beneficiaries of stage 3(a) are mainly high income taxpayers. In 2024-25, when stage 3(a) first comes into effect, almost a third of the benefit goes to the top 10 per cent of taxpayers and the top 20 per cent will get more than half of the benefit. At the other end of the distribution the bottom 10 per cent gets none of the benefit while the bottom 20 per cent gets less than one per cent of the benefit. The income distribution is shown in Figure 1.

Figure 1 – Income distribution of Stage 3(a) of the tax cuts in 2024-25



Source: Budget Paper 2, 2019-20 and author calculations (see Appendix 1: Method)

Figure 1 breaks all taxpayers into 10 equal groups. The 10 per cent with the lowest incomes are in the first decile. The 10 per cent with the next lowest incomes are in decile two and so on up to the highest 10 per cent of taxpayers in the tenth decile.

SPLITTING THE BILL

The 2019 tax plan has very different stages that come into effect in very different time frames. Stage 1(a) comes into effect in the traditional budget time frame, over the next four years, and is well targeted to middle income earners. The increase in the LMITO enjoys bi-partisan support and will come into immediate effect. If it passes parliament, then eligible taxpayers will get the benefit when they submit their 2018-19 tax return.

Stage 2(a) and particularly stage 3(a) come into effect much later. In the case of stage 3(a), it will come into effect outside the budget forward estimate period. Predicting the state of the budget and the economy over the next four years is difficult and these estimates are regularly revised in future budgets. Predicting the state of the economy and the budget further than the budget forward estimates is virtually impossible. It is impossible to say what impact a large tax cut like stage 3(a) will have on the budget and the economy.

Stage 3(a) does not enjoy wide spread support. The Labor party has previously said they are unhappy with such a large tax cut that disproportionately benefits high income taxpayers. Also given it does not come into effect for six years, there is no urgency in passing the tax cut immediately.

Given there is strong support for some parts of the 2019 tax plan and less support for other parts, the Senate could split the bill allowing the tax cuts for low and middle income earners in stage 1(a) to come into effect while voting against stage 3(a) which mainly goes to high income earners.

CONCLUSION

Stage 3(a) represents a tax cut that flows overwhelmingly to those on high incomes. It is a tax cut that will further erode our progressive income tax system. It is also a tax cut that will not come into effect until well into the future, at a time when the Government cannot predict what impact it will have on the budget and the economy.

If the Government is determined to continue to run budget surpluses into the future then the $95 billion cost to the budget of stage 3(a) could well mean future spending cuts that will impact all Australians.

The Senate could split the 2019 tax plan and pass those parts that have strong parliamentary support and are due to come into effect in the short term.

APPENDIX 1: METHOD

We have calculated the benefit of the tax cut flowing to taxpayers 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.