

The LMITO and stage 3 tax cuts by electorate

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SUMMARY

The government is planning to scrap the Low- and Middle-Income Tax Offset (LMITO) in 2022-23, which mainly goes to middle income taxpayers. The 50 per cent of taxpayers between the fourth and eighth deciles get 80 per cent of the LMITO. In 2024-25 the government's stage 3 tax cuts will begin, which mainly go to high income earners. The majority (53 per cent) of the tax cut goes to the top 10 per cent of taxpayers.

The scrapping of the LMITO will see 90 per cent of taxpayers pay more tax. The stage 3 tax cuts are not due to begin until 2024-25 and they will mostly cut the taxes of people on high incomes. The net effect of the two tax changes will be that the two thirds of taxpayers on less than \$90,000 a year are worse off, while the third of taxpayers on more than \$90,000 a year are better off.

Despite benefiting fewer people, the stage 3 tax cuts are expected to reduce government revenue by about twice as much as the LMITO.

In Australia's representative democracy, the geographic spread of the benefit of the various tax changes is important. In particular the spread between electorates that make up the 151 seats in the House of Representatives, helps explain why the Government is so keen on the stage 3 tax cuts and happy to see the LMITO come to an end.

The Labor Party represents electorates that dominate those that have the biggest proportion of taxpayers getting the largest benefit from the LMITO (eight of the top 10 and 14 of the top 20). Liberal Party electorates dominate those that have the largest

proportion of taxpayers getting the biggest benefit from the stage 3 tax cuts (seven of the top 10 and 12 of the top 20). This helps explain why the Liberal Party have been strong advocates for the stage 3 tax cuts and less concerned about the LMITO coming to an end.

It is less easy to understand why the Coalition Government’s junior partner, the National Party, support the stage 3 tax cuts. The stage 3 tax cuts will see 40 per cent of taxpayers get no benefit. The electorates that have the largest proportion of taxpayers who get no benefit are mainly represented by the National Party. Six of the National Party’s 16 electorates are in the top 10 electorates getting no benefit. There are 10 National Party electorates in the top 20. That represents almost two thirds of all National Party electorates. Despite this the National Party have been advocating for the stage 3 tax cuts as part of the Coalition Government.

LMITO VERSUS STAGE 3 TAX CUTS

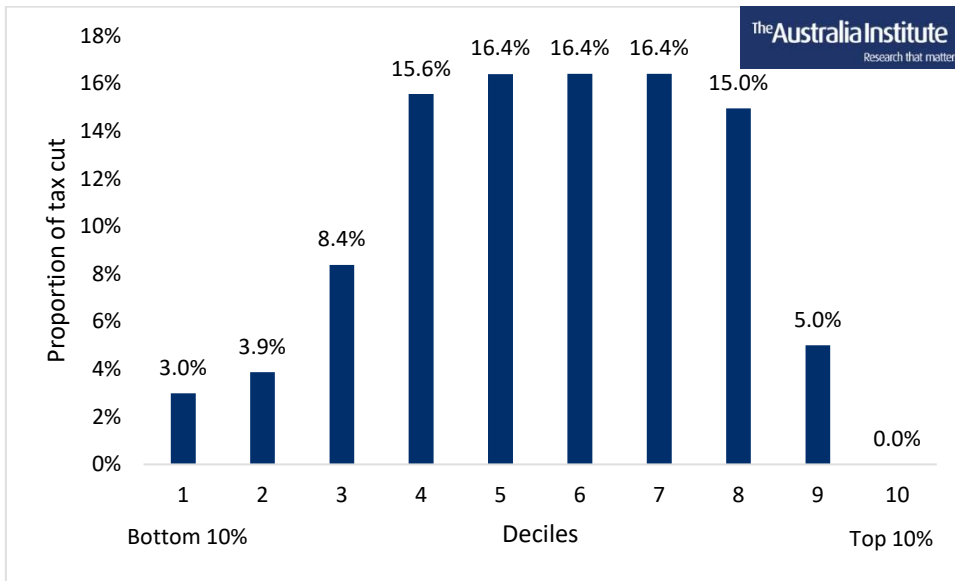
The Morrison Coalition Government is planning two major changes to the tax system. The first change to the tax system will occur when the Low- and Middle-Income Tax Offset (LMITO) ends in 2021-22, with refunds being paid for the last time in 2022-23. The end of the LMITO represents a tax increase for everyone who receives it. The LMITO is a tax offset that is paid to people when they submit their tax return. The rates of the LMITO are shown in Table 1.

Table 1 – Rates of the LMITO

Taxable income	LMITO
\$37,000 or less	\$255
\$37,001 to \$48,000	\$255 plus 7.5% of the portion of taxable income over \$37,000
\$48,001 to \$90,000	\$1,080
\$90,001 to \$126,000	\$1,080 minus 3% of the portion of taxable income over \$90,000

Most of the benefit of the LMITO goes to middle income earners. The 50 per cent of taxpayers between the fourth and eighth deciles get 80 per cent of the LMITO. None goes to those in the top 10 per cent and only five per cent goes to those in the top 20 per cent. The income distribution of the LMITO is shown in Figure 1.

Figure 1 – Income distribution by decile of LMITO by decile in 2021-22



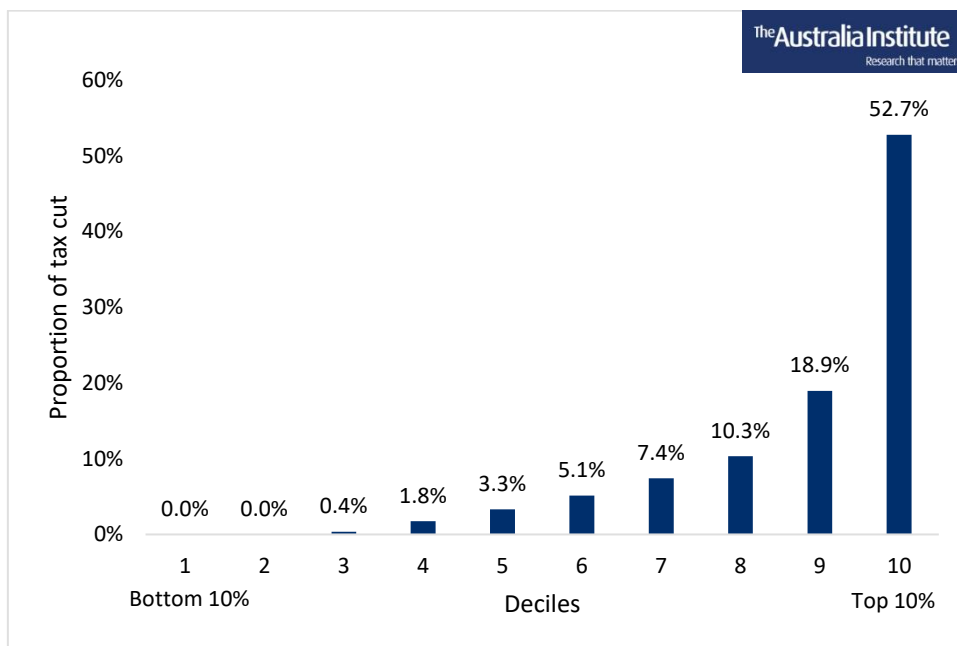
Source: Author’s calculations (see appendix A)

In July 2024 the stage 3 tax cuts will come into effect. These tax cut will:

- Increase the income at which the top tax bracket begins from \$180,001 to \$200,001.
- Remove the 37 per cent bracket which previously applied to incomes from \$120,001 to \$180,000.
- Lower the income tax rate for the new bracket that extends from \$45,001 to \$200,000 from 32.5 per cent to 30 per cent.

The beneficiaries of the stage 3 tax cuts are very different from the beneficiaries of the LMITO. Far fewer people benefit from the stage 3 tax cuts and those who do are mainly on high incomes. Those earning \$45,000 or less a year will get nothing from the tax cut, while those earning \$200,000 a year will get a tax cut of \$9,075 per year. Looking at the income distribution of the tax cut by deciles we see that the top 10 per cent of taxpayers get most of the tax cut (53 per cent), while the bottom 20 per cent of taxpayers get nothing. The distribution of the stage 3 tax cuts by income is shown in Figure 2.

Figure 2 – Income distribution by decile of stage 3 tax cuts in 2024-25



Source: Author’s calculations (see appendix A)

While the LMITO benefits many more taxpayers (90 per cent of them) than the stage 3 tax cuts (60 per cent), the stage 3 tax cuts will reduce budget revenue by more than double the LMITO. The LMITO is expected to reduce budget revenue by \$7.4 billion in its final year of operation.¹ The stage 3 tax cuts are expected to reduce revenue by more than twice as much, \$15.7 billion, in its first year of operation.²

ISSUE OF TIMING

The removal of the LMITO and the introduction of the stage 3 tax cuts do not occur at the same time. The LMITO ends in 2021-22 (with the refunds paid in 2022-23), while the stage 3 tax cuts do not start until July 2024. This means that almost 90 per cent of those who get the LMITO will face a tax increase in 2022-23. None of them will get any benefit from the stage 3 tax cuts until 2024-25.

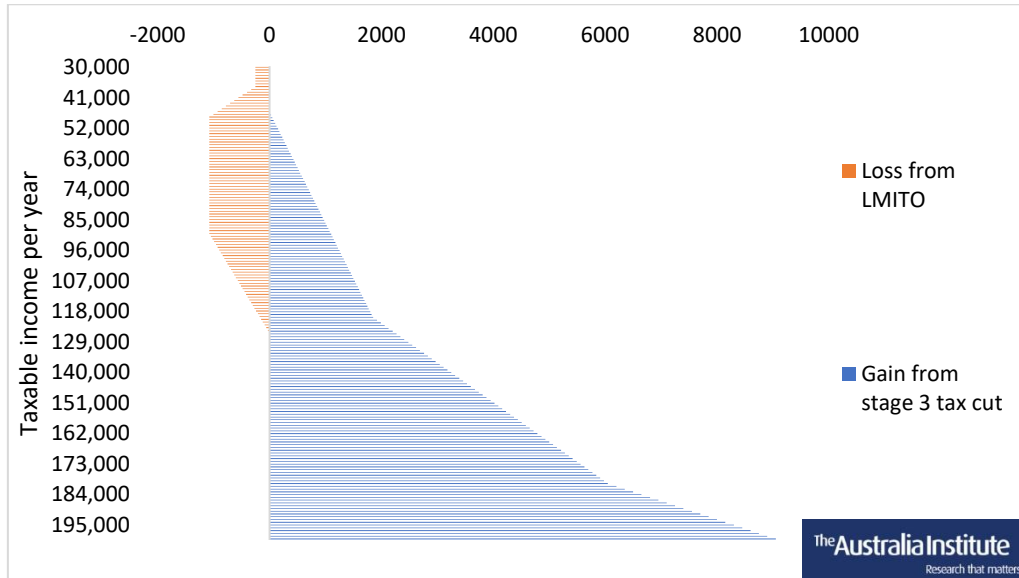
Even if they did coincide, the beneficiaries of the stage 3 tax cuts are very different to the beneficiaries of the LMITO. Figure 3 shows taxable incomes from \$30,000 per year to \$200,000 per year, and the amount of LMITO that people on those incomes will lose

¹ Commonwealth of Australia (2021) *Budget 2021-22*, Budget paper No. 2, available at <https://budget.gov.au/2021-22/content/bp2/download/bp2_2021-22.pdf>

² Wright S (2021) *Stage 3 tax cuts to cost \$184 billion as decade of deficits looms*, SMH, 28 July, available at <<https://www.smh.com.au/politics/federal/stage-3-tax-cuts-to-cost-184-billion-as-decade-of-deficits-looms-20210727-p58dd1.html>>

(in orange) and the amount of stage 3 tax cuts that people on those incomes will gain (in blue).

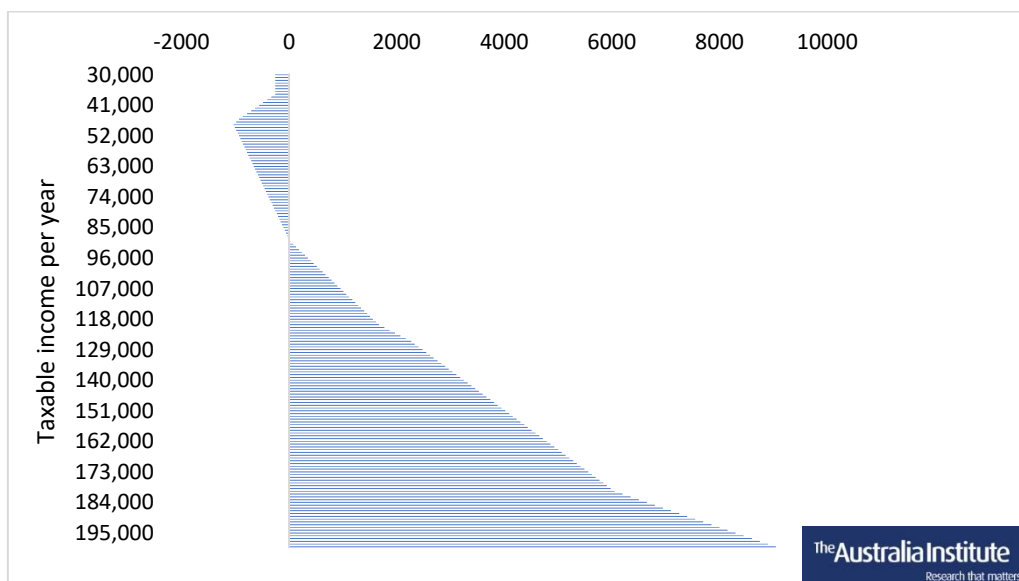
Figure 3 – Loss from removal of LMITO and gain from stage 3 tax cuts for incomes from \$30,000 to \$200,000 per year



Source: Author's calculations

Subtracting the stage 3 tax cut gains from the LMITO losses at the various income levels, shows what the net effect of the two tax changes will be in 2024-25, when the stage 3 tax cuts come into effect. This is shown in Figure 4.

Figure 4 – Value of stage 3 tax cuts minus value of LMITO lost by taxable income for 2024/25



Source: Author's calculations

Everyone earning more than \$90,000 will be better off in net terms. This represents a third of taxpayers. Everyone earning less than \$90,000 will be worse off. This represents two thirds of taxpayers.

ELECTORATE DISTRIBUTION OF TAX CUTS

Taxation law is made by the Parliament, and the House of Representatives is made up by representatives from 151 electorates. The remaining 76 parliamentarians are state and territory representatives in the Senate. This means that the geographic distribution of the tax cut beneficiaries by electorates are important in understanding how political decisions are made.

This paper takes taxation statistics by postcode from the Australian Tax Office and aggregates them into Commonwealth Electoral Divisions. The taxation statistics, from 2018-19 (the latest year), show the number of people in each tax bracket by postcode. The tax brackets in 2018-19 are:

- Less than or equal to \$18,200
- \$18,201 to \$37,000
- \$37,001 to \$90,000
- \$90,001 to \$180,000
- More than \$180,000

Aggregating taxpayers by postcode into Commonwealth Electoral Divisions gives the number of taxpayers in each of these tax brackets by electorate.³

ELECTORATES BENEFITING MOST FROM THE LMITO

The main beneficiaries of the LMITO are middle income earners. The maximum rate for the LMITO is for people earning from \$45,000 to \$90,000 per year. The income brackets by electorate do not exactly line up with the maximum rate of the LMITO they do come very close. The number of taxpayers earning between \$37,000 and \$90,000 per year by electorate is a good proxy for those that get the greatest benefit from the LMITO.

The electorates that have the largest proportion of taxpayers getting the greatest benefit from the LMITO are mainly Labor electorates. Of the top 10 electorates, eight are represented by the Labor Party and two are represented by the Liberal Party. The

³ Details on how this was done can be found in Appendix B

top 20 are similar with 14 of the top 20 electorates represented by Labor and 6 represented by Liberals. The seats in the top 10 are all electorates on the edges of Australia’s big capital cities, including Sydney, Melbourne, Brisbane and Adelaide. The 10 electorates that have the largest proportion of taxpayers getting the greatest benefit from the LMITO is shown in Table 2.

Table 2 – 10 electorates that have the largest proportion of taxpayers earning between \$37,000 and \$90,000 per year

Rank	Electorate	State	Party	Proportion
1	Spence	SA	ALP	52%
2	Chifley	NSW	ALP	51%
3	Holt	VIC	ALP	50%
4	Blair	QLD	ALP	50%
5	Kingston	SA	ALP	50%
6	Macarthur	NSW	ALP	50%
7	Forde	QLD	LIB	49%
8	Makin	SA	ALP	49%
9	Lindsay	NSW	LIB	49%
10	Gorton	VIC	ALP	48%

Source: Taxation Statistics 2018-19 (see Appendix B)

The proportion of taxpayers in the top 10 electorates who benefit the most from the LMITO is also very high. About half of all taxpayers in those electorates get either the maximum rate or something close to that. The lack of Liberal Party electorates in the top 10 and top 20 might help explain why the Coalition Government is currently planning to end the LMITO in 2021-22.

The electorates that have the smallest proportion of taxpayers getting the greatest benefit from the LMITO are mainly electorates represented by the Liberal Party. Of the 10 electorates, eight are Liberal, one is independent, and one is Labor. The top 20 also sees the Liberal Party dominate, with 16 of the top 20 seats. The remaining four have one each from the National Party, Labor Party, Greens and an independent.

The electorates in the top 10 are all wealthy electorates in the inner parts of capital cities. Electorates in Sydney make up six of the 10, with Melbourne and Perth each having two. The 10 electorates that have the smallest proportion of taxpayers getting the greatest benefit from the LMITO is shown in Table 3.

Table 3 – 10 electorates that have the smallest proportion of taxpayers earning between \$37,000 and \$90,000 per year

Rank	Electorate	State	Party	Proportion
1	Bradfield	NSW	LIB	32%

2	Wentworth	NSW	LIB	32%
3	North Sydney	NSW	LIB	32%
4	Curtin	WA	LIB	32%
5	Warringah	NSW	IND	33%
6	Kooyong	VIC	LIB	33%
7	Goldstein	VIC	LIB	33%
8	Berowra	NSW	LIB	34%
9	Sydney	NSW	ALP	34%
10	Tangney	WA	LIB	35%

Source: Taxation Statistics 2018-19 (see Appendix B)

While these electorates have a much smaller proportion of taxpayers getting the maximum, or near, maximum rate, we still see about a third of the taxpayers in the electorate getting the maximum rate.

THE ELECTORATES BENEFITING FROM THE STAGE 3 TAX CUTS

In July 2024, the last stage of the Commonwealth Government's tax plan will come into effect. This stage involves a number of changes to the tax rates and brackets. The result of this will reduce the progressive nature of the income tax system by flattening the tax brackets. This includes removing the 37 per cent tax bracket. After the stage 3 tax cut people earning from \$45,001 to \$200,000 per year will pay the same marginal rate of tax.

The stage 3 tax cut will:

- Increase the income at which the top tax bracket begins from \$180,001 to \$200,001.
- Removes the 37 per cent bracket which previously applied to incomes from \$120,001 to \$180,000.
- Lower the income tax rate for the new bracket that extends from \$45,001 to \$200,000 from 32.5 per cent to 30 per cent.

Modelling from the Parliamentary Budget Office (PBO) shows that almost half (45 per cent) of the benefit of the tax cut goes to those earning more than \$180,000.⁴ This is the group that will get the largest benefit from the tax cut. The electorate data includes an income bracket for those earning more than \$180,000. From this we can

⁴ Wright S (2021) *Stage 3 tax cuts to cost \$184 billion as decade of deficits looms*, SMH, 28 July, available at <<https://www.smh.com.au/politics/federal/stage-3-tax-cuts-to-cost-184-billion-as-decade-of-deficits-looms-20210727-p58dd1.html>>

find the electorates that have the largest proportion earning more than \$180,000 which we can use as a proxy for those getting the largest benefit from the stage 3 tax cuts.

The top 10 electorates that have the largest proportion of taxpayers getting the greatest benefit from the stage 3 tax cuts are mainly Liberal electorates. Of the top 10, seven are Liberal, two are Labor and one is independent. They are electorates in wealthy areas of the capital cities of Sydney, Melbourne and one in Perth. Table 4 shows the top 10 electorates that have the largest proportion of taxpayers getting the biggest benefit from the stage 3 tax cuts.

Table 4 – 10 electorates that have the largest proportion of taxpayers earning more than \$180,000 per year

Rank	Electorate	State	Party	Proportion
1	Wentworth	NSW	LIB	15%
2	Warringah	NSW	IND	14%
3	North Sydney	NSW	LIB	14%
4	Curtin	WA	LIB	12%
5	Bradfield	NSW	LIB	11%
6	Kooyong	VIC	LIB	11%
7	Goldstein	VIC	LIB	11%
8	Higgins	VIC	LIB	10%
9	Macnamara	VIC	ALP	8%
10	Grayndler	NSW	ALP	8%

Source: Taxation Statistics 2018-19 (see Appendix B)

The prevalence of Liberal Party electorates might help to explain why the Government is very keen on the stage 3 tax cuts.

The 10 electorates that have the smallest proportion of taxpayers earning \$180,000 or more per year are very different. They are all electorates with Labor representatives. They are mostly located on the edges of capital cities. The exceptions to this are the seats of Lyons in Tasmania, which covers most of central Tasmania and the seat of Blair in Queensland which extends from Ipswich, west of Brisbane, north into rural areas.

Table 5 – 10 electorates that have the smallest proportion of taxpayers earning more than \$180,000 per year

Rank	Electorate	State	Party	Proportion
1	Spence	SA	ALP	1%
2	Chifley	NSW	ALP	1%
3	Kingston	SA	ALP	1%
4	Bruce	VIC	ALP	1%

5	Makin	SA	ALP	1%
6	Holt	VIC	ALP	1%
7	Blaxland	NSW	ALP	1%
8	Lyons	TAS	ALP	1%
9	Fraser	VIC	ALP	1%
10	Blair	QLD	ALP	1%

Source: Taxation Statistics 2018-19 (see Appendix B)

ELECTORATES GETTING LEAST BENEFIT FROM THE STAGE 3 TAX CUTS

A large number of taxpayers will get no benefit from the stage 3 tax cut. This is people earning \$45,000 or less per year, which is about 40 per cent of all taxpayers. The data doesn't allow us to calculate the proportion of taxpayers earning \$45,000 or less per year but it does allow us to calculate the proportion earning \$37,000 or less per year. This is a reasonable proxy for those that will miss out on the stage 3 tax cuts.

Six of the top 10 are National Party electorates, with the remaining four represented by the Labor Party. The National Party have 16 seats in the House of Representatives, which makes six seats in the top 10 a significant proportion of total National Party seats. The top 20 electorates see an additional four National Party electorates making the list. This means that 10 National Party electorates are in the top 20 electorates that have the largest proportion of taxpayers that get no benefit from the stage 3 tax cuts.

Table 6 – 10 electorates that have the largest proportion of taxpayers earning \$37,000 or less per year

Rank	Electorate	State	Party	Proportion earning \$37,000 or less
1	Lyne	NSW	NAT	50%
2	Blaxland	NSW	ALP	50%
3	Wide Bay	QLD	NAT	49%
4	Page	NSW	NAT	48%
5	Richmond	NSW	ALP	47%
6	Hinkler	QLD	NAT	47%
7	Cowper	NSW	NAT	47%
8	Maranoa	QLD	NAT	47%
9	Watson	NSW	ALP	46%
10	Gilmore	NSW	ALP	46%

Source: Taxation Statistics 2018-19 (see Appendix B)

This is surprising since the National Party, as part of the government, have been advocating for the stage 3 tax cuts. The National Party are advocating for a tax cut that is less likely to benefit their electorates.

CONCLUSION

The LMITO will benefit middle income earners who are more likely to live in Labor electorates on the edges of the large capital cities. The stage 3 tax cuts are most likely to benefit high income earners who live in Liberal electorates in the wealthy areas of Australia's largest capital cities. Those getting no benefit from the stage 3 tax cuts are more likely to live in National Party electorates in poorer rural electorates.

Looking at the beneficiaries of the LMITO and stage 3 tax cuts by electorate helps explain why the Liberal Party have been such strong advocates for scrapping LMITO and introducing the stage 3 tax cuts. But it does not explain the support of the National Party. While Liberal Party electorates in the major capital cities will have the larger proportion of taxpayers getting the greatest benefit from stage 3, the rural National Party electorates will see large proportions that get no benefit at all.

With the LMITO benefiting more people than the stage 3 tax cuts, one might expect in a representative democracy that the LMITO would be preferred. But with the National Party's support, the Liberal Party can cut taxes for taxpayers who are more likely to be in their electorates and raise taxes on people who are less likely to be in their electorates.

APPENDIX A

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 growth 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.

APPENDIX B

The electorate data was constructed from Taxation Statistics 2018-19 data. The data gives counts of taxpayers by postcode and by taxable income range. The postcodes were aggregated into Commonwealth Electoral Divisions (2019) using a correspondence from the Australian Bureau of Statistics.