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Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee

Transmitted by email: economics.sen@aph.gov.au

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Re: Deloitte submission to the Senate Economics Legislation Committee Inquiry: Treasury Laws Amendment (Income Tax Relief) Bill 2016

Deloitte welcomes the opportunity to make a short submission to the Senate Economics Legislation Committee inquiry into the *Treasury Laws Amendment (Income Tax Relief) Bill 2016.* The bulk of this submission is drawn from our Tax Reform publication last year *Shedding light on the debate; Mythbusting tax reform #1*, analysing bracket creep amongst other matters. In making this submission, Deloitte is cognisant of the importance of Budget repair in the current fiscal environment.

Key points:

1. Bracket creep affects taxpayers in all tax brackets, with families and lower income earners particularly impacted by the erosion of incentives to work. Accordingly we support the relief proposed for average full time wage earners in the *Treasury Laws Amendment (Income Tax Relief) Bill 2016.*

2. In our publication *Shedding light on the debate; Mythbusting tax reform #1, (relevant extracts are contained in the Appendix following)* we identified that taxpayers with incomes between $30,000 and $37,000 face the largest challenge from bracket creep and we encourage the Committee, when circumstances permit, to consider the impact of bracket creep on this group.

3. Given the current fiscal environment, it may be appropriate to consider targeted relief for bracket creep (that is, restrict the benefits of tax relief to the tax bracket targeted).

4. Deloitte supports the continuation of the debate and process directed to broader reform of the wider tax system.

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5. It is also our view that changes to marginal tax rates and thresholds should be considered together with their overall interaction with the transfer system.

Yours sincerely

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Appendix

1. Taxpayers with incomes between $30,000 and $37,000 face the largest challenge from bracket creep

Australia's progressive personal income tax system is based on marginal rate thresholds that are fixed in dollar terms, meaning government revenues benefit as higher wages gradually drive individual taxpayers into higher marginal tax brackets.

Overall revenue gains from bracket creep can be divided into two components:

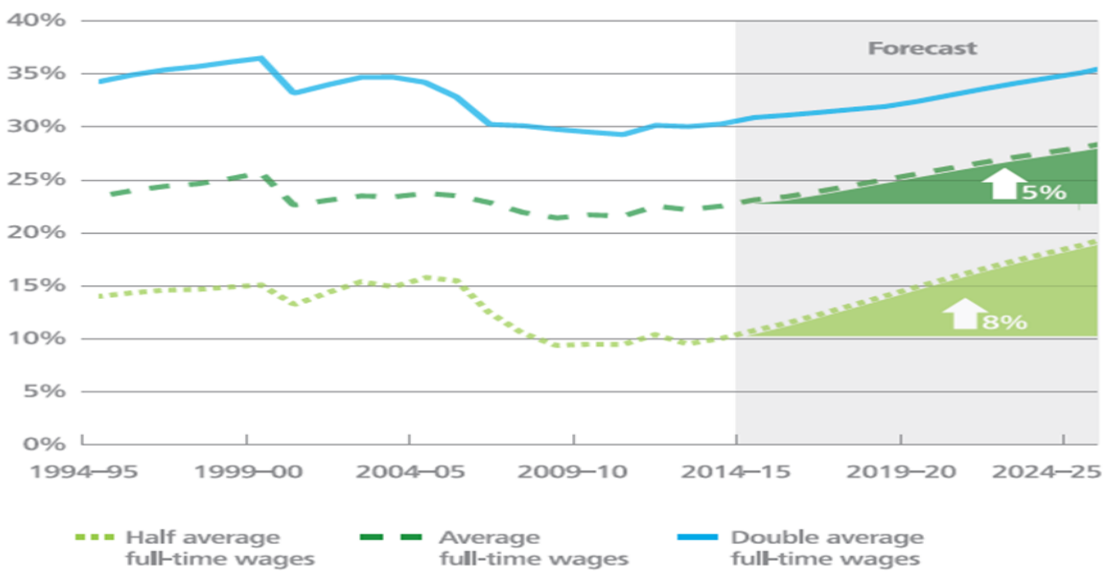
- **A nominal component** which occurs as wages rise with price inflation, thereby increasing average tax rates even if real wages are going nowhere
- **A real component,** which occurs when wage rises outpace price inflation, shifting taxpayers even further into higher tax brackets. This type of bracket creep is a natural feature of a progressive income tax system.

The first form of bracket creep generates a cut in real disposable income over time, whereas the second form of bracket creep involves a sharing of real wage growth between taxpayers and governments.

Whilst those on average full-time wages will feel the pain of bracket creep, there's an even bigger group facing an even larger challenge:

- It is true there are 800,000 taxpayers with incomes between $70,000 and $80,000 (whose marginal tax rate may therefore soon jump 4.5 percentage points as they move into the next tax bracket in the absence of the measures in the Bill)
- Yet there are also 1.3 million taxpayers with incomes between $30,000 and $37,000 (whose marginal tax rate may therefore soon jump by 13.5 percentage points as they move into the next tax bracket).

Chart 1: Average tax paid at different levels of income



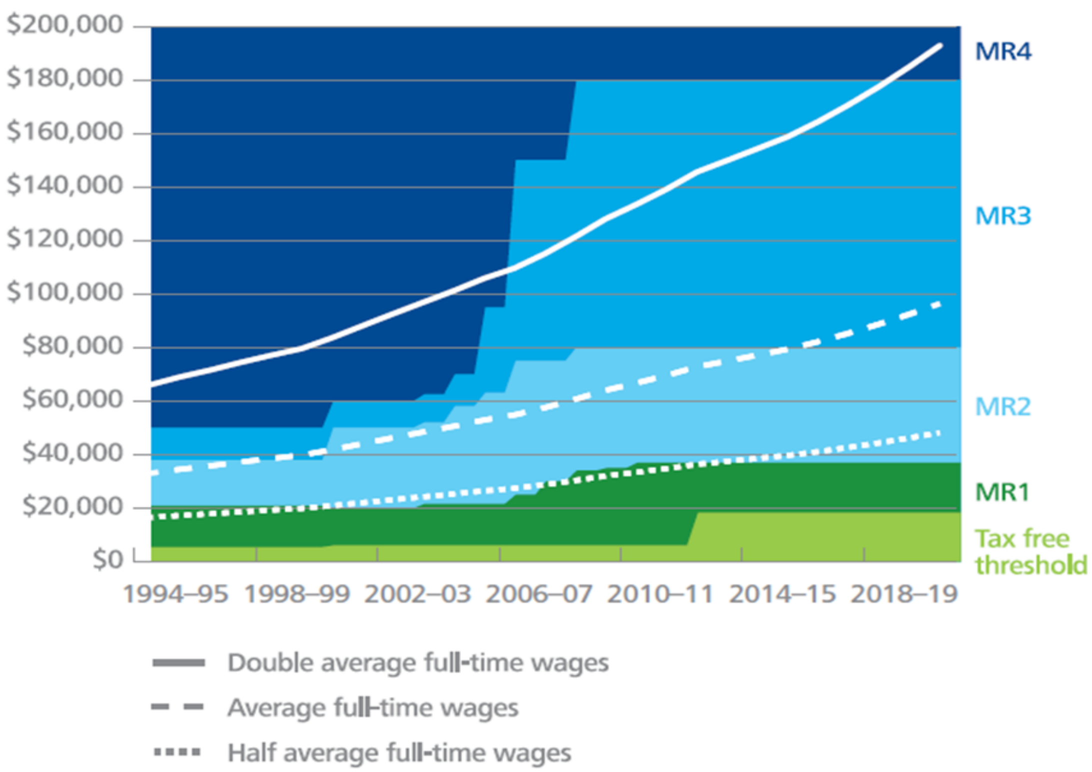
Source: Deloitte Access Economics

As Chart 1 shows in the absence of the measures proposed in the Bill, the average tax paid by a person earning average weekly ordinary time earnings (AWOTE– the income of full-time workers) is forecast to increase from a rate of around 23.3% in 2014–15 to 28.2% in 2024–25. That's a notable increase of a little less than five percentage points.

However, for a person earning half this amount, their average tax paid is set to increase by eight percentage points over this period, lifting from 11.0% in 2014–15 to a projected 19.0% in 2024–25.

Although that's not quite a doubling, it is a larger increase than that faced by those on average full-time earnings.

Chart 2 : Marginal tax rate (MR) paid by those at different levels of income



Source: Deloitte Access Economics

Over time, there will be substantial shifts in marginal tax rates faced by typical taxpayers (see Chart 2). In a few years, a person earning average weekly ordinary time earnings is expected to be in the second top marginal tax bracket for the first time since the turn of the current century[1]. That means they'll be paying over a third of every extra dollar earned in tax.

As more and more people are subject to higher and higher marginal rates of tax, the incentives to work are eroded. But that is particularly true for the less well-off, for whom interactions between the tax and transfer systems can produce substantial changes in take home income.

The less well-off are also the same group of people bracket creep is expected to affect the most.

[1] This chart was prepared prior to the introduction of the Bill and does not take into account the measures in the Bill.