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Mr Mark Fitt
Committee Secretary
Senate Economics and References Committee
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018 [Provisions] (the PITP Bill)

Dear Mr Fitt

We refer to your correspondence of 11 May and thank you for the invitation to provide a submission to the Committee on the PITP Bill. The comments in this submission relate to the system-wide equity and efficiency implications of the proposed flattening of the personal income tax rate structure, and a gender analysis of the PITP Bill.

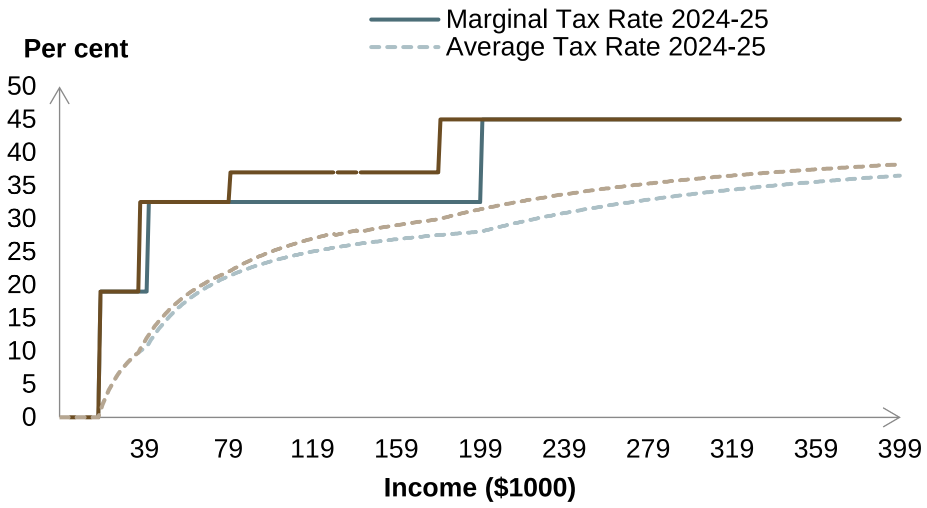
The analysis summarised here is supported by the detailed research presented in the attached chapters of the recently published book, Stewart (ed), *Tax, Social Policy & Gender* (2017, ANU Press):

1. Chapter 1, Miranda Stewart, “Gender Inequality in Australia’s Tax-Transfer System”;
2. Chapter 5, Guyonne Kalb, “Taxes, Transfers, Family Policies and Paid Work over the Female Life Cycle”;
3. Chapter 9, Miranda Stewart, Sarah Voitchovsky and Roger Wilkins, “Women and Top Incomes in Australia”; and
4. A recent blog post prepared by Miranda Stewart for the Tax and Transfer Policy Institute (TTPI) 2018 Budget Forum, “Tax Caps and Tax Cuts: Good for Australia?”

Removal of the 37 % rate is regressive and inefficient

Australia’s progressive income tax rate structure dates back to the first federal income tax, enacted in 1915 with bipartisan support, and in earlier colonial income tax statutes. This submission opposes the removal of the 37% tax rate which would arise if the full PITP Bill changes are implemented (by the 2024-25 year). This is illustrated in **Figure 1**.

Figure 1: Proposed tax rate change



Source: Stewart, Miranda (2018), Budget Forum 2018: Tax Caps and Tax Cuts: Good for Australia?, Austaxpolicy: Tax and Transfer Policy Blog, 14 May 2018, Available from: http://www.austaxpolicy.com/budget-forum-2018-tax-caps-tax-cuts-good-australia/

It is common for Australian governments to make periodic adjustments to the thresholds for each income tax bracket to account for inflation, as the income tax applies to nominal income. This submission does not specifically address the upward adjustments of the bracket thresholds in the PITP Bill to address so-called “bracket creep”, although it is debatable whether the threshold changes are necessary for either fairness or efficiency at this stage.

However, this submission argues that the removal of the third rate in the progressive rate structure is unnecessary and a retrograde step. It is a permanent change to the personal income tax rate structure that will make the income tax less progressive. It undermines the fundamental principle of our progressive income tax which aims to tax on the basis of ability to pay. Higher income earners pay more in Australia because they have more capacity to pay. It is appropriate to maintain progressivity across the middle and upper middle of the wage distribution.

Progressivity in the personal income tax also plays a broader role in Australia’s overall tax system. Most other taxes in our tax system are proportional or regressive in nature, including most tariffs and excise, the Goods and Services Tax (although the exclusions render it less regressive), many fees and charges, and most State taxes. The progressive rate structure of the personal income tax, combined with social security payments that go mostly to the poorest in Australia, is critical to deliver progressivity in the system as a whole.

There is no efficiency case for lowering the tax rate structure to benefit the upper middle and top of the income distribution. There is no evidence of high elasticity or responsiveness of work effort for those in the middle and top of the income distribution, or of excessive tax planning at these levels of income.

While the particular change appears modest, the removal of another step in progressivity in the PITP Bill will permanently flatten the rate structure. Each country has its own history of income tax and examples of both more progressive and less progressive rate structures can be found in other countries. For information of the Committee, the **Appendix** summarises the income tax rate structure from three comparable OECD countries: the United Kingdom, Germany and Canada. These countries have retained several steps in the progressive rate structure, including in Germany, a continually increasing structure across the middle of the distribution.

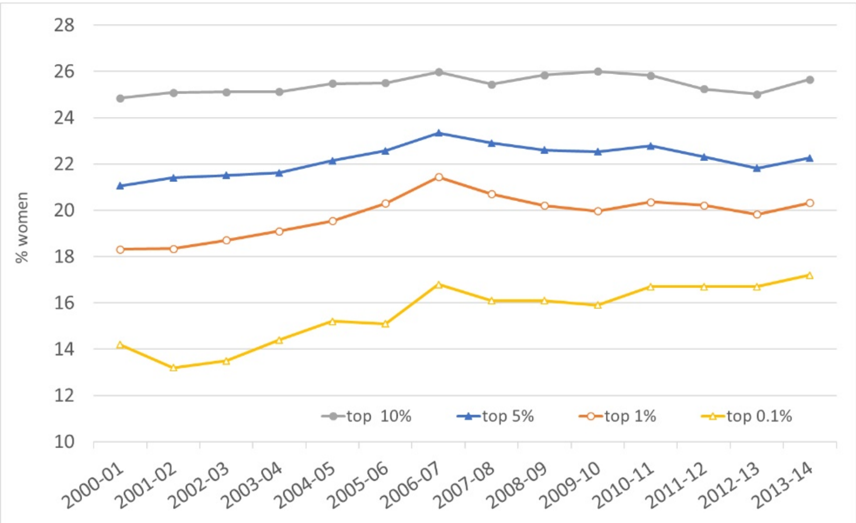
The permanent personal tax rate cut has a permanent fiscal cost, leading to the income tax raising less revenue from upper middle and top income earners in the future. Furthermore, this flattening of the rate structure and lowering of tax revenues raised is being done without broadening the tax base or undertaking much needed reform of the tax system. In contrast, for example, New Zealand has lower tax rates but a broader base in its tax system: New Zealand essentially taxes from the first dollar (with no tax-free threshold), and it also levies a much broader base and higher rate GST. These combine to provide a higher level of tax revenue in New Zealand to fund public goods and services.

Gender inequality effect of the tax cut

The proposed removal of the 37% rate will not benefit most women. The income tax cuts proposed in the PITP Bill will be of most benefit to individuals with the highest incomes. Analysis by the ANU Centre for Social Research and Methods has shown that tranches two and three of the proposed income tax rate cuts, taking effect in 2022-23 and 2024-25, would disproportionately favour high income earners.

Both the average and median wage for women (and hence, most women in the population) are well below the threshold for the income tax rate cut. Using the full sample of ATO individual tax records data, our research finds that there is significant gender inequality at the top of the income distribution. In 2013–14, women comprised 25.7% of the top 10% of income earners; 22.3% of the top 5%, 20.3% of the top 1% and 17.2% of the top 0.1%. This is shown in **Figure 2** (see Stewart, Voitchovsky & Wilkins at **Attachment 3**).

Figure 2: Women with top incomes (2000-01 to 2013-14)



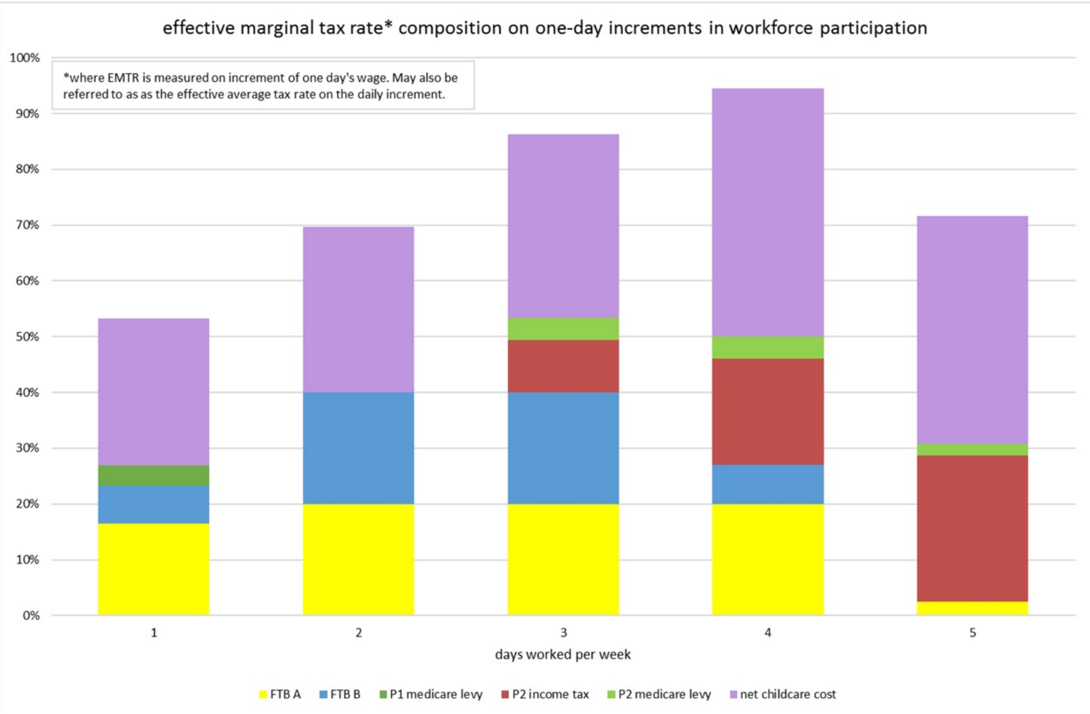
Source: Figure 9.2, Stewart, Voitchovsky & Wilkins (2017)

In 2013–14, the income required to be in the top 10% was $94,236; the top 1% earn more than $237,340 and top 0.1% more than $698,107.[1] More than three quarters of the benefit of the tax rate cut will go to men.

Inefficiency of the rate cut

The tax cut does not address the key inefficiency in our tax-transfer system, which deters work and reduces the ability of households to save and consume. Australia's existing PIT rate structure combines with our tightly means tested and targeted cash transfer system to produce the highest effective marginal tax rates (EMTRs) for individuals towards the lower-middle and bottom of the income distribution. This is the result of the combined withdrawal of family payments or Newstart, the net cost of childcare and the personal income tax rates. In particular, this negatively affects women with caring responsibilities, deterring them from increasing work participation hours. **Figure 3** illustrates the effect of combined tax and transfer rules on earnings by day of the second earner (almost always the woman) in a moderate wage household with two young children.

Figure 3: EMTR on second earner, salary $50,000, primary earner $50,000, two children aged 2, 3 (2016)



Source: Stewart (2017), Figure 1.8b.

The changes proposed under the PITP Bill do little to address these high EMTRs. The interim Low and Middle Income Tax Offset will provide targeted assistance to low income earners but will push up the EMTR faced by women in the lower middle of the distribution.

The most pressing economic growth agenda we face is increasing women's paid work hours. While women's participation rates have increased markedly since the 1970s, this increase has been concentrated almost entirely in part-time work. The proportion of women employed part-time is 46% while for men this

[1] Excluding capital gains and dividend imputation credits.

proportion is only 17%. The gender disparity for those caring for children is even starker: the proportion of women caring for a child under 5, working part time is 62%, while for men this proportion is 8%.

As Guyonne Kalb points out, given an ageing society, an important question among policymakers should be: what are the policies currently in place with regard to encouraging labour force participation? Examining the tax and transfer as a whole, Kalb finds that high EMTRs, combined with childcare costs, have a disincentive effect on female participation rates, particularly pronounced for low income families, with one or both adults depending on income support (**Attachment 2**).

The Turnbull Government has publicly stated its commitment to increasing women's participation rates. It has signed up to the G20 target of increasing participation by 25 per cent by 2025, and the Spring Women's Economic Statement will have a focus on female workforce participation. Lowering the high rates of EMTRs which women face and supporting the cost of childcare are two ways to stimulate higher workforce participation rates to meet these goals (**Attachment 1**).

Better resourcing of families instead of a tax cut

It may be argued that households (and women in them) may benefit from the tax cut for the higher earner in the household. However, delivering the tax cut proposed by the PITP Bill to all individuals on those high wages (as noted above, mostly men), or to the higher income earner in a family or household, does not have the effect of distributing the benefit equally among household members.

If it is intended to deliver a tax cut to households, in particular to families, then a more effective approach would be to make direct payments to the second earner in the household; or to increase the level and reduce targeting of Family Tax Benefit Part A, as well as childcare payments. That is, the Government should direct the tax cut by means of more universal family payments. This would reverse the trend of government policy to reduce the scope of the family payments system for middle income families in the last few years. If made more universal, high EMTRS facing second earners would be reduced and families with children would be supported. This brief analysis is intended to illustrate that the government has alternatives available to it, that would more directly respond to concerns of lower and middle earners while continuing to deliver equity and efficiency in the personal income tax system.

Conclusion and Recommendation

For the above reasons, the Government should not proceed with the removal of the 37% rate in the personal income tax. Please let us know if you have any questions or require further information.

Sincerely

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APPENDIX: Examples of Income Tax Rate Structures

England: Income tax rates

https://www.gov.uk/income-tax-rates (note personal allowances do not apply for top rate payers).

Band	**Taxable income**	**Tax rate**
Personal Allowance	Up to £11,850	0%
Basic rate	£11,851 to £46,350	20%
Higher rate	£46,351 to £150,000	40%
Additional rate	over £150,000	45%

Scotland income tax rate structure

The table shows the Scottish Income Tax rates you pay in each band if you have a standard Personal Allowance of £11,850 (note personal allowance does not apply for top rate payers).

Band	**Taxable income**	**Scottish tax rate**
Personal Allowance	Up to £11,850	0%
Starter rate	£11,850 to £13,850	19%
Basic rate	£13,851 to £24,000	20%
Intermediate rate	£24,001 to £43,430	21%
Higher rate	£43,431 to £150,000	41%
Top rate	over £150,000	46%

Germany Income Tax Rates

http://taxsummaries.pwc.com/ID/Germany-Individual-Taxes-on-personal-income

Germany has progressive tax rates ranging as follows (2017 tax year):

Taxable income range for single taxpayers (EUR)		Taxable income range for married taxpayers (EUR)		Tax rate (%)
Over	Not over	Over	Not over	
0	8,820	0	17,640	0
8,820	54,058	17,640	108,116	14*
54,058	256,304	108,116	512,608	42
256,304	and above	512,608	and above	45

* Geometrically progressive rates start at 14% and rise to 42%.

In addition, Germany levies a surcharge tax of 5.5% solidarity surcharge tax. Members of officially recognised churches pay church tax as a surcharge on their income tax. The rates are either 8% or 9%, depending on the federal state where the individual resides.

Canada Income Tax Rates

https://www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/canadian-income-tax-rates-individuals-current-previous-years.html

Federal tax rates for 2018

15% on the first $46,605 of taxable income, +

20.5% on the next $46,603 of taxable income (on the portion of taxable income over 46,605 up to $93,208), +

26% on the next $51,281 of taxable income (on the portion of taxable income over $93,208 up to $144,489), +

29% on the next $61,353 of taxable income (on the portion of taxable income over 144,489 up to $205,842), +

33% of taxable income over $205,842.

PLUS STATE INCOME TAX RATES: EXAMPLE ONTARIO

5.05% on the first $42,960 of taxable income, +
9.15% on the next $42,963, +
11.16% on the next $64,077, +
12.16% on the next $70,000, +
13.16 % on the amount over $220,000