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

Dear Committee Secretary

Senate Economics Legislation Committee inquiry into Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018

Ernst & Young (EY) welcomes the opportunity to provide our comments to the Senate Economics Legislation Committee inquiry into the Treasury Laws Amendment (Personal Income Tax Plan) Bill 2018 (**the Bill**).

We support the Bill, which proposes to implement the Government's 2018/19 Budget announcement to reform Australia's personal tax rates in three steps:

Step one

- Introduction of an additional non-refundable 'low and middle income tax offset' for the 2018-19 to 2021-22 income years.

Step two

- The top threshold for the 32.5% tax bracket will increase from $87,000 to $90,000 from 1 July 2018.
- In 2022-23 the $37,000 threshold will be lifted to $41,000, and the $90,000 threshold will be raised to $120,000. The low income tax offset is also increased.

Step three

- In 2024-25 the personal tax system will be simplified by abolishing the 37% tax bracket. The 32.5% bracket will apply from $41,001 up to the top marginal tax rate threshold which will also be adjusted to $200,000.

The changes are set out in this table:

Rate (%)	2018-19 to 2021-22 ($)	2022-23 and 2023-24 ($)	2024-25 onwards ($)
0	0 - 18,200	0 - 18,200	0- 18,200
19	18,201 - 37,000	18,201 - 41,000	18,201 - 41,000
32.5	37,001 - 90,000	41,001 - 120,000	41,001 - 200,000
37	90,001 - 180,000	120,001 - 180,000	N/A
45	180,001+	180,001+	200,001+

In this submission we outline the reasons for our support. We recognise that the design of Australia's income tax and tax transfer system is a complex mix of policies, including analysis of equity and inequity issues, tax fairness and the need of government to fund expenditure required by Australian voters. As well however it involves providing appropriate incentives for individuals to participate in the workforce, and is relevant in measuring competitiveness which is relevant for mobility of Australian individual taxpayers who might work overseas if their skills are internationally attractive.

Recognising all of these interdependencies, we set out the key reasons for our support below.

1. **Australia's personal tax rates have long been overdue for some reform to reflect the ongoing inflation in the wages and salaries paid to Australian workers and to Australian individual taxpayers. The resulting lack of adjustments has led to bracket creep, causing Australia's taxpayers to progressively have higher personal taxes paid.**

   The last substantial adjustment to Australia's personal tax rates were in the 2008-09 Budget, is clear from review of the Australian Taxation Office (ATO) summary of prior year personal tax rates at . https://www.Aust.gov.au/Rates/Individual-income-tax-for-prior-years/.

   Since that Budget the only changes of significance were the introduction of the 2% Budget deficit levy on incomes over $180,000 which expired under the relevant statute on 30 June 2017).

2. **The statistics and history of personal taxation in recent years show that Australia's personal tax system operates inequitably against people in working age, and confirm the need for action in this Bill.**

   The bulk of Australia's personal tax and transfer payments changes have been very much focused on low income taxpayers. These taxpayers have benefited overwhelmingly from lower taxes and in fact taxpayers with taxable incomes under $18,000 pay no tax, and those with taxable incomes under $37,000 pay negligible tax.

   This is consistent with Australia's highly progressive tax system. But the tax and transfer payment benefits cut out at lower middle incomes and have meant that middle income taxpayers have not benefited materially. Their marginal taxes have continued to increase.

   Taxpayers not eligible for transfer payments have seen increasing income taxes as a percentage of income. Such burdens have fallen particularly on:

   - Single income taxpayers without children
   - Dual income taxpayers without children
   - Family taxpayers whose incomes fall outside the limits for the transfer payments.

   These increases have occurred at a time of increasing housing costs due to Australia's growth, and increasing energy costs.

   A Productivity Commission (PC) report released on 7 October 2015 (details on Appendix 1) concludes that the Australian system of transfer payments from Government to public is unusual compared to international standards because rates of such payment decline with increasing income above a specified level. High effective marginal tax rates (EMTRs) for some groups receiving transfers can influence individuals' decisions regarding hours worked.

   The PC report also concludes that Australia's tax and transfer system is very progressive and targeted, leading to a redistribution of income from high to low income households — though the extent of redistribution is likely to be more muted if considered on a life cycle rather than snapshot basis. Part of the reason for this high progressivity, particularly when using a snapshot analysis, is Australia's relatively low reliance on consumption taxes.

   The PC report states that its "**deliberately simple projections suggest that an increasing share of the tax burden will fall on the working-age population.**" However, the size of the shift depends on economic conditions, how tax and transfer policies change over time, and the effect of the maturation of the Superannuation Guarantee on Age Pension reliance"**.**

   In our view the reforms as included in the Bill are necessary to restore tax equity for such taxpayers in the Australian workforce.

As well as the Productivity Commission data, the ATO statistics released on 27 April 2018 and outlined at Appendix 2 provide a compelling indication of the need for personal tax equity. The ATO statistics confirm the inequity of the personal tax rates structure at today's date, in our view, and the need for action including that in the Bill.

3. **The reforms in the Bill barely keep place with the impact of inflation.**

   We have produced an illustrative analysis of the effect of inflation on the thresholds which has driven the bracket creep.

   We set out a simple scenario which illustrates how the effect of even low inflation or increase in taxpayer earnings makes reform of the threshold necessary included in Appendix 2.

   The shortform summary shows that if Australia's tax rate thresholds, going forward, were merely indexed by inflation since 2008-09 then the tax threshold amount for 32.5% tax rate would increase by the year 2019 to $112,848 (see Appendix 2, Fig 1).

   Hence we propose the measures introduced in the Bill should be implemented as it would moderately resolve bracket creep.

   In fact we would prefer earlier bracket creep rectification. But we recognise the desire of the government for budget integrity and the staged delivery of the reforms.

4. **The Henry Review, commissioned by Prime Minister Kevin Rudd and Treasurer Wayne Swan, recommended simplification of Australia's personal tax rates into three bands. Its recommendation 2 was:**

   > **"Personal taxation A1 — Personal Income tax**
   >
   > **Recommendation 2:** Progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments. A high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity."

   So the Henry Review favoured a three-band personal tax system, as is planned in this Bill. In our view the Bill is consistent with the simplified three-band direction proposed by the Henry Review.

5. **Australia's personal tax rates are relevant also for competitiveness of our tax system and to provide incentives to work.**

   In our view, the bracket creep and its layering additional tax burdens onto Australia's working age population is not good policy. It:
   - Creates disincentives to work
   - Creates incentives to tax structuring rather than to work to grow Australia
   - And the incentives to tax structuring are greater, the greater the divergence between personal tax and corporate tax rates.

   The Bill addresses all of these challenges.

If more information is required, in the first instance please contact any of Alf Capito, Tony Stolarek or Ian Burgess.

Yours sincerely

Ernst & Young

Appendix 1

Discussion from recent Productivity Commission review

That Australia's transfer system is heavily progressive, ie. income based, is supported by the Productivity Commission's report "Tax and Transfer Incidence in Australia" Commission working paper released on 7 October 2015 (https://www.pc.gov.au/research/completed/tax-and-transfer-incidence). Some relevant extracts are set out below.

2.2 Transfer payments in Australia

Transfer payments are defined in this paper as cash payments provided by governments to individuals and families. All cash payments are administered by the Australian Government and financed from general government revenue (ABS 2015a; DSS 2014b). Most are only available to Australian residents,[1] with eligibility determined by income and assets tests. Most payments have tapered withdrawal rates — rates of payments decline with each additional dollar of income earned above a specified level. This system makes the Australian system unusual by international standards (chapter 3).

… In the Australian system, cash transfers come in four basic forms:

- pensions
- allowances
- supplementary payments
- family payments.

Figure 2.2 listed major transfer payments by form of payment and payment group

	Retirees	People with disabilities	Carers	Students	People who are unemployed	Payments for families
Pensions	Age Pension Veterans' service pensions Defence widow/ers pensions	Disability Support Pension Veteran's disability pensions	Carer Payment			Child Care Benefit Child Care Rebate Family Tax Benefit Part A Family Tax Benefit Part B Parental Leave Pay Parenting Payment Schoolkids Bonus
	Wife Pension					
Allowances	Widow Allowance		Carer Allowance	ABSTUDY Austudy	Newstart Allowance	
				Youth Allowance		
Supplementary payments	Seniors Supplement		Carer Supplement Child Disability Assistance Payment	Income Support Bonus		
	Pension Supplement					
	Mobility Allowance Rent Assistance[b]					

(page 38) Effective average and marginal tax rates

Australia's progressive tax system and targeted transfer system can produce high effective marginal tax rates (EMTRs) for some groups, particularly those receiving transfers. As discussed in chapter 2, these EMTRs can influence individuals' decisions regarding hours worked.

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1 An Australian resident is a person who is living in Australia and is either an Australian citizen, a permanent visa holder, or holds a protected Special Category Visa

3.4 Lessons from the literature

The literature cited in this chapter, notwithstanding the measurement issues described above and that it is somewhat dated in parts, highlighted some consistent findings. Overall, most studies suggest that Australia's tax and transfer system is very progressive and targeted, leading to a redistribution of income from high to low income households — though the extent of redistribution is likely to be more muted if considered on a life cycle rather than snapshot basis. Part of the reason for this high progressivity, particularly when using a snapshot analysis, is Australia's relatively low reliance on consumption taxes.

6 Tax and transfer incidence over time

Key points

- Tax and transfer flows vary over time even in the absence of changes to policies. At an individual level, this reflects changing personal and financial circumstances. At an aggregate, system level, it reflects changes to demographics and economic conditions.
- …The incidence of the tax and transfer system is likely to change over time as a result of income growth and the ageing of the population.
  - A simple illustrative 20-year projection of population, income and inflation suggests that substantial changes to tax and transfer flows are likely if the tax and transfer system is left unchanged.
  - **Total income tax paid is projected to increase substantially in real terms as average income tax rates rise, though the size of the increase depends on assumptions about future wage growth and adjustments to income tax thresholds.**

    Bracket creep is specifically addressed, albeit using a simplified approach.
  - **Total expenditure on pension payments is projected to increase significantly in real terms due to population ageing and relatively generous rules for the indexation of payment rates, though the absence of assets testing from the model may mean that future Age Pension expenditure is overstated.**
  - Total expenditure on other types of transfer payments that are typically indexed to changes in consumer prices **(such as family payments and payments to students) is projected to decline in real terms** as the number of families eligible for these payments declines. This reflects growth in real incomes and changes to the population structure.
  - These deliberately simple projections suggest that an increasing share of the tax burden will fall on the working-age population. However, the size of the shift depends on economic conditions, how tax and transfer policies change over time, and the effect of the maturation of the Superannuation Guarantee on Age Pension reliance.

Appendix 2

Bracket Creep in personal tax rates in Australia

This Appendix shows that that there has been no material change in Australian personal tax rates since the 2008-2009 tax year – 9 years ago. This is outlined using summaries from the ATO website.

In particular the threshold "step change" thresholds are shown, to set out:

- The top tax rate at which ordinary-to-middle income taxpayers could have had a 32% marginal tax rates if the threshold had been indexed, and what the actual tax law provided, and what the Bill provides
- For high income taxpayers, the minimum income at which the marginal tax rate of 45% would have commenced, if the threshold had been indexed, and what the actual tax law provided, and what the Bill provides.

Figure 1: Threshold for middle income tax rates increases

This shows, for example, that if the top income level for the 32% marginal tax rate as set in the 2008-2009 year ($80,000) had been indexed for inflation at a 2.5% pa tax rate then the income level in 2018-9 would have been $102,487, and the income if a 3.5% inflation were used. The Bill slightly increases the income level to $90,000, but that level is still low until the 2022-23 year.

Year	Top income for 32% MTR	If threshold increased at inflation rate of ($)		Threshold in the existing law ($)	Threshold in the Bill ($)
		2.5%	3.5%		
2009	80,000	80,000	80,000	80,000	
2010		82,000	82,800	80,000	
2011		84,050	85,698	80,000	
2012		86,151	88,697	80,000	
2013		88,305	91,802	80,000	
2014		90,513	95,015	80,000	
2015		92,775	98,340	80,000	
2016		95,095	101,782	80,000	
2017		97,472	105,345	87,000	
2018		99,909	109,032	87,000	
2019		102,407	112,848		90,000
2020		104,967	116,798		90,000
2021		107,591	120,885		90,000
2022		110,281	125,116		90,000
2023		113,038	129,496		120,000
2024		115,864	134,028		120,000
2025		118,760	138,719		200,000

Figure 2: Threshold for top marginal income tax rates does not increase much
This shows, for example, that if the start of the 45% tax rate as set in the 2008-2009 year ($180,000) had been indexed for inflation at a 2.5% pa tax rate then the income level in 2018-9 would have been $230,415, and the income if a 3.5% inflation were used. However the Bill does not make any change until the 2022-23 year.

This shows clearly that high income taxpayers continue to attract high marginal tax rates on their higher income levels.

Year ending 30 June	Income at which the top MTR commences	If threshold increased at inflation rate, threshold would go to ($)		Threshold in the existing law ($)	Threshold in the Bill ($)
		2.5%	3.5%		
2009	180,000	180,000	180,000	180,000	
2010		184,500	186,300	180,000	
2011		189,113	192,821	180,000	
2012		193,840	199,569	180,000	
2013		198,686	206,554	180,000	
2014		203,653	213,784	180,000	
2015		208,745	221,266	180,000	
2016		213,963	229,010	180,000	
2017		219,313	237,026	180,000	
2018		224,795	245,322	180,000	
2019		230,415	253,908		180,000
2020		236,176	262,795		180,000
2021		242,080	271,992		180,000
2022		248,132	281,512		180,000
2023		254,335	291,365		180,000
2024		260,694	301,563		180,000
2025		267,211	312,117		200,000
2026		273,891	323,042		200,000
2027		280,739	334,348		200,000
2028		287,757	346,050		200,000

ATO summary of personal tax rates

This summary, drawn from the ATO website, shows that there has been no material change in Australian personal tax rates since the 2008-2009 tax year – 9 years ago. The charts, show directly as presented by the ATO, exclude the Medicare Levy and Temporary Budget Repair Levy in the years when they were operative.

Resident tax rates 2017–18	
Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $37,000	19c for each $1 over $18,200
$37,001 – $87,000	$3,572 plus 32.5c for each $1 over $37,000
$87,001 – $180,000	$19,822 plus 37c for each $1 over $87,000
$180,001 and over	$54,232 plus 45c for each $1 over $180,000

Resident tax rates 2016–17	
Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $37,000	19c for each $1 over $18,200
$37,001 – $87,000	$3,572 plus 32.5c for each $1 over $37,000
$87,001 – $180,000	$19,822 plus 37c for each $1 over $87,000
$180,001 and over	$54,232 plus 45c for each $1 over $180,000

https://www.ato.gov.au/Rates/Individual-income-tax-rates/

Resident tax rates 2015–16	
Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $37,000	19c for each $1 over $18,200
$37,001 – $80,000	$3,572 plus 32.5c for each $1 over $37,000
$80,001 – $180,000	$17,547 plus 37c for each $1 over $80,000
$180,001 and over	$54,547 plus 45c for each $1 over $180,000

Resident tax rates 2009–10	
Taxable income	Tax on this income
$1 – $6,000	Nil
$6,001 – $35,000	15c for each $1 over $6,000
$35,001 – $80,000	$4,350 plus 30c for each $1 over $35,000
$80,001 – $180,000	$17,850 plus 38c for each $1 over $80,000
$180,001 and over	$55,850 plus 45c for each $1 over $180,000

Resident tax rates 2008–09	
Taxable income	Tax on this income
$1 – $6,000	Nil
$6,001 – $34,000	15c for each $1 over $6,000
$34,001 – $80,000	$4,200 plus 30c for each $1 over $34,000
$80,001 – $180,000	$18,000 plus 40c for each $1 over $80,000
$180,001 and over	$58,000 plus 45c for each $1 over $180,000

https://www.ato.gov.au/Rates/Individual-income-tax-for-prior-years/

Appendix 3

The progressivity of the Australian tax system, and we submit the case for personal tax fairness which supports passage of this Bill, is contained in the most recent statistics released by the ATO in relation to personal tax payments.

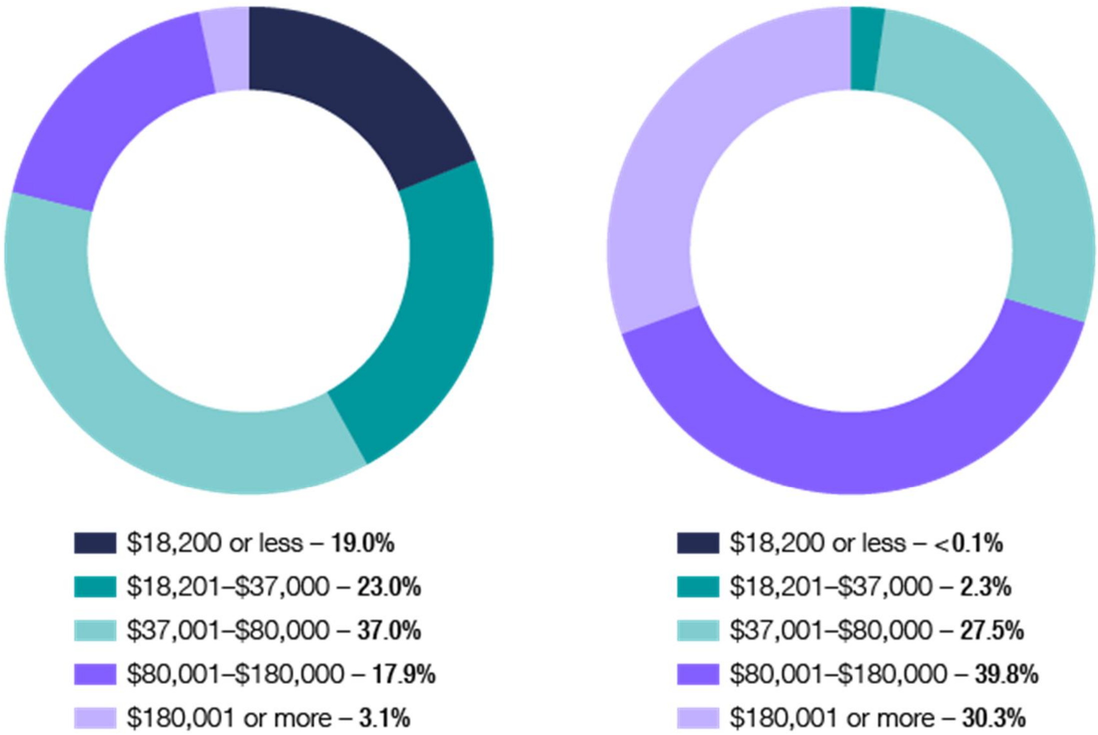
These statistics, covering the 2015 year, released by the ATO in April 2018. - https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2015-16/?anchor=Individuals100people show:

- Taxpayers earning under $18,200pa taxable income, comprising 19% of the taxpayer population, pay less than one tenth of one percent of taxes paid – essentially, no tax
- Taxpayers earning under $18,201-$37,000pa, comprising 23% of the taxpayer population, pay only 2.3% of income tax after the tax-based transfer payments and before non-income tax based transfer payments
- All-up, taxpayers earning under $80,000pa comprise 79% of the population and pay only 29.8% of taxes
- Taxpayers in the $80,000-$180,000pa band comprise 17.9% of the population and pay 39.8% of the income tax
- Taxpayers earning over $180,000pa comprise 3.1% of the taxpayer population and pay 30.3% of the income tax collections.

We say this ATO package of statistics is a powerful indicator of the inequity of the Australian tax system, showing:

- Low-income taxpayers pay in actual fact minimal tax
- Middle income taxpayers pay more than their fair share
- High income taxpayers pay well in excess of their fair share.

Chart 9: Number of individuals and net tax, by tax bracket, 2015–16 income year



The data for the above chart, as well as similar data back to the 2012-13 income year, is available.