

by Danielle Wood, Budget Policy Program Director, and John Daley, CEO, Grattan Institute

Grattan modelling of the government's Personal Income Tax Plan highlights costly cuts to taxes for high-income earners

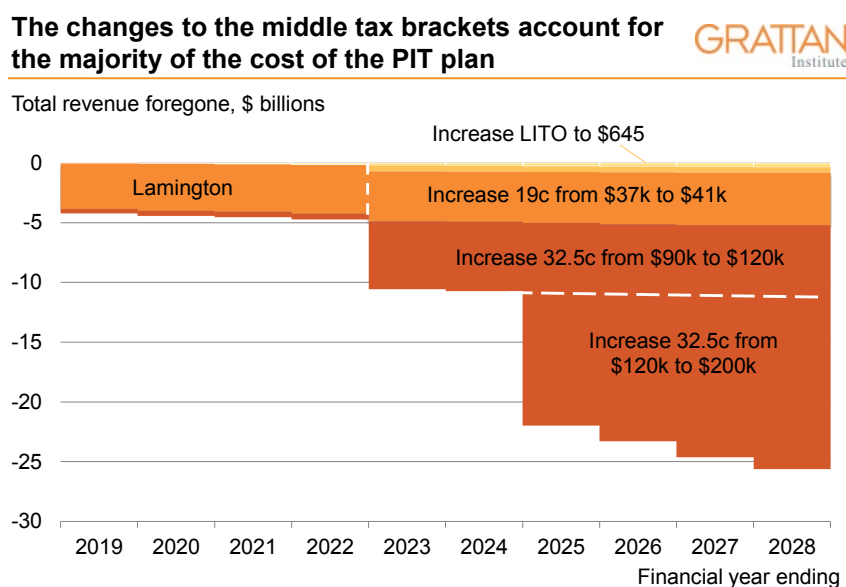
New Grattan Institute analysis highlights that most of the revenue reductions from the Turnbull Government's full Personal Income Tax Plan are the result of lower taxes on high-income earners. Once the three-stage plan – including removing the 37c bracket – is complete, **\$15 billion** of the annual **\$25 billion cost** of the plan will result from collecting less tax from the top 20% of income earners, who currently have a taxable income of \$87,000 or more.

The PIT plan will do little to unwind bracket creep's gradual reduction of the progressivity of the tax system. Even with the PIT plan, average tax rates are forecast to be higher for all taxpayers in 2027-28 – except for very high-income earners who aren't much affected by bracket creep in the first place. A taxpayer who earns \$120,000 today (more than 90% of other taxpayers) will pay an average tax rate of 29% in 2027-28, unchanged from today. In contrast, average tax rates for middle-income earners will be higher. The average tax rate for a taxpayer who earns \$36,000-a-year today (more than 40% of other taxpayers) will increase 6 percentage points (from 10% to 16%). As a result, the highest-income taxpayers will bear a lower share of the total tax burden.

Costing and distributional analysis of PIT plan

The 2018-19 budget shows the annual cost of the PIT Plan until 2022. The Treasurer has indicated the ten-year cost of the plan is \$140 billion. Grattan's analysis shows the annual costs of the plan until 2028. The Grattan costing takes into account all elements of the PIT plan.

Most of the revenue reductions until 2021-22 are a result of the Low and Middle Income Tax Offset ("the Lamington"). But once the plan is fully implemented in 2024-25, there are much bigger revenue reductions because the top of the 32.5 cent bracket increases first to \$120,000 and then to \$200,000 (removing the 37c bracket). In 2028, these bracket changes account for \$20 billion of the \$25 billion in lower revenue.



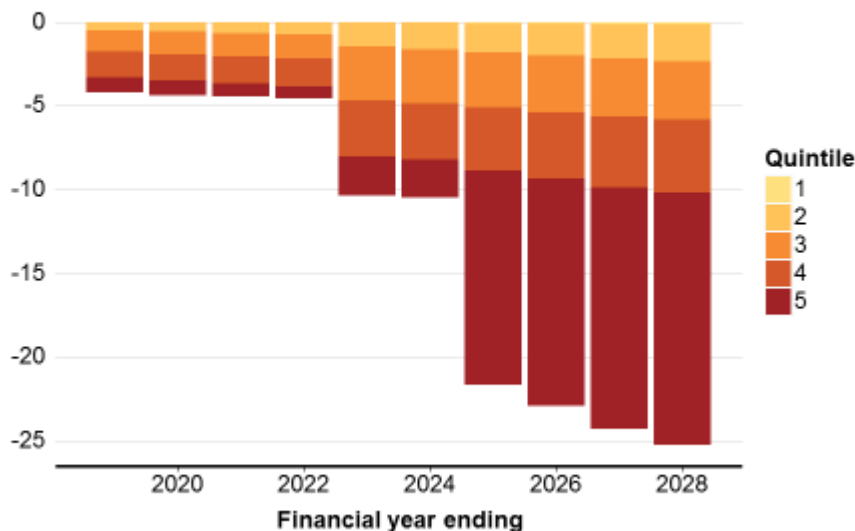
Note: Excludes interaction effects ($-\\$1/2 b$ in any year)
Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16.

Once fully implemented, most of the reduction in revenue under the PIT plan is retained by the top 20% of income earners, with a taxable income of \$87,000 or more. In 2028, the reduction in tax collected from this group will account for **\$15 billion** of the \$25 billion cost of the plan.

Top 20% of income earners account for 60 per cent of revenue foregone under the PIT Plan



Total revenue foregone, \$ billions



Source: Commonwealth Budget Papers, 2018-19; Grattan analysis of ATO sample file 2015-16

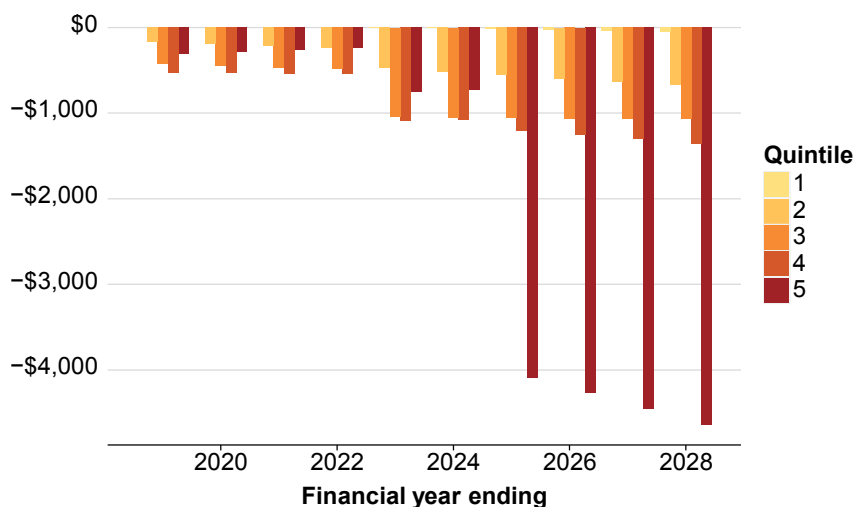
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By 2024-25, the income tax cuts are much larger for high-income earners, in absolute terms. Those in the top 20 per cent will get an average tax cut of \$4,600 a year, compared to \$700 a year for someone in the second income quintile (\$24,000 - \$48,000).

Top 20% of income earners get the biggest tax cuts



Average reduction in income tax paid by year under PIT by income quintile, \$



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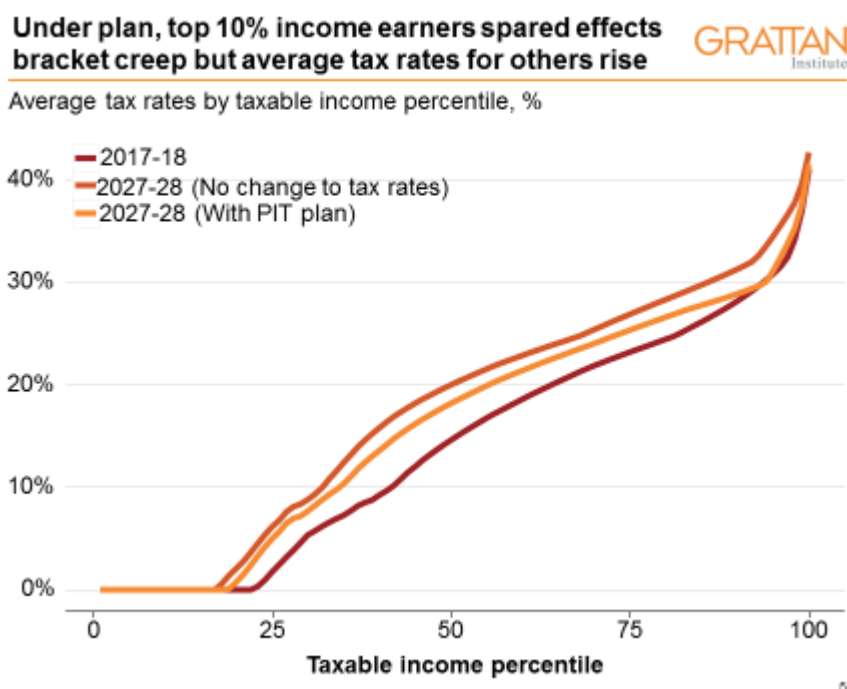
Impact of the PIT plan on tax system progressivity

Australia's progressive tax system ensures that people with higher incomes pay higher average rates of personal income tax. Without changes to tax scales, bracket creep gradually increases average tax rates for all taxpayers. Middle-income earners are affected most in terms of higher average tax rates.

The government claims the PIT plan protects middle-income Australians from bracket creep. Certainly the plan reduces average tax rates in 2027-28 for all taxpayers compared to what they would be if there were no changes to rates or brackets over that period.

But middle-income earners are not spared from bracket creep under the PIT plan. The average tax rate for a taxpayer at the 50th percentile will still increase by 3 percentage points (from 15% to 18%) compared to 2017-18. Without further changes, average tax rates will be higher for most taxpayers.

The exception is the top 10% of income earners. Average tax rates for those on the highest incomes are virtually unchanged under this plan.



Once fully implemented, the PIT plan doesn't change the progressivity of the tax system much. Overall, those on high incomes will pay a similar proportion of total tax revenues with or without the plan. But because of bracket creep in the meantime, high income earners will be paying a lower proportion than today.

Table 1: Share of personal income tax paid falls for highest income earners under PIT plan

Share of total personal income tax paid by income decile (%)

Decile	2017-18	2027-28 (no change to tax rates)	2027-28 PIT Plan
1	0	0	0
2	0	0.04	0.01
3	0.4	0.8	0.7
4	1.6	2.3	2.1
5	3.4	4.3	4.1
6	5.7	6.3	6.2
7	8.5	8.7	8.8
8	12.1	12.2	12.3
9	17.8	17.9	17.8
10	50.4	47.5	47.9

BACKGROUND

In the 2018-19 Budget the Government announced major changes to the tax system. The three-stage plan (the PIT plan) will be implemented over seven years as below. Each of these changes is factored into the Grattan costing.

Step 1: Low and Middle Income Tax Offset (“Lamington”)

Taxpayers earning between \$20,200 and \$125,000 will receive a temporary, non-refundable tax offset for 2018-19 to 2021-22, in addition to the Low Income Tax Offset (LITO). The new offset will provide tax relief of up to \$530 and it will be received as a lump sum payment at tax time.

Step 2: Changes to tax thresholds and Low Income Tax Offset

In 2018-19 the top threshold of the 32.5% tax bracket will be increased from \$87,000 to \$90,000.

The top threshold for the 32.5% tax bracket will be moved again from \$90,000 to \$120,000 in 2022-23.

In 2022-23 the low and middle-income tax offset will end. The top threshold of the 19% tax bracket will increase from \$37,000 to \$41,000, and LITO will increase from \$445 to \$645.

Step 3: Reducing the number of tax brackets from five to four

In 2024-25 the top threshold for the 32.5% tax bracket will increase to \$200,000, eradicating the 37% tax bracket entirely. This means taxpayers who earn between \$41,000 to \$200,000 will all face the same marginal tax rate – 32.5%. Taxpayers earning more than \$200,000 will still pay 45 cents in the dollar.