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CENTRE FOR SOCIAL  
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## **Comparison of the Coalition 2018-19 Federal Budget Income Tax Measures and the Labor Proposal**

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The research note has been produced to compare the impacts of the personal income tax measures contained in the 2018-19 Federal Budget with the impacts of the Australian Labor Party (ALP) opposition proposal as outlined by the Hon. Bill Shorten MP. in his Budget Reply speech. The research note builds upon analysis by the ANU Centre for Social Research and Methods of the 2018-19 Federal Budget personal income tax measures (CSRM Research Note No. 3/2018).

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## Introduction

The Federal Budget for 2018-19 contains a number of changes to the personal income taxation system for Australia. The leader of the Labor opposition, The Hon. Bill Shorten MP., outlined alternative changes to the personal income taxation system, the *Working Australians Tax Refund*, in his Budget Reply Speech.

This paper compares the distributional and fiscal consequences of the Coalition 2018-19 Federal Budget personal income tax measures and the Labor alternative personal income tax policy. The paper compares: (i) average tax rates under the two policies; (ii) the effect on revenue over a ten year period; and (iii) the impact on households at different points in the income distribution.

## Methodology

The approach adopted in this paper is to use the ANU PolicyMod model of the Australian tax and transfer system. This model is based on the most recent Australian Bureau of Statistics (ABS) Survey of Income and Housing (2015-16) and has been adjusted for changes in the population since 2015-16 so that it better reflects the population of 2017/18 and projected population changes beyond 2017-18. This is achieved using a range of government administration data, official statistics and ABS population projections. The model simulates the current policy settings of most of the Australian tax and transfer system. In this paper we simulate the Coalition and the Labor proposed personal income tax changes and apply the assumptions in the 2018-19 Federal Budget around wages and prices changes into the future. We compare the proposed policies with that of the existing policy to determine the overall fiscal impact of the policy change and the distributional impact.

The basic methodology involves the creation of a base file in PolicyMod for each year using the existing legislated policies. A comparison data set is also created in PolicyMod using the alternative or proposed policies (Coalition and Labor) – in this analysis the policy change relates to personal income taxation. Both data sets are based on the same underlying population, demographic and economic assumptions and survey data. For each year we can directly calculate the impact on each of the approximately 21,000 income units (18,000 households) from policy change in the budget. These changes are then aggregated to household groups, such as low income or high income households or different family types.

The model does not attempt to impose or estimate any behavioural change on persons as a result of policy change. It should be expected that tax cuts would have some behavioural consequences relative to the current policy however these impacts are not estimated here.

## **Policy Changes**

### ***Coalition 2018-19 Budget personal income tax changes***

The changes are in two stages. The first stage consists of modest tax cuts provided in 2018-19 that are directed towards low and middle income earners. The second stage are more significant tax cuts that are directed more towards middle and higher income earners. The Government's rationale for the tax cuts are that they are "... providing tax relief to encourage and reward working Australians ..... to make personal income tax in Australia lower, simpler and fairer" and that "The plan involves: immediate relief for low and middle-income earners; helping to protect Australians' earnings from bracket creep; and ensuring more Australians pay less tax by making personal taxes simpler and flatter." (Commonwealth of Australia 2018: 1-2)

Modelled changes:

#### *1) Low and Middle Income Tax Offset*

A benefit of up to \$200 for taxpayers with taxable income of \$37,000 or less. Between \$37,000 and \$48,000, the value of the offset will increase at a rate of three cents per dollar to the maximum benefit of \$530. Taxpayers with taxable incomes from \$48,000 to \$90,000 will be eligible for the maximum benefit of \$530. From \$90,001 to \$125,333, the offset will phase out at a rate of 1.5 cents per dollar. The benefit of the Low and Middle Income Tax Offset is in addition to the existing Low Income Tax Offset. This offset is available for the 2018-19 to 2021-22 financial years only.

- 2) From 2018-19 financial year the \$87,000 tax bracket will be increased to \$90,000 with the rate of 32.5 per cent continuing.
- 3) From 2022-23 the Low Income Tax Offset increases from \$445 to \$645 and the personal income tax bracket for the 19 per cent rate extended to \$41,000 from \$37,000. LITO withdrawn at 6.5 per cent between \$37,000 and \$40,000 and then removed at the current 1.5 per cent rate.
- 4) 32.5 per cent tax rate threshold increased from \$90,000 to \$120,000 in 2022-23.

- 5) From 2024-25 the 32.5 per cent tax rate threshold extended to \$200,000 and the top rate of 45 per cent applied beyond that threshold (up from the previous \$180,000).

### ***Labor Policy***

The Labor policy is also in two stages. The first stage is a modest tax cut in 2018-19 directed towards low and middle income earners. This is identical to the Coalition policy in the 2018-19 Federal Budget. Labor is also extending the \$87,000 tax threshold to \$90,000 in 2018-19.

The second stage involves the introduction of the *Working Australians Tax Refund* which increases the generosity of the proposed Low and Middle Income Tax Offset.

Modelled changes:

- 1) 2018-19 Federal Budget Low and Middle Income Tax Offset (as described above) in 2018-19, and \$87,000 threshold increased to \$90,000 in 2018-19.
- 2) *Working Australians Tax Refund*

From 2019-20 the Low and Middle Income Tax Offset will be replaced by the Working Australians Tax Refund. This is a benefit of up to \$350 for a taxable income of \$37,000 or less. Between \$37,000 and \$48,000, the value of the offset increases at a rate of 5.25 cents per dollar to the maximum benefit of \$928. Taxpayers with taxable incomes from \$48,000 to \$90,000 will be eligible for the maximum benefit of \$928. From \$90,001 to \$125,333, the offset will phase out at a rate of 2.625 cents per dollar. The benefit of the Low and Middle Income Tax Offset is in addition to the existing Low Income Tax Offset. This offset, unlike the Coalition version, is permanent.

The Labor policy does not include any further changes proposed by the Coalition beyond 2021. We have assumed that the Budget Repair Levy is not reintroduced by Labor.

This paper does not consider the impact of other income tax changes that Labor has announced including, changes to negative gearing, capital gains and franking credits.

## Results

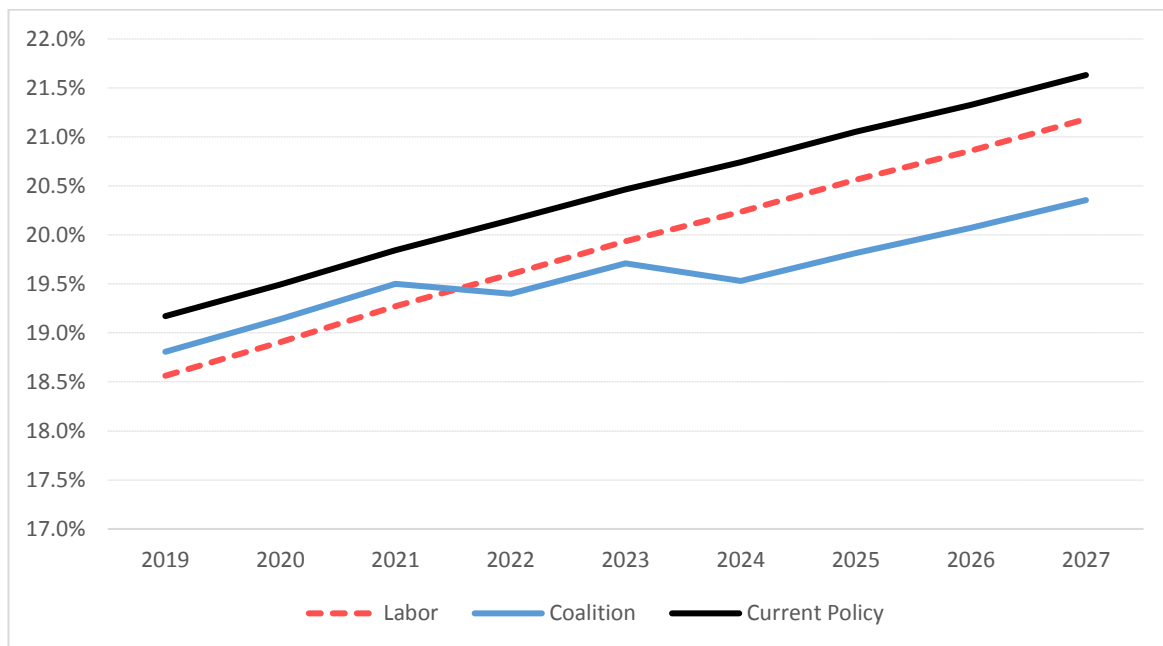
### *Average tax rates*

The following considers projected average personal income tax rates over the period 2019-20 to 2027-28 under the current policy settings (Base), the Coalition policy and the Labor policy.

We find that, under the current policy settings with the budget settings for wage growth, average tax rates would increase from 19.2 per cent in 2019-20 to 21.6 per cent in 2027-28 (Figure 1). Under the Labor policy average tax rates are lower than under the current policy settings, increasing from 18.6 per cent in 2019-20 to 21.2 per cent in 2027-28. Under the Coalition policy average tax rates are slightly higher over 2019-20 to 2021-22 than under the Labor policy setting, but the difference is small. The difference between average tax rates under the Coalition and Labor policies increase after the second stage of the Coalition policy is introduced in 2022-23 and increases again in 2024-25 when the top tax bracket is increased to \$200,000. In 2022-23 the average tax rate under the Coalition policy is projected to be 19.4 per cent. By 2027-28 the average tax rate is 20.4 per cent under the Coalition policy which is about 1.2 per cent lower than under the projected current policy setting and 0.8 per cent lower than under the Labor policy.

These projections of the size of the difference between the current policy setting and the Coalition and Labor policies is dependent upon strong wages growth of 3.5 per cent from 2020 onwards.

**Figure 1 Average Tax Rates, Households 2018-19 to 2027-28**



Source: PolicyMod, ANU.

### ***Distributional Impact of Tax Change Analysis***

This section presents the distributional analysis of the Coalition and Labor policy settings compared to the outcomes projected under the current policy settings. For example, for 2027-28 we develop a base year on 2027-28 data with prices and wages projected for that year and simulate the current policy. An analogous approach is used for the proposed policies. In this section we directly compare the three simulations to estimate the direct impact of the new policy in comparison with the existing policy.

Two years are selected for comparison. We consider 2019-20 and 2027-28. The 2019-20 year is the first year in which there is a difference between the Coalition and Labor policies with the Labor *Working Australians Tax Refund* being at higher rate than the Coalition Low and Middle Income Tax Offset. The 2027-28 year includes the Coalition changes for 2022-23 and 2024-25 financial years and hence the effects of the proposed policy change are more substantial.

### **2019-20**

Table 1 shows the changes for 2019-20. The Coalition policy, at a cost to the budget of around \$4.2 billion in 2019-20, the largest impact in dollar terms is the fourth quintile (between 60 and 80 percentiles) while the third quintile has the

largest impact in terms of share of disposable income.<sup>1</sup> The bottom two income quintiles (bottom 40 percent) experience only a modest impact as these households are made up of very low income households who pay relatively little or no tax – very often age pensioners or unemployed or disability pensioners. The tax cuts are targeted to low and middle income individuals – who tend to mostly reside in middle to middle-high income households. There are still gains to the top income group as it is still possible for low or middle income individuals to reside in high income households.

Similarly, the Labor policy, at a cost to the budget of \$7 billion has the largest gains to the fourth quintile (\$1,227) and the top quintile (\$1,004). In percent terms the largest gains are for quintile 3 and 4 both at 1.1 per cent of disposable income. The increases in disposable household income for all income quintiles are larger in 2019-20 under the Labor policy than under the Coalition policy.

### 2024-25

By 2024-25 the proposed tax reform in the budget is complete. By 2027-28 there are very substantial differences in the impact of the Coalition and Labor policies on household disposable incomes (Table 1). In dollar terms, under the Coalition policy, high income households receive much more significant tax cuts. Households in the fifth income quintile are estimated to gain \$5,871 in disposable household income in 2027-28. The overall tax cuts increase disposable income by around 1.6 per cent and this varies from 0.2 per cent for low income households up to 2.3 per cent for high income households.

Under Labor policy the biggest increase in income in 2027-28 is for the fourth income quintile (\$1,164) with increases for the other income quintiles ranging from \$84 for the first income quintile to \$1,164 for the fourth income quintile. In percentage terms, the largest increase in income is for the third quintile at 1 per cent and just 0.3 per cent for the top quintile.

The first and second income quintiles are projected to have a slightly higher income growth impact under the Labor policy than the Coalition policy in 2027-28. The fourth income quintile is projected to be about \$1,200 a year better off under the Coalition policy. The big difference is the much greater impact on the

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<sup>1</sup> The income quintiles are calculated using equivalised disposable (after-tax) household income and are based upon the income distribution for the entire population. The new OECD equivalence scale has been used to adjust for differences in household size and demographic composition which effect costs of living. This scale takes the value of 1 for a single person household and adds 0.5 for each subsequent adult and 0.3 per child.



incomes of high income families of the Coalition policy (\$5,871 compared to \$786 under Labor.

The Labor policy becomes relatively less valuable through time as their tax offset is not indexed with inflation or wages and therefore becomes relatively less valuable. This policy also tends to have a greater impact on lower income households through time as the lack of indexation means that the offset applies increasingly to lower income households.

The absolute size of the Coalition tax cuts for 2027-28 is estimated to be \$21.7 billion. The absolute size of the Labor tax cuts for 2027-28 is estimated to be \$7.6 billion.<sup>2</sup>

**Table 1. Average change in disposable income per household, Coalition and Labor compared to current policy, 2019-20 and 2027-28**

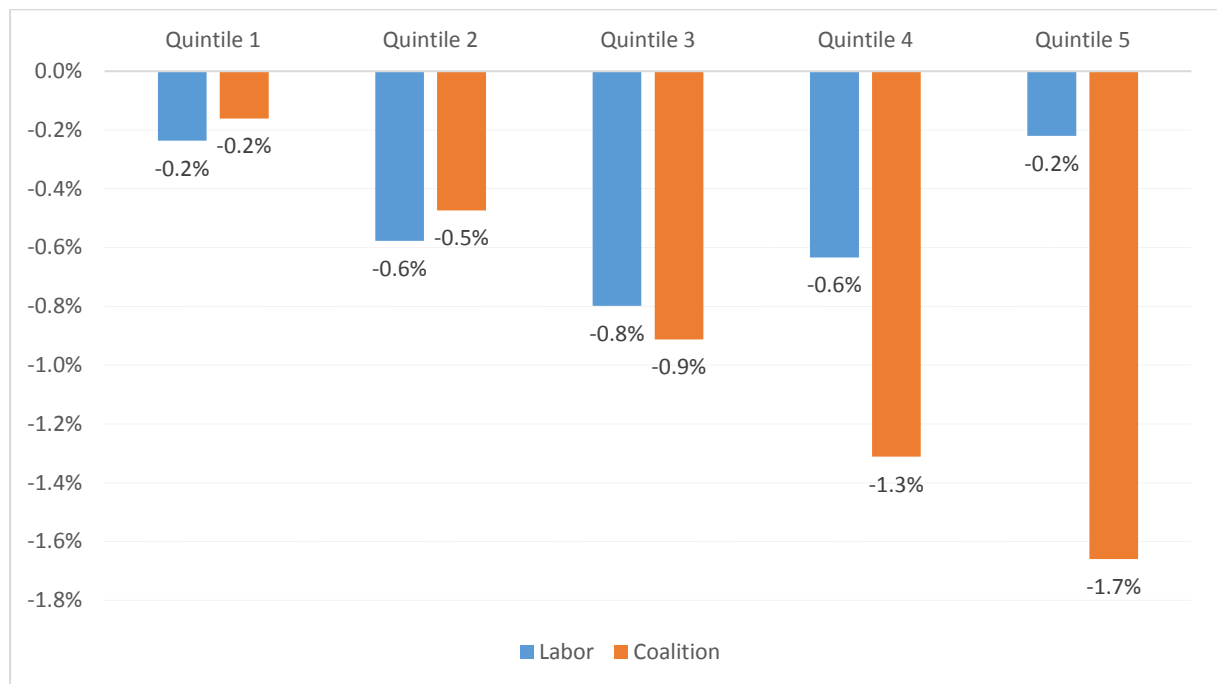
<b>Average change in disposable income per household</b>						
	Q1	Q2	Q3	Q4	Q5	All
<b>Coalition</b>						
2019-20	\$34	\$190	\$523	\$722	\$634	\$417
2027-28	\$57	\$338	\$1,122	\$2,402	\$5,871	\$1,920
<b>Labor</b>						
2019-20	\$58	\$329	\$901	\$1,227	\$1,004	\$698
2027-28	\$84	\$411	\$983	\$1,164	\$786	\$675
<b>Proportion change in total disposable income</b>						
	Q1	Q2	Q3	Q4	Q5	All
<b>Coalition</b>						
2019-20	0.1%	0.4%	0.7%	0.6%	0.3%	0.4%
2027-28	0.2%	0.5%	1.1%	1.7%	2.3%	1.6%
<b>Labor</b>						
2019-20	0.2%	0.6%	1.1%	1.1%	0.5%	0.8%
2027-28	0.2%	0.6%	1.0%	0.8%	0.3%	0.6%

Source: PolicyMod, ANU.

<sup>2</sup> The Budget reports the tax offsets on a cash basis. This means that is the offset is allocated in the following financial year. In this paper we allocate the cash offset to the current financial year.

Considering average tax rates by quintiles by 2027-28 we find substantial differences between the Coalition and Labor (Figure 2). Relative to the current policy the Coalition policy has the largest tax reduction to the highest income group with an average reduction of 2.3 per cent whereas Labor only reduces this group’s tax rate by 0.3 per cent. Labor also favours households in the bottom two quintiles with modest, albeit larger, tax cuts.

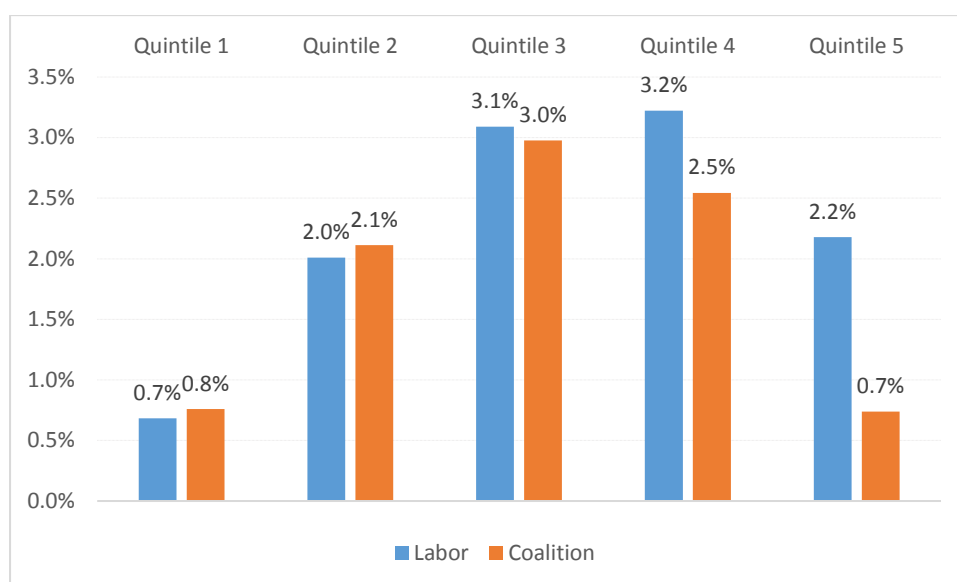
**Figure 2. Change in average tax rates for Labor and Coalition policies as compared to the current policy settings 2027-28**



Source: PolicyMod, ANU.

While tax rates are lower when we compare with the current policy in 2027-28 we do find that average tax rates are higher compared to current personal income tax rates (Figure 3). By 2027-28, under the 2018-19 Federal Budget assumed projected wage growth, all income groups pay higher average tax rates. Under both the Coalition and Labor the largest increases are quintile 3 and quintile 4 with increases of between 2.5 per cent and 3.2 per cent. The more substantial differences are for quintile 5 where Labor increased average tax rates by 2.2 per cent compared to just 0.7 per cent under the Coalition. For the lowest income quintile Labor's policy we estimate will increase rates by 0.7 per cent compared to the Coalition at 0.8 per cent.

**Figure 3. Increase in average tax rates by 2027-28 for Labor and Coalition as compared to 2017-18 rates**



Source: PolicyMod, ANU.

Our analysis shows that the Coalition policy leads to a modestly less progressive tax system compared to the current tax policy. Currently, the top 20 per cent of households pay 61.2 per cent of personal income taxation. This is projected to decline to 58.3 per cent under the current policy by 2027-28 since bracket creep tends to have a disproportionately larger impact on low and middle income households. Under the Coalition policy by 2027-28 the share is unchanged at 58.3 per cent.

The Labor policy also leads to a modestly less progressive tax system than the current system with it being estimated that the top 20 per cent of households paying 59.1 per cent in 2027-28.

## Conclusion

The Coalition tax policy in the 2018-19 Federal Budget contains significant taxation measures. Initially these measures are tax cuts targeted at lower and middle income individuals but by the middle of next decade the measures are weighted towards higher income individuals.

The Labor policy, *Working Australians Tax Rebate*, outlined by the Leader of the opposition in his Budget reply speech gives greater tax cuts over the period 2019-20 to 2021-22, although the difference in dollar terms is not large. The Labor policy extends these tax cuts through to 2027-28 and they are generally projected to be modestly smaller in percentage terms by 2027-28 as they were in 2019-20.

By 2027-28 we do find that neither the Coalition or Labor tax cuts are significant enough to overcome bracket creep, meaning that tax rates will continue to rise through the next decade – particularly so under the Labor tax policy. The Coalition reduces their tax rates relatively to Labor to more adequately address bracket creep from 2022-23 onwards.

The main difference is that from 2024-25 the tax cuts under the Coalition policy for high income earners are larger than those projected under the Labor policy. In terms of progressivity, bracket creep is expected to lower progressivity by 2027-28. The Coalition and Labor policies both add modestly to this lowering of progressivity. We suggest caution be taken in interpreting the distributional analysis presented in this paper since it is unlikely, in reality, that our tax system would stay unchanged with no adjustment for bracket creep for the next 10 years.

## References

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